December 23, 2015

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed a statutory initiative that proposes changes to California's sick leave requirements and increases in California's statewide minimum wage above those scheduled in current law (A.G. File No. 15-0105, Amendment #1).

Background

California's Low-Wage Workers. Based on household surveys, we estimate that roughly one-quarter of California workers—currently around 4 million people—make less than $13 per hour. About half of these workers are more than 30 years old. Occupations with large numbers of low-wage workers include food preparation and service, building and grounds cleaning and maintenance, and retail sales.

Labor Market Conditions Vary by Region. Labor market conditions—such as wages and unemployment rates—vary considerably across California's regions.

Wages. Workers in inland California generally receive lower wages than workers in the state's coastal areas. For example, median wages in San Francisco and San Jose are more than 50 percent higher than median wages in Fresno and Bakersfield.

Unemployment Rates. In October 2015, California's statewide unemployment rate was a bit below six percent, but four counties—San Francisco, San Mateo, Santa Clara, and Marin—had unemployment rates below four percent. In contrast, seven counties—all in the inland part of the state—had unemployment rates above nine percent.

Joint Funding of Health and Social Services Programs. Federal, state, and county governments jointly provide various health and social services to Californians. These programs include Medi-Cal, California Work Opportunity and Responsibility to Kids (CalWORKs), and many others. An individual's or family's eligibility to receive these services can depend on many factors, primarily income. In many cases, those factors also determine the way that costs are shared among federal, state, and county governments.

The In-Home Supportive Services Program (IHSS). The IHSS program provides personal care and chore services to certain individuals to help them remain safely in their own homes and communities. Recipients, who must be low-income and aged, blind, or disabled, are eligible to receive assistance with tasks such as bathing, dressing, housework, and meal preparation. In most cases, the recipient is responsible for hiring and supervising a paid IHSS provider—oftentimes a family member or relative. Wages of IHSS providers vary by county, with some counties paying the state-mandated minimum wage and some counties paying upward of $13 per hour. In 2015-16, it is estimated that 470,000 individuals will receive IHSS and about 430,000 individuals will work as IHSS providers. The total cost to the state for the IHSS program is estimated to be about $2.8 billion (along with roughly $1 billion in county funds and $4.4 billion in federal funds) in 2015-16.

California's Paid Sick Leave

Paid sick leave is a benefit that provides pay for employees during health-related work absences. Since July 2015, state law has required that most employees receive at least three days of paid sick leave per year. IHSS providers and some other types of employees are not subject to this requirement. The cities of San Francisco, Oakland, and Emeryville have established sick leave requirements that exceed the state's.

California's Minimum Wage

Minimum Wages Established Under Federal, State, and Local Laws. Minimum wage laws establish minimum hourly rates of pay for employees within a specified jurisdiction. Although federal law establishes a minimum wage of $7.25 per hour, many state governments and some local governments have established higher minimum wages. California's statewide minimum wage currently is set at $9 per hour, making it one of seven states with minimum wages at or above $9 per hour. (Washington has the highest statewide minimum wage at $9.47 per hour.) Most employees are subject to the statewide minimum wage, with limited exceptions. Self-employed individuals, including workers classified as independent contractors, are generally exempt from state and national minimum wage laws.

Some local governments in California have established minimum wages that are higher than the current statewide minimum wage. For example, the cities of San Francisco, Oakland, and Emeryville all have minimum wages higher than $12 per hour. Los Angeles—California's largest city—recently passed a law to raise that city's minimum wage to $15 per hour by 2020.

Statewide Minimum Wage Scheduled to Increase. Under a law passed in 2013, California's statewide minimum wage is scheduled to increase to $10 per hour on January 1, 2016. No further statewide increases are scheduled under current law.

Past Increases to California Statewide Minimum Wage. The prices of goods and services tend to rise over time. These rising prices are called "inflation." The federal government measures the rate of inflation using indices that estimate price changes over time. One such index used to measure inflation in California is the California Consumer Price Index (CA CPI). The CA CPI reflects the changes in prices of goods and services in the Los Angeles and San Francisco metropolitan regions over time.

California established a statewide minimum wage in 1916. Since that time, the state periodically has raised the minimum wage. Although the state's minimum wage has never declined, it has often grown more slowly than inflation. Unlike California, current laws in 15 states and the District of Columbia establish minimum wages that automatically increase proportionally to rising prices for goods and services.

PROPOSAL

Minimum Wage

Annual Increases Through 2021. The measure increases California's statewide minimum wage on July 1st every year for five years (from July 2017 to July 2021). The measure applies different minimum wages to employers of different sizes. By July 1, 2021, however, all employers, regardless of size, would be required to pay a minimum wage of $15 per hour.

Annual Inflation-Driven Increases Starting in 2022. The measure provides annual increases in California's minimum wage each July beginning in 2022. These annual increases would be based on inflation reported in the CA CPI for urban wage earners and clerical workers in the prior year. Accordingly, the percentage increase in July 2022 would be equal to the estimated percentage increase in prices for goods and services in the Los Angeles and San Francisco metropolitan regions between 2020 and 2021. The measure specifies that no adjustment would be made to the statewide minimum wage if prices decreased in the prior year.

Paid Sick Leave

The measure increases the amount of annual paid sick leave required by the state from three days to six days. It also adds IHSS providers to the set of employees entitled to paid sick leave.

ECONOMIC EFFECTS

The nature and magnitude of this measure's economic effects are highly uncertain. These effects would depend on how households and businesses respond to the higher minimum wage and minimum sick leave. A large body of research has studied some economic effects—such as changes in employment in some industries or for some age groups—of the minimum wage increases of the last few decades. However, those minimum wage increases were different from this measure in two important ways: (1) they affected a much smaller share of the workforce, and (2) most of them were not indexed to inflation.

Except where otherwise noted, the estimated economic effects of this measure—and the resulting fiscal effects described in the next section—primarily relate to the ongoing annual effects of the $15 per hour minimum wage and six days of sick leave proposed for 2021, relative to the $10 per hour and three days of sick leave established under current law.

Responses by Low-Wage Workers

Under the measure, the statewide minimum wage in 2021 would be $5 per hour higher than provided by current law. As a result, this measure would raise income for many workers who otherwise would have earned less than $15 per hour. (The net effects on workers' incomes would depend on the responses by businesses described below.) The higher minimum wage likely would (1) encourage more people to enter the labor force, (2) affect workers' decisions to change jobs, and (3) allow workers to spend more money.

Responses by Businesses

Businesses that employ low-wage workers would face higher labor costs as a result of this measure. These businesses would respond to higher costs in several ways, including raising prices or producing goods and services with fewer low-wage workers. Profits would likely decline for some of these businesses.

Substitution Away From Low-Wage Workers. Businesses use a variety of resources to produce goods and services. These resources include low-wage labor, higher-wage labor, machines, and buildings. This measure would increase the cost of employing low-wage labor compared to other resources. As a result, businesses would have an incentive to employ fewer low-wage workers. Job opportunities for these workers would likely diminish. As they face higher costs for low-wage workers, businesses likely would rely more heavily on other types of resources. For example, businesses could use machines to automate some tasks that otherwise would be performed by low-wage workers.

Changes likely would occur at multiple levels of the economy. Individual businesses or entire industries could contract, expand, or adopt different business practices as they adjust to the shifts in relative costs. For example, a restaurant that relies heavily on low-wage workers could go out of business and be replaced by a different restaurant that relies less heavily on such workers.

Price Increases. In some cases, businesses that face higher labor costs would pass those costs on to their customers by raising prices. (This is particularly true for businesses with competitors located principally in California.) These price increases would have two distinct effects:

- ***Relative Prices Would Change.*** The prices of some goods and services would increase compared to other prices. Consumers would respond by buying fewer of the relatively expensive goods and more of the relatively cheap goods.
- ***Cost of Living Would Increase.*** The overall cost of living would increase, reducing the total amount of goods and services that consumers could purchase. Accordingly, while consumers would be putting more money in the economy each year, each dollar would buy fewer goods and services.

Overall, the price increases resulting from the measure likely would lead to a cumulative increase in the level of the CA CPI ranging from a few tenths of a percent to roughly 1 percent. As described below, we expect the measure's effects to be greatest in the inland regions of the state—areas generally not included in the CA CPI. As a result, we expect the average price increases faced by California consumers to be somewhat higher than the price increases measured by the CA CPI. Although the timing of these price increases is uncertain, they likely would lead to modest increases in the annual inflation rate over a period of several years.

Likely Reduction in Profits. The increased labor costs resulting from this measure likely would reduce some businesses' profits, particularly those that rely heavily on low-wage workers. At the same time, businesses that employ relatively fewer low-wage workers than their competitors could become more profitable. This is because they would have a cost advantage that would allow them to increase sales. On net, we would expect income for business owners to decline to some extent.

Economic Effects of Sick Leave

The increase in required sick leave from three days to six days per year could have a variety of economic effects, all likely much smaller than the economic effects of the higher minimum wage. For example, to the extent that the additional sick leave would be costly for employers and valued by workers, it could result in slight wage reductions for workers who make more than the minimum wage. The sick leave requirement also could reduce transmission of contagious diseases.

Economic Effects Depend on Many Factors

Likely Reduction in Aggregate Employment. This measure likely would reduce the number of jobs in the California economy. The magnitude of this effect is highly uncertain. The net effect on employment could be close to neutral, or it could be as large as several percent of total statewide employment. (As of today, 1 percent of statewide employment is roughly 160,000 jobs.) Even if the measure's net effect on employment were relatively small, it could have substantial effects on the relative labor market opportunities available to different groups of workers.

Effects Depend on Wage Growth . . . Future trends in wage growth will determine the number of workers affected by this measure. If, absent this measure, wages would have grown slowly, then this measure will apply to more workers, and its economic effects will be larger and more widespread. If, on the other hand, wages would have grown quickly, then this measure will apply to fewer workers, and its economic effects will be smaller, though still significant.

. . . And Business Cycles. The short-term effects of each annual minimum wage increase could vary depending on whether California is experiencing a recession or an economic boom. A recession could make it more difficult for businesses and consumers to absorb the costs of a minimum wage increase, potentially exacerbating any state and local revenue reductions and spending increases resulting from this measure. On the other hand, additional spending by low-wage workers could help in an economic slump.

Effects Would Vary Across Regions. Because labor market conditions vary across California's regions, the measure would have different effects in different parts of the state. The lower a region's wages, the larger the effects of this measure likely would be. As noted earlier, some California cities have raised their minimum wages above the statewide level. In cities with the highest minimum wages, this measure could affect few workers, so the effects in those cities may be small. In the end, we expect this measure to have proportionally larger effects in California's inland regions than in its coastal regions.

Costs Outside of California. Some portion of the profit reductions described above likely would be borne by business owners—including investors in stocks—who reside in other states or abroad. To the extent that this type of "cost exporting" occurs, it could slightly reduce the measure's fiscal effects on California's state and local governments.

Payments to and From the Federal Government. This measure would affect a variety of payments between California and the federal government. For example, it would change many Californians' federal tax payments, as well as federal funding for various health and social services programs. To the extent that a net change in the total amount of these payments would result, it would affect economic growth in California.

FISCAL EFFECTS

The measure's net effects on government revenues and expenditures are highly uncertain. In many cases, the uncertainty in these effects parallels the uncertainty in the economic effects discussed in the prior section. As noted above, the state and local government fiscal effects described in this section primarily relate to the ongoing annual effects of the $15 per hour minimum wage proposed for 2021. In other words, we focus here on the fiscal effects of the fully implemented minimum wage increase, not the smaller wage increases that would occur initially.

Effects on State and Local Revenues

The proposal would affect many state and local revenue sources—most notably the state's income taxes and sales taxes of both state and local governments. We discuss the likely effects on these two revenue sources below.

Change in State Income Tax Revenue. The state collects income taxes from individuals and businesses under the personal income tax—the state government's largest revenue source—and corporation tax. On net, the measure could increase or decrease state revenue from income taxes. The annual revenue changes could range from a loss of several hundred million dollars to a gain of a couple of hundred million dollars. These changes would be the net result of three main economic effects:

- ***Higher Income for Workers.*** With more income, many low-wage households would pay higher income taxes to the state. In addition, fewer households would be eligible for the state's recently enacted earned income tax credit, reducing the amount of money refunded to taxpayers.
- ***Lower Income for Businesses.*** Although the total income lost by businesses likely would be smaller than the total income gained by low-wage workers, business owners tend to have much higher incomes. Higher-income households pay higher marginal personal income tax rates, so each dollar of income lost by such business owners would have a larger effect on income tax revenue than each dollar of income gained by low-wage workers. Lower corporate profits also would likely somewhat reduce revenue from the corporation tax.
- ***Higher Prices.*** Each year, the state adjusts its income tax brackets to reflect changes in the CA CPI such that higher consumer prices lead to lower income tax revenue. Accordingly, the likely price increases resulting from this measure would reduce state revenue from the personal income tax.

Likely Increase in State and Local Sales Tax Revenue. State and local government sales tax revenues depend on the level of taxable sales, which is the total dollar value of all taxable goods sold in California. The measure's net effect on sales tax revenue is uncertain and would depend on the extent to which the measure results in:

- ***Changes in Income.*** These changes in income would result from (1) higher incomes for many low-wage workers, (2) employment reductions, and (3) lower business incomes.
- ***Higher Prices.*** As described above, the measure likely would increase prices for a broad range of goods and services. It would also likely increase prices of taxable goods relative to other goods and services. The effect of these changes on taxable sales would depend on the magnitudes of the price increases and on the strength of consumer responses.

The likely change in annual sales tax revenue would range from a loss of a couple of hundred million dollars to a gain of more than $1 billion. A revenue loss could occur if consumers respond strongly to price increases, spending a smaller share of their income on taxable goods. A revenue gain could occur if consumers respond weakly to price increases, spending a larger share of their income on taxable goods. The largest revenue gains or losses could occur if price increases were relatively large. Smaller price increases would lead to revenue changes closer to the middle of the range. The measure's effects on sales tax revenue would also depend on the number of low-wage jobs that are lost in the state's economy, as the magnitude of that job loss would affect overall spending.

In the short run, the measure's effects on sales tax revenue could be different from those described above. In particular, the measure could generate some temporary spikes in sales tax revenue from the purchase of "big-ticket items"—infrequent, major purchases of durable goods, like cars or household appliances. Many households borrow money to purchase these types of goods. Low-wage workers could respond to higher wages by making debt-financed purchases, temporarily boosting sales tax revenue.

Overall Net Change in State and Local Revenues Uncertain. Our best estimate is that this proposal would lead to a net change in combined state and local revenues ranging from a loss of hundreds of millions of dollars to a gain of over $1 billion.

Effects on IHSS Program

This measure would have fiscal implications for the state's IHSS program. We estimate that increasing the minimum wage and providing paid sick leave for IHSS providers would increase state costs for the IHSS program by about $1 billion to $2 billion annually. Below, we discuss the main components of these increased costs.

Raising Providers' Wages to $15 Costs Over a Billion Dollars Annually. We estimate that the proposal to increase the minimum wage would likely increase the state costs for payments to IHSS providers by $1 billion to $1.5 billion annually by 2020-21.

Service Costs of Paid Sick Leave for IHSS Providers Uncertain, but Likely in the Low Hundreds of Millions Annually. Although the cost of compensating IHSS providers for sick leave would largely depend on how the policy is implemented and the rate at which providers utilize their accrued sick leave, we estimate that the state cost of providing paid sick leave for IHSS providers could range from $100 million to $200 million annually. Since the measure stipulates that any hours an IHSS provider takes in paid sick leave is not deducted from a recipient's authorized service hours, our estimate assumes a "back-up provider" is found to deliver services to a recipient while the regular provider is sick. For purposes of this analysis, we assume that all costs associated with paid sick leave would be eligible for federal financial participation. To the extent federal funding is not available to compensate providers for sick time, the state costs associated with providing paid sick leave under this measure would be roughly double what we estimate.

Administrative Costs of Paid Sick Leave for IHSS Providers Uncertain, but Likely in the Tens of Millions Annually. Implementing paid sick leave for IHSS providers would likely require the state to establish at least two new administrative processes that could result in additional state costs: (1) the establishment of a system to secure and utilize a network of back-up providers, and (2) a method for tracking and reporting the paid sick leave that IHSS providers accrue and use. The administrative costs of these activities are unknown, but could be in the tens of millions of dollars annually.

Other Effects on State and Local Government Spending

State Revenue Changes Would Affect Formula-Driven Elements of State Budget. Two major provisions in the State Constitution contain formulas that incorporate state revenues. These formulas determine state budget allocations in two areas. Proposition 98 requires that a minimum level of funding be provided each year to the state's public schools and community college districts. Proposition 2 requires that a minimum level of money be set aside for budget reserves and debt payments. In general, increased state revenues result in more money being dedicated for these purposes. Conversely, if this measure resulted in lower state tax revenues, it could reduce the required amounts of funding for schools, reserves, and debt payments.

Increased Public Employee Costs. California's state and local governments employ workers who would be affected by this measure, increasing state and local government employee compensation costs. Costs would start to increase in 2017-18 and would continue to increase each year thereafter. By 2021-22, the state could face increased annual costs of hundreds of millions of dollars, while local governments could face increased annual costs in the low billions of dollars. The magnitude of these cost increases depends on several factors, including wage growth trends and pressure to increase wages for higher-paid workers.

Likely Savings From Lower Enrollment in Health and Social Services Programs. This measure would likely affect state and county expenditures on health and social services programs—notably Medi-Cal and CalWORKs—due to its effects on families' incomes. These income changes would affect the number of people receiving services; the value of the services they receive; and the way costs are shared among federal, state, and county governments. On net, these effects likely would reduce overall state and county government expenditures on these programs. These savings could range from the low hundreds of millions of dollars to over $1 billion annually.

Other Program-Specific Costs. This proposal could affect state and local government costs for many other public programs, particularly those that pay certain service providers. These programs include:

- ***Developmental Services.*** The state's Department of Developmental Services provides services to California residents with developmental disabilities. The proposal likely would increase the state's payments to community-based service providers by an amount ranging from hundreds of millions of dollars to over $1 billion annually by 2021-22.
- ***Long-Term Care Providers.*** The proposal would likely increase the state's annual costs for certain long-term care providers by roughly $100 million by 2021-22. The state pays for these providers through the Medi-Cal program.
- ***Child Care.*** The state subsidizes child care services for some low-income working families by issuing vouchers and by contracting directly with child care providers. To the extent that higher incomes resulting from the measure cause families to become ineligible for care, state costs could decrease. A higher minimum wage could also cause child care providers to charge higher rates to cover increased costs. State costs would increase if the state chose to raise voucher amounts or reimbursement rates.
- ***Unemployment Insurance (UI) Program.*** The UI program provides payments to certain workers who lose their jobs. State payments to support the UI program could rise in some scenarios.

- ***Contracts.*** Many governments contract with private businesses to provide certain services, such as janitorial services. This measure likely would lead some of these businesses to increase their prices, leading to higher government costs. The total magnitude of these costs is uncertain.

Summary of Fiscal Effects

This measure would have the following major fiscal effects on state and local governments:

- Change in annual state and local tax revenues potentially ranging from a loss of hundreds of millions of dollars to a gain of over $1 billion. Changes in state revenues would affect required state budget reserves, debt payments, and funding for schools and community colleges.
- Net increase in state and local government spending totaling billions of dollars per year. Cost increases, primarily for government employees and home care providers, would be offset in part by savings from lower enrollment in health and social services programs.

Sincerely,

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Mac Taylor
Legislative Analyst

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Michael Cohen
Director of Finance