Occupational Licensing Reduces Racial and Gender Wage Gaps: Evidence from the Survey of Income and Program Participation

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September 9, 2017.

Abstract

In order to work legally, 29% of U.S. workers require an occupational license. We show that occupational licensing reduces the racial wage gap between white and black men by 43%, and the gender wage gap between women and white men by 36%-40%. For black men, a license is a positive indicator of non-felony status that aids in firm screening of workers, whereas women experience differentially higher returns to the human capital that is bundled with occupational licenses. The information and human capital content of licenses enable firms to rely less on race and gender as predictors of worker productivity.

JEL Classification: D21, D84, J24, J31, J41, J70, K23, K31, L51

Keywords: Wage inequality, statistical discrimination, occupational licensing, screening, signaling, optimal regulation.

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1 Introduction

The study of occupational licensing is important for at least two reasons. First, 29% of US workers are required to have an occupational license in order to lawfully perform their jobs (Kleiner and Krueger, 2013). Second, while other labor market institutions, such as unions, have been declining in prevalence since 1950, the fraction of licensed workers has been steadily increasing at an average of 4 percentage points per decade (Kleiner and Krueger, 2013).

In this paper, we study the effect of occupational licensing on racial and gender wage gaps. Because licensed practitioners are required to fulfill minimum entry standards, including passing criminal background checks, and in some cases undergoing additional job-specific training, occupational licensing may update employers' priors about the productivity of workers (Leland 1979; Lundberg and Startz 1983; Law and Kim 2005; Anderson et al. 2016). In particular, occupational licensing may reduce wage inequality if it lessens the information asymmetry in the market between workers and firms at a differentially higher rate for women and minorities, as compared to white men (Phelps 1972; Arrow 1973; Coate and Loury 1993).

The two canonical theories of occupation licensing both predict the existence of wage premiums for licensed workers relative to their unlicensed peers. In the context of the market power story of Adam Smith and Milton Friedman, occupational licensing creates barriers to entry and promotes economic rents to the license holders through a *quantity* restriction on the labor supply (Smith 1937; Friedman 1962; Pagliero 2011; Thornton and Timmons 2013). An alternative view in the literature is that occupational licensing serves the public good by imposing a *quality* restriction on labor supply (Leland 1979; Ronnen 1991; Anderson et al. 2016; Deming et al. 2016). In this latter framework, the wage premium earned by licensed workers reflects the higher average quality of licensed workers relative to their unlicensed

peers.[1]

Using detailed licensing data from a special topical module of the Survey of Income and Program Participation (SIPP), a nationally representative survey, we provide evidence for substantial heterogeneity in the licensing premium by race and gender. The heterogeneity in the licensing premiums that we document is large enough to reduce, by 43%, the wage gap between black men with licenses and white men with licenses, while narrowing, by 36%-40%, the wage gap between women with licenses and white men with licenses. In fact, we *cannot* reject the null hypothesis of no wage gap between *licensed* black men and *licensed* white men. By contrast, we *can* reject the null hypothesis of no wage gap between *unlicensed* black men and *unlicensed* white men. In the discrimination literature, one leading intervention that has a similarly dramatic effect of closing the black–white wage gap among men is controlling for ability in wage regressions using the Armed Forces Qualification Test Scores (AFQT) scores (Neal and Johnson, 1996). A similarly striking finding in the literature on the convergence of male and female wages is the result in Goldin (2014a), which shows that the gender wage gap is substantially closed after one accounts for the nonlinear effect of hours worked on wages.

There are two distinct mechanisms that account for the convergence in wages for licensed minorities and licensed women relative to their licensed white male counterparts. For black men, the license serves as a positive indicator for non-felony status, used by firms in screening workers. To show this, we construct a new data-set, using a recent report by the American Bar Association, in which we code the 16,343 legal citations that govern the ability of felons to possess occupational licenses in each state. After matching these legal citations to the

[1]Friedman (1962) was skeptical of this view. He argued that restricting supply necessarily restricts the potential for labor specialization within an occupation because there are fewer practitioners to specialize. Moreover, creating barriers to entry restricts innovation by new firms. Both the specialization and the innovation effects lead to a reduction in average quality rather than an increase in average quality due to occupational licensing.

relevant state-occupation pairs, coding the citations separately, and then sorting them into two distinct categories – those imposing a permanent ban on felons from ever having an occupational license and those imposing a temporary ban on felons – we find that black men earn a substantially higher license premium in licensed occupations that have mandatory permanent bans for felons when compared to licensed occupations with no ban at all for felons. Moreover, the "ban" premium for black men in licensed occupations diminishes in firm size, which is consistent with firms using occupational licensing as a screening device for felons.[2]

To examine the robustness of our results, we adopt three approaches that test for selection on unobservables. First, we exploit the richness of the SIPP licensing data to directly control for whether a given worker has a personal taste for having a license: a question in the SIPP asks whether the respondent pursued the license for personal or professional reasons. Second, we place an upper bound on any residual selection bias by comparing the change in the estimated wage gaps for licensed workers as we use successively more detailed occupation controls. Third, we implement an instrumental variables strategy that is motivated by ideas in Gandhi and Houde (2016).

This paper contributes to several strands of literature. First we contribute to the literature on measuring the licensing premium. Kleiner and Krueger (2010) and Kleiner and Krueger (2013) provided the first such measures of the licensing premium using nationally representative data – an approach in the literature that they pioneered by doing the important work of collecting primary survey data and making it publicly available. The most recent measurement is the estimated premium of 7% in Gittleman et al. (2015), which is an

[2]The operating assumption here is that larger firms are more efficient at employee screening than smaller firms because they possess better screening technologies, e.g. a large Human Resources department with the capacity to conduct criminal background checks on all job applicants (Victor et al., 2012).

average premium across both race and gender. We contribute by showing that the licensing premium for white women (12%), black women (15%) and for black men (14%), is higher than the average premium, while the licensing premium for white men (4%) is lower than the average premium. In addition to documenting heterogeneity in the licensing premium by race and gender, we provide evidence that the heterogeneity is due to a reduction in asymmetric information between firms and workers for black men and due to differentially higher returns to human capital that is bundled with the license for women.

Our work also contributes to the theoretical literature on occupational licensing by providing an analytically tractable model of licensing that focuses on the firm–worker interaction in the spirit of models of statistical discrimination (Coate and Loury, 1993; Moro and Norman, 2004). The standard model of occupational licensing is Leland (1979), which studied licensing from an optimal legislation vantage point.[3] By contrast, we build a micro-founded model in which the licensing decision of workers and the wages offered by firms are endogenous outcomes of a two-period sequential screening game played by firms and workers. The model predicts a larger licensing premium for workers from groups with lower expected ability (women and minorities) and larger licensing premium when the license is bundled with additional human capital. Both of these predictions are borne out in the empirical analysis. We link back to the optimal regulation literature by computing the optimal cost of the licensing from the perspective of incumbent workers and firms. Similar to the result in Persico (2015), we find that incumbent workers and firms benefit from licensing.

Our work also contributes to the empirical literature on asymmetric information and black–white labor market disparities. For example, our results on the wage premium for black men in occupations that ban felons provides further evidence that reducing asymmetric

[3]Whereas Leland (1979) focused on whether it is socially optimal to have quality standards Persico (2015) studied the incentives of incumbent workers to impose occupational requirements for new entrants.

information between firms and workers reduces racial wage and employment disparities (De Tray, 1982; Holzer et al., 2006; Agan and Star, 2016; Miller, 2016). Recent studies of ban-the-box efforts, which remove criminal check-boxes from job applications, focus on the role of asymmetric information on the probability of employment (extensive margin), but here we focus on the effect of asymmetric information on wages (intensive margin) (Shoag and Veuger, 2016; Agan and Star, 2016). In this respect, our paper is most similar to De Tray (1982), who showed that veteran status confers a higher wage premium to black veterans than to white veterans, as a result of firm screening on veteran status.[4]

The rest of the paper is organized as follows: first we discuss the predicted effect of licensing on wage inequality under standard models of discrimination. After describing our data, we present our empirical specification and the main findings of the paper. We then test for asymmetric information and human capital bundling as key drivers for heterogeneous licensing premiums, and we perform robustness tests on our main results. Next, we develop a screening model of occupational licensing that generates the comparative statics that we document. We conclude by discussing how our findings contribute to the current policy debate on reducing occupational licensing across in the US.

2 Models of Discrimination

In the seminal model of taste-based discrimination (Becker, 1957), there are two types of workers (e.g., male and female or black and white). For the group that is subject to taste-based discrimination by the employer, workers of this group receive wages equal to the marginal product of their labor minus the discrimination coefficient. The discrimination coefficient is a monetary measure of the employer's level of prejudice. In equilibrium, the

[4]We thank Joshua Angrist for pointing us to this paper in the literature.

prevailing wage gap in the labor market between the worker types is determined by the discrimination coefficient of the marginal discriminator (i.e., the most prejudiced employer with whom female or minority employees interact). In a perfectly competitive labor market, discrimination is undermined because unbiased employers have lower labor costs, conditional on worker productivity (Arrow 1972, 1973). Subjecting an industry to occupational licensing shifts the labor supply curve inward. If incumbent firms control the licensing process, this creates an opportunity for biased firms to discriminate on the margin of which workers are permitted licensure in the occupation. If the entry criterion is not subject to the bias of prejudiced firms, then licensure creates a labor scarcity that reduces the opportunity for biased firms to offer unequal wages, ceteris paribus.

In contrast to Becker's model of taste-based discrimination, models of statistical discrimination by Phelps (1972), Arrow (1973), Coate and Loury (1993) *do not* unambiguously predict smaller gender and racial wage gaps in licensed occupations, relative to unlicensed occupations. In models of statistical discrimination, worker productivity is imperfectly observed and employers use their priors on the joint distribution of worker productivity and observable worker characteristics (e.g., race or sex) to predict productivity. Statistical discrimination against female and minority workers occurs when employers believe that workers of these types are less qualified, on average, or have a productivity that is drawn from a noisier distribution than their male or white peers, respectively. For example, if employers believe that women have lower (higher) expected productivity than that of white men, in equilibrium, women will receive lower (higher) wages than white men.[5] Likewise, holding expected productivity constant across groups, if employers believe that the productivity distribution of women is noisier (sharper) than that of white men, in equilibrium, women will receive lower

[5]The initial wages will be lower but over time as the firm learns about worker productivity from on-the-job performance these wage gaps should diminish, as in Altonji and Pierret (2001).

(higher) wages than white men. An important theoretical finding in the literature is that employer priors about worker productivity by worker type can itself endogenously generate wage gaps through a self-fulfilling prophecy mechanism even if the priors are incorrect at the outset (Coate and Loury 1993).

In a model of statistical discrimination, occupational licensing provides workers with a signal that may be differentially informative to employers for workers of a given race or gender. The informational content of an occupational license comes from at least four sources: (a) the non-zero bureaucratic cost of obtaining the license, which allows for signaling of type; (b) the additional human capital or training that, is bundled with the licenses; (c) the license's potential as a proxy for unobservables, such as felony status of an employee, which is a specific instance of signaling or can aid in employee screening by the firm; (d) the license's function as a marker of group identity and belonging (i.e., licensing as a club good) (Akerlof and Kranton, 2005; Cornes and Sandler, 1996).

The empirical literature on statistical discrimination and the recent literature on ban-the-box initiatives and related policies provide evidence that employers systematically mispredict the joint distribution of both worker productivity and race and worker felony status and race (Altonji and Pierret, 2001). Holzer et al. (2006) and Wozniak (2015) showed that employer-initiated criminal background checks increase the likelihood of firms hiring African American men and that employee drug testing increases black employment and relative wages (respectively). Similarly, Goldsmith et al. (2006) found that non-whites receive a lower return on prior experience than whites but that non-whites receive higher returns than whites for accumulating post-employment experience. These results give credence to the idea that occupational licenses may be differentially informative to employers, particularly for black men.

3 Data & Descriptive Statistics

The recent empirical advances in the study of occupational licensing are powered by a topical module on occupational licensing in the 2008 panel of the Survey of Income and Program Participation (SIPP). This data-set is among the first nationally representative data-sets on US workers in which both the wages and license statuses of workers are jointly recorded. In addition to wages and a licensing variable, the SIPP data includes standard demographic data (e.g. race, gender, education, and union status), as well as occupational codes that follow the 2010 Standard Occupation Classification (SOC).

In our empirical framework, we use the SOC occupational codes to control for wage heterogeneity across occupations in estimating the licensing premium for white men, black men, white women, and black women. In the SOC, there are twenty-three 2-digit major groups. Each 2-digit major SOC group in turn has detailed 3-digit SOC subgroups that contain professions with similar characteristics. Each 3-digit occupation code can further be disaggregated to collection of occupations with 6-digit SOC numbers. For example, the 2-digit SOC group (21) "Community and Social Service Occupations" nests the 3-digit sub group (21-1) "Counselors, Social Workers, and Other Community and Social Service Specialists." This 3-digit subgroup in turn contains two separate 6-digit SOC codes for "Social Worker" (21-1020) and "Counsellor" (21-1020). Our occupation fixed effects are based on the 3-digit detailed subgroups, whereas our licensing variable is reported as a 6-digit SOC value. The license premium that we estimate is thus estimated by comparing the wages of workers in the same occupation who work in states that vary in whether a license is required to practice said occupation.

Prior to the advent of this topical module in the SIPP, the most comprehensive data on occupational licensing and wages in the US was a Gallup survey covering 1,614 respondents

who represented 300 occupations (Kleiner and Krueger, 2010). The estimated wage premium from this survey was 15% for licensed workers, when compared to their unlicensed peers. Kleiner and Krueger (2013) built on this survey by nearly doubling the sample size, using a telephone survey to collect data from 2,513 individuals. In this larger sample, Kleiner and Krueger estimated a wage premium of 18% for licensed workers. The advantages of the SIPP over the prior surveys is that the SIPP has a much larger sample size (by a factor of 10 for each) as well as enhanced coverage of occupations – the SIPP covers over 800 occupations, compared with the 300 occupations covered by the previous surveys.

As of 2015, the Current Population Survey (CPS) also includes a license variable. The principal advantage of the SIPP data relative to the CPS data is that the SIPP data contains more licensing variables and richer licensing variables. Whereas the CPS has just one licensing variable, an indicator for whether the worker has an occupational license, the SIPP contains responses to nine additional questions about the license and license holder. For example, respondents in the SIPP specified why they pursued the license (personal or professional reasons), and whether the license required training. We utilize the responses to these questions, for example, to test whether heterogeneity in the licensing premium by race and gender is driven by heterogeneity in the returns to training or heterogeneity in the pure signaling value of the license among different worker types: those who have a taste for *credentialization* and those who do not. Moreover, the SIPP has more detailed data on firm size for each employee that allows us to test for evidence linking wage inequality to occupational licensing through the channel of asymmetric information, in particular screening by firms.

Our data comes from Wave 13 to Wave 16 of the SIPP 2008 Panel.[6] To select our sample,

[6]The occupational licensing topical module of the SIPP was conducted during Wave 13.

we follow the criterion adopted by Gittleman et al. (2015) – a pioneering study that uses the SIPP to estimate a homogeneous licensing premium. Our sample is restricted to individuals between the ages of 18 and 64 who have an implied hourly wage of between $5 and $100.[7] We dropped observations with imputed wages and imputed license status because using imputed wages would bias our estimates of the license premium toward zero since license status is not included in the imputation process (Hirsch and Schumacher, 2004).

In order to test our felony hypothesis, we supplement SIPP with a database from the Criminal Justice Section of the American Bar Association (ABA) that contains the universe of license restrictions that felons face when applying for an occupational license in each occupation and in each state of the US. In total there are 16,343 such restrictions. We organize legal felony restrictions into three categories: those imposing a permanent ban on felons from ever having an occupational license, those imposing a temporary ban on felons, and those imposing no ban at all on a felon's ability to hold an occupational license.[8] For each state-occupation pair, if there are multiple offenses that result in different consequences for the licensing eligibility, we code our felony variable to correspond to the most severe punishment. This biases us *against* finding different effects between the most severe category (i.e., permanent ban) and the least severe category (i.e., no ban). In essence, our felony results are by construction a lower bound on the true felony effects. For example in New Jersey there are 4 legal citations for offense that would affect an attorney's eligibility to practice law. Since "suspend attorney for any felony permanently and without discretion" is one of the four consequences, we code the attorney occupation in NJ as one with a permanent ban on felons.

[7]The hourly wage is implied by the monthly earning of the main job, hours worked per week, and number of weeks worked in that month.

[8]Most of the bans involve denying applications and suspending current license holders.

In creating this new data-set, we use an online tool developed by the Department of Labor, O*net SOC auto coder, and a web-scraping application to sort each of the 16,343 citations into correct 6-digit SOC codes. This allows us to include occupation fixed effects into our felony hypothesis wage regressions. Figure 1 illustrates the extent of occupational licensing by state. Figure 2 illustrates, for each state, the number of bans affecting a felon's ability to hold an occupational license. Ohio, the most restrictive state, has 83 such bans: 59 permanent and 24 temporary. The least restrictive state, Wyoming, has 23 such bans: 13 permanent and 10 temporary. Felons are barred from holding licenses as truck drivers in every state, while felons are restricted from being nursing aides in 48 states. Eight of the 10 most restricted occupations involve the licensee as a direct personal advocate or helper of the customer. The remaining two concern the operation of motor vehicles. Bans appear to be most common in professions where the personal safety of clients and public safety come into question.

In Table I, we report a summary of the demographic and wage data for workers who are unlicensed, licensed in occupations without felony bans, licensed in occupations with felony bans, and workers who are certified. Overall, when compared to unlicensed workers, workers who are licensed are on average older, more educated, more likely to be female, self-employed, and working in a service industry or for the government. Moreover, on average, workers with a license earn more than unlicensed workers. In particular, workers in occupations with felony bans out earn workers in occupations with licensing requirements that do not exclude felons. When we cut the data by race and gender, a similar pattern emerges for white men, black men, white women, and black women: increasing mean wages for licensed workers relative to their unlicensed counterparts. The unconditional licensing premiums in occupations without felony bans are: 15% for white men, 24% for black men, 32% for white women, and 38% for

black women (Table II). For each group, except for black women, the unconditional licensing premium is higher yet in occupations with felony restrictions.

4 Empirical Specification

The goal of our empirical model is to estimate the occupational license premium, allowing for heterogeneity by race and gender. Given the estimates of the model we test whether occupational licensing closes the wage gap between white men and the three other demographic groups that we study: black men, white women, and black women. We also test whether the source of any changes in the racial and gender earning gaps is due to the reduction in asymmetric information in the labor market or due to heterogeneity in the returns to human capital, skills, or training that is bundled with the occupational license.

In our baseline specification, we estimate the following wage regression:

$$\begin{aligned}\log(\text{wage}_{ijsm}) = \tau_0 + \tau_1 blackman_i + \tau_2 whitefemale_i + \tau_3 blackfemale_i \\ + \tau_4 license_i + \tau_5 license_i * blackman_i + \tau_6 license_i * whitefemale_i + \tau_7 license_i * blackfemale_i \\ + \tau_8 ban_i + \tau_9 ban_i * blackman_i + \tau_{10} ban_i * whitefemale_i + \tau_{11} ban_i * blackfemale_i \\ + X_i\Gamma + \theta_s + \theta_o + \theta_m + + \epsilon_{ijsm} \quad (1)\end{aligned}$$

The dependent variable is the log of hourly wages for individuals i working in profession j in state s in month m. X is a vector of standard demographic characteristics including quadratic in age, education levels (indicators for high school dropout, some college degree, college graduate, and post-graduate), indicators for union membership, government workers, and self-employment. θ_S, θ_m, and θ_O are state, month, and occupation fixed effects. In our

context, profession j is defined by 6-digit SOC code while occupation o is defined by 3-digit SOC code. We also include a separate indicator for *certified* workers, i.e., workers whose credential is issued by private body.

Our empirical model is similar to Wozniak (2015) in that we have mutually exclusive indicators for each racial and gender group. This specification facilitates clear comparisons of racial and gender wage gaps in the two license conditions. The Greek symbols τ_1, τ_2 and τ_3 represent the mean wage gap between unlicensed white men and unlicensed black men, white women and black women (respectively). The *license* indicator equals 1 if the worker is licensed to work in her current occupation, and the *ban* indicator equals 1 if the licensed profession has mandatory bans against felons that is either temporary or permanent. Therefore, τ_4 indicates the license premium in non-banned professions for white men while τ_5 to τ_7 capture the heterogeneity of license premium in non-banned professions for black men, white women, and black women. The Greek symbols τ_8 to τ_{11} refer to the additional license premium from working in banned professions. For example, the expected license premium for black men in non-banned professions equals $\tau_4 + \tau_5$ while that in banned professions equals $\tau_4 + \tau_5 + \tau_8 + \tau_9$. All standards errors that we report are clustered at the state level.

5 Results

5.1 Occupational Licensing Reduces Gender and Racial Wage Gaps

In Table III we present the results from our baseline wage regression. In column (1), we first estimate the license premium using a specification in which we do not distinguish between licenses in occupations with felony bans and licenses in occupations with no felony ban. Under this specification, the license premium for white men is 7.54%, whereas the

license premium for black men equals 12.5%. White women and black women also receive higher license premiums than white men: 13.7% and 15.9%, respectively.[9] The returns to occupational licensing are uniformly higher for women and minorities when compared to white men; moreover, this results in a reduction in both the racial and gender wage gaps for licensed workers when compared to the gender and racial wage gaps experienced by their unlicensed counterparts. The gender wage gaps for unlicensed white women and unlicensed black women, when compared to unlicensed white men, are 15.1% and 23.3% (respectively), whereas the racial wage gap between unlicensed black men and unlicensed white men is 11.6%. By contrast, the gender wage gap for licensed white women is 40% lower, at 9.0% (1.3%), and 36% lower for licensed black women, at 14.9% (2.3%). Moreover, the racial wage gap between licensed black men is 43% lower, at 6.6% (3.6). In fact, we cannot reject the null hypothesis of a zero wage gap between licensed black men and licensed white men.

In cases of estimating heterogeneous effects Solon et al. (2015) recommend reporting the results from both unweighted and weighted regressions. The results that we have presented so far are from the unweighted regressions. In Table IV, we present the results using the survey sample weights. Consistent with the empirical guidance in Solon et al. (2015), we find that the regression results for the unweighted and weighted specifications are most *dissimilar* when there is unmodeled heterogeneity. For example, when we regress the log of wages on license status without accounting for whether the licensed occupation permanently bans felons, we find an *insignificant positive* effect of licensing on the wages of white women in our weighted specification. In our unweighted specification, which we first reported, we find a *positive significant* effect of licensing on white women's wages. After including interactions to account for heterogeneity in the licensing premia due to the existence of permanent felony bans, we

[9] Gittleman et al. (2015), who employed the same data-set, and further pooled their license premiums across both race and gender, found an average license premium of 7.57%.

find a *positive significant* effect of licensing on white women's wages in *both* the weighted an unweighted samples. The same is true when we look at the license premium for black men: for the weighted regressions, the black male license premium flips sign from negative to positive as we go from the base case to the case with the permanent felony ban interactions. The sign on the coefficient for the black male license premium for the unweighted regressions, by contrast, maintains a positive sign in both specifications. Moreover, it is similar in magnitude to the coefficient from the weighted regressions with the permanent felony ban interactions included in the model. In our particular case, in the presence of unmodeled heterogeneity, we find that the results from the unweighted regression are more robust.

Continuing with the unweighted regressions in remainder of our results sections has two expository advantages relative to using the weighted regressions. First, the results in the base case with unmodeled heterogeneity closely parallel the final results in the model with richer heterogeneity. Second, the point estimates are more precisely estimated, as noted in Solon et al. (2015). This is important for what we will do next. In the following sections we decompose the relative wages gains to occupational licensing into two primary channels: the license as a signal of non-felony status, and the license as a supplement to the human capital of workers. One way to think of this is that in subsequent sections, we add other components of the occupational license, which as of now, are *unmodeled* heterogeneity. When we reach our most saturated regression model in Section 5.4, which includes interactions for felony restrictions, human capital bundled with the license and new individual level variables, which allow us to account for selection into licensing for personal reasons, we will again report both the results from the weighted regression and the unweighted regression, following the guidance in Solon et al. (2015). We will find that for this fully-saturated model that the results are very similar. Moreover, we include all of the results from the weighted regressions

in the online appendix to the paper for the reader to see how weighting the results affects the magnitude and signs of the coefficients that we estimate for the intermediate results.

5.2 License Signals Non-Felony Status For Black Men

When we separate out licenses into those with felony bans and those without felony bans, we find that all workers in occupations with felony bans earn more than their counterparts in unbanned occupations. As reported in column (2) of Table III, white men in banned occupations earn a 3.2% wage premium, black men earn a 16.4% wage premium on top of this baseline premium earned by white men, for an overall total of 19.6%. The wage premium for white women in occupations with felony restrictions is 1.6% less than the wage premium of their white male counterparts. Likewise, black women in occupations that bar felons experience a wage premium that is 0.4% smaller than the wage premium of their white male counterparts.

When we further refine our definition of occupations with felony bans to include only those occupations with permanent bans on felons, the wage gains for women in banned occupations are erased. As reported in column 3 of Table III, white women in licensed occupations with permanent felony bans earn 0.4% less than white women in licensed occupations without permanent felony bans. Similarly, black women in licensed occupations with permanent felony bans earn 1.4% less than white women in licensed occupations without permanent felony bans. In contrast, white men in licensed occupations with permanent felony bans earn 3.3% more than white men in occupations without permanent felony bans. (This wage gain, however, is not statistically significant). For black men working in licensed occupations with permanent felony bans, the wage premium is 18.9% when compared to black men in occupations without permanent felony bans. It is worth noting that the wage premium for

the license as a signal of non-felon status is 5.7 times larger for black men than for white men, and that there is no wage premium paid to women of either race for signaling non-felon status.

Under both measurements of felony bans in column (2) and (3) of Table III, we find that men, in particular black men, benefit from the positive non-felony signal of an occupational license. In fact, black men in occupations *with* felony bans earn, on average 5% *more* than their white male counterparts. Whereas black men in licensed occupations *without* permanent felony bans earn 10.4% *less* than white men. This result is consistent with the prediction of of the model in Section 6 (corollary 1.2), in which licensed workers who face higher licensing cost earn higher wages. Because black men are 6 times more likely to have a felony record than white men, felony restrictions on occupational licenses impose a higher average cost burden on black men.

Given the richness of the SIPP data, we can test whether the wage premium to black men is due to asymmetric information. We test for evidence of firm screening by looking at whether the ban premium for black men decreases in firm size. Victor et al. (2012) conducted a study on the use of criminal background checks in hiring decisions. Their sample includes 544 randomly selected firms from the membership of the Society for Human Resources Management. The study indicated that 52% of small firms (<100 employees), 31% of medium firms (100 to 499 employees), and 17% of large firms (>2,500 employees) did not conduct background checks for all job candidates. Firms may not perform background checks on all job applicants for at least three reasons: (i) each background check is costly and total cost scales with the number of applicants rather than the number of job openings, (ii) background checks by private services are susceptible to human error, and (iii) some states have restrictions on using criminal records in the job search process (US Department

of Labor 2001; Cavico et al. 2014). Because the probability of no background checks by firms decreases by firm size, the asymmetric information about employee status decreases by firm size, which predicts that the ban premium for black men should likewise decrease by firm size. In Table V, we split the sample into different firm sizes. As shown from column (1) to (4), when firm size gets larger (> 100), the additional ban premium for black men is at first stable, at around 22%, then begins to fall off monotonically for firms with > 500 and > 1000 employees.

The wage premium for black men in occupations with felony bans is very large, so naturally we were concerned that the occupations with felony bans were different from those without felony bans in ways that could explain this very large wage premium. For example, we were concerned that states with felony restrictions on occupational licenses have higher instances of black-white discrepancies in arrests, which could have caused the felony restrictions in the first place. We were also concerned that occupations with felony restrictions were disproportionately in government jobs, where wage discrimination is more closely monitored because of the strict enforcement of anti-discrimination employment laws. In light of Goldin's pollution theory of discrimination, we were also concerned that felony restrictions would be more likely to appear in occupations with a higher fractions of white workers as a means of shielding white workers from competition with black workers (Goldin, 2014b). Likewise, we were concerned that bans might appear in union jobs where wages are naturally higher, on average, and differentially so for black men.[10]

In Table VI, we test these competing hypotheses by running four separate regressions in which we control for heterogeneous returns to wages by race and gender of: (i) the differences in the log of the disparity in arrest rates between blacks and whites, (ii) the

[10]We thank Bill Spriggs and David Neumark for pointing out these alternative explanations during NBER Summer Institute (2016) and encouraging us to explore them.

fraction of whites in the worker's current occupation, (iii) whether the worker is employed by the government, and (iv) the worker's union status. Our key finding here is that the wage premium experienced by black men in occupations with felony restrictions is robust even after controlling for these four factors. Previously, we found a wage premium of 18.9% for black men in licensed occupations with felony restrictions when we did not control for these factors. After controlling for these factors, the estimated wage premium for black men in licensed occupations with felony restrictions ranges from 17% to 19%. To put this wage premium into context, it is 24% larger than the premium that black men earn from working in the public sector and one third smaller than the union wage premium for black men. It is also equivalent to the wage increase associated with working in an occupation that is 30% whiter than his current occupation. Most strikingly, the wage premium for black men in licensed occupations with felony bans is equivalent to the wage gains that a black man would earn due to moving from a state where black men are 6 times more likely to be arrested than white men to a state where white men are 1.7 times more likely to be arrested than a black man.

As an additional check on our results, we also test whether heterogeneous returns to education can rule out the ban premium that we estimate. In Table I, we saw that the fraction of workers with a college degree was higher in licensed occupations with felony restrictions when compared to licensed occupations without felony restrictions and unlicensed workers. The education gradient is even steeper for the fraction of workers with postgraduate degrees. Workers in licensed occupations with felony restrictions are 1.5 times more likely to have postgraduate training than workers in licensed occupations without felony restrictions and more than 3 times as likely to have postgraduate training when compared to unlicensed workers.

In Table VII we run three separate wage regressions – one for licensed workers in occupations with felony bans, one for licensed workers in occupations without felony bans, and one for unlicensed workers. As our education control, we include a dummy variable *postHS*, which equals one if the worker has postsecondary education, and zero otherwise. In the regressions we also include interactions between this dummy variable and race and gender, which allows for heterogeneous returns to education by race and gender. For black men in licensed occupations with felony restrictions we find no evidence for higher returns to education relative to white men. The estimated coefficient on the interaction between *postHS* and the indicator variable for black male is -0.36% and statistically insignificant. It is, moreover, less than one tenth of the main effect (4.8%) of post high school education on wages for all workers. By contrast, black men in licensed occupations without felony bans experience a 7.98% increase in wages relative to white male counterparts. Heterogeneous returns to post high school education do not explain the wage premium that black men experience in occupations with felony restrictions, even though heterogeneous returns to education do increase expected wages for black men in licensed occupations without felony bans by 8%.

5.3 Returns to Human Capital Bundled with Licenses

In addition to signaling felony status, licensing can affect worker wages and racial and gender wage gaps through a human capital channel. Occupational licensing, because it is costly, can signal unobserved ability. Moreover, some occupational licenses require workers to undergo training, pass an exam,[11] or engage in continuous education as a condition of obtaining and maintaining the license. We think of training and continuous education requirements of

[11]Pagliero (2010) showed that there is a positive correlation between wages and the difficulty of licensing exams.

licenses as primary observable forms of human capital for which workers may be compensated. Heterogeneity in the returns these observable forms of human capital by race and gender could arise if firms believe that there are differences in the underlying stock of this human capital by race and gender.

In Table VIII we regress log wages on licensing and on controls for whether the license has a training requirement, a continuous education requirement, and a mandated examination. Comparing the results of these three regressions in columns (2)-(4) with the results from the baseline regression model in column (1), we find that training and continuous education account for some of the license premium that we estimate in the baseline model for all workers. White men in licensed occupations with training requirements earn 4.2% more than white men in licensed occupations with no training requirements. The license training premiums are higher still for black men (7.1%), white women (7.9%), and black women (6.2%). As shown in column (5) of Table VIII, these results are similar when we control for the skill content of the occupations using the occupation-specific skill indexes developed by the Occupational Information Network (O*NET).[12] White men in licensed occupations with continuous education earn a premium of 3.3%, which is lower than the premium to continuous education for black men (6.9%) and white women (7.6%) but identical to the continuous education premium experienced by black women (3.3%). The results are robust

[12]This data uses comprehensive information on worker skills in each 6-digit occupation that is developed by occupational analysts using the information from a randomly selected pool of incumbent workers. The skill attributes are: **Content skills** which include reading, listening, writing, speaking, mathematics, and science; **Process skills** which include critical thinking, active learning, learning strategy, and monitoring; **Complex skills** which refer to complex problem solving; **Social skills** which include coordination, instructing, negotiation, persuasion, service orientation, and social perceptiveness; **System skills** which include judging and decision making, systems analysis, and systems evaluation; **Resource Management skills** which include time and management of financial. material, and personal resources; **Technical skills** which include equipment maintenance and selection, installation, operation control and monitoring, operations analysis, programming, quality control analysis, repairing, technology design, and troubleshooting. To ensure that the measures accurately reflect workers' job requirements in our sample, we use the July 2014 version, which is contemporaneous with our extract of the SIPP data.

to controlling for the skill requirements of the job, as reported in column (6) of Table VIII.

When taken together, these results suggest that differentially higher returns for women and minorities to the human capital that is bundled with licensing is in part responsible for the narrowing of the racial and gender wage gaps that we document. To be clear, all workers, including white men, earn a wage premium because of the training and continuous education undertaken to obtain a license.[13] In addition to differentially higher returns to training, women in licensed occupations without felony bans also receive an additional license premium from factors unrelated to human capital, which we term the residual signaling component of the license. This residual signaling results in a 4.3%-4.6% wage premium for white women in licensed occupations without felony restrictions relative to white men in licensed occupations without felony restrictions, and an even higher wage premium of 7.6%-8.3% for black women. By comparison, black men in licensed occupations without felony restrictions experience a license premium that is 1.2 percentage points *less* than that of their white male counterparts. In fact, as a percentage of the total license premium, the residual signaling component of the license relative to the training component of licensing is higher for white women than for white men (47% versus 38%) and likewise higher for black women than black men (37% versus 16%).

5.4 Main Results Robust to Controlling for Selection in Licensing

In interpreting these results, we were concerned about two mains forms of selection and their effects on the estimated racial and gender wage gaps. First, there is occupational selection. Because there are differences in the kinds of jobs that men and women most commonly choose, occupational selection will account for some of the gender wage gap. Secondly, there

[13]Passing an exam to qualify for a license appears to have a significant impact only on the wages of white women.

is selection into who chooses to obtain a license. The desire to obtain a license is potentially correlated with unobserved ability as well as unobserved taste for *credentialization*: an individual may enjoy having an occupational license as a signifier of his or her human capital.

To address the first issue of occupation selection, we use varying levels of the occupational fixed-effects used in our wage regression to trace out the relationship between better occupational controls on the estimated gender and racial wage gaps. In our first specification, we compute the racial and gender wage gaps from a model that includes no occupational fixed effects. In this model there is no attempt to control for occupational selection. Next we run a specification in which we include 2-digit occupational fixed effects and we compute the gender and racial wage gaps. Finally, we run a specification in which we include 3-digit fixed effects and then compute the gender and racial wage gaps.

The predicted gender and racial wage gaps for both licensed and unlicensed workers is sensitive to including 2-digit occupation fixed effects, relative to using no occupation fixed effects. By comparison, going from 2-digit occupation fixed effects to 3-digit occupation fixed effects has a much smaller effect on the predicted wage gaps. Moreover, the effect of more detailed occupational controls is less pronounced for licensed workers than unlicensed workers. For example, for *unlicensed* white women, the predicted wage gap goes from -0.22 to -0.18 to -0.16 as we increase the detail of the occupational controls (Figure 3). The predicted wage gap for *licensed* white women goes from -0.071 to -0.085 to -0.087 as we increase the detail of the occupational controls (Figure 3). For black men, we also find that a zero wage gap is within the confidence interval whether we use the detailed 3-digit occupational controls or if we use the more broad 2-digit occupational controls. Likewise, for both licensed and unlicensed workers of all demographic types, the 2-digit and 3-digit wage gap confidence intervals are overlapping. This gives us confidence that our results are less likely to be

severely undermined by concerns about occupational selection.

To address the second type of selection, selection into licensing, we use a unique variable in the SIPP data. The survey asks respondents: "Did [he/she] get this certificate or license mainly for work-related or mainly for person interest." To test for whether self-selection into licensing can account for our main results, we re-estimated our empirical model, controlling for whether an individual pursued a license mainly for personal interest. The variable "personal" equals 1 if the worker pursued the license for personal reasons and 0 otherwise. If a personal interest in the licensed profession is positively (negatively) correlated with unobserved ability, then our OLS estimates would overstate (understate) the effect of licensing on wages. An alternative view of this selection due to a taste for credentialing is the lens of compensating differentials. Viewed through this lens, individuals who self-select into licensing receive lower wages if there is some consumption value to having the credential itself. Workers without this inherent taste for the licensed occupation would need to be paid a compensating differential in order to equalize their utility from working in the occupation to that of their peers with a personal interest in the license. We find that workers who pursue a license for personal reasons, on average, earn a lower wage as reported in Table IX column (2). This finding is consistent with the taste for *credentialization* viewpoint. The coefficient that we estimate on license status by race and gender are unaffected by introducing this control variable, and our estimated racial and gender wage gaps are unchanged.

As a final check on our main results, we propose an instrumental variable strategy. As our instrument for whether an occupation is licensed, we use the product distance instrument in Gandhi and Houde (2016). These instruments are the optimal version of the instruments proposed in Berry et al. (1995), i.e. the BLP instruments. In a standard discrete choice model, even if characteristics of each product is exogenous we can run into a problem of weak

instruments if we do not use the optimal instruments. Gandhi and Houde (2016) showed that for a given product o, with product characteristic L_o, that the Euclidean distance d_o between this product characteristic and the product characteristic of competing products L'_o is an approximation for the optimal BLP instruments:

$$d_o = \sqrt{\sum_{o'} (L_o - L'_o)^2}. \tag{2}$$

Using simulated data, they found that these product-space instruments perform better than the standard BLP instruments, producing unbiased estimates of the true parameters that also have less dispersion about the mean. In our context the product being chosen is the occupation o, and the product characteristic is whether that occupation is licensed L_o. We define the set of competing occupations to be all other occupations o' that share the same 3-digit standard occupation code (SOC) as occupation o.

In column (3) of Table IX we present the results from a instrumental variables regression of log wages on license status by race and gender. For completeness we include controls for the human capital associated with licensing in addition to the personal indicator variable, which captures whether an individual sorted into a licensed occupation for personal or professional reasons. The first-stage coefficient on the instrument is positive and significant (t-stat: 18). Moreover, the f-stat on the first stage is large (f-stat: 332), which is consistent with the stated purpose of constructing strong optimal instruments from the full mean of product characteristics.

For *licensed* workers in occupations without felony restrictions and with no continuous education requirements, instrumenting does change the license premium. The license premium for white men falls from a significant 3.8% to a statistically insignificant -1%. The license premium for women, both black and white, in licensed occupations without felony

restrictions also falls. The decline for black women is larger than the decline for white women by 4 percentage points. This results in a near equalization of the licensing wage premium between black women (2.3%) and white women (2.8%). The license premium of black men in occupations without felony restrictions upends this trend – it rises from 1.1% to 4.6%.

The overall decline in the unobserved signaling component of licensing for white men, white women, and black women is compensated for by a positive increase in the relative importance of continuous education on the license premium of these workers. The premium of continuous education for white men doubles from 2.1% to 5.6%. The differential premium to continuous education for white women relative to white men increases by 1.5 percentage points, from 4.45% to 5.95%, while it more than triples for black women, from 1.8% to 5.93%, yielding a near equalization between the returns to the human capital bundled with licensing for women of both races. This increase in the returns to human capital with licensing reinforces the point that licensing reduces the gender wage gap through conferring differentially higher returns to human capital for women. The return to continuous education for black men is just one percentage point higher than the return for white men. As such the human capital associated with licensing does not play a prominent role in reducing the racial wage gap between black men and white men.

Another important result from our IV procedure is the estimated wage premium for black men in occupations with felony restrictions. Consistent with our OLS results, the wage premium for black men in banned occupations is large and significant at 18.2%. The wage premium for white men in occupations with felony restrictions is one fifth as large, at 3.5%. The wage premium for women in occupations with felony restrictions is smaller than that for white men by 1.2 percentage points (white women) and 0.8 percentage points (black women). These results confirm what we know from the prior OLS regression results – occupational

licensing reduces the racial wage gap between black men and white men in cases where the license serves as a veritable signal of non-felony status. Moreover, by comparing the results in Table X, in which we use the survey sample weights, to the results in Table IX, in which we do not, we see that the results are robust to either weighting procedure.

6 A Screening Model of Occupational Licensing

In the spirit of Coate and Loury (1993) and Moro and Norman (2004), we develop a model of occupational licensing in which there is endogenous occupation selection and endogenous wage determination. Our model differs from these two self-fulfilling prophecy models in that we assume that the distribution of worker ability is heterogeneous by worker type, fully known to employers, and correctly perceived by employers *ex ante*. The assumptions that we make allow for a unique equilibrium wage for licensed and unlicensed workers for each race and gender group.

In contrast with our model, which admits a unique equilibrium, self-fulfilling prophecy models admit multiple equilibria.[14] We are expressly interested in comparative statistics of the model that capture whether occupational licensing results in a heterogeneous wage premium for licensed workers by race and gender precisely *because* firms may have different priors over the underlying distribution of worker ability by these types or *because* workers face average cost of investing in the licensing signal that differs by race and gender, as is the case with African-American men – a group disproportionately affected by felon restrictions on occupational licenses.

[14]That self-fulfilling prophecy models have multiple equilibria is a feature of this class of models. The existence of multiple equilibria in self-fulfilling prophecy models demonstrates how inequality in labor market outcomes can arise between two *ex ante* identical groups of workers. By comparison, our goal in this paper is to take firm beliefs about workers' abilities as given and determine the extent to which workers sort into licensed occupations in order to signal their type.

Our model is a two-sector, two-period model of firms and workers, consisting of a unit measure of risk neutral workers and an occupational licensing requirement for workers in sector 1 but not for workers in sector 2. In period 1, firms set wages to maximize profits, namely ω_L for the licensed sector 1 and ω_U for the unlicensed sector 2. In period 2, workers choose the sector that delivers the highest utility given the wages offered by firms and given the relative preferences of workers over employment in the two sectors. The equilibrium of the model is a vector of wages (ω_L, ω_U) and fraction of workers f that satisfy the utility maximization motive of workers and the profit-maximizing motive of firms. Because firms, which are the uninformed party in our model, move first, our model falls under the technical definition of a screening model (Stiglitz and Weiss, 1990).

6.1 Description of Worker's Preferences and Abilities

Each worker, indexed by the subscript i, is endowed with an ability a_i and a relative taste for the unlicensed sector ϵ_i. The ability type and the relative sector preference are independently and identically distributed across workers and drawn from the following two uniform distributions: $a_i \sim U[\mu_a - \sigma_a, \mu_a + \sigma_a]$ and $\epsilon_i \sim U[\mu_\epsilon - \sigma_\epsilon, \mu_\epsilon + \sigma_\epsilon]$, where we assume that average ability is positive (i.e. $\mu_a > 0$).[15] The sector taste parameters μ_ϵ and σ_ϵ, are measured in units of dollars so that they enter the worker's utility function on the same footing as wages. The ability and preference distribution is allowed to be different for workers of different racial and gender groups. For notational simplicity, however, we suppress the group index and solve the model separately for each group.

Obtaining an occupational license is costly for workers of all abilities. In order to obtain

[15] We assume uniform distributions for the sake of tractability.

an occupational license, a worker of ability a_i incurs a cost:

$$c(a_i) = c_0 - \theta(a_i - \mu_a). \tag{3}$$

The parameter $c_0 > 0$ in the cost function captures the unconditional average cost of obtaining an occupational license.[16] The parameter θ is the marginal benefit of ability. Each unit increase in ability lowers the cost of licensing by an amount θ. For ability measures that make it easier for a worker to obtain an occupational license (e.g., I.Q.) we will assume a positive marginal benefit of ability (i.e., $\theta > 0$). For ability measures such as a worker's level of criminality or criminal history, which make obtaining an occupational license more difficult, we assume a negative marginal benefit of ability (i.e., $\theta < 0$).

In the unlicensed sector, a worker i receives utility $V_{U,i}$, which is the sum of the wages earned in the unlicensed sector, ω_U, and the relative taste that she has for the unlicensed sector ϵ_i:

$$V_{U,i} = \omega_U + \epsilon_i. \tag{4}$$

In the licensed sector, a worker i receives utility $V_{L,i}$, which is the difference between the wages earned in the licensed sector, ω_L, and the cost, $c(a_i)$, that she incurred in order to obtain the license:

$$V_{L,i} = \omega_L - [c_0 - \theta(a_i - \mu_a)]. \tag{5}$$

6.2 Firms

In each sector there is a single representative firm. Firms do not observe worker ability but observe whether a worker has a license or not. Because licensing is costly, and differentially

[16] It is also the cost of licensing for the worker of average ability $a_i = \mu_a$.

so (according to worker ability), an occupational license acts as a job market signal in an analogous way to education in Spence (1973).

Each firm, j, possesses a technology that converts one unit of worker ability into $\bar{\omega}$ dollars worth of goods. In the licensed sector, $j = 1$, the occupational license is also bundled with an exogenous level of useful human capital (training) $0 \leq h \leq 1$, which augments the workers ability to utilise the technology by a factor of $(1 + h)$. The cost of acquiring this human capital is born by the workers through the licensing cost in equation (3).

The expected profit for the representative firm in the licensed occupation (sector 1) is given by:

$$E[\pi_1] = \underbrace{\overbrace{\bar{\omega}(1+h)}^{\text{Avg. Output per Worker}} \times E[a_i|L_i = 1] \times \overbrace{E[P(L_i = 1|a_i)]}^{\text{Measure of Workers}}}_{\text{Expected Revenue}} - \underbrace{\omega_L E[P(L_i = 1|a_i)]}_{\text{Expected Labor Cost}}, \tag{6}$$

where $E[a_i|L_i = 1]$ is the expected ability of a worker conditional on employment in the licensed sector and $E[P(L_i = 1|a_i)]$ is the fraction of workers working in the licensed sector.

The expected profit for the representative firm in the unlicensed occupation (sector 2) is given by:

$$E[\pi_2] = \underbrace{\bar{\omega} \times E[a_i|L_i = 0] \times E[P(L_i = 0|a_i)]}_{\text{Expected Revenue}} - \underbrace{\omega_U E[P(L_i = 0|a_i)]}_{\text{Expected Labor Cost}}, \tag{7}$$

where $E[a_i|L_i = 0]$ is the expected ability of a worker conditional on employment in the unlicensed sector, and $E[P(L_i = 0|a_i)]$ is the fraction of workers employed in the unlicensed sector.

Theorem 1. *If the average cost of licensing falls within the well-defined interval $c_0 \in (\underline{c}, \bar{c})$, where $\underline{c} = h\bar{\omega}\mu_a - \mu_\epsilon - 3\sigma_\epsilon$ and $\bar{c} = h\bar{\omega}\mu_a - \mu_\epsilon + 3\sigma_\epsilon$, there exists a unique subgame perfect Nash*

equilibrium in which the wage in the licensed occupation (ω_L^*) and the unlicensed occupation (ω_U^*) are given by:

$$\omega_L^* = \left(1 + \frac{2}{3}h\right)\bar{\omega}\mu_a + \frac{1}{3}c_0 + \frac{1}{3}\mu_\epsilon - \sigma_\epsilon, \tag{8}$$

$$\omega_U^* = \left(1 + \frac{1}{3}h\right)\bar{\omega}\mu_a - \frac{1}{3}c_0 - \frac{1}{3}\mu_\epsilon - \sigma_\epsilon. \tag{9}$$

and the fraction of workers with an occupational license (f) is an interior point $0 < f < 1$ governed by the equation:

$$f \equiv E[P(L_i = 1|a_i)] = \frac{1}{2} + \left(\frac{h\bar{\omega}\mu_a - c_0 - \mu_\epsilon}{6\sigma_\epsilon}\right). \tag{10}$$

Proof. See Appendix. □

Corollary 1.1. *Wages are unambiguously higher in the licensed sector than in the unlicensed sector, and the wedge between these two wages is increasing in the cost of licensing. In equilibrium, unlicensed workers also experience a wage benefit from the human capital that is bundled with the licensing. This wage benefit is half the human capital benefit experienced by licensed workers.*

The fact that licensing is bundled with human capital h increases the market return to licensed labor and, in doing so, increases the value of the outside option of workers who opt not to become licensed. Consistent with this prediction of the model, Han and Kleiner (2016) provide evidence that workers in a licensed occupation who do not possess a license but are allowed to practice because of *grandfathering* provisions experience a 5% increase in wages as a result of their occupation becoming licensed, when compared to similar unlicensed workers in occupations with no licensing requirements. By contrast, the wage premium to licensed workers in the occupation, when compared to similar unlicensed workers in occupations with

no licensing requirements, is 12 percentage points higher than the wage premium experienced by grandfathered workers.

Corollary 1.2. *Given two distinct groups of workers B and W such that the average cost of licensing is greater for group B than for group W (i.e., $c_{o,B} > c_{0,W}$) unlicensed B workers earn less than unlicensed W workers, whereas licensed B workers earn more than licensed W workers, ceteris paribus. This follows from the fact that wages are decreasing in c_0 for unlicensed workers (equation 9) but increasing in c_0 for licensed workers (equation 8).*

The result of this corollary maps into the empirical fact that we documented in Section 5.2, which is that unlicensed black men earn less, on average, than unlicensed white men, whereas licensed black men working in occupations with felony restrictions earn, on average, slightly more than licensed white men in similar occupations. The presumption here is that the felony restriction imposes a higher average cost of licensing on black men relative to white men. Using data from the Bureau of Justice Statistics, Sakala (2014) documents that black men are six times more likely to be incarcerated than white men, which is consistent with this assumption.

Theorem 2. *If $\mu_\epsilon > 0$, the licensing premium is unambiguously* increasing *in average cost of the occupational license, c_0 and the dispersion of the relative taste for the unlicensed occupation σ_ϵ. The licensing premium is also increasing in the level of human capital bundled with the license, if the licensing premium is less than 100%. By contrast, the licensing premium is unambiguously* decreasing *in the average ability of workers μ_a; in other words, workers from groups with lower average ability benefit more from the licensing signal.*

Proof. By definition the license premium is:

$$\alpha \equiv \frac{\omega_L^* - \omega_U^*}{\omega_U^*} = \frac{\frac{1}{3}\bar{\omega}\mu_a h + \frac{2}{3}(c_0 + \mu_\epsilon)}{\left(1 + \frac{1}{3}h\right)\bar{\omega}\mu_a - \frac{1}{3}(c_0 + \mu_\epsilon) - \sigma_\epsilon}. \tag{11}$$

The derivative of the licensing premium with respect to the mean ability is:

$$\frac{d\alpha}{d\mu_a} = -\frac{\bar{\omega}[h(\mu_\epsilon + \sigma_\epsilon + c_0) + 2(c_0 + \mu_\epsilon)]}{3{\omega_U^*}^2} \implies \frac{d\alpha}{d\mu_a} < 0. \tag{12}$$

The derivative of the licensing premium with respect to h is:

$$\frac{d\alpha}{dh} = \frac{\bar{\omega}\mu_a[2\omega_U^* - \omega_L^*]}{3{\omega_U^*}^2} \tag{13}$$

Therefore $\frac{d\alpha}{dh} > 0 \implies 2\omega_U^* - \omega_L^* > 0$, which holds when $\frac{\omega_L^* - \omega_U^*}{\omega_U^*} < 1$ (i.e., $\alpha < 1$).

The license premium increases in c_0 because the wage gap (numerator) increases in c_0 and the wage in the unlicensed sector (denominator) is decreasing in c_0. The positive relationship between the licensing premium and the dispersion in sector taste comes from the fact that wages in the unlicensed sector (denominator) fall with σ_ϵ. □

In section 5.1 we showed that the licensing premium for women and black men is greater than the licensing premium for white men. This result is consistent with groups with lower perceived ability earning higher licensing premiums. Likewise, in agreement with the predictions of Theorem 2, we showed that the licensing premium is higher, on average, for occupations where there is a training component bundled with the license. This is especially true for women, who relative to men, experience a higher return to the human capital that is bundled with licenses.

Theorem 3. *Define the* ***industry surplus*** *as the sum of firm profits and worker wages net of the licensing cost. The industry surplus is maximized by a non-negative average cost of licensing, c_0^*, which is the mean of the maximum cost of licensing for which there is an interior solution and the productivity gains from the licensing that are due to the human*

capital that is bundled with the license:

$$c_0^* = \frac{1}{2}\left(\bar{c} + h\bar{\omega}\mu_a\right). \tag{14}$$

Proof. See Appendix. □

One important caveat here is that the industry surplus differs from the typical social surplus in that it abstracts from the welfare loss experienced by customers from higher prices. In this respect, this welfare calculation is closer in spirit to the producer surplus in Persico (2015), where the goal is to determine whether firms and incumbent workers, acting collusively, benefit from licensing, given that workers will endure the cost of licensing. One can reinterpret Theorem 3 as saying that under a general set of circumstances, incumbent firms and workers, in aggregate, benefit from occupational licensing and would advocate for licensing in their occupation.

Corollary 3.1. *The industry surplus maximizing cost of occupational licensing is increasing in the mean ability of workers,* μ_a.

Theorem 3 and its companion corollary provides one potential explanation for why instances of occupational licensing has been increasing over time, even as the workforce has become more skilled.

7 Welfare Discussion and Conclusion

From Adam Smith to Milton Friedman to the present day, the study of occupational licensing has been an active area of intellectual inquiry for economists (Smith, 1937; Friedman, 1962; Gittleman et al., 2015). In a classical sense, the topic of occupational licensing centers on

interactions between firms, workers, the government, and end-use consumers — essentially every economic actor save an international trading partner. The age-old debate in licensing is whether licensing does indeed result in higher quality workers or whether licensing is simply a labor market distortion that reduces supply and increases price without any compensating improvements in quality. In this paper we contribute to another dimension of debate by framing occupational licensing as a labor market signal that is potentially informative of worker ability. Moreover, we consider the prospect that occupational licensing can play a role in augmenting the human capital of workers through any mandatory training and continuous education bundled with the license. Within this framework we then consider whether there exist heterogeneous returns to occupational licensing for workers by race and gender that are tethered to the informational content of the license.

Indeed, we do find evidence for heterogeneous returns to licensing by race and gender – for black men the key driver of these returns is the license as a positive indicator of non-felony status, whereas for women the heterogeneous returns are driven by human capital associated with licensing. The findings of our paper raise the pertinent welfare question: "Does occupational licensing have an overall negative or positive effect on labor market outcomes for black men?" On the intensive margin, we show that occupational licensing raises the wages of black men by allowing black men without a felony record to separate themselves from black men with a felony record by sorting into occupations that bar felons. On the extensive margin, it restricts the size of the potential labor pool of black men by excluding felons. If this extensive margin restriction on felons, in equilibrium, reduces the probability of black male employment by a sufficiently large amount, the labor force participation losses could outweigh the positive wage gains for black men on the intensive margin. Shoag and Veuger (2016), for example, found that ban-the box initiatives resulted in

increased employment of workers in the highest crime census tracts. It is also possible that the loss of the signal results in market failure due to adverse selection: absent the felon signal for black men, firms may resort to hiring white men at higher rates in order to mitigate the risk of hiring a black man who is felon. In this case, the welfare consequences of removing occupational licensing are unambiguously negative for black men.

Law and Marks (2009) empirically tested the impact of licensing on female and minority labor force participation using individual-level data spanning 9 decades: 1870 to 1960. They found that licensing *increased* the employment of black and female workers in skilled occupations including engineers, pharmacists, plumbers, and registered and practical nurses. This result is similar to the recent findings by Holzer et al. (2006) and Wozniak (2015), who showed, respectively, that employer-initiated criminal background checks increase the likelihood of firms hiring African-American men and that employee drug testing increases black employment and relative wages. Similarly, Agan and Star (2016), in a recent audit study, showed that the ban-the-box initiatives in New York and New Jersey, which outlawed employer questions about workers' criminal past, increased the disparity in call-back rates between black and white workers from 7% to 45%. When taken together, the increase in the *wages* for black men who are employed in licensed professions, which we document in this paper, and the increase in *number* of black men employed suggest that occupational licensing can play a key role in mitigating the labor market discrimination faced by black men, both on the intensive and the extensive margins.

Whereas economists have traditionally viewed occupational licensing as a labor market friction, the evidence in this paper and the related literature suggest that this labor market friction can play a role in reducing the labor market inequality faced by women and minority men. This is not a normative statement about occupational licensing being a "good" labor

market institution – rather it is a statement about heterogeneity in the experience of this labor market friction by race and gender and its resultant effects on reducing gender and racial wage inequality.

A key implication of our work is that efforts to limit occupational licensing will be Pareto improving if these efforts can reduce the barriers to entry for the licensed occupations using a mechanism that informs the labor market of worker productivity as well. This dual purpose is of particular policy consequence for African-American men, for whom an occupational license, in many cases, credibly signals the absence of a felony conviction.

8 Figures & Tables

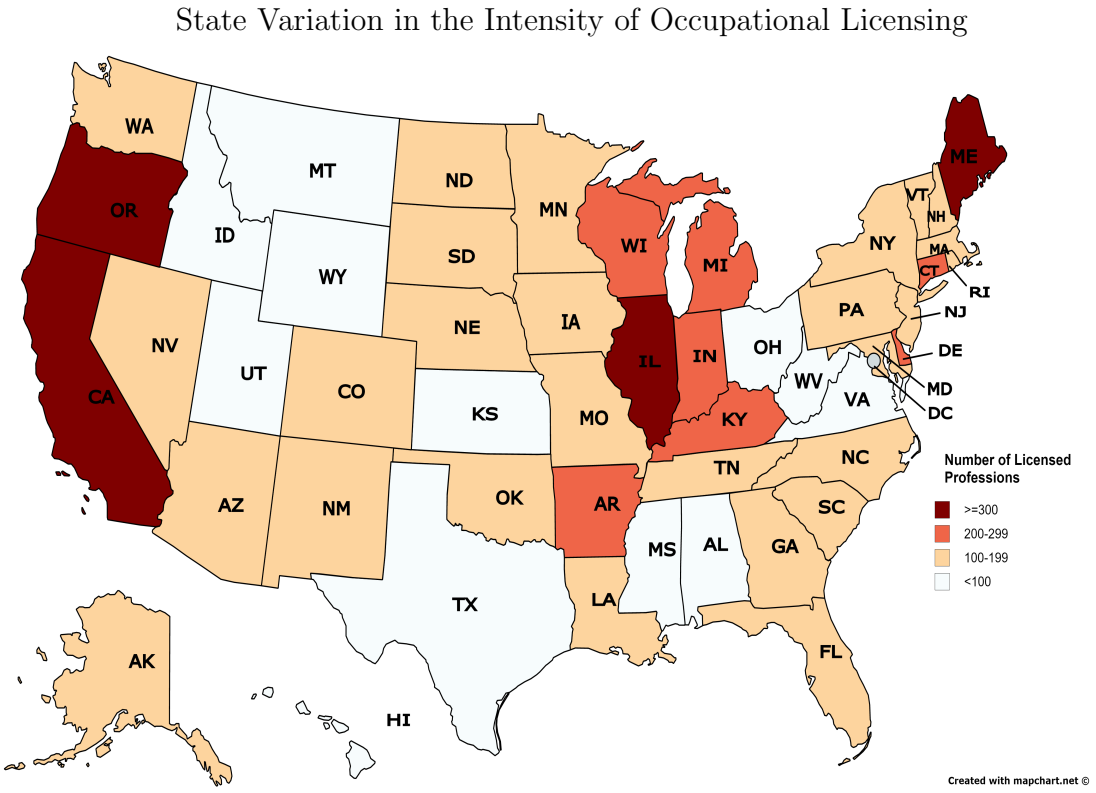


Figure 1: This map is a color-coded depiction of the United States. The states shaded in with darker colors are the states where the intensity of occupational licensing is the strongest, whereas the states that are lightly shaded are the states where the intensity of occupational licensing is the weakest. California, for example has over 300 occupations that require a license, while Texas has fewer than 100 occupations that have licensing requirements.

State Variation in the Intensity of Felony Restrictions on Occupational Licenses

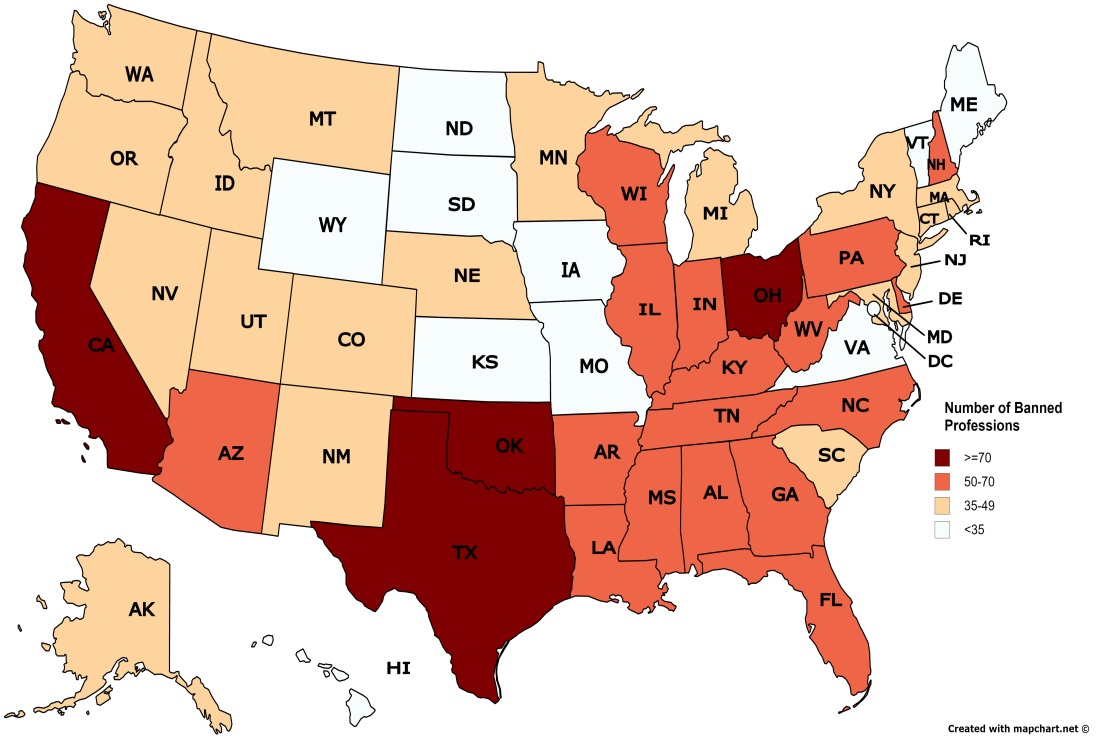


Figure 2: This map is a color-coded depiction of the United States. The states shaded in with darker colors are the states where the intensity of felony restrictions on occupational licensing is the strongest, whereas the states that are lightly shaded are the states where the intensity of felony restrictions on occupational licensing are the weakest. California, for example has over 70 occupations that preclude felons from obtaining an occupational license, while Iowa has fewer than 35 occupations that preclude felons from obtaining an occupational license.

Expected Wage Gaps Converge with Detailed Occupation Controls

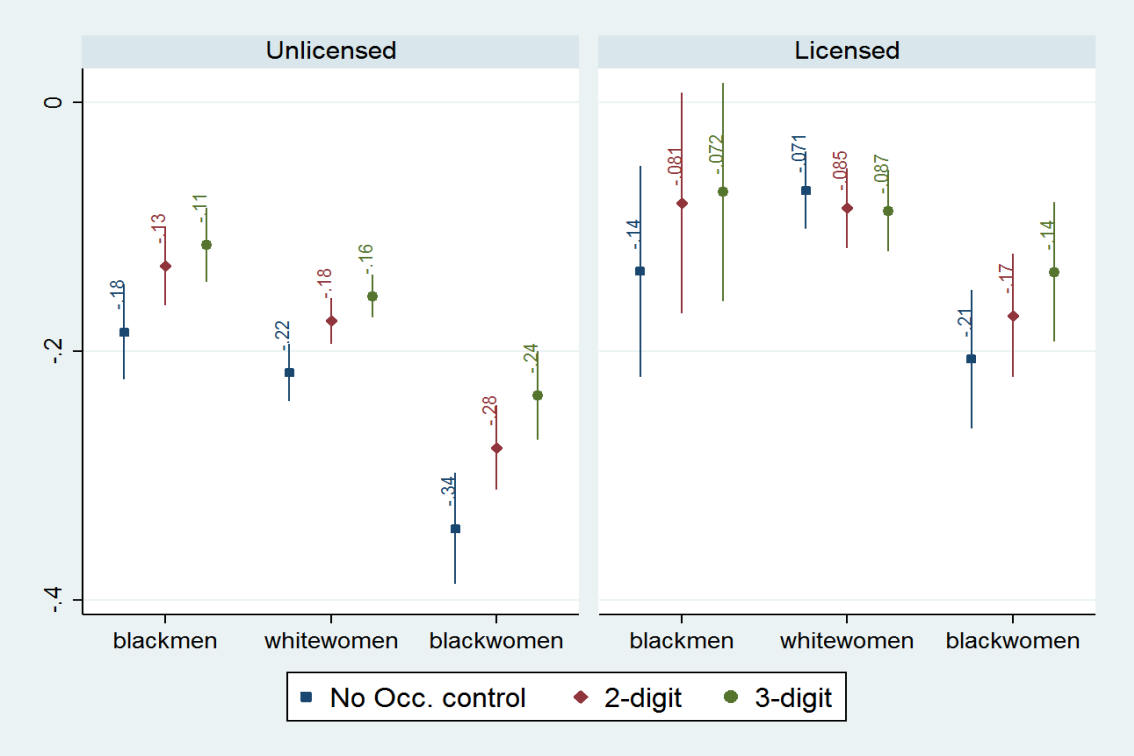


Figure 3: The graph displays the difference in predicted mean log wages between black men, black women and white women when compared to white men in occupations that *do not* require a license (left panel) and in occupations that *do* require a license (right panel). Each predicted wage gap is reported on the figure along with error bars representing a 95% confidence interval around the expected racial and gender wage gaps.

Expected Wage Gaps Converge with Detailed Occupation Controls

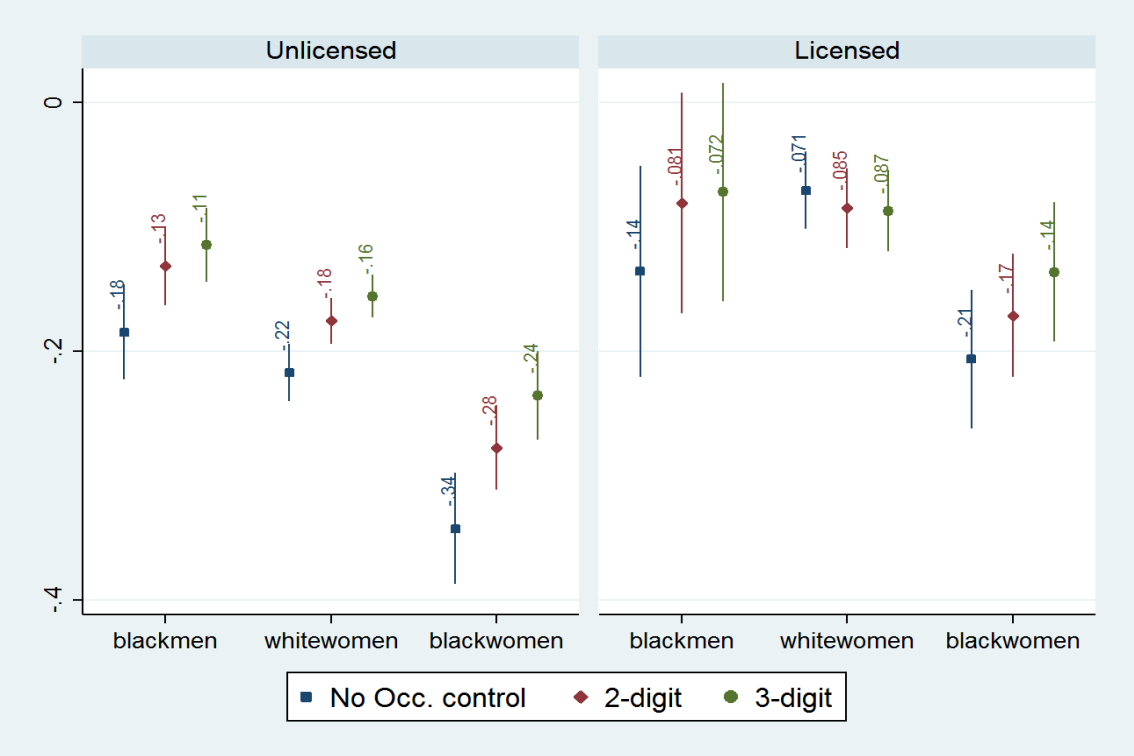


Figure 4: The graph displays the difference in predicted mean log wages between black men, black women and white women when compared to white men in occupations that *do not* require a license (left panel) and in occupations that *do* require a license (right panel). Each predicted wage gap is reported on the figure along with error bars representing a 95% confidence interval around the expected racial and gender wage gaps.

Expected Wage Gaps Converge with Detailed Occupation Controls

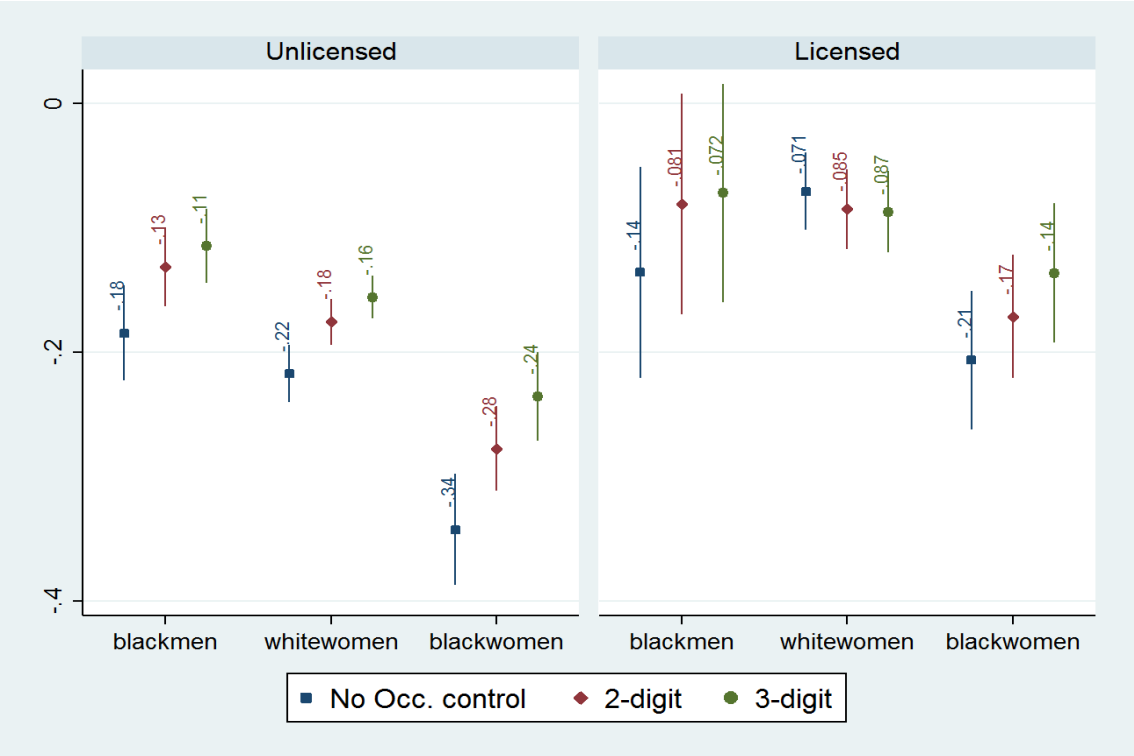


Figure 5: The graph displays the difference in predicted mean log wages between black men, black women and white women when compared to white men in occupations that *do not* require a license (left panel) and in occupations that *do* require a license (right panel). Each predicted wage gap is reported on the figure along with error bars representing a 95% confidence interval around the expected racial and gender wage gaps.

Table I: Summary of Wages and Demographic Characteristics by License Status

	Unlicensed		Licensed (no felony bans)		Licensed (with felony bans)		Certified	
	mean	sd	mean	sd	mean	sd	mean	sd
hourly wage	20.89	14.33	25.14	14.42	27.96	15.68	25.88	15.73
white man	0.42	0.49	0.39	0.49	0.28	0.45	0.48	0.50
black man	0.05	0.22	0.03	0.18	0.02	0.14	0.04	0.20
white woman	0.38	0.49	0.45	0.50	0.56	0.50	0.35	0.48
black woman	0.06	0.24	0.06	0.23	0.07	0.26	0.05	0.21
other ethnicity	0.08	0.27	0.06	0.24	0.07	0.25	0.08	0.27
age	41.42	12.63	43.82	11.47	44.04	11.10	42.68	11.34
hispanic	0.14	0.35	0.07	0.25	0.08	0.26	0.08	0.27
high school drop-out	0.08	0.26	0.02	0.13	0.01	0.12	0.02	0.15
some college	0.18	0.38	0.12	0.32	0.07	0.25	0.14	0.34
college	0.21	0.41	0.28	0.45	0.32	0.47	0.22	0.42
post-graduate	0.08	0.28	0.20	0.40	0.30	0.46	0.16	0.36
union member	0.10	0.29	0.20	0.40	0.26	0.44	0.13	0.34
government worker	0.15	0.36	0.32	0.47	0.35	0.48	0.12	0.32
self-employed	0.02	0.14	0.04	0.19	0.03	0.17	0.03	0.18
service worker	0.49	0.50	0.67	0.47	0.82	0.39	0.59	0.49
Observations	213,549		23,376		38,736		18,573	

Data Source: *Wave 13 to Wave 16 of SIPP Panel 2008.*

Note: This table reports summary statistics of the wage and demographic data from the Survey of Income and Program Participation, covering May 2012 through November 2013. Following the literature, we restrict the sample to individuals aged between 18 to 64 with implied hourly wage from $5 to $100 on the main job (Gittleman et al., 2015). Observations with imputed wages and license status are dropped.

Table II: Summary of Wages by Race, Gender and Licensing Status

	mean	**sd**	**min**	**max**	**N**
Unlicensed					
White men	23.73	15.60	5.00	100.00	80,492
Black men	18.63	12.40	5.00	100.00	9,152
White women	18.33	12.02	5.00	98.00	72,644
Black women	15.92	10.31	5.00	100.00	11,738
Other	22.70	16.20	5.00	100.00	15,599
Subtotal	20.84	14.22	5.00	100.00	189,625
Certified					
White men	27.72	15.17	5.00	100.00	10,000
Black men	23.23	14.09	5.00	81.00	804
White women	24.47	15.35	5.00	98.00	7,433
Black women	21.05	12.52	5.00	59.00	981
Other	25.82	17.33	5.00	91.00	1,507
Subtotal	25.93	15.37	5.00	100.00	20,725
Licensed (without felony bans)					
White men	27.27	14.87	5.00	100.00	13,709
Black men	23.08	13.14	5.00	87.00	1,142
White women	24.23	13.43	5.00	98.00	16,019
Black women	21.89	13.46	5.00	100.00	1,992
Other	24.45	17.26	5.00	100.00	2,159
Subtotal	25.26	14.36	5.00	100.00	35,021
Licensed (with felony bans)					
White men	29.90	16.18	5.00	100.00	4,714
Black men	25.46	14.33	6.00	88.00	332
White women	27.14	14.22	5.00	100.00	9,419
Black women	21.49	13.23	5.00	71.00	1,184
Other	34.83	21.55	6.00	100.00	1,146
Subtotal	28.00	15.58	5.00	100.00	16,795
Total	22.30	14.62	5.00	100.00	262,166

Data Source: *Wave 13 to Wave 16 of SIPP Panel 2008.*

Note: This table reports summary statistics of wages by race and gender and licensing status using data from wave 13 to wave 16 of SIPP Panel 2008, which covers May 2012 through November 2013. We restrict the sample to individuals aged between 18 to 64 with implied hourly wage from $5 to $100 on the main job. Observations with imputed wages and license status are dropped.

Table III: Women and Black Men Earn Larger Licensing Premium than White Men

	(1) Base Model	(2) All Felony Bans	(3) Permanent Felony Bans
blackman	-0.116***	-0.115***	-0.116***
	(0.0144)	(0.0144)	(0.0144)
whitewoman	-0.151***	-0.151***	-0.151***
	(0.00888)	(0.00887)	(0.00889)
blackwoman	-0.233***	-0.233***	-0.233***
	(0.0175)	(0.0174)	(0.0175)
license	0.0754***	0.0632***	0.0664***
	(0.0129)	(0.0176)	(0.0158)
license_blackman	0.0497	-0.0152	0.0122
	(0.0401)	(0.0546)	(0.0479)
license_whitewoman	0.0611***	0.0668***	0.0728***
	(0.0157)	(0.0211)	(0.0183)
license_blackwoman	0.0838***	0.0815***	0.0993***
	(0.0249)	(0.0276)	(0.0293)
ban		0.0320*	0.0327
		(0.0189)	(0.0232)
ban_blackman		0.164**	0.156**
		(0.0805)	(0.0644)
ban_whitewoman		-0.0166	-0.0375
		(0.0259)	(0.0273)
ban_blackwoman		-0.00420	-0.0471
		(0.0438)	(0.0391)
Constant	1.828***	1.829***	1.830***
	(0.0527)	(0.0528)	(0.0528)
Observations	262,166	262,166	262,166
R-squared	0.526	0.526	0.526

Data Source: *Wave 13 to Wave 16 of SIPP Panel 2008.*

Notes: This table reports a regression of log hourly wages on license status of the worker. The results demonstrate that all workers earn a license premium. The license premium earned by black men and both black and white women are larger than the license premium earned by white men. The license premium for black men comes through most strongly in occupations with licenses that preclude felons. All regressions include month fixed effects, a quadratic in age, education levels, a Hispanic indicator, 'Other race' indicator, union status, a government worker indicator, a self-employed indicator, a service worker indicator, as well as state and 3-digit occupation fixed effects. In addition, indicators for 'certification' and 'license not required for jobs' are included. The sample is restricted to respondents aged 18-64 with hourly wages on the main job between $5 and $100 from May 2012 through November 2013. Observations with imputed wages and license status are dropped. (*** p<0.01, ** p<0.05, * p<0.1; Robust standard errors clustered at state level.)

Table IV: Women and Black Men Earn Larger Premium than White Men (Weighted)

	(1) Base Model	(2) All Felony Bans	(3) Permanent Felony Bans
blackmen	-0.0972***	-0.101***	-0.101***
	(0.0161)	(0.0159)	(0.0158)
whitewomen	-0.134***	-0.139***	-0.139***
	(0.00858)	(0.00860)	(0.00864)
blackwomen	-0.206***	-0.212***	-0.212***
	(0.0162)	(0.0174)	(0.0175)
license	0.0614***	0.0779***	0.0790***
	(0.0165)	(0.0168)	(0.0157)
license_blackmen	-0.0422	-0.0382	0.00564
	(0.0703)	(0.0706)	(0.0609)
license_whitewomen	0.0329	0.0535**	0.0639***
	(0.0225)	(0.0232)	(0.0194)
license_blackwomen	0.103**	0.124***	0.121***
	(0.0406)	(0.0394)	(0.0329)
ban		0.0993***	0.103***
		(0.0143)	(0.0183)
ban_blackmen		0.146**	0.134***
		(0.0625)	(0.0470)
ban_whitewomen		0.0479**	0.0300
		(0.0198)	(0.0227)
ban_blackwomen		0.0696**	0.0518
		(0.0331)	(0.0315)
Constant	1.778***	1.790***	1.790***
	(0.0606)	(0.0615)	(0.0616)
Observations	262,166	262,166	262,166
R-squared	0.523	0.525	0.525

Data Source: *Wave 13 to Wave 16 of SIPP Panel 2008.*

Notes: This table reports a regression of log hourly wages on license status of the worker using the survey sample weights. The results demonstrate that all workers earn a license premium. The license premium earned by black men and both black and white women are larger than the license premium earned by white men. The license premium for black men comes through most strongly in occupations with licenses that preclude felons. All regressions include month fixed effects, a quadratic in age, education levels, a Hispanic indicator, 'Other race' indicator, union status, a government worker indicator, a self-employed indicator, a service worker indicator, as well as state and 3-digit occupation fixed effects. In addition, indicators for 'certification' and 'license not required for jobs' are included. The sample is restricted to respondents aged 18-64 with hourly wages on the main job between $5 and $100 from May 2012 through November 2013. Observations with imputed wages and license status are dropped. (*** p<0.01, ** p<0.05, * p<0.1; Robust standard errors clustered at state level.)

Table V: Ban Premium for Black Men Decreasing in Firm Size

	Firm size			
	(1)	(2)	(3)	(4)
	>100	>200	>500	>1000
blackmen	-0.111***	-0.115***	-0.123***	-0.142***
	(0.00661)	(0.00769)	(0.00929)	(0.0111)
whitewomen	-0.136***	-0.131***	-0.128***	-0.121***
	(0.00350)	(0.00405)	(0.00508)	(0.00600)
blackwomen	-0.241***	-0.235***	-0.244***	-0.223***
	(0.00597)	(0.00682)	(0.00846)	(0.0101)
license	0.0519***	0.0490***	0.0353***	0.0160
	(0.00648)	(0.00769)	(0.00958)	(0.0114)
license_blackmen	-0.0374*	-0.0640**	0.0390	0.0984***
	(0.0220)	(0.0262)	(0.0323)	(0.0362)
license_whitewomen	0.0757***	0.0720***	0.0828***	0.0955***
	(0.00878)	(0.0105)	(0.0131)	(0.0156)
license_blackwomen	0.105***	0.0985***	0.107***	0.144***
	(0.0168)	(0.0201)	(0.0252)	(0.0300)
ban	0.00720	0.0122	0.0387**	0.0317*
	(0.0102)	(0.0122)	(0.0154)	(0.0183)
ban_blackmen	0.218***	0.221***	0.164**	0.132
	(0.0449)	(0.0558)	(0.0719)	(0.0808)
ban_whitewomen	-0.00457	0.00338	-0.0172	-0.0310
	(0.0133)	(0.0159)	(0.0198)	(0.0236)
ban_blackwomen	0.00353	-0.0640**	-0.101***	-0.117***
	(0.0252)	(0.0307)	(0.0370)	(0.0436)
Constant	1.685***	1.686***	1.588***	1.603***
	(0.0297)	(0.0339)	(0.0387)	(0.0440)
Observations	102,860	74,967	49,020	35,724
R-squared	0.540	0.545	0.550	0.552

Data Source: *Wave 13 to Wave 16 of SIPP Panel 2008.*

Notes: This table reports a wage regression on license status conditional on firm size. The focal result here is that the ban premium for black men is decreasing in firm size as we go from companies with 200 employees to companies with 500 and 1000 employees. All regressions include month fixed effects, a quadratic in age, education levels, a Hispanic indicator, 'other race' indicator, union status, a government worker indicator, a self-employed indicator, a service worker indicator, as well as state and 3-digit occupation fixed effects. In addition, indicators for 'certification' and 'license not required for jobs' are included. The sample is restricted to respondents aged 18-64 with hourly wages on the main job between $5 and $100 from May 2012 through November 2013. Observations with imputed wages and license status are dropped. (*** p<0.01, ** p<0.05, * p<0.1; Robust standard errors are clustered at state level.)

Table VI: Wage Premium for Black Men in Banned Occupations Robust

	(1) Racial Disparity in Arrest	(2) Government Employment	(3) Frac. White in Occupation	(4) Union Status
license	0.0673***	0.0571***	0.0663***	0.0647***
	(0.0158)	(0.0155)	(0.0156)	(0.0159)
license_blackmen	0.0170	0.0206	-0.0139	0.0104
	(0.0470)	(0.0491)	(0.0454)	(0.0489)
license_whitewomen	0.0720***	0.0766***	0.0763***	0.0786***
	(0.0185)	(0.0184)	(0.0179)	(0.0185)
license_blackwomen	0.0985***	0.114***	0.0883***	0.100***
	(0.0294)	(0.0297)	(0.0295)	(0.0290)
ban	0.0335	0.0407*	0.0325	0.0305
	(0.0234)	(0.0237)	(0.0233)	(0.0233)
ban_blackmen	0.139**	0.133**	0.156**	0.154**
	(0.0634)	(0.0649)	(0.0707)	(0.0685)
ban_whitewomen	-0.0388	-0.0422	-0.0375	-0.0344
	(0.0274)	(0.0271)	(0.0278)	(0.0282)
ban_blackwomen	-0.0460	-0.0683*	-0.0456	-0.0447
	(0.0394)	(0.0396)	(0.0390)	(0.0394)
ldisparity	-0.0881***			
	(0.00640)			
ldisparity_blackmen	0.0719***			
	(0.0251)			
ldisparity_whitewomen	0.0125			
	(0.0184)			
ldisparity_blackwomen	0.0415			
	(0.0328)			
fracwhite		0.657***		
		(0.0625)		
fracwhite_blackmen		-0.0883		
		(0.105)		
fracwhite_whitewomen		-0.0348		
		(0.0462)		
fracwhite_blackwomen		-0.0994		
		(0.107)		
govt			0.0117	
			(0.0129)	
govt_blackmen			0.140***	
			(0.0268)	
govt_whitewomen			-0.0207	
			(0.0155)	
govt_blackwomen			0.0485	
			(0.0291)	
union				0.198***
				(0.0151)
union_blackmen				0.0742
				(0.0447)
union_whitewomen				-0.0469***
				(0.0134)
union_blackwomen				-0.0139
				(0.0304)
Constant	1.798***	1.402***	1.823***	1.830***
	(0.0495)	(0.0790)	(0.0530)	(0.0529)
Observations	261,617	262,166	262,166	262,166
R-squared	0.526	0.531	0.526	0.526

Data Source: *Wave 13 to Wave 16 of SIPP Panel 2008.*

Notes: This table reports a regression of wages on licensing status. To test whether the ban premium experienced by black men is robust, we control for heterogeneity by race and gender in four key variables that could also be correlated with whether an occupation has a felony ban: (i) the log of the racial disparity in arrest between blacks and whites, (ii) public sector employment, (iii) fraction of whites in occupation and (iv) worker union status. (*** p<0.01, ** p<0.05, * p<0.1; robust standard errors clustered at state level.)

Table VII: Ban Premium for Black Men not Due to Heterogeneous Returns to Education

	(1) Licensed (with felony bans)	(2) Licensed (no felony bans)	(3) Unlicensed
blackman	0.0702	-0.170**	-0.105***
	(0.0901)	(0.0795)	(0.0195)
whitewoman	-0.168*	-0.127**	-0.143***
	(0.0927)	(0.0517)	(0.00883)
blackwoman	-0.224***	-0.283*	-0.226***
	(0.0814)	(0.144)	(0.0225)
postHS	0.0477	0.103***	0.0943***
	(0.0622)	(0.0276)	(0.00885)
postHS_blackman	-0.00362	0.0798	-0.0152
	(0.129)	(0.109)	(0.0297)
postHS_whitewoman	0.0747	0.0566	-0.0191
	(0.0982)	(0.0491)	(0.0130)
postHS_blackwoman	0.0808	0.156	-0.0178
	(0.0967)	(0.135)	(0.0237)
Constant	1.901***	1.655***	1.788***
	(0.186)	(0.144)	(0.0567)
Observations	14,878	28,065	198,412
R-squared	0.511	0.446	0.534

Data Source: *Wave 13 to Wave 16 of SIPP Panel 2008.*

This table reports three separate wage regressions conditional on license status. The goal of these regressions is to test whether the licensing premium to black men in occupations with felony bans is driven by differentially higher returns to post-secondary education for black men in these occupations. We find that black men in these occupations do not experience differentially higher returns to post-secondary education relative to white men. (*** p<0.01, ** p<0.05, * p<0.1; Robust standard errors are clustered at state level.)

Table VIII: Women Differentially Benefit from Human Capital Bundled with Licensing

	(1) Base Model	(2) training	(3) continuous education	(4) exams	(5) training	(6) continuous education	(7) exams
blackmen	-0.116***	-0.119***	-0.117***	-0.120***	-0.110***	-0.108***	-0.111***
	(0.0144)	(0.0162)	(0.0150)	(0.0166)	(0.0165)	(0.0154)	(0.0170)
whitewomen	-0.151***	-0.156***	-0.156***	-0.155***	-0.154***	-0.154***	-0.154***
	(0.00889)	(0.00888)	(0.00932)	(0.00916)	(0.00834)	(0.00880)	(0.00861)
blackwomen	-0.233***	-0.235***	-0.234***	-0.235***	-0.226***	-0.224***	-0.226***
	(0.0175)	(0.0183)	(0.0172)	(0.0189)	(0.0180)	(0.0170)	(0.0186)
license	0.0664***	0.0257	0.0408***	0.0507**	0.0223	0.0359**	0.0507**
	(0.0158)	(0.0216)	(0.0147)	(0.0216)	(0.0221)	(0.0150)	(0.0229)
license_blackmen	0.0122	-0.0122	-0.0133	-0.0217	-0.0302	-0.0266	-0.0399
	(0.0479)	(0.0617)	(0.0673)	(0.0678)	(0.0650)	(0.0710)	(0.0711)
license_whitewomen	0.0728***	0.0434**	0.0446**	0.0479***	0.0460**	0.0454**	0.0499***
	(0.0183)	(0.0195)	(0.0173)	(0.0176)	(0.0200)	(0.0180)	(0.0183)
license_blackwomen	0.0993***	0.0827**	0.0989***	0.0861**	0.0759**	0.0918***	0.0791**
	(0.0293)	(0.0348)	(0.0328)	(0.0330)	(0.0353)	(0.0323)	(0.0338)
ban	0.0327	0.0335	0.0327	0.0329	0.0212	0.0206	0.0208
	(0.0232)	(0.0234)	(0.0237)	(0.0235)	(0.0219)	(0.0221)	(0.0220)
ban_blackmen	0.156**	0.152**	0.154**	0.154**	0.170**	0.171**	0.172**
	(0.0644)	(0.0648)	(0.0649)	(0.0644)	(0.0731)	(0.0730)	(0.0727)
ban_whitewomen	-0.0375	-0.0365	-0.0376	-0.0373	-0.0274	-0.0285	-0.0282
	(0.0273)	(0.0275)	(0.0274)	(0.0276)	(0.0271)	(0.0269)	(0.0272)
ban_blackwomen	-0.0471	-0.0492	-0.0493	-0.0476	-0.0382	-0.0384	-0.0366
	(0.0391)	(0.0391)	(0.0393)	(0.0390)	(0.0380)	(0.0382)	(0.0379)
requirement		0.0423*	0.0352**	0.0155	0.0372	0.0307*	0.00647
		(0.0218)	(0.0168)	(0.0270)	(0.0227)	(0.0171)	(0.0266)
requirement_blackmen		0.0293	0.0342	0.0389	0.0294	0.0285	0.0395
		(0.0488)	(0.0555)	(0.0537)	(0.0466)	(0.0574)	(0.0513)
requirement_whitewomen		0.0362**	0.0409**	0.0321**	0.0370**	0.0446***	0.0337**
		(0.0144)	(0.0164)	(0.0148)	(0.0151)	(0.0159)	(0.0146)
requirement_blackwomen		0.0193	-0.000825	0.0158	0.0241	0.00547	0.0212
		(0.0299)	(0.0291)	(0.0348)	(0.0308)	(0.0302)	(0.0360)
Constant	1.830***	1.832***	1.838***	1.832***	1.274***	1.282***	1.273***
	(0.0528)	(0.0528)	(0.0525)	(0.0525)	(0.0872)	(0.0865)	(0.0870)
Skill					X	X	X
Observations	262,166	262,166	262,166	262,166	257,286	257,286	257,286
R-squared	0.526	0.526	0.526	0.526	0.540	0.541	0.540

Data Source: *Wave 13 to Wave 16 of SIPP Panel 2008.*

Notes: This table reports wage regressions in which we to test whether the licensing premium is due to occupational licensing increasing the human capital of workers. All regressions include month fixed effects, a quadratic in age, education levels, a Hispanic indicator, 'Other race' indicator, union status, a government worker indicator, a self-employed indicator, a service worker indicator, as well as state and 3-digit occupation fixed effects. In addition, indicators for 'certification' and 'license not required for jobs' are included. that are heterogeneous by race and gender. The sample is restricted to respondents aged 18-64 with hourly wages on the main job between $5 and $100 from May 2012 through November 2013. Observations with imputed wages and license status are dropped. (*** p<0.01, ** p<0.05, * p<0.1; Robust standard errors are clustered at state level.)

Table IX: Main Results Robust to Controlling for Selection

	(1) Base Model	(2) Licensed by Choice	(3) IV Model
blackmen	-0.102***	-0.102***	-0.105***
	(0.0166)	(0.0163)	(0.0191)
whitewomen	-0.144***	-0.144***	-0.146***
	(0.00926)	(0.00936)	(0.00934)
blackwomen	-0.213***	-0.213***	-0.217***
	(0.0163)	(0.0164)	(0.0225)
license	0.0498***	0.0515***	0.0114
	(0.0160)	(0.0159)	(0.0598)
license_blackmen	-0.00454	-0.00372	0.0329
	(0.0830)	(0.0849)	(0.123)
license_whitewomen	0.0322	0.0335	0.0235
	(0.0205)	(0.0210)	(0.0261)
license_blackwomen	0.114***	0.110***	0.0635
	(0.0385)	(0.0390)	(0.0748)
ban	0.0248	0.0252	0.0449**
	(0.0236)	(0.0237)	(0.0209)
ban_blackmen	0.126*	0.125*	0.119*
	(0.0727)	(0.0725)	(0.0636)
ban_whitewomen	-0.0357	-0.0365	-0.0248
	(0.0259)	(0.0259)	(0.0239)
ban_blackwomen	-0.0735	-0.0740	-0.0351
	(0.0484)	(0.0473)	(0.0414)
con_edu	0.0403**	0.0388**	0.0724***
	(0.0188)	(0.0187)	(0.0171)
con_edu_blackmen	0.0135	0.0129	0.00821
	(0.0628)	(0.0684)	(0.0496)
con_edu_whitewomen	0.0462**	0.0456**	0.0571***
	(0.0211)	(0.0217)	(0.0206)
con_edu_blackwomen	0.00867	0.0153	0.0628
	(0.0419)	(0.0418)	(0.0410)
person		-0.0517	-0.0384
		(0.0372)	(0.0372)
person_blackmen		0.0315	0.0359
		(0.104)	(0.104)
person_whitewomen		-0.0438	-0.0458
		(0.0516)	(0.0523)
person_blackwomen		-0.145*	-0.167**
		(0.0818)	(0.0801)
Constant	1.770***	1.779***	1.782***
	(0.0607)	(0.0607)	(0.0611)
Observations	262,166	262,166	262,166
R-squared	0.526	0.526	0.525
First Stage coeff			0.204
SD			0.0123
First Stage F			277.5

Data Source: *Wave 13 to Wave 16 of SIPP Panel 2008.*

Notes: This table reports results on the effect of licensing on wages when we control selection into licensing. In column (2) we control for whether an individual pursued a license for personal reasons. In column (3) we use the product space instruments in Gandhi and Houde (2016) to instrument for the license decision. All regressions include month fixed effects, a quadratic in age, education levels, a Hispanic indicator, 'Other race' indicator, union status, a government worker indicator, a self-employed indicator, a service worker indicator, as well as state and 3-digit occupation fixed effects. In addition, 'license not required for jobs' are dropped. (*** p<0.01, ** p<0.05, * p<0.1; Robust standard errors are clustered at state level.)

Table X: Main Results Robust to Controlling for Selection (Weighted)

	(1) Base Model	(2) Licensed by Choice	(3) IV Model
blackmen	-0.102***	-0.102***	-0.100***
	(0.0166)	(0.0163)	(0.0204)
whitewomen	-0.144***	-0.144***	-0.143***
	(0.00926)	(0.00936)	(0.0101)
blackwomen	-0.213***	-0.213***	-0.214***
	(0.0163)	(0.0164)	(0.0227)
license	0.0498***	0.0515***	0.0268
	(0.0160)	(0.0159)	(0.0736)
license_blackmen	-0.00454	-0.00372	-0.0413
	(0.0830)	(0.0849)	(0.194)
license_whitewomen	0.0322	0.0335	0.00100
	(0.0205)	(0.0210)	(0.0456)
license_blackwomen	0.114***	0.110***	0.0622
	(0.0385)	(0.0390)	(0.126)
ban	0.0746***	0.0767***	0.0414*
	(0.0217)	(0.0218)	(0.0210)
ban_blackmen	0.122*	0.122*	0.126**
	(0.0683)	(0.0707)	(0.0603)
ban_whitewomen	-0.00350	-0.00298	-0.0201
	(0.0256)	(0.0258)	(0.0246)
ban_blackwomen	0.0404	0.0358	-0.0281
	(0.0494)	(0.0481)	(0.0416)
con_edu	0.0403**	0.0388**	0.0700***
	(0.0188)	(0.0187)	(0.0172)
con_edu_blackmen	0.0135	0.0129	0.0162
	(0.0628)	(0.0684)	(0.0502)
con_edu_whitewomen	0.0462**	0.0456**	0.0610***
	(0.0211)	(0.0217)	(0.0210)
con_edu_blackwomen	0.00867	0.0153	0.0680*
	(0.0419)	(0.0418)	(0.0406)
person		-0.0517	-0.0377
		(0.0372)	(0.0372)
person_blackmen		0.0315	0.0312
		(0.104)	(0.103)
person_whitewomen		-0.0438	-0.0466
		(0.0516)	(0.0524)
person_blackwomen		-0.145*	-0.169**
		(0.0818)	(0.0798)
Constant	1.770***	1.779***	1.781***
	(0.0607)	(0.0607)	(0.0618)
Observations	262,166	262,166	262,166
R-squared	0.526	0.526	0.525

Data Source: *Wave 13 to Wave 16 of SIPP Panel 2008.*
Notes: This table reports results on the effect of licensing on wages when we control selection into licensing using the survey sample weights. In column (2) we control for whether an individual pursued a license for personal reasons. In column (3) we use the product space instruments in Gandhi and Houde (2016) to instrument for the license decision. All regressions include month fixed effects, a quadratic in age, education levels, a Hispanic indicator, 'Other race' indicator, union status, a government worker indicator, a self-employed indicator, a service worker indicator, as well as state and 3-digit occupation fixed effects. In addition, 'license not required for jobs' are dropped. (*** p<0.01, ** p<0.05, * p<0.1; Robust standard errors are clustered at state level.)

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9 Online Appendix

9.1 Proof of Theorem 1

To solve this sequential game, we use the solution concept of sub-game perfect equilibrium (SPE). In an SPE, we solve the model using backwards induction. First, workers in period 2 sort in to the sector that produces the highest net return, given wages and their preferences. Next in period 1, the representative firm in each sector chooses the corresponding wage to maximize firm profits, given the sorting of workers.

9.1.1 Period #2: Workers Choose Sector

Starting in period 2, the probability that a worker of ability a_i sorts into the licensed sector, $P(L = 1|a_i)$, is given by the probability that the net benefit of working in the licensed sector is greater than the net benefit of working in the unlicensed sector:

$$P(L_i = 1|a_i) = \text{Prob}(V_{L,i} > V_{U,i}) \tag{15}$$

$$= \text{Prob}(\omega_L - c_0 - \omega_U + \theta(a_i - \mu_a) > \epsilon_i) \tag{16}$$

$$= \frac{1}{2} + \frac{\Delta\omega + \theta(a_i - \mu_a)}{2\sigma_\epsilon}, \tag{17}$$

where, $\Delta\omega \equiv (\omega_L - c_0) - (\omega_U + \mu_\epsilon)$ is the expected net benefit of licensing across workers of all types. The conditional probability of licensing in increasing the expected net benefit of licensing. It is also increasing in worker ability for cases where worker ability lowers the cost of licensing $\theta > 0$ but decreasing in worker ability in cases where worker ability increases the cost of licensing $\theta < 0$.

9.1.2 Period #1: Firms Choose Wages

Next we must compute firm profits given the sorting decisions of workers. In order to compute profits for the representative firms in both the licensed and unlicensed sectors, we first compute the fraction of workers who sort into the licensed profession and the unlicensed profession, i.e. $E[P(L_i = 1|a_i)]$ and $E[P(L_i = 0|a_i)]$, because these quantities enter the expect labor cost of the firms.

$$E[P(L_i = 1|a_i)] = \frac{1}{2\sigma_a}\int_{\mu_a-\sigma_a}^{\mu_a+\sigma_a} P(L_i = 1|a_i)da_i \tag{18}$$

$$= \frac{1}{2\sigma_a}\int_{\mu_a-\sigma_a}^{\mu_a+\sigma_a} \left[\frac{1}{2} + \frac{\Delta\omega + \theta(a_i - \mu_a)}{2\sigma_\epsilon}\right] da_i \tag{19}$$

$$= \left(\frac{1}{2} + \frac{\Delta\omega}{2\sigma_\epsilon}\right) \underbrace{\frac{1}{2\sigma_a}\int_{\mu_a-\sigma_a}^{\mu_a+\sigma_a} da_i}_{=1} + \left(\frac{\theta}{2\sigma_\epsilon}\right)\frac{1}{2\sigma_a}\underbrace{\int_{\mu_a-\sigma_a}^{\mu_a+\sigma_a}(a_i - \mu_a)da_i}_{=0} \tag{20}$$

$$= \frac{1}{2} + \frac{\Delta\omega}{2\sigma_\epsilon} \tag{21}$$

Given that we have a two sector model, a worker is either employed in the licensed or in the unlicensed sector. Consequently:

$$E[P(L_i = 0|a_i)] = 1 - E[P(L_i = 1|a_i)] \tag{22}$$

$$= \frac{1}{2} - \frac{\Delta\omega}{2\sigma_\epsilon} \tag{23}$$

To compute firm profits, we must also compute the expected ability level of a worker given that she has a license $E(a_i|L_i = 1)$ and given that she does not have a license $E(a_i|L_i = 0)$ both of which contribute to firm revenue:

$$E[a_i|L_i = 1] = \int_{\mu-\sigma_a}^{\mu+\sigma_a} a_i P(a_i|L_i = 1)da_i \tag{24}$$

$$= \int_{\mu-\sigma_a}^{\mu+\sigma_a} a_i \frac{P(L_i = 1|a_i)P(a_i)}{P(L_i = 1)}da_i \tag{25}$$

$$= \frac{1}{2\sigma_a}\int_{\mu-\sigma_a}^{\mu+\sigma_a} a_i \frac{\left[\frac{1}{2} + \frac{\Delta\omega+\theta(a_i-\mu_a)}{2\sigma_\epsilon}\right]}{\frac{1}{2} + \frac{\Delta\omega}{2\sigma_\epsilon}}da_i \tag{26}$$

$$= \frac{1}{2\sigma_a}\int_{\mu-\sigma_a}^{\mu+\sigma_a} a_i \left[1 + \frac{\theta(a_i - \mu_a)}{(\sigma_\epsilon + \Delta\omega)}\right] da_i \tag{27}$$

$$= \frac{1}{2\sigma_a}\int_{\mu-\sigma_a}^{\mu+\sigma_a} a_i da_i + \frac{\theta}{2\sigma_a(\sigma_\epsilon + \Delta\omega)}\int_{\mu-\sigma_a}^{\mu+\sigma_a}(a_i^2 - a_i\mu_a)da_i \tag{28}$$

$$= \mu_a + \frac{\theta}{2\sigma_a(\sigma_\epsilon + \Delta\omega)}\left(2\sigma_a\mu_a^2 + \frac{2}{3}\sigma_a^3 - 2\sigma_a\mu_a^2\right) \tag{29}$$

$$= \mu_a + \frac{\theta\sigma_a^2}{3(\sigma_\epsilon + \Delta\omega)} \tag{30}$$

$$\tag{31}$$

Similarly,

$$E[a_i|L_i=0] = \int_{\mu-\sigma_a}^{\mu+\sigma_a} a_i P(a_i|L_i=0)da_i \tag{32}$$

$$= \int_{\mu-\sigma_a}^{\mu+\sigma_a} a_i \frac{P(L_i=0|a_i)P(a_i)}{P(L_i=0)}da_i \tag{33}$$

$$= \frac{1}{2\sigma_a}\int_{\mu-\sigma_a}^{\mu+\sigma_a} a_i \frac{\left[\frac{1}{2}-\frac{\Delta\omega+\theta(a_i-\mu_a)}{2\sigma_\epsilon}\right]}{\frac{1}{2}-\frac{\Delta\omega}{2\sigma_\epsilon}}da_i \tag{34}$$

$$= \frac{1}{2\sigma_a}\int_{\mu-\sigma_a}^{\mu+\sigma_a} a_i \left[1-\frac{\theta(a_i-\mu_a)}{(\sigma_\epsilon-\Delta\omega)}\right]da_i \tag{35}$$

$$= \frac{1}{2\sigma_a}\int_{\mu-\sigma_a}^{\mu+\sigma_a} a_i da_i - \frac{\theta}{2\sigma_a(\sigma_\epsilon-\Delta\omega)}\int_{\mu-\sigma_a}^{\mu+\sigma_a}(a_i^2-a_i\mu_a)da_i \tag{36}$$

$$= \mu_a - \frac{\theta}{2\sigma_a(\sigma_\epsilon-\Delta\omega)}\left(2\sigma_a\mu_a^2+\frac{2}{3}\sigma_a^3-2\sigma_a\mu_a^2\right) \tag{37}$$

$$= \mu_a - \frac{\theta\sigma_a^2}{3(\sigma_\epsilon-\Delta\omega)} \tag{38}$$

$$\tag{39}$$

Putting this all together, we get that profits in the licensed sector are given by:

$$\pi_1 = \underbrace{\left((1+h)\bar{\omega}\left[\mu_a+\frac{\theta\sigma_a^2}{3(\sigma_\epsilon+\Delta\omega)}\right]-\omega_L\right)}_{\text{Expected Profit per. licensed worker}} \times \underbrace{\left[\frac{1}{2}+\frac{\Delta\omega}{2\sigma_\epsilon}\right]}_{\text{Frac. Licensed workers}}, \tag{40}$$

Firm profits in the unlicensed sector are given by:

$$\pi_2 = \left(\bar{\omega}\left[\mu_a-\frac{\theta\sigma_a^2}{3(\sigma_\epsilon-\Delta\omega)}\right]-\omega_U\right)\left[\frac{1}{2}-\frac{\Delta\omega}{2\sigma_\epsilon}\right] \tag{41}$$

Firm 1 chooses ω_L to maximize its profits, π_1. This results in the following first order condition, $\frac{\partial\pi_1}{\partial\omega_L}=0$:

$$\underbrace{-\left(1+\left[\frac{(1+h)\bar{\omega}\theta\sigma_a^2}{3(\sigma_\epsilon+\Delta\omega)^2}\right]\right)\left[\frac{1}{2}+\frac{\Delta\omega}{2\sigma_\epsilon}\right]}_{\text{Decrease in Unit Profit}} + \underbrace{\frac{1}{2\sigma_\epsilon}\left((1+h)\bar{\omega}\left[\mu_a+\frac{\theta\sigma_a^2}{3(\sigma_\epsilon+\Delta\omega)}\right]-\omega_L\right)}_{\text{Increase in Volume}} = 0 \tag{42}$$

$$\implies -\left(\sigma_\epsilon+\Delta\omega+\left[\frac{(1+h)\bar{\omega}\theta\sigma_a^2}{3(\sigma_\epsilon+\Delta\omega)}\right]\right)+\left((1+h)\bar{\omega}\left[\mu_a+\frac{\theta\sigma_a^2}{3(\sigma_\epsilon+\Delta\omega)}\right]-\omega_L\right)=0. \tag{43}$$

$$\implies -\sigma_\epsilon-\Delta\omega+(1+h)\bar{\omega}\mu_a-\omega_L=0 \tag{44}$$

$$\implies \omega_L = -\sigma_\epsilon-\Delta\omega+(1+h)\bar{\omega}\mu_a \tag{45}$$

To get the best response function of the firm in the licensed sector, we re-arrange the expression above and substitute in the definition for the net benefit of licensing $\Delta\omega = (\omega_L - c_0) - (\omega_U + \mu_\epsilon)$:

$$\boxed{\omega_L(\omega_U) = \frac{1}{2}[(1+h)\bar{\omega}\mu_a + \omega_U + c_0 + (\mu_\epsilon - \sigma_\epsilon)]} \tag{46}$$

The best response function for the wages in the licensed sector is increasing in the level of human capital that is bundled with the license h and with the quality of the firm's technology $\bar{\omega}$. It is also increasing in the wage offered by the unlicensed firm, the cost of licensing and the minimum taste for the unlicensed sector, $\mu_\epsilon - \sigma_\epsilon$.

To find the best response function for firm 2, we assert that firm 2 chooses ω_U to maximize its profits, π_2. This results in the following first order condition $\frac{\partial \pi_2}{\partial \omega_U} = 0$:

$$\underbrace{\left(\left[\frac{\bar{\omega}\theta\sigma_a^2}{3(\sigma_\epsilon - \Delta\omega)^2}\right] - 1\right)\left[\frac{1}{2} - \frac{\Delta\omega}{2\sigma_\epsilon}\right]}_{\text{Change in Unit Profit}} + \underbrace{\frac{1}{2\sigma_\epsilon}\left(\bar{\omega}\left[\mu_a - \frac{\theta\sigma_a^2}{3(\sigma_\epsilon - \Delta\omega)}\right] - \omega_U\right)}_{\text{Change in Volume}} = 0. \tag{47}$$

$$\implies \left(\left[\frac{\bar{\omega}\theta\sigma_a^2}{3(\sigma_\epsilon + \Delta\omega)}\right] - (\sigma_\epsilon - \Delta\omega)\right) + \left(\bar{\omega}\left[\mu_a - \frac{\theta\sigma_a^2}{3(\sigma_\epsilon - \Delta\omega)}\right] - \omega_U\right) = 0 \tag{48}$$

$$\implies -(\sigma_\epsilon - \Delta\omega) + \bar{\omega}\mu_a - \omega_U = 0 \tag{49}$$

$$\implies \omega_U = -\sigma_\epsilon + \Delta\omega + \bar{\omega}\mu_a \tag{50}$$

$$\tag{51}$$

To get the best response function of the firm 2, we re-arrange the expression above and use the definition for the net benefit of licensing $\Delta\omega = (\omega_L - c_0) - (\omega_U + \mu_\epsilon)$:

$$\boxed{\omega_U(\omega_L) = \frac{1}{2}[\bar{\omega}\mu_a + (\omega_L - c_0) - (\mu_\epsilon + \sigma_\epsilon)]} \tag{52}$$

The best response function for the wages in the unlicensed sector is increasing with the quality of the firm's technology $\bar{\omega}$, the average ability of all workers, and the competing wages in the licensed sector. It is decreasing in the cost of obtaining a license and the maximum taste for the unlicensed sector by workers, $\mu_\epsilon + \sigma_\epsilon$. At the Nash equilibrium both firms wages are mutual best responses. Substituting the best response of the firm in the licensed sector into the best response function for

the firm in the unlicensed sector, we solve for the equilibrium wage in the unlicensed sector ω_U^*.

$$\omega_U(\omega_L) = \frac{1}{2}[\bar{\omega}\mu_a + (\omega_L - c_0) - (\mu_\epsilon + \sigma_\epsilon)] \tag{53}$$

$$\implies \omega_U = \frac{1}{2}[\bar{\omega}\mu_a + -c_0 - (\mu_\epsilon + \sigma_\epsilon)] + \frac{1}{2}\left[\frac{1}{2}[(1+h)\bar{\omega}\mu_a + \omega_U + c_0 + (\mu_\epsilon - \sigma_\epsilon)]\right] \tag{54}$$

$$\implies \frac{3}{4}\omega_U = \left(\frac{3}{4} + \frac{1}{4}h\right)\bar{\omega}\mu_a - \frac{1}{4}c_0 - \frac{1}{4}\mu_\epsilon - \frac{3}{4}\sigma_\epsilon \tag{55}$$

$$\implies \boxed{\omega_U^* = \left(1 + \frac{1}{3}h\right)\bar{\omega}\mu_a - \frac{1}{3}c_0 - \frac{1}{3}\mu_\epsilon - \sigma_\epsilon} \tag{56}$$

To solve for the equilibrium wages in the licensed sector, we insert equilibrium wages from the unlicensed sector into the best response function for the licensed sector:

$$\omega_L = \frac{1}{2}[(1+h)\bar{\omega}\mu_a + \omega_U + c_0 + (\mu_\epsilon - \sigma_\epsilon)] \tag{57}$$

$$\implies \omega_L = \frac{1}{2}[(1+h)\bar{\omega}\mu_a + c_0 + (\mu_\epsilon - \sigma_\epsilon)] + \frac{1}{2}\left[\left(1 + \frac{1}{3}h\right)\bar{\omega}\mu_a - \frac{1}{3}c_0 - \frac{1}{3}\mu_\epsilon - \sigma_\epsilon\right] \tag{58}$$

$$\implies \boxed{\omega_L^* = \left(1 + \frac{2}{3}h\right)\bar{\omega}\mu_a + \frac{1}{3}c_0 + \frac{1}{3}\mu_\epsilon - \sigma_\epsilon} \tag{59}$$

Comment: Wages in the licensed sector are larger than wages in the unlicensed sector, assuming c_0, μ_ϵ, σ_ϵ, μ_a are all positive. Hence of $\omega_U^* > 0 \implies \omega_L^* > 0$.

To solve for the fraction of licensed workers, we substitute equilibrium wages into the expression for the fraction of licensed workers in equation (21):

$$f = \frac{1}{2} + \frac{\bar{\omega}\mu_a h - c_0 - \mu_\epsilon}{6\sigma_\epsilon}. \tag{60}$$

Defining $\underline{c} \equiv h\bar{\omega}\mu_a - \mu_\epsilon - 3\sigma_\epsilon$, it is straight forward to show that if the average cost of licensing, c_0, is lower than $\underline{c}$ that licensing is sufficiently cheap that all workers obtain a license and work in the licensed sector, hence $f = 1$. Likewise defining $\bar{c} \equiv h\bar{\omega}\mu_a - \mu_\epsilon + 3\sigma_\epsilon$, it is straight forward to show that if the average cost of licensing, c_0, is higher than $\bar{c}$ that licensing is sufficiently onerous that all workers prefer not to obtain a license, hence $f = 0$. It is only for intermediate value $c_0 \in (\underline{c}, \bar{c})$, that we observe a non-zero fraction of workers in both the licensed and unlicensed sectors.

9.2 Proof of Theorem 3

The total social surplus is the sum of the firms revenue minus the expected cost of licensing. Since the expected wages of employees is a cost to firms and a benefit to workers, it nets out in the social surplus calculation, in the case where we place an equal weighting on firm profits and net worker wages:

$$SS = \underbrace{(1+h)\bar{\omega}\left(\mu_a + \frac{\theta\sigma_a^2}{3(\sigma_\epsilon + \Delta\omega)}\right)\left(\frac{1}{2} + \frac{\Delta\omega}{2\sigma_\epsilon}\right)}_{\text{Firm 1 Revenue}} + \underbrace{\bar{\omega}\left[\mu_a - \frac{\theta\sigma_a^2}{3(\sigma_\epsilon - \Delta\omega)}\right]\left(\frac{1}{2} - \frac{\Delta\omega}{2\sigma_\epsilon}\right)}_{\text{Firm 2 Revenue}} \tag{61}$$

$$- \underbrace{\left[c_0 - \frac{\theta^2\sigma_a^2}{3(\sigma_\epsilon + \Delta\omega)}\right]\left(\frac{1}{2} + \frac{\Delta\omega}{2\sigma_\epsilon}\right)}_{\text{Expected Licensing Costs}} \tag{62}$$

$$= \frac{1}{2\sigma_\epsilon}(1+h)\bar{\omega}\left(\mu_a(\sigma_\epsilon + \Delta\omega) + \frac{1}{3}\theta\sigma_a^2\right) + \frac{1}{2\sigma_\epsilon}\bar{\omega}\left(\mu_a(\sigma_\epsilon - \Delta\omega) - \frac{1}{3}\theta\sigma_a^2\right) \tag{63}$$

$$- \frac{1}{2\sigma_\epsilon}\left(c_0(\sigma_\epsilon + \Delta\omega) - \frac{1}{3}\theta\sigma_a^2\right) \tag{64}$$

$$\tag{65}$$

To find the socially optimally cost of licensing, we take the derivative of the social surplus with respect to the cost, c_0. Recall the following:

$$\Delta\omega = \frac{1}{3}(\bar{\omega}\mu_a h - c_0 - \mu_\epsilon) \implies \frac{d\Delta\omega}{dc_0} = -\frac{1}{3} \tag{66}$$

Therefore

$$\frac{d(SS)}{dc_0} = 0 \tag{67}$$

$$\implies -\frac{1}{6\sigma_\epsilon}(1+h)\bar{\omega}\mu_a + \frac{1}{6\sigma_\epsilon}\bar{\omega}\mu_a - \frac{1}{2\sigma_\epsilon}(\sigma_\epsilon + \Delta\omega) + \frac{1}{6\sigma_\epsilon}c_0 = 0 \tag{68}$$

$$\implies -\frac{1}{6\sigma_\epsilon}h\bar{\omega}\mu_a - \frac{1}{2\sigma_\epsilon}(\sigma_\epsilon + \Delta\omega) + \frac{1}{6\sigma_\epsilon}c_0 = 0 \tag{69}$$

$$\implies h\bar{\omega}\mu_a + 3(\sigma_\epsilon + \Delta\omega) - c_0 = 0 \tag{70}$$

$$\implies h\bar{\omega}\mu_a + 3\sigma_\epsilon + \bar{\omega}\mu_a h - c_0 - \mu_\epsilon - c_0 = 0 \tag{71}$$

$$\implies 2c_0 = 2h\bar{\omega}\mu_a + 3\sigma_\epsilon - \mu_\epsilon = 0 \tag{72}$$

$$\implies c_0^* = h\bar{\omega}\mu_a + \frac{3}{2}\sigma_\epsilon - \frac{1}{2}\mu_\epsilon \tag{73}$$

$$\implies \boxed{c_0^* = \frac{1}{2}(\bar{c} + h\bar{\omega}\mu_a)} \tag{74}$$

Table XI: Ban Premium for Black Men Decreasing in Firm Size (Weighted)

	Firm size			
	(1)	(2)	(3)	(4)
	>100	>200	>500	>1000
blackmen	-0.105***	-0.100***	-0.104***	-0.122***
	(0.0210)	(0.0234)	(0.0294)	(0.0367)
whitewomen	-0.127***	-0.119***	-0.117***	-0.113***
	(0.00961)	(0.0120)	(0.0151)	(0.0189)
blackwomen	-0.219***	-0.212***	-0.224***	-0.193***
	(0.0283)	(0.0300)	(0.0278)	(0.0295)
license	0.0624**	0.0574*	0.0558	0.0397
	(0.0265)	(0.0336)	(0.0426)	(0.0488)
license_blackmen	-0.0284	-0.0751	0.0275	0.0613
	(0.0885)	(0.119)	(0.0996)	(0.122)
license_whitewomen	0.0699**	0.0620	0.0627	0.0757
	(0.0346)	(0.0396)	(0.0504)	(0.0584)
license_blackwomen	0.143***	0.122**	0.0915	0.109
	(0.0529)	(0.0552)	(0.0762)	(0.0933)
ban	0.0665***	0.0740**	0.0888**	0.0629
	(0.0235)	(0.0313)	(0.0382)	(0.0452)
ban_blackmen	0.161***	0.102	0.0872	0.0930
	(0.0543)	(0.104)	(0.116)	(0.134)
ban_whitewomen	0.0697	0.0738	0.0647	0.0707
	(0.0429)	(0.0522)	(0.0526)	(0.0487)
ban_blackwomen	0.0831*	0.0142	-0.00637	0.00347
	(0.0463)	(0.0796)	(0.0906)	(0.100)
Constant	1.670***	1.580***	1.548***	1.522***
	(0.0997)	(0.109)	(0.106)	(0.114)
Observations	102,860	74,967	49,020	35,724
R-squared	0.535	0.541	0.551	0.557

Data Source: *Wave 13 to Wave 16 of SIPP Panel 2008.*

Notes: This table reports a wage regression on license status conditional on firm size using the survey sample weights. The focal result here is that the ban premium for black men is decreasing in firm size as we go from companies with 200 employees to companies with 500 and 1000 employees. All regressions include month fixed effects, a quadratic in age, education levels, a Hispanic indicator, 'other race' indicator, union status, a government worker indicator, a self-employed indicator, a service worker indicator, as well as state and 3-digit occupation fixed effects. In addition, indicators for 'certification' and 'license not required for jobs' are included. The sample is restricted to respondents aged 18-64 with hourly wages on the main job between $5 and $100 from May 2012 through November 2013. Observations with imputed wages and license status are dropped. (*** p<0.01, ** p<0.05, * p<0.1; Robust standard errors are clustered at state level.)

Table XII: Wage Premium for Black Men in Banned Occupations Robust (Weighted)

	(1) Racial Disparity in Arrest	(2) Government Employment	(3) Frac. White in Occupation	(4) Union Status
license	0.0796***	0.0695***	0.0794***	0.0773***
	(0.0156)	(0.0158)	(0.0155)	(0.0156)
license_blackmen	0.0106	0.0155	-0.0154	0.00465
	(0.0599)	(0.0640)	(0.0579)	(0.0612)
license_whitewomen	0.0634***	0.0674***	0.0665***	0.0703***
	(0.0194)	(0.0195)	(0.0192)	(0.0194)
license_blackwomen	0.120***	0.137***	0.109***	0.121***
	(0.0331)	(0.0336)	(0.0305)	(0.0315)
ban	0.106***	0.102***	0.104***	0.0992***
	(0.0184)	(0.0191)	(0.0187)	(0.0182)
ban_blackmen	0.119**	0.123**	0.102*	0.128**
	(0.0465)	(0.0476)	(0.0513)	(0.0502)
ban_whitewomen	0.0268	0.0277	0.0328	0.0409*
	(0.0229)	(0.0237)	(0.0246)	(0.0223)
ban_blackwomen	0.0485	0.0467	0.0408	0.0543*
	(0.0330)	(0.0314)	(0.0325)	(0.0321)
ldisparity	-0.0777***			
	(0.00766)			
ldisparity_blackmen	0.0610**			
	(0.0275)			
ldisparity_whitewomen	0.00896			
	(0.0190)			
ldisparity_blackwomen	0.0510			
	(0.0376)			
fracwhite		0.646***		
		(0.0678)		
fracwhite_blackmen		-0.0705		
		(0.119)		
fracwhite_whitewomen		-0.00166		
		(0.0440)		
fracwhite_blackwomen		-0.108		
		(0.109)		
govt			0.0111	
			(0.0128)	
govt_blackmen			0.138***	
			(0.0303)	
govt_whitewomen			-0.0170	
			(0.0172)	
govt_blackwomen			0.0536	
			(0.0320)	
union				0.194***
				(0.0171)
union_blackmen				0.0809*
				(0.0436)
union_whitewomen				-0.0530***
				(0.0172)
union_blackwomen				-0.00881
				(0.0337)
Constant	1.736***	1.339***	1.754***	1.761***
	(0.0546)	(0.0924)	(0.0609)	(0.0611)
Observations	261,617	262,166	262,166	262,166
R-squared	0.525	0.530	0.526	0.525

Data Source: *Wave 13 to Wave 16 of SIPP Panel 2008.*

Notes: This table reports a regression of wages on licensing status, using survey sample weights. To test whether the ban premium experienced by black men is robust, we control for heterogeneity by race and gender in four key variables that could also be correlated with whether an occupation has a felony ban: (i) the log of the racial disparity in arrest between blacks and whites, (ii) public sector employment, (iii) fraction of whites in occupation and (iv) worker union status. (*** p<0.01, ** p<0.05, * p<0.1; robust standard errors clustered at state level.)

Table XIII: Ban Premium for Black Men not Due to Returns to Education (Weighted)

	(1) Licensed (with felony bans)	(2) Licensed (no felony bans)	(3) Unlicensed
blackmen	0.0467	-0.199*	-0.0886***
	(0.0847)	(0.116)	(0.0268)
whitewomen	-0.211**	-0.0891*	-0.134***
	(0.0828)	(0.0521)	(0.00848)
blackwomen	-0.180**	-0.246*	-0.209***
	(0.0828)	(0.136)	(0.0271)
postHS	0.0365	0.113***	0.0900***
	(0.0564)	(0.0293)	(0.0113)
postHS_blackmen	0.0241	0.128	-0.0209
	(0.129)	(0.149)	(0.0388)
postHS_whitewomen	0.119	0.0277	-0.0166
	(0.0848)	(0.0535)	(0.0149)
postHS_blackwomen	0.0367	0.151	-0.0135
	(0.0878)	(0.129)	(0.0304)
Constant	1.891***	1.710***	1.752***
	(0.169)	(0.160)	(0.0582)
Observations	14,878	28,065	198,412
R-squared	0.522	0.453	0.532

Data Source: *Wave 13 to Wave 16 of SIPP Panel 2008.*

This table reports three separate wage regressions conditional on license status using survey sample weights. The goal of these regressions is to test whether the licensing premium to black men in occupations with felony bans is driven by differentially higher returns to post-secondary education for black men in these occupations. We find that black men in these occupations do not experience differentially higher returns to post-secondary education relative to white men. (*** p<0.01, ** p<0.05, * p<0.1; Robust standard errors are clustered at state level.)

Table XIV: Women Benefit from Human Capital Bundled with Licensing (Weighted)

	(1) Base Model	(2) training	(3) continuous education	(4) exams	(5) training	(6) continuous education	(7) exams
blackmen	-0.101***	-0.105***	-0.102***	-0.107***	-0.0959***	-0.0927***	-0.0980***
	(0.0158)	(0.0190)	(0.0166)	(0.0194)	(0.0183)	(0.0162)	(0.0188)
whitewomen	-0.139***	-0.145***	-0.144***	-0.144***	-0.144***	-0.144***	-0.143***
	(0.00864)	(0.00883)	(0.00926)	(0.00923)	(0.00810)	(0.00859)	(0.00851)
blackwomen	-0.212***	-0.214***	-0.213***	-0.214***	-0.205***	-0.204***	-0.204***
	(0.0175)	(0.0180)	(0.0163)	(0.0184)	(0.0177)	(0.0162)	(0.0182)
license	0.0790***	0.0218	0.0498***	0.0561**	0.0162	0.0453***	0.0554*
	(0.0157)	(0.0223)	(0.0160)	(0.0268)	(0.0236)	(0.0168)	(0.0290)
license_blackmen	0.00564	-0.0237	-0.00454	-0.0448	-0.0298	-0.00915	-0.0499
	(0.0609)	(0.0737)	(0.0830)	(0.0806)	(0.0777)	(0.0873)	(0.0849)
license_whitewomen	0.0639***	0.0272	0.0322	0.0333	0.0293	0.0327	0.0355
	(0.0194)	(0.0234)	(0.0205)	(0.0220)	(0.0242)	(0.0212)	(0.0227)
license_blackwomen	0.121***	0.105**	0.114***	0.111***	0.100**	0.108***	0.106**
	(0.0329)	(0.0430)	(0.0385)	(0.0411)	(0.0432)	(0.0381)	(0.0415)
ban	0.103***	0.0472*	0.0746***	0.0806**	0.0306	0.0590**	0.0690*
	(0.0183)	(0.0255)	(0.0217)	(0.0364)	(0.0276)	(0.0222)	(0.0377)
ban_blackmen	0.134***	0.101	0.122*	0.0802	0.113	0.135*	0.0937
	(0.0470)	(0.0812)	(0.0683)	(0.0881)	(0.0871)	(0.0781)	(0.0950)
ban_whitewomen	0.0300	-0.00568	-0.00350	-0.000205	0.00559	0.00596	0.0111
	(0.0227)	(0.0287)	(0.0256)	(0.0310)	(0.0294)	(0.0256)	(0.0311)
ban_blackwomen	0.0518	0.0339	0.0404	0.0407	0.0392	0.0440	0.0456
	(0.0315)	(0.0378)	(0.0494)	(0.0360)	(0.0378)	(0.0480)	(0.0362)
requirement		0.0603**	0.0403**	0.0232	0.0582**	0.0361*	0.0155
		(0.0243)	(0.0188)	(0.0302)	(0.0256)	(0.0186)	(0.0303)
requirement_blackmen		0.0333	0.0135	0.0581	0.0250	0.000927	0.0488
		(0.0576)	(0.0628)	(0.0622)	(0.0556)	(0.0648)	(0.0610)
requirement_whitewomen		0.0443**	0.0462**	0.0393**	0.0459**	0.0507**	0.0407**
		(0.0174)	(0.0211)	(0.0185)	(0.0177)	(0.0207)	(0.0179)
requirement_blackwomen		0.0171	0.00867	0.0120	0.0172	0.0114	0.0130
		(0.0367)	(0.0419)	(0.0402)	(0.0370)	(0.0414)	(0.0408)
Constant	1.761***	1.763***	1.770***	1.764***	1.245***	1.252***	1.245***
	(0.0611)	(0.0612)	(0.0607)	(0.0614)	(0.119)	(0.116)	(0.118)
Skill					X	X	X
Observations	262,166	262,166	262,166	262,166	257,286	257,286	257,286
R-squared	0.525	0.526	0.526	0.525	0.539	0.539	0.539

Data Source: *Wave 13 to Wave 16 of SIPP Panel 2008.*

Notes: This table reports wage regressions in which we to test whether the licensing premium is due to occupational licensing increasing the human capital of workers. All regressions include month fixed effects, a quadratic in age, education levels, a Hispanic indicator, 'Other race' indicator, union status, a government worker indicator, a self-employed indicator, a service worker indicator, as well as state and 3-digit occupation fixed effects and use survey sample weights. In addition, indicators for 'certification' and 'license not required for jobs' are included. that are heterogeneous by race and gender. The sample is restricted to respondents aged 18-64 with hourly wages on the main job between $5 and $100 from May 2012 through November 2013. Observations with imputed wages and license status are dropped. (*** p<0.01, ** p<0.05, * p<0.1; Robust standard errors are clustered at state level.)