MERCATUS CENTER
George Mason University

RESEARCH SUMMARY

Barriers to Prosperity: The Harmful Impact of Entry Regulations on Income Inequality

Entry regulations require would-be members of a profession to pass exams, meet educational requirements, and obtain permits and licenses. Proponents of entry regulations argue that these regulations improve the quality of service, but most studies show there is no relationship between licensing and quality. Entry regulations may, however, make it difficult for low-income workers to establish footholds in many industries. Workers instead choose to accept jobs that pay less and do not take full advantage of their skills.

In a recent study in *Public Choice*, Dustin Chambers, Patrick McLaughlin, and Laura Stanley illustrate that these regulations may increase income inequality by preventing workers' access to higher-paying professions. The study finds that countries with more stringent entry regulations tend to experience more income inequality.

Below is a brief summary of the study. To read the study in its entirety, please see "Barriers to Prosperity: The Harmful Impact of Entry Regulations on Income Inequality."

ENTRY REGULATIONS AS A BARRIER TO PROSPERITY

Entry regulations, including fees, permits, and licenses, inhibit the ability of workers to start new businesses or enter certain professions. When these regulations act as costly barriers to entry, they can make it difficult for low-income workers to move into entry-level occupations.

When these entry regulations limit labor market opportunities for low-income earners, they can increase income inequality for multiple reasons:

- Low-income earners might abandon their preferred occupation or business in favor of a lower-paying but more accessible alternative.
- Would-be providers might enter a market illegally and face the risk of both civil and criminal sanctions. Illegal entrants must use real resources in order to evade detection.
- If consumers perceive licensing as indicative of provider quality, the artificially limited number of licensed providers can command premiums for their services.

KEY FINDINGS

The authors find that countries requiring a higher number of procedures to start a new business tend to experience higher levels of income inequality: adding one additional regulatory procedure to start a new business is associated with an increase in the share of national income accruing to the top 10 percent of households by just over one-half a percentage point.

Because these initial findings do not necessarily imply that additional procedures cause the increase in inequality, the authors reestimate the original model using a different approach and find similar results, though the size of the estimated relationship is larger. The authors estimate that each additional startup regulation increases the share of national income accruing to the top 10 percent of households by approximately 2.15 percentage points. In addition, the estimates imply that adding one additional startup procedure increases the Gini coefficient by 1.37, meaning that income inequality has increased.

SUGGESTED SOLUTIONS

Many policymakers focus on income inequality. This study illustrates that entry regulations are a contributing factor to higher income inequality. Countries with more burdensome entry regulations tend to experience higher income inequality. Policymakers should focus on mitigating these effects by adopting the following reforms:

- *Avoid establishing ineffective entry regulations*. Before promulgating entry regulations, regulators should identify the social problem they are seeking to solve and provide sufficient evidence that the social problem is widespread.
- *Consider alternative policies to address social problems*. Regulators should evaluate a broad suite of alternative policies before creating new entry regulations. Alternative policies could include licensing, certification and titling in lieu of occupational barriers, and mandatory labeling or information disclosure for would-be producers of consumer products.