DOES LICENSING OF HEALTH CARE PROFESSIONALS IMPROVE HEALTH CARE?

Randall G. Holcombe, Ph.D.

ABSTRACT

If government licensing of health care professionals were eliminated, a wide range of private sector alternatives would emerge to replace current licensing systems. Some of those systems, such as private sector regulatory agencies and brand names, could play a large role in ensuring high-quality health care, and other mechanisms, such as board certification and hospital practicing privileges, already are in place. Non-governmental mechanisms to ensure high-quality health care would work better if all government restrictions on health care professionals were eliminated.

INTRODUCTION

The claim that eliminating govenment licensing of health care professionals would improve the quality of health care and lower its cost sounds outrageous enough most people would dismiss it without serious consideration. This paper gives the idea serious consideration and shows, after analyzing it, the idea is quite plausible. All of the benefits of government licensure can be provided by market institutions more effectively, and at lower cost. Many of those market mechanisms are already in place, and already serve to regulate the quality of health care professionals at least as effectively as government licensing. After considering the alternatives, this paper recommends the government licensing of health care professionals be eliminated, and free entry be allowed into the industry.

THE DEMAND FOR PRODUCT QUALITY REGULATION

The first step to take in analyzing the way market mechanisms can substitute for licensure is to understand what benefits licensure provides consumers. Health care is one of many goods and services with quality dimensions important to consumers, but which consumers are not in a good position to observe or evaluate. Health care is not unique in this regard. For example, when people eat in restaurants, they want their food prepared with fresh ingredients in sanitary conditions and handled in a safe manner. They are willing to pay for sanitary kitchen conditions and the safe handling of food, but restaurant customers will find it difficult to determine whether these characteristics they are willing to pay for are in fact satisfied. Similarly, airline passengers want airlines to maintain their aircraft to certain standards, and are willing to pay for that maintenance. In many cases, passengers may not even understand what maintenance standards should be met, but they are still willing to pay for airlines to meet standards they are unable to observe and do not fully understand.[1]

Sometimes sellers themselves may be able to assure customers that difficult-to-observe quality standards are being met. Firms do have an incentive to protect their reputations. Other times customers will want more than just the seller's assurance quality standards are being met, and in such cases buyers may be willing to pay for an independent third party to inspect and verify quality standards are being met. Medical licensure serves this role.

The arguments below suggest market mechanisms may be more effective in actually ensuring products meet quality standards than government licensure. Because people often take it for granted government is needed to fulfill this role, the next several sections examine a number of market mechanisms that help ensure customers their purchases meet certain quality standards in areas the customers themselves are not in a good position to observe or judge.

THE SUPPLY OF PRODUCT QUALITY REGULATION

One market mechanism for assuring product quality is through the use of brand names. Sellers use brand names to try to attract customers, and if customers are satisfied with a seller, they can use the seller's brand name to identify the seller and use the seller's services again. But because the brand name identifies the seller to all customers, if customers are dissatisfied they can use the brand name identification to avoid that seller. Sellers have an incentive to maintain their quality in dimensions that are difficult for buyers to observe, because if buyers suspect the firm has quality lapses, they will avoid the firm – and precisely because some quality dimensions customers care about are difficult to observe, firms will have difficulty demonstrating to skeptical customers their quality meets difficult-to-observe standards. Consider some examples.

McDonald's has established a valuable brand name by offering consistent quality throughout their restaurants. Customers familiar with a McDonald's in Los Angeles can be reasonably sure they will get the same quality food at a McDonald's in Chicago or New York. Similarly, people who dislike McDonald's for any reason can easily avoid shopping there because their locations are identified by the McDonald's brand name. If there was some suspicion customers at McDonald's were getting sick from eating their food, the McDonald's brand would suffer, regardless of whether there was any merit to that suspicion. Thus, brand names alone give sellers a powerful incentive to maintain their quality even if customers find some aspects of quality difficult to observe or evaluate.

When a woman claimed in 2005 to have found part of a severed finger in her chili at a Wendy's restaurant, business fell at Wendy's and the firm lost $2.5 million in sales even though the woman's claim was quickly revealed to be a hoax.[2] This shows how fragile a firm's brand-name reputation is, even when it is well-publicized the firm did nothing to lower its quality. Another example is the accounting firm Arthur Andersen. Once one of the most reputable firms in the business, with one of the most valuable brand names, when the firm was caught up in the Enron scandal it all but disappeared. Yet another example is ValuJet, the airline that had some safety issues culminating in an airplane crash in the Florida Everglades in 1996. The crash, it turned out, was due to an error in loading cargo, but the airline's reputation was so damaged its brand name became a liability and it changed its name to AirTran Airways.

Currently, health care professionals do not rely heavily on brand names because customers rely on government regulations for assurance of quality in the health care industry. Were the health care industry not so heavily regulated, brand names would play a more significant role, and would assist customers of the health care industry to get the type and quality of health care they want.

Another source of quality assurance comes from firms that sell information about the quality of various goods and services. Perhaps the most widely-known company of this type is Consumers Union, publisher of *Consumer Reports* magazine and the website ConsumerReports.org. Because health care professionals are so heavily regulated, there is little demand for this type of quality information about physicians and other health care professionals, but Consumers Union already periodically reviews prescription drugs, even though they are heavily regulated. Firms such as Standard & Poor's and Moody's Investors Service rate the quality of financial assets for investors, and such industry-specific publications as *Car and Driver* and *Popular Photography* also provide consumers with product quality information. There is good reason to surmise if the health care industry were not so heavily regulated, people would pay firms like Consumers Union and Moody's for ratings of health care professionals.

PRIVATE SECTOR REGULATORY AGENCIES

The market mechanisms just described show how consumers can be assured of product quality without government regulation, but sometimes these mechanisms may not be sufficient and consumers may view third party verification of quality as important. If government were not involved in this verification, private sector regulatory agencies would emerge that would serve a similar function as government regulatory agencies. This is not an abstract idea, but one that operates today in a number of industries. This section will discuss two private sector regulatory agencies – Underwriters Laboratories (UL) and Best Western Motels – to illustrate how private sector regulatory agencies work.[3]

Underwriters Laboratories is a privately-owned company established in Chicago in 1894 to test and certify electrical equipment. UL is not affiliated with any government, although sometimes governments require certain purchases of electrical equipment have the UL seal of approval. UL inspects and tests electrical equipment to determine whether its design poses any electrical hazards, such as the threat of electrical shock or fire. If UL determines the product meets its standards, it allows the firm to display the UL seal of approval on the product certifying the product meets its regulatory standards. If the product does not meet its standards, UL offers the producer advice on how the product could be redesigned to meet the UL requirements.

UL is a private sector regulatory agency. It sets regulatory standards, tests products to see if they meet its standards, and when they do, certifies that fact. Nobody is required to get UL approval for the products they sell, although some customers may refuse to purchase products that are not UL approved.

A noteworthy feature of UL is all the costs of regulation are paid for by the regulated firms, and the firms that are regulated voluntarily choose to be regulated. Why would a firm choose to be regulated when it is not legally required? It is to assure customers that certain difficult-to-observe aspects of their products meet the quality standards of an independent regulator who is in a position to know more about that quality than the purchaser. When customers care about the quality of their purchases but have difficulty evaluating quality, the sellers have an incentive to pay for a private sector regulatory agency to certify quality. The cost of UL approval is included in the price of the product. UL is a perfect example of a private sector regulatory agency.

Best Western Motels is another private sector regulatory agency regulating the quality of motels. The quality of one's motel is not as critical as the quality of one's health care, which is probably why the government does not regulate or certify the quality of motels. But customers care about the quality of the motels where they stay, and motel quality is difficult to judge from the street. One mechanism the market uses to deal with this quality issue is brand names. Names like Holiday Inn and Sheraton provide an indicator to customers about the quality of the motel behind the sign. Best Western provides a similar service for motels not a part of a national chain.

Best Western owns no motels. Rather, like UL, Best Western certifies the quality of motels owned by others. To become a member of Best Western and display the sign outside a motel, the motel must comply with a host of regulations set out by the firm.[3] There are requirements related to the minimum width of hallways, the temperature that must be able to be maintained in the bathrooms, the quality of television reception, the quality and number of wastebaskets in the rooms, the number of parking spaces the motel must have and much more. As with UL, the motels pay to be inspected and certified by Best Western, and motels meeting Best Western's standards and pay their fee are allowed to display the Best Western logo. Best Western also periodically inspects all member motels to ensure the motels continue to meet company standards.

No motels are required to be members of Best Western, or to meet Best Western standards, but many motels pay for the privilege of being regulated by Best Western. Firms are willing to pay for the privilege of being regulated by Best Western because the certification of the Best Western regulatory agency conveys valuable information to motel consumers, and consumers are willing to pay the member motels more for this information than the motels have to pay Best Western to convey it.

In addition to its activities as a private sector regulatory agency, Best Western provides one service to its members: a reservation service. People can call a toll-free number to locate Best Western motels at their destination and reserve rooms. The main function Best Western serves, however, is to regulate and certify the quality of member motels, and without its regulatory function, its reservation service would probably not be viable, because potential customers would have no assurance about the quality of the motel taking the reservation. One could imagine, in the absence of government regulation, a similar regulatory apparatus for physicians. The American Medical Association (AMA) might expand its role to offer patients referrals to AMA member doctors, or new competing regulatory agencies (Best Western Doctors?) might emerge as an alternative to the AMA.

THE ADVANTAGE OF PRIVATE REGULATORY AGENCIES

If private sector regulatory agencies merely substituted for the regulation the government already does, there would be little to recommend them. However, private sector regulatory agencies offer substantial advantages over government regulation.[4] One advantage of private regulation is the regulated firms pay for it. In addition to the obvious advantage taxpayers are not forced to pay for regulation they do not desire, this has the policing function of assuring the regulation is worth the cost. Regulation that is not cost-effective will not be able to pay for itself, thus eliminating non-cost-effective regulation. Furthermore, because private sector regulatory agencies are paid for their services, they have an incentive to provide better regulatory services to their customers at lower cost, constantly improving their product. Government regulation is slow to change, and often requires legislation for improvements, making private sector regulation more responsive to the demands of consumers. Because with private sector regulation the regulated firms voluntarily agree to be regulated, if regulation ever ceases to be cost-effective, the regulation and the regulated firms will pass out of existence.[5]

Another advantage is regulatory firms have an incentive to make sure products they certify actually have the quality features consumers demand. Contrast this with government regulation. When there is a governmental regulatory failure, rather than losing money government regulatory agencies actually gain money by claiming they do not have enough inspectors and other resources to police those it is regulating, resulting in increased government funding. Private sector regulatory firms would lose business if there are problems with the goods and services they certify, whereas government regulatory agencies benefit when there are problems with the goods and services they certify.

Another advantage of private sector regulation is it is easier for the regulatory agency to refuse certification to a firm it regulates. All it has to do is to say it is no longer certifying that firm's products. The firm is still free to sell its unregulated products without regulatory approval. A motel no longer meeting Best Western standards can just take the Best Western sign down and still offer its motel services. However, with government regulation, a firm not meeting standards can no longer continue in business. Thus, regulated airlines that have had problems known to the Federal Aviation Administration (FAA), such as Aloha Airlines, Alaska Airlines and ValuJet, have been allowed to continue their operations despite the FAA's knowledge they were deficient in certain areas, because the alternative of stopping them from doing business was viewed as too severe by the regulators.

Private sector regulatory agencies are better than government regulatory agencies because private sector agencies have an incentive to make sure the goods and services they certify actually meet their standards, whereas the incentives for government regulatory agencies are weaker, at best, and sometimes may go in the opposite direction.

WHY ARE THERE SO FEW PRIVATE SECTOR REGULATORY AGENCIES?

Despite the advantages of private sector regulatory agencies, there are not more of them for two reasons. First, other private sector mechanisms for assuring product quality, such as brand names, often provide sufficient assurance to customers, so it is not worth the cost to establish an independent regulator. The second and more significant reason is in most instances where it would be worth the cost to establish a private sector regulatory agency, the government steps in with its own regulation, financed by tax dollars. If government establishes a regulatory agency like the Food and Drug Administration (FDA) to regulate the quality of medical drugs, then there will be much less demand for drug manufacturers to hire a private sector regulatory agency at their own cost to provide a mostly duplicative function. Government regulation preempts private sector regulation.

Until Upton Sinclair published *The Jungle* in 1906, exposing unsanitary practices in the meat-packing industry, there was little demand for the regulation of this activity.[6] Immediately after the book was published, the Food and Drug Act was passed the same year, preempting the opportunity for private regulators to establish themselves. Before potential problems in a market appear, there is little demand from consumers for regulation from the private sector or from government. Whenever problems appear, the government typically is quick to legislate a regulatory solution. The FDA, for example, was not created in anticipation of possible problems in the food processing industry, but rather in response to public demand after the industry's activities were exposed.[7]

If the government did not act so quickly, the market would have provided its own regulatory solution, likely through many channels. In the absence of government regulation at taxpayer expense, the market solutions discussed below would be more common, but even with the existence of "free" government regulation, the examples above show when there is some regulatory activity government has not yet undertaken, the market will step in to fill the void.

WHAT DOES MEDICAL LICENSURE ACTUALLY CERTIFY?

While the requirements to obtain certification to be a health care professional may be demanding, once a health care professional is licensed, certification lasts for life, and can only be lost if the state actively intervenes to take it away. Most states require licenses be renewed, and include requirements for renewal such as continuing education credits. However, there are no requirements health care professionals pass an exam to retain their state certification, or even that they learn anything. Physicians may be found guilty of multiple cases of malpractice, may lose the privilege to practice at hospitals, may lose specialty board certification, or more benignly, may not keep up with advances in the profession, yet the physician's state certification to practice medicine will remain. There are high initial standards, but there are very few competency standards to meet after being initially certified.

Compare the certification requirements for physicians with those the Federal Aviation Administration (FAA) imposes on airline pilots. Airline pilots not only must pass a rigorous screening process to get licensed, they must get recurrent training every six months, and more significantly, they must pass a ground test and a flight test every six months to remain licensed. Unless they pass a non-trivial test on flight skills every six months, they are no longer allowed to fly. Physicians, once licensed, can continue to practice medicine indefinitely with no additional tests or checks of their skills, ever. Keep in mind pilots face the same personal risks as their passengers from substandard skills. If a plane crashes, the pilot is sitting up front and is at least as likely to be injured or killed as the airplane's passengers. Compare that to a surgeon who, if he or she makes a mistake, can inflict great harm to a patient, but the surgeon faces almost no personal risk of physical harm for mistakes. In light of the different personal risks, if the purpose of state certification is really to protect the customers who purchase services, it would make more sense to have physicians than pilots undergo periodic testing and recertification. The point is for health care professionals who have been licensed for more than a few years, that license carries with it scant assurance of continued competence.

EXISTING PRIVATE SECTOR ALTERNATIVES TO MEDICAL LICENSURE

If the regulation of medical professionals were completely done away with today, there already are well-established alternatives to the current regime of government regulation that could ensure patients receive the same quality medical care they now get under government regulation. One alternative would be to go only to physicians who are members of the AMA. Currently, all states require physicians to pass the United States Medical Licensure Examination (USMLE). That examination is sponsored by the Federation of State Medical Boards (FSMB) and the National Board of Medical Examiners (NBME). The NBME is controlled by physicians, so physicians determine who is qualified to join their ranks through the state licensing procedure. The AMA is an association of physicians, so all AMA members meet the current government standards for practicing medicine. If all regulation were done away with immediately, a person could obtain the same standard of care as under the current regulatory regime by choosing only to go to a doctor who is a member of the AMA. The AMA, as it currently exists, could immediately play the role of a private sector regulatory agency just like Underwriters Laboratories and Best Western, if government licensing were immediately abolished.[8]

If licensure requirements were done away with, people would know they need to be more selective in the way they choose their doctors. Brand names would play a much bigger role in medicine, more physicians would become dues-paying members of the AMA, and members would display that affiliation along with their names as an assurance of quality. Rather than posting a sign, "John Smith, M.D.," outside the office, that sign would say "John Smith, M.D., Member of the American Medical Association." In the absence of government regulation, patients could limit their search for a physician only to AMA members, and could ensure themselves of receiving the same quality of medical care they could get in the current regulated environment.

In addition to AMA membership, there are a number of other non-governmental mechanisms currently in place to signal the quality of a physician. Board certification for practice in specialty areas is common, even though it is not required by law, and it would take on added significance in the absence of government regulation. Another mechanism already in place is the screening hospitals do to allow physicians the privilege of practicing there. Hospitals have incentives to monitor the quality of medical professionals who practice in their establishments, and not all physicians in an area will have privileges at their local hospitals. Furthermore, hospitals restrict the types of practice so, for example, a dermatologist would not be permitted to do open heart surgery in the hospital, even though the physician's state license carries with it no such restriction. In the current environment of government regulation, it may not even occur to patients to inquire as to whether their doctors have the privilege of practicing at the local hospital. Without government regulation, information about whether they are members of the AMA, whether they are board-certified, and whether they can practice at the local hospital would carry more significance.

There are already market mechanisms in place able to ensure patients receive today's level of quality medical care without government regulation. These market mechanisms – such as specialty board certification and hospital practicing privileges – already provide a better indicator of quality than government licensing. If government regulation were completely eliminated today, no new mechanisms or institutions would have to be designed to maintain the current level of quality health care.

BENFITS OF DEREGULATION

There would be little point in eliminating medical certification if all it would accomplish would be to maintain the current level of quality. Elimination of government regulation would open the door to new types of private regulation allowing patients to have a wider variety of options, and would allow them to ensure they receive higher-quality health care.

Under the existing regulatory regime, the government sets a standard, and in order to practice, the medical professional must meet that standard. This excludes people who are below the standard, although as noted above, because of the nature of the regulation, some practitioners who met the standard when they were certified may no longer meet the current standard, but still are allowed to practice. Another effect of the single standard for certification is it removes some of the incentive to exceed the standard. The single standard creates the impression either a medical practitioner is qualified to practice, or is unqualified, and because the standard does not differentiate higher quality from lesser quality, patients tend to accept the government's standard in many cases, and not search further for indicators of quality. Government regulation is protecting them from unqualified personnel, patients reason, so they choose medical professionals on other dimensions, such as personality, or office location, or how long patients must wait to be seen.

Regulation takes away some of the incentive for patients to discriminate based on quality, because all practitioners meet the government's standards, and it takes away some of the ability for patients to discriminate based on quality, because there is only one standard under the regulatory regime. This, in turn, takes away some of the incentive for medical professionals to exceed the government-mandated standards, because when patients do not discriminate based on quality, there is little reason for medical practitioners to offer higher quality. Deregulation would give customers both greater incentive and greater ability to discriminate among medical practitioners based on quality.

In a deregulated regime, there would be an incentive for physicians who wanted to exceed AMA standards to create competing health care regulatory firms. One could imagine Best Western Doctors, that might insist on recurrent training and testing for membership. Best Western Doctors could then advertise their members meet a higher standard for people who want better care, and patients would have the choice of seeing either an AMA doctor or a Best Western Doctor. Under such a regime, Best Western Doctors could earn a premium by agreeing to be held to higher quality standards. Deregulation would make it easier for patients to find higher-quality medical care, because a deregulated environment would be more conducive to generating information.

While in some cases patients may want to search for quality that exceeds state certification requirements, in other cases they might be willing to accept lower standards in exchange for lower cost. For a minor injury requiring stitches, for example, one might be content to go to a clinic specializing in treating minor injuries and illnesses, and most doctors would agree it does not require an M.D. degree to sew up a cut. Similarly, there is no reason why a patient would have to see a physician to get a routine physical examination. Medical firms without M.D.s on their staffs could specialize in giving physical exams, and could refer patients to M.D.s if those exams turned up any suspicious signs.

Some will worry such alternatives would result in lower quality, but the common alternatives now to having a physician give a physical, or sew up a cut, are self-treatment, or no treatment at all. Considering the whole range of alternatives, allowing unlicensed practitioners to practice medicine can result in better care overall, if those unlicensed practitioners are more convenient and less expensive. But in an unregulated environment it is unlikely many medical practitioners would be completely uncertified. They would be more likely to work for medical firms with brand-name reputations, and/or to be certified to lesser standards. For example, in many states midwives are allowed to deliver babies – something unheard of a few decades ago. Yet there seems to be little in the way of adverse consequences from allowing this lower standard of care.

Sometimes people want a higher level of quality than the currently-legislated minimum, and sometimes people will be satisfied with lower quality for minor ailments, in exchange for lower costs and increased convenience. The current regulatory environment cuts out those options, so sacrifices health care quality. Furthermore, absent government regulation, private regulators would have a greater incentive to ensure those they regulate really do meet the standards the regulators set. Not only could private sector certification replace government medical licensure laws, for many reasons the private sector alternative would be superior to the current regime of governmental licensure of health care professionals. This conclusion is more than just speculation. This analysis shows many of the private sector alternatives to governmental licensure already are in place.

AFFILIATIONS:

Randall G. Holcombe, Ph.D., DeVoe Moore Professor of Economics, Florida State University, Tallahassee, Florida.

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