

MICHAEL D. TANNER

An aerial view of the San Francisco skyline at sunset. The sky is a mix of orange, yellow, and purple. The Transamerica Pyramid is the central focus, with the Transamerica Tower to its right and the Transamerica Pyramid to its left. The city's dense urban landscape is visible in the foreground and middle ground.

Cato's Project on Poverty and Inequality in California

FINAL REPORT

MICHAEL D. TANNER

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Dear Californian,

For people outside your state, California conjures images of glitz and glamour: Silicon Valley, Hollywood, and Beverly Hills. Yet California has the highest poverty rate in the nation, and the chasm between the ultra-rich and the poverty-stricken continues to widen. How is it that a state with ongoing economic growth, pockets of vast wealth, and some of the nation's most extensive social welfare programs can be leaving so many of its residents behind? It was to answer this question that the Cato Institute launched the Project on Poverty and Inequality in California in spring 2019.

Less than a year after the project's launch, California was devastated by the COVID-19 pandemic. Already suffering poor and marginalized communities were hit hardest and were least prepared for the fallout. Rebuilding California's economy in the pandemic's wake must focus on those most in need. California's recovery must be a fully inclusive one.

Drawing on the Cato Institute's decades of research and expertise on issues critical to fighting poverty, we have examined ways in which California should reform its policies and programs to help lift people out of poverty and to enable them to fully participate in the state's economy.

In addition, we have tapped into the knowledge and experience of Californians on the frontlines of these issues. I have repeatedly visited all parts of the state for meetings, town halls, and roundtable discussions to solicit input and suggestions. I personally have met with more than 100 political leaders, community activists, businessmen and -women, and ordinary citizens. These consultations cut across

partisan, ideological, and demographic lines and were invaluable in helping to formulate our recommendations.

As a result of our research, we have concluded that too many of California's laws, policies, and regulations are regressive, trapping people in poverty and making it harder for them to climb the economic ladder. These policies involve criminal justice, education, housing, the existing welfare system, and regressive regulations.

If the goal of public policy is to enable every Californian to flourish and rise as far as their talents will take them, it is not nearly enough to simply provide social welfare benefits to those in need. Rather, California must remove those policy barriers to economic participation and individual achievement that push people into poverty.

Accordingly, this report offers 24 specific proposals for reform at the federal, state, and local levels. No doubt, many will be controversial. It is unlikely that everyone will agree with everything that the report says. Still, we hope that these efforts will spark much-needed discussion and build a broad bipartisan consensus for reform.

Speaking for myself and my colleagues at the Cato Institute, we look forward to working with you to help empower Californians living in poverty and to create a more inclusive California economy.

Respectfully submitted,

Michael D. Tanner

Director

Cato Institute Project on Poverty and Inequality in
California

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Section 1: An Overview of Poverty and Inequality in California

COVID-19 has been a tragedy for California. More than 4 million Californians have contracted the disease, and over 64,000 have died from it. And beyond the cost of illness and death, the pandemic and the state's actions to contain it have devastated California's economy. Low-income and minority Californians in particular have felt the brunt of both the virus and the economic impact.

Yet if COVID-19 exacerbated and exposed the state's poverty problems, it was not the cause of them. Even before the pandemic, far too many Californians struggled to get by.

This in a state that (even with the pandemic) has relatively strong economic growth, pockets of vast wealth, and an extensive social welfare system. California has the largest economy of any state. In fact, with a gross domestic product of nearly \$3 trillion, if California were a country, its economy would be the world's fifth largest, behind only the United States as a whole, China, Japan, and Germany. The state's real gross domestic product grew 3.4 percent in 2019,¹ and

while its unemployment rate was slightly above the national average, it still was only around 4.1 percent.² And the state is home to more than one million millionaires, including 189 of the United States' 724 billionaires.³ Clearly there is a mismatch between the state's growth and wealth and the struggles of many of its citizens.

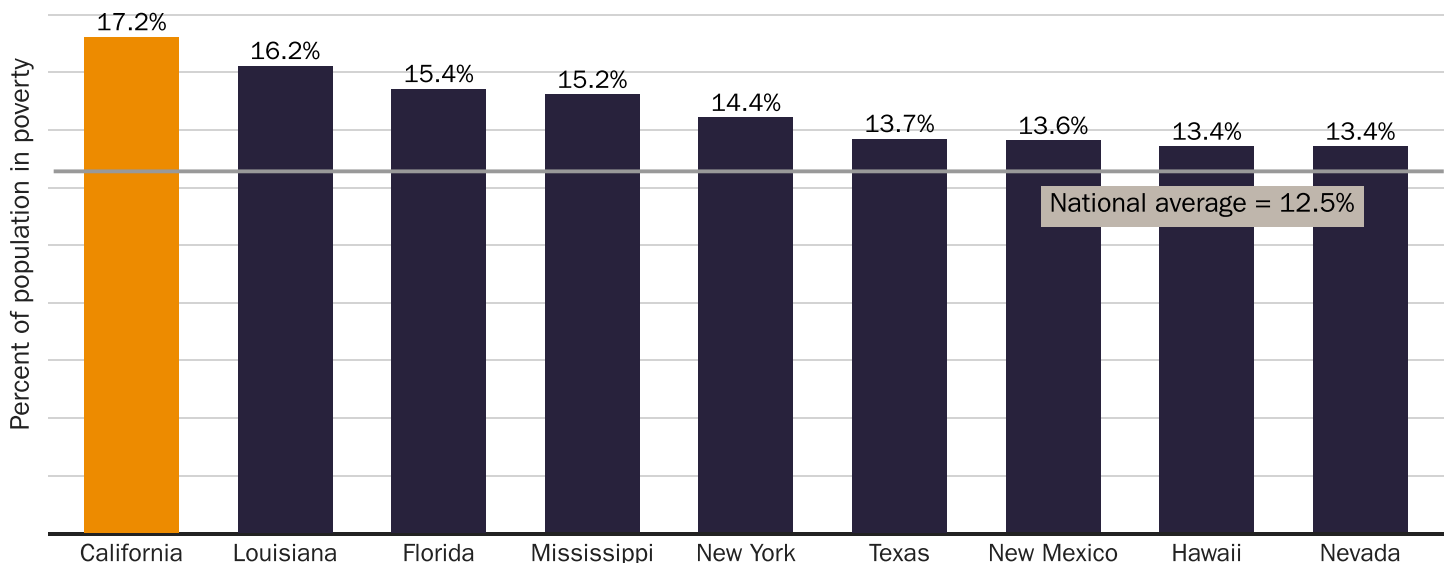
BEFORE COVID-19

In 2019, before the pandemic, almost 7 million Californians lived below the poverty level, according to the U.S. Census Bureau's Supplemental Poverty Measure. That is roughly 17.2 percent of the state's population. This gave California the highest poverty rate in the nation, considerably higher than states such as Louisiana and Mississippi that are typically associated with high levels of poverty (see Figure 1.1).

A more specific measure, the California Poverty Measure (CPM), developed jointly by the Stanford Center on Poverty

Figure 1.1

Supplemental poverty measures, three-year averages



Source: Liana Fox, "The Supplemental Poverty Measure: 2019," U.S. Census Bureau, September 15, 2020, p. 29, Table 5.

and Inequality and the Public Policy Institute of California, improves upon the Supplemental Poverty Measure by taking into account regional differences in housing prices and the role of government programs specific to California. The CPM shows only a slight reduction in poverty from California’s many government transfer programs such as the California Work Opportunities and Responsibility to Kids (CalWORKs) and CalFresh. It also indicates the substantial reduction in poverty that would result from reducing the state’s notoriously high housing costs. According to the CPM, roughly 35.2 percent of Californians live in or near poverty.⁴

The state’s high cost of living plays a significant role in California’s poverty rate. Under the CPM, considering the state’s cost of living, the thresholds (for San Francisco, with its high housing costs) are \$29,500 for a household with a single parent and one child and \$37,400 for a family of four.⁵ The state’s low-cost and midrange counties are also above the national levels (see Table 1.1).

The existence of so much poverty amid such widespread wealth highlights the high level of economic inequality in the state. Using the traditional Gini coefficient measure of economic inequality, California ranks as the nation’s fifth most unequal state (see Figure 1.2).⁶ This is particularly problematic because much of this inequality stems from government policies, both historical and ongoing.

In the last few years before the pandemic, inequality in California had begun to decline, primarily because of rising wages for low-income workers. For example, in 2019, families in the lowest decile of earnings had incomes 34 percent higher (adjusted for inflation) than in 2014. Meanwhile, earners in the top 10 percent saw their incomes grow by only 18 percent over the same period. As a result, the gap between the two groups shrank by 12 percent.⁷ Unfortunately, COVID-19 threatens to reverse this progress.

“The existence of so much poverty amid such widespread wealth highlights the high level of economic inequality in the state.”

Another notable area of concern is the lack of economic mobility for low-income Californians. Most California children who grow up in poverty will earn low incomes as adults.⁸ A 2020 study by the Urban Reform Institute found disparities in economic mobility among races. African Americans and Latinos in California metropolitan areas such as San Jose, San Francisco, and Los Angeles experience some of the least upward mobility in America.⁹

Table 1.1
Poverty thresholds broken down by low-cost, midrange, and high-cost counties

Counties		Share of residents	CPM threshold		Average CPM threshold
			Owner with mortgage	Renters	
Low cost	Butte, Colusa, Del Norte, Fresno, Glenn, Imperial, Kern, Kings, Lassen, Madera, Merced, Modoc, Plumas, Siskiyou, Sutter, Tehama, Trinity, Tulare, Yuba	9.70%	\$24,200–\$26,400	\$24,000–\$26,000	\$24,930
Midrange	Alpine, Amador, Calaveras, El Dorado, Humboldt, Inyo, Lake, Mariposa, Mendocino, Mono, Nevada, Riverside, Sacramento, San Bernardino, San Joaquin, Shasta, Sierra, Solano, Stanislaus, Tuolumne, Yolo	22.60%	\$26,600–\$30,400	\$26,300–\$30,000	\$27,880
High cost	Alameda, Contra Costa, Los Angeles, Marin, Monterey, Napa, Orange, Placer, San Benito, San Diego, San Francisco, San Luis Obispo, San Mateo, Santa Barbara, Santa Clara, Santa Cruz, Sonoma, Ventura	67.70%	\$30,800–\$38,000	\$30,300–\$37,500	\$33,760

Source: “Poverty Thresholds—California Poverty Measure, by Family Composition and Housing Tenure,” Kids Data, Population Reference Bureau; and “County Population Totals: 2010–2019,” U.S. Census Bureau, 2016.
Note: CPM = California Poverty Measure.

COVID-19'S EFFECTS

COVID-19 and its associated economic fallout have only made poverty in California deeper, more widespread, and more painful. First, the virus has been more prevalent in low-income communities, both because many low-wage workers work in jobs that prevent sheltering at home and because housing costs often force large extended families to live together, facilitating the spread of COVID-19.¹⁰

A California Healthline study found that in the first nine months of the pandemic, infection rates were as much as three times higher in communities with poverty rates higher than 20 percent, compared to communities with poverty rates lower than 10 percent. Even within the same city, neighborhoods that are only a few miles apart have had vastly different infection rates that varied by income. For example, the 94621 zip code area, in the city of Oakland, had an infection rate of 54 confirmed cases per 1,000 residents as of late November 2020. In comparison, the 94618 zip code area, covering the Rockridge and Upper Rockridge neighborhoods a few miles north of Oakland, and where only 5 percent of residents live below the poverty line, had only 4 confirmed infections per 1,000 people over the same period.¹¹ See Figure 1.3 for more examples.

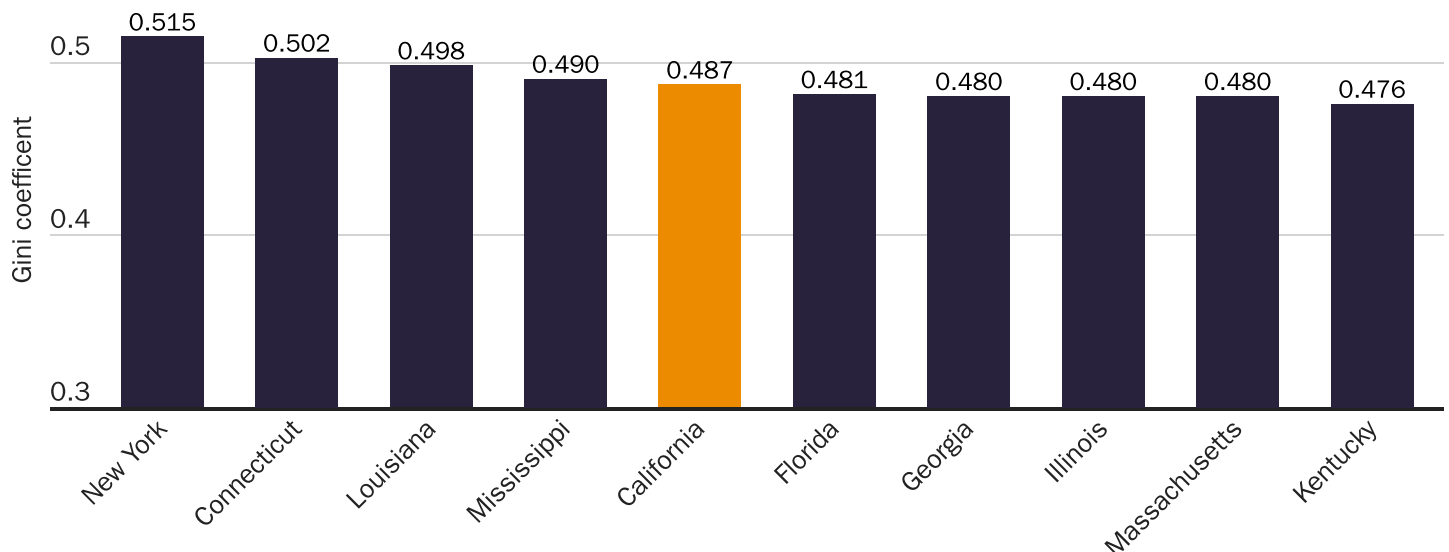
And given the high incidence of poverty in minority communities, it is no surprise that African Americans, Latinos, and Pacific Islanders all have higher rates of infection than do white Californians (see Figure 1.4).¹²

Second, beyond the illness and lost lives, the economic effects of the pandemic for Californians who are poor have also been grim. Historically, economic slowdowns nearly always hit low-income families and communities hardest. With little savings, precarious attachment to the labor market, and limited access to new opportunities, low-income families are the least prepared for riding out such downturns. COVID-19's economic consequences have been particularly burdensome for these families. In December 2020, more than a third of low-income Californians surveyed said that their personal finances were worse than a year before.¹³

Job sectors with a high proportion of low-wage workers, such as restaurants, entertainment, and tourism, have had the largest declines in employment. Estimates found that business sectors with the highest percentage 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.¹⁴ During the worst months of the pandemic, unemployment rates for those with incomes under \$30,000 reached as high as 30 percent, compared to 5 percent for families with incomes in excess of \$150,000.¹⁵ Both the size of the job losses in the low-wage sectors and the divergence in impact between low- and high-wage employment have been substantially worse than during the Great Recession of 2008.

Figure 1.2

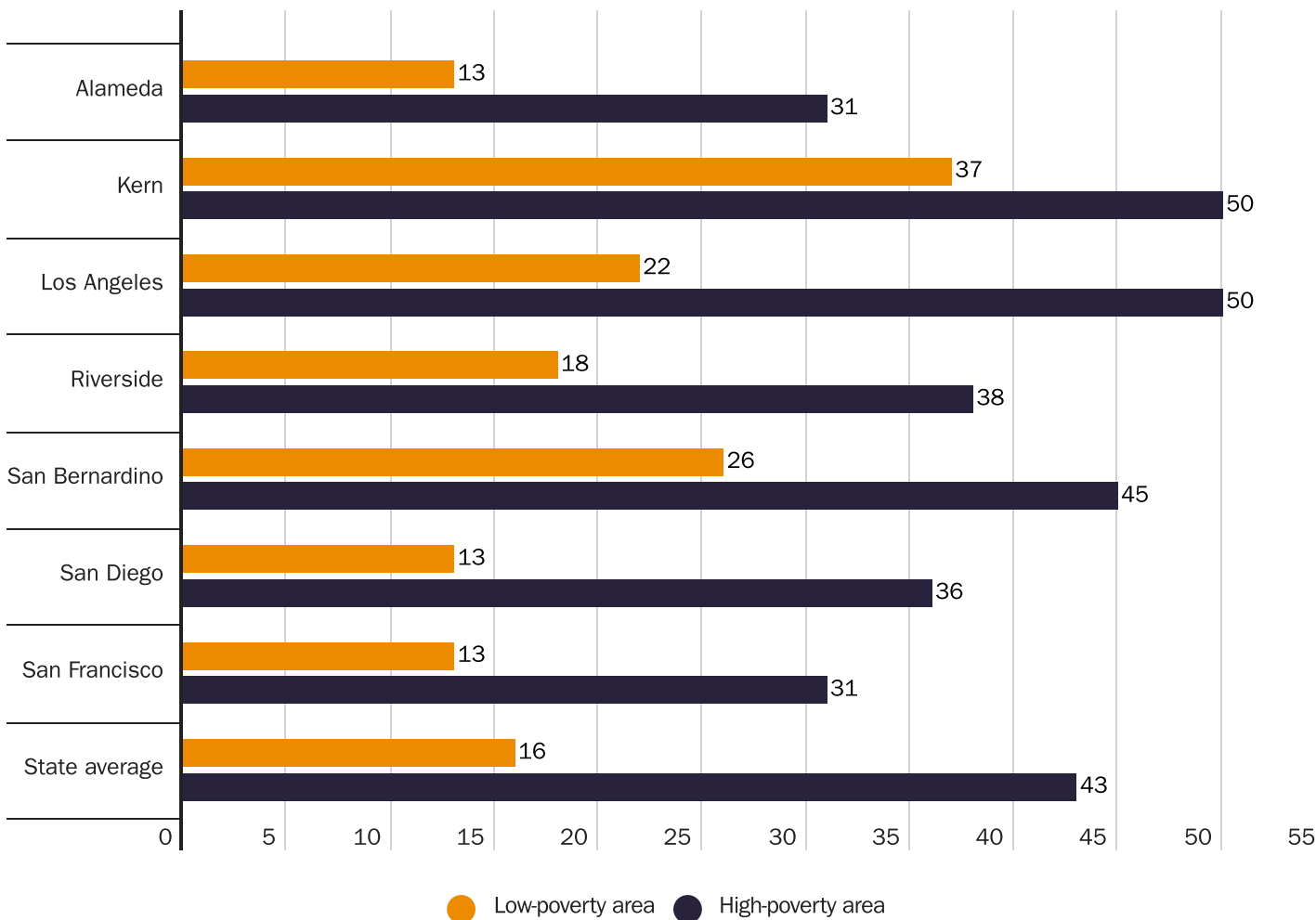
Gini index of income inequality, top 10 states



Source: 2019 American Community Survey, U.S. Census Bureau, Gini coefficient.

Figure 1.3

Poverty and COVID-19 infections per 1,000 residents in different income sections of the same California metro areas



Source: Phillip Reese, “High-Poverty Neighborhoods in California Are Bearing the Brunt of COVID’s Scourge,” *US News & World Report*, December 16, 2020.

Note: Low-poverty areas are defined as less than 10 percent of the population below the poverty line, and high-poverty areas have more than 20 percent of the population below the poverty line.

Moreover, many people 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.¹⁶ Latinos, Asian Americans, and African Americans were all more likely than white Californians to fall into this category (see Figure 1.5).¹⁷

Employment and income decline attributable to the pandemic appear to have been particularly severe for women and female-headed households. Before COVID-19 hit, men and women in California had similar rates of labor force participation, but with the pandemic, a significant gap has

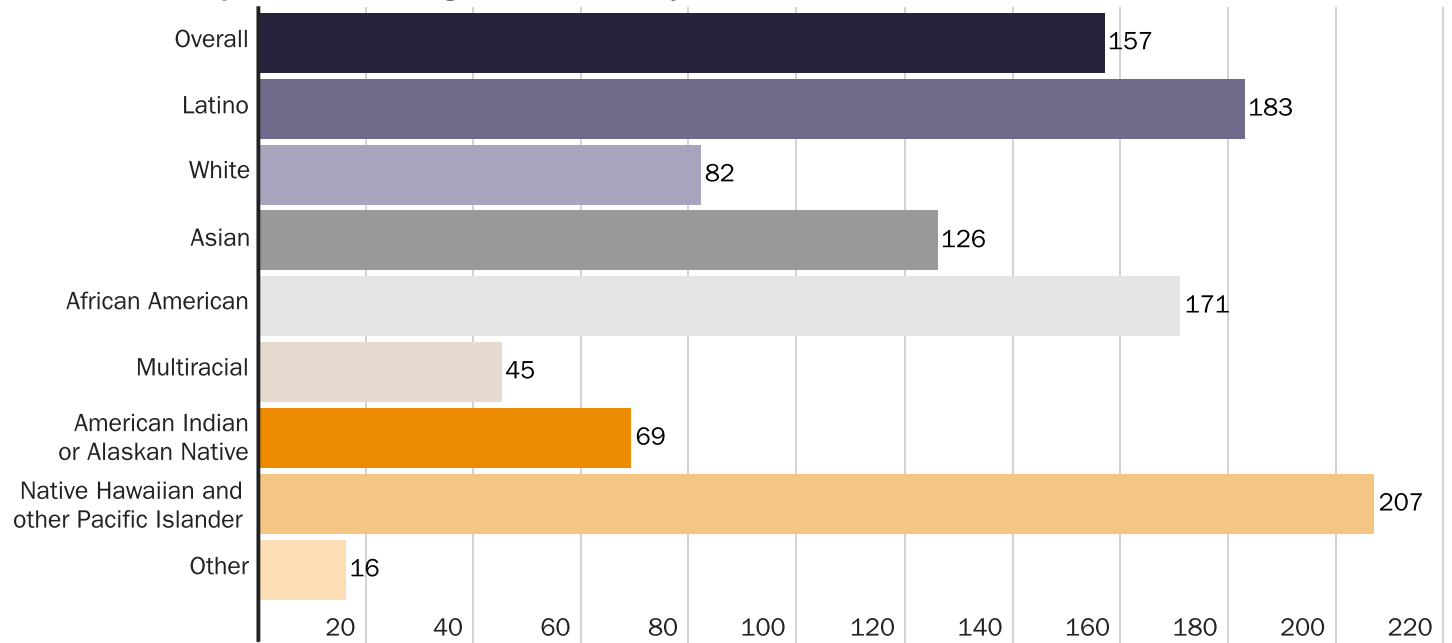
opened, with women 3 percent less likely to be employed than men. The evidence also suggests that this effect has been greatest for women with low incomes and women who are heads of household.¹⁸

As a result, roughly one-third of low-income Californians reported in December 2020 that they had been unable to pay a monthly bill within the past year, 35 percent reported missing a rent or mortgage payment, and 43 percent reported having to use a food bank.¹⁹

As California reopens its economy, we should see a reduction in many of these poverty metrics. Recall that in the Great Recession, California lost roughly 1.3 million jobs but had fully recovered by 2014.²⁰ Many economists believe that

Figure 1.4

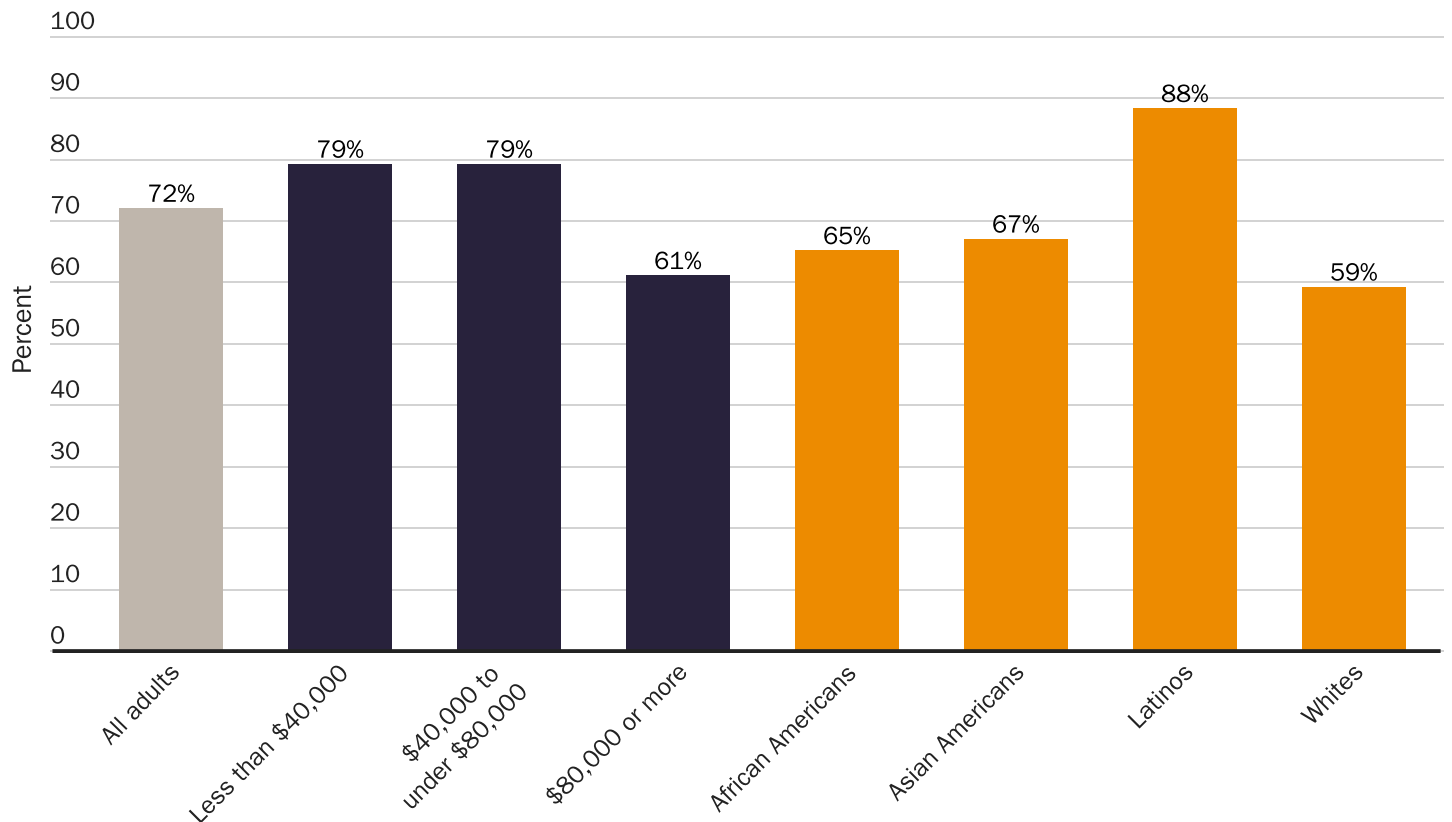
COVID-19 deaths per 100,000 through June 6, 2021, by race



Source: “All Cases and Deaths Associated with COVID-19 by Race and Ethnicity,” California Department of Health; and “ACS Demographic and Housing Estimates,” 2019 American Community Survey, U.S. Census Bureau.

Figure 1.5

Percentage of Latinos’ and lower-income Californians’ employment affected



Source: Mark Baldassare et al., “PPIC Statewide Survey: Californians and Their Economic Well-Being,” Public Policy Institute of California, December 2020. Note: Data represent the share of Californians who are in a household where someone lost their job and/or their hours or pay were reduced.

because the current economic downturn results from an extraordinary outside circumstance combined with unprecedented government action rather than underlying weakness in the economy, the bounce back will be much swifter. On the other hand, the economic rebound that we have seen so far has been uneven, leading many economists to describe it as a “K-shaped recovery” (see Figure 1.6), with a far quicker return to normal for higher-income workers.²¹

Moreover, some economic changes brought about by the pandemic may be permanent, such as

- the shift toward working from home,
- the decline in business travel with its effects on the hospitality industry,
- further moves toward automation,
- greater consolidation of businesses and a reduction in the viability of small and family-owned enterprises,
- a reduction in job security and an increase in “gig work,” and
- an increase in the wage premium on education and technical skills.

Both the government and those living in poverty will be forced to adapt to this changing economic environment. It therefore becomes all the more critical that California target its efforts at economic recovery toward those people and

communities who have been hardest hit and are most likely to suffer long-term consequences.

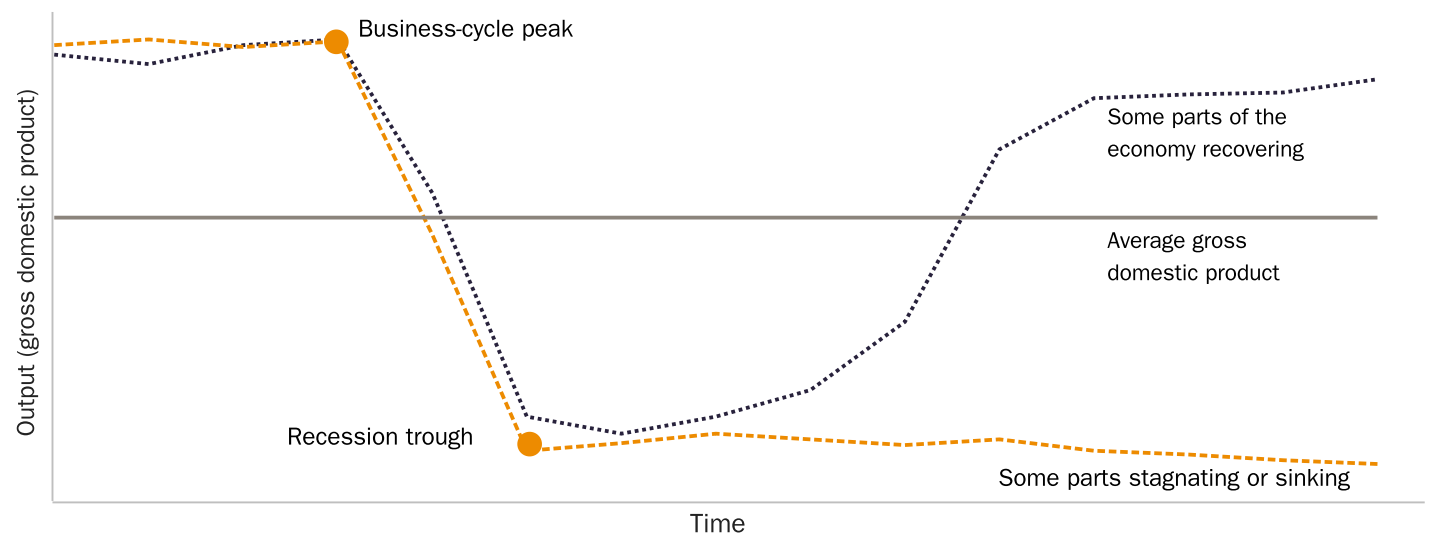
WHO ARE CALIFORNIA'S POOR?

Poverty is not evenly distributed across California, and people of color are far more likely to live in poverty than white residents. Roughly 23 percent of Latino families have incomes below the poverty line, as do more than 18 percent of African American households and about 16 percent of Asian American households, compared to a little under 13 percent of white California households (see Figure 1.7).²²

Poverty rates are much higher in female-headed households, at roughly 32 percent.²³ Childhood poverty is also widespread, with more than one in five California children living in families with incomes below the poverty level.

There is also significant geographical variation in rates of poverty and inequality across the state. Los Angeles County has the state's highest poverty rate, with more than a quarter of residents living in poverty (using the CPM). That amounts to more than 2.5 million people. The county's “deep poverty rate,” encompassing the poorest of the poor, is also the state's second highest, at 6.7 percent. Other high-poverty regions include Orange County and the Central Coast. The state's lowest rate of both poverty and deep poverty is in the Sacramento area, followed by the San Francisco Bay Area (see Figure 1.8).²⁴

Figure 1.6
K-shaped recovery



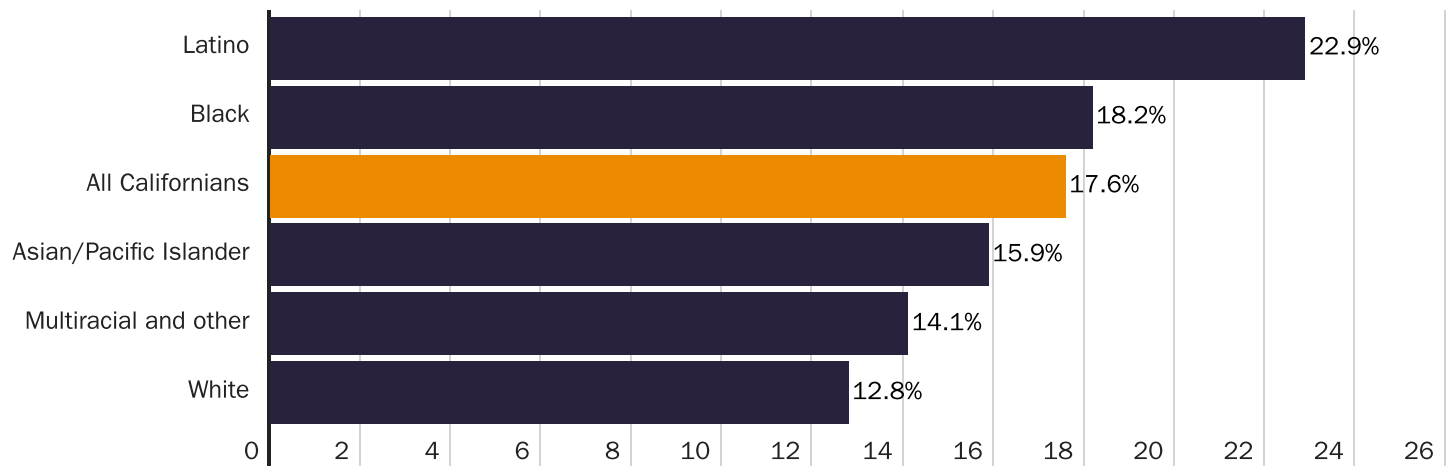
Source: Yuqing Liu, *Business Insider*, 2020.

However, the variation in poverty rates between neighborhoods that may be only a few miles apart can be significant. For instance, between 2016 and 2018, the Manhattan Beach and Redondo Beach area had a poverty rate of around 7.5 percent. Meanwhile, its neighbor to the east, the Gardena and Lawndale area, had a poverty rate hovering around 25.3 percent. Less than five miles separate their city halls.

Communities with high minority concentrations also tend to have much higher poverty rates, reflecting the higher incidence of poverty among those populations and the state’s long history of residential segregation. For example, between 2016 and 2018, Santa Clara, which is 88 percent white, had a poverty rate of 7.7 percent, while majority-minority Oakland had a poverty rate of 34.9 percent.²⁵

Figure 1.7

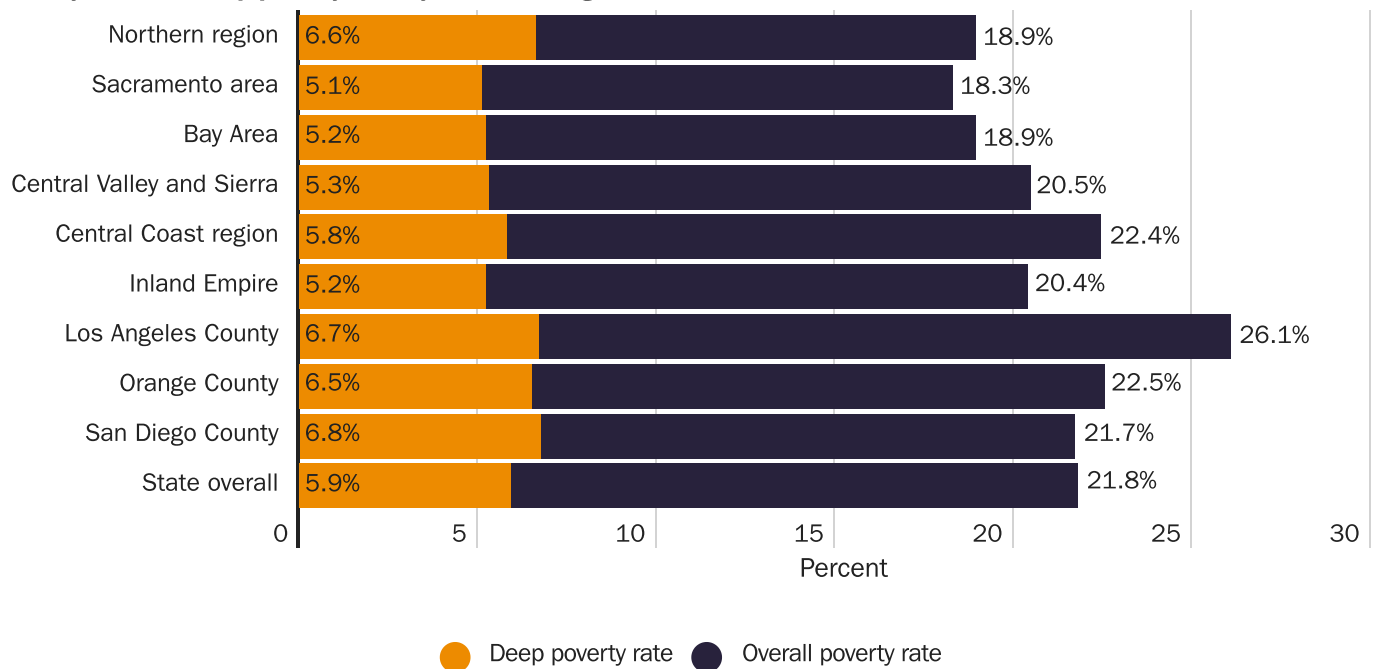
California poverty rate by race



Source: “Who’s in Poverty in California?,” Public Policy Institute of California.

Figure 1.8

Poverty rate and deep poverty rate by California region



Source: Christopher Wimer et al., “The California Poverty Measure: Poverty and Deep Poverty in California,” Stanford Center on Poverty and Inequality, 2012, p. 8, Figure 10.

REDUCING POVERTY

California spends more than \$66 billion annually on social welfare programs, and the federal government adds an additional \$120 billion on programs serving low-income Californians. Roughly one in six California households receives some form of government assistance. The biggest and most widespread of these programs include CalWORKs (the state's administrator of the federal Temporary Assistance to Needy Families program), MediCal (Medicaid), CalFresh, the Special Supplemental Nutrition Program for Women, Infants, and Children, housing assistance, the federal earned-income tax credit (EITC), and its state counterpart CalEITC (see Figure 1.9). Although the largest portion of funding for most of these programs comes from the federal government, the state ranks seventh in per-capita welfare spending.

Traditionally, efforts to reduce poverty have targeted material deprivation. These initiatives include ensuring that the poor have access to adequate food, shelter, health care, and so on. That is what the previously mentioned programs are designed to do. If one were to look at Maslow's hierarchy of needs (see Figure 1.10), most anti-poverty efforts focus heavily on the bottom of the pyramid. And, in this very narrow regard, such efforts have been successful

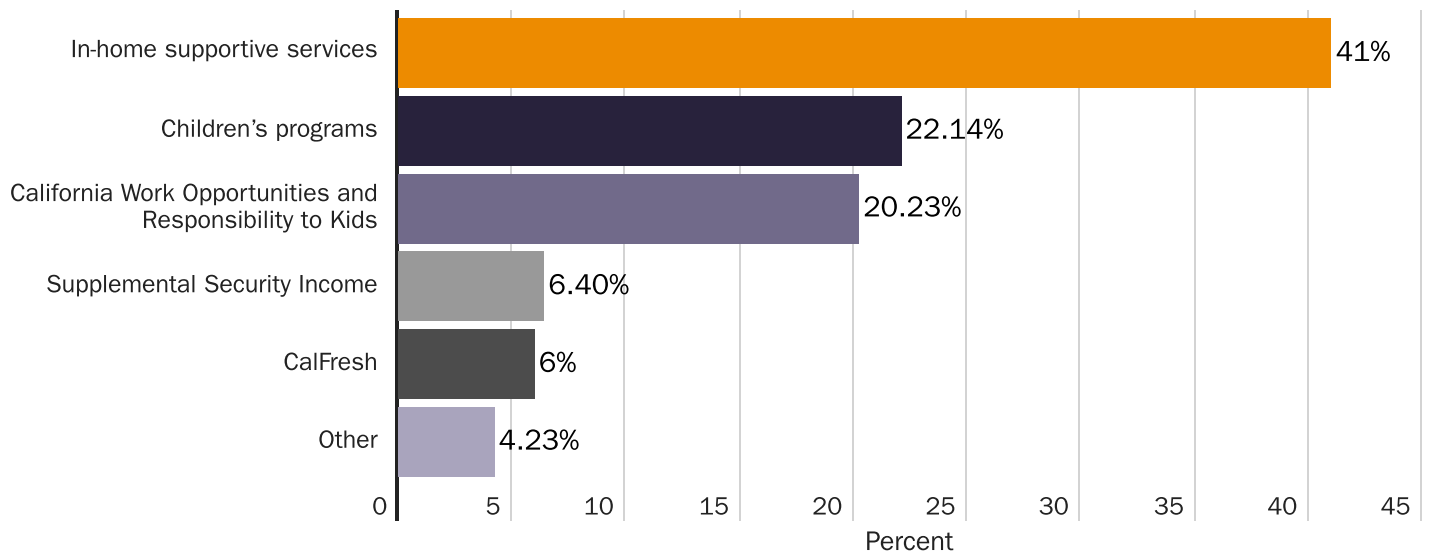
in reducing poverty rates. Estimates show that California's poverty rate would be nearly 18 percent higher in the absence of these programs (see Figure 1.11).²⁶

But we should also consider the counterfactual. What actions would the poor have taken in the absence of welfare, and how would their lives have changed as a result? We know that incentives matter, and there is a vigorous debate about the degree to which the availability of welfare creates incentives toward poverty-inducing behavior by discouraging work and encouraging non-marital births. Most contemporary scholarship, such as that by Robert Moffitt of Johns Hopkins University, points to a real but very modest negative effect of these programs on human behavior.²⁷ Research for the Cato Institute has suggested that someone leaving welfare for an entry-level job would likely suffer an initial loss of income. However, this report does not address the likely long-term impact, which could well be more positive.²⁸

Still, looking at the totality of available evidence, it is hard to argue that welfare spending has not contributed to the decline in the material deprivation and hardships of poverty. Surveying the available literature, Rebecca Blank of the University of Wisconsin concludes that "transfer programs unambiguously make people less poor."²⁹

Figure 1.9

California welfare spending for 2020–2021



Source: "2021–22 May Revision to the Governor's Budget," Office of California Governor Gavin Newsom, May 14, 2021; and "The 2021 Budget: Nutrition Access Programs," California Legislative Analyst's Office, February 4, 2021.

Figure 1.10

Maslow's hierarchy of needs

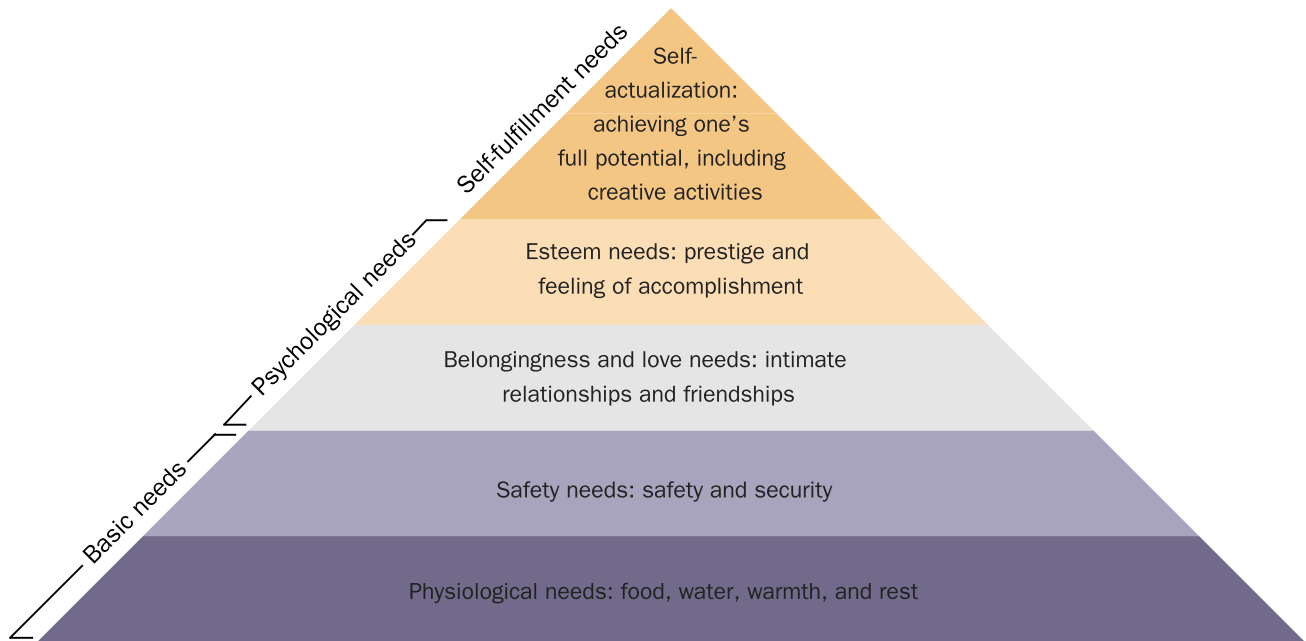
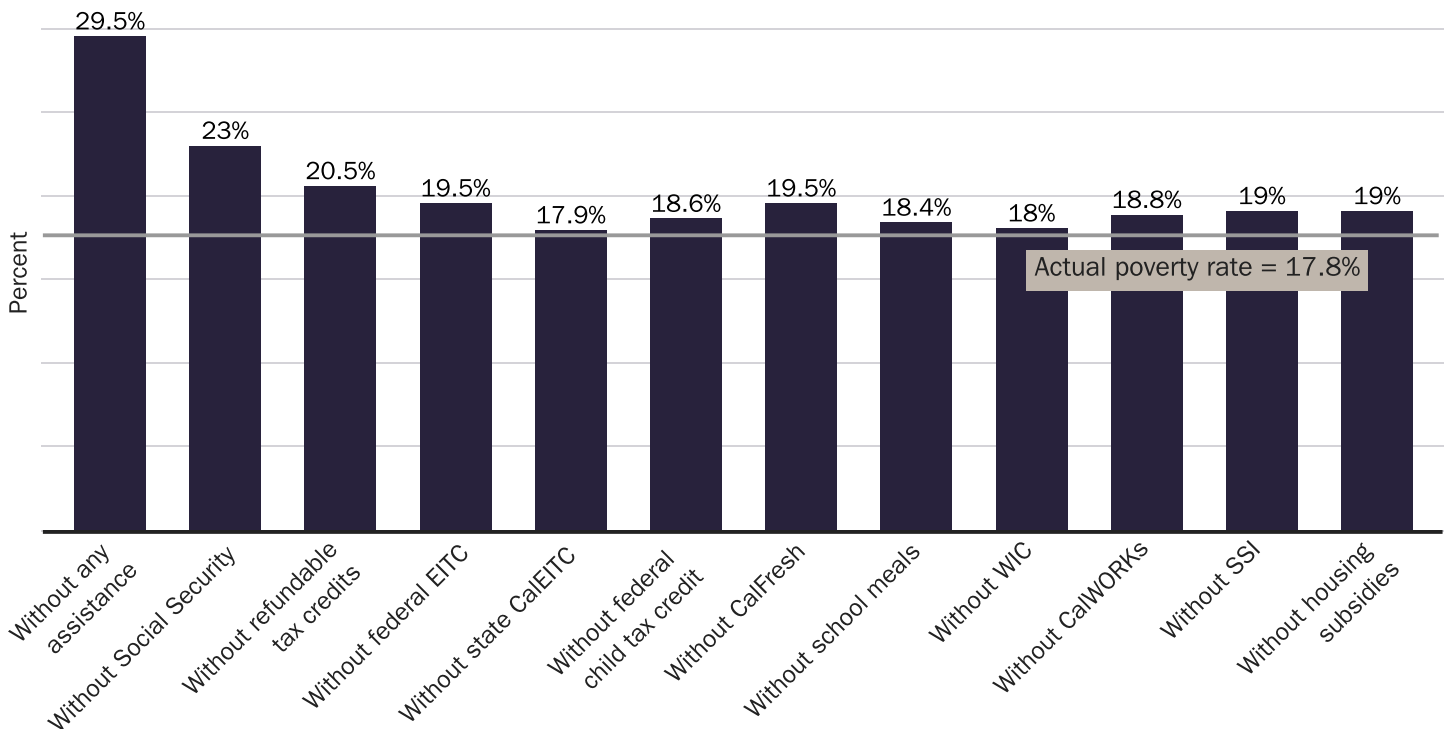


Figure 1.11

California poverty rates without various welfare programs



Source: Marybeth Mattingly et al., "Poverty Declines in California, but More than 1 in 3 Are Poor or Nearly Poor," Stanford Center on Poverty and Inequality, October 2019, p. 2, Figure 2.

Notes: EITC = earned-income tax credit; WIC = Special Supplemental Nutrition Program for Women, Infants, and Children; CalWORKs = California Work Opportunities and Responsibility to Kids; and SSI = Supplemental Security Income.

But a long-term solution to poverty requires greater aspirations. We should seek to ensure not only that people are fed and housed but that they rise as far as their talents can take them.

Perhaps *The Economist* put it best:

If reducing poverty just amounts to ushering Americans to a somewhat less meager existence, it may be a worthwhile endeavour but is hardly satisfying. The objective, of course, should be a system of benefits that encourages people to work their way out of penury, and an economy that does not result in so many people needing welfare in the first place. Any praise for the efficacy of safety nets must be tempered by the realization that, for one reason or another, these folks could not make it on their own.³⁰

Yes, California's anti-poverty policies should ensure that people have their basic needs met, but those policies should also enable every Californian to become a fully actualized being, capable of being all that they can be.

It is also important to recognize that, contrary to stereotypes, low-income Californians generally maintain a strong work ethic. For instance, focus groups conducted by the Business Roundtable repeatedly found that low-income Californians "indicated a willingness to work hard and do not want 'something for nothing' from the government."³¹ In fact, nearly 80 percent of low-income California families with at least one working-age adult had someone in the family who was working, and 58 percent had someone who was working full time.³² In addition, low-income Californians showed a strong interest in investing in their children's future and generally believed that their children will be better off than they are.³³ What is blocking their escape from poverty is not a lack of desire but a lack of opportunity.

In proposing a better way to fight poverty, we should not blindly support cutting programs for the sake of cutting. Nor should we assume that what California is doing is working and that the state should simply spend more. Not every existing program is accomplishing its purpose. Debates over funding tend to be sterile, partisan, and zero-sum affairs. This is likely to be even more true given the fiscal constraints

that the state will be under post-pandemic. Such questions were largely avoided in developing this report.

Therefore, we should ask whether there are policy alternatives that would ameliorate the suffering of those living in poverty at least as well as existing efforts while also creating the conditions that would enable people to live fulfilled and actualized lives. Is it possible to achieve or even expand on the poverty reductions realized by current policies without the negative side effects accompanying such policies? Can we fight poverty in a way that is compatible with the economic growth that will reduce poverty in the future? Finally, can we fight poverty in a way that empowers Californians living in poverty to control their own lives?

“We should seek to ensure not only that people are fed and housed but that they rise as far as their talents can take them.”

The recommendations that follow are designed to provide Californians living in poverty with that opportunity.

RECOMMENDATIONS SUMMARY

After listening to a broad cross-section of social justice and anti-poverty activists, along with business, political, and other key stakeholders, as well as to the poor and working poor themselves, Cato's Project on Poverty and Inequality in California has developed a set of policy recommendations designed to reduce poverty and empower low-income Californians.

Importantly, our conversations with Californians on the frontlines of anti-poverty efforts have confirmed our belief that any effective long-term approach to fighting poverty in California must go beyond simply providing public assistance. Reform must establish an environment that enables every resident of the state to flourish, become self-supporting, and rise as far as their individual talents can take them. That need has only grown more important because of the COVID-19 pandemic and the economic

disruption that has accompanied it.

Unfortunately, far too often, existing laws, policies, and regulations trap many Californians in poverty, preventing them from fully participating in the benefits of the state's economy. Therefore, most of our recommendations are focused on reforming these barriers to economic participation, including policy reforms concerning housing and homelessness, the criminal justice system, education, welfare, and regulatory barriers to an inclusive economy.

Housing and Homelessness

Any effort to address poverty in California must deal with the state's lack of affordable housing. The median home price in California now tops \$500,000, while the median rent for a two-bedroom apartment exceeds \$2,300 per month, nearly 60 percent above the national median. In some cities such as San Francisco and Los Angeles, average monthly rent exceeds \$3,000. These high costs are the result of basic economics: demand badly exceeds supply. Estimates suggest that California needs at least 3.5 million new housing units just to meet currently projected demands.

At the same time, the state faces a raising epidemic of homelessness. There are an estimated 130,000 homeless people in California, including more than 28,000 in the San Francisco Bay Area and 60,000 in Los Angeles County. Even often overlooked cities like San Diego face a crisis, with more than 8,000 homeless. By some calculations, more than 47 percent of all unhoused homeless in the United States live in California. We are witnessing a major human tragedy.

At the heart of these twin crises lies a plethora of government regulations that make it harder to build housing or provide services for the homeless.

Recommendations

1. End exclusionary zoning.
2. Move to an "as by right"/ministerial approval process for new construction.
3. Restructure the California Environmental Quality Act (CEQA) to limit the use of lawsuits to strict environmental criteria.

4. Standardize and cap building fees.
5. Reduce the power of local agency formation commissions.
6. Reverse efforts to criminalize homelessness.
7. Strengthen California's conservatorship laws while continuing to protect civil liberties and individual autonomy.
8. Expand and extend CEQA exemptions for homeless housing/shelter projects. Allow emergency shelters in any zone, without a conditional use or discretionary permit.

“Cato’s Project on Poverty and Inequality in California has developed a set of policy recommendations designed to reduce poverty and empower low-income Californians.”

Criminal Justice Reform

Over recent years, California has made progress toward reforming its criminal justice system. Despite these reforms, the system continues to burden communities of color and those with low incomes. Around 182,000 Californians remain behind bars, many for nonviolent offenses. Perhaps more significantly, as many as eight million Californians have a criminal record that can make it difficult to find employment and housing or take advantage of educational opportunities.

Reforming the criminal justice system is, in part, a matter of fairness, given the system's long-standing biases against low-income people and communities of color. But criminal justice reform will also have a significant practical effect on poverty.

Recommendations

9. Resist any effort to roll back recent criminal justice reforms, including Propositions 47 and 57.
10. Take additional steps to reduce overcriminalization,

including the decriminalization of victimless crimes, further reduction in penalties for nonviolent offenses, and continued moves to the greater use of restorative justice.

11. Curtail the use of fines and fees as punishment, especially in cases where they pose a disproportionate hardship on low-income offenders.
12. Establish a mechanism to automatically expunge criminal records after a designated period for those who do not reoffend.
13. Upgrade programs within the prison system to prepare offenders who have completed their sentence for transitioning into society.

Education Reform and Workforce Development

Access to a quality education is vital to escaping poverty. Yet despite spending \$12,500 per student, California's public schools underperform compared to nationwide averages—and particularly fail low-income communities. The type of innovation necessary to transform California's education system is unlikely to occur in a system dominated by a government-run monopoly. At the same time, it is unfair to keep low-income and minority students trapped in schools that fail to meet their needs. Schools should exist to serve the needs of children and their parents, not the schools themselves, the teachers, or the school system. California schools should be opened to greater competition, parental control, and choice.

Recommendations

14. Remove barriers to the growth of charter schools and other alternatives to traditional education models. Specifically, lawmakers should eliminate the Local Control Funding Formula funding gap between districts and high-need charter schools.
15. Establish a tuition tax credit program to finance scholarships for low-income families to attend the school of their choice.
16. Restructure future pension obligations to shift more

resources to the classroom.

17. Increase emphasis on vocational and technical education and make greater use of apprenticeships.

Welfare Reform

California maintains a robust social safety net. On a combined basis, federal and state anti-poverty programs spend more than \$100 billion every year in California to fight poverty. That spending has reduced poverty rates from what they would be in the absence of those programs. But while mostly successful in reducing material poverty, California's welfare system is much less successful at reducing dependency and assisting low-income Californians to attain prosperity. In particular, eligibility rules for many programs can discourage work, savings, child support, and other steps that can help those living in poverty take greater control over their lives and situations.

“Access to a quality education is vital to escaping poverty. Yet California's public schools underperform compared to nationwide averages and fail low-income communities.”

Recommendations

18. Abolish asset tests for California Work Opportunity and Responsibility to Kids, or CalWORKs, and other programs.
19. Expand welfare diversion programs.
20. Prioritize cash payments within the social welfare system over in-kind benefits or indirect payments to vendors. To the degree possible, restructure existing social welfare programs and reallocate existing resources into an expanded state EITC.

Economic Inclusion

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. Therefore, California should generally pursue tax and regulatory policies that encourage continued growth.

But economic growth can have a significant effect on poverty reduction only if all Californians can fully participate in the opportunities it offers. Economic growth will do little to reduce poverty if all the benefits from that growth accrue solely to those at the top of the economic scale.

All too often, government regulations can block the poor from joining in on those benefits, making it more difficult to get a job or start a business. However well-intentioned, government actions can create a two-tier economic system that locks out the poor while protecting those with more connections or resources to navigate the system.

“All too often, government regulations can block the poor from joining in on those benefits, making it more difficult to get a job or start a business.”

Recommendations

21. Repeal occupational licensing that is not strictly necessary to protect health and safety.
22. Rethink occupational zoning.
23. Deregulate childcare to reduce costs and increase supply.
24. Reduce barriers to entrepreneurship and job creation.

Section 2: Housing and Homelessness

There is no way to address poverty in California without addressing the lack of affordable housing and the associated rise in homelessness. As Governor Newsom has said, “It’s a disgrace that the richest state, in the richest nation—succeeding across so many sectors—is falling so far behind to properly house, heal and humanely treat so many of its own people.”¹

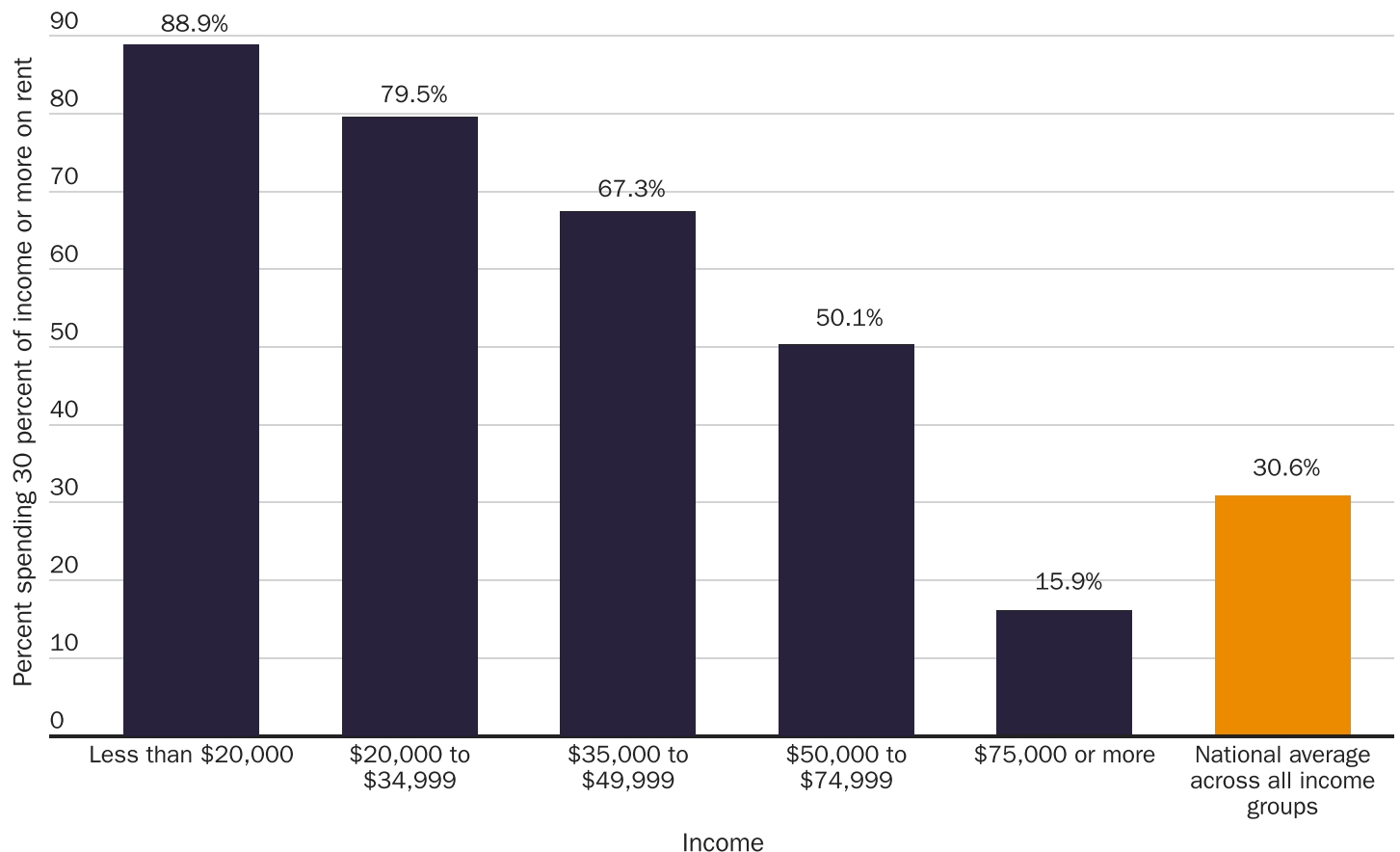
Stable and affordable housing is critical to fighting poverty on several levels. A home in a safe neighborhood, with good schools and close to jobs, can serve as a springboard for economic success. On the other hand, a lack of affordable housing can confine poor families to dangerous neighborhoods with substandard schools and few economic opportunities.²

Economists generally agree that families should spend roughly no more than about 30 percent of their income on housing. The reality, however, is that most people living in poverty spend much more. Indeed, Americans in the bottom third of incomes who rent spend on average 40 percent of their income on housing.³ In California, this problem is extensive and extends further up the income scale. For low-income Californians, the share of rent-burdened households is more than 80 percent (see Figure 2.1).⁴ In addition, 37 percent of middle-income families spend above the 30 percent threshold.

With a median home price statewide exceeding \$500,000, the Hoover Institution estimates that less than a third of

Figure 2.1

Portion of Californians who are rent-burdened compared to the national average



Source: “American Communities Survey,” U.S. Census Bureau, 2019.

Note: Rent burdened is defined as spending more than 30 percent of income on rent.

California families, even in multi-earner households, can afford the state’s median home price. In some areas, such as the city of San Francisco or Santa Clara County, barely 15 percent of households can afford to purchase a home at the median price.⁵

The median rent for a two-bedroom apartment tops \$1,500 per month, roughly 55 percent higher than the national median (see Figure 2.2).⁶ In some cities, such as Los Angeles and San Francisco, average rents can exceed \$3,000 per month.⁷ From 2005 to 2015, rents increased by 38 percent in Los Angeles, 43 percent in San Francisco, 28 percent in Riverside, 33 percent in San Diego, 24 percent in Sacramento, and 57 percent in San Jose.⁸ Since then, the rise has only accelerated. California has six of the 15 most expensive rental markets in the nation.⁹ More than half of California renters pay rents that exceed industry standards for affordability. Considering that the U.S. Census Bureau’s

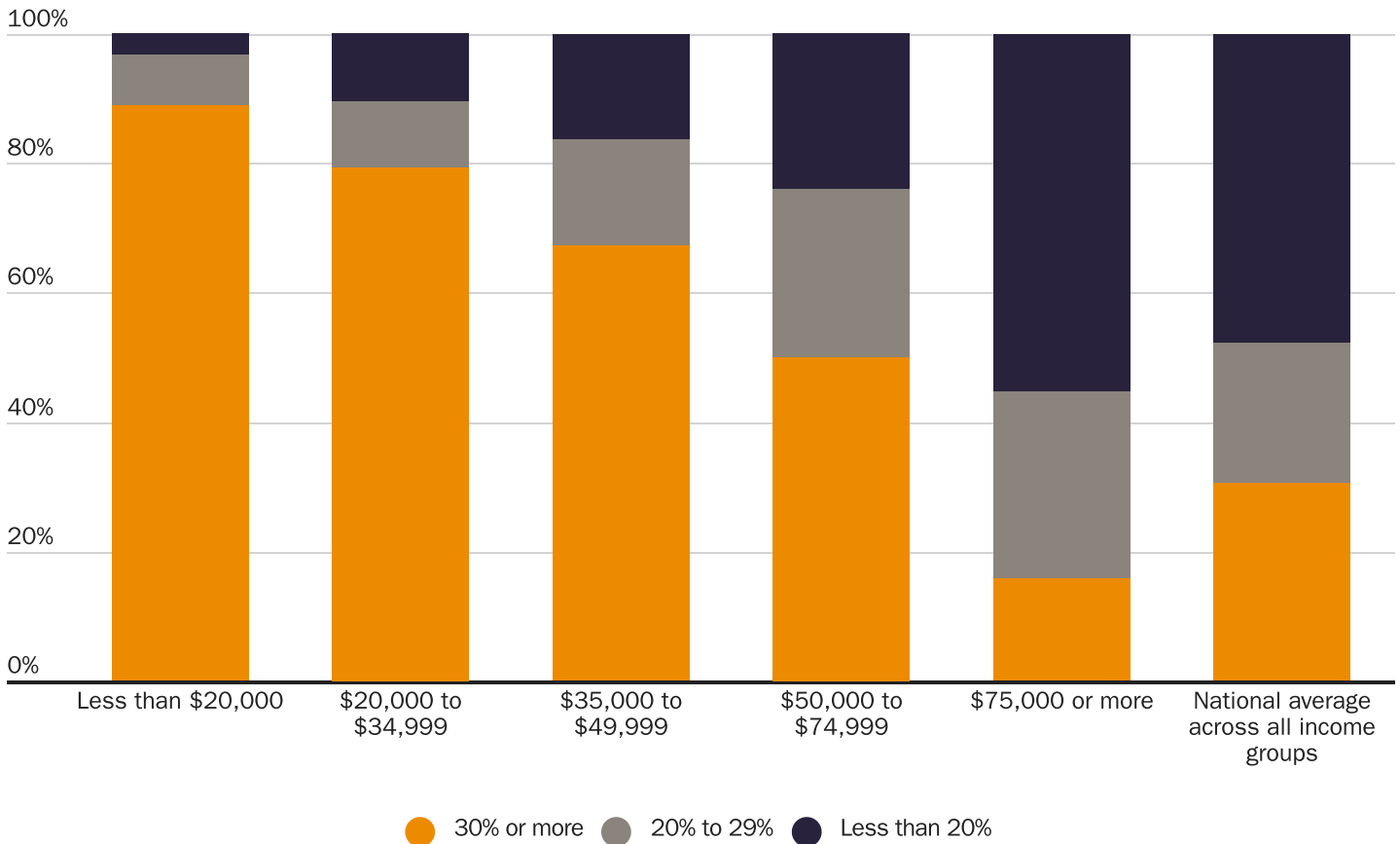
official poverty threshold for a family of three is \$20,212 per year, or \$1,684 per month, and that the median rent in California for a two-bedroom home was \$1,562 in 2018 (and, as previously noted, much higher in some areas), the problem is obvious.¹⁰ See Figure 2.3 for states with the highest average rents for a one-bedroom apartment.

As a result, more than half of Californians worry that they or someone in their family will not be able to afford housing. Such anxiety is particularly high among low-income Californians, with nearly two-thirds expressing worries about housing costs.¹¹ There is good reason for worry. The high cost of housing carries significant consequences for the state’s poor.

EFFECTS ON PEOPLE WHO ARE POOR

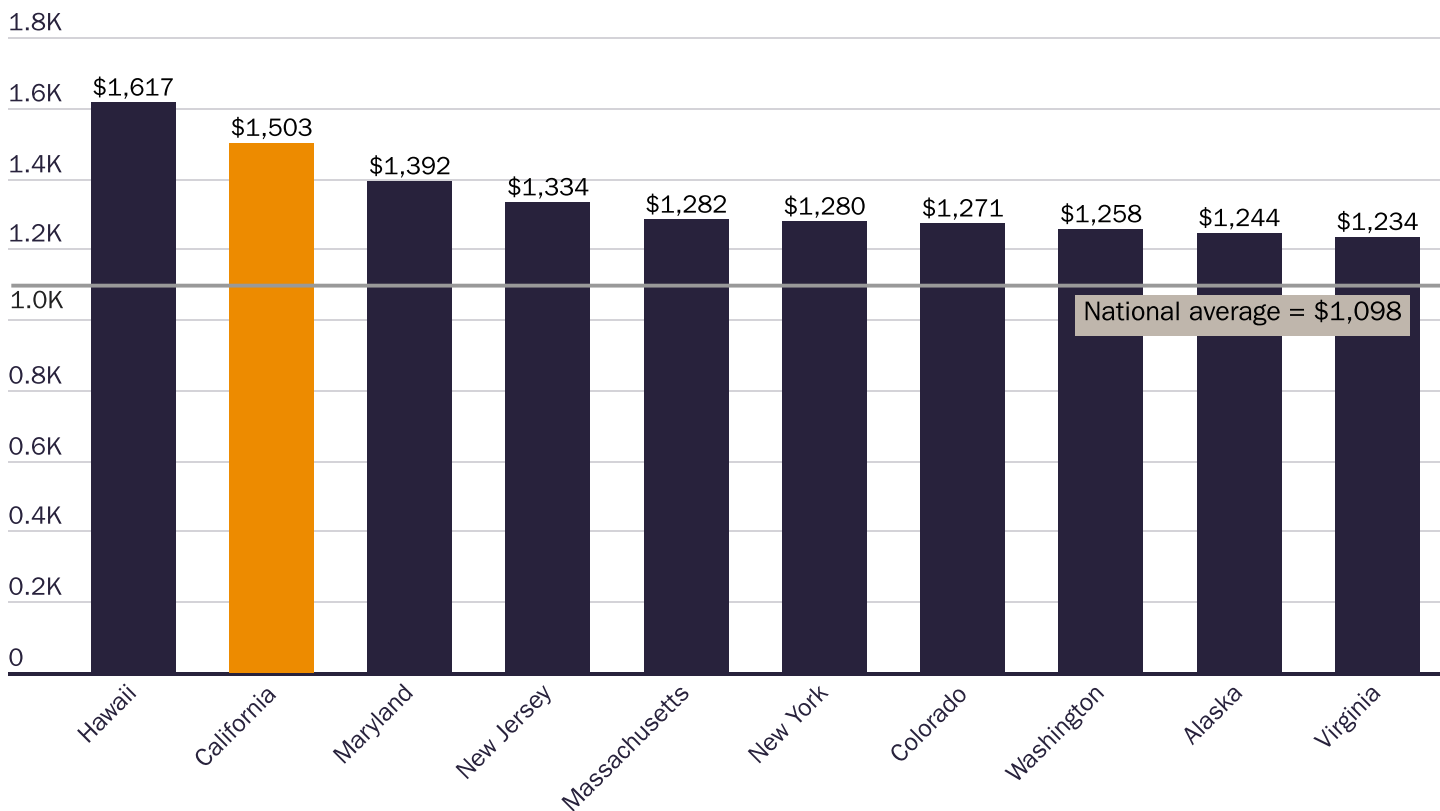
Using the official Census Bureau definition of poverty, 12.5 percent of Californians would be considered poor,

Figure 2.2
Rent spending by income group in California compared to the national average



Source: “American Communities Survey,” U.S. Census Bureau, 2019.
 Note: Rent burdened is defined as spending more than 30 percent of income on rent.

Figure 2.3
States with highest average rent for a one-bedroom apartment in 2021



Source: "Average Rent by State 2021," World Population Review.

ranking the state 18th in the nation.¹² However, using the Supplemental Poverty Measure, which considers the cost of living (housing being the biggest component), California's poverty rate rises to 18.1 percent, the highest in the nation.¹³

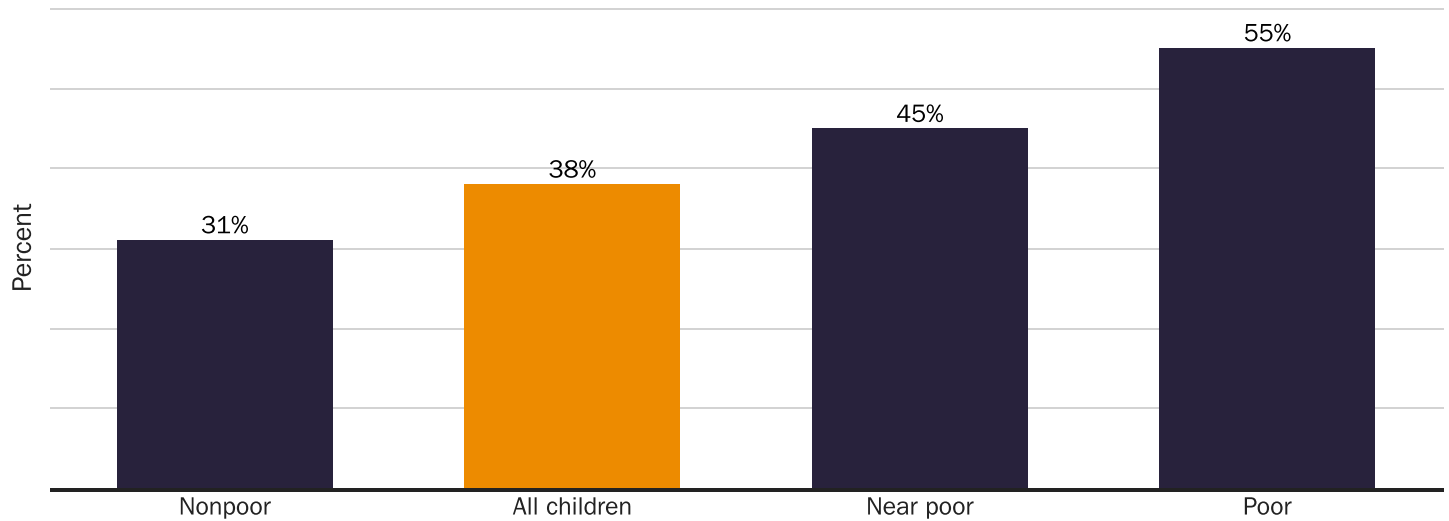
High housing costs harm low-income Californians in several ways. Most obviously, high rents put an enormous budgetary strain on Californians living in poverty. One study, for example, found that 38 percent of low-income families in Ventura and Santa Barbara counties were forced to cut spending for food or health care.¹⁴

Unsurprisingly, low-income people move far more often than those with better housing options. In part, this may be an attempt to move from neighborhoods with high crime, poor schools, and few resources.¹⁵ However, moves are also frequently precipitated by circumstances beyond a person's control, including an inability to pay rent, changes in family circumstances (i.e., the birth of a child or loss of a job), or the unsuitability of the conditions of the rental unit (i.e., lack of heat, plumbing problems, pest infestations, etc.).

An analysis of data from the American Housing Survey shows that 55 percent of children in low-income families move each year, compared to less than a third of children from non-low-income families (see Figure 2.4). Another study found that roughly 20 percent of low-income families had moved more than six times in six years.¹⁶ Families that spend more than half their income on rent were more likely to move than those with lower income shares spent on rent.

Studies also show that a lack of stable housing often brings about other forms of instability that contribute to trapping families in poverty. Results from the Milwaukee Area Renters Study, conducted from 2009 to 2011, found that workers who involuntarily lost their housing were roughly 20 percent more likely to subsequently lose their jobs compared to similar workers who did not lose their housing.¹⁷ Similarly, a 2015 study by Matthew Desmond and Carl Gershenson of Harvard University found that workers who had been forced to move were significantly (11–22 percent) more likely to be laid off compared to observationally identical workers who were not forced to move.¹⁸

Figure 2.4
Percentage of children who moved from 2007–2009 by income group



Source: Rebecca Cohen and Keith Wardrip, “Should I Stay or Should I Go? Exploring the Effects of Housing Mobility on Children,” Center for Housing Policy, February 2011.

Likewise, frequently uprooting children from their schools can make learning more difficult. A study by the Urban Institute found that “children experiencing residential instability demonstrate worse academic and social outcomes than their residentially-stable peers, such as lower vocabulary skills, problem behaviors, grade retention, increased high school drop-out rates, and lower adult educational attainment. . . . Residential instability is related to poor social development across age groups.”¹⁹

According to the Center for Housing Policy, families that move involuntarily face a higher risk of adverse educational outcomes following the move, such as increased difficulty in school and excessive school absenteeism among children.²⁰ Thus, housing instability can indirectly lead to poorer academic performance, which can mean an increased likelihood that children who are poor will become adults who are poor.

Californians are twice as likely to live in crowded housing than are Americans in general (in 2018, 8.3 percent of Californian households were crowded compared to 3.4 percent nationwide).²¹ California now has the second lowest number of housing units per capita, after Utah, of any state, 15 percent less than the national average. Some estimates suggest that California is short at least 3.5 million housing units compared to expected demand.²² Others indicate that the state will need to build 180,000–250,000 housing units per year to meet current needs.²³

The high cost of housing also forces people who are poor into neighborhoods with fewer jobs and resources, lower performing schools, and higher crime rates. Moreover, the search for affordable housing leads to longer commute times. According to a report by California’s Legislative Analyst’s Office, every 10 percent increase in a region’s median rent leads to an additional 4.5 percent increase in commuting time.²⁴

There are many factors driving the high cost of California housing. At its heart though is the simple matter of supply and demand. A state with job growth, natural scenic wonders, and a gentle climate will undoubtedly attract a growing population. Since 1950, California’s population has grown by 320 percent. That is generally a good thing—a growing population is an asset—but a growing population will inevitably put strains on housing stocks. Through the 1960s, California built many more homes relative to its population than the rest of the United States. This resulted in new housing for the many people who were moving to California, and at prices that, while higher than the national average, were still affordable to most families. However, in the 1970s and ’80s, California’s housing production dropped relative to the rest of the United States. The drop was even sharper in the highly desirable coastal regions.²⁵

Yet despite the need, the number of new construction permits declined over the past three years, falling by 5 percent

from 2017 levels (see Figure 2.5).²⁶ And this was before COVID-19 further slowed new housing starts.

THE STATE OF HOUSING IN CALIFORNIA

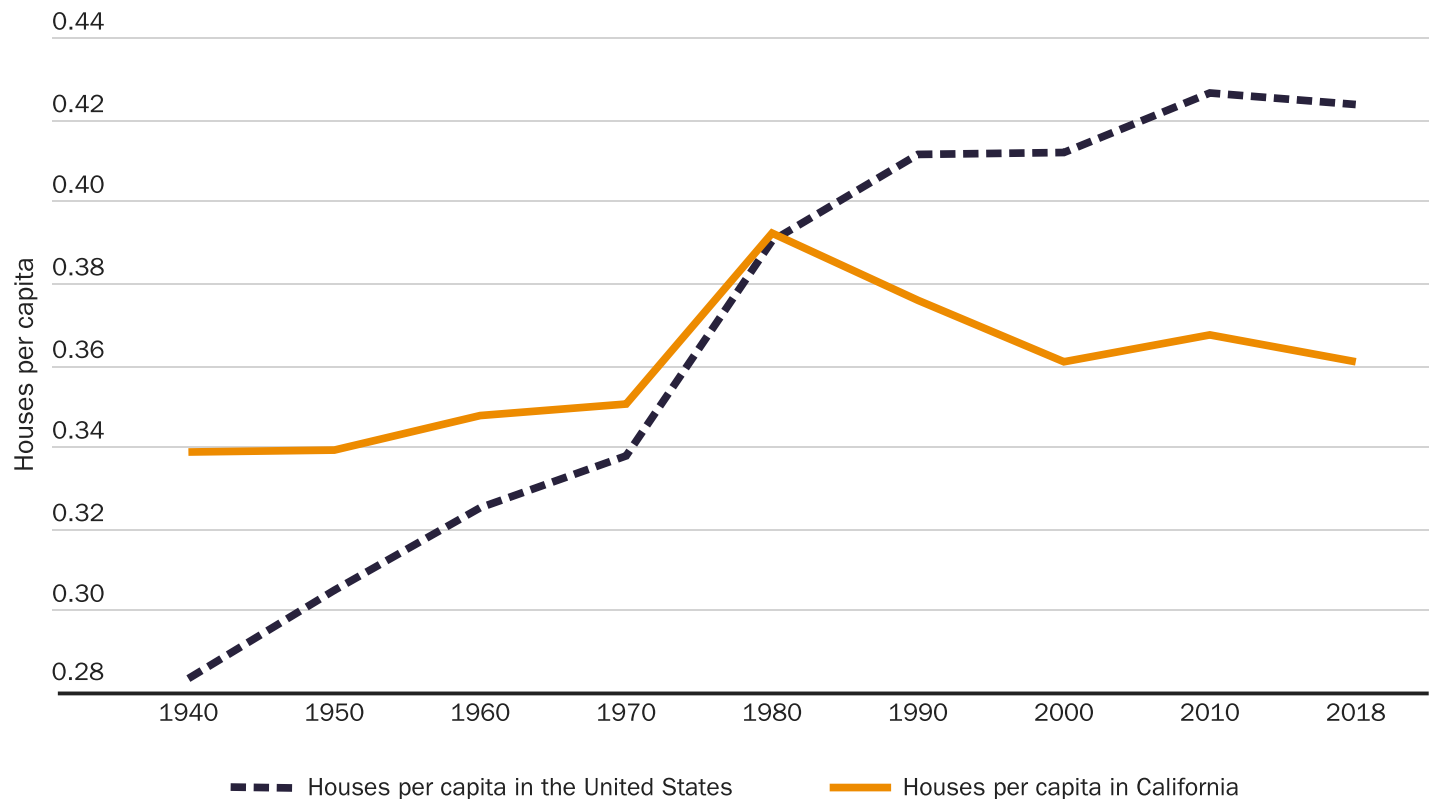
Given the factors driving the state's rapid population growth, we would expect strains on housing supplies and rising costs in even the best-run state. But far too many of California's housing problems are products of decades-old legislation and rulemaking that were either flawed from the start (such as exclusionary zoning policies) or went unreformed for so long that they fail to mirror the state's dynamic and decades-long transformation.

Currently, every city and county is required to develop a general plan that sets forth that community's vision for future development, including land use and housing. The housing provisions are supposed to be updated every eight

years to ensure that they meet the Regional Housing Needs Assessment (RHNA).²⁷ However, there are no penalties for noncompliance with this provision. As a result, a substantial minority of California communities, estimated to be at least 20 percent, do not update their housing plans as required. This includes such wealthy and populous communities as Huntington Beach.²⁸ Even those cities that do submit their plans often submit deficient ones, and only 18 California jurisdictions are on track to meet their RHNA goals.²⁹ Recent reforms have made the system better, and efforts to hold wealthy communities to the law's standards are admirable, but the system remains fundamentally flawed.

More significantly, wealthy communities frequently game the system to shift the housing burden to their less affluent neighbors. For example, Beverly Hills was required to plan for only *three* additional units of housing during the 2013–2021 planning period, while the much poorer city of Imperial, in Imperial County, with a population slightly

Figure 2.5
Growth rate of housing units per capita in California and the United States



Source: Author's calculations using "New Privately-Owned Housing Units Authorized by Building Permits," U.S. Census Bureau, 2018; and "Population Totals," U.S. Census Bureau, 2020.

more than half that of Beverly Hills and roughly the same geographic area was assigned over 1,300.³⁰ Notably, in 2013, Imperial’s unemployment rate was more than twice that of Beverly Hills. The RHNA process planned for unemployment, not equity.

Even when communities comply with the planning process, however, and assume a share of new construction that is not only equitable but economically efficient, they frequently fail to follow through and meet their housing goals: only a small share of new housing that municipalities plan for is eventually built.³¹

That is because a smorgasbord of state and local rules, regulations, and policies has made it far too difficult to build housing or provide shelter and services for homeless people. A “sizable” number of construction approvals in San Francisco, according to a report from the Turner Center, take more than 10 years.³² In Santa Monica, the median approval time for new housing is longer than three years.³³ In one well-known case, the city of Solana Beach has taken over 27 years to provide affordable housing units that it promised to residents.³⁴ The time required to secure approval for a project can vary widely between jurisdictions and even between projects that should be broadly similar. There is also a severe lack of data on approval processes, despite this clearly being of interest to policymakers and stakeholders.

It is extremely hard to change those barriers to housing because the immediate beneficiaries of higher housing prices are, naturally, existing homeowners, who see the value of their homes rise commensurately, as well as landlords, who can charge correspondingly higher rents. Municipalities also benefit from both higher property values and limits on low-income housing. Moreover, historically, zoning and other regulations have been driven by efforts to maintain racial and class homogeneity in neighborhoods.³⁵ This creates a powerful and well-connected NIMBY (not in my back yard) constituency that has blocked numerous new construction projects as well as efforts to reform the state’s building regulations.³⁶

Economists Roderick Hills and David Schleicher point out that the issues driving NIMBYism are much more likely to be of importance to wealthier residents. Poor families struggling to put a roof over their heads are less likely to be concerned

about whether there are sufficient “green spaces” or whether new construction blocks their view. As Hills and Schleicher put it, “On any given zoning vote, the supporters of restrictive zoning have an advantage over the supporters of additional housing supply even when less restrictive zoning across a given local government might be preferred by city residents.”³⁷

“It is extremely hard to change those barriers to housing because the immediate beneficiaries of higher housing prices are, naturally, existing homeowners.”

Despite, and because of, the continued resistance to reforms that would increase California’s housing production, housing and homelessness were the most important issue for California voters before the COVID-19 pandemic and will likely return to the forefront of the political conversation as the pandemic recedes.³⁸ While California’s housing shortage is the most widespread problem for low-income residents, California’s homelessness crisis is the most visible image of poverty in California. These challenges are closely related, and efforts to expand access to affordable housing will ameliorate California’s crisis of homelessness and stem the flow of low-income Californians to the streets.

RECOMMENDATIONS

Housing

California’s housing shortage is the product of decades of shortsighted government policies, and rolling back these government policies, many of which stemmed from institutional racism,³⁹ is the first step toward creating a future in which Californians at all income levels can afford housing. Notably, California’s strict regulation of land-use applies to subsidized affordable housing just as it does to market-rate housing. As such, reforming land-use regulation would help to make spending on subsidized housing in California more

efficient, in addition to promoting construction of market-rate developments. Clearly, these reforms should be an area where advocates of both free-market policies and continued government involvement should be able to work in tandem.

Reform is essential. California must build more housing. Therefore, we recommend the following.

End Exclusionary Zoning

Today's California landscape—acres of single-family houses across Los Angeles, San Diego, and even denser cities like San Francisco—wasn't predetermined. It was created by decades of government regulations; chief among these were zoning ordinances.

Zoning is typically set by each community to limit broad categories of development on each plot of land within the community. The limits apply to both type and form of use. Type zoning includes whether permitted development may be single-family residential, multifamily residential, or commercial, while form zoning specifies such things as building heights and bulk, the share of land that a building can occupy, the minimum distance between a building and roads or neighboring properties, and parking requirements. Some jurisdictions also include "design" requirements mandating that the physical form and aesthetics of development are uniform throughout a neighborhood.⁴⁰

There is consensus among economists that zoning inflates the cost of housing by limiting the amount of land available for housing as well as the amount of housing that can be built on a given piece of land, thereby reducing the overall availability of housing stock. As Harvard's Edward Glaeser points out, the price of a house consists of three elements: construction costs, the value of the land, and the value of the right to build on the property.⁴¹ Zoning and land-use laws drive up the value of the right to build on the property both directly and indirectly, leading to higher housing costs. According to a more recent study, zoning and other land-use regulations drive up the price of a quarter-acre lot by almost \$200,000 in Los Angeles and over \$400,000 in San Francisco.⁴²

Studies suggest that California's zoning ordinances increase housing costs by 30 percent in Los Angeles and Oakland and 50 percent in San Francisco and San Jose.⁴³

Until recently, more than 56 percent of available California residential property had been zoned solely for single-family homes, a much greater proportion than for similar high population states. But the state has finally begun taking steps to mediate the impact of zoning restrictions.

“Studies suggest that California's zoning ordinances increase housing costs by 30 percent in Los Angeles and Oakland and 50 percent in San Francisco and San Jose.”

In 2016, the legislature passed a package of laws to permit accessory dwelling units (ADUs) statewide and updated this legislation in 2017 and again in 2019.⁴⁴ ADUs are secondary dwellings on a property that cannot be bought or sold, such as a detached in-law's cottage or a basement rental apartment.

In 2021, the state went much further, passing Senate Bill 9, which allows property owners in most areas of the state to split their lots into two parcels and to construct duplexes on those lots. It effectively permits the construction of up to four units on property that had previously been zoned only for a single-family home.⁴⁵ This represents an important victory for affordable housing. Still, it remains to be seen how effective the legislation will prove in practice, since it leaves in place many of the nondensity zoning rules that can make duplex—or any new housing—construction impractical. Indeed, while abolishing single-family zoning (i.e., zones commonly classed as R1 in municipal zoning codes) has become a goal for land-use regulation reformers, the details of how municipalities mandate that new housing is constructed matter as much—if not more—than whether one or two units can be built on a given lot.⁴⁶

Many of these restrictions often act as hidden construction restraints, but even when they don't block new construction, they significantly increase the cost of building. According to the Legislative Analyst's Office, each additional requirement or restriction adds 3–5 percent to the cost of a home.⁴⁷

Common restrictions include parking requirements, setback rules, minimum lot sizes, and restrictions on tiny houses.⁴⁸

Parking Requirements

Among the most common nondensity restrictions are parking requirements: a mandate that a certain number of parking spaces be set aside for each new housing unit. Because available parking areas are often limited by spatial constraints, especially in urban areas, they effectively limit new construction. At a minimum, they force developers to purchase additional land and augment construction plans. In cities where land is expensive, this adds considerably to building costs. In Los Angeles, parking bundled with a housing unit was associated with \$200 more in monthly rent or \$40,000 in the purchase price.⁴⁹ And before they were repealed in 2018, parking restrictions in San Francisco were estimated to add \$20,000–\$50,000 to the cost of an apartment.⁵⁰ (San Diego has also eliminated some parking requirements but only for projects within half a mile of public transit.⁵¹) Today, all other California communities for which we have data mandate some sort of minimum parking requirement. Notably, a bill in the state legislature that would have eliminated parking requirements near transit was indefinitely stalled due to a procedural move.⁵²

“Individual renters and homebuyers can make decisions better than those imposed by zoning codes.”

Jurisdictions beyond California are already starting to reap the benefits of having cut their parking requirements: Miami, for example, eliminated parking requirements for buildings under 10,000 square feet, and new housing production that takes advantage of this change has begun to reach the market.⁵³

Setback Rules

In many areas, zoning codes require a certain amount of open space between a building and the property line or sidewalk. These regulations are designed to promote open space, to allow easier access to the property, and for a variety of other ostensibly public goals.⁵⁴ Generally, setback

requirements vary depending on a city’s zoning code and the zoning of a particular property and may be different for different sides of the building (i.e., the rear of a building as opposed to the front). In effect, setback requirements are what make “detached residential” zones detached: a required setback prevents building townhouses, which would share walls on the property line.

By mandating open space, zoning codes institute a one-size-fits-all solution to the problem of how to use land most effectively. By using setbacks to bundle open space with housing, municipalities force residents to buy or rent space that they may not need or want and to pay higher prices for a privilege they may not desire. A more market-based system, eliminating these mandates, would allow developers and property owners to build a variety of housing forms, including both detached and townhouse-type buildings, increasing housing supply at a wider variety of price points and more efficiently using valuable land. Individual renters and homebuyers can make decisions better than those imposed by zoning codes.

Minimum Lot Sizes

As the name suggests, minimum lot size requirements mandate that each building be located on a lot of no less than a given size, which varies depending on zoning and a municipality’s zoning code. Minimum lot size requirements are similar to density restrictions, although while a duplex or triplex, for example, would violate density limitations, they could be built without violating a minimum lot size requirement. Like setbacks and parking mandates, minimum lot sizes are a sort of “enforced bundling” regulation: the minimum lot size bundles land with a building without mandating that the land be used for open space or parking. The drawback of minimum lot sizes is that residents may or may not find the land desirable, but the property will undoubtedly cost more than an identical property without the additional land. A household may or may not want a yard, but forcing households to buy or rent a 4,000-square-foot lot when they only desire a fraction of that forces the housing market to provide a more costly form of housing at the expense not only of households’ budgets but also at households’ ability

to make the choice. Like parking requirements, the effect of minimum lot sizes may appear negligible to a casual observer, but a study of land-use regulation in Massachusetts shows that, in fact, this enforced bundling of land has among the highest effects on home price of any restriction.⁵⁵

Restrictions on Tiny Houses

A variety of restrictions block people from living in “tiny houses,” which typically are under 600 square feet in size and often significantly less expensive than traditional buildings.⁵⁶ Minimum lot sizes and density restrictions both play a part here. Building one tiny home on a lot can lead to only minor cost savings, given that minimum lot requirements would mandate the purchase of likely unnecessary land alongside the tiny home. Trying to use land more effectively and building more tiny homes on a lot, on the other hand, likely would run afoul of density restrictions in many areas. Despite these regulatory hurdles, tiny homes provide an important form of housing for a much lower cost and could reasonably become an important part of California’s housing stock.

“A variety of restrictions block people from living in ‘tiny houses,’ which typically are under 600 square feet in size and often significantly less expensive than traditional buildings.”

Moreover, permitting duplexes should be considered the bare minimum for housing reform. Any real fix for California’s housing shortage will require opening communities to multi-unit housing with few, if any, limitations.

Of course, some might argue that recent experience with the COVID-19 virus argues against increased density. Certainly, some of the hardest hit areas of California and the United States were among the most densely populated.⁵⁷ On the other hand, Seoul, South Korea, is 60 percent denser than Manhattan yet had far fewer cases. Moreover, a more

detailed look at county and borough breakdowns in the New York metro area suggests that density plays a smaller role than macro data indicate. Bronx County has the highest rate of infections per capita in the metropolis, while Manhattan County, the densest county in the United States, has the lowest.⁵⁸ Similarly, Staten Island appears to have a higher infection rate than Manhattan.⁵⁹ In California, San Francisco had a much lower infection rate than Los Angeles, despite much denser housing. Essentially, government delays and mismanagement of the crisis mattered a great deal more than simple density, despite a narrative highlighting density from some in government and the media.

We also need to differentiate between types of density. An apartment generates one type of density, but very expensive housing that results in multiple roommates or multiple generations sharing a very small apartment yields an equal density but under circumstances much more conducive to the spread of disease. Single-family housing requirements don’t necessarily reduce density as much as might be thought and may, in fact, lead to greater health risks.⁶⁰

Others argue that while affordable housing is needed, building more market-rate housing will do nothing to solve the problem. But this fundamentally misunderstands how housing markets work.

In a well-functioning housing market, filtration occurs. As people become wealthier, they tend to exchange their current living arrangements for better, more costly homes. They may move to a bigger apartment in a better neighborhood or buy instead of rent. In doing so, they make their previous, less expensive location available for new occupants. As everyone moves up the scale, units at the bottom open up for those with limited incomes. A lack of availability of housing at the upper end, however, locks everyone in place, ultimately leading to fewer available units at the lower end. Building more high-end housing actually increases the supply of affordable housing. One study, by the Upjohn Institute, found that building “100 new market-rate units create[d] about 70 below-median income equivalent units.”⁶¹

Some point out that inclusionary housing mandates, which require market-rate developments to set aside or otherwise fund below-market-rate units, are responsible for creating affordable housing when developers build market-rate

housing. While inclusionary mandates are well-intentioned, they act as a tax on new housing and can end up crowding out, rather than promoting, new housing supply.

Finally, some worry that new housing construction will lead to gentrification of low-income neighborhoods and will displace current residents. This is not an unwarranted concern. Rising rents have made it harder for Californians to stay in their homes, and people intuitively connect rising rents with the new “luxury housing” production that builders complete in response to rising rent. The empirical evidence, however, suggests that this first impression is not the case. In fact, according to another Upjohn study, new market-rate housing reduces rents in the surrounding area by 5–7 percent.⁶²

“New housing itself does not cause higher rents in the surrounding neighborhood, even if the new housing has a higher rent than the neighborhood’s median.”

Moreover, the feared displacement is already occurring despite existing housing restrictions. In fact, those restrictions contribute to displacement. Low-income communities are far less likely to have the time, access, information, or organization to block new construction. Developers, facing a lengthy, expensive, and litigious process if they attempt to build in upper-income communities, are likely to move new construction to lower-income neighborhoods.

Reducing zoning restrictions would instead make it easier to build in higher-income areas that have higher rents. A pro-building program would open these areas to new building and spread the new housing across a wider area, as opposed to the current concentration of new housing in lower-income areas where residents are at risk of displacement.

At the same time, rising rents are correlated with new market-rate housing construction because higher rents make these projects possible, but the new housing itself does not cause higher rents in the surrounding neighborhood, even if the new housing has a higher rent than the

neighborhood’s median. Market-rate housing also increases the overall housing supply in a neighborhood. It can be thought of as providing a sort of buffer, allowing more people in the neighborhood overall and allowing new residents in the area without significant out-migration. New housing is positive-sum rather than zero-sum: people can move into the new housing without existing residents moving out.

At long last, California has begun taking steps to increase its housing supply. But given the state’s desperate need for more housing, and the impact of high housing costs on the most vulnerable Californians, none of these changes is sufficient. California should eliminate exclusionary zoning restrictions once and for all.

Move to a By-Right/Ministerial Approval Process

With some local variations, there are two types of review process for new construction. The most common in California is discretionary review. Under this process, even if a proposed project complies with all relevant zoning and other regulations, planning authorities may choose to approve or deny a requested permit (i.e., they have discretion over the permit’s approval). In general, discretionary review processes allow members of the community to appeal the permit’s issuance, which triggers delays and a public hearing process during which a project’s opponents can voice their views. Notably, because discretionary permits include active decisionmaking by government officials, some level of review under the California Environmental Quality Act (CEQA) is required.

The alternative approach is by-right or ministerial review, under which authorities *must* approve a permit if it complies with all relevant zoning and other regulations (i.e., the approval is not granted at the discretion of authorities but pursuant to relevant laws). This process still takes time, but it is generally much quicker than a discretionary process, as the criteria for approval are more limited, as is the appeal process for those who object to the permit (if such a process exists at all).⁶³

In general, cities and counties choose which approval process they follow. Today, a third of California cities, including Santa Monica, Long Beach, and San Francisco, use discretionary review for most new housing, while a few,

including Los Angeles and San Diego, have a ministerial/by-right system for even some multifamily projects.⁶⁴ The biggest exception to local control over the review process is the Subdivision Map Act, which requires that when a lot is divided into smaller pieces, including vertically (such as for condominiums), there must be a discretionary approval process.⁶⁵ In the state's Coastal Zone, the California Coastal Commission also has the power of discretionary review over development projects.⁶⁶

“Today, a third of California cities, including Santa Monica, Long Beach, and San Francisco, use discretionary review for most new housing.”

Many jurisdictions, especially in coastal areas where opposition to new housing is strongest, require multiple layers of review. Planning commissions, building departments, fire departments, health departments, and city councils may all weigh in.⁶⁷

As a result, discretionary review can significantly delay new construction and/or increase its cost. One study, looking at the review process in the San Francisco Bay Area, found that every additional layer of review added 4 percent to the cost of a home.⁶⁸

Discretionary review also opens the door to corruption. The San Francisco Public Works scandal in early 2020 highlights the fact that arcane permitting processes provide opportunities for misconduct.⁶⁹ The regulatory process has created a very valuable and scarce good (building permits) with unclear standards for its distribution: nobody should be surprised when unscrupulous actors accept bribes or kickbacks in exchange for favorable treatment. In contrast, it's much harder to see opportunities for corruption in a ministerial process: the city has no discretion in deciding whether to issue permits and therefore has no discretion to abuse.⁷⁰

The good news is that in recent years rules for secondary review have been weakening. Los Angeles is perhaps the most notable case of a city moving to ministerial approvals

for some housing. Los Angeles allows developments with up to 50 units to go through a ministerial, rather than discretionary, process. In 2014–2016, about a quarter of projects with more than five units in Los Angeles went through a ministerial process. Clearly this is better than the process in other cities, but from the fact that so many projects still went through a discretionary process, it is apparent that Los Angeles can further broaden its reforms.⁷¹

The biggest attempt at statewide reform came in 2016, when then governor Jerry Brown proposed changes to streamline the system of approvals, reducing both the time and cost involved for many new construction projects. Brown would have

- established a statewide ministerial permit process for multifamily infill housing projects that conformed to existing zoning regulations and included at least 5 percent affordable housing,
- established time limits for local officials to raise objections to these projects,
- limited design review,
- eliminated CEQA review, and
- required relocation assistance for displaced households.⁷²

Brown's proposal failed in part because unions objected to its lack of a prevailing wage provision. However, with some changes, it could still serve as a starting point for reform at the statewide level. In particular, the Legislative Analyst's Office has suggested that the affordable housing requirements be dropped.⁷³ Those changes would make the proposed reforms even more effective.

However, localities don't need to wait for state action. As Los Angeles and San Diego show, much of the push for reform has happened at the local level. A good start would be for municipalities to institute a ministerial process for all permitting of multifamily homes that comply with relevant zoning and land-use regulation. There would still be challenges (such as the Subdivision Map Act), but requiring developers to clear another hurdle and adding another delay to much-needed new housing make no sense if the proposed development complies with all relevant laws.

Restructure the California Environmental Quality Act

With the possible exception of single-family zoning, few California regulations have had as much effect on the housing supply as the California Environmental Quality Act (CEQA). Former governor Brown once called reforming CEQA, “the Lord’s work.”⁷⁴ CEQA reform has been advocated by other top Californian officials from across the political spectrum, including Sacramento mayor and former state senate president pro tempore Darrell Steinberg, State Sen. Andreas Borgeas of Fresno, business leaders, and affordable housing advocates.⁷⁵

Passed in 1970, and signed into law by then governor Ronald Reagan, CEQA was intended to provide local decision-makers with information and to ensure that environmental effects were not overlooked in approving new development. In practice, it has proved cumbersome and ripe for abuse.

The law mandates environmental review covering as many as 18 separate areas, including parking, traffic, air and water quality, endangered species, and historical preservation.⁷⁶ This is a notably stricter standard of review than other states: only Washington state, Minnesota, New York, and Washington, DC, have comparable requirements.

Most CEQA reviews for housing go relatively smoothly, requiring only a preliminary review. However, for the substantial number of projects that require a more extensive Environmental Impact Report (EIR), the process can be both lengthy and expensive. A study of CEQA reviews from 2004 to 2013 found that, on average, local agencies took two and a half years to approve a project requiring an EIR.⁷⁷

As problematic as that delay can be, it is not the EIR process that causes the most concern about CEQA’s effects on affordable housing. Rather, it is a provision that allows virtually anyone residing in California to sue virtually any project based on environmental concerns. The goal was worthy—to give average citizens, who would be most affected by environmental impacts, a role in the approval process. In practice, all sorts of people sue for all sorts of reasons, which may or may not be truly related to environmental impact. For instance, labor unions may sue to obtain control over allocation of jobs or to force higher wages. Rival developers may sue to delay or block a competing project. So-called bounty hunters file suit to score a quick financial settlement. And, of course, NIMBYs

frequently sue to block projects that they feel would be disruptive to the “character” of their communities.⁷⁸ Moreover, in roughly half of CEQA lawsuits, the person or organization filing the suit is anonymous.

The overwhelming majority of CEQA suits are not related to housing. In fact, about half target government projects. Still, a substantial number (roughly 29 percent) concern residential development, and more than two-thirds of those target the sort of infill projects that are unlikely to have major environmental impacts (see Figure 2.6).⁷⁹

“A good start would be for municipalities to institute a ministerial process for all permitting of multifamily homes that comply with relevant zoning and land-use regulation.”

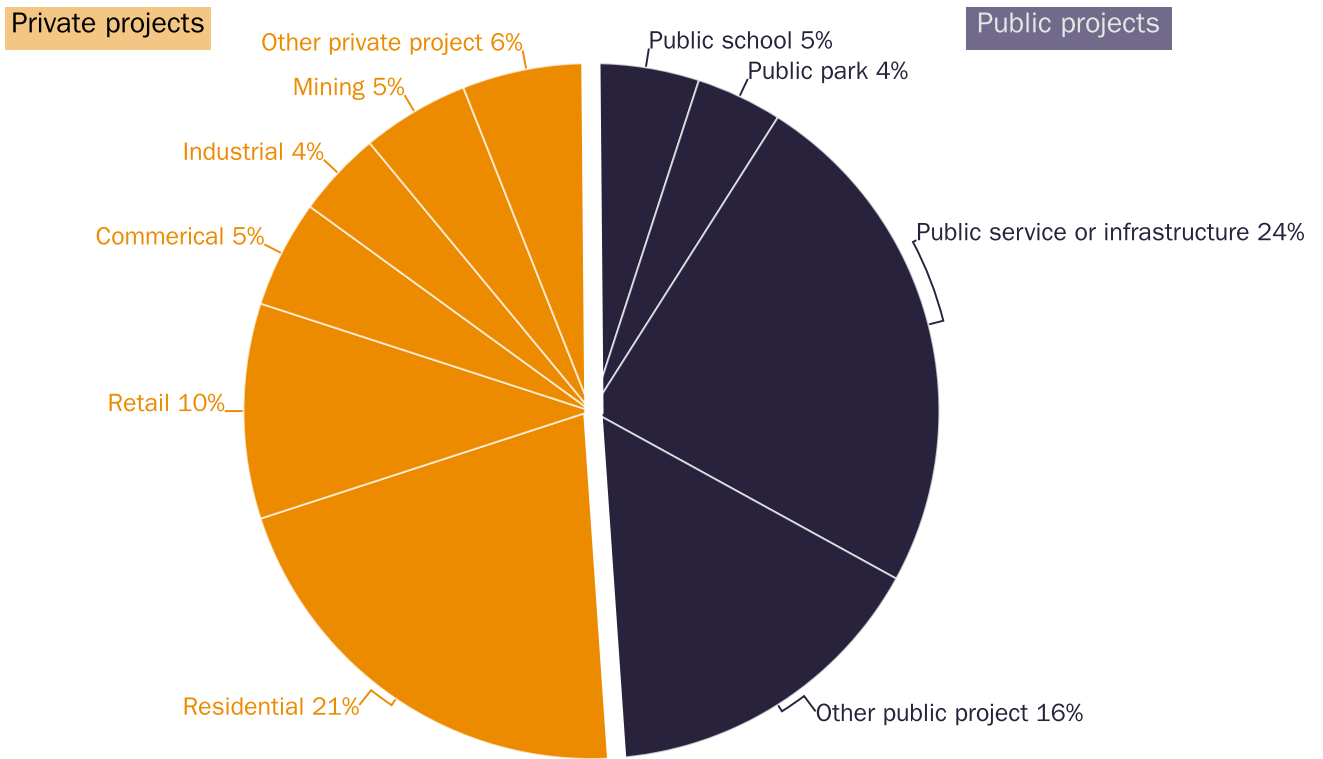
Theoretically, there is an exemption for infill housing (known as a Class 32 exemption). The Class 32 exemption has five criteria:

- consistent with general plan zoning,
- occurs within city limits and lot size is less than five acres in an urban area,
- not in an endangered species habitat,
- no significant effects on traffic, noise, air quality, or water quality, and
- served by utilities and public services.

However, a Class 32 exemption doesn’t realistically cover all infill housing (traffic impact is an easy hook to use against it). Additionally, while getting a Class 32 exemption may be one of the easiest methods to CEQA compliance, that process itself is far from painless. And finally, the threat of lawsuits remains even if a project has received a Class 32 exemption.⁸⁰ There is also an exemption stemming from a 2018 law for housing and mixed-use projects in unincorporated county areas. But that is not likely to help cities that face the biggest housing crunch.

Figure 2.6

California Environmental Quality Act challenges to public and private projects spending for 2020–2021



Source: Jennifer Hernandez et al., “In the Name of the Environment: How Litigation Abuse under the California Environmental Quality Act Undermines California Environmental, Social Equity, and Economic Priorities—and Proposed Reforms to Protect the Environment from CEQA Litigation Abuse,” Holland & Knight, 2019.

Looking strictly at lawsuits that are filed may understate CEQA’s effects because the mere threat of litigation is often enough to force the cancellation of projects or obtain a settlement that reduces the number of housing units and increases their cost. As local elected officials repeatedly told our project, CEQA is frequently used as “a blackmail tool.”

There are several ways to reform CEQA to prevent its abuse while continuing to ensure adequate environmental protections. A report by Jennifer Hernandez and David Friedman includes a set of reforms to CEQA that we would direct policymakers’ attention to:

- require CEQA lawsuit filers to disclose their identities and interests,
- eliminate duplicative lawsuits for projects that have completed the CEQA process, and
- restrict judicial invalidation of approvals to projects that would harm public health, destroy irreplaceable tribal resources, or threaten the ecology.⁸¹

In addition, the Class 32 infill exemption could be expanded, with traffic impact being removed as a hurdle for projects near high-frequency transit. Another approach to CEQA reform would be expanding ministerial approval processes, given that ministerially approved projects are already exempt from CEQA review. The ministerial option is particularly notable as it can be pursued at the local level, without potentially contentious state legislation.

Standardize and Cap Building Fees

The construction of new housing can bring economic benefits to communities, promoting regional and state-wide economic growth, enhancing employers’ access to the labor pool, and generating additional tax revenue. On the other hand, new construction also imposes costs on a community through increased demands for public services and infrastructure. In general, housing tends to bring less tax revenue compared with new costs than commercial

development. This is especially true given Proposition 13's limitations on property taxes. Therefore, communities attempt to recoup these costs by imposing a variety of fees on new development. Those fees can add considerably to the cost of new construction, from 6 to 18 percent of the cost of a home.⁸²

The number, timing, and size of fees varies significantly from city to city, adding about \$20,000 to the cost of a home in Sacramento, more than \$80,000 in Oakland, \$140,000 in Orange County, and a probable state high of \$157,000 in Fremont.⁸³ On average, California has the highest such fees in the nation. Notably, these fees have been particularly hard on low-income Californians, communities of color, and first-time homebuyers. In some anti-growth communities, fees have been deliberately set so high as to discourage building altogether.

“Fees are a politically popular way to finance government services because they spare current homeowners and businesses while hitting easy and unpopular targets such as developers.”

Such fees are a politically popular way to finance government services because they spare current homeowners and businesses while hitting easy and unpopular targets such as developers (who then pass the cost to renters and future homeowners). And if the high cost of new housing keeps low-income families and people of color out of some communities, that is often a goal as well.⁸⁴

Still, the necessity for increasing building and impact fees is debatable at best. While Proposition 13 certainly limited property tax revenue, California government at all levels has hardly been starved for revenue. Between 1977 and 2018, local government revenue increased from \$3,300 per person to \$4,183.87 (in 2019 inflation-adjusted dollars), according to data from the Census Bureau.⁸⁵ Other revenues, particularly for school districts and transportation funding, increasingly come from the state. Accordingly, state government revenue

increased from \$3,745.45 per person in 1977 to \$5,193.00 in 2017 (in 2019 dollars).⁸⁶

California's government is clearly larger today than it was in 1977. Local governments employed four times as many people on a per capita basis in 2018 as they did in 1977, while the state doubled its per-capita inflation-adjusted expenditures since Proposition 13 passed.⁸⁷

It is entirely appropriate to debate California's overall tax burden and the structure of taxes it imposes. But the use of building and impact fees as a generalized revenue source is contributing to the state's shortage of affordable housing.

Building fees should be limited to offsetting the actual cost of development on a community's services. Accordingly, California should establish a statewide cap on fees based on the median home price with a jurisdiction. Assemblyman Tim Grayson (D-Concord), for example, has introduced legislation that would limit fees to 12 percent of the median home value unless there is a waiver from the state.⁸⁸ In addition, such fees should be assessed on a per-square-foot basis, thereby removing a disincentive for the construction of smaller, less-expensive homes.

Reduce the Power of Local Agency Formation Commissions

Local Agency Formation Commissions (LAFCOs) are regional planning commissions that regulate land use, determine city boundaries, and oversee “special districts” that provide services to many cities, such as fire and police services, water and sanitation, and airport and harbor oversight. While this role is important for services that cut across traditional municipal boundaries, LAFCOs also increase housing costs through intervention in the development process, both as a regulatory agency and as a planning authority.

LAFCOs regulate city and special district boundaries, so any city that wishes to expand must receive LAFCO approval. Given the political dynamics of new housing construction in areas with resisting populations, many cities may find it easier to build housing on undeveloped land. But this often requires expanding the city's boundaries, and that is where they run up against the power of LAFCOs.

Because LAFCOs are made up of elected and politically appointed officials, they are subject to the same political pressures that have limited new housing construction. In particular, LAFCOs are highly responsive to the powerful and well-organized NIMBY constituencies rather than to those seeking additional housing. Moreover, LAFCOs are charged with preventing urban sprawl, protecting agricultural land, and preserving open spaces. But “urban sprawl” can be interpreted in a variety of ways, depending on the interests of political and social groups that wish to prevent development. As a result, the same inefficient, time-consuming, expensive, and often litigious approval process ends up restricting this potential supply of new housing, as is seen with housing within current municipal boundaries.

“Far too many Californians experiencing homelessness have simply ‘fallen to the street’ because they lack access to affordable housing.”

Legislators should limit the discretion and authority of LAFCOs to block new housing construction. A regulatory structure that was established decades ago in a very different environment should be updated to reflect the state’s housing crisis. LAFCOs should operate with a general presumption in favor of boundary expansions for the purpose of building new housing. In particular, legislators should eliminate LAFCOs’ responsibility to prevent urban sprawl and should substitute a charge that LAFCOs prioritize the expansion of city boundaries and their spheres of influence to accommodate new housing that can efficiently tie into existing city services and organizations.

Homelessness

The increasing number of Californians experiencing homelessness represents a profound human tragedy. It also represents a challenge to the community. There are distinct community quality-of-life issues tied to increased

homelessness. And as the COVID-19 pandemic has shown, there are also public health issues.⁸⁹ There was urgency to solving the homeless crisis prior to the outbreak. That has only increased in its aftermath.

The lack of affordable housing has been a significant contributor to the state’s growing homeless population. Statewide, California has more than 130,000 homeless people, including around 28,000 in the San Francisco Bay Area and 60,000 in Los Angeles County.⁹⁰ Even often-overlooked cities such as San Diego have homeless populations in excess of 8,000.⁹¹ (Even a small county like Santa Barbara has more than 1,800 people experiencing homelessness.) By some calculations, more than half of all people who are homeless in America reside in California (see Figure 2.7).⁹²

Homelessness is often attributed to issues outside housing, such as mental health and substance abuse. Obviously, many of the people in California who are homeless, particularly those who are visibly unhoused and on the streets, suffer from one or both challenges. But far too many Californians experiencing homelessness have simply “fallen to the street” because they lack access to affordable housing. Any interruption in income—because of a lost job, medical problem, family emergency, etc.—can lead to eviction and then to homelessness. Some estimates suggest that in cities like Los Angeles, as many as two-thirds of homeless people fall into this latter category.⁹³

Our recommendations that are designed to make housing more affordable overall would go a long way toward reducing the number of people experiencing homelessness. However, there are also specific steps that the state should take to deal with homeless populations, including the following recommendations.

Reverse Efforts to Criminalize Homelessness

Many localities have responded to the rise in homelessness by enacting a variety of measures to criminalize behavior associated with homeless people, such as sleeping, sitting, or panhandling in public places.

One study, by the University of California, Berkeley School of Law, found that California was among the leading states

in terms of anti-homeless laws. At least 58 California cities, counties, and towns had passed more than 500 separate ordinances that made common behavior by homeless people illegal. Compared to other states, California cities were 25 percent more likely to have laws against sitting, lying down, or other types of loitering and 20 percent more likely to have a citywide ban on sleeping in public. While nationally only a third of U.S. cities prohibit sleeping in a car or other vehicle, fully 74 percent of California cities do.⁹⁴ Moreover, as the number of people experiencing homelessness in California has increased, so too have the number and severity of these laws (see Figure 2.8).⁹⁵

These laws are an attempt to respond to legitimate quality-of-life issues associated with large homeless populations. However, they are neither effective nor humane.

Law enforcement interacts with homeless populations in several ways. Some cities, like San Francisco, maintain special police “homeless outreach officers” to respond to issues surrounding homelessness, both in terms of services and law enforcement. People who are homeless also regularly encounter police officers working their beats. And, of course, the police respond to complaints involving

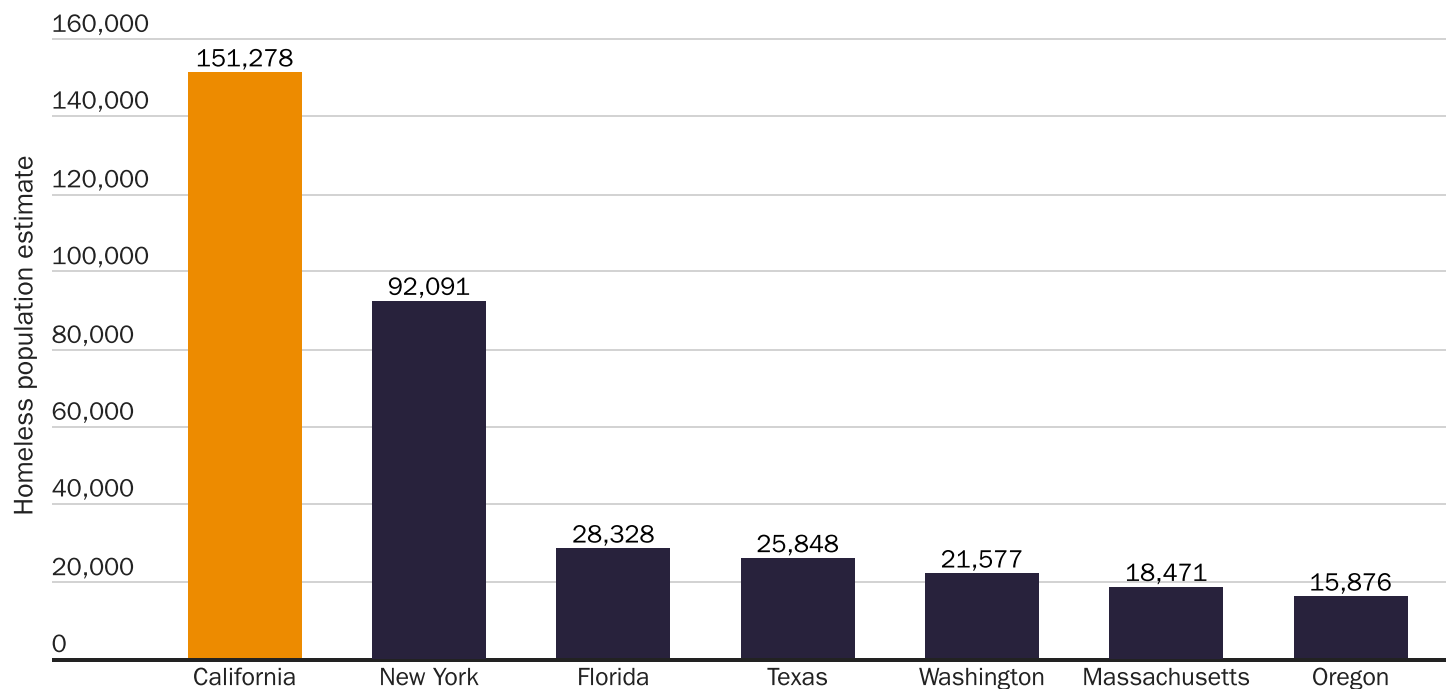
homeless people. According to a survey of people without housing in San Francisco, 45 percent of those living on the street, 46 percent of those camping in parks, and 20 percent of those living in a vehicle reported being approached by police at least once monthly.⁹⁶

While many of these interactions are relatively benign, others raise serious concerns about civil liberties. For example, 56 percent of respondents to the previously mentioned survey report being searched in the past year, 46 percent within the past month.⁹⁷ This suggests something akin to a “stop and frisk” policy applied to homeless populations.

Most frequently police simply try to move homeless people from areas of high concentration or visibility. This seldom results in any permanent change, as most people simply move to another location. In the absence of shelters or other forms of housing, there is simply no place for them to go.

Some police practices are considerably more troubling. For example, police frequently confiscate or destroy a homeless person’s possessions, including blankets, tents, sleeping bags, cash, identification, and prescription medications. Roughly 46 percent of homeless people in San Francisco

Figure 2.7
Homelessness by state, 2020



Source: “State of Homelessness: 2020 Edition,” National Alliance to End Homelessness, 2020.

reported having belongings confiscated within the past year, and 38 percent said those items were destroyed.⁹⁸

Such actions are particularly counterproductive. If a person is living in a vehicle, and the vehicle is then towed, police have deprived the person of not only what is likely their most valuable asset but also their residence. Similarly, confiscation or destruction of someone's personal property makes their life harder, and the loss of identification can make it especially hard to access services, find housing, or gain employment.

People who are homeless are also frequently cited and fined for minor quality-of-life violations. According to the San Francisco Human Services Agency, for example, police in that city alone issued 51,757 citations for "quality of life" crimes that predominantly or exclusively involved homeless people between 2004 and 2014. Some 22,000 of these were violations of such laws as bans on sleeping in public.

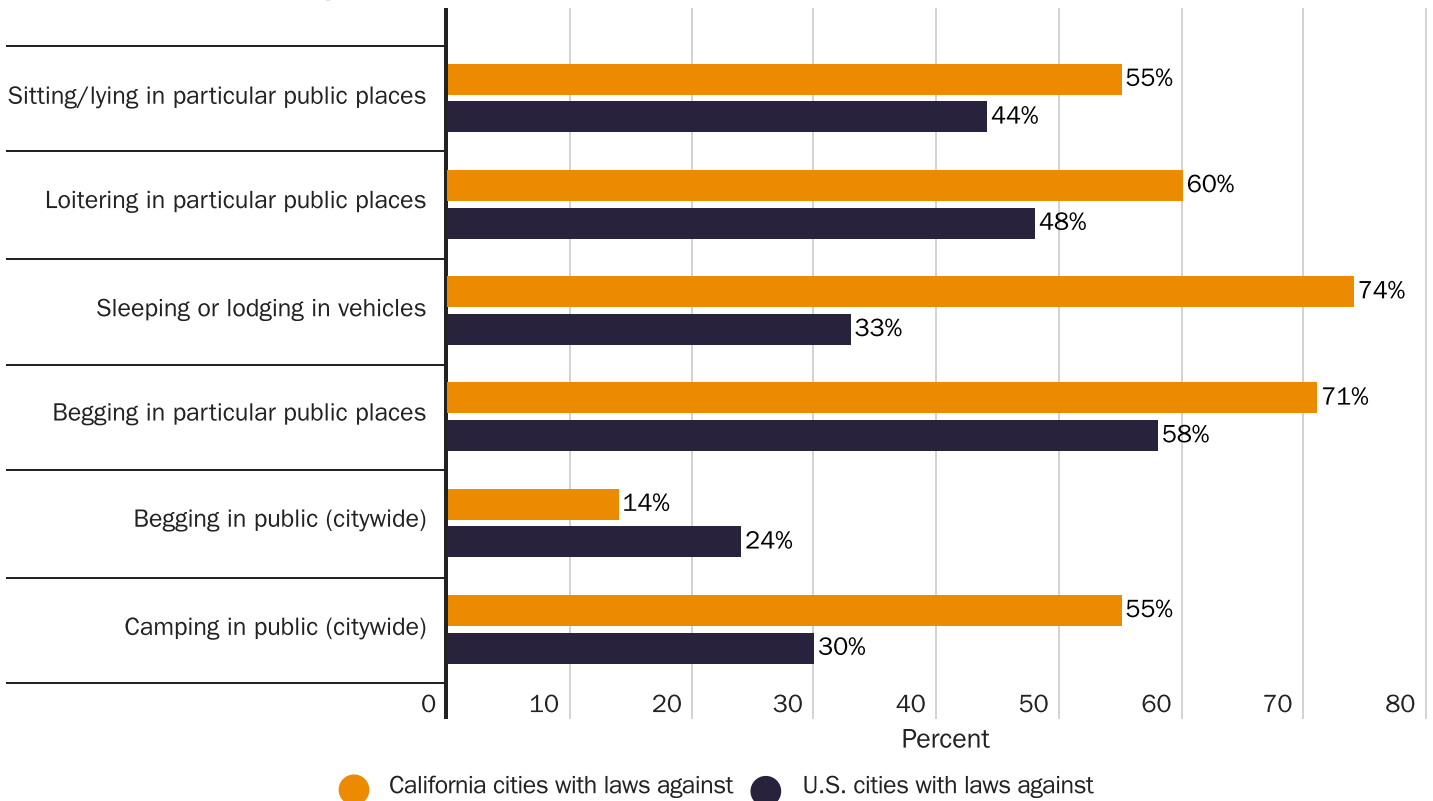
The excessive use of fines disproportionately affects low-income Californians (see pp. 44–45). Those issues are

likely to loom even larger for the homeless population, which is unlikely to have the resources to pay such fines. As a result, many homeless people are likely to end up in jail. In San Francisco, as much as 5 percent of the city's homeless population is in jail on any given night, and fully half of the city's homeless people have spent at least one night in jail in the past year.⁹⁹

Even brief jail time can lead to a vicious cycle that traps people on the streets. There is a perception among some elected officials that jail can offer rehabilitative services to people experiencing homelessness that they would not otherwise receive. This perception, however, is inaccurate. A report by the state auditor's office found that only a fraction of inmates receive mental health services, job training, or other rehabilitation (see Figure 2.9).¹⁰⁰ There is no reason to expect that this is better in county jails, especially because the length of stay is often not long enough for rehabilitation to be attempted. Incarceration is not helpful for a person's mental health or job prospects.

Figure 2.8

Prevalence of laws that target homelessness in California compared to the nation



Source: Marina Fisher et al., "California's New Vagrancy Laws: The Growing Enactment and Enforcement of Anti-Homeless Laws in the Golden State," Berkeley Law Policy Advocacy Clinic, February 12, 2015, <http://dx.doi.org/10.2139/ssrn.2558944>.

Strengthen California's Conservatorship Laws While Continuing to Protect Civil Liberties and Individual Autonomy

While a lack of affordable housing remains the biggest single driver of homelessness, we cannot ignore the fact that some homeless people are suffering from mental illness or substance abuse problems so severe that it inhibits their ability to function within society. Some of these individuals are clearly a danger to themselves or others or are so incapacitated that they cannot seek assistance on their own.

In 2019, California passed legislation designed to strengthen the state's conservatorship laws, creating a pilot program that allows county health officials to force some homeless individuals into housing and/or treatment. The program applies to individuals who have been placed on a psychiatric hold eight times within a year. The affected individuals are entitled to legal representation and can contest the mandated treatment.¹⁰¹ Currently, this program is being tried in Los Angeles, San Diego, and San Francisco.

Given the long history of abuse of involuntary commitment, there is a particular need to exercise caution in

strengthening conservatorship. Historically, that abuse has particularly affected women, the LGBTQ community, and people holding unpopular political opinions. There is a need to respect individual autonomy and lifestyle choices even if we disapprove of those choices. However, concerning people who are mentally ill and homeless, this respect for autonomy must be carefully balanced with a recognition that some people are—at least temporarily—unable to sensibly make and appreciate choices.

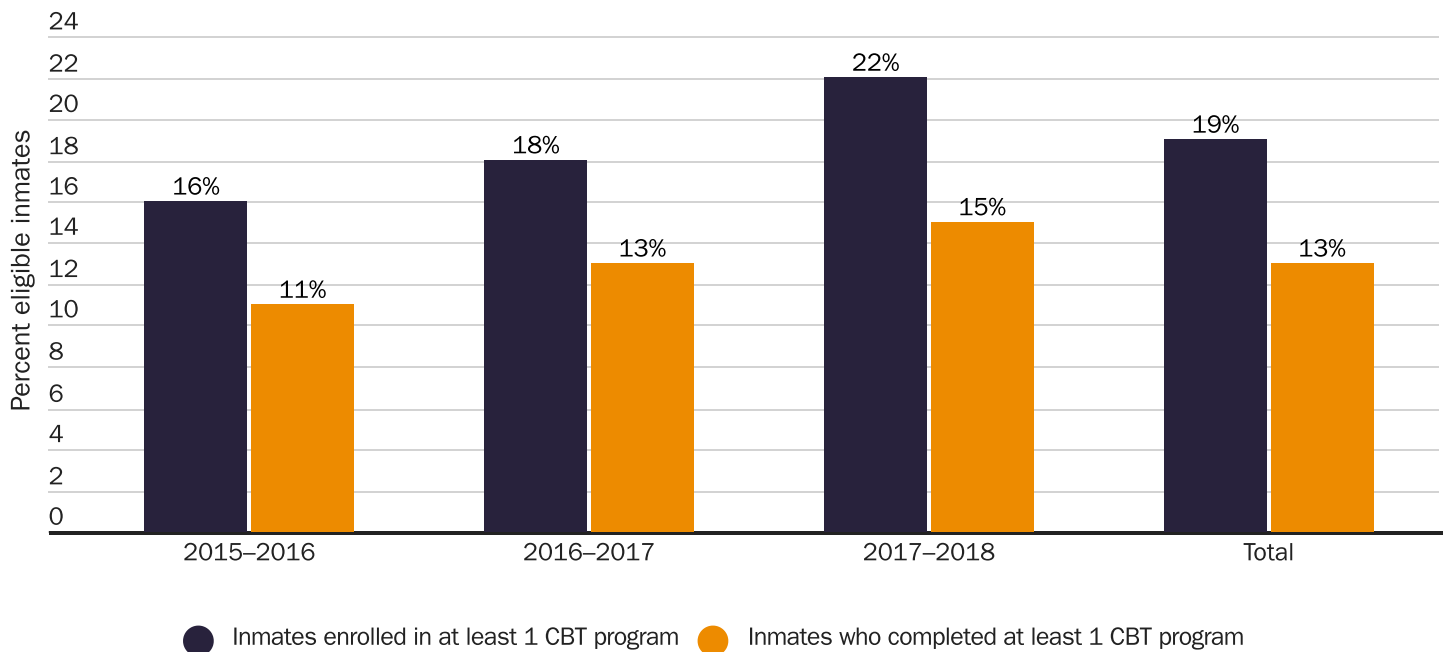
It is also important to differentiate conservatorship from the law enforcement approach. The purpose of conservatorship is to ensure treatment and housing, not to punish. We have too often seen where the involvement of law enforcement causes the situation to escalate.

Expand and Extend CEQA Exemptions for Homeless Housing/Shelter Projects and Allow Emergency Shelters in Any Zone

As previously discussed, CEQA has been a barrier to affordable housing. But CEQA has also been used to block

Figure 2.9

California inmates enrolled in cognitive behavioral therapy (CBT) programs



Source: "California Department of Corrections and Rehabilitation: Several Poor Administrative Practices Have Hindered Reductions in Recidivism and Denied Inmates Access to In-Prison Rehabilitation Programs," California State Auditor Report 2018-113, January 2019, <http://www.auditor.ca.gov/pdfs/reports/2018-113.pdf>.

Note: CBT is designed to help inmates with mental health problems.

shelters and other services for homeless people. Given that CEQA opens the door to often-frivolous lawsuits, neighbors can sue to delay much-needed new shelter space, and they have done so in several cases.¹⁰²

Homeless shelters are a stopgap measure in California's work to house residents, but it's a necessary one. For some community members to block or delay housing for unsheltered neighbors is disappointing, but at its heart, it is a problem with the law that California can take bolder steps toward fixing. California has already taken some steps to exempt homeless shelters from CEQA, and legislation introduced last year would have expanded those exemptions statewide, but it died in committee.¹⁰³

State law does require critics to designate zones in which homeless shelters are permitted, but some cities have chosen

“We cannot ignore the fact that some homeless people are suffering from mental illness or substance abuse problems so severe that it inhibits their ability to function within society.”

zones that account for relatively small areas of the overall municipality.¹⁰⁴ There is simply no compelling rationale for putting up regulatory hurdles to prevent the provision of shelter for homeless residents. Shelters for people experiencing homelessness should be allowed by-right in all parts of a city. While shelters are a stopgap measure, they are a necessary one.

Section 3: Poverty and Criminal Justice Reform

Criminal justice reform is traditionally thought of more as a question of social justice—particularly at times of reckoning with racism and other inequities in the system—rather than as an anti-poverty measure. Yet a closer look shows it to be not only a consequential step toward reducing poverty but also an essential one.

As President Barack Obama’s Council of Economic Advisers pointed out in 2016:

The costs of criminal justice policies are not limited to direct government expenditures. Individuals who obtain a criminal record or serve a prison sentence often face difficult circumstances when they return to society. Having a criminal record or a history of incarceration is a barrier to success in the labor market, and limited employment or depressed wages can stifle an individual’s ability to become self-sufficient. Beyond earnings, criminal sanctions can have negative consequences for individual health, debt, transportation, housing, and food security. Further, criminal sanctions create financial and emotional stresses that destabilize marriages and have adverse consequences for children.¹

Politicians love to portray themselves as “tough on crime.” But there are real consequences to heavy sentencing in terms of poverty. A study by scholars at Villanova University concluded that mass incarceration has increased the U.S. poverty rate by an estimated 20 percent. Another study found that a family’s probability of being poor is 40 percent greater if the father is incarcerated.² Since an estimated 1.5 million children had a parent in state or federal prison as of 2016, this is an enormous problem.³ Minority children are particularly at risk. Rates of parental incarceration are two to seven times higher for African American and Hispanic children than white children. An African American child whose father does not have a high school diploma faces roughly 50/50 odds that

the father will be in prison by the child’s 14th birthday.⁴ In addition, children of incarcerated parents are at high risk for several adverse life outcomes, including anti-social and violent behavior, mental health problems, dropping out of school, and unemployment. Harvard political scientist Robert Putnam points out that there is a “spillover effect” in areas of high incarceration, affecting even children whose parents are not incarcerated.⁵

“A study by scholars at Villanova University concluded that mass incarceration has increased the U.S. poverty rate by an estimated 20 percent.”

Estimates suggest that if a father goes to a detention facility, the likelihood increases by 38 percent that his family will fall into poverty while he is incarcerated.⁶ Also, incarceration permanently affects wages. Someone who has been incarcerated can expect to earn roughly 40 percent less than someone who has avoided detention. And the effects are long-lasting. A Pew Charitable Trusts survey found that inmates released in 1986 were still in the bottom 20 percent of incomes in 2006, 20 years after completing their sentences.⁷

Of course, that assumes that people who were previously incarcerated can find jobs at all. Recent job application experiments find that applicants with criminal records were 50 percent less likely to receive an interview request or job offer relative to otherwise identical applicants with no criminal record. Those disparities were even more significant for African American applicants.⁸ A study by the National Institute of Corrections found that being arrested at any point in a person’s life was a bigger barrier to finding a job than any other employment-related stigma, including long-term unemployment, being on welfare, or

having a GED instead of a high school diploma.⁹ Another study of recently released prisoners in New York City found that only 9 percent had jobs paying more than minimum wage and that more than half were unemployed.¹⁰

Among those with a criminal record, the combination of greater difficulty in finding a job and lower wages not only consigns them to poverty but also makes it much harder for them to provide for their families, either directly or through paying child support. That is one reason why states report that as many as 40 percent of “hard to collect” child-support cases involve a parent with a criminal record.¹¹ This often creates a vicious cycle because failure to pay child support can result in arrest and imprisonment, making future payment even more difficult.¹²

Of course, incarceration is not the only reason for low wages and increased unemployment among those with a criminal record. The people most likely to go to prison are disproportionately likely to experience other markers of socioeconomic disadvantage, including low educational attainment, weak attachment to the workforce, and substance abuse or mental health problems. Approximately 65 percent of respondents to a 2003 nationwide survey of incarcerated people had not completed high school, and 14 percent had less than an eighth-grade education.¹³ Many were unemployed before prison, or at least not employed in traditional jobs, and pre-incarceration incomes for this group were already far below their nonincarcerated peers.¹⁴ After all, educated, financially stable individuals with few social problems are less likely to commit crimes.¹⁵

A GOOD START, BUT MUCH MORE TO DO

In recent years, California has developed a reputation as a leader on criminal justice reform. The state has made progress, significantly reducing incarceration rates even before COVID-19 forced the widespread early release of non-violent offenders.

This is a significant shift from the state's scandalous past. By 2006, California had more than 253,000 inmates in its adult correction facilities, including roughly 173,000 in prisons—more than double the system's capacity.¹⁶

The inhumane conditions resulting from such overcrowding led the courts to order a reduction in the state's prison population to no more than 137.5 percent of capacity, a decision that the Supreme Court upheld in 2011.¹⁷ In response, California passed the 2011 California Public Safety Realignment Act (Assembly Bill 109), which transferred many nonviolent and low-level offenders from state prisons to county jails.

“Among those with a criminal record, the combination of greater difficulty in finding a job and lower wages consigns them to poverty.”

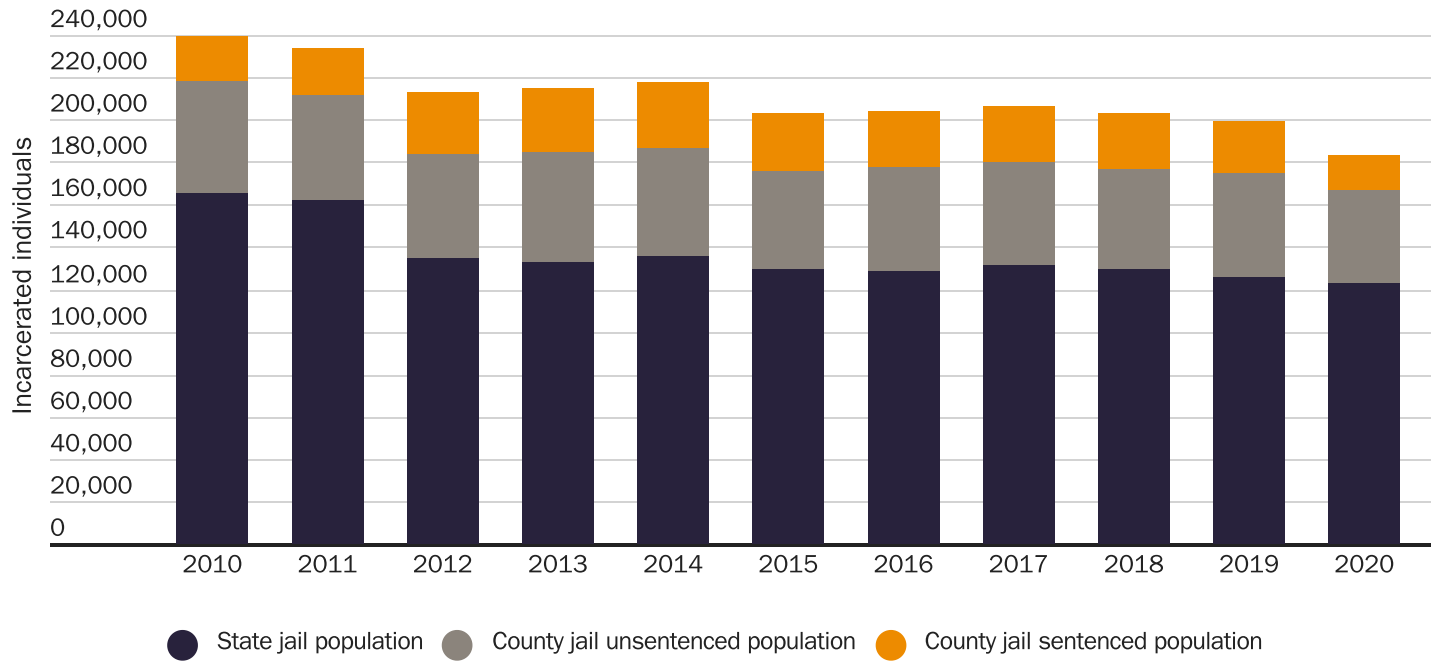
This shifted inmates in the prison system, but there was only a modest decrease in the overall population. A much bigger change occurred in 2014 with the passage of Proposition 47, which reduced many petty offenses from felonies to misdemeanors. The legalization of marijuana in 2016 also led to reductions in incarceration.

As a result, the state's prison and jail populations have declined by 31.5 percent since 2010 to 182,738 by 2020 (see Figure 3.1).

The reduction in incarceration does not appear to have led to any increase in crime rates (see Figure 3.2). Indeed, California's overall crime rate is low. There was an uptick in murder rates in 2020 and 2021, but that was common in metropolitan areas across the country. Nor, contrary to some criticism, has it been a driving force behind the state's growing problem with homelessness (see Figure 3.3).

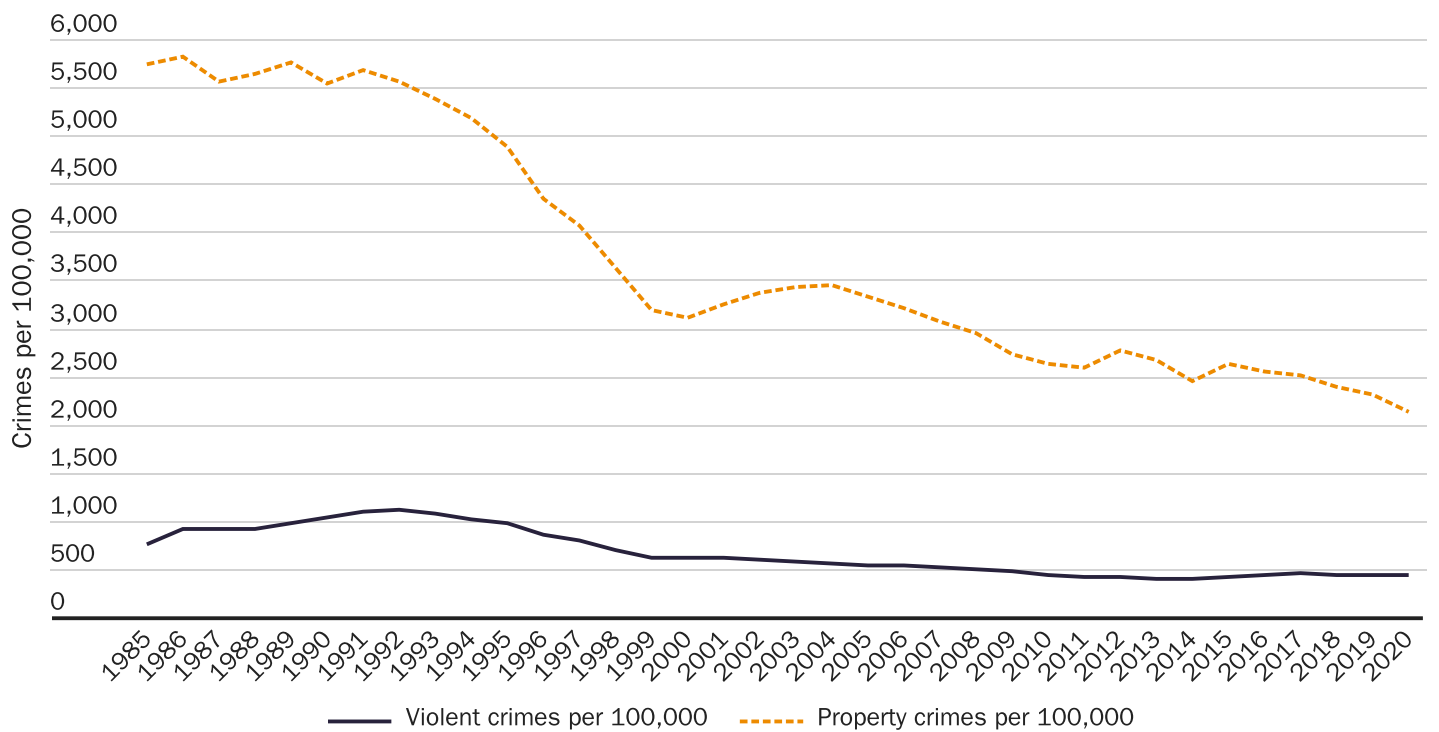
COVID-19 has forced further reduction in the state's incarcerated population. Prisons, with their densely packed populations, are natural breeding grounds for the virus. For instance, as of October 2020, three-quarters of San Quentin's 2,900 inmates had tested positive for COVID-19, and 28 inmates had died from it. By August 2021, almost 400 prison staff also had contracted the virus, and at least one had died from it.¹⁸ Other state prisons and local jails have seen similarly high infection rates. As a result, the courts have ordered substantial reductions in prison

Figure 3.1
California's incarcerated population



Source: "Jail Profile Survey," California Board of State and Community Corrections, https://www.bscc.ca.gov/s_fsojailprofilesurvey/; and "Adult Population Projections 2007–2012," California Department of Corrections and Rehabilitations, 2007, https://web.archive.org/web/20171219032429/http://www.cdcr.ca.gov/Reports_Research/Offender_Information_Services_Branch/Projections/S07Pub.pdf.

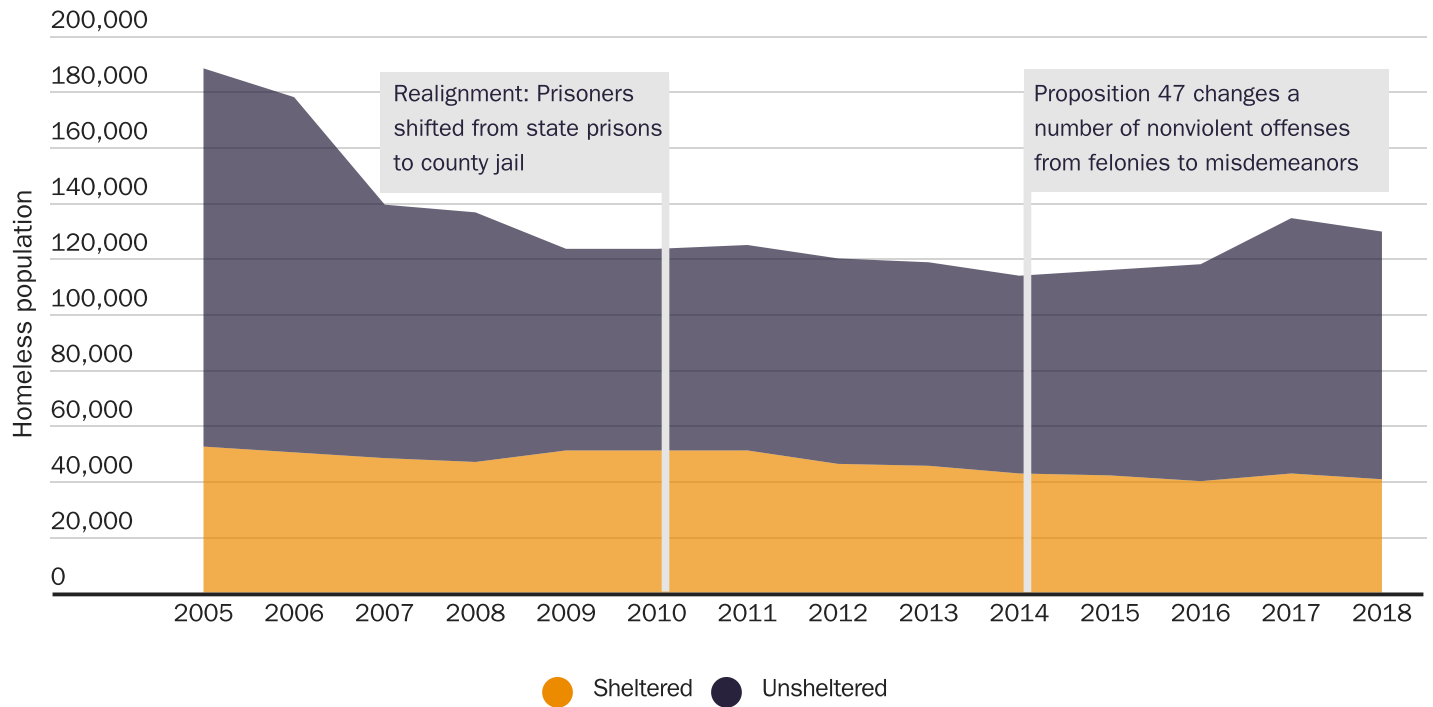
Figure 3.2
California's historical crime rates



Sources: Author's calculations using "Crimes and Clearance Statistics," California Department of Justice, 2020, <https://openjustice.doj.ca.gov/exploration/crime-statistics/crimes-clearances>; and "Resident Population of California," Federal Reserve Economic Data, updated December 24, 2020, <https://fred.stlouisfed.org/series/CAPOP>.

Figure 3.3

California homeless populations and Proposition 47



Source: "CoC Homeless Populations and Subpopulations Report," HUD Exchange, U.S. Department of Housing and Urban Development, <https://www.hudexchange.info/programs/coc/coc-homeless-populations-and-subpopulations-reports/>.

populations. Gov. Gavin Newsom gave COVID-19 as one major reason to close two state prisons over the next three years.¹⁹ Overall, the state's prison population has declined by 18 percent between February and July 2020. Even larger decreases occurred in some county jails.²⁰

As a result of both COVID-19 mitigation efforts and earlier ongoing reforms, California's prison population is now nearly as low as it was in 1993 (see Figure 3.4).

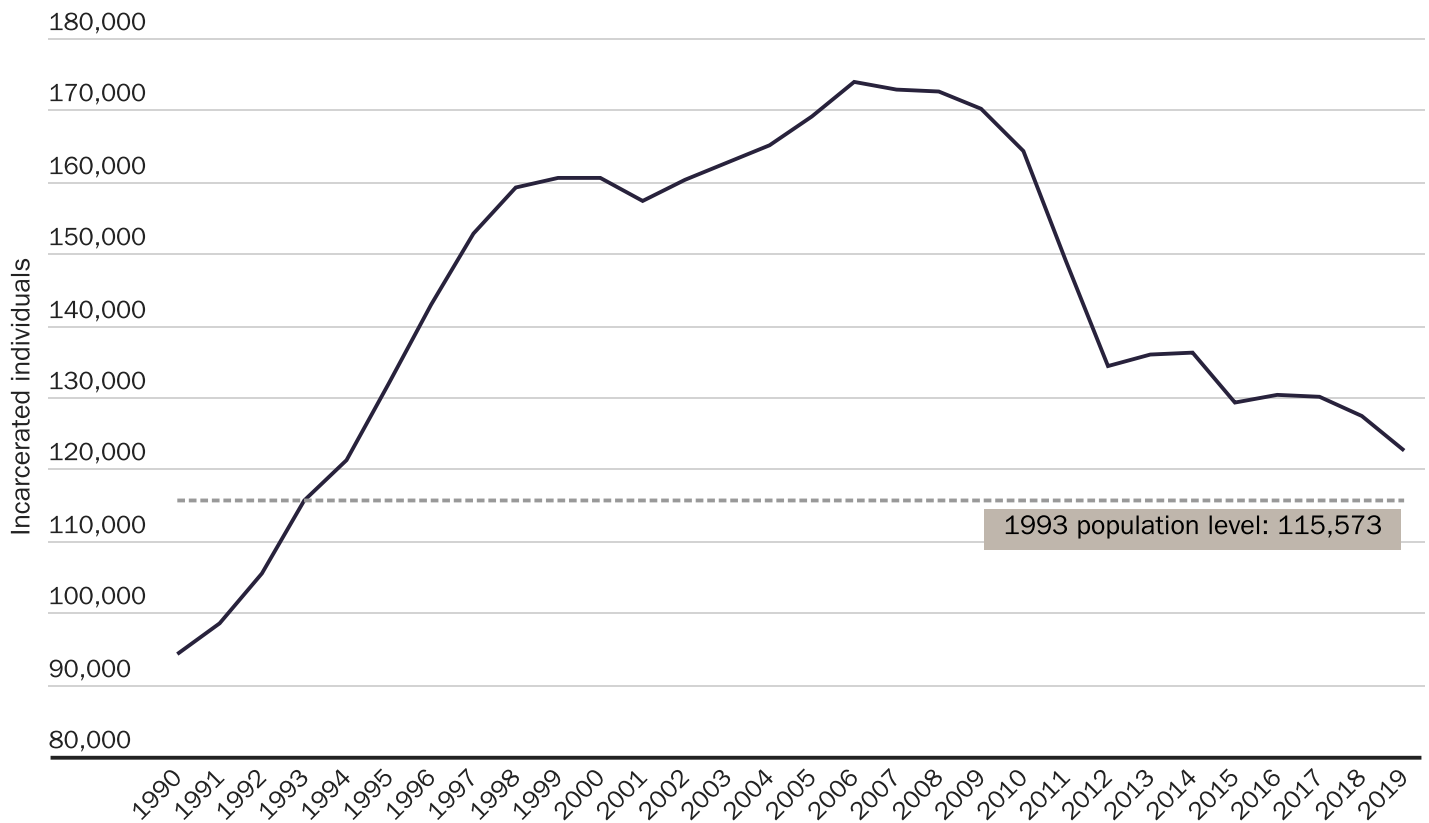
However, the system continues to burden communities of color and people with low incomes. About 115,000 Californians remain behind bars, many for nonviolent offenses. On a per capita basis, California's incarceration rate ranks 32nd, higher than other large, urban states such as Illinois, New Jersey, or Massachusetts, although it's notably lower than the median, reflecting success in some of the state's reforms.

Achieving criminal justice reform has, of course, been complicated by the increase in shootings and other violent crime in some California cities. Many cities, including Los Angeles, Oakland, and San Diego, have seen spikes in violent crimes, especially shootings and homicides.

Statewide, the murder rate in 2020 was 5.5 homicides per 100,000 population, compared to 4.2 per 100,000 in 2019. In absolute terms, this amounted to a year-on-year increase of 523 homicides.²¹ On the other hand, property crimes decreased from 2019 to 2020, continuing a decades-long trend that started in about 1990.

Previous criminal justice reforms, as well as the policies of reformist district attorneys, are often blamed for both real and perceived increases in crimes. Such blame is misplaced. For instance, there appears to be no correlation between changes in crime rates and the policies followed by local district attorneys. San Francisco District Attorney Chesa Boudin has pursued some of the most progressive reform efforts, yet assaults in the city are down from 2019 to 2020. Homicides have increased, but the increase was smaller than in other U.S. cities during the same period.²² San Diego, on the other hand, saw increased homicides despite not having made any of the far-reaching changes that Los Angeles or San Francisco made.²³ While opponents of criminal justice reforms are quick to blame the changes for an increased homicide rate, they often fail to acknowledge

Figure 3.4

California's historical prison population

Source: "Prison Population over Time," The Facts: State-by-State Data, Sentencing Project, 2020, <https://www.sentencingproject.org/the-facts/#detail?>

that property crimes continue to decrease. Rising crime rates have become a standard political talking point, but the facts on the ground appear much more nuanced.

Realistically, it will only be possible to determine the causes for 2020's increased homicide rate after more time has passed. More importantly, it is still too soon to tell whether this is the beginning of a long-term trend. All the same, it's just as necessary for advocates of reform to acknowledge the increased homicide rate and put forward an explanation for it as it is for opponents of reform to acknowledge that there is not, in fact, an increase in many types of crime. It is also, as a matter of public opinion, important for reformers to help the public understand what is happening in an evidence-based way: recent polling has shown that almost two-thirds of Californians think that crime is getting worse, yet they also support expanding rehabilitation, as opposed to returning to the incarceration rates of previous eras.²⁴

Beyond the possibility that 2020's homicide rate was statistical noise, the COVID-19 pandemic, which made

2020 an aberration in so many ways, could be at the root of the increased murder rate. Reporting from elsewhere in the nation has suggested that school closures, virtual schooling, and increased time spent at home made it harder for civil society and community groups to access at-risk youth and try to prevent crimes.²⁵ The mental health effects of the pandemic may also play a role.²⁶ Advocates of increased incarceration counter that, unlike the United States, many international jurisdictions saw decreased murder rates despite the pandemic, but these accounts do not acknowledge that many international jurisdictions had stricter lockdown policies, often including curfews, and they do not engage with the divergent trends in property crime and violent crime.²⁷

Obviously, reform of the criminal justice system must be carried out responsibly and with full attention to the need to protect Californians from crime. But both as a matter of justice and as a vital part of any anti-poverty program, responsible reforms must be pursued.

RECOMMENDATIONS

Resist Any Effort to Roll Back Recent Criminal Justice Reforms

California Propositions 47 and 57, passed in 2014 and 2016, respectively, are landmarks in the evolution of California's criminal justice system. While the two initiatives were different, the two campaigns were closely connected, and the propositions warrant discussion in the same setting. Proposition 47 focused on sentencing, while Proposition 57 focused on parole.

Proposition 47 had three main effects:

- It reclassified some theft and drug-related crimes from felonies to misdemeanors.
- It allowed individuals serving sentences for felonies that were reclassified to petition for resentencing under the new rules.
- It allowed individuals with past convictions for reclassified felonies to have their criminal records changed in accordance with the new rules.²⁸

In practice, this meant that several crimes, including forgery and receiving stolen property, which could previously have been charged as either felonies or misdemeanors, can now only be charged as misdemeanors. Shoplifting and petty theft (both applying to property valued at less than \$950) became misdemeanors only, with shoplifting carrying a maximum sentence of six months in jail.²⁹

Proposition 57 also had three major points:

- Individuals incarcerated for nonviolent offenses became eligible for parole after serving the full length of the sentence for the primary crime for which they were sentenced (i.e., the sentence that was the longest). Notably, this includes nonviolent "third strike" offenders serving indeterminate-length sentences.³⁰
- It expanded opportunities for "good behavior" credits toward parole consideration, including introducing credit for educational and rehabilitative programs. Notably, violent offenders (except those sentenced to

death or without the possibility of parole) are eligible for this provision as well.³¹

- It shifted the responsibility from prosecutors to judges for deciding whether juvenile suspects of certain crimes will be tried as adults.

Propositions 47 and 57 both passed by significant margins—60 and 65 percent of voters respectively supported the initiatives³²—but they have also received significant criticism since implementation. Some of this criticism blames the propositions for increased property crime.³³ The evidence for those claims is mixed. A University of California, Berkeley, study found that, with some caveats, a possible increase in property crime of 5–7 percent—an increase to be sure but not the spike that Proposition 47 and 57 detractors claim occurred. A more substantiated criticism would note that rehabilitation efforts promised by the Proposition 47 and 57 campaigns have been poorly implemented.³⁴

“Obviously, reform of the criminal justice system must be carried out responsibly and with full attention to the need to protect Californians from crime.”

Critics of the reforms put an initiative (Proposition 20) on the 2020 ballot that would have singled out one change from each of the previous initiatives for rollback. It would have introduced a new felony charge for serial theft, allowing individuals to be charged with a felony the third time they are charged with theft below Proposition 47's \$950 threshold (but above a new \$250 threshold). It would also have exempted individuals convicted of any of a list of 22 violent or sex crimes from the easier parole consideration standards implemented by Proposition 57.³⁵ Californians rejected Proposition 20 by an overwhelming 62–38 percent margin.³⁶

Nevertheless, opponents are expected to continue pushing for changes to these landmark reforms. Another ballot initiative cannot be ruled out. Californians should resist these efforts.

Beyond simply resisting calls to roll back criminal justice reforms, California policymakers should be more vocal about the state's successes in these areas, as well as place them in context more effectively. While California has made major steps forward on criminal justice reform and decarceration, Propositions 47 and 57 should be the beginning of the conversation, not the end. Notably, while California's incarceration rate is low by U.S. standards, it is still relatively high by worldwide standards, more than double that of comparable countries like Canada and South Korea. Clearly, then, there is much room for continued improvement.³⁷

All the same, support for Propositions 47 and 57 and opposition to Proposition 20 show that Californians have meaningfully shifted away from the "tough on crime" views of the past. In fact, elected officials may be lagging public opinion in this area, leaving an opportunity open for courageous policymakers to push forward with further reforms to criminal sentencing and parole. On the other hand, future opportunities for major reform may be more difficult than what has already been accomplished. So far, reforms have focused on nonviolent offenders, so California's state prison population is overwhelmingly composed of people who have committed violent or otherwise serious crimes. According to a report by the California Budget and Policy Center, just under half of new prisoners in 2017 had been convicted of assault or weapons charges.³⁸

Take Additional Steps to Reduce Overcriminalization

Meaningful reform needs to start at the beginning of the criminal justice process—not only with policing practices but also with the laws that the police enforce. Far too many "crimes" are designed to protect us from ourselves, impose a value judgment against vices or other conduct that a majority disapproves of, or turn errors of judgment into illegal activities, even in the absence of intent. Too often, criminal law is used as a blunt instrument against a broad range of societal issues. Worse, some communities see the criminalization of minor offenses as a form of revenue.

Politicians should realize that every time they make something illegal, they are empowering the police to enforce that

law with force, with all that entails for the criminal justice system. A law is not merely an advisory opinion; it opens the door to the use of force, arrest, trial, imprisonment, and all the rest. Moreover, enforcement for minor offenses has long been applied unequally, with serious consequences for low-income communities and minority populations.

“Beyond simply resisting calls to roll back criminal justice reforms, California policymakers should be more vocal about the state's successes in these areas.”

Opportunities for reducing overcriminalization include

- decriminalizing drugs,
- rolling back the criminalization of tobacco,
- decriminalizing sex work,
- decriminalizing traffic infractions,
- ending disproportionately punitive “anti-gang” enforcement,
- repealing California's “three strikes” law and eliminating mandatory minimum sentences,
- separating mental health treatment from the criminal justice system when possible,
- overhauling the California Penal Code,
- preventing over-policing, and
- expanding options for restorative justice.

Decriminalize Drugs

The most obvious area for reform is the so-called war on drugs. Given that 8 percent of prisoners admitted to California's state prison system were convicted on drug charges (and likely at least as high a percentage of county jail inmates), this is the largest area for decarceration outside of violent or property crimes. Although California legalized marijuana in 2016, the state continues to arrest about 220,000 people annually for drug-related crimes.³⁹ This has a significant effect on poverty given that a criminal

record halves a person's chance of gaining employment.

The war on drugs has largely failed, and a new approach is necessary. Marijuana legalization was an important step in the right direction (although aspects of the new regulatory regime for marijuana businesses could be better-tailored), but like Propositions 47 and 57, it should be a first step rather than the last step. Other jurisdictions have made bold steps forward on drug decriminalization that reduce incarceration without serious adverse effects. Perhaps the best example of drug decriminalization is in Portugal, which decriminalized all drugs in 2001. Police in Portugal are no longer allowed to make arrests for drug use, yet adverse drug-related public health outcomes have decreased.⁴⁰ In the United States, the first major step toward drug decriminalization was made by California's neighbor, Oregon, which decriminalized all drugs pursuant to a ballot measure in 2020.⁴¹ While it is still too early to assess the effect of Oregon's decriminalization measure, a report from Oregon's Criminal Justice Commission projected that beyond criminal convictions dropping overall, the measure would nearly eliminate the racial disparity in drug convictions.⁴²

“In the United States, the first major step toward drug decriminalization was made by California's neighbor, Oregon, which decriminalized all drugs pursuant to a ballot measure in 2020.”

Roll Back the Criminalization of Tobacco

While California has made dramatic steps forward on criminal justice reform, and especially on the prohibition of controlled substances, in some areas the state has taken significant steps back. Perhaps the most significant regression concerns the regulation of tobacco products. In recent years, California has raised the age for tobacco consumption and banned flavored tobacco. State lawmakers' push to institute new laws criminalizing tobacco use is puzzling given that the same lawmakers have simultaneously realized that the same sort of laws are counterproductive when applied to marijuana

and other drugs. The same concerns apply to California's ban on flavored tobacco as apply to a flavored tobacco ban at the federal level, which a coalition of criminal justice reform and civil rights groups criticized on the grounds that it would open the door to unnecessarily punitive enforcement and racial disparities.⁴³ California policymakers need to know that although these policies may cause modest declines in tobacco use, they are not without notable tradeoffs. Additionally, these laws (and related alcohol regulations) narrow entrepreneurship opportunities that could create jobs.

Decriminalize Sex Work

Of course, drug and other controlled substance laws are not the only laws against victimless crimes that adversely affect the poor. Sex work accounted for almost 9,000 arrests in 2014, the most recent year for which complete data were accessible.⁴⁴ While this is a relatively small share of California's total arrests, decriminalizing sex work is an important and achievable reform. California has taken some steps in reforming the law around sex work, but there is more to be done. Los Angeles County, for instance, under the new administration of District Attorney George Gascón, is declining to prosecute new cases of California's law against loitering to commit prostitution.⁴⁵ This is a straightforward reform that could easily be applied elsewhere to roll back the harmful effects of the criminal justice system on low-income people.

Decriminalize Traffic Infractions

While most traffic- and driving-related offenses are infractions (i.e., administrative rather than criminal), they all too often open the door to racial profiling and other institutional problems that disproportionately affect Californians who are poor. There is a long history documenting how driving-related enforcement has narrowed individuals' Fourth Amendment rights.⁴⁶ In particular, there is an ongoing problem with pretextual stops, in which police officers stop drivers for minor offenses to uncover evidence for unrelated (and sometimes imagined) crimes. Our colleagues have criticized this law enforcement practice elsewhere, and empirical evidence suggests that these stops exacerbate racial

disparities.⁴⁷ Indeed, the California Highway Patrol curbed its use decades ago in response to racial profiling concerns, and San Francisco has recently rolled back its use.⁴⁸ On the other hand, reports suggest that law enforcement in some cities still widely use pretextual stops, leading to deteriorated relationships between communities and law enforcement.⁴⁹ A concrete step toward rolling back racial injustice in policing and building better relationships between police and communities would be to curb searches after unrelated traffic stops, except in extenuating circumstances or where there is probable cause for a search unrelated to the traffic stop.

Beyond rolling back pretextual stops, the Los Angeles County district attorney, in the same reform package as the sex worker change, is declining to prosecute cases of driving on a suspended license or without one, except for repeat offenses. This is another infraction that disproportionately affects people in poverty.⁵⁰ Drivers' licenses are often revoked or suspended because of inability to pay unrelated criminal justice fines or fees. Viewed through this lens, these laws do little more than criminalize poverty in many cases.

Opponents of reform will likely argue that these changes will harm public safety on the roads. Los Angeles' new policy will provide evidence with which to evaluate this claim and will act as a test case for this potentially helpful policy.

End Disproportionately Punitive Anti-Gang Enforcement

Alongside criticism of California's anti-gang enforcement more generally, on grounds that it exacerbates racial disparities, the use of gang-related sentencing enhancements has come under criticism, including from the California Committee on Revision of the Penal Code.⁵¹ The committee's report notes that over 90 percent of individuals sentenced with gang enhancements are African American or Hispanic. Beyond the issue of racial disparities, there is little conclusive evidence that these sentencing enhancements are an effective approach to anti-gang enforcement.

Understanding of gangs has advanced since these sentencing enhancements were instituted. Most gang members leave in under two years, and community-based responses, rather than law enforcement and incarceration, are more

effective at rolling back gang activity.⁵² California has an opportunity to bring its legal system up to the current state of knowledge about anti-gang enforcement by taking these sentencing enhancements off the books. The savings realized from reduced incarceration could be used to fund community-based nonpolice interventions that help individuals avoid gangs and prevent criminal activity by gangs.

Repeal California's "Three Strikes" Law and Eliminate Mandatory Minimum Sentences

In addition to reducing overcriminalization (i.e., reducing the number of infractions that can saddle people with jail time or financial penalties), California must take further steps to minimize the use of unnecessarily long prison sentences. The research on whether sentence length is an effective method of deterring or preventing crime is ambiguous, but many people remain in prison long after their likelihood of reoffending has dropped to a very low level.⁵³ Particularly with Proposition 57's provisions that expanded access to parole, California has already made steps toward ensuring that individuals' sentences are not excessively long, but there is still more to be done.

“California law includes provisions that require mandatory minimum sentences for nonviolent offenses, including drug offenses.”

As noted by the California Committee on Revision of the Penal Code, California law includes provisions that require mandatory minimum sentences for nonviolent offenses, including drug offenses.⁵⁴ One-size-fits-all approaches like mandatory minimum sentences prohibit discretion in sentencing and prevent judges from taking the nuances of a particular case or a particular convicted individual's situation into account. Particularly for nonviolent offenses, this sort of discretion is necessary and can allow for alternatives to incarceration that better support the rehabilitation of convicted individuals without unduly impairing their earning potential or ability to support family members.

Additionally, California should repeal its “Three Strikes” law. The Three Strikes law has already been revised by Proposition 36, which expanded access to rehabilitation options for individuals who would otherwise have received enhanced sentences under Three Strikes. However, according to data from Californians for Safety and Justice, over 18,000 people are in California prisons for nonviolent “third strike” sentences.⁵⁵ This amounts to just over 15 percent of the state prison population as of 2020.⁵⁶ Clearly, given the number of people, and particularly the number of nonviolent offenders, affected by Three Strikes, this is still a pressing area of reform for California policymakers. And much like the case against mandatory minimum sentences, the reasoning behind repealing Three Strikes is simple: it unduly constrains judges from tailoring sentences to individual offenders, considering all the relevant circumstances.

Where Possible, Separate Mental Health Treatment from the Criminal Justice System

It's also important to stop using the prison system as a de facto mental health treatment program. California has a system of mental health courts that appear to help, although their implementation appears to be uneven across counties. A statewide program using Proposition 36 drug courts as a model could be a path to improvement. On the other hand, mental health courts help divert individuals from incarceration after a trial, but they leave unaddressed the issue of pretrial incarceration.

There are a few options for improving mental health care outside of prisons and jails, and the option that California policymakers pick will have implications for the state's longer-term model and especially its budgeting.

Judges refer defendants who are unfit to stand trial to state mental hospitals, but there are not enough beds for all the individuals referred to them. Each state hospital bed costs more than \$200,000, which is less than mental health beds in state prisons. Fixing the shortage of state hospital beds would lend credibility to calls to shift some mental health responsibilities back to the state level, but judges should be able to refer defendants to county-level facilities as well, although suitable treatment does not exist in every county.⁵⁷

Overhaul the California Penal Code

While these recommendations represent concrete steps toward reducing overcriminalization, a focused, in-depth approach is necessary to excise all the aspects of the California Penal Code that are outdated, unjust, or otherwise counterproductive.

“The California Penal Code, with nearly 600 sections, is more than five times longer than the Model Penal Code.”

Unfortunately, California's situation is not unique. A Manhattan Institute report noted that in a five-state sample, the average penal code was many times longer than the Model Penal Code drafted by the American Law Institute.⁵⁸ The California Penal Code, with nearly 600 sections, is more than five times longer than the Model Penal Code.⁵⁹ To systematically roll back overcriminalization, California should reevaluate its penal code, section by section, and remove any law that is unnecessary, outdated, or unjust. Furthermore, given that the legislature passes new laws every year, it could help prevent the return of overcriminalization by placing a mandatory sunset clause on all new criminal laws. This sunset clause, taken from an idea at the federal level to restrain executive branch bureaucracies, would require renewed debate over the merits of criminal laws and help ensure that the California Penal Code does not again grow to an unmanageable scale.⁶⁰

Prevent Over-Policing

Over-policing is similar to overcriminalization. Police officers are increasingly asked to deal with a myriad of issues, including wellness checks, mental illness, drug overdoses, interfacing with the homeless, and traffic accidents and citations. Examining the Los Angeles Police Department's dispatches throughout 2018, only 12 percent of dispatches were for violent crimes, compared to almost 40 percent for nonviolent complaints and 38 percent for property crimes

(see Figure 3.5). The number one reason for dispatches: noisy parties.⁶¹

Examining Los Angeles’ police dispatches leads to another concern. Although only a small fraction of the total, almost 10,000 dispatches involved juveniles. Rather than armed police, social workers or others with appropriate training would seem to be the right authorities to handle these situations.

The overuse of police in these instances increases the possibility of a more serious criminal offense occurring. Such over-policing also erodes trust in the police in minority and low-income communities and places both police officers and civilians in danger.⁶²

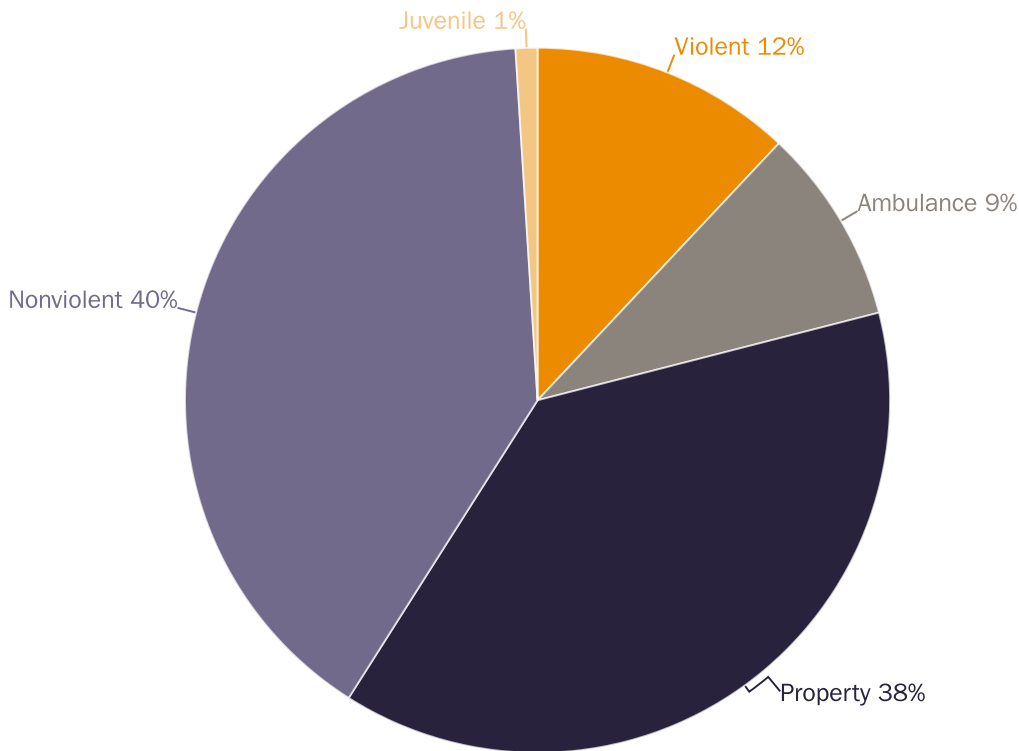
Expand Options for Restorative Justice

Particularly for the juvenile justice system and in schools, policymakers in some jurisdictions have introduced new restorative justice options in recent years, but adoption of these is still far from widespread. Restorative justice, as

noted by the California courts’ handbook on the subject, focuses on repairing the damage that a crime has caused instead of punishing the offender.⁶³ In general, restorative justice options include restitution of some sort, as well as education designed to help offenders understand that their actions have had negative consequences for others. Programs both within and outside California provide lessons for potential wider implementation.

In Northern California’s Yolo County, a Neighborhood Court restorative justice program featuring listening sessions has outperformed the traditional system of punishments, with a significantly lower recidivism rate. In Brooklyn, New York, the school system’s restorative justice program has become a national model, so there are a variety of programs from which California can draw best practices for future implementation.⁶⁴ These programs, like drug and mental health courts, are yet another option for policymakers when looking to replace the current system of punishments with options that place less burden on convicted individuals and their families.

Figure 3.5
2018 Los Angeles Police Department dispatches



Source: “LAPD Calls for Service 2018,” Los Angeles Police Department, updated November 30, 2020, <https://data.lacity.org/Public-Safety/LAPD-Calls-for-Service-2018/nayp-w2tw>.

Curtail the Use of Fines and Fees as Punishment

Criminal justice reformers often focus on incarceration, but it is important to recognize that the criminal justice system can heavily burden low-income individuals, even without detention, through the imposition of excessive fines and fees.

Although there is enormous variation from case to case and offense to offense, the base fine for adult felony in California generally ranges from \$300 to \$10,000, while misdemeanor base fines run from \$150 to \$1,000.⁶⁵ Fines for traffic offenses run from \$35 to \$490. On top of the fine, offenders are often hit with a variety of fees, assessments, penalty surcharges, and restitution requirements. They may also be subject to asset forfeiture.

Fines and fees represent a substantial source of revenue to both the state and local governments. In California's fiscal year 2018–2019, the state collected \$1.4 billion in fines and fees from the criminal justice system. That's just the tip of the iceberg; Californians owed an additional \$10.6 billion that had not yet been paid.⁶⁶

Roughly 40 percent of the revenue from these fines and fees goes to the judicial branch, while a similar amount goes directly to municipal governments. The remaining 20 percent is distributed to a variety of state programs and funds.⁶⁷ This can create a substantial conflict of interest for state and local governments. On the one hand, policymakers have an interest in both reducing crime rates and safeguarding the rights of defendants and offenders. On the other hand, they stand to benefit from an increase in convictions and the imposition of financial penalties. Judges in particular are conflicted because they determine whether to impose fines, but the judicial branch can boost its revenue if judges convict more often or impose harsher penalties.⁶⁸

While the revenue from fines and fees creates a bias for policymakers to maintain the status quo, it makes for an unreliable source of revenue. Default rates are high, and collection—especially from transient or low-income offenders—can be costly. Overall, 40 percent of cases where fines and fees were assigned in 2019 were past due by September of that year.⁶⁹

The administrative costs of collection are relatively high, roughly 15 percent. Some counties with high default rates

can end up spending more on collection than they take in. For instance, in 2019, Los Angeles County collected \$3.4 million in fees while spending \$3.9 million for collection.⁷⁰ Even the state auditor has suggested that fee revenue is inconsistent and inefficient.⁷¹ And, in 2018, after the legislature directed the Judicial Council (a judicial branch policymaking body) to study fines and fees, the Judicial Council was unable to fulfill the legislature's statutory direction on time because the 58 different collection programs (one for each county) had uncoordinated data collection programs.⁷²

“It is important to recognize that the criminal justice system can heavily burden low-income individuals, even without detention, through the imposition of excessive fines and fees.”

If the benefits to state and local governments are uncertain, the burden for low-income Californians is not. For example, fines are not generally tied to ability to pay. The collection of criminal debt can often add 40 percent or more in interest and processing fees. As a result, fines can pose an enormous and disproportionate hardship on people who are poor.⁷³

Fees can be even more onerous because they are usually assessed uniformly regardless of the crime or the defendant's income. Some fees, like public defender fees, are only likely to be levied on people with lower incomes, so not only are fees harder for lower-income people to pay, but lower-income people must pay more types of fees than other defendants.

Failure to pay promptly can carry significant consequences. Within 20 days, collection agencies begin adding interest and penalties. Wage garnishments, bank levies, and suspension of drivers' licenses are common. For instance, in 2019, more than 4.2 million Californians had suspended licenses because they could not afford fines or fees or had not appeared for a citation.⁷⁴ That amounts to more than one of every six adults in California.

Losing a driver’s license can lead to a cascade of adverse consequences, including job loss, that can plunge a family further into poverty.⁷⁵ A traffic ticket or citation for other minor offenses may be a modest annoyance for a middle-class individual. For people who are poor, this same penalty can amount to financial ruin. The families of offenders often share the burden imposed by excessive fines and fees, which can sometimes total more than a family’s annual income. Paying off the court-ordered debt and thereby avoiding both new interest and penalty charges and avoiding the possibility of jail frequently comes at the cost of food, rent, or other necessities.

In some cases, failure to pay fines or fees can even result in jail time. When fines are included on top of jail time, the accumulated debt can make reentry into society that much more difficult. The U.S. Justice Department has warned that excessive fines mean that “individuals may confront escalating debt; face repeated, unnecessary incarceration for nonpayment despite posing no danger to the community; lose their jobs; and become trapped in cycles of poverty that can be nearly impossible to escape.”⁷⁶

“A traffic ticket or citation for other minor offenses may be a modest annoyance for a middle-class individual. For people who are poor, this same penalty can amount to financial ruin.”

Recently, California lawmakers have begun to make reforms to the fine and fee systems. Some local jurisdictions, such as San Francisco and Los Angeles, have eliminated most criminal justice administrative fees. Last year, the California State Legislature passed AB 1869, which ends California state agencies’ ability to impose and collect 23 administrative fees, most of which disproportionately fell on minorities and people who are poor. It is expected to relieve Californians of as much as \$16 billion in outstanding criminal justice debt.⁷⁷ In addition, Senate Bill 190, passed in 2017, prohibited the use of fees in the juvenile justice system and for adult defendants ages 18–21,

though some counties, notably San Diego and Orange, appear to have ignored the law to some degree.⁷⁸ Moreover, the courts do not always appear to be conducting “ability to pay” hearings as the law requires.

Beyond current reforms, California could explicitly prohibit counties from levying administrative fees in the criminal justice process. On the other hand, California could expand ability-to-pay evaluations for criminal justice fines to avoid unduly burdening people with fines. For those who are found unable to pay the fine associated with an infraction, California could expand restorative justice options, including education, rehabilitation, and community service.

Establish a Mechanism to Automatically Expunge Criminal Records after a Designated Period for Those Who Do Not Reoffend

Currently, an astounding 20 percent of Californians—more than 8 million people—have a criminal record. Having a record can cause profound and long-lasting disadvantages. More than 4,800 California laws impose some form of sanction or restriction on those with criminal records even after they have completed their sentence.⁷⁹ This can mean the loss of employment and even bar a person from hundreds of regulated jobs, as well as from government employment or government contracts. He or she can also be barred from enlisting in the military.⁸⁰ As a result, in 2017, roughly 46 percent of former offenders said that they were having difficulty finding a job.⁸¹

California has taken steps to help those with criminal records. In 2014, the state became one of the first to pass “ban-the-box” legislation, which prohibited state agencies from asking most job applicants about their criminal history. That prohibition was extended to the private sector in 2017 with passage of AB 1008. Several cities, including San Francisco and Los Angeles, have also passed their own versions of ban the box. In addition, California participates in the National Helping Individuals with Criminal Records Re-Enter through Employment Network, which connects ex-offenders with potential employers who have indicated a willingness to hire people with a record.⁸²

Despite those positive reforms, a criminal record remains a barrier to many employment opportunities. For example, a criminal history can prevent someone from receiving an occupational license, in some cases permanently. Moreover, the consequences of a criminal record go far beyond employment. For instance, “crime-free housing” laws, which have proliferated in California cities, effectively shut people with criminal records out of housing in these cities. Immigrants, including lawful permanent residents as well as those who remain undocumented, can be deported for even extremely minor offenses, and having a criminal record can prevent individuals’ immigration status from advancing or disqualify individuals from the Deferred Action for Childhood Arrivals program.

“Several states have recently begun to experiment with a new approach to criminal records, a mechanism whereby a record is automatically expunged after a designated period without the person reoffending.”

It is also important to recognize that those convicted of crimes that were reclassified because of Propositions 47 and 57 did not automatically receive relief from those criminal records. Rather, they must apply for reclassification, a process that leaves much discretion in the hands of local district attorneys.⁸³ Further, while prosecutors are required to clear or reclassify criminal records for individuals convicted of minor marijuana-related offenses, implementation of this requirement has varied significantly by jurisdiction. Some have required a case-by-case review, while others, such as San Francisco and Los Angeles, made it automatic.⁸⁴

Several states have recently begun to experiment with a new approach to criminal records, a mechanism whereby a record is automatically expunged after a designated period without the person reoffending. Pennsylvania’s Clean Slate Act, passed in 2018 and extended in 2019, is widely considered a model for this approach.⁸⁵ The Pennsylvania law immediately expunges any record for which an individual

was not convicted (acquitted or the charges dropped), even if they were convicted of other charges in the case. In addition, records of a conviction are automatically sealed after 10 years for summary and most misdemeanors, including drunk driving, prostitution, and shoplifting.⁸⁶

Some observers have criticized clean-slate (and ban-the-box) reforms, saying that these will (and in the case of banning the box, already have) increase other areas of discrimination. This argument is built on data from ban-the-box policies that show that, although banning the box increased the likelihood that people with criminal records would receive a callback from a job, it decreased the likelihood that young African American and Hispanic men would receive a callback, ostensibly because employers, prevented from discriminating based on criminal record alone, instead discriminated against demographic groups who they view as more likely to have a criminal record.⁸⁷ This unintended consequence is clearly cause for concern, but it is cause for a more tailored clean-slate policy and a more effective ban-the-box policy rather than discarding these policies altogether and reopening the door to significant discrimination against people with criminal records. Indeed, expungement itself has been suggested as a further reform that would increase the effectiveness of banning the box.⁸⁸ Beyond the potential unintended consequence of discrimination, opponents of clean-slate reforms have expressed concern that employers will rely on sometimes-spotty background check systems that will use data produced before records were expunged.

A few different considerations are cause for optimism about clean-slate policies. First, even opponents of the reforms acknowledge that ban the box accomplished its central goal of decreasing discrimination against people with criminal records. Second, in part because ban-the-box reforms were focused on employment, the evidence of increased discrimination may not be generalizable to policy areas like housing or education, where expungement would help people with criminal records gain access to resources from which they are currently banned by law.

That said, clean-slate proponents have a duty to allay the very real data-driven concerns that opponents of reform raise. Several additional considerations for policymakers could help minimize these unintended outcomes. First, more

education is necessary for employers: a significant share of hesitancy over hiring applicants with criminal records appears to stem from concerns about legal liability, which are not, in fact, grounded.⁸⁹ As such, one potential step forward would be to educate employers about the minimal risks they expose themselves to by hiring people with criminal records. Relatedly, the legislature can clarify the law on this point and shield employers from liability related to hiring people with criminal records. This would decrease real or imagined barriers to employment of people with criminal records. Second, additional rehabilitative opportunities can help make people with criminal records more employable. Third, given that opponents to clean slate and ban the box highlight third-party background checkers as a source of unintended consequences, potential reforms could focus on this aspect. One way forward would be to limit the access that these background checkers receive to conviction and arrest records by increasing privacy for individuals in the criminal justice system. Limiting public release of names and other information about people involved with the criminal justice system could further strengthen expungement.

Upgrade Programs within the Prison System to Better Prepare Offenders to Transition into Society

Nearly 95 percent of all incarcerated individuals will eventually be released from prison.⁹⁰ California has an obligation, therefore, to ensure that, when the time comes, these individuals are prepared for reentry into society. Those leaving prison, especially those who have been incarcerated for long periods, need help adjusting to technology and life changes that have occurred while they were in prison. And prisoners who have been recently released need help with locating employment and housing, continuing their education, and obtaining medical and mental health care, as well as legal assistance to deal with outstanding fines and fees and to clear their records where possible.

So far, California's efforts in this regard have fallen short. Its reentry programs remain largely ad hoc, underfunded, and lacking state support or coordination. This is one reason why nationwide data show that half of

previously incarcerated people are unable to find stable work within a year after reentry and are almost 10 times more likely to be homeless.⁹¹ The lack of transitional services is also a significant contributor to California's nearly 50 percent recidivism rate.⁹² (In fairness, the recidivism rate is inflated by petty larceny and drug-related offenses, which account for the majority of reoffending.)

“Those leaving prison, especially those who have been incarcerated for long periods, need help adjusting to technology and life changes that have occurred while they were in prison.”

Campaigners for Propositions 47 and 57 promised that savings from reduced incarceration costs would be used to provide additional support for rehabilitation and transition programs.⁹³ Yet, according to a report from the state auditor, only 38 percent of at-risk inmates have their rehabilitative and transitional needs met. Worse, on March 17, 2020, all prison rehabilitative services were suspended because of COVID-19.

As the auditor's report illustrates, however, even before COVID-19 forced this shutdown, those services were both inadequate and mismanaged.

Take education, for example. We know that inmates who receive educational instruction while incarcerated are 43 percent less likely to reoffend after their release.⁹⁴ And while California community colleges provide services to prison inmates, beyond pilot programs, access to four-year degrees is still limited.⁹⁵ This is a clear area for improvement, especially given new funding sources for prison education through Pell Grants.

Similarly, take mental health. The “deinstitutionalization” of mental illness in the 1950s and 1960s, across the United States, was intended to divert patients from state mental health hospitals to federally funded mental health services in communities. Then, in California, another wave of changes in the 1990s, now known as mental health realignment, systematically transferred responsibility of mental health

services from the state level to the county level. Realignment also shifted some funding from the state level to the county level. An inadvertent consequence of this policy has been the emergence of prisons and jails as institutions that house those in the most need of mental health care.

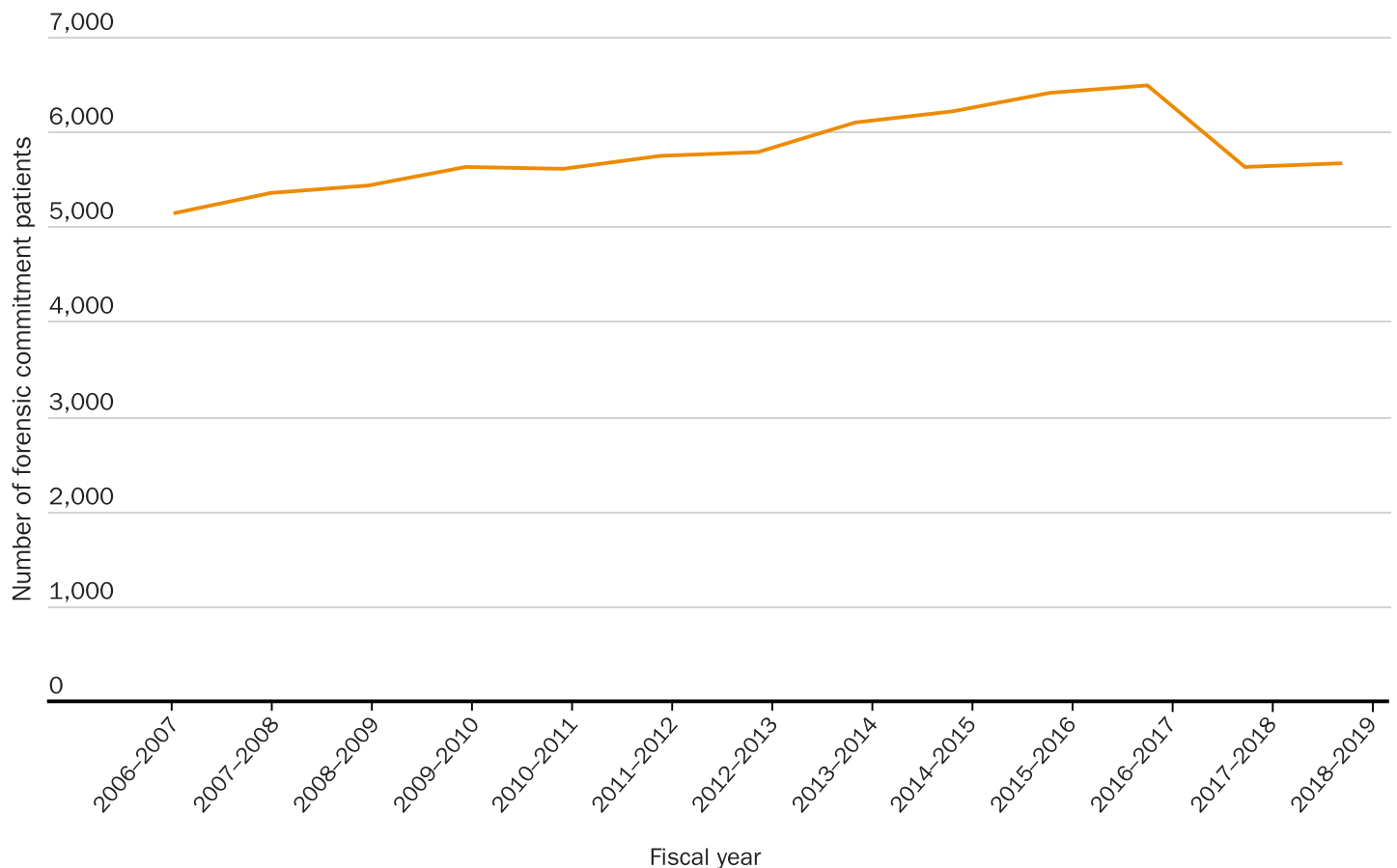
A 2016 Stanford University study found that more than 30 percent of incarcerated Californians were receiving treatment for a “serious mental disorder” at that time (a 150 percent increase since 2000).⁹⁶ Over 90 percent of people treated by the Department of State Hospitals in 2016–2017 were referred there by criminal courts. And, between 2011 and 2016, the number of defendants deemed incompetent to stand trial after arrest rose by 60 percent (see Figure 3.6).⁹⁷

An increasingly large share of the demand for mental health services in California is filled by prisons and jails, with Los Angeles County Jail System the single largest

mental health facility in the nation, according to some sources.⁹⁸ Data from September 2018 demonstrates that an average of 30 percent of the Los Angeles County jail population was receiving mental health care, either through psychotropic medication or housing in mental health units.⁹⁹

Los Angeles County’s debate over mental health care and incarceration is an instructive case for the rest of the state as it determines how to provide better care for incarcerated individuals. The Los Angeles Men’s Central Jail has inadequate mental health care facilities, and county supervisors voted to tear it down and build a replacement that focuses more on mental health care.¹⁰⁰ In response to calls for greater diversion efforts and decarcerating individuals with mental health conditions, the supervisors voted to cancel the contract altogether.¹⁰¹ The concern here is that the supervisors are letting ideas of “the perfect be the enemy of the good” and failing to make incremental improvement.¹⁰²

Figure 3.6
California state hospitals forensic commitment population



Source: “Forensic vs. Civil Commitment Populations,” California Department of State Hospitals, last updated March 25, 2021.

Section 4: Education and Workforce Development

Few things are as key to escaping poverty as receiving a quality education. Yet, in far too many ways, California’s public education system has failed poor and marginalized communities.

California’s school system is the nation’s largest, serving more than 6.2 million students. Individual school districts can also be enormous: the Los Angeles Unified School District, for example, is the second biggest in the nation. Statewide, California spent roughly \$97.2 billion for K–12 schools (counting federal, state, and local monies) in the 2018–2019 year, or about 48 percent of the state budget.¹ Spending has increased steadily in recent years and now amounts to roughly \$12,000 per student, an increase of about \$2,000 over the past five years.² This puts California in the middle of the pack nationally, though below other populous states such as New York and Illinois (see Figure 4.1).³

Although California schools have seen some improvements in recent years, California still ranks near the bottom in terms of student performance. According to data from the National Assessment of Educational Progress, California’s public school test scores are significantly below average, tied with the District of Columbia in 45th place.⁴ And a 2017 Cato Institute study, which accounted for student body heterogeneity, estimated that California’s public schools ranked 35th in the nation.⁵ That is slightly better than U.S. News & World Report’s estimate, which put California schools 44th nationally, but still below the median.

Other measures are even grimmer. In 2019, only 52 percent of California students met college-readiness benchmarks in ACT reading and math scores.⁶ Just 83.3 percent of California high school students graduate, making the state home to the highest dropout rate in the nation.⁷ Eighth-grade students lagged behind national standards in both math and English language arts with only 37 and 49 percent, respectively, meeting benchmarks on California’s Smarter Balanced assessments.⁸

Among fifth graders, only 38 percent and 52 percent met these benchmarks. Clearly, California is failing half its students—by its own standards—across grade levels.

Moreover, looking at California’s public schools on a state-wide basis does not really tell the story of how badly they have failed students in low-income and minority communities.

Data show persistent academic achievement gaps by both income and race. On average, across all grade levels and incomes, African American and Latino students score significantly lower on standardized tests (measuring proficiency in both English language arts and mathematics) than white or Asian students (see Figure 4.2).⁹

“Although California schools have seen some improvements in recent years, California still ranks near the bottom in terms of student performance.”

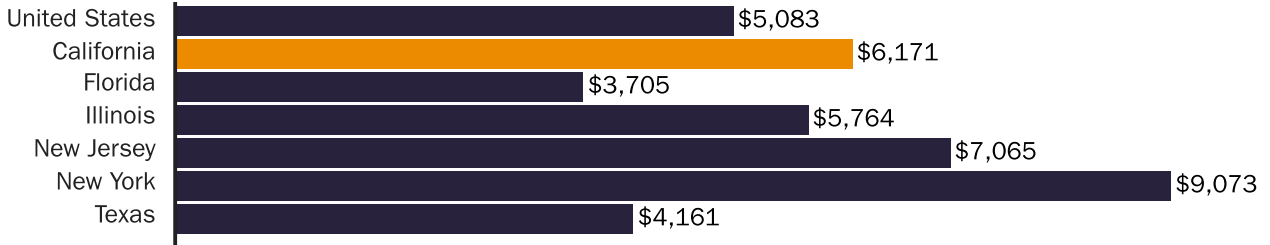
And when it comes to preparing students for college or a career, California schools do a surprisingly poor job across the board, but they fail African American and Latino students even more severely. In 2018, only 21 percent of African American students and 35 percent of Latino students who graduated were considered fully prepared for college or a career compared to 52 percent of white students and 74 percent of Asian students (see Figure 4.3). African Americans also have much lower graduation rates than other groups, are much more likely to be absent from school more than 10 percent of the time, and are more likely to be suspended or subjected to other types of school discipline.¹⁰

In addition to race, there are also significant academic achievement disparities by income. Across all races and ethnicities, low-income students scored in the 39th percentile

Figure 4.1

How California ranks in education investment and spending compared to other states

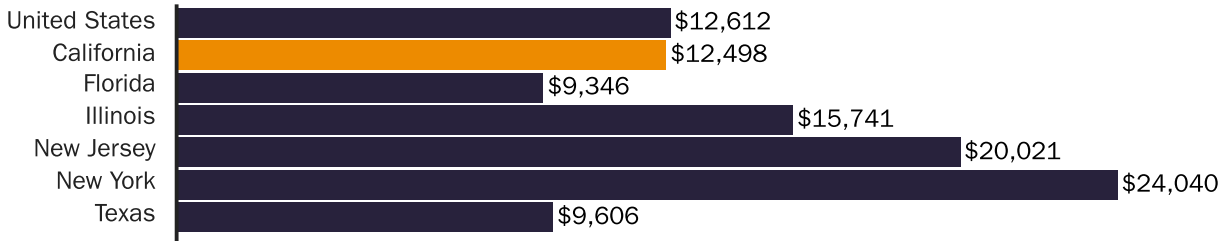
Per capita tax revenue, 2017



Percent of economy invested in education, 2017



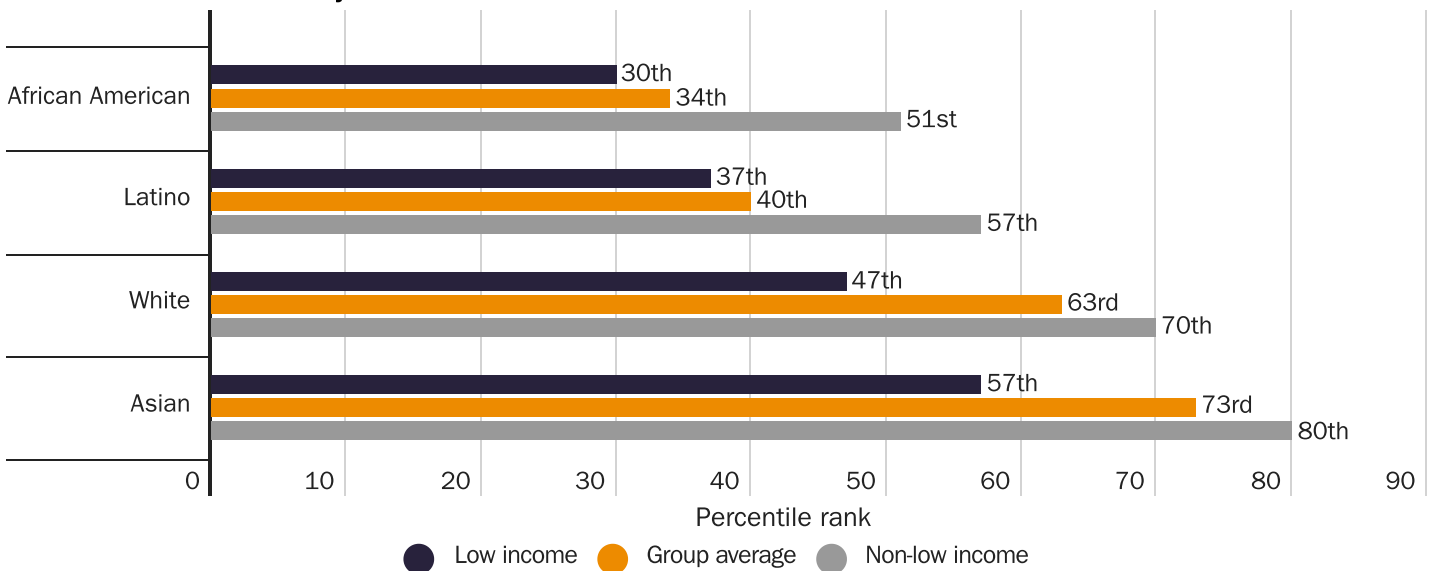
Per pupil expenditures, 2018



Source: Carrie Hahnel, "California's Education Funding Crisis Explained in 12 Charts," Policy Analysis for California Education, October 2020, <https://edpolicyinca.org/publications/californias-education-funding-crisis-explained-12-charts>.

Figure 4.2

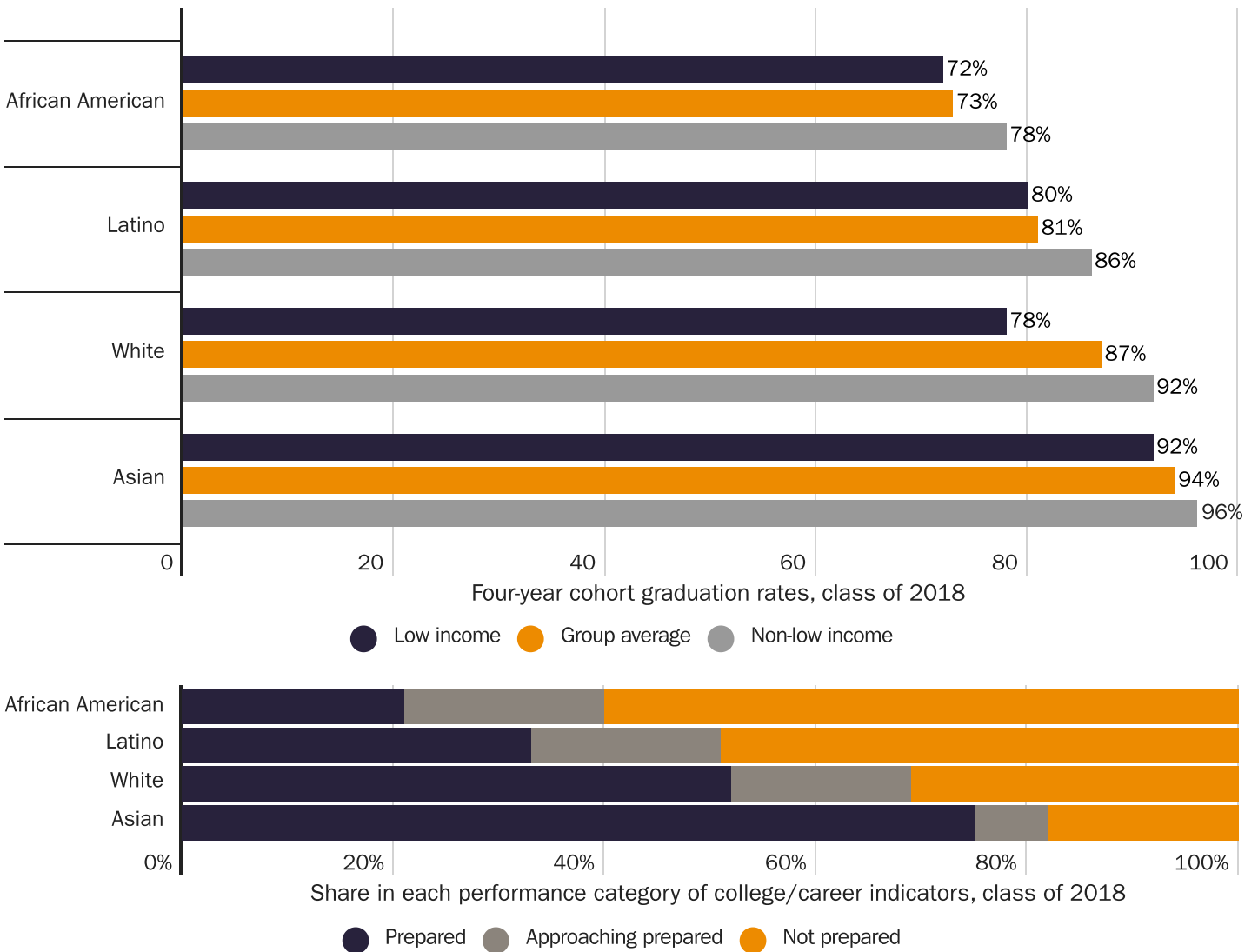
Educational achievement by race and income



Source: Ned Resnikoff, "Narrowing California's K-12 Student Achievement Gaps," Legislative Analyst's Office, January 31, 2020, p. 5, figure 3, <https://lao.ca.gov/Publications/Report/4144>.

Figure 4.3

Graduation rates and post-secondary preparedness gaps in California by race and income



Source: Ned Resnikoff, "Narrowing California's K-12 Student Achievement Gaps," Legislative Analyst's Office, January 31, 2020, p. 6, figure 4, <https://lao.ca.gov/Publications/Report/41144>.

on state standardized tests. Low-income students have a graduation rate of only 80 percent.¹¹ Moreover, low-income students of all races perform worse on standardized tests, are less likely to graduate, and are less likely to be prepared for college or a career than higher-income students of the same race or ethnic makeup (see Table 4.1).

For reasons of race and geography, California schools are increasingly segregated along class lines. Perhaps nowhere else is the broad array of social services that underserve disadvantaged Californians, and the broad array of reforms needed to combat poverty, more apparent than in education. Redlining and racism in housing has concentrated

disadvantaged communities in specific areas where lackluster schools hold back young peoples' earning potential and where over-policing funnels individuals into the criminal justice system. Education is a key policy area in the effort to alleviate poverty, particularly because it helps people increase their ability to get well-paying jobs that they can use to support themselves and their families. It is impossible to deny the extent to which educational opportunities divide our society.

Studies consistently find that students from schools attended mostly by poor children have lower levels of academic achievement than those from schools attended by more affluent students. Of course, some might blame

Table 4.1
Educational attainment for other student groups

	Four-year cohort graduation rates	Share “deemed” prepared for college/career	College-going rate
All students	83%	42%	64%
Low-income youth	80%	34%	57%
Homeless youth	69%	24%	50%
Foster youth	53%	10%	48%
English learners	68%	15%	42%
Students with disabilities	66%	9%	45%

Source: Ned Resnikoff, “Narrowing California’s K–12 Student Achievement Gaps,” Legislative Analyst’s Office, January 31, 2020, p. 7, figure 5, <https://lao.ca.gov/Publications/Report/4144>.

this disparity on the many other social problems that disproportionately affect poor children—problems that no school, no matter how good, can remedy. Many teachers complain that they are expected to make up for missing parents, poor nutrition, neighborhood violence, and other issues outside their control. They cannot be expected to do so. Nonetheless, the fact that those same poor children, facing those same social problems, perform better in schools in high-income neighborhoods is “one of the most consistent findings in research on education,” according to Gary Orfield and Susan Eaton of Harvard University.¹²

In fact, some studies show that a student’s educational achievement correlates at least as strongly with his or her classmates’ family income as with that of their own family.¹³ A dismal 18 percent of children nationwide from low-income families score “proficient” on scholastic achievement tests, compared to roughly 48 percent of the rest of the student population. However, in schools with high concentrations of low-income students, only 7.4 percent of low-income students—less than half as many—score “proficient.”¹⁴ As Robert Putnam writes in *Our Kids*, “There’s no denying that rich and poor kids in this country attend vastly different schools,” a fact that he blames in part for “the growing youth class gap.”¹⁵

If class divides our government school system, so does race. Sixty years after *Brown v. Board of Education*, our schools are once again becoming segregated by race. The typical Latino student in California, for instance, attends a school with Latino enrollment about 15 percent higher than the statewide average.¹⁶ Schools with nonwhite enrollments of

99–100 percent also increased to 7.3 percent from 4.9 percent of total California schools during the same timeframe.

A report from the University of California Academic Senate concludes that much of the academic achievement gap for students of color is the result of systemic racial and class inequities.¹⁷

These inequities are not simply a question of funding. Although disparities between school districts’ revenues (the result of different property tax bases) may be a source of inequity in other states’ education systems, this is less of an issue in California. For historical reasons, including Proposition 13’s limits on property taxes, state funding accounts for a larger share of school district funding than local property tax revenues, allowing for a more equitable distribution of funding than is the case in other states.¹⁸

California’s most recent move toward funding students directly is its Local Control Funding Formula (LCFF). Signed into law in 2013 and largely implemented in time for the 2015–2016 school year, the LCFF sets funding for school districts using a per-student base grant from the state, with additional supplemental funding for each student in a high-need category (for example, non-native English speakers or low-income students) and even further funding if there is a high concentration of high-need students.¹⁹

Indeed, California’s struggle to effectively educate disadvantaged students appears to be a function of structural issues rather than simply a lack of funding.

Moreover, the link between funding and student achievement is tentative at best. Eric Hanushek, perhaps the leading expert on this issue, has studied the effect of per-pupil

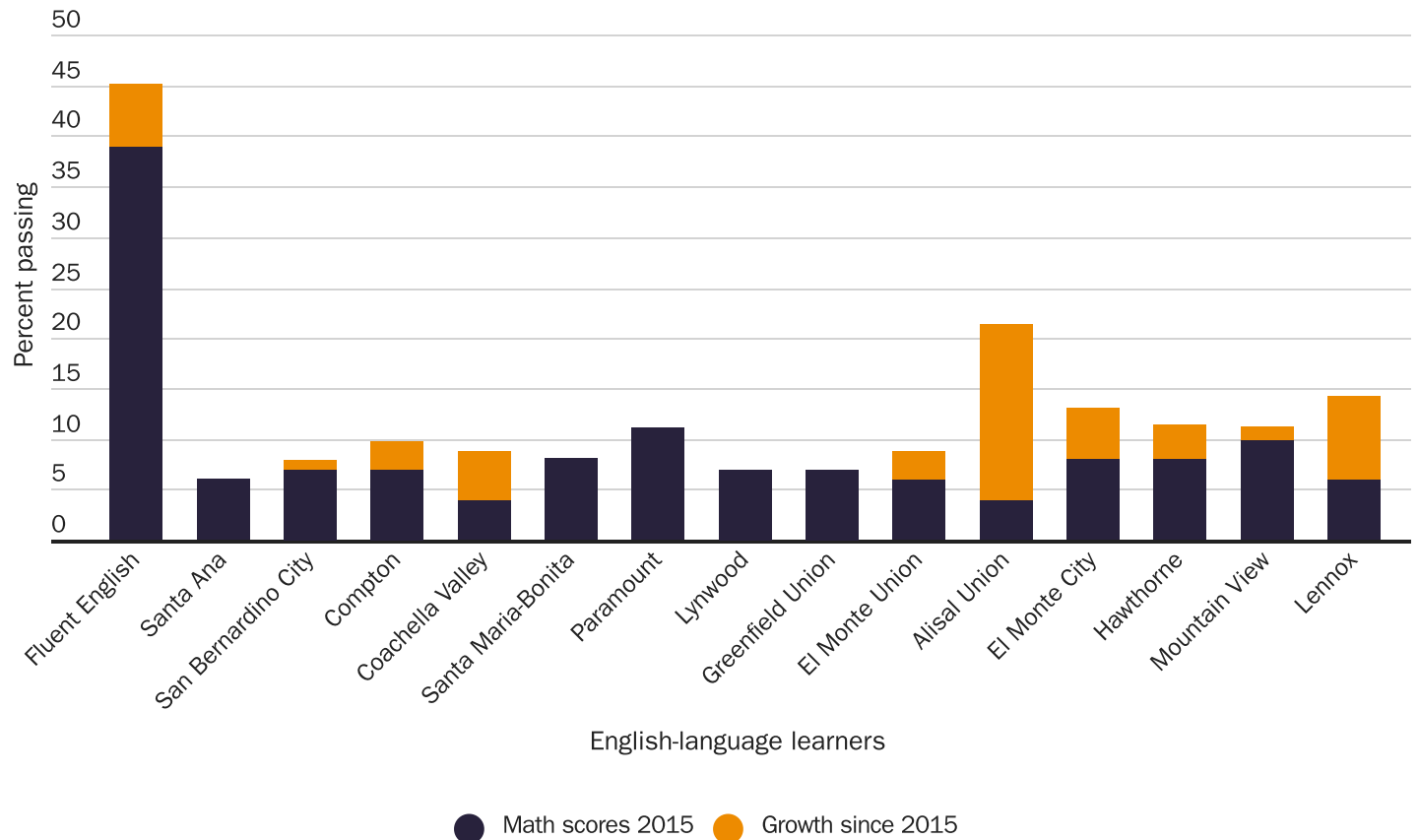
expenditures on academic outcomes, finding either no relationship or a relationship that is weak or inconsistent, while some other scholars find benefits in specific cases, depending on how the money is used.²⁰ Despite the lack of consensus, leading researchers on the issue agree that any effect of per-pupil expenditures on academic outcomes depends on how the money is spent, not on how much money is spent. For example, Hanushek concludes that “few people . . . would recommend just dumping extra resources into existing schools,”²¹ while from the other side of debate, Larry Hedges and Rob Greenwald note that “the results do not provide detailed information on the educationally or economically efficient means to allocate existing and new dollars.”²²

California’s experience with per-pupil funding is similarly mixed. Some low-income school districts have seen an improvement in outcomes after receiving additional funding through LCFF, while others have stagnated or even seen a decline in performance (see Figure 4.4).²³

In addition, a state auditor’s report shows serious transparency issues that have made it nearly impossible to determine whether districts are spending their additional funding on disadvantaged students as intended.²⁴ The audit also finds a loophole allowing districts to treat any unspent supplemental and concentration funds in a given year as base funds the following year, which can be used for general purposes. Both the California legislature and the state Board of Education have said that they are working to resolve these issues, but improvements remain to be seen.²⁵

It would be unfair, of course, to attribute all of California’s academic problems to failures of its public school system. Many other socioeconomic factors play important roles. There is also significant overlap between poorly performing schools and patterns of housing segregation based on both race and income. Regardless, the state shouldn’t continue to throw money at the existing system without fundamental reforms.

Figure 4.4
Math test scores for English-language learners



Source: Ricardo Cano, “Mind the Achievement Gap: California’s Disparities in Education Explained,” CalMatters, February 3, 2020.

THE IMPACT OF COVID-19

One of the most interesting things about the COVID-19 pandemic is the way it has exposed flaws in so many government institutions. Many of California's long-standing problems, including in housing, the criminal justice system, and business regulation, have been both exacerbated and highlighted by COVID-19 and the response to it. In particular, the pandemic has made it difficult to ignore problems with the state's public school system.

Most California public schools closed in March 2020 and did not return to in-person learning until at least April 2021. Even where schools did reopen, many districts only partly reopened, leading California to have one of the lowest rates of in-person schooling. As of September 2021, the Delta variant of COVID-19 has raised significant questions about whether the pace of reopening will continue.²⁶

“The COVID-19 crisis has further exposed, among other problems, the ways that California's educational system marginalizes disadvantaged students and limits the schools that perform best for them.”

School closures are harmful to children in many ways. Children suffer psychologically from the absence of contact and socialization. They are less able to build relationships with their teachers, and studies show that academic performance declines substantially during prolonged school closures.²⁷ Parents also often must sacrifice work and income to stay home and care for school-age children.

All these problems are particularly severe for low-income and minority students, who frequently lack access to broadband internet and other “study from home” essentials. A McKinsey report predicts that white students will be set back 4 to 8 months' worth of learning as a result of COVID-19-related school closures, while students of color could be set back 8 to 12 months.²⁸

The COVID-19 crisis has further exposed, among other problems, the ways that California's educational system marginalizes disadvantaged students and limits the schools that perform best for them. On the other hand, these revelations provide an opportunity to get things right for the future and build back a more inclusive society.

RECOMMENDATIONS

Remove Barriers to the Growth of Charter Schools and Other Alternatives to Traditional Education Models

Specifically, lawmakers should eliminate the LCFF funding gap between districts and high-need charter schools.

Roughly 10 percent of California children attend charter schools, with a higher rate of African American enrollment than in traditional public schools.²⁹

California charter schools generally outperform traditional public schools, particularly for disadvantaged students. A study by the Center for Research on Education Outcomes at Stanford University found that “charter students in poverty have growth equivalent to 14 more days of learning in reading and 29 more days of learning in math than their [traditional public school] peers.” Another study by Policy Analysis for California Education came to a similar conclusion.³⁰

A 2019 study by the University of Southern California and Innovate Public Schools found that charter schools made up 27 percent of the top performing schools in Los Angeles compared to about 18 percent of schools overall and 57 percent of San Francisco Bay Area schools, using criteria such as math and reading scores, suspension rates, and completion of the so-called A–G requirements for admission to the University of California system. African American and Latino students in particular had a much higher A–G completion rate in charter schools than did their peers in traditional public schools.³¹ And a report by the California Charter Schools Association found that African American and Latino graduates of charter schools not only apply to University of California schools at a higher rate but also have

nearly twice the acceptance rate of minority graduates of traditional public schools.³² Other studies are more ambiguous, and certainly there are poorly performing charter schools, but the body of research suggests that charter schools are one of the brighter spots in California’s education system, especially for low-income families.

Despite this, California remains surprisingly hostile to charter schools. The most frequent complaint is that charter schools somehow harm overall district finances, thereby depriving traditional public schools of funding. However, an overwhelming body of research shows that, to the extent that charter school expansion has any ill effects on districts’ fiscal situations, these can be easily offset by refund programs.³³ On the other hand, charter-related challenges account for a minuscule share of school districts’ fiscal troubles overall.³⁴

At one point in 2019, the California State Assembly considered legislation to establish a moratorium on all new charter schools. While the moratorium was ultimately rejected, the legislature did enact new restrictions to slow the spread of charter schools, including AB 1505, which gives school districts more authority to reject charter applications that they feel are redundant or would harm the district’s finances. The legislature also passed AB 1507, which prohibits charter schools from operating outside their authorizing district in most situations.³⁵

Charter schools are also underfunded compared to traditional public schools. Traditionally, schools are funded through local property taxes, but this has left low-income communities, where property values are low, at a severe disadvantage compared to their wealthier neighbors. This problem was further complicated by California’s Proposition 13, which held down property taxes, leading the state government to step in to provide school funding that would have otherwise come from property taxes.

California has made a number of reforms to school financing over the years, but the most recent major school financing reform was 2013’s LCFF, which was designed to reduce disparities in education funding between districts while also providing additional support to those districts with high concentrations of disadvantaged students. Using the LCFF, the state provides districts with a base grant per student to help equalize funding between districts and

provides additional funding to districts with concentrations of high-need students.

The LCFF treats charter and traditional schools similarly in terms of the base grant. However, the LCFF caps the amount of supplemental funding that some charter schools can receive for high-need students. This cap impacts roughly a third of charter school students and reduces charter schools’ supplemental funding allowance by roughly 20 percent compared to what similar traditional schools receive. This disparity is even greater—as much as 24 percent in some cases—for those charter schools with the highest concentrations of disadvantaged students.³⁶

“At one point in 2019, the California State Assembly considered legislation to establish a moratorium on all new charter schools.”

Yet the evidence shows that any impact that charter school funding has on traditional school funding is negligible—if it can be found at all. According to some reports, the disparity between charter and traditional school funding was created to discourage districts from packing disadvantaged students into charter schools.³⁷ While that is clearly a concern, especially as it could potentially exacerbate segregation, the right approach to this potential problem is not to place an undue financial burden on schools that serve high concentrations of disadvantaged students but to ensure that these students and their families have access to high-quality schools.

Establish a Tuition Tax Credit Program to Finance Scholarships for Low-Income Families to Attend the School of Their Choice

While charter schools offer an alternative to traditional public schools, they are still, in the end, government-run schools. Government oversight puts limits on how innovative charter schools can be. Therefore, an approach that is liable to yield even greater fruit for poor and disadvantaged

students is to open America's large and thriving private education sector to them.

First, and perhaps most important from the standpoint of alleviating poverty, private school choice would enable low-income families to take advantage of better schools. Although the quality of private schools is far from uniform, the evidence from more than 30 years of studies shows that private schools consistently outperform public schools in terms of test scores, graduation rates, future income, lower violence levels, parental satisfaction, and other critical metrics.³⁸

“According to April 2021 polling by the Public Policy Institute of California, 42 percent of parents surveyed reported that they would send their youngest child to private school if they could.”

Currently, some 664,231 students attend 3,915 private schools in California.³⁹ However, the cost of attending these schools can be quite high. The average cost of attending a private elementary school in California is more than \$11,080; the cost of attending a private secondary school is more than \$19,830.⁴⁰ As a result, only about 13 percent of students enrolled in the state's private schools come from low-income households. In effect, wealthy Californians can escape underperforming schools, while low-income families remain trapped.

One way to rectify this disparity of opportunity is to provide parents with financial assistance if they wish to send their child to a private school. Essentially, this means allowing education funding to follow the child regardless of where that child attends school.

The best way to open more educational opportunities to low-income Californians would be to establish a program of tuition tax credits or educational savings accounts. These programs provide tax credits to individuals and corporations that contribute to a scholarship fund operated by private charitable foundations. These scholarships are then offered

to parents to cover tuition, fees, and other expenses needed to send their children to private school or, in some cases, a public school in another district. In this way, these scholarships operate much like vouchers, with the critical difference being that the money contributed to the scholarship fund never passes through the state treasury or any other publicly managed account.⁴¹ Today, 19 states operate tuition tax credit programs, and roughly 225,000 students have received scholarships through those programs (see Figure 4.5).⁴²

Many Californians want their children to have the expanded access to private schools that a tuition tax credit would provide: according to April 2021 polling by the Public Policy Institute of California, 42 percent of parents surveyed reported that they would send their youngest child to private school if they could.⁴³ Notably, 14 percent said that they would choose public charter schools, a higher share than the roughly 10 percent of California students enrolled in charter schools, so Californians appear to be interested in increased access to charter schools as well.⁴⁴

A measure to establish a tuition tax credit program in California will likely be on the 2022 ballot.⁴⁵

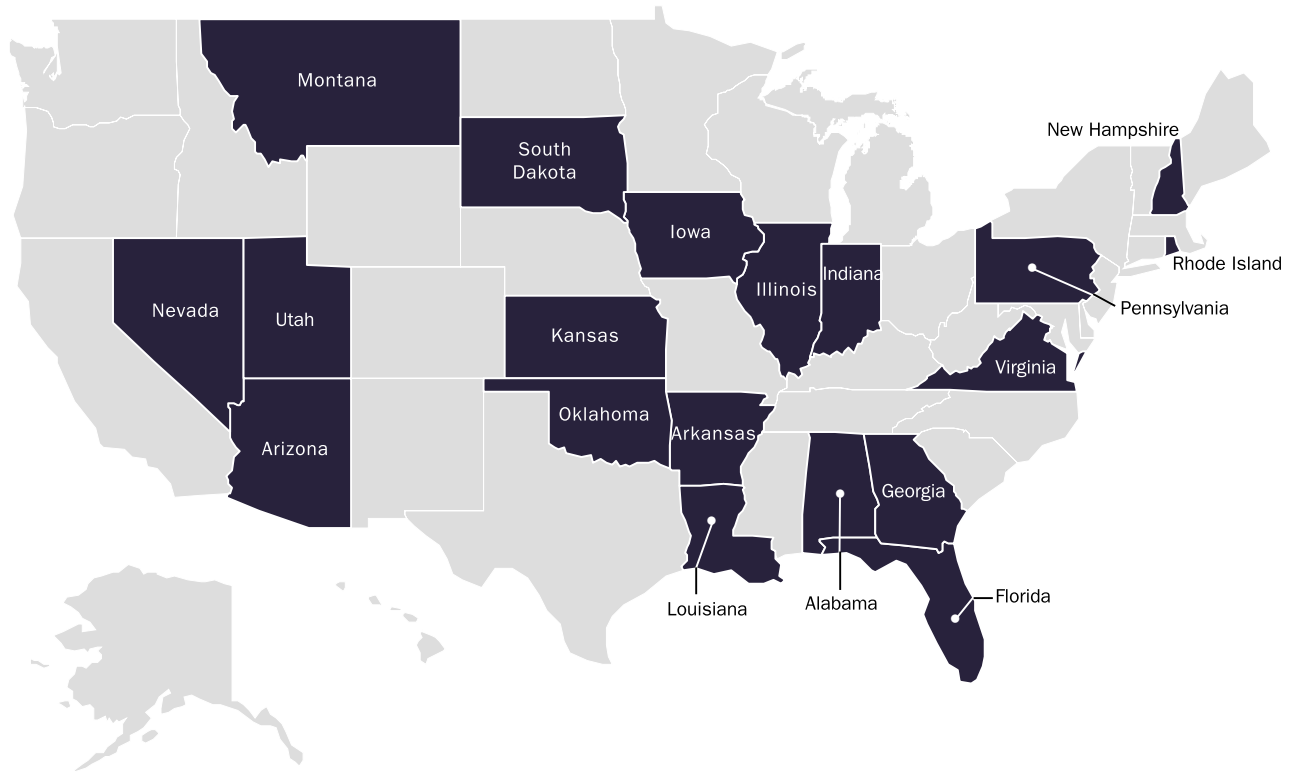
Restructure Future Pension Obligations to Shift More Resources to the Classroom

Whatever one thinks about the level of total education funding in California, increases in spending do not necessarily translate into more resources in the classroom. Thus, we see a 27 percent increase in education spending since 2012, while teacher salaries (to cite one example) have risen by only 7 percent.⁴⁶

The biggest single culprit for this funding drain is pensions. Today, district contributions to the California State Teachers' Retirement System (CalSTRS) consume 19.1 percent of payroll, up from 8 percent as recently as 2013 (see Figure 4.6).⁴⁷

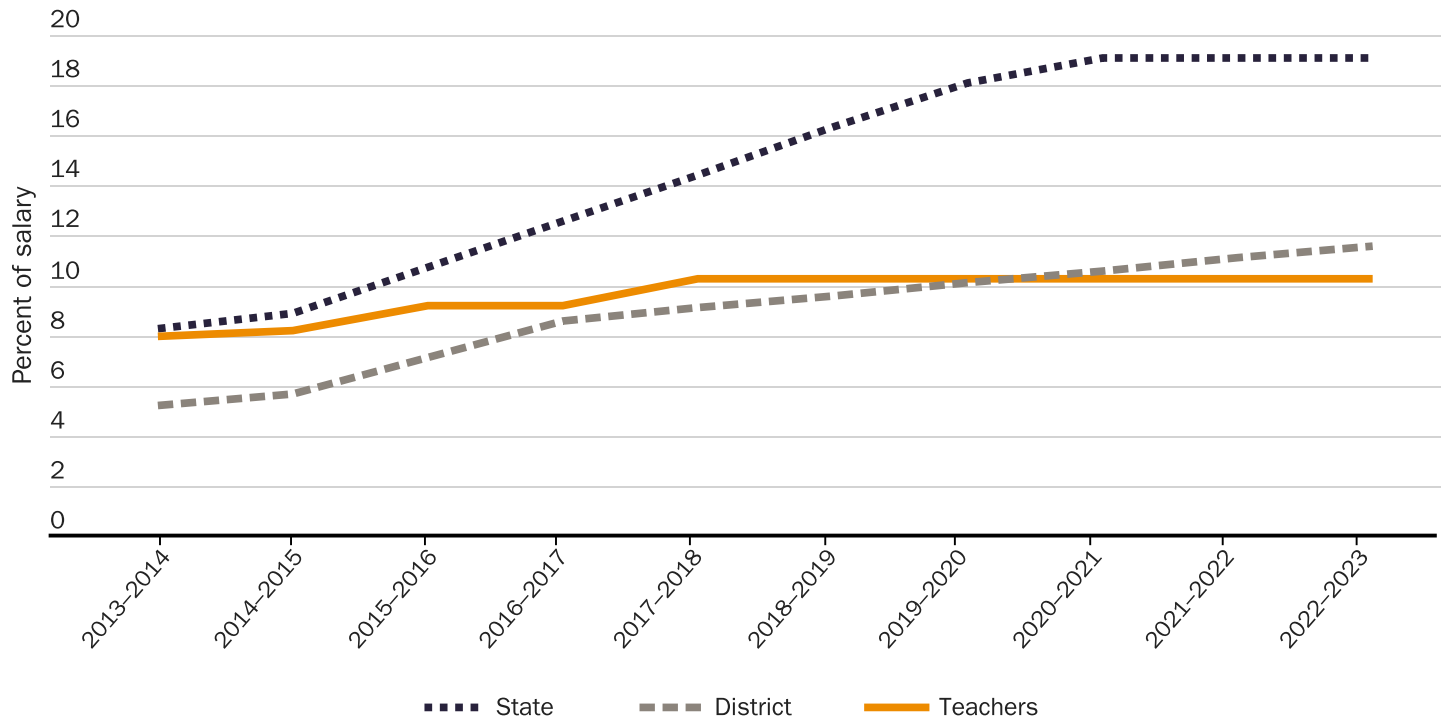
Public employee pensions in California are troubled across the board, but the education system's pension obligations are especially problematic. Despite rising contributions, the program faces more than \$100 billion in unfunded obligations. To put that in perspective, those unfunded obligations exceed the entire amount of the state's K–12 education funding for 2020.⁴⁸

Figure 4.5
Tuition-tax credit systems by state



Source: "School Choice in America," EdChoice, <https://www.edchoice.org/school-choice/school-choice-in-america/>.

Figure 4.6
Teacher pension plan payments in California; portion paid by each group



Source: Yuxuan Xie and Justin Allen, "California Teacher Pension Payments 2013–2023," EdSource, March 19, 2019, <https://edsources.org/2019/new-data-detail-soaring-costs-of-california-school-pensions-2/610118>.

California is one of several states whose teachers don't participate in the Social Security system. Rather, they receive their full retirement benefits through the CalSTRS system. The benefits are fairly generous. Teachers who retire at age 60 after 25 years in the classroom receive 50 percent of their final pay annually; that amount increases to 60 percent if they taught for 30 years.

California's Supreme Court has repeatedly ruled that public pension benefits in effect on the date of hire are a contract creating a vested right for employees, meaning that existing benefits can't be cut and that employee contributions can't be raised without compensation.⁴⁹ But those pensions were promised at a time when the plan's investments were riding high. That changed with the Great Recession, when the market's downturn wiped out nearly 25 percent of the fund's value in 2009.⁵⁰ Since then, the system has compounded the problem in an attempt to obfuscate the true size of the shortfall by relying on overly optimistic estimates for future returns.⁵¹

The court-imposed limits on changes to benefits and contributions put both the state and local districts in a vice. Still, there are some steps that can be taken to reduce future obligations and allow more education funds to go directly to classrooms and students.

To California's credit, then Governor Jerry Brown and the legislature passed the Public Employees' Pension Reform Act (PEPRA) in 2013 and a CalSTRS funding plan (AB 1469) in 2014 with the goal of averting long-term fiscal crises stemming from public pensions.⁵² The combination of cost savings and increased pension contributions mandated by PEPRA and AB 1469 will, in theory, ensure that CalSTRS is fully funded by the mid-2040s, which is when the AB 1469 funding plan expires.⁵³ The goal of these reforms—a fully funded pension system—is laudable, but several structural challenges remain.

First, and perhaps most importantly, despite these reforms, it is still not a foregone conclusion that CalSTRS will be fully funded on time—or ever. A variety of possibilities, including a downturn in the stock market or decreased tax revenues, could knock CalSTRS off its path toward fully funded status. When these events occurred in 2020 as a result of the coronavirus pandemic, not only did CalSTRS' investments fall short of expectations, but the state delayed a planned increase

in contributions to the fund. Combined, this increased CalSTRS' shortfall between assets and liabilities.⁵⁴

Second, the CalSTRS funding plan requires spending more on pensions, which while necessary to keep CalSTRS solvent does not address the concern that pension costs crowd out classroom spending. While the ongoing challenge of pension costs will be a factor in future decisionmaking for all California school districts, other analysts suggest that this challenge will pose a greater problem for high-poverty districts and disadvantaged students.⁵⁵

“To California's credit, then Governor Jerry Brown and the legislature passed the Public Employees' Pension Reform Act in 2013 and a CalSTRS funding plan (AB 1469) in 2014 with the goal of averting long-term fiscal crises stemming from public pensions.”

To put California's school districts on sounder fiscal footing, and to ensure that money is spent most efficiently toward the goal of educating students, it's worth asking some fundamental questions about public pensions, and possibly making some structural changes. Policymakers need to reevaluate the purpose of public pensions. Clearly pensions are one part of a broader package of teacher compensation, which is intended to recruit and retain good teachers. It is a dubious proposition that pension spending is as efficient toward the goal of recruiting and retaining talented teachers as other components of teachers' compensation packages are: teachers receive the benefits of pension spending years or decades in the future, while the economic truth remains that a dollar today is worth more than a dollar tomorrow.

This is not to say that retirement benefits should be entirely eliminated from California teacher compensation packages, but some share of spending that goes toward pensions—projected to reach about 40 percent of payroll—would be better spent on benefits that are more

efficient at recruiting and retaining talented teachers.⁵⁶ Given that California policymakers have a duty to spend taxpayers' money in the most efficient way possible, they must consider how to decrease pension costs going forward so that more money is available for uses that directly support students' learning.

As previously noted, pension obligations for currently serving teachers cannot be retroactively revised, so any restructuring would apply to future hires. While this would seem to limit potential savings, it's important not to understate the savings that can be gained from forward-looking pension reform: efforts to limit the growth of overall pension obligations will mean that less money needs to be set aside to fund these obligations.

There are many options for controlling pension costs. One of the most suggested options is switching from the current defined-benefit program to a defined-contribution—commonly called “401(k)-style”—program, which is standard in the private sector.

“There are many options for controlling pension costs. One of the most suggested options is switching from the current defined-benefit program to a defined-contribution—commonly called ‘401(k)-style’—program.”

Switching to a defined-contribution program has several benefits: perhaps most importantly, because contributions to the plan are made at the same time as employees earn benefits, there is no possibility of an unfunded liability. Defined-contribution programs also allow employees greater flexibility. These plans commonly offer different investment options that allow the employee to choose a portfolio in line with their personal financial situation and goals. Employees can also more easily keep their benefits (i.e., their savings account) if, for instance, they work in a different district or choose a different job. A noteworthy example is

the defined-contribution plan offered by the University of California system.⁵⁷

From a fiscal perspective, beyond the benefit of fully funding retirement liabilities at the time they are created, defined-contribution plans also share investment risks and returns more fairly between taxpayers and employees. One of the key problems of CalSTRS is that it relies on estimates of financial market returns that are, at best, an educated guess: any time the stock market drops, the gap between CalSTRS assets and liabilities widens substantially, placing the program farther from the goal of full funding. On the other hand, unexpectedly high returns on CalSTRS investments are not passed on to program members as they would be under a defined-contribution program. And while the exact costs of a defined-contribution plan depend on the details of that plan, there is a potential for cost savings in the billions of dollars per year for local governments.⁵⁸

All that said, previous reform attempts have shown that both a defined-contribution and a hybrid defined-benefit/defined-contribution plan are politically difficult in California. A brief review of reform attempts includes a hybrid plan as a point of PEPRA, the Little Hoover Commission's recommendation to institute a hybrid plan, as well as a more recent proposal from Assemblyman Kevin Kiley, which would have created a defined-benefit plan and incentivized participation using higher salaries for plan members.⁵⁹ PEPRA, as enacted, omitted Governor Brown's hybrid plan proposal, and Kiley's proposal died in committee. Nationwide, however, there are several reforms that can serve as examples for California.⁶⁰ The federal government, for instance, uses a hybrid plan and enrolls employees in Social Security (from which many California public employees are excluded). Some states also provide workers a choice between different pension plan options.

PEPRA and the CalSTRS funding plan are admirable first steps in what will be a long-term effort to ensure fiscal solvency for California's schools. These laws put California's public pension program on a sounder fiscal footing, but the current situation is not sustainable. Pension spending equal to 40 percent of teacher salaries and a new gap between assets and liabilities every time the stock market

underperforms is simply not a responsible long-term plan for California's teacher pensions. Reforming the system would provide more choices for teachers, more realistic financial planning for districts, and more resources for students.

Increase Emphasis on Vocational and Technical Education, and Make Greater Use of Apprenticeships

California has one of the more robust apprenticeship programs in the country. Currently, some 74,000 Californians are enrolled in one of 1,400 such programs, in such fields as automotive services, information technologies, health services, and hospitality, among others.⁶¹ Still, that represents less than 4 percent of Californians aged 18–24 who do not attend (or have not graduated from) college.

“Research suggests that allowing high school students to participate in apprenticeships can lead to better job prospects and higher wages after graduation.”

To be eligible for an apprenticeship, Californians are generally required to be at least age 18 and a high school graduate. Yet research suggests that allowing high school students to participate in apprenticeships can lead to better job prospects and higher wages after graduation. Moreover, participation in such programs tends to increase the likelihood of high school graduation for low-income students by as much as 7 percentage points.⁶²

In addition to apprenticeships, California's education system should place greater emphasis on vocational, technical,

and other education programs that will better prepare students for a career if they do not go on to college.

Currently there are 74 public vocational schools in California, with a total enrollment of 470,000.⁶³

Notably, many of these resources exist in California's community colleges. While California's community colleges provide an important resource, particularly for disadvantaged communities, and reforming education past the 12th-grade level is beyond the scope of this paper, there is a strong argument for moving some of these vocational resources to high schools. Clearly, moving vocational opportunities to earlier in a student's educational path helps the student gain earning potential earlier in life, helping them enter the workforce and support themselves sooner, instead of relying on family or government support while they gain job training after high school.

Furthermore, the apprenticeships and vocational training that do exist are imperfect. As others have noted, key challenges nationally include connecting potential workers to apprenticeships and more closely integrating education and apprenticeship programs.⁶⁴ Although there is progress to be made, California is well-placed to make policy changes that will expand apprenticeships and vocational education and, through doing so, increase disadvantaged Californians' earning potential. In part because vocational training is already situated in the community college system, California can implement a dual enrollment model, in which students can be enrolled in both high school and college classes, for internship and vocational training programs. This model has worked elsewhere in the country, and while dual enrollment is an option for some California students, it is not implemented on a wide scale for vocational fields.⁶⁵

Shifting to a dual enrollment model and locating some services for apprenticeship participants in high schools would also expand the opportunities for students to connect with apprenticeship programs, helping to overcome a key challenge that apprenticeship programs face in trying to attract participants.

Section 5: Welfare Reform

California maintains a robust social safety net. On a combined basis, federal and state anti-poverty programs spend more than \$100 billion every year in California, almost \$15,000 for every poor person living in the state. Overall, more than 100 federal, state, or local anti-poverty programs provide some level of benefits to Californians. Roughly 70 of these provide benefits to individuals, while the others target low-income communities. Many of these programs are small and narrowly targeted, but others are extensive and cover large numbers of Californians.

Generally, the state’s social welfare programs for individuals fall into four silos (see Table 5.1):

1. Cash assistance (California Work Opportunities and Responsibility to Kids [CalWORKs]; the state’s implementation of the federal Temporary Assistance to Needy Families program [TANF]; the earned-income tax credit [EITC]; and California EITC [CalEITC], a supplement to the federal program)
2. Food and nutritional assistance (CalFresh, the state’s implementation of the federal Supplemental Nutrition Assistance Program [SNAP, or food stamps]; the Special Supplemental Program for Women, Infants, and Children [WIC]; and school lunch programs)
3. Health care and health insurance (Medi-Cal, the state implementation of Medicaid; and Affordable Care Act subsidies)
4. Education and job training

Reliable estimates of how many Californians receive some form of government assistance are difficult to come by, in part because individuals can participate in multiple programs and because recordkeeping is decentralized. However, roughly 13 million Californians, approximately a third of the state’s population and over half of the state’s children, are enrolled in Medi-Cal.¹ Approximately 4.6 million Californians participate in CalFresh, including more than a quarter of Californian children.²

Most studies suggest that social welfare spending reduces poverty rates from their projected levels in the absence of those programs. For instance, the Stanford Center on Poverty and Inequality research estimates that without social welfare programs, California’s poverty rate would be roughly 12 percentage points higher and that the “deep poverty” rate would be nearly three times as high.³ As Rebecca Blank of the University of Wisconsin concludes after surveying the available literature, “transfer programs unambiguously make people less poor.”⁴ This should not really be a surprise: giving people money or the equivalent generally means that they have more money.

But while mostly successful in reducing material poverty, California’s welfare system is much less successful at reducing dependency and assisting low-income Californians in escaping poverty.

Therein lies the fundamental failure of California’s anti-poverty efforts: the state has focused on the alleviation of poverty, making sure that people have food, shelter,

Table 5.1
California social welfare programs

Category of assistance	Programs
Cash assistance	California Work Opportunity and Responsibility to Kids, Temporary Assistance for Needy Families, earned-income tax credit (EITC), and CalEITC
Food and nutritional assistance	CalFresh, Supplemental Nutrition Assistance Program, Special Supplemental Program for Women, Infants, and Children, and school lunch programs
Health care and health insurance	Medi-Cal, Medicaid, and subsidies under the Affordable Care Act
Education and job training	CalJOBS and welfare-to-work program

and other basic needs. That may be a necessary part of an anti-poverty policy, but it is far from sufficient. A truly effective anti-poverty program would not just alleviate the symptoms of poverty but would eradicate the disease itself. We should seek to ensure not only that people are fed and housed but that they are able to rise as far as their talents can take them. We focus too much on poverty and not enough on prosperity.

“By focusing too narrowly on the material aspects of poverty, we neglect the more important necessities for human flourishing.”

President Lyndon B. Johnson called for doing more than simply fighting material poverty. Johnson created the war on poverty not only to “relieve the symptom of poverty, but to cure it and, above all, to prevent it.” Yes, it sought to meet the “basic needs” of those in poverty, but more importantly, it strove to “replace despair with opportunity.”⁵ Yet by focusing too narrowly on the material aspects of poverty, we neglect the more important necessities for human flourishing. Our tax and spending policies should be better designed to enable every person to become a fully actualized being, capable of realizing success as they define it.

Of course, none of us is an island. We interact with others all the time, and we all survive and prosper because of that interaction. In addition, all of us will experience times of greater dependency, such as during childhood or old age. In times of distress, our community, private charity, and possibly even the government may need to intervene.

Yet government intervention will always be a second-best solution. Of necessity, centralized welfare programs reduce an individual's autonomy, self-ownership, and choices. There is a reason why, even in cases of individuals with mental and physical disabilities, we attempt to maximize everyone's self-sufficiency and ability to manage their own lives. Increasingly we find that programs once intended to be stopgap or emergency measures have become vectors for long-term, even multigenerational, dependency.

People who are poor themselves recognize how the existing welfare system fails to address their larger needs. According to a 2016 *Los Angeles Times* poll, conducted with the American Enterprise Institute, 71 percent of individuals living below the poverty level believed then that the government lacks the knowledge to eliminate poverty, even if it is willing to spend whatever is necessary. Moreover, the poll shows that people living below the poverty level were split evenly (at 41 percent) on the question of whether the welfare system helps people escape from poverty or encourages people to stay poor. Finally, by a 48 percent to 41 percent margin, low-income people believed that people who have been poor for a long time are likely to remain poor despite government assistance. Indeed, people with incomes above the poverty level were more likely to have a favorable impression of the welfare system and government's efficacy in alleviating poverty than were low-income people.⁶

A second poll, conducted by the Cato Institute in 2019, found similar results. Nationwide, 63 percent of welfare recipients said that the war on poverty has failed. And 76 percent of welfare recipients agreed that economic growth would do more to reduce poverty than an expansion of traditional social welfare programs.⁷

In proposing a better way to fight poverty, we should not blindly support cutting programs for the sake of cutting them. Nor should we assume that what California is doing now is working and that the state should simply do more of it. Rather, we should ask what actions can be taken to ameliorate the suffering of those living in poverty at least as well as existing efforts while also creating the conditions that enable people to live more fulfilled and self-directed lives. Is it possible to achieve or even expand on the reductions in material poverty that we have seen without settling for the negative side effects accompanying government poverty programs today? Can we fight poverty in a way that is compatible with the economic growth and with reducing poverty, including generational poverty, in the future? Finally, can we fight poverty in a way that provides people a greater degree of empowerment over their lives?

This report provides recommendations for achieving these goals in ancillary policy areas—tackling issues such as

housing, criminal justice reform, education, and economic inclusion, all of which are designed to improve opportunities for Californians in poverty and in general. The goal is to make safety net and social welfare programs far less necessary. This section is devoted to those areas within the state's social welfare system that are ripe for reform.

RECOMMENDATIONS

Abolish Asset Tests for CalWORKs and Other Programs

Too often, the importance of savings and wealth accumulation gets neglected in the context of poverty discussions. The logic behind this omission is obvious: immediate needs for food, shelter, and so on must be met before more long-term goals can be addressed. Yet even a relatively small amount of savings can make a significant difference in the short term, enabling payment of a car repair or health care bill and preventing such unanticipated expenses from forcing a family into a cycle of debt and poverty.

Over the longer term, savings are even more critical. For example, studies show that single mothers with savings are significantly more likely to keep their families out of poverty than other single mothers, even after correcting for a variety of social and economic factors.⁸ Other studies show that families with assets have greater household stability, are more involved in their community, demonstrate greater long-term thinking and planning, and provide increased opportunity for their children.⁹ Clearly the ability to save and accumulate assets offers a wide array of benefits.

Some observers suggest that the whole definition of poverty should be revised to consider the accumulation of assets or the lack of them. One common definition of “asset poverty” would define people as “asset poor” if they lack sufficient savings or other assets to survive for three months at the poverty level. This form of poverty can be measured two ways: 1) by net worth (i.e., the value of all assets, such as car, home, savings account, etc.) minus debts or 2) by liquid assets, meaning cash or assets that can easily be converted to cash.¹⁰

Studies have long shown that levels of asset poverty exceed levels of income poverty in the United States. Using the first measure, net worth, roughly one out of five Americans can be considered asset poor. Looking at liquid assets measurements, the picture is even worse: more than a third of Americans can be regarded as asset poor.¹¹ However, even these measures may understate the severity of the lack of savings or assets among lower-income Americans. For instance, according to the Federal Reserve, 46 percent of adults in 2015 said that they either could not cover an emergency expense costing \$400 or would cover it by selling something or borrowing money.¹² It should be no surprise that asset poverty is a much bigger problem for people who are poor. Using a liquid assets measure, more than 80 percent of Americans in the lowest income quintile can be considered asset poor.¹³

“Too often, the importance of savings and wealth accumulation gets neglected in the context of poverty discussions.”

The consequences of asset poverty for poor households are substantial. Most obviously, a lack of savings or other assets leaves a family more vulnerable to unanticipated expenses or a sudden change in economic circumstances. Events like job loss, divorce, or a health crisis can cause financial difficulties for all families. For those without savings to fall back on, these problems can become a full-blown crisis.¹⁴

Lack of savings and assets also makes it harder for people to invest in things that can help them escape poverty, such as relocating, purchasing a house or car, starting a business, or pursuing education for themselves or their children.¹⁵

In addition to effectively imposing a high marginal implicit tax on saving, asset tests can be arbitrary, capricious, and confusing, treating similar assets differently depending on the state, the program, or even the attitude of investigators. As the Federal Reserve Bank of Boston points out in a 2006 study, while one family may be able to retain its retirement savings when it applies for a means-tested program, another similar

family that uses a different retirement saving vehicle or lives in a different state may be ineligible for the same program unless it depletes its retirement savings. Also, a household may qualify for some programs but not for others based solely on different rules for the various programs.¹⁶

Finally, asset tests can be an inefficient use of state resources. California spends more than \$6.4 million annually on asset testing and verification but has found that only 1 percent of cases exceed asset limits, most of those by insignificant amounts.¹⁷

In recent years, California has taken steps to reduce its use of asset testing for welfare programs. For instance, the state eliminated asset limits for CalFresh in 2015.¹⁸ And, in the 2019–2020 legislative session, the legislature increased the exempt value for vehicles under CalWORKs to \$25,000.¹⁹

However, the state continues to impose asset limits for other programs. For instance, other than the vehicle exemption, CalWORKs applicants can have no more than \$10,000 in total assets. Asset testing for SNAP has been eliminated in California, but asset limits remain for older adults to qualify for Medi-Cal; and any assets valued above \$5,000 counted against Section 8 eligibility.

California should review these and other social welfare programs to remove—or at least increase—asset limits and encourage savings.

Prioritize Cash Payments System over In-Kind Benefits or Indirect Payments

Several California localities have taken the COVID-19 response as an opportunity to experiment with what proponents called a universal basic income, among them Oakland, Stockton, and Marin County. None of these experiments implemented a true universal basic income—all were means tested, and in the cases of Oakland and Marin County, they were limited to specific groups such as low-income women of color—but they did move in the direction of providing cash benefits with minimal strings attached.

The cash benefit portion of these experiments is particularly important. By placing strict limits on TANF, the 1996 federal welfare reforms accelerated an already growing trend toward substituting “in-kind” benefits or indirect payments

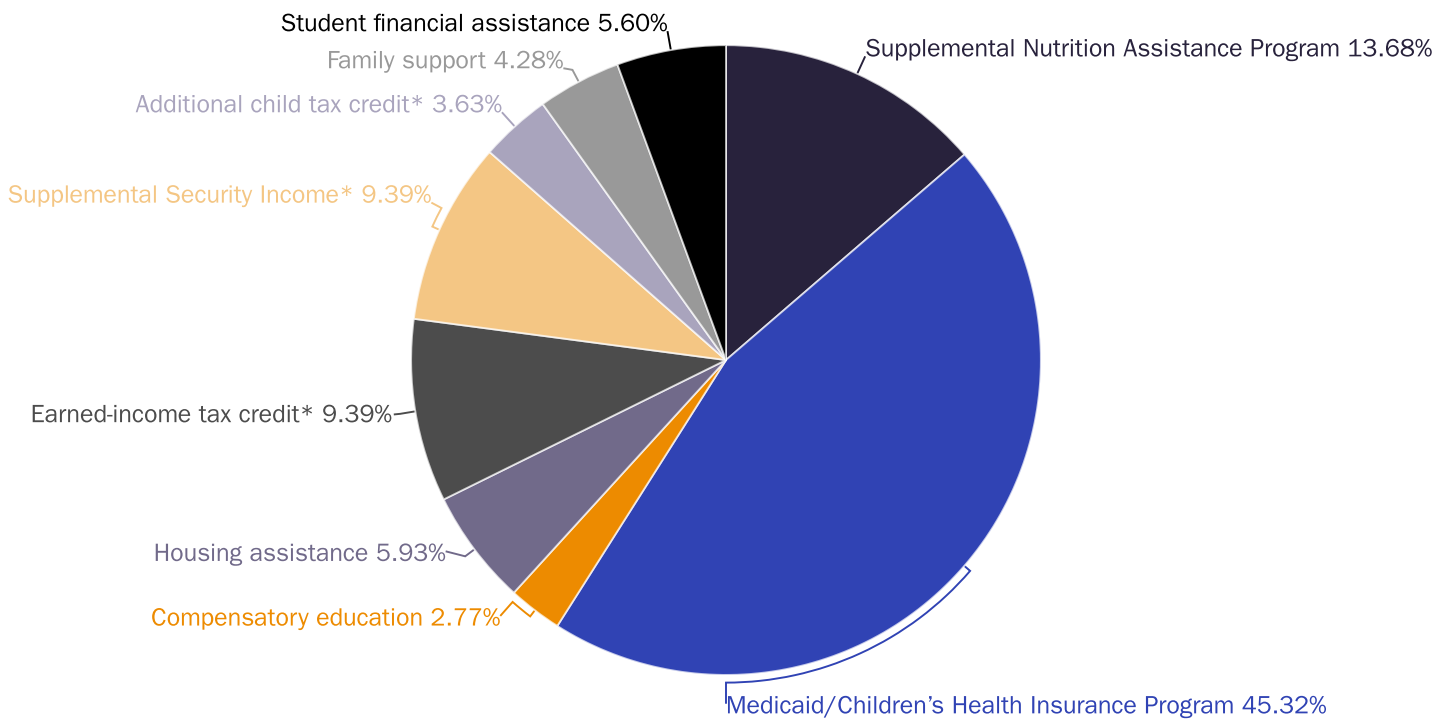
to vendors in lieu of cash. Today, most benefits are provided not in cash but as “in-kind” benefits. Indeed, direct cash assistance programs, including refundable tax credits, now make up 24 percent of direct federal transfers.²⁰ See Figure 5.1 for federal spending on social welfare programs. In-kind programs, such as food stamps, housing assistance, and Medicaid provide people with assistance but only for specific purposes. In most cases, the payments are made directly to service providers. The person being helped never even sees the money. People who are poor are not expected to budget or choose among competing priorities the way individuals who are not on welfare are expected to do.

Direct cash payments provide substantial advantages over other types of assistance. Cash benefits offer a greater degree of transparency and consistency, treating similarly situated people the same. Too often, existing programs reward those who can best navigate the system rather than those most in need. On the distribution side of the program, cash requires less bureaucracy to administer and can even save taxpayers money and allow more resources to go toward beneficiaries.

“Too often, existing programs reward those who can best navigate the system rather than those most in need. On the distribution side of the program, cash requires less bureaucracy to administer and can even save taxpayers money.”

Providing cash also treats low-income people like adults. The recipient, rather than the government, chooses how much they should spend for housing, food, education, health care, and so on. Most of the rest of us make such budgeting decisions. Moreover, many programs go even further in limiting the use of benefits to government-approved purchases. For example, WIC can only be used to buy certain foods determined by government regulation.²¹

Figure 5.1

Federal spending on social welfare programs

Source: Gene Falk, "Low-Income Assistance Programs: Trends in Federal Spending," Congressional Research Service, May 7, 2014.

Note: *Denotes cash assistance programs.

Finally, while most economic and racial segregation in housing can be traced to housing policies, the current welfare system also contributes to the geographic concentration of poverty. Because only certain providers are both qualified and willing to accept payment through many social welfare programs, low-income people are often forced to live in areas with high concentrations of poverty. Often these areas have more crime, fewer economic opportunities, and a lack of social cohesion. Children are often stuck with failing local schools, which leave them less prepared for the job market and limit their opportunities.

California has an existing program that can be better utilized to expand and accelerate the move to cash-based benefits. Currently, in addition to the federal EITC, low-income Californians are eligible for the state version of the credit (CalEITC). However, the state program is much smaller and more narrowly targeted than its federal counterpart. For example, in 2017, Californians received more than \$6.4 billion in benefits from the federal EITC, compared with \$351 million from the state version.²²

The legislature significantly expanded the program in 2019, a move that was expected to increase California benefits to roughly \$1 billion annually.²³ Despite this expansion, only one out of seven Californians who receive benefits under the federal EITC also receive state EITC benefits.²⁴

Currently, to be eligible for CalEITC, families with children must have incomes below \$22,000 annually, while childless adults must have annual incomes below \$15,000. This is well below the federal threshold (as high as \$54,000 for families, depending on filing status and number of children, and \$21,000 for childless adults).

Rather than to continue to throw more money at current and new safety net programs, California should use existing resources to expand CalEITC. To do so, California should consolidate existing anti-poverty programs and fold them into a single fully refundable tax credit.²⁵ Those eligibility requirements and restrictions present in the consolidated anti-poverty programs but not incorporated within the current CalEITC should be eliminated.

As part of this change, the state should request that the federal government also consolidate funding for targeted anti-poverty programs into a single block grant that California can combine with existing funding to support the new, expanded CalEITC.

Of course, initially, certain programs targeted to disabled people, older adults, foster children, and other groups with special needs, as well as certain health care programs such as Medi-Cal, may have to remain outside this framework. However, even in these cases, the state should pursue efforts to consolidate such programs, create a single point of delivery, and shift to cash benefits, either separately or as part of the new EITC where possible.

Finally, to the degree possible, the new CalEITC should be provided as a true wage supplement. That is, payments should be made regularly throughout the year (ideally tied to wage payments), rather than once annually only after filing taxes.

Shifting from the current hodgepodge of programs to a single, cash-based approach (to the degree practicable)

“Welfare benefits help meet immediate material needs but simultaneously set up incentives that can penalize work, marriage, and other routes to self-sufficiency.”

would offer several advantages. Shifting from in-kind benefits to cash would also increase transparency and equity, treat recipients fairly while encouraging responsibility, and reduce bureaucratic oversight of participants and associated administrative overhead. By eliminating certain unemployment or household requirements, the change would also increase incentives for work and marriage. The income-based phasing out of benefits under California's current welfare programs (including its EITC) creates a situation where workers' payroll taxes, benefit phaseouts, and costs of going to work (transportation, clothing, childcare, and so on) can leave an individual worse off if they try to increase their income outside the welfare system. Replacing existing welfare

programs with a more comprehensive state EITC would not eliminate such disincentives, but it could significantly reduce them.

Finally, because it would incorporate funding from existing programs and cut administrative costs, this reform could be accomplished without any net increase in spending. Over the long term, such a shift would be a win for both recipients and taxpayers.

Expand Welfare Diversion Programs

Most welfare programs suffer from an internal contradiction. Welfare benefits help meet immediate material needs but simultaneously set up incentives that can penalize work, marriage, and other routes to self-sufficiency. For example, the combination of lost benefits, taxes, and employment costs can often mean that someone leaving welfare for work will see little, if any, increase in short-term income.

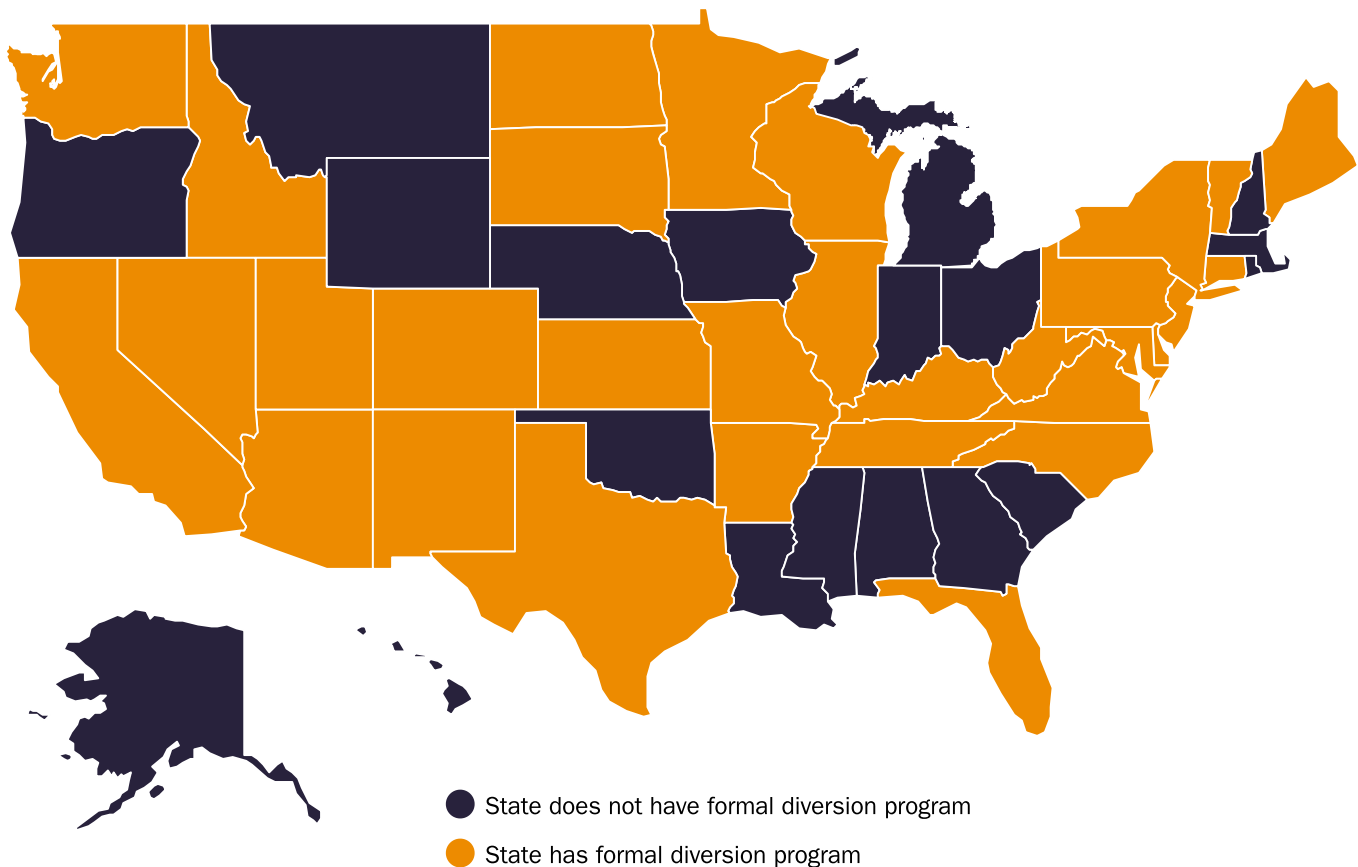
This problem is exacerbated by the fact that many people apply for welfare because of a short-term financial problem—for instance, divorce, fear of eviction, or a sudden health issue. In such cases, signing up for traditional welfare may do more harm than good, failing to solve the immediate crisis while locking the recipient into long-term dependency.

California is one of 32 states that maintains a welfare diversion program, which provides a lump-sum cash payment in lieu of traditional welfare benefits when certain qualifications are met (see Figure 5.2).²⁶

These programs are designed to assist families facing an immediate financial crisis or short-term need. Families are given a single cash payment in the hope that once the immediate problem is resolved, there will be no need to go on long-term welfare. In exchange for receiving the lump-sum payment, welfare applicants forfeit their eligibility for TANF (CalWORKs) during their benefit term.²⁷

This CalWORKs diversion program is administered at the county level. The county assesses whether an applicant would benefit from a lump-sum diversion program, considering factors such as the applicant's work history, prospects for employment, housing situation, and childcare arrangements. If the county determines that the family is eligible for the program, the family is given the option

Figure 5.2

Welfare diversion programs by state

Source: Katie Shantz, Ilham Dehry, and Sarah Knowles, "States Can Use TANF Diversion Payments to Provide Critical Support to Families in Crisis," *Urban Wire* (blog), Urban Institute, January 27, 2021.

of participating. The county and the participating family then negotiate a cash or noncash payment (or service) in exchange for the family agreeing not to apply for TANF during the period of the diversion. If the family *does* apply for TANF, the family either repays the lump sum out of its TANF benefits or has its five-year TANF time limit reduced. The lump-sum diversion payment generally is not considered income in determining food stamp eligibility. Moreover, during the period of the diversion, the applicant's family may be eligible for Medicaid benefits and childcare. (However, Medicaid eligibility is not automatic; the county is supposed to follow existing procedures for making a Medicaid determination.) In addition, any child support collected by the applicant or recovered by the county cannot be used to offset the diversion payment.²⁸

Several studies indicate that for individuals who have not previously been on welfare, diversion programs significantly

reduce their likelihood of ending up there. Studies also suggest that diversion program participants are subsequently more likely to become or remain employed than they are to become recipients of traditional welfare.²⁹

Moreover, diversion programs may work particularly well as California recovers from the COVID-19 pandemic response. Research from the Urban Institute points out that many families are facing short-term or unique economic challenges that may require assistance but do not require long-term participation in the welfare system. For example, diversion funds can be used to pay for rent, utilities, and other housing-related costs or provide short-term food assistance, mental health and substance abuse treatment, domestic violence services, or vehicle repair.³⁰

However, many California counties are underutilizing this valuable tool. Only about 18 counties currently use

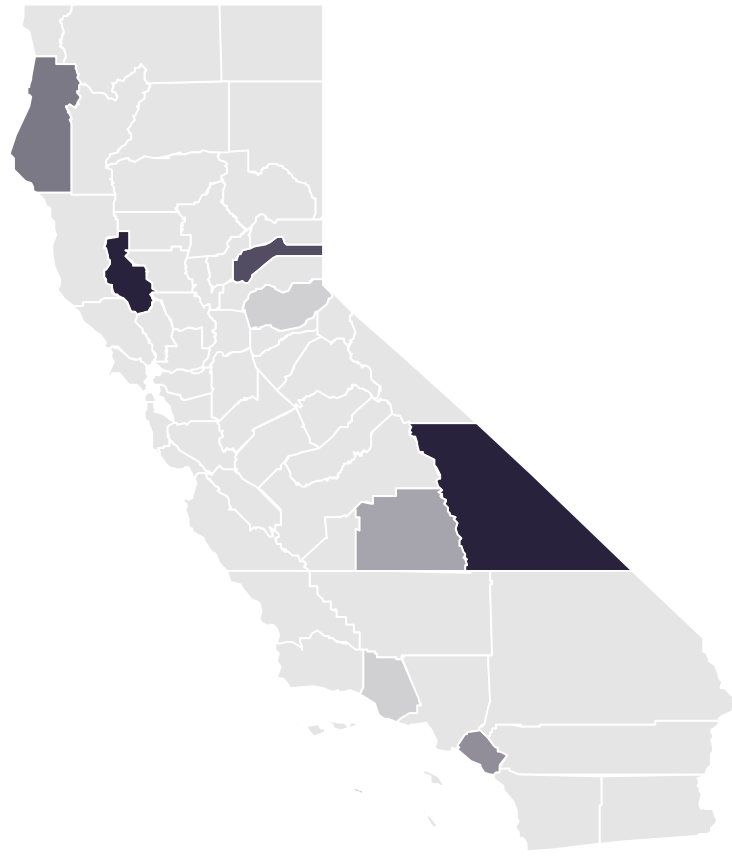
diversion programs (see Figure 5.3). Before considering population, Orange County spends the most on diversion programs, followed by Inya County (which, when considering population, spends the most). Still, spending on diversion programs remains low even for many of the counties that use them: Orange County spent around

\$120,000 on diversion programs while spending over \$100 million on CalWORKs in 2020.

Diversion should be the first recourse for many welfare applicants. Therefore, the California Department of Social Services should actively incentivize counties to prioritize and expand their use of this valuable tool.

Figure 5.3

Welfare diversion spending per 100,000 residents by county



Diversion spending per 10,000



Source: Author's calculations using "County Population Totals: 2010–2019," U.S. Census Bureau, last revised April 20, 2021, <https://www.census.gov/data/tables/time-series/demo/popest/2010s-counties-total.html>; and California Department of Social Services.

Section 6: 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

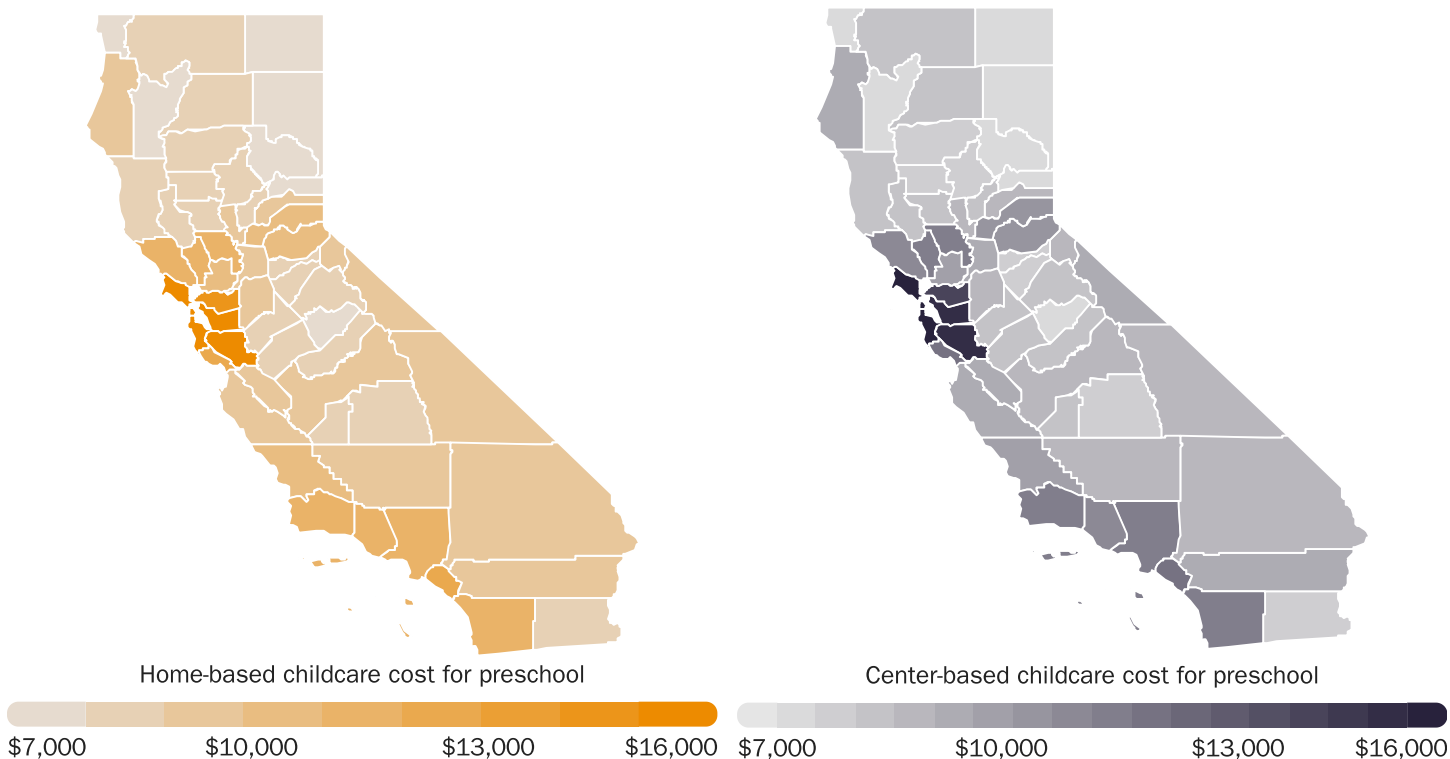
Even before the pandemic, childcare options in California had been steadily declining for years. Between 2014 and 2019, the number of home-based and center-based childcare providers decreased by 5.5 percent, which is over 57,000 providers. Despite the state’s extensive efforts to keep them afloat, COVID-19 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

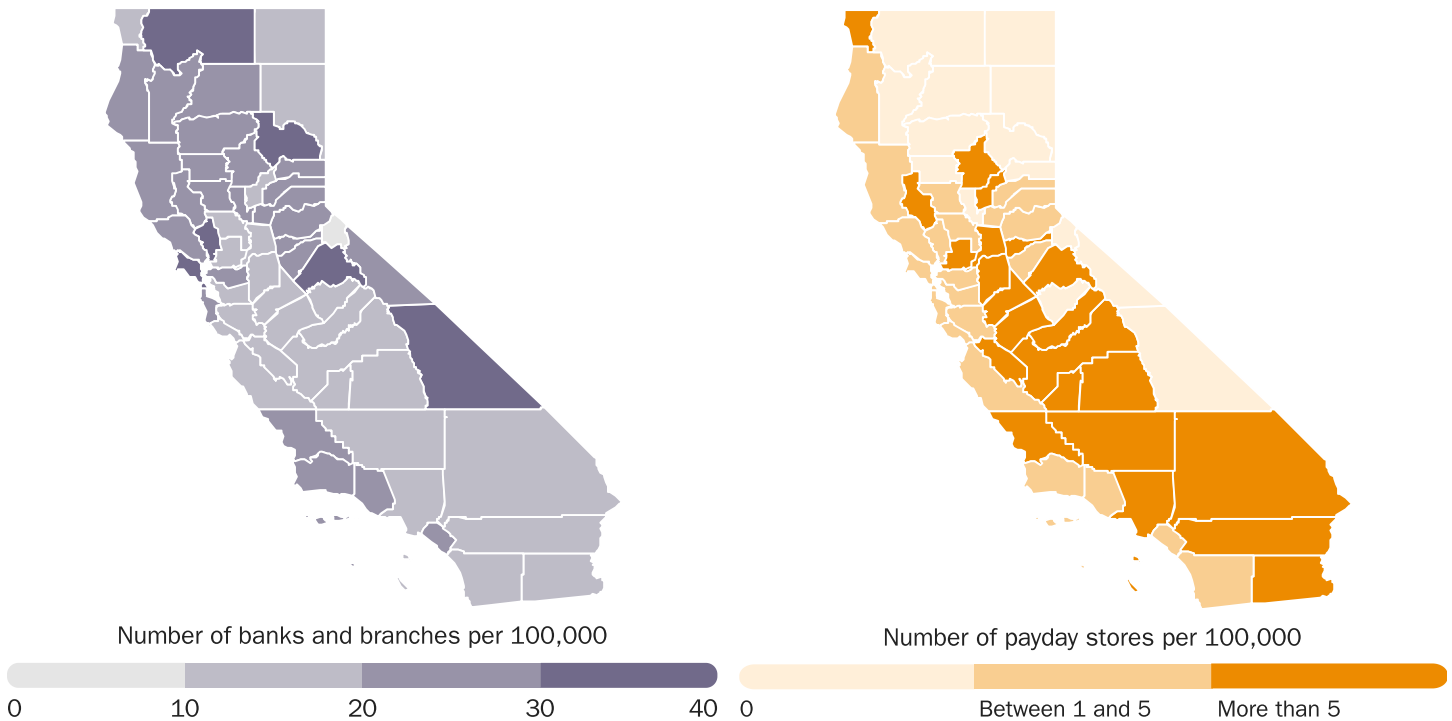
card, or wiring money out of state or overseas. The immediacy of payout is also important for low-income people who must contend with daily expenses and cannot wait for a check to clear through traditional banking.

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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