Inclusive Economic Growth

California has experienced strong economic growth for many years, averaging 5.8 percent for the past five years. A growing economy is essential to reducing poverty, but current trends are worrisome. Even before the COVID-19 pandemic, California's economic growth was beginning to slow, and the state was starting to see an outflow of businesses and jobs. CNBC's annual index of America's Top States for Business ranks California 32nd overall and dead last for "cost of doing business" and "business friendliness."[1] And *Forbes* ranks California 47th for "business costs" and 40th for "regulatory environment."[2]

Making matters worse, both the pandemic and the government's response to it have had an enormous effect on the state's economy. Throughout 2020 and the first part of 2021, lockdown orders shuttered many businesses. When businesses were open, capacity limits and public fears of the pandemic limited customers. While some businesses, particularly in the technology sector and other white-collar jobs, were able to adjust, many could not. By September 2020, as many as 20,000 California businesses were forced to close permanently. San Francisco, San Jose, and Oakland were all in the top 10 U.S. cities with the highest percentage of small businesses that closed for good. San Francisco was number one, with nearly half of the city's small businesses still closed.[3] Unemployment reached a high of 16.4 percent in May 2020 and remains substantially above 2019 levels.

Low-income Californians have been hit particularly hard by the pandemic. It is estimated that those business sectors with the highest number of low wage workers suffered job losses in the range of 24 percent at the height of the pandemic, versus 5–6 percent among businesses with a high percentage of higher-earning employees.[4] Both the size of the job losses in the low wage sectors and the divergence in impact between low and high wage employment are substantially worse than during the Great Recession of 2008.

Moreover, many of those who still had jobs suffered reductions in their hours or other reductions in earnings. Among households with incomes below $40,000, 69 percent reported that someone in their household lost a job, had reduced hours, or had a reduction in wages since the start of the pandemic.[5] Latinos, African Americans, and Asian Americans were all more likely than white Californians to fall into this category.[6]

> "California should generally pursue tax and regulatory policies that encourage continued economic growth. That means reducing taxes and regulations where possible."

Even before the pandemic, roughly 25.8 percent of unemployed Californians lived in poverty, compared to 16.4 percent of those with a job.[7] Low-income Californians were far more likely to be unemployed and to live in communities that offered fewer jobs or opportunities for entrepreneurship.

While it is not necessarily true that a rising tide lifts all boats—many people who are poor have far too many holes in their boats or lack a boat altogether—it is hard to visualize a way to significantly reduce poverty in California without some sort of rising tide. Therefore, California should generally pursue tax and regulatory policies that encourage continued economic growth. That means reducing taxes and regulations where possible.

Still, as important as such pro-growth economic policies are, they are not sufficient. Economic growth can have a significant effect on poverty reduction only if all Californians can fully participate in the opportunities that it offers and only if the benefits from that growth don't accrue solely to those at the top of the economic scale.

Therefore, as California begins to rebuild its economy in the wake of the pandemic, it should ensure that recovery efforts include those Californians who have long been locked out of the benefits of economic growth. This does not require new programs or new spending.

California already has a generous social safety net for families and a wide variety of business subsidies. Rather, California policymakers should address government regulations that can make it difficult for poor and other disadvantaged Californians to find a job or start a business. However well-intentioned, many government actions can create a two-tier economic system that locks out people who are poor while protecting those with more connections or resources to navigate the system.

RECOMMENDATIONS

Repeal Occupational Licensing That Is Not Strictly Necessary to Protect Health and Safety

California has one of the broadest and most onerous occupational licensing regimes in the United States. More than 126 professions require a license to practice in the state.[8] In 2015, 20.7 percent of all employees in California were required to have a license for their profession.[9] An additional 6.9 percent of occupations require some form of official certification. And while most people think of licensed professions as those including doctors, engineers, or pilots, the category also includes locksmiths, travel agents, makeup artists, and tree trimmers, among many others. In fact, a recent study shows that California is more likely to impose licensing requirements on low-income professions than any state except Arizona and Louisiana.[10] (Arizona has undertaken significant reform of its occupational licensing system since that study was released.) California is often one of a handful of states to license many professions (see Table 6.1).

Licensing requirements can be costly and time-consuming. On average, obtaining a license takes 827 days, costs $486, and requires passing two exams.[11] That burden is especially heavy for low-income Californians, who often lack the time, money, and other resources to navigate the licensing system. A study by the Archbridge Institute found that occupational licensing in California increased inequality in the state (as measured by the Gini coefficient) by as much as 12.77 percent and decreased upward mobility among low-income Californians by 5.53 percent. This is consistent with studies from other states. An Arkansas study, for instance, found that a two-thirds reduction in the number of jobs requiring a license reduced African American poverty by 15.3 percent.[12]

Rethink Occupational Zoning

Section 2 of this report looks at the ways in which residential zoning prices Californians living in poverty out of

Table 6.1
Licensing regulations by state

State	Number of low-income jobs that require licenses	Average fees	Average estimated number of days lost
Washington	77	$209	163
Louisiana	77	$360	202
California	76	$486	827
Nevada	75	$704	861
Arkansas	72	$246	642
Rhode Island	72	$223	326
Oregon	69	$335	537
Arizona	68	$612	765
Virginia	68	$291	620
Hawaii	63	$438	988

Source: Dick M. Carpenter II et al., *License to Work: A National Study of Burdens from Occupational Licensing*, 2nd ed. (Arlington, VA: Institute for Justice, 2020), p. 23, Table 6.

affordable housing and helps block the provision of shelter and services for the state's homeless population. Zoning can reduce low-income people's access to jobs as well.

Home-based employment is particularly well-suited for low-income single parents, who lack the resources for childcare or transportation. These are frequently the types of businesses that can be started with minimal capital investment or by those with limited skills, including daycare, cosmetology, catering, baking, auto repair, and so on.

In addition, telecommuting and other "work from home" opportunities have expanded dramatically since the start of the pandemic. Some estimates suggest that 42 percent of workers have been working from home. However, there has been a significant class divide for workers able to take advantage of remote work.

> "It is likely that when the 2020 data are released, nearly 60 percent of Californians will live in regions where there is little or no affordable childcare."

Roughly a quarter of corporate executives, information technology managers, financial analysts, accountants, and insurance underwriters have opportunities to work from home, as do roughly 14 percent of "professional and related" workers such as lawyers, software designers, scientists, and engineers. For workers in occupations that fall in the top 10 percent of earnings, more than a quarter have telecommuting options. However, less than 1 percent of workers in occupations with average wages in the bottom 25 percent have the same options. In the bottom 10 percent of average wage occupations, the percentage of workers who can work from home is so small that the Bureau of Labor Statistics cannot even measure it.

Some jobs will never be easily transferable to telecommuting. However, even when they are, there are numerous regulations and zoning laws limiting the type of jobs that can be done from home, the number of people that can work there, and the time that workers can spend in the home.

For example, in most California counties, only county residents can be employed by a home-based business. In those counties, such as Los Angeles, most allow no more than one noncounty resident employee. This forces business owners to increase their overheads by purchasing office space. In certain areas of California where office space is particularly expensive, entrepreneurs may choose not to expand their business because the cost is too high.

Fresno prohibits customers from visiting home businesses (with limited exceptions for instructional classes), and Los Angeles and Sacramento limit the number of customers to no more than one per hour.

And under the California Homemade Food Act, qualifying home businesses can earn no more than $50,000 per year. Moreover, counties must opt into the act's provisions, and 57 of California's 58 counties have not done so.[13]

Deregulate Childcare to Reduce Costs and Increase Supply

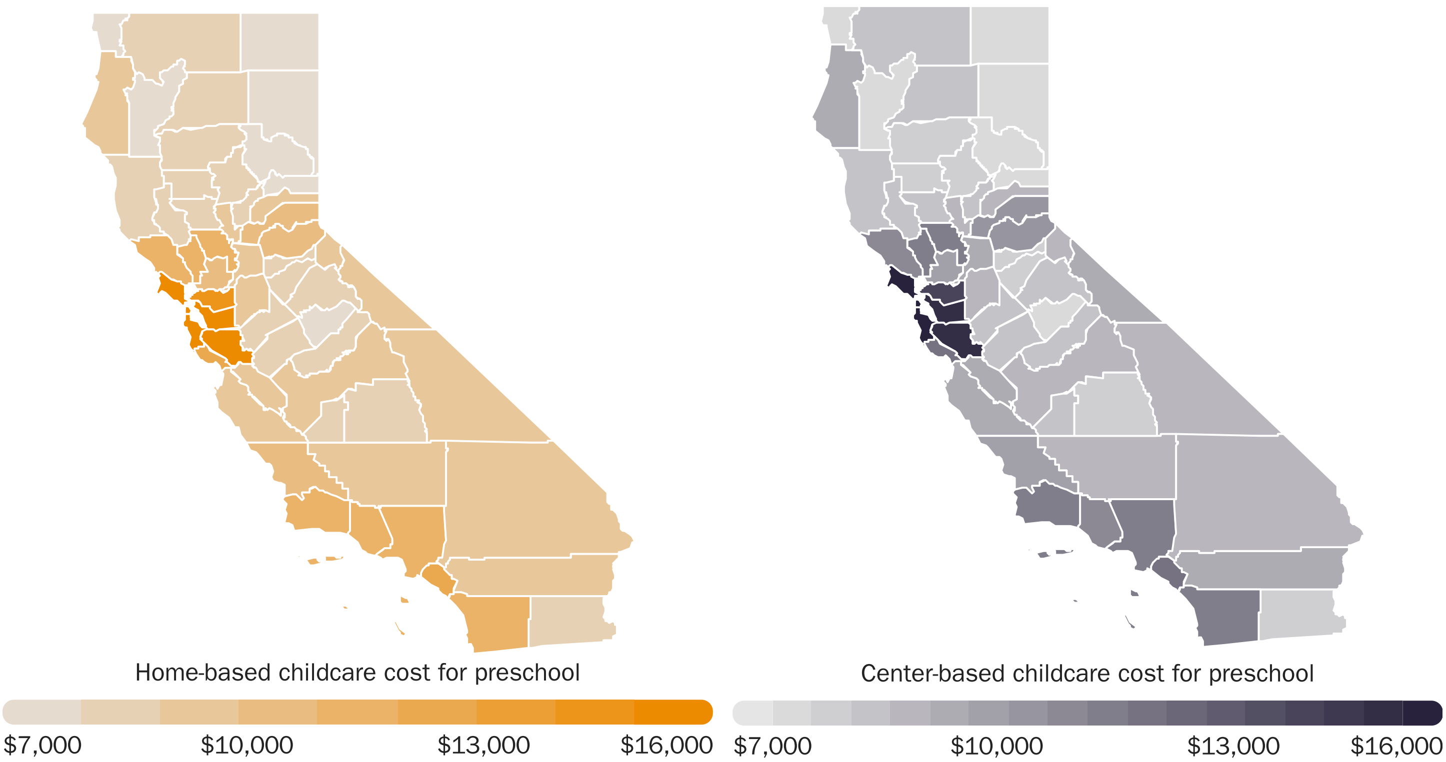
Even before the pandemic, childcare options in California had been steadily declining for years. Between 2014 and 2019, the number of home-based and center-based childcare providers decreased by 5.5 percent, which is over 57,000 providers. Despite the state's extensive efforts to keep them afloat, COVID-19 forced many more to shut down. It is likely that when the 2020 data are released, nearly 60 percent of Californians will live in regions where there is little or no affordable childcare.

Even when childcare is available, it is often prohibitively expensive. The average annual cost of center-based childcare is $16,945, and the average annual cost of home-based childcare is $11,200. For comparison, the cost of tuition at a college in the University of California system averages $12,570. In fact, center-based childcare exceeds the cost of tuition at a University of California college. In six counties, even home-based childcare is more expensive than college (see Figure 6.1). Since the average income of a two-parent household in California is $68,034, many families will spend almost a quarter of their income on childcare.

So far, efforts to fix childcare scarcity have largely involved shifting costs from individual families to taxpayers through

Figure 6.1

Average annual cost of home-based and center-based childcare for a preschooler by county



Source: "Annual Cost of Child Care, by Age Group and Facility Type," Kids Data, Population Reference Bureau, 2018.

subsidies at both the state and federal levels. The COVID-19 relief bill that passed Congress in March 2021, for example, included roughly $39 billion in childcare subsidies. Yet increasing subsidies has a dangerously limited ability to deliver long-term and affordable childcare to the market. First, as we have seen in areas as diverse as higher education and health care, there is a tendency for industries to absorb subsidies by raising prices without increasing capacity or reducing costs.[14] Second, the structure of subsidies often limits parental choices. Surveys have consistently shown that many parents prefer small, local, informal childcare options rather than large institutional settings. But many of those informal options are not eligible for existing government-backed subsidies. Third, subsidies fail to deal with the underlying issues at play in the childcare market, such as artificially restricted supply and the associated increase in prices.

Of course, few would oppose local regulations designed to ensure children's health and safety in childcare settings. However, an increasing number of regulations have more to do with protecting large institutional childcare providers from competition or increasing salaries for childcare professionals than they do with legitimate health and safety concerns.

For example, childcare personnel must have at least 12 post-secondary semester credits or equivalent quarterly units in early childhood education or a current Child Development Associate credential (with the appropriate age endorsement) from the Council for Professional Recognition.[15] Childcare facilities are also heavily prescribed. Facilities must have at least 25 square feet of indoor space and 75 square feet of outdoor space per child. The indoor space requirement does not count space for bathrooms, hallways, offices, food areas, storage, or any area occupied by shelving or cabinets. Outdoor space does not include pools or swimming areas. Outdoor areas must also be surrounded by a fence at least four feet high.

Such regulations add heavily to the cost of childcare. For instance, tightening the ratio of children to staff members by one child reduces the number of childcare centers in a given market by 9.2–10.8 percent.[16] Other studies suggest that such a staff restriction can add as much as 9–20 percent to the cost of caring for a child.[17] Similarly, increasing the average years of education required for childcare staff can reduce the availability of providers in a market by 3.2–3.8 percent.[18] In both cases, the additional costs appear to fall most heavily on low-income communities.[19] Moreover, such regulations tend to protect large institutional childcare from competition by local and informal care options. Yet institutional childcare is not only more expensive but often is not available in low-income communities.

Efforts to make childcare more affordable should not, therefore, focus on subsidizing over-regulated and high-cost institutional care. Rather, reform efforts should focus on expanding childcare options and reducing costs by eliminating regulations not directly related to health and safety.

Reduce Barriers to Entrepreneurship and Job Creation

Entrepreneurship is good for economic growth generally, but it also plays an important role in upward and intergenerational mobility.

For low-income workers and communities of color, starting a business is a popular option despite the risks. Black entrepreneurs have 12 times the wealth as black people who work for an employer.[20] Some 50 percent of small businesses that are run by women are owned by black women. Immigrants are twice as likely to start a business than native-born Americans. After all, starting one's own business is part of the American dream.

Excessive taxes and regulations make it inordinately more difficult for low-income individuals to start a business. Despite benefiting greatly from Silicon Valley, a mecca of tech startups, California's legislators rarely pay attention to the negative effects of taxation and regulation on small, minority-owned businesses. California has consistently ranked as one of the worst states to start a business.

Regulators should reform several areas that greatly hinder widespread entrepreneurship. While many changes are apt to spark the usual partisan debates, there are many initiatives that should draw broad bipartisan support: reducing fees involved in running a business, deregulating the cannabis industry, eliminating caps on liquor licenses, and reconsidering some minimum wage increases would make California more competitive, prosperous, and inclusive.

Reduce and Streamline the Business Permitting Process

There are 4.1 million small businesses in California that employ almost half the state's workers. These small businesses are especially important to low-income communities, providing services in places that larger companies frequently avoid and, more importantly, providing jobs and a chance to break into the larger economy. However, it is not always easy for these businesses to get up and running.

> "Entrepreneurship is good for economic growth generally, but it also plays an important role in upward and intergenerational mobility."

California's business environment is a mixed bag for startups. For example, Business.org ranks six California cities (San Francisco, San Jose, San Diego, Los Angeles, Sacramento, and Riverside) among the most startup friendly cities in the nation.[21] However, these rankings are heavily influenced by the thriving tech industry. When looking at other types of businesses, particularly small businesses in underserved communities, the environment is decidedly less welcoming.[22] The Small Business and Entrepreneurship Council, for instance, ranks California next to last in the nation (ahead of only New Jersey) in terms of policy environment for small business.[23]

Many of the barriers to small businesses are not statewide large-scale policies but rather the sort of petty bureaucracy that can thrive at the local level. For example, on top of dealing with state taxes, higher property values, and a changing regulatory climate, restaurants must also obtain all the proper permits required by their municipality. It is common for a restaurant to have to get a building permit, health permit, and signage permit, just to name a few. Sometimes it can take years for a business to acquire everything it needs to open, and in some cases the excessive processes can cause entrepreneurs to give up. In San Francisco, starting a storefront business can take years and cost tens of thousands of dollars, according to San Francisco Supervisors Hillary Ronen and Matt Haney.[24] Municipalities need to consider whether every required permit is necessary or just another obstacle.

Other fees and taxes also make it difficult to start a small business. Many business owners cite California's $800 per year franchise tax as a particular burden for small businesses.[25] And, of course, all this takes place in a generally high-tax, high-regulation state. Therefore, policymakers from Sacramento to local city councils should carefully consider the effect of new fees, taxes, and regulations on small business entrepreneurship.

Reboot the "Gig" Economy

Roughly 10 percent of Californians work in the so-called gig economy, doing short-term jobs instead of ongoing, managed employment. Ride-sharing services such as Uber and Lyft are perhaps the most visible examples of this class of employment, but the gig economy also includes all sorts of freelance, part-time, and temporary jobs, including those for musicians, designers, and nurses.

Such jobs can offer many advantages to workers, including the freedom to set their own hours. On the other hand, because gig workers are classified as independent contractors rather than employees, most gig jobs do not provide benefits such as health insurance and sick leave. Moreover, several recent court cases—most notably *Dynamex Operations West Inc. v. Superior Court of Los Angeles*—have called into question how contracted gig economy workers should be defined. Workers for Dynamex, a package delivery service, accused the company of violating their wage rights by misclassifying employees as independent contractors. The court agreed, ruling that Dynamex had to pay lost wages.

California lawmakers attempted to deal with these issues by passing AB 5, which established a new definition of "employee" based on the *Dynamex* decision. Henceforth, a worker would be classified as an employee if (a) the worker is free from control or direction of the hiring entity, (b) the work is outside the company's usual business, and (c) the worker is independently involved in an occupation, trade, or business of the same nature as the work performed. Ride-sharing services, which were among the primary targets of AB 5, were quick to fight back, and in November 2020, California voters passed Proposition 22, exempting app-based transportation and delivery companies from AB 5 provisions. In addition, the legislature created exemptions for more than 100 industries and employment categories. AB 5 is now in a way obsolete.

"Policymakers from Sacramento to local city councils should carefully consider the effect of new fees, taxes, and regulations on small business entrepreneurship."

Still, large portions of the gig economy remain under regulatory threat. Opponents of AB 5 contend that as many as 400 different job categories, from cleaning services to truck drivers, remain subject to AB 5 provisions.[26] Many of these jobs offer the type of flexibility or lack of entry-level costs that make them appealing to low-income workers. Even if such estimates are exaggerated, the applicability of AB 5 is often unclear, creating an open-ended source of litigation. Small businesses in particular are ill-suited to navigating this complex question. As a result, many have cut back or shied away from hiring in situations where AB 5 *might* apply.

In addition, Proposition 22 is currently under fire after an Alameda appellate court judge ruled it unconstitutional. This could be detrimental to apps like Uber and Lyft and the clientele that rely on them for things such as getting to work or getting home from a night out. Uber and Lyft had already begun to offer drivers more benefits as part of Proposition 22. However, those fighting against it do not believe that is enough, ignoring that for most drivers Uber or Lyft are only side jobs.

Ideally California should repeal AB 5 in its entirety. At the very least, legislators should clarify its applicability and extend exemptions to jobs and employers that would most benefit low-income communities.

Deregulate the Cannabis Industry

In 1996, California became the first state to legalize medical marijuana. In 2016, the state took another huge step by making recreational cannabis legal to be bought and sold. Now California accounts for a quarter of all marijuana sales in America. As a result, California has more cannabis businesses than any other state.[27] One of many obstacles to the growth of the industry is that not all cities have opted into the selling of recreational marijuana. To stimulate the industry, state legislators should urge all municipalities to do so.

In addition, California marijuana grower and retailer licensing differs by location. Obtaining a license should be a quick, simple, and transparent process open to all. There can be punitive fees of up to $96,000 for retailers depending on expected revenue. For microbusinesses permitted to grow and distribute cannabis, fees can amount to $300,000.[28] While wealthier entrepreneurs might be able to shoulder these fees, they completely price out low-income people from entering the market.

Make It Easier to Obtain a Liquor License

As part of California's COVID-19 lockdowns, restaurants were forced to shut their doors, and some never reopened. The restaurant industry is notoriously risky and is an industry that many minorities rely on for employment. In America, one in two restaurant employees is a minority, a quarter alone are Latino, and 40 percent of restaurant owners are minorities, compared to 29 percent of businesses across the country.[29] A major barrier that stops many restaurants from maximizing their revenue is liquor licenses.

Caps on liquor licenses in areas increase prices of licenses dramatically. For instance, in Los Angeles and San Francisco, caps on licenses have led to some being sold on the secondhand market for hundreds of thousands of dollars.[30] While large corporations can easily purchase a liquor license, startup restaurants struggle immensely.

Reevaluate Minimum Wage Increases

California's minimum wage is scheduled to increase incrementally to $15 an hour statewide by 2023. In addition, many localities have minimum wages higher than the statewide mandate, running as high as $16.30 per hour in Sunnyvale and Mountain View. Several other minimum wage hikes are pending or scheduled. In addition, more than a dozen communities have enacted variations of "Hero Pay," mandating a temporary minimum wage increase for certain categories of low wage essential workers who continued working despite the pandemic.[31]

In recent years, there has been increasing disagreement among economists about the employment effects of modest increases in the minimum wage in a growing economy, though there remains a consensus that there is a tradeoff between increasing incomes for some workers and decreasing employment opportunities for others. Workers most likely to lose jobs because of these increases are those with the least training, employment skills, and attachment to the labor force.

> "Ideally California should repeal AB 5 in its entirety. At the very least, legislators should clarify its applicability and extend exemptions to jobs and employers that would most benefit low-income communities."

However, the COVID-19 era does not have a normal growing economy. Many businesses that rely on minimum wage workers, particularly small service-based businesses, ordinarily operate on low profit margins. Pandemic restrictions have further reduced those margins. A restaurant that can only operate at a fraction of its previous capacity will not be able to employ as many people for as many hours at previous wage levels. Mandating an increase in wages under these circumstances will inevitably lead to fewer jobs. For example, grocery store chain Kroger responded to Long Beach's "Hero Pay" ordinance by closing three underperforming stores.[32]

Even when minimum wage increases do not result in a loss of jobs, workers may still end up worse off. A recent study in the *Harvard Business Review* found that minimum wage hikes in California decreased hours worked and, therefore, total compensation for many workers.[33] It found that for every $1 increase in the minimum wage, the average number of hours each worker worked per week decreased by 20.8 percent. For an average business in California, these changes resulted in five fewer hours per worker per week, which meant a 13.6 percent reduction in total wage compensation for a minimum wage worker. In many cases, the decline in hours also led to a loss in eligibility for other benefits. The study found that a $1 increase in the minimum wage resulted in the percentage of workers working more than 20 hours per week (the cutoff for retirement benefits) decreasing by 23 percent, while the percentage of workers with more than 30 hours per week (the eligibility threshold for health care benefits) decreased by 14.9 percent.

Given the uncertainty surrounding the post-COVID-19 recovery, California should reevaluate and possibly postpone any scheduled increases in the minimum wage until the pandemic has passed and unemployment has returned to pre-pandemic levels.

Don't Overregulate E-Banking and Other Alternative Forms of Banking

Low-income Californians frequently lack easy access to banks and banking services. In fact, California has the most banking deserts of any state in the nation (see Figure 6.2). Some 62 urban areas statewide, and 48 rural areas, can be classified as banking deserts.[34] For example, in Los Angeles, nearly one in five neighborhoods lacks banks or credit unions.[35]

Without easy access to a traditional bank, low-income Californians are often forced to rely on alternative financial arrangements, such as check cashing services and short-term lenders. They also may keep large amounts of cash in their homes or on their persons, making them targets for both crime and police harassment. As Figure 6.2 shows, there is a direct overlap between areas of California with few traditional banking services and those with many payday lenders and other alternatives. For individuals with no bank account, these centers may be the only way that they can access banking services, such as cashing a paycheck, getting a money order, paying bills, purchasing or reloading a prepaid debit card, or wiring money out of state or overseas. The immediacy of payout is also important for low-income people who must contend with daily expenses and cannot wait for a check to clear through traditional banking.

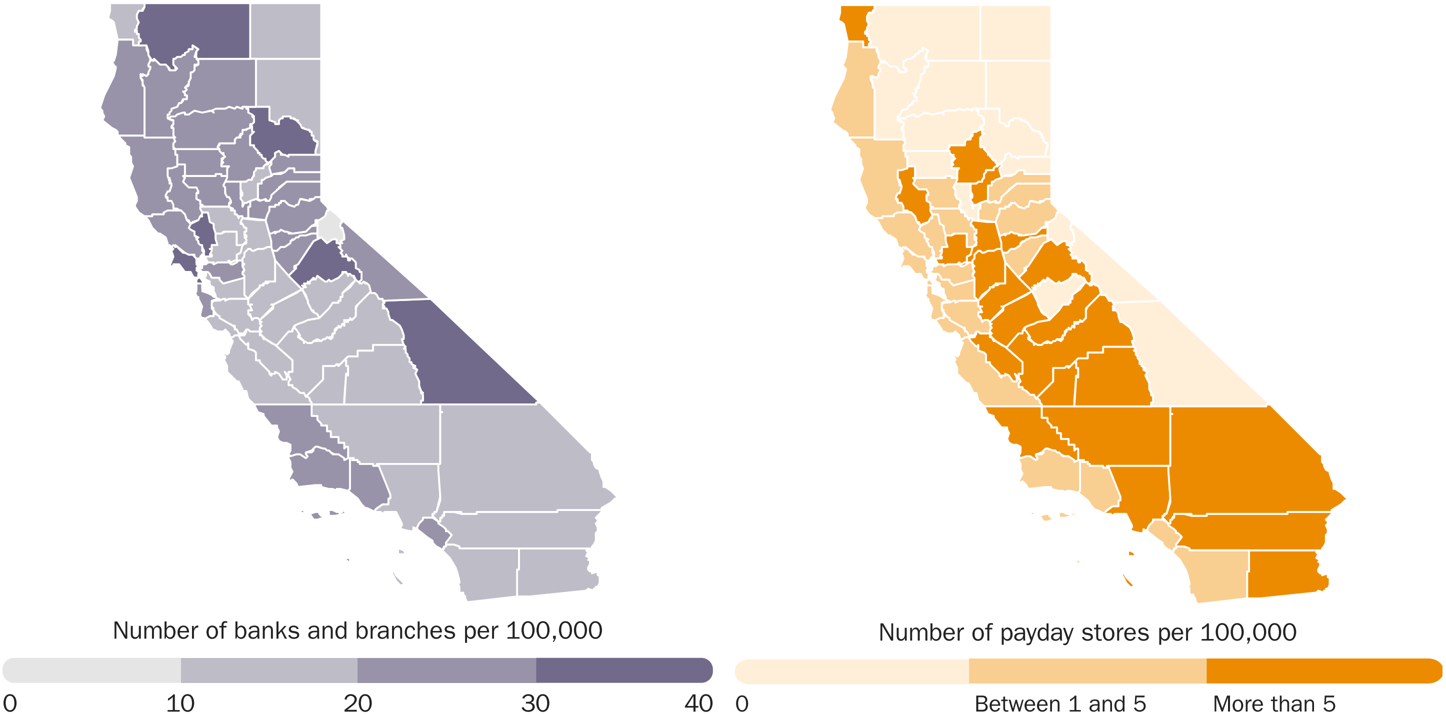
However, such convenience can come at a steep price. Fees for many alternative services are high and creeping upward. Generally, this reflects the risk being assumed by the centers operating in an environment with a high default rate. Attempts to regulate alternative banking and lending services by, for example, capping interest charges have generally proven counterproductive, forcing people who are poor to use even riskier, costlier, and less-regulated services. A far better approach is to expand access and competition within the alternative banking industry.

> "Given the uncertainty surrounding the post-COVID-19 recovery, California should reevaluate and possibly postpone any scheduled increases in the minimum wage until the pandemic has passed."

There are two paths to expanding bank access. The first is direct government provision. For example, in 2019, California Gov. Gavin Newsom legalized public banking, and Los Angeles became one of the first cities to consider opening a public bank. Arguments for a public bank include the ability to lend to severely low-income individuals and to create new jobs. However, while banks have every reason to base lending on whether people can pay their loans back, state-run banking services have far less incentive to do so. The 2008 banking crisis is a prime example of what happens when those incentives are undercut. Political pressures are bound to push government-run banks to adopt unsound lending measures and other poor business practices.[36] A previous government-banking experiment, the Los Angeles Community Development Bank, failed in 2004 because it gave out too many loans that were not paid back. Despite it now being legal, California legislators should not be tempted to open public banks.

Figure 6.2

Concentration of California banks and payday stores by county



Source: James R. Barth, Priscilla Hamilton, and Donald Markwardt, *Where Banks Are Few, Payday Lenders Thrive: What Can Be Done about Costly Loans* (Santa Monica, CA: Milken Institute, 2013).

Fortunately, there is another approach. Several companies have begun using computers and other technology to make financial services available in low-income areas either through existing physical structures or to forgo a brick-and-mortar presence altogether, operating entirely online. Because they do not operate traditional bank branches and, therefore, do not have the overheads of traditional banks, these "fintechs" are able to offer low-cost, easily accessible alternatives to traditional banks. Low-income Californians, especially younger Californians, may not have easy access to a brick-and-mortar bank, but nearly all have cellphones and, therefore, access to e-banking. Among the companies seeking to enter the electronic banking market are Amazon, Facebook, and Walmart.[37]

Already, fintech has helped underbanked people with access to their COVID-19 stimulus checks. Fintech firms worked with the IRS to get unbanked people their money through MasterCard prepaid cards, which helped many people who would have otherwise had to wait weeks for the IRS to send them a check.[38]

In addition, many companies that have a significant California presence, but have not traditionally offered financial services, such as Kroger, Walmart, Walgreens, and CVS, have begun offering financial services.[39] Combined with e-banking, these expanded banking alternatives promise to give low-income Californians greater access to safe, affordable, and convenient banking.

While most banking regulation takes place at the federal level, California should be careful not to stifle these new and innovative alternative banking options. AB 1864, which became law in 2020, gives the state more power over its financial institutions, including fines of up to $1 million a day for various rule infractions. While regulations have not been finalized, most observers believe this legislation could lead to far greater oversight and regulation of alternative financial institutions. California legislators should be wary of how this new power is exercised.

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