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Independent Professional
Practice

by Milton Friedman

and

Simon Kuznets

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Income from Independent Professional Practice

Preface

THIS STUDY OF INCOMES from independent professional practice can be viewed as a detailed description of the income structure of five professions, as an empirical case study of the factors determining the incomes individuals receive for their work, and as an attempt to arrive at conclusions relevant to public policy. From the first point of view, the substantive results for the individual professions are of major interest. These are presented in detail in the separate chapters and are summarized in Chapter 9; they call for no further comment here.

The comments that follow are addressed to readers interested in the broader implications of the study and the general approach adopted. This approach treats professional activity as taking place in an economy best described as a free enterprise system in which the production of goods and distribution of incomes are regulated primarily by the impersonal mechanism of the market. The efficient functioning of such a system depends greatly on the freedom with which resources flow from one use to another in response to changes in economic conditions. The incentive to the flow of resources is provided by changes in the prices paid for them and hence in the incomes individuals receive.

The incomes that individuals receive thus play a dual role: they help to regulate the allocation of resources among different uses and they are the means whereby the social product is distributed. To evaluate their effectiveness in regulating the allocation of resources, it is essential to separate differences in income that are consistent with the free flow of resources from those that are not. If every individual were entirely free to choose his occupation, the "whole of the advantages and disadvantages" of different occupations would continually tend toward equality for persons with similar ability. Persistent differences in pecuniary returns would compensate for differ-

ences in training, the attractiveness of the work, the risks involved, and the like. Actual differences in income are a combination of such 'equalizing' differences, temporary differences that arise from imperfect adjustment to changing economic conditions, and differences that reflect persistent hindrances to the free choice of occupation. These hindrances may arise from the requirement of relatively rare abilities, or they may be implicit in the institutional setting, or they may be introduced by society at large or groups within it.

Average earnings of professional workers are substantially higher than average earnings of nonprofessional workers. Part of this difference compensates for the longer period of training needed by professional workers and is therefore an 'equalizing' difference. The analysis presented in Chapter 3 suggests that the entire difference cannot be thus explained; at least in part, it reflects a hindrance to the free choice of occupation. Individuals are not equally free to choose a professional or non-professional career. The professions require a relatively high level of ability, and for many persons entry into the professions is hindered by the social and economic stratification of the population. The economic stratification of the population is important because capital invested in professional training, unlike capital invested in factories and machines, can rarely be obtained on the open market; it must be provided by the prospective practitioner himself, his parents, or a benefactor. The many young men who do not have and cannot get the money needed to finance their training are barred from the professions. In consequence, the amount invested is controlled only in part by expected returns.

Public investment in professional training by government and by philanthropists has supplemented private investment. Few if any professional workers pay the entire cost of their training. This public investment in professional training raises two important questions of social policy. First, how much public investment is needed? Second, should the returns from public investment accrue to the individuals in whose training the investment is made? An answer to the first question re-

quires not only data on current public investment but also clarification of the meaning of 'proper' amount of public investment. Neither is provided by our analysis which takes account only of private investment. From one point of view, investment in professional training would be adjusted to investment in other fields if average earnings in the professions exceeded average earnings in comparable pursuits by an amount sufficient to replace public plus private investment and to pay the market rate of interest on that investment. But if public investment were so adjusted, the second question would arise, since, under present institutional arrangements, the return on the public investment would accrue to the professional workers. Whether this is socially desirable and if not what policies should be adopted to distribute the costs and gains in a socially advantageous way are problems that may force themselves upon public attention before long.

The hindrances to the free choice of occupation that hamper adjustments between the professions and other occupations do not seriously hamper adjustments within the professions. In the absence of purposeful interference, there appears to be sufficient mobility among the different areas of professional practice to make the differences in pecuniary returns reflect differences in age, costs of training, the nonpecuniary advantages of the type or location of practice, and the like. In other words, these differences tend to be of the 'equalizing' type. True, adjustment is not perfect, and at times may be slow and halting; but adjustment there is. This conclusion is supported by our analysis of income differences among professions, regions, and communities of varying size, and by the evidence we have collected on the influence of type and organization of practice, and number of years in practice.

Purposeful interference is often present. In a large and apparently increasing segment of the field, governmental bodies or professional associations are in a position to hinder adjustments that would otherwise occur. It is not part of our task to judge the desirability of these interferences. Our task is merely to evaluate their effects on the incomes of professional work-

ers. This we have attempted to do in one special case, limitation of entry into medicine. The analysis has both methodological and substantive interest. Presented in detail in Chapter 4, it is a by-product of an attempt to explain the observed difference between average income in medicine and average income in dentistry, a similar profession in which there is little or no difficulty of entry other than that arising from scarcity of ability and cost of training. The available evidence on the conditions of entry in the two professions demonstrates that average income in medicine exceeds average income in dentistry by more than it would if entry into the two professions were equally easy. To determine how much larger the difference is, we resorted to the device of estimating what the difference would be if entry were equally easy. The analysis is necessarily conjectural and our quantitative results are only a rough approximation. But the problem is real, and a rough approximation seems better than none.

It is not easy to evaluate the importance of the factors that give rise to 'equalizing' differences. These factors are numerous and varied, many are vague and subjective, and their quantitative effects are merged. The attempt in Chapter 4 to explain the observed difference between average incomes in medicine and dentistry is an experiment in estimating the separate influence of these factors by interweaving empirical observation, personal judgment, and theoretical analysis. The conclusions reached are obviously restricted to medicine and dentistry, but the methods used are of fairly general applicability.

Analysis of the factors determining the incomes individuals receive contributes to an understanding not only of how incomes regulate the allocation of resources but also of how they distribute the social product, and the conclusions reached may have an important bearing on the desirability of measures designed to change the distribution of income. For example, the desirability of relating federal grants to the per capita income of particular states depends in part on the factors explaining income differences among states. As already noted, the

analysis presented in Chapter 5 suggests that community differences in professional incomes are primarily 'equalizing'. The differences are small among communities of the same size but in different geographic regions of the country. Though decidedly larger, the differences among communities of varying size in the same region do not appear attributable to immobility. We do not know whether a similar conclusion is valid for other occupations or the public at large; but its apparent validity for the professions warns against the acceptance of the opposite conclusion for other groups without investigation.

Most of the questions that arise when incomes are viewed as the means whereby the social product is distributed differ from those so far considered. How much do incomes vary from individual to individual? Is the inequality of income greater or smaller in years of prosperity than in years of depression? Are the income differences among individuals fairly stable, or does the relative income status of individuals shift considerably from year to year? What are the factors responsible for the inequality of income among individuals pursuing the same occupation in the same community?

We have attempted to answer these questions for professional workers in Chapters 4, 5, 6, and 7. Few of our substantive results are of general interest. Perhaps the most novel part of the analysis is our attempt, particularly in Chapter 7, to investigate changes in the relative income status of individual professional workers. Paucity of data has prevented most previous studies of the distribution of income from tackling this problem, though it is clearly an important one. A wide variability of annual income has a very different meaning if the disparities it reflects are persistent than if they are temporary in the sense that individuals who rank high in the income scale one year may rank low the next. We found a surprising degree of stability in the relative income status of professional workers. The variability of income for a two- or three-year period is not much smaller than the variability of annual income (Chapters 4 and 7). Without further investiga-

tion, this conclusion cannot be assumed valid for other groups. But the methods by which it was reached are applicable to the extensive data that are now becoming available on the incomes of the same individuals in successive years.

A recurrent question about the distribution of income is whether there is a consistent relation between inequality of income and general economic conditions. Other studies have suggested that such a relationship does exist, though the evidence is far from conclusive. The data have never been adequate, nor has the relation between inequality and general economic conditions been clear-cut. We found no consistent relation for the professions. The changes in inequality from year to year, though sizable, are irregular; and we are inclined to attribute them to that convenient catchall—chance variation.

The analysis presented in this book was completed in 1941; and the data utilized cover primarily the years from the late 'twenties through 1936. No attempt has been made since the completion of the analysis to bring it up to date, either by a search for more recent data or by a thorough treatment of them. However, as questions arose concerning the validity of some conclusions in the original draft of the report, we used such of the data for more recent years as were easily available to see whether they confirmed or disproved the conclusions drawn from the data for earlier years.

To the extent that our detailed analysis is confined to data for a few years, our conclusions may be limited by the peculiarities of that segment of historical reality. We have tried to reduce these limitations by making the conclusions independent of year-to-year fluctuations in the data; by supplementing statistical data with qualitative evidence on the institutional background of the professions over a longer period than can be covered by statistical series; and by pressing the analysis to a level at which some of the important factors that account for the observed income similarities and differences can be approximated. We present the detailed evidence in order to permit readers to judge the extent to which our at-

tempt to overcome the limitations of a brief historical period is successful.

One aim of our analysis is to reduce a segment of changing reality to factors whose persistence over time can be more easily appraised. Yet judgments may naturally differ as to the likelihood that the observed similarities and differences in income among the professions and between professions and other pursuits, as well as the factors that account for these similarities and differences, will persist. Such judgments must rest upon one's view of the persistence or transitoriness of a variety of institutional peculiarities of our economic society; and they will naturally differ so long as our knowledge of the factors that make for social development is incomplete. We have tried to add to such knowledge and thus narrow the area within which judgments can honestly diverge. The absolute and relative quantitative differences shown by our data will naturally change, and have already changed, as life went on and people were born, worked, fought, and died. In that sense our report is a still-life picture of a segment of the past. But some of the factors suggested and their consequences are likely to persist. And it is particularly hoped that the methods used in the analysis have validity beyond the limits of the historical data used; and will stand the test of further use for some time to come.

The present investigation began in 1933, as a by-product of the study of national income of the United States for 1929-32 conducted by the U. S. Department of Commerce in collaboration with the National Bureau. In connection with this study, which was under the general direction of Simon Kuznets, a special questionnaire survey of the more important professional groups was undertaken to remedy the lack of reliable data on income originating from independent professional practice. Usable data for 1929-32 were obtained for four groups: physicians, dentists, certified public accountants, and consulting engineers. The obvious significance of these data for purposes other than that for which they were collected led Kuznets to undertake a detailed analysis of them. Early in 1936, he completed a tentative manuscript summarizing the

findings for the four professions and four years for which data were then available. This first draft was incomplete and needed much further work, but the pressure of other tasks made it impossible for him to devote the time needed.

Milton Friedman took up the work in 1937, and from then on both the statistical analysis and the preparation of the manuscript were in his charge, though plans for further work were developed jointly by the two authors, and Kuznets critically reviewed the manuscript and participated in its revision. Friedman expanded the study to include additional samples collected by the Department of Commerce, providing data for years after 1932 for lawyers, as well as for three of the four professions previously covered. This expansion involved testing the samples for bias, devising methods for correcting biases (see Appendix A), summarizing the statistical evidence, and integrating it with earlier results. The wider range of years and professions permitted new inferences to be drawn, and provided a check on the inferences previously drawn by Kuznets. Friedman also added new material. The result of Friedman's work was a completely rewritten version of the earlier manuscript. Chapter 3, Section 2 of Chapter 4, Chapter 7, Appendix A, the appendices to Chapters 4, 5, and 7, and most of Chapter 2 are entirely new, and the remainder has been altered very substantially in both form and content.

In a preface written by two individuals jointly, it is naturally difficult for either properly to indicate his feeling of indebtedness to the other. Perhaps it will suffice to say that each of us feels that whatever defects the present work may have would have been multiplied many-fold but for his collaborator.

No study can pass through the hands of the research staff and directors of the National Bureau without being improved in the process. Thanks are due the staff members and the directors for the elimination of many deficiencies of the original manuscript, and apologies for those that still remain.

Careful scrutiny of the manuscript by Wesley C. Mitchell removed errors, changed the emphasis at several important

points, and made many a page more readable. In addition, his steady and unflagging support greatly eased our task. The organization of the book was improved as a result of extensive discussions with Arthur F. Burns, who read several drafts of the entire manuscript and made many valuable suggestions. Chapters 3 and 4, parts of which were published in *Bulletin* 72-73, owe much to the stimulating criticism of Frederick C. Mills. W. Allen Wallis and Moses Abramovitz read the entire manuscript in draft form and made many helpful suggestions, the former, particularly on Chapters 5 and 7, the latter, particularly on Chapters 3 and 4.

The manuscript was commented upon by several directors of the Bureau. We are indebted to each of them, especially C. Reinold Noyes, William L. Crum, Theodore O. Yntema, and Winfield W. Riefler, for their criticisms and constructive suggestions.

Edna E. Deutsch assisted Friedman from the time he took over the direction of the study in 1937. She organized and carried out most of the computations, prepared Appendix B, assisted in the gathering of source material, compiled the indexes, and checked the proof. In addition, she carried most of the load of seeing the manuscript through its several versions. We are deeply indebted to her for faithful and exact work. Thanks are also due Lucille Kean, Arthur Stein, and Richard Machol, who assisted in the early stages of the work. We are grateful to Martha Anderson for editing the manuscript with her usual care, and to H. Irving Forman for the excellence of the charts.

We are indebted to the Department of Commerce for making the original questionnaire returns available to us, for permission to use them, and for generous cooperation in other ways. Officials of various professional societies and firms publishing professional directories have always provided needed information. Specific acknowledgment for detailed information is made at the appropriate points in the text.

MILTON FRIEDMAN
SIMON KUZNETS

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