



ENTREPRENEURSHIP AND HOME BUSINESSES

BY CHRIS EDWARDS

THE ISSUE: STATE AND LOCAL RULES CAN DISCOURAGE HOME-BASED BUSINESSES, WHICH ARE A PIPELINE FOR AMERICAN ENTREPRENEURSHIP

The pandemic has created lasting changes to the economy. More people are working from home, video calls are replacing business travel, and workers are switching jobs to find a better work-life balance. Another development is that home-based entrepreneurship is booming. The pandemic alerted people to the advantages of running a business from their homes, and new internet platforms are making it more feasible than ever. The number of arts and crafts businesses selling on Etsy.com, for example, jumped from 2.6 million in 2019 to 7.5 million in 2021 (see Figure 1).¹

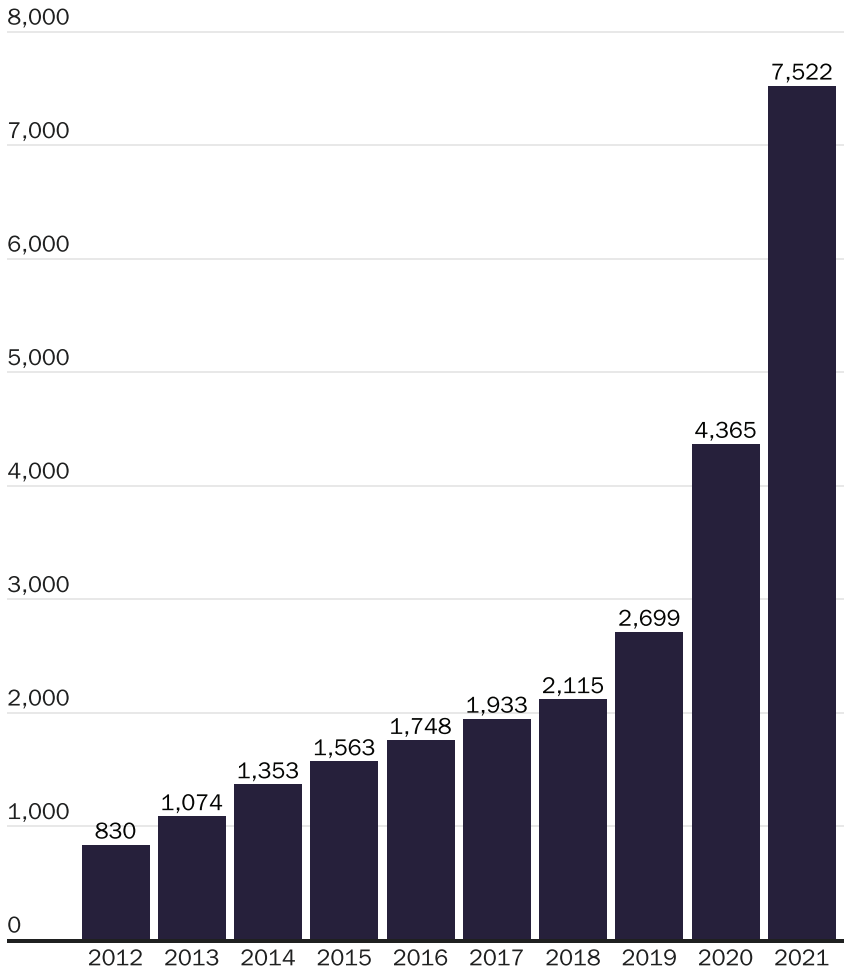
Overall, the Small Business Administration (SBA) estimates that about half of America's 30 million or so businesses are home-based.² These include accountants, daycare providers, repair persons, musicians, tutors, food producers, yoga teachers, contractors, caterers, wedding planners, dog groomers, haircutters, massage therapists, lawn-care specialists, software writers, and bloggers. Many great companies were launched from homes and garages, including Amazon, Apple, and Hewlett-Packard.

As the pandemic gripped the nation, the share of Americans working from home almost doubled in 2020 to 42 percent.³ Since then, what started as a necessity has turned into a strong preference for many Americans who prefer to live and work at home. Indeed, home-based businesses provide many economic and lifestyle advantages over traditional work. They can provide a primary household income, supplemental income, or backup source of income while allowing people to care for children or elderly parents or to avoid the cost and hassle of a daily commute. According to a 2022 Institute for Justice (IJ) survey of 1,902 home-based entrepreneurs, over half of home-based entrepreneurs are women—a larger share than among all U.S. small businesses—and 31 percent of respondents listed having a disability as one reason for starting their business at home.⁴ Other than earning income, the top reasons individuals surveyed said they launched their home business were: to be their own boss, to have a more flexible schedule, to work at something enjoyable, and to have a better work-life balance.

Home businesses also have benefits for local communities. They reduce automobile pollution and congestion. Neighborhood customers of home businesses, such as daycares and tutoring services, gain from the convenience. Home businesses can also “bring goods and services into areas whose needs are not being met because they are far from commercial centers.”⁵

Finally, home-based businesses are critical for entrepreneurship and innovation. Without locating at home, some businesses would not be viable if entrepreneurs had to foot the costs of commercial rent, commuting, and perhaps childcare. This

FIGURE 1 The number of active Etsy sellers has soared in recent years



Source: Marina Pasquali, "Etsy: Number of Active Sellers 2012–2021," Statista.com.

dynamic is evident in the booming cottage food industry (home food production for retail sale),⁶ which—as the *New York Times* recently examined—has benefited from new internet food platforms:

Several days a week, Juliet Achan moves around the kitchen of her apartment in Greenpoint, Brooklyn, stirring up dishes from her Surinamese background: fragrant batches of goat curry, root vegetable soup and her own take on chicken chow mein. She packages the meals, and they are picked up for

delivery to customers who order through an app called WoodSpoon. “Joining WoodSpoon has made a huge difference during the pandemic, giving me the flexibility to work safely from home and supplement my income,” Ms. Achan said.⁷

Homes have also been important for the American craft beer industry, which exploded after home brewing was federally legalized in 1978 and state beer distribution laws were relaxed starting in the 1980s. The number of breweries in America has grown from less than 100 in 1980 to more than 8,300 today.⁸ Craft brewing is a \$22 billion industry today that grew out of a previously illegal home-based activity.⁹

There is no better place for low-cost product experimentation than an entrepreneur’s home. Homes are low-cost incubators to test business ideas before larger investments are made. Startups are risky and have high failure rates, so entrepreneurs need early, low-cost feedback from consumers. Food entrepreneurs, for example, want to test recipes with consumers but may not be able to initially afford commercial kitchen space. Home production can give entrepreneurs the confidence, skills, and capital they need to later open a brick-and-mortar location.

Despite home businesses’ many benefits, they often face significant legal barriers. First, local governments impose zoning rules that can ban, restrict, or raise costs for home businesses in residential neighborhoods. Such restrictions accumulated during the 20th century, but changes in culture and technology should prompt state and local policymakers to rethink yesterday’s restrictive rules.

Early in the nation’s history, most Americans worked from their homes (not only as farmers but also as doctors, lawyers, blacksmiths, retailers, and so on), but this changed with the rise of large-scale industry in the 19th century. Twentieth-century governments then solidified the separation with single-use, or “Euclidean,” zoning, which split cities into residential, commercial, and industrial zones.¹⁰ The purpose of such zoning was to “address the possibility that nonresidential uses will inflict negative externalities on residential neighborhoods.”¹¹ Businesses were assumed to impose noise, congestion, and other problems that conflict with residential lifestyles.

However, 20th-century zoning was usually based not on analyses of actual externalities but on blunt rules based on tradition, guesswork, and elitist views.¹² Initially, cities allowed only certain occupations to be performed in homes, or they specified lists of occupations not allowed. As the century progressed, cities added layers of rules, permits, licenses, hearings, and other bureaucratic hurdles to home businesses.

Most cities retain elements of these regulatory regimes today. In a 2004 report on home businesses, the SBA found that “many zoning codes incorporate outright prohibitions, prescriptive requirements, or limits on various aspects of home-based businesses (e.g., number of employees, visitors, parking, exterior changes,

or specific industries).¹³ Other common restrictions regard signage, renovations, outdoor activities, materials storage, deliveries, noise, odors, animals, square footage, types of occupations, number of visitors, truck parking, and retail sales on premises.¹⁴

Recent studies have found substantial variations among cities' regulation of home businesses, with many localities still imposing restrictions that appear excessively strict.¹⁵ While some cities allow home businesses "by right," some require conditional-use permits for many types of businesses. Such permits may involve substantial paperwork, a public notice and comment period, and public hearings. After these processes, officials can still deny requests at their discretion. Such rules are sure to discourage home businesses in these cities (and, by extension, small business formation).

Second, there are industry-specific barriers to some types of home businesses. With cottage food, for example, state and local rules often specify which products can be sold, where they can be sold, and the sales volume allowed. Wyoming allows home businesses to sell just about any type of food that complies with federal laws within an annual sales limit of \$250,000.¹⁶ Rhode Island, on the other hand, only allows farmers to sell food made in their homes, and even these farmer sales are restricted in various ways.¹⁷

Other regulations prevent business owners from serving clients at their homes. In Nashville, for example, IJ represented Lij Shaw, a music producer who records musicians at his home studio, and Pat Raynor, a hair stylist who serves her clients in a single-chair salon in her house.¹⁸ The two entrepreneurs wanted to work from home for cost and lifestyle reasons—Lij was raising his daughter, and Pat was short on money after her husband's death—but a Nashville zoning ordinance prohibited home businesses from serving clients on their property. Shaw and Raynor have a limited number of customers, and there was no evidence that their activities affected their neighbors, yet the city ordered them to end their home business activities. With IJ's help, the entrepreneurs fought back in court and in the press. In the midst of the pandemic, Nashville relented and in July 2020 temporarily relaxed its ban on home businesses that serve customers. However, that reprieve is scheduled to expire in 2023.

THE POLICY SOLUTIONS: LIBERALIZE ZONING AND OTHER STATE AND LOCAL REGULATIONS RESTRICTING HOME BUSINESSES

Several policy reforms would encourage the proliferation of home businesses to the benefit of many American workers and consumers. First, local zoning rules should be liberalized. Public policy should respect individual rights, and private property is a core right. People own their homes and should be able to use them as they see fit. As such, governments' default position should be allowing home-based businesses. On the other hand, one's right to use and enjoy their home is limited by the rights of others within neighborhoods, and local governments can consider negative externalities created by home businesses, such as traffic and noise. But the traditional planning goal in many cities to allow zero, or near zero, externalities from home businesses is clearly inapt, especially when the tolerance level for externalities from nonbusiness activities in residential areas is not zero.

Some common zoning restrictions on home businesses, moreover, have little to do with externalities at all—for example, limits on the business use of space within one's home. Furthermore, any negative externalities from home businesses need to be balanced against the positive benefits to neighborhoods. Most people think that entrepreneurs offering daycares, music lessons, tutoring, and handyman services in their neighborhoods are providing benefits, not creating a nuisance. Indeed, many neighborhoods have social media pages advertising services provided by locals. Municipal governments also should consider that restrictive zoning rules will push entrepreneurs' skills and income elsewhere and that home businesses often sprout into local brick-and-mortar businesses.

Policymakers in many states and cities have started to reconsider zoning rules because of today's changing society. IJ reports, for example, that since 2015, 30 states have either created new cottage food laws or significantly liberalized existing laws.¹⁹ Home daycares are another area of substantial zoning reforms. In the past, many governments considered home daycares a "problem use" and barred them. With today's high demands for childcare by dual-working couples and pressure to increase daycare supply, at least 18 states have passed laws to preempt excessively tight local zoning restrictions on home daycares.²⁰

Generally, local governments should reform their zoning laws to allow home-based businesses to operate by right, rather than requiring conditional-use permits. They should liberalize rules for parking and serving clients from homes. They should repeal rules limiting the amount of space allowed for business use within homes and other restrictions unrelated to externalities. General local ordinances related to parking, noise, and other nuisance issues should apply equally to homes used for businesses and all other homes.

Second, policymakers should loosen regulations surrounding certain industries that benefit from home-based businesses. As the legalization of home brewing demonstrates, deregulation breeds entrepreneurship and economic development, and feared downsides usually don't materialize. When regulations are too restrictive, moreover, home businesses may go underground. Before Atlanta's deregulation of cottage food in 2012, for example, producers "were prohibited, under most circumstances, from selling any type of food that was not prepared in a commercial-grade kitchen used solely for commercial purposes." As a result, there were "a lot of home cooks selling baked goods under the table, without licensing or food safety training."²¹

Since the rules on home businesses vary widely across jurisdictions, places with restrictive rules should consider industry-specific reforms along the lines of less-regulated cities and states. With cottage food laws, for example, Rhode Island actually shuts down moms for selling home-baked cookies.²² Yet we know that selling baked goods from home is a safe and beneficial activity because nearly all other states allow it. More broadly, state and local policymakers should study the experience of the five states—Montana, North Dakota, Oklahoma, Utah, and Wyoming—that have enacted "food freedom" laws allowing wide latitude to cottage food businesses.²³ Cities and states should also ensure that their daycare regulations permit home-based options.

Third, state governments should consider acting to preempt overly restrictive local rules and to provide a sort of "freedom baseline" for home businesses, as several states have done recently. Florida, for example, enacted legislation in 2021 requiring local governments to allow home business activities within reasonable limits.²⁴ Home businesses are subject to general zoning rules on parking, signage, storage of hazardous materials, and other typical items. But the Florida law blocks localities from implementing outright bans and punitive treatment of home businesses.

ACTION PLAN

Americans want to earn income from home—to test business ideas and to benefit their communities—and many others want to buy from them. A general rule of markets is that voluntary exchanges such as these are mutually beneficial and provide substantial gains for society as a whole. The American economy has shifted toward service industries and the internet; many Americans want jobs that are flexible; and many families need to juggle childcare and eldercare needs. Rather than creating barriers to home businesses, governments should work to facilitate them with rules that balance property rights with reasonable limits on externalities in residential neighborhoods.

State governments therefore should

- establish basic freedom guidelines for home businesses aimed at preventing unreasonable bans and restrictions at the local level;
- liberalize rules for cottage food businesses along the lines of Wyoming and other “food freedom” states; and
- preempt excessively tight local zoning restrictions on home daycare businesses.

Local governments should

- generally allow home-based businesses to operate by right rather than requiring conditional-use permits;
- recognize that home businesses form a crucial part of local economies and that some grow into brick-and-mortar businesses;
- adopt or revise zoning codes to treat activities related to home businesses, such as parking, equally as compared with similar nonbusiness activities; and
- repeal special, industry-specific restrictions on home businesses unrelated to actual neighborhood externalities.

NOTES

1. David Curry, "Etsy Revenue and Usage Statistics," Business of Apps, May 4, 2022.
2. "Frequently Asked Questions," U.S. Small Business Administration, Office of Advocacy, September 24, 2019.
3. "American Time Use Survey Summary," Economic News Release, U.S. Bureau of Labor Statistics, July 22, 2021.
4. Jennifer McDonald, "Entrepreneur from Home," Institute for Justice, January 2022.
5. Henry B. R. Beale, "Home-Based Business and Government Regulation," U.S. Small Business Administration, Office of Advocacy, February 2004.
6. For background, see Jennifer McDonald, "Flour Power," Institute for Justice, September 2018.
7. Julie Creswell, "The Home Cooks (and Start-Ups) Betting on Prepared Meals," *New York Times*, April 10, 2022.
8. Aaron Staples, Dustin Chambers, and Trey Malone, "How Many Regulations Does It Take to Get a Beer? The Economic Geography of Beer Regulations," Center for Growth and Opportunity at Utah State University Working Paper no. 2020.017, September 16, 2020.
9. "Stats and Data: National Beer Sales and Production Data," Brewers Association.
10. The name stems from the 1926 U.S. Supreme Court case *Village of Euclid v. Ambler Realty Co.*, under which the Court established that cities could separate land uses in zoning codes under their general police powers.
11. Anika Singh Lemar, "The Role of States in Liberalizing Land Use Regulations," *North Carolina Law Review* 97, no. 2 (January 2019): 293–354.
12. Olivia Gonzalez and Nolan Gray, "Zoning for Opportunity: A Survey of Home-Based-Business Regulations," Center for Growth and Opportunity at Utah State University Policy Paper no. 2020.006, March 2020; and Nolan Gray and Olivia Gonzalez, "Home-Based Businesses Are Coming. As COVID-19 Accelerates Remote Working, Are Cities Prepared?," *City Journal*, March 31, 2020.
13. Beale, "Home-Based Business and Government Regulation."
14. Patricia Salkin, "Modernizing Zoning for Home Occupations," *Zoning Practice* 9 (September 2006); and Robin Wheeler, "Zoning for Home-Based Businesses in New York," *New York Zoning Law and Practice Report* 10, no. 3 (November/December 2009).
15. M. Nolan Gray and Olivia Gonzalez, "Making Room for Home-Based Businesses: A Survey of 12 Zoning Ordinances," February 2017; and Jennifer McDonald, "Entrepreneur from Home," Institute for Justice, January 2022.
16. "Selling Homemade Food in Wyoming," Institute for Justice.
17. "Selling Homemade Food in Rhode Island," Institute for Justice.
18. McDonald, "Entrepreneur from Home."
19. "Recent State Reforms for Homemade Food Businesses," Institute for Justice.
20. Lemar, "The Role of States in Liberalizing Land Use Regulations."
21. Deborah Geering, "New Rules Boost Home-Based Food Businesses," *Atlanta*, October 24, 2012.
22. Anita Baffoni, "There Has to Be a Way": Portsmouth Entrepreneur Urges State to Allow the Sale of Homemade Food," WPRI.com, March 11, 2021.
23. "Recent State Reforms for Homemade Food Businesses," Institute for Justice.
24. "CS/HB 403—Home-based Businesses," Florida Senate, 2021.

