



The impact of licensing requirements on industrial organization and labor: Evidence from the U.S. private security market



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ABSTRACT

The consequences of occupational licensing regulations on the private security market are examined. Analysis suggests that these regulations impact the number of private security firms in a state, the distribution of firm size, and the average wage of private security employees. Regulations imposed in some states reduce the number of private security firms, increase the size of firms, and raise average wages in the industry. The hypothesis that some licensing requirements act as barriers to entry is examined, as are arguments that these requirements alleviate asymmetric information problems in the industry.

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1. Introduction

Occupational licensing in the United States has been an increasingly popular technique for regulating professions. [Carpenter et al. \(2012\)](#) estimates that in the 1950s one in every 20 occupations required a license, but by 2012 this ratio had risen to around one in three.¹ Researchers have used a variety of methods to evaluate outcomes of these licensing practices. [Kliener and Krueger \(2013\)](#), for instance, use survey evidence to support their claim that licensing is used to “fence out” competition and raise wages for the licensees. Their findings suggest that licensing is associated with an 18% increase in wages for the license holders compared to the same professions in places where licensing is not required. This figure is similar to the 15.6% wage premium estimated by [Thornton and Timmons \(2013\)](#) that result from state-level occupational licensing for massage therapists. The conclusion that occupational licensing is used as a political tool to erect barriers to entry and aid incumbent firms is the prominent position in the literature (e.g. [Friedman, 1962](#); [Meehan and Benson, 2015](#); [Skarbek, 2008](#)). In

contrast, asymmetric information is the typical political justification for occupational licensing, and this contention has been defended by a few scholars. [Leland \(1979\)](#) concludes that minimum quality standards involved in occupational licensing can increase welfare. Similarly, [Law and Kim \(2005\)](#) defend licensing by citing what appear to be historical indications of reduced information asymmetries through licensing as urbanization increased through the Progressive Era.

This study will measure the impacts of licensing requirements on the average wage of private security guards, the number of firms in a state, and size of those firms, in an effort to better inform the occupational licensing debate with empirical evidence on a particular labor market. While the findings reveal apparent relationships between various requirements and wages, numbers of firms and firm size, some of the results should be interpreted with caution. Experience and training requirements, for instance, are often mandated before a private security firm or guard can obtain a license, and while these requirements could reduce competition by limiting the number of licensed firms and employees, they could also increase productivity (which would increase employee wage). The competition and productivity impacts of some licensing requirements are difficult to separate. Therefore, evidence of licensing impacts on wages, firm size and firm numbers is not sufficient to provide policy prescriptions. Such evidence must be combined

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¹ [Kliener and Krueger \(2013\)](#) estimate that 29% of U.S. workers are required to obtain a license to practice.

with information available from another study of this industry that considers licensing impacts on the quality of services provided in order to guide public policy.²

Licensing of private security guards and private patrol services is of major importance across the U.S. In 2010 there were 9659 security firms employing 600,186 private security guards and patrol personnel³ in the U.S., as compared to 705,009 sworn police officers.⁴ The private security industry also provides an interesting platform for this analysis because it impacts many people beyond those directly involved as buyers and sellers in the market. While private security protects specific potential targets for criminals, several studies find that private security also generates positive externalities in terms of reductions in the general levels of property and violent crime (e.g. *Benson and Meehan, 2015; MacDonald et al., 2012*).

The paper proceeds as follows; in *Section 2* the data and empirical approach are discussed, and *Section 3* concludes with a discussion that unifies and interprets the empirical results.

2. Data, methodology, and empirical results

2.1. Data

Data for state-level⁵ private security employment, number of firms, and size of firms were obtained from the U.S. Census County Business Patterns database.⁶ These data will measure the relative state level growth in the private security industry as a proxy for entry into this market. From 1998 to 2010 the number of security guards and patrol officers in the U.S. grew over 24%, from 482,472 in 1998, to 600,186 in 2010, while the number of firms increased by 47% during the same period.

Private security licensing regulation data were collected by examining and coding both state statutes and administrative codes accessed through Lexis Nexis⁷ and West Law Next⁸ databases. Data were recorded for 1998–2010 for all 50 states.⁹

The focus is on licensing requirements that are likely to influence the cost of entry into the private security market for individuals who want to establish a new firm. After surveying the state codes and statutes, the four licensing requirements that appear most

consistently across states and that establish minimum criterion to entry (licensure) into the industry were determined to be¹⁰:

- the bond/insurance requirement necessary to obtain a private security license¹¹;
- law-enforcement or security industry experience required to obtain a security license;
- training necessary to qualify for licensure;
- an examination that must be taken to qualify for licensure.

Within the data, these licensing requirements are recorded as the dollar value of required bond/insurance, years of law enforcement experience (public law enforcement or private security experience) required based on a 2000 h work year, hours of pre-license and continuing training necessary, and a dummy variable indicating that an examination must be passed.¹² If a security agency (firm) license is necessary to practice as an individual entity in the state, then the agency requirements are used. If a simple private security guard license is all that is necessary to establish a firm, then these data are used.¹³ All data collected assume entry for provision of services by unarmed security guards. These data are expected to establish a lower bound for entry into the marketplace. Individual licensing in the form of trainee licenses or security guard licenses that are conditional on existing agency employment are not included, as these regulations do not determine entry of new competitors.

Many within state changes to these regulations occurred from 1998 to 2010. Seven states changed bonding and/or insurance requirements, and two more instituted these requirements for the first time. Five states changed training requirements over the data period, and another six implemented training requirements for the first time. Two states also changed experience requirements, while another implemented them for the first time.

These changes do not appear to be geographically related. North and South Dakota, for instance, have taken different approaches to private security guard licensure. Over the data period, North Dakota increased the bond/insurance private security guard firm license requirement twice, first from \$5000 to \$10,000, then again from \$10,000 to \$300,000. North Dakota also instituted an 80 h training requirement and a one and a half year experience requirement over the same period. Conversely, South Dakota did not require any licensure across the same period. In addition, from 1998 to 2010 the number of private security guard firms increased by 42% in South Dakota, while the number of firms in North Dakota rose by only 9%.

These data differ from the data used by *Carpenter et al. (2012)* because of the focus on the entry threshold criterion. Entry as an independent firm or contractor is the focus here, not entry as an agent of an existing company. The examination, training, and experience requirements for licensure as a security guard used by

² *Meehan and Benson (2015)* offer evidence of supply side regulatory capture in the U.S. private security industry, however, as licensing boards that include industry members tend to increase bond/insurance, training, and testing requirements for new entrants but not existing firms or for licensing renewal.

³ According to the 2010 county business pattern data. <http://www.census.gov/econ/cbp/> under NAICS code 561612. Note that these data do not include "in-house" security employment. They only represent employment by firms specializing in the provision of security services.

⁴ <http://www.fbi.gov/about-us/cjis/ucr/crime-in-the-u.s/2010/crime-in-the-u.s.-2010/tables/10tbl74.xls>

⁵ State level data are used because the employee data at the county level, within the county business pattern database, often provide a range value (0–19, 20–99, etc.) for county-level observations rather than the actual number of private security guard employees. As the employment data become more aggregated (state level as opposed to the county level) the shading of the employee data becomes less extensive, although it continues for some small population states. No range data is used in this analysis. Since state-level data on number of firms is never shaded, the sample size changes from 617 observations when using firm data to 572 with employee data.

⁶ <http://www.census.gov/econ/cbp/>, NAICS code 561612

⁷ <http://www.lexisnexis.com/en-us/product-sign-in.page>

⁸ <https://lawschool.westlaw.com/shared/signon10.asp?path=%2fdesktopdefault.aspx>

⁹ Only 49 states were used in this analysis because the requirements for New Mexico were not clear. Data in this state were collected for two of the four requirements, but training and experience requirements were not collected because it is uncertain what the requirements were for a private security firm employing unarmed guards.

¹⁰ One obvious requirement that is omitted is licensing fees. Regulatory requirements establishing a lower bound on entry are employed in the following analysis, but determining the licensing fee consistent with the lowest bound was not possible for states with particularly complex fee structures. The fees in some states increase with the number of employees; in others, fees vary for different licensure classifications. Similarly, fees for conducting background checks explicitly are added in some states but not in others, even though such checks are required.

¹¹ This requirement is the dollar value of combined liability and property insurance to obtain a license, and/or the amount of money a firm has to pay as a bond. Applicants must prove that they have a sufficient level of insurance or bond before they can be licensed. The summation of the two is used if states required both. If the state requires one or the other the minimum of the two is used.

¹² These data are also used in *Benson and Meehan (2015)* and *Meehan and Benson (2015)*.

¹³ An exception to this rule is Maryland where the licensing requirements apply to firms with 5 or more employees. Since most of the firms in the state have more than 5 employees, these data are used, assuming that, in practice, this is the lower bound for entry. The analysis in *Section 2.3* does change based on firm size to take into account these licensing requirement differences in Maryland.

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