MARIJUANA'S SOCIAL EQUITY MISFIRE
WHY STATE EFFORTS TO PROMOTE RESTORATIVE JUSTICE WITHIN THE CANNABIS INDUSTRY HAVE FAILED, AND HOW A MARKET-BASED APPROACH CAN PROVIDE BETTER OUTCOMES

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INTRODUCTION

States have increasingly applied social equity goals within their marijuana legalization programs. This effort began at the municipal level, but Massachusetts created a statewide social equity plan within its framework for legal marijuana in 2018, and ensuing states—including Connecticut, Illinois, New Jersey, New York, Virginia, and Vermont—have iterated with alternative approaches to addressing social equity.

Nominally, social equity programs are designed to bring about restorative justice for what are viewed as arbitrary and discriminatory arrests, convictions and incarceration of Americans during the War on Drugs. However, current approaches to social justice employed by all these states fail to target relief to the affected populations and create new barriers for legacy suppliers of marijuana products to gain legitimacy on a legal market.

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Part 2 reviews the history of the drug war and assesses the extent to which it was designed and executed in a discriminatory fashion. It reviews arrest and use statistics compiled by federal agencies and concludes that the drug war was designed and executed in racially discriminatory ways that created social inequities.

Part 3 elaborates on the collateral consequences that individuals suffer as a result of a prior drug conviction beyond the initial penalty of fines or jail time. Carrying a prior conviction may negatively affect an individual's ability to pursue gainful employment, attend college, or apply for a business loan for the remainder of their lives.

Part 4 details existing state efforts to promote social equity within their regulated marijuana markets. It highlights instances where these efforts have systematically failed to bring about the restorative justice envisioned by proponents. Part 5 provides further analysis on these insights by examining whether social equity plans are working as intended and what considerations should be made before undertaking a plan to promote social equity.

Part 6 makes recommendations for how social equity plans should be structured in the future. It focuses on two overarching themes, each with various implications and subcomponents. First, state-regulated marijuana markets should be structured to intentionally facilitate the transition of legacy suppliers—those who previously manufactured or distributed marijuana on an unlicensed basis—into the regulated market by minimizing barriers to entry. Too often, state efforts to promote social equity within regulated marijuana markets have had the unintended consequence of creating a new version of the drug war. Second, states can focus on restorative justice measures once they have ceased causing new harm. These include expunging convictions for actions that are no longer a crime and following tort law traditions to redress specific harms suffered by individuals who were directly affected by the drug war. These tort law traditions may extend up to and possibly include the payment of financial damages, for which guidance is provided.
THE DRUG WAR WAS DESIGNED TO AND HAS PUNISHED DISTINCT SEGMENTS OF THE POPULATION

For decades, black Americans have been arrested and incarcerated for drug crimes at far higher rates than white Americans. Former White House counsel and domestic affairs advisor John Ehrlichman has admitted the Nixon administration’s real goal in launching the drug war was to develop a pretext for harassing black Americans and antiwar protestors.

As Ehrlichman infamously admitted, “We knew we couldn’t make it illegal to be either against the war or black, but by getting the public to associate the hippies with marijuana and Blacks with heroin, and then criminalizing both heavily, we could disrupt those communities. We could arrest their leaders, raid their homes, break up their meetings, and vilify them night after night on the evening news. Did we know we were lying about the drugs? Of course we did.”

Former White House counsel and domestic affairs advisor John Ehrlichman has admitted the Nixon administration’s real goal in launching the drug war was to develop a pretext for harassing black Americans and antiwar protestors.

Ehrlichman’s candid characterization of the Nixon administration’s motives in launching the drug war reveals an open hostility to perceived political opponents, including racial minorities. These motives are highly consistent with public pronouncements by officials like Harry Anslinger during an earlier incarnation of the drug war launched by the Franklin Roosevelt administration. Assuming Ehrlichman’s characterization of the motives was accurate, however, is insufficient to establish that the drug war was discriminatory in practice. To establish that basis, data must demonstrate that the groups targeted by Ehrlichman and his allies were in fact arrested at rates substantially disproportionate to their rate of drug usage.

**Drug Use.** Federal data from the National Survey on Drug Use and Health reveals self-reported drug use for various substances over a range of demographic factors, including race. This data shows the proportion of black Americans who have used marijuana in the past year has consistently remained within two percentage points of the percentage of white Americans to have used marijuana in the past year over the time measured, which stretches between 2003 and 2020. Asian, Hispanic and Pacific Islander respondents generally indicate lower use rates than both white and black respondents. Figure 1 displays past-year usage rates by race throughout the time series of this dataset.

Data indicating the usage rates of opium or cocaine and their derivatives is more limited. Federal data does distinguish individuals that have consumed illicit drugs other than

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marijuana by race beginning in 2017. This is plotted in Figure 2. It reveals that a larger share of white Americans use these drugs than black Americans, at least in recent years.

These data generally show that black Americans are only slightly more likely to consume marijuana than white Americans while white Americans are slightly more likely than black Americans to consume drugs other than marijuana. This data appears to fly in the face of Ehrlichman’s characterizations that black Americans would be associated with heroin and “hippies” would be associated with marijuana.
Throughout the period of the drug war, black Americans accounted for roughly 13% of the U.S. population. Therefore, if the drug war had been executed indiscriminately, roughly 13% of possession arrests should have been of black Americans. Unfortunately, the data clearly rejects this null hypothesis.

**Arrests.** There is evidence to show the drug war was initially used in precisely the way envisioned by Ehrlichman and his former colleagues in the White House—targeting the predominantly White antiwar movement for marijuana offenses while targeting the black population for opium or cocaine and their derivatives. Between passage of the Controlled Substances Act in 1970 and the Violent Crime Control and Law Enforcement Act of 1994 (“1994 Crime Bill”), a large majority of individuals arrested nationwide on charges related marijuana were white, while arrests related to opium or cocaine and their derivatives trended more heavily black. On a proportional basis, however, black Americans were arrested at higher rates relative to their share of the population for all substances throughout the time period. This is true even for marijuana-related offenses.4

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However, following passage of the 1994 Crime Bill, additional federal resources targeted toward the enforcement of drug laws appear to have exacerbated the racial disparity in arrest rates. After 1994, black Americans began to account for an increasing proportion of marijuana-related arrests but a decreasing proportion of arrests for possession of opium or cocaine and their derivatives. Figures 3 and 4 demonstrate these trends, which provide additional nuance to the debate on the racially disparate effects of the drug war.5

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5 The FBI dataset did not categorize arrests for racial groups other than white, Black or African American, and American Indian or Alaska Native until 2013 when it began to record separate categories for Asian, Pacific Islander, and Unknown. The number of arrests in these new categories remained immaterial throughout the dataset. Nearly all arrest records are categorized as either “white” or “Black or African American.”
The 1994 Crime Bill made grants to states for law enforcement and prison construction if those states adopted new minimum sentencing laws. As such, the Crime Bill not only changed the racial composition of arrests in percentage terms, but the overall number of arrests grew dramatically following its passage. Figure 5 demonstrates a rapid growth in...
arrests for marijuana possession between the early 1990s and 2009, when annual arrests peaked at 585,018 nationwide. Figure 6 shows this acceleration of arrests did not exist for possession of opium, cocaine or their derivatives. The marginal increase in enforcement resulting from the 1994 Crime Bill appears to have been concentrated on marijuana prohibition within black communities.

**FIGURE 5: POSSESSION ARRESTS FOR MARIJUANA NATIONWIDE 1985 - 2020, BY RACE**

**FIGURE 6: POSSESSION ARRESTS FOR OPIUM, COCAINE AND DERIVATIVES NATIONWIDE, 1985 - 2020, BY RACE**
After 2009, a downward trend began in marijuana possession arrests as federal prosecutors began to exercise greater discretion in the prosecution against state-regulated medical marijuana programs. Throughout the 2010s, 19 states plus the District of Columbia enacted new medical marijuana programs. In addition, 11 states plus the District of Columbia legalized marijuana for adult use, beginning with Colorado and Washington in 2012. These laws generally made it permissible within state law for individuals to possess marijuana in amounts reflecting personal use, leading to a rapid decline in arrest rates for marijuana possession nationwide throughout the decade. Between 2009 and 2020, annual arrests for marijuana possession nationwide fell by 61.2%. These laws also permitted state-licensed entities to engage in the commercial cultivation, manufacturing and distribution of marijuana to create a legal supply chain. Federal data shows this change resulted in a nationwide decline in arrests for the sale and manufacturing of marijuana products between 2010 and 2020 of 71.0%.

Between 2009 and 2020, annual arrests for marijuana possession nationwide fell by 61.2%.

Over a similar time period, annual arrests for the sales and manufacturing of opium or cocaine and their derivatives also fell dramatically. Between 2006 and 2020, arrests for these offenses declined by 68.8%. The racial composition of these arrests also changed substantially. At the high point of enforcement in 2006, 63.3% of those arrested on these charges were black. That proportion fell to 39.3% by 2020 with the racial composition of arrests trending more white as the overall number of arrests declined. These findings provide further support for the notion that marginal increases in the enforcement of drug laws tend to be concentrated in black communities.

The figures presented in this section make clear that the drug war has had the discriminatory effects on distinct segments of the American population that it was intended to have when launched by the Nixon Administration, even if the data tells a more nuanced story. The 1994 Crime Bill led to a surge in enforcement efforts that appears to have been concentrated in black communities. It led to a greater overall number of marijuana-related arrests, with black Americans accounting for most of the marginal increase in arrest numbers. A third inflection point has been the growing liberalization of marijuana laws
within the states since 2010, which led to a rapid decline in the number of marijuana-related arrests nationwide. On a proportional basis, however, black Americans have accounted for an increasing share of marijuana-related arrests during this period, as seen in Figure 1.

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Related Crimes. Can the racial disparity in drug-related arrest rates be explained by arrestees’ involvement in other criminal activity that may have brought them in more frequent contact with law enforcement? A statistical analysis of black and white prison inmates who were arrested on drug charges indicates that white inmates were more likely to have been involved in other criminal activity. Among black inmates, 47% were arrested for possession or sales of illegal drugs alone, while only 19% of white inmates were arrested on these charges alone. About 80% of white inmates “had more charges indirectly related to drugs, such as committing a crime in order to buy drugs, or being high while committing a crime.” Even after using advanced statistics to adjust for differences in socioeconomic factors, the analysis shows that black Americans are more than twice as likely to be arrested for possession alone than white Americans and more than eight times as likely to be arrested on a sales charge without other associated crimes. Simply put, white inmates are far more likely to have been engaged in other criminal activity.

Moreover, the analysis surveyed inmates for their drug of choice and reported that black inmates were far more likely to prefer marijuana, at 49% of respondents compared to just 10% of white respondents. Half of white respondents preferred heroin versus only 7% of black respondents. Although these survey results (conducted in 2011 and 2012) don’t

7 Ibid.
8 Ibid.
clearly indicate those were the substances for which inmates had been arrested, the substances of arrest are likely close to those figures. This would provide further evidence that drug enforcement in the period following the 1994 Crime Bill was concentrated heavily against marijuana in black communities. Moreover, this disparate effect cannot be explained by other involvement in criminal activity.
The government’s war on demographic segments of the American public over the past 50 years has broken up families, ruined lives, and curtailed individuals’ dreams of starting a business, attending college, or accepting lucrative employment. Indeed, a drug conviction not only carries immediate criminal penalties, but it can follow a person throughout their life and foreclose prospective future opportunities even after individuals have paid fines or served prison time.

In a 2018 survey, 84% of employers indicated that they conducted criminal history background checks for all job applicants using a national database, while 89% screened job applicants using county or statewide databases. Empirical research indicates that a criminal conviction reduces the likelihood of a white job applicant receiving a callback by 50% and by nearly two-thirds for Black job applicants. Moreover, state occupational licensing requirements often automatically disqualify all applicants with a criminal history,

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foreclosing the opportunity to gain employment in many low- to medium-income occupations. Nationwide, 841 occupational licensing provisions preclude ex-offenders from being licensed solely on the basis of past criminal conduct. Another 1,814 provisions allow licensing boards to screen applicants for “good moral character.”

Similarly, a 2018 survey of institutions of higher education revealed that 72% examine criminal history information as part of the admission process. The rejection rate for applicants with felony convictions was 2.5 times greater than for other individuals even when controlling for other factors like scores on college admissions exams.

The federal government also discriminates against those with prior convictions through its lending programs for small businesses. Loans made available through the Small Business Administration automatically bar applicants on probation or parole from receiving a loan regardless of the strength of their business plan. Further, any applicant with a prior felony conviction must undergo an additional screening process known as “character determination” that has no publicly available standards and appears to be assessed arbitrarily.

Data presented in Section II illustrates how these disadvantages have been disproportionately prevalent among black Americans, particularly following passage of the

1994 Crime Bill. These Americans have suffered disproportionately higher arrest rates than those in other racial groups as a result of the drug war, and this was always the intent.

Disproportionate prevalence, however, does not imply that all black Americans have suffered these disadvantages nor that all those who received drug-related convictions were black. Indeed, criminal convictions and their subsequent consequences are suffered on an individual basis even if the laws leading to them are applied in ways that exert a disparate impact on certain groups.
STATE EFFORTS TO ACHIEVE SOCIAL EQUITY THROUGH CANNABIS LEGALIZATION

Over the past decade, as states have taken action to curtail the drug war by creating legal markets for adult-use marijuana, advocates have in many cases attempted to also redress historical injustices created by the drug war. A key challenge has been to delineate exactly who the victims of the drug war have been. Under varying definitions, they may include those who were arrested on a marijuana-related charge, those who were convicted, or their direct family members. In other cases, states have included persons adjacent to these victims, such as those who reside in communities that have had disproportionately high arrest rates, regardless of whether these individuals suffered any direct harm from the drug war. Various attempts at restitution or targeted public benefits have been offered to both direct victims and adjacent persons.
MASSACHUSETTS

In 2018, Massachusetts became the first state to adopt regulations creating a statewide “social equity” component within its cannabis program. The Massachusetts Social Equity Plan paired prospective qualified cannabis licensees or employees with mentors so they could learn valuable skills intended to increase their chances of success within the regulated cannabis industry. It also waived license application and monthly seed-to-sale tracking fees for qualified applicants, cut annual license fees in half, and reserved entire classes of cannabis licenses for social equity applicants only. Only qualified social equity applicants would be able to operate a social consumption lounge or a delivery-only license. To be eligible for this special treatment, an applicant or their spouse or parent had to have a cannabis-related conviction on their record. Alternatively, an applicant could have lived in a census tract with extraordinarily high historical arrest rates for marijuana and have an income no greater than four times the median for households in that area. In other words, the same advantages became equally available to both direct victims and adjacent persons in Massachusetts.

ILLINOIS

Next came Illinois—the first state to legalize cannabis through the legislative process. In 2019, Illinois lawmakers took great pride in their efforts to craft a legalization bill intended to achieve social equity goals. The law defined social equity applicants in 3 ways:

1. Businesses in which at least 51% ownership and control was held by individuals who had been arrested for a marijuana offense that would be legal following the bill’s passage, or their direct family members.

2. Businesses in which at least 51% ownership and control was held by individuals who had resided for at least 5 of the 10 preceding years in an area with historically high drug-related arrest rates.

3. Businesses in which at least 51% of employees either had been arrested for a marijuana offense that would be legal following the bill’s passage or currently reside in an area with historically high drug-related arrest rates.

As in Massachusetts, the Illinois legislation granted equal advantages to both direct victims of the drug war and adjacent persons, but it also allowed businesses that simply hired from among these groups to also gain the same advantages. These advantages included:

- Access to low-interest loans provided by the state;
- Technical assistance for completing a license application, establishing operations or applying for a loan;
- Reduced licensing and application fees
- Eligibility to receive a 20% bonus on the state’s scoring of any application to receive one of the limited licenses available

In addition, Illinois would dedicate one-fourth of marijuana tax revenues toward a grant-making program called Restoring Our Communities. This program would make grants to nonprofits and other community-based organizations to provide services of community benefit within areas disproportionately impacted by the drug war. The program would prioritize proposals designed to address the “root causes of violence” or the “social determinants of health,” among other goals. At the time, Reason Foundation noted that the goals of the Restoring Our Communities program were so nebulous that it would be extremely difficult to measure its effectiveness and hold grant recipients accountable for the ways in which they spent public funds.16

“**In November 2022, Illinois issued its first social equity retail license to a group of “wealthy and connected owners,” as described by the Chicago Tribune. The ownership includes a former Chicago police detective from the narcotics unit, a former executive of the Chicago Transit Authority, and other investors.**

Almost immediately upon passage, lawmakers and advocacy groups like the American Civil Liberties Union hailed the social equity provisions in Illinois as a new model for the nation.\textsuperscript{17} However, that praise has quickly given way to criticism from social equity applicants.\textsuperscript{18} Three and a half years passed before the state issued a single license to a social equity applicant. In November 2022, Illinois issued its first social equity retail license to a group of “wealthy and connected owners,” as described by the \textit{Chicago Tribune}.\textsuperscript{19} The ownership includes a former Chicago police detective from the narcotics unit, a former executive of the Chicago Transit Authority, and other investors. The business qualified as a social equity applicant not on the basis of ownership, but because it hired at least six employees who meet the social equity criteria. Its dispensary opened in December 2022 in the affluent River North area of Chicago.\textsuperscript{20}

\begin{quotation}
\textbf{Applicants have complained that the state has taken so long to issue licenses that they have burned through cash and can find no new sources of financing.}
\end{quotation}

The state concurrently issued a second social equity dispensary license to a group that has no forecast opening date.\textsuperscript{21} Applicants have complained that the state has taken so long to issue licenses that they have burned through cash and can find no new sources of financing. Traditional sources of capital, such as bank loans, are unavailable in the state-


\textsuperscript{21} McCoppin, note 19.
licensed marijuana industry due to the federal illegality of marijuana. Applicants have also been unable to bring on new equity investors because they cannot alter the ownership makeup detailed on license applications submitted years ago. In fact, the state has even barred recipients of conditional licenses from accepting new equity investors if they need to raise capital to make their businesses operational, or they risk forfeiting the conditional licenses they spent years trying to obtain.

Critics believe well-capitalized businesses, including especially those that were given early approval licenses for the adult-use market because they were already operating medical marijuana facilities, have used lawsuits to delay the issuance of any new licenses so they can monopolize the existing market. In the meantime, social equity applicants are struggling to stay afloat for lack of financing.

"Despite Illinois’ efforts to become a model for the nation of cannabis social equity initiatives, the market has been dominated by a handful of large companies, many of which are publicly traded. State data has shown that more than three-fourths of statewide cannabis inventory was grown by just six companies."

Despite Illinois’ creation of a low-interest loan program for social equity businesses within the 2019 law, no loans have been granted to date. Illinois partnered with chartered financial institutions to manage the loan program, but those financial institutions were unable to issue loans to federally illegal cannabis companies. A November 2022 press release from the agency overseeing the loan program states:

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24 Vinicky, note 18.
Program participants have encountered significant delays in receiving capital through financial institutions due to the complexities of navigating a new industry that remains illegal under federal law, as well as institutions’ fiduciary, regulatory responsibilities and underwriting standards that are set independent of the program.25

In response, Gov. J.B. Pritzker’s administration announced the state will make loans directly to social equity licensees that are fully forgivable. However, no amount of funding is available to dispensary licensees—the most common license type.26 Licensees have also complained that funds are restricted for operational purposes and cannot be used for construction of facilities nor purchase of equipment, which are the initial hurdles these licensees need to overcome.27

Craft growers are a license type largely reserved to social equity applicants and entitles the licensee to operate no more than 5,000 square feet of canopy space. These licenses were limited to 40 statewide under the legalization law and are eligible for the largest amount of funding under the forgivable loan program. Craft growers have complained that 5,000 square feet is too small of a growing space for licensees to profitably recover the capital costs involved in building out a grow facility and that competitors with greater economies of scale can operate more profitably. As a result, investors are fleeing from craft growers.28

Despite Illinois’ efforts to become a model for the nation of cannabis social equity initiatives, the market has been dominated by a handful of large companies, many of which are publicly traded. State data has shown that more than three-fourths of statewide cannabis inventory was grown by just six companies.29 The rules nominally created to benefit social equity applicants have been manipulated to ensure wealthy and politically connected individuals can secure licenses. Meanwhile, direct victims of the drug war have largely been excluded from the marketplace by high barriers to entry.

26 Ibid.
27 Vinicky, note 18.
28 Ibid.
NEW YORK

New York has become the latest state to attempt to structure its cannabis market around social equity initiatives. There, so-called “justice-involved” individuals—those with past marijuana convictions or their direct family members—have exclusive access to the first 150 adult-use dispensary licenses. Among the 150 licenses to be awarded, just 60 will be available among the five boroughs of New York City, combined.

To be eligible, at least 30% of an applicant’s total equity must be owned by a justice-involved individual and that individual must exercise sole control over the business. This means the applicant can have passive investors accounting for no more than 70% of total ownership. In addition, the justice-involved individual must be able to demonstrate, through tax records or other financial documents, that a prior legal business they have owned and controlled was profitable for at least two years. In its instructions, the New York Office of Cannabis Management clarifies that successful management of a nonprofit does not qualify, nor does operation of more than one business which were each profitable for one year. The justice-involved individual must have been an owner and manager of a successful for-profit business over an extended period.

…the sum of these requirements means that New York is reserving licenses for individuals who have already achieved financial or commercial success despite themselves or a relative having a prior conviction for marijuana.

Finally, the justice-involved individual must also have a “significant presence” in New York State, which means they can either demonstrate residency or significant assets like land, vehicles or rental homes. The “significant presence” appears to be a prima facie violation of the Dormant Commerce Clause, which disallows states from erecting barriers to the free movement

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of goods, people, and capital between the states, and, indeed, a federal district court judge has already enjoined the licensing process across much of the state on that basis.

Regardless, the sum of these requirements means that New York is reserving licenses for individuals who have already achieved financial or commercial success despite themselves or a relative having a prior conviction for marijuana. The program is not designed to offer new opportunities to individuals whose economic prospects elsewhere have been hampered as a legacy of the drug war.

During a 30-day period running from August to September 2022, New York’s Office of Cannabis Management received more than 900 applications for this initial round of dispensary licensing. Despite the federal injunction against issuing licenses across most of the state, the Office of Cannabis Management announced the winners of 36 provisional licenses in late November 2022.

Yet, despite New York’s insistence that these licenses be reserved for individuals with successful track records of running a profitable, legal business, they will be deprived of the ability to make key business decisions affecting their brands and market share. Instead, bureaucrats within the Office of Cannabis Management will select the location of each dispensary, lease facilities, and assign them to licensees at random. The assigned location may not even be in the region of the state where the justice-involved individual resides and could require them to relocate. The Office will determine a market rate to lease each space based on prevailing rents in the surrounding neighborhood and licensees will be


responsible for paying rent on spaces they did not choose.\textsuperscript{36} In a market environment, by contrast, entrepreneurs would be free to search out properties they can afford while balancing the desire for cost containment against the likelihood of attracting customers to a given location.

New York will go even further by making $200 million available in forgivable loans so social equity applicants can renovate their state-supplied facilities and purchase the equipment necessary to operate a dispensary. This equates to an average of $1.33 million in funding per authorized dispensary to cover up-front capital costs. As retail storefronts only, dispensaries are typically less capital-intensive than advanced cultivation, manufacturing or distribution facilities. A publication from the National Cannabis Industry Association estimates the total capital need for dispensaries to be between $250,000 and $750,000.\textsuperscript{37}

\begin{quote}
 Meanwhile, law enforcement in New York has begun cracking down on existing cannabis retailers who were already in operation before the social equity application process was announced despite having not received any public funding.
\end{quote}

New York has selected a private investment fund led by former NBA star Chris Webber to manage the $200 million Social Equity Cannabis Investment Fund and disburse those dollars to license winners.\textsuperscript{38} The fund will receive $50 million from state taxpayers and is responsible for raising the remainder on private equity markets, although reports indicate Webber and his partners have been unable to raise any substantial capital.\textsuperscript{39}

\textsuperscript{36} State of New York, note 31.
\textsuperscript{39} Brad Racino and Sean Teehan, “Smoke and Mirrors: Inside the Murky $200M effort to Kickstart NY’s Marijuana Industry,” NY Cannabis Insider, December 1, 2022, Smoke and mirrors: Inside the murky $200M effort to kickstart NY’s marijuana industry - syracuse.com.
Meanwhile, law enforcement in New York has begun cracking down on existing cannabis retailers who were already in operation before the social equity application process was announced despite having not received any public funding. The New York Marihuana Regulation & Taxation Act was signed into law by the governor in March 2021, but rules to govern the marketplace were delayed as former Gov. Andrew Cuomo’s sexual harassment scandal impeded progress in agency staffing and rulemaking. Many of the final rules to govern the marketplace were not adopted until November 2022. In the meantime, dozens of retailers emerged organically across New York under the premise that possession of marijuana was legal.

The legalization statute allows adults to gift marijuana to other adults without remuneration, and so these early retailers adopted a pricing scheme in which a patron buys a pipe, sticker, or other object and is gifted marijuana alongside the transaction.

The legalization statute allows adults to gift marijuana to other adults without remuneration, and so these early retailers adopted a pricing scheme in which a patron buys a pipe, sticker, or other object and is gifted marijuana alongside the transaction. This has become the default business model in jurisdictions like the District of Columbia, where possession and gifting of marijuana is legal for adults, but which do not issue express commercial cannabis licenses. Early marijuana entrepreneurs in New York simply sought to take advantage of these legal provisions in the same way peers had done in similar jurisdictions. A spokesperson for New York’s Office of Cannabis Management says, “None of them are compliant, none of them are allowed. … They’re jumping the gun,” when referring to these early operators. However, there is no express law against retailers who gift marijuana incidental to a separate transaction and a survey of markets with similar laws in place reveals this is a common business practice. When Connecticut sought to end the


“\textbf{A spokesperson for New York’s Office of Cannabis Management says, “None of them are compliant, none of them are allowed. ... They’re jumping the gun,” when referring to these early operators. However, there is no express law against retailers who gift marijuana incidental to a separate transaction and a survey of markets with similar laws in place reveals this is a common business practice.}”


In mid-November 2022, the Office of Cannabis Management launched a task force along with New York City Hall and law enforcement agencies to systematically go after gifting businesses. Within its first week, officers seized nearly 100,000 packages containing cannabis products—estimated at $2.5 million worth of inventory.\footnote{Amelia Pollard, Tiffany Kary and Gregory Korte, “New York City Is Cracking Down on Your Local Weed Bodega,” Bloomberg, December 12, 2022, https://www.bloomberg.com/news/features/2022-12-12/new-york-city-says-its-going-to-go-after-illegal-pot-sellers.} In other cases, authorities have impounded dozens of delivery vans.\footnote{Southall, Note 43.}
The individuals being arrested or having their assets seized for operating marijuana gifting businesses are clearly “justice-involved.” The nature of these arrests and asset seizures indicates these individuals are suffering right now negative consequences related to enforcement of marijuana prohibition. Moreover, while arrest rates have fallen since the Marihuana Regulation & Taxation Act was signed, data shows that black and Hispanic New Yorkers continue to be arrested at higher rates.47

"The nature of these arrests and asset seizures indicates these individuals are suffering right now negative consequences related to enforcement of marijuana prohibition. Moreover, while arrest rates have fallen since the Marihuana Regulation & Taxation Act was signed, data shows that black and Hispanic New Yorkers continue to be arrested at higher rates."

These facts call into question the wisdom of New York’s overall approach to social equity, as it appears destined to benefit politically favored entities whose owners have already experienced financial success at the expense of a population of legacy cannabis entrepreneurs who have not even requested taxpayer support. This irony doesn’t seem to be lost on many observers. As one of the law’s chief architects says, “The idea of rounding up black and brown bodega store owners is a political nightmare.”48 However, the Office of Cannabis Management contends that open competition will inhibit the success of its preferred licensees—on whose behalf the office would make some of the most significant business decisions—stating, “You can’t have a sustainable business if you’re competing with 20 pop-ups a block.”49

48 Stewart, Note 41.
49 Pollard, Note 45.
As one of the law’s chief architects says, “The idea of rounding up black and brown bodega store owners is a political nightmare.”

**ELSEWHERE**

The approaches to social equity adopted by Massachusetts, Illinois and New York illustrate well the range of social equity regimes currently in existence. However, this list of programs is not exhaustive. Key components of legalizations laws in Connecticut, New Jersey, Virginia and Vermont attempt to address social equity, while a number of municipalities have enacted social equity programs as well. Each of these programs borrows from or holds components in common with one of the programs detailed above. That may include giving extra weight to license applicants from particular groups, reserving licenses outright for particular groups, or providing public funding for community support programs or as direct subsidies to licensed businesses. Many also share in the weaknesses of Illinois and New York by erecting substantial barriers to entry.

Connecticut’s approach to social equity includes reserving half of all licenses for social equity applicants. An applicant is qualified as a social equity applicant if they can demonstrate a household income less than 300 percent of the state’s median household income during the three years preceding the application and have been a resident of an area that historically had disproportionate arrests for marijuana. The total number of licenses in Connecticut is determined at the will of the regulator (and without legislative review). However, the licensing fee for any social equity applicant who happens to win a cultivation license is $3 million—a high bar for any applicant who must certify their household income is less than three times the median.

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New Jersey gives priority in licensing to applicants from particular groups, according to a sliding scale. At the top of the scale are qualified social equity businesses, which are defined as those owned by individuals who have lived in a zip code with below-average median incomes or relatively high health uninsured rates or who have prior convictions for cannabis-related offenses. Secondary preference is given to businesses owned by individuals belonging to racial minority groups, women, or disabled veterans. A third tier of preference is given to businesses located in a legislatively defined impact zone or which is owned by individuals who have lived in an impact zone or employs residents of an impact zone. As seen in Illinois, the eligibility parameters of the New Jersey program extend far beyond individuals who have suffered direct harms as a result of the drug war and can allow even wealthy and connected individuals to receive licensing preferences if they can demonstrate past residency patterns or simply propose to hire entry-level workers who can demonstrate those residency patterns.

... the licensing fee for any social equity applicant who happens to win a cultivation license is $3 million—a high bar for any applicant who must certify their household income is less than three times the median.

Similarly, Virginia counts as a social equity applicant not only businesses for which at least two-thirds of the ownership is held by those with prior cannabis convictions or their direct family members, but also any business for which at least two-thirds of ownership is held by persons who have lived in a census tract with historically high marijuana arrest rates or are economically distressed, or by individuals who graduated from a historically black college or university located in Virginia. In addition to these requirements, an applicant must have been a Virginia resident for at least one year prior to applying—a potential violation of the Dormant Commerce Clause. Social equity applicants are intended to become eligible for licensing priority, technical assistance, and subsidized business loans offered by the state.
Vermont waives the application and licensing fees for social equity applicants during their first year, and offers substantial reductions to licensing fees in ensuing years. It also offers low-interest loans and outright grants to social equity applicants to cover startup and operational expenses, but only $500,000 was appropriated to finance this program, although large licensees may privately contribute additional amounts. To qualify as a social equity applicant, the business owners must have either been incarcerated themselves or had a family member who was incarcerated for a marijuana offense or the owners must have lived in a community with historically disproportionate arrest rates for marijuana offenses. Alternatively, if the owners are racially Black or Hispanic, their business is automatically qualified as a social equity applicant.54

In 2022, Massachusetts expanded its initial offerings for social equity applicants when lawmakers created a new trust fund to offer subsidized loans to social equity applicants using 15 percent of revenue from marijuana taxes.55

As seen in Illinois, the eligibility parameters of the New Jersey program extend far beyond individuals who have suffered direct harms as a result of the drug war and can allow even wealthy and connected individuals to receive licensing preferences if they can demonstrate past residency patterns or simply propose to hire entry-level workers who can demonstrate those residency patterns.

The City of Oakland was technically the first jurisdiction in the country to adopt a formal social equity plan for cannabis in 2017. Other local governments in California, including Los Angeles, Sacramento, and San Francisco, soon thereafter began to create parallel programs. The State of California made grant funding available to local jurisdictions that enacted these programs. However, the state created no formal statewide process. Although

this analysis focuses primarily on statewide social equity programs, it reviews some examples from California jurisdictions in Part 5.

**TABLE 1: SUMMARY OF EXISTING APPROACHES TO SOCIAL EQUITY**

<table>
<thead>
<tr>
<th>Eligibility</th>
<th>Massachusetts</th>
<th>Illinois</th>
<th>New York</th>
<th>Connecticut</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1. Prior conviction; 2. Spouse or child of person with prior conviction; 3. Residence in designated neighborhood for 5 years; 4. Racially Black or Latino; 5. Prior business experience in impacted communities</td>
<td>1. Prior conviction; 2. Direct family member of person with prior conviction; 3. Residence in designated neighborhood for 5 years; 4. Majority of employees meet the above criteria</td>
<td>Must satisfy ALL of: 1. Prior conviction or direct family member of person with prior conviction; majority ownership and control; At least 2 years of control of a profitable business</td>
<td>1. Income less than 300% of state median household income for 3 years; 2. Residence in designated neighborhood for 5 years or during childhood</td>
</tr>
</tbody>
</table>

| License Caps? | No | Yes | Yes | Yes |
| License Fees? | $10,000 reduced to $2,500 for SE applicants; Cultivation licenses are $1,250-$50,000 depending on canopy size, with 50% reduction for SE applicants | $20,000 to $100,000; May be waived for SE applicants | $200,000 | $250,000 for manufacturing or retail with fees reduced by half for SE applicants; Up to $3 million for cultivation |

| Licensing Preference? | No | Yes, 20% added to score | Yes, for delivery licenses | Expedited processing only |

| Reservation of Certain License Types? | Retail delivery and social consumption licenses are reserved for SE applicants for 2 and 3 years, respectively | Up to 55 dispensary licenses are reserved for SE applicants | Half of available delivery, microbusiness, nursery and retail licenses | Half of all license types |

| Capitalization Requirement? | Yes | No | No | No |

| Premises Requirement | Time of application | Time of licensure | Time of licensure | Time of licensure |

| Disqualification for Prior Convictions? | Non-cannabis felonies | No | Non-cannabis felonies | Non-cannabis felonies |

| Approach to Facilitating Capital Access | Subsidized loans | Subsidized/ forgivable loans | Forgivable loans | Subsidized loans |
ARE SOCIAL EQUITY PLANS WORKING?

This analysis has already noted some key deficiencies of existing social equity plans. In addition, programs that allow business owners to qualify as social equity applicants simply because they have lived in an area where other individuals have been arrested for marijuana, or who hire employees who live in areas where others have been arrested, or simply come from economically depressed areas, arguably fail to effect justice for individuals who have been directly harmed by the drug war. At best, these populations are simply adjacent to the individuals who have suffered tangible, direct harms. At worst, these expanded eligibility parameters allow insiders to manipulate social equity programs to capture a privileged position.

“At best, these populations are simply adjacent to the individuals who have suffered tangible, direct harms. At worst, these expanded eligibility parameters allow insiders to manipulate social equity programs to capture a privileged position.”
CORRUPTION OF INTENT BEHIND SOCIAL EQUITY PRACTICES

Section IV highlighted how the first and only social equity retailer to open in Illinois was owned by wealthy insiders, including a former narcotics police officer, simply because they pledged to hire some employees from designated neighborhoods. Similarly, New York’s social equity provisions benefit only those applicants who are likely to have achieved previous financial success. Those aren’t isolated examples: The well-heeled have been able to manipulate existing social equity programs to their own benefit in nearly every location to have enacted a program.

In Los Angeles, media reports say recruiters have canvassed low-income housing projects on the city’s south side, offering $7,000 to individuals with previous cannabis convictions in order to list their name on an application.

In some cases, large companies have simply recruited individuals who satisfied social equity criteria to serve as front men for a license application. In Los Angeles, media reports say recruiters have canvassed low-income housing projects on the city’s south side, offering $7,000 to individuals with previous cannabis convictions in order to list their name on an application.56 In other cases, financiers have offered to pay social equity applicants an annual salary from the business of around $35,000 while financiers assumed total operational control and rights to earnings. In still more reported cases, individuals who met social equity criteria allowed their names to be listed as majority owners on license applications even though profit-sharing agreements signed with financiers entitled them to only 10 percent of net profits.57

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These stories aren’t unique to Southern California. During a special round of licensing exclusive to social equity applicants in Arizona, at least 58 percent of 1,506 applications held ties to large commercial marijuana companies or their investors. Shell companies without known owners backed more than 200 of these applications. At least in some cases, the qualifying social equity applicants signed contracts with their backers that entitled them to none of the operating profits and under which they would exert no meaningful control. Instead, they would receive a $50,000 payout should the application be successful while backers would gain a license worth millions of dollars.58

“At least in some cases, the qualifying social equity applicants signed contracts with their backers that entitled them to none of the operating profits and under which they would exert no meaningful control. Instead, they would receive a $50,000 payout should the application be successful while backers would gain a license worth millions of dollars.”

Beyond the issues of front men and manipulation of social equity definitions, simple delays in licensing have pushed other social equity applicants to sell out their positions to larger companies. Most jurisdictions that have established social equity programs have faced prolonged series of lawsuits (over definitions, processes, residency requirements, and other claims) that held up the awarding of licenses. In the meantime, applicants who had to secure a property, pay interest on startup loans, or pay legal and consulting fees as part of their initial license preparation may exhaust their cash flow and personal resources. This has led to would-be social equity entrepreneurs giving up or selling out to larger brands.59


Even in Massachusetts, where lawmakers were first to incorporate social equity initiatives into the statewide marijuana program, large publicly traded companies have been able to gain control of smaller licensees despite state rules intended to protect social equity licensees and prevent market concentration. Nominally, no person is supposed to control more than three recreational licenses in Massachusetts, yet publicly traded companies have been able to gain meaningful control over dozens of small businesses. These companies use their public stock and credit to access capital unavailable to small startups and then offer high-interest loans to those startups that include acquisition rights. They have made loans of $1 million or more available at interest rates of 14 percent or higher, with requirements that recipients dedicate at least 70 percent of free cash flow toward loan payments until the principal is retired. They also must source their inventory from the lender and the lender is assured right of first refusal on any prospective sale of the business.\textsuperscript{60} Since cannabis lending is not a competitive marketplace due to federal restrictions on the financing of any marijuana-related business, small and social equity entrepreneurs often must accept these deals in order to establish a business in an industry with extremely high barriers to entry.

\begin{quote}
The end result is that programs intended to benefit individuals who may have been harmed by the drug war often enrich well connected and well capitalized firms instead. This has clearly not been the intent behind these programs, but it has been the result.
\end{quote}

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WHAT IS THE PURPOSE OF SOCIAL EQUITY?

Proponents of social equity programs say these policies serve to atone for social injustices committed by the government through its prosecution of the drug war. This premise raises several questions about both intent and practice of the related programs:

1. **Does reserving licenses for a handful of individuals achieve broad justice?**

   Even if these licenses could be allocated efficiently and without manipulation, the benefits of reserving licenses or granting license preferences would accrue only to a select few while the broader population of individuals that suffered damages from the government’s drug war would see no redress. Many individuals who were arrested on marijuana charges may have no interest in operating a licensed marijuana business. Others may not have the skills to do so successfully. Still more may find themselves ineligible due to technicalities in the qualifying criteria. The intended justice will not be delivered to these individuals.

   *Most existing social equity programs, however, do not even attempt to award licenses exclusively to those who have suffered real harms from the drug war. Instead, they often include individuals who may have lived in geographic proximity to harmed individuals—thus redirecting the redress of harms toward parties who suffered no harm.*

Most existing social equity programs, however, do not even attempt to award licenses exclusively to those who have suffered real harms from the drug war. Instead, they often include individuals who may have lived in geographic proximity to harmed individuals—thus redirecting the redress of harms toward parties who suffered no harm. Even community-based job training and other programs financed through marijuana tax revenues fail to target these benefits to individuals or families that were directly harmed by the drug war. Instead, they are available to broad communities, including those that were never directly harmed.
2. **Is the legal marijuana industry large enough to achieve the sought-after justice?**

Legal marijuana products are sold in a competitive marketplace that includes otherwise comparable illicit marijuana products. Legal products must compete on price and quality with illicit competitors but tax and regulatory costs impose a price disparity between these goods. As policymakers escalate tax rates in order to finance social benefit programs, they also deteriorate the competitive position of legal goods. Evidence shows consumers generally prefer legal goods if the prices are comparable, but consumers will turn to illicit suppliers as the relative price of legal goods escalates. As a result, high-tax jurisdictions like California have seen two-thirds of market demand satisfied by illicit suppliers more than five years after legalization.

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Policymakers therefore face a tradeoff between taxes and adoption of the legal market. If taxes on legal marijuana products are intended to be a primary financing mechanism for broad social benefit programs, then the market itself may be imperiled.

3. **What about individuals who remain illicit sellers?**

States have imposed high barriers to entry for legal marijuana markets by limiting the availability of licenses, imposing high fees, capitalization requirements, and similar

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restrictions. This labyrinth of red tape has made the legal market inaccessible to legacy marijuana suppliers. State social equity programs have uniformly failed to account for these individuals and continue to criminalize their behavior even as they promise to deliver justice by granting franchise to or even subsidizing their prospective competitors.

New York, for example, now faces the prospect of arresting hundreds of marijuana vendors and seizing their assets in order to protect the market share of a group of licensees likely to have already experienced financial success. While New York policymakers tout their social equity bona fides, a cynic might characterize this scenario as a second wave of the drug war.

New York, for example, now faces the prospect of arresting hundreds of marijuana vendors and seizing their assets in order to protect the market share of a group of licensees likely to have already experienced financial success. While New York policymakers tout their social equity bona fides, a cynic might characterize this scenario as a second wave of the drug war.

4. **Is it appropriate for states to provide financing to licensed marijuana companies?**

Connecticut, Illinois, Massachusetts, New York, Vermont, and Virginia all plan to offer financial backing to marijuana businesses through subsidized or forgivable loans. The intention behind these programs is to ease the natural barriers to entry in an industry for which traditional small business loans are unavailable. While states are rightly concerned about easing access to capital for marijuana entrepreneurs, direct financial support from state coffers presents serious potential problems. If a state directly finances a marijuana company, it aids and abets a federal crime and enlists itself as an affiliate of a federal criminal enterprise. Parties who aid and abet can be punished as the principal in a crime. Affiliates to federal criminal enterprises are subject to asset seizure and its agents, including both officers and employees, are subject to arrest by federal law enforcement. These entities and their agents could be subject to both
criminal liabilities and civil penalties through federal Racketeer Influenced and Corrupt Organizations (RICO) laws. Under RICO, private parties can bring civil actions claiming damages as a result of the conduct of a federal criminal enterprise.

These concerns are not merely theoretical. The California State Treasurer’s Office commissioned a study in 2018, for instance, that examined the feasibility of creating a state-backed financial institution to service the banking needs of licensed marijuana companies. The report concluded that providing financial services to state-licensed marijuana companies would implicate both federal aiding and abetting and RICO laws. In particular, it concluded, “California and its employees are not immune from prosecution under federal criminal statutes. Several statues authorize the federal government to seize and forfeit property associated with federal criminal acts.” Based on this observation, California abandoned the idea of creating a state-run financial institution.

Similarly, multiple lawsuits have been filed in civil court in which plaintiffs have claimed private damages under RICO due to the actions of state-licensed marijuana companies. Despite state licensure, these companies clearly meet the definition of federal criminal enterprises under RICO because they are organized as an enterprise to conduct federal criminal activity. Therefore, all a plaintiff must prove in a RICO civil suit is that they suffered injury as a direct result of that activity. To date, plaintiffs have mostly failed to prove injury, although they have claimed a loss in value or use of properties adjacent to licensed marijuana facilities due to odor or concerns about neighborhood safety. Regardless of the outcome of prior existing cases, they illustrate a general awareness that marijuana companies and their affiliates can be sued civilly in addition to potential criminal liabilities.

Providing loans or other means of direct financing to a marijuana company clearly implicates the concerns raised in California regarding aiding and abetting or affiliating with a federal criminal enterprise. Federal law enforcement has exercised discretion in the prosecution of state marijuana markets, but there is no assurance that enforcement

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will not resume under a future administration. That means states that provide direct financing are assuming substantial legal and financial risks. The market has demonstrated private investors and entrepreneurs are willing to assume these risks on their own if they can secure state licensure, so it may be prudent for states to allow private actors to provide all financing of marijuana companies.

"Federal law enforcement has exercised discretion in the prosecution of state marijuana markets, but there is no assurance that enforcement will not resume under a future administration. That means states that provide direct financing are assuming substantial legal and financial risks."

The answers to these questions might point to a model of social equity that is drastically different from what states have embarked on. Existing programs have failed to legitimate and transition existing marijuana suppliers into a regulated marketplace. They have failed to compensate individuals or their families for the direct harms of misguided government action. They have instead promised a path to prosperity for a select few. In practice, those pathways have even been manipulated to benefit parties entirely different from the intended populations.
A NEW MODEL FOR SOCIAL EQUITY

Justice is achieved only by correcting specified wrongs. In tort law, a person must demonstrate they suffered specific damages as a direct result of the negligent or mendacious actions of others. A court may then award financial payments as compensation for these damages from the offending to the aggrieved party. Although many advocates of social equity programs for marijuana correctly identify disproportionate racial bias in the way the drug war was prosecuted, these advocates imprecisely target benefits toward broad groups without considering specific harm. It has only added to the confusion that these benefits can be and often have been usurped by entirely unintended parties.

Governments should begin their efforts toward social equity by ceasing the policies and enforcement patterns that created harm in the first place. This means widespread arrests and asset seizures for marijuana-related activity should give way to a framework in which existing market actors can transition to the legal market.
A more effective model for social equity would level the playing field so that existing marijuana suppliers can successfully compete in a legal and regulated marketplace. Governments should begin their efforts toward social equity by ceasing the policies and enforcement patterns that created harm in the first place. This means widespread arrests and asset seizures for marijuana-related activity should give way to a framework in which existing market actors can transition to the legal market. Instead of erecting a new series of barriers for this legal market, policymakers should actively seek to eliminate them.

Second, policymakers should seek to redress the past harms inflicted on individuals or their families due to misguided and discriminatory government action. Primarily, this should include expunging the criminal convictions with which individuals have been tarnished so they no longer confront barriers to employment or other opportunities. Some states appear to believe this redress does not go far enough and evince an eagerness to make financial compensation for their past actions. If states are to embark on this form of restitution, they should adhere to tort law tradition. Moreover, there is some precedent under which liberal republics have compensated aggrieved individuals for specific damages resulting from discriminatory government action.

Combined, these two overarching themes imply a series of concrete actions states should consider when designing any social equity platform within the cannabis industry:

**TRANSITION LEGACY SUPPLIERS TO THE REGULATED MARKET**

1. **Minimize disqualifications for previous cannabis convictions.** Out of 39 states with existing medical marijuana programs, at least 35 automatically disqualify individuals with felonies from licensure and only four of these states exempt qualified marijuana-related convictions from this disqualification. In addition, five adult-use marketplaces exclude persons with marijuana-related felony convictions from licensure. These restrictions apply to more than just owners. Eleven states with adult-use marijuana

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65 Amber Littlejohn and Eliana Green, "MCBA National Cannabis Equity Report: 2022,” https://minoritycannabis.org/equitymap/equity-download/. Additional state medical marijuana programs have been created since publication of this report. The report identifies 35 of 36 states as imposing a licensing restriction against persons with marijuana-related felonies, although there are now 39 state medical marijuana programs.

66 Ibid. These states are: Alaska, Maine, Montana, New Jersey and Oregon.
programs also require criminal background checks for employees. While most of these states may still allow persons with prior cannabis convictions to work in the industry, Arizona specifically includes prior cannabis convictions as a disqualifying event. In total, many state marijuana programs forbid legacy marijuana suppliers from competing in the regulated market.

**Out of 39 states with existing medical marijuana programs, at least 35 automatically disqualify individuals with felonies from licensure and only four of these states exempt qualified marijuana-related convictions from this disqualifications.**

Given that the collateral consequences of a prior conviction can impede the development of alternative income streams, it is likely a portion of these individuals will continue to supply marijuana goods on the illicit market and never enter the regulated market despite boasting experience and expertise in satisfying consumer demand within the industry. Often, the most qualified and knowledgeable individuals to manage or staff a regulated marijuana business are those who hold decades of experience in the illicit market. Moreover, blocking the transition of these individuals to the regulated market could perpetuate the illicit market.

For public safety reasons, policymakers may wish to block individuals who display a history of violent crime or connection to foreign drug cartels from licensure within the regulated industry. However, individuals whose legal history involves only nonviolent cannabis offenses should not be barred from licensure or employment.

2. **Set no caps on the number of licenses available.** Most states that have created regulated marijuana markets have artificially limited the number of licenses available and forced applicants to compete for the available licenses. States vary in their method of applicant selection from random lottery (e.g. Arizona) to merit-based competition (e.g. Nevada). Policymakers have limited the availability of licenses out of concern that an excessive supply could result from having too many licensees and that excess supply could find its way to the illicit market. Ironically, license caps virtually ensure illicit
markets will remain vibrant because they prevent legacy suppliers from successfully transitioning to the regulated market.

License caps are the ultimate barrier to entry and create market speculation for the licenses themselves that has invited bribery and public corruption. Well-heeled business interests tend to prevail in securing limited licenses because they have the financial wherewithal, knowledge, and political connections to ensure win licenses and exclude potential competitors from the marketplace.

As executive director of the Minority Cannabis Business Association Amber Littlejohn says, “The best thing you can do for social equity is open up the market.” This eliminates the first barrier to entry faced by legacy suppliers who would like to transition to the legal market—securing government permission to open a business. It also obviates the need for complicated formulas granting preferences to particular


persons or groups. Instead, all market participants can compete openly for consumer loyalty and experiment with different business models. Just as in markets for other goods, the best regulator of supply is consumer demand.

3. **Minimize license fees.** High application and annual licensing fees are another barrier to entry to the legal marketplace that impedes the transition of legacy suppliers. High fees ensure only the well capitalized can afford to open a legal cannabis business. Policymakers must bear in mind that traditional financing sources such as bank loans are typically unavailable in the cannabis industry and entrepreneurs must rely heavily on private equity to finance their business. Financial barriers to entry like license fees tend to reserve the legal industry for those who already enjoy substantial financial assets.

"Policymakers must bear in mind that traditional financing sources such as bank loans are typically unavailable in the cannabis industry and entrepreneurs must rely heavily on private equity to finance their business. Financial barriers to entry like license fees tend to reserve the legal industry for those who already enjoy substantial financial assets."

In Illinois, license fees can range as high as $850,000. In Florida, the state recently announced a new fee structure for its medical market that charges a non-refundable application fee of $140,000 and biennial license fees of $1.33 million. Although states like Illinois offer fee reductions for qualified social equity applicants, the financial barrier to entry imposed by the fees alone can be substantial and often force applicants to sell equity shares in order to surmount this barrier. By contrast, in Colorado, annual fees for most license types are $1,500 while in Washington they are $1,381.

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72 Marijuana Policy Project, note 70.
4. **Allow entrepreneurs to operate at a size and scale they can manage.** Every entrepreneur has a different range of skillsets, capital assets and management ability. Some can effectively fill niche components of the supply chain while others can operate large, vertically integrated businesses. Policymakers should allow each of these actors to compete on an open market to the best of their abilities.

Currently, five states prohibit full vertical integration within their adult-use markets (California, New Jersey, New York, Virginia and Washington) and 13 states with medical markets require vertical integration.\(^{73}\) Although there is no evidence that banning vertical integration helps legacy suppliers to compete,\(^{74}\) requiring vertical integration substantially increases barriers to entry due to capital costs. Vertical integration means that licensees need to acquire and improve multiple facility types, acquire the talent to operate each facility, and reserve sufficient working capital for each facility to be successful. Only large corporations with wealthy investors can typically raise sufficient capital to meet these requirements. Vertical integration should be neither prohibited nor required.

5. **Do not establish capitalization requirements.** Sixteen state medical and adult-use programs require applicants to demonstrate they have a minimum amount of liquid capital before a license will be awarded. Requirements range as high as $2 million in Connecticut, Georgia and Pennsylvania.\(^{75}\) This is another financial barrier to entry that benefits large corporations with wealthy investors at the expense of legacy suppliers hoping to transition to the regulated market.

Moreover, decisions about firm capitalization should be a market function that has little to do with regulators. While they are intended to ensure a prospective licensee can successfully manage a marijuana business, state regulators do not risk their own capital nor do career bureaucrats often have extensive expertise in the factors that lead a for-profit business to become successful. Market participants who risk their own capital should have sole discretion to determine how much capital is needed to be successful. Often, capital flows to entrepreneurs after they have been awarded a license and not before.

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\(^{73}\) Littlejohn and Green, note 65.

\(^{74}\) Ibid.

\(^{75}\) Ibid.
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6. **Do not require physical premises before a license can be issued.** Fourteen adult-use and 19 state medical programs require an applicant to demonstrate the rights to control a specific parcel as a condition for licensure. These requirements often force applicants to expend capital securing and servicing a commercial lease without any assurance they will be able to operate a business at the property. Sadly, this requirement has forced many applicants into bankruptcy as lawsuits and bureaucratic confusion have led to prolonged delays in the licensing process. As applicants are forced to service lease obligations, their capital is depleted.\(^76\)

There is no need for applicants to assume these financial liabilities prior to securing a license. For instance, Illinois offers a two-step licensing process in which applicants are awarded a conditional license and can then secure a property. Once the property has been secured and improved, regulators can inspect the facility and then grant a full license.

7. **Facilitate access to capital.** Access to capital can be a critical barrier to entry for many small businesses and legacy suppliers in an industry that has limited access to financial services. However, states can take some actions to ease this burden. First, states can help facilitate basic financial services by constructing a data-sharing portal that allows financial institutions to more easily complete the know-your-customer requirements imposed by the U.S. Justice Department. Michigan has launched this type of data-sharing portal and financial institutions can review the transactions of their clients to

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ensure each aligns with a transfer of inventory to a valid licensee and that total financial activity is not anomalous for the industry.\textsuperscript{77}

Secondly, states can ease or eliminate blue-sky laws that layer state restrictions on top of existing federal restrictions when it comes to raising equity capital. Easing blue-sky laws allows entrepreneurs to crowd-source ventures by soliciting capital from a wide array of friends, family and other investors.

**PURSUE RESTORATIVE JUSTICE**

1. **Automatically expunge convictions for behaviors that are now legal.** No one should remain in prison or carry the collateral consequences of a past criminal conviction for an action that is no longer a crime. Expungement of prior marijuana convictions should be a featured component of all marijuana legalization laws. This expungement should be automatic so that persons carrying convictions do not need to bear the legal costs of an application, which can range as high as $4,000. Empirical data from Michigan shows that just 6.5 percent of eligible persons pursued expungement when they had to apply and pay fees to do so.\textsuperscript{78}

Nine states have made expungement of past marijuana-related convictions automatic as part of their legalization statutes. These include: California, Connecticut, Illinois, Missouri, New Jersey, New Mexico, New York, Rhode Island and Vermont.\textsuperscript{79}

2. **Do not assume all harmed individuals wish to start a legal cannabis business.** Granting licensing preferences or exclusivity to previously convicted persons is an ineffective means to accomplish restorative justice. Simply put, the population of individuals wishing to start a regulated marijuana business is unlikely to perfectly overlap the population of previously convicted persons.


Simply put, the population of individuals wishing to start a regulated marijuana business is unlikely to perfectly overlap the population of previously convicted persons.

In particular, limited-license states like Connecticut and Illinois have reserved a portion of available licenses for qualified social equity applicants. Even if the populations of previously convicted persons and those wishing to start a regulated marijuana business enjoyed perfect overlap, restorative justice could not be achieved by granting a license to only a select handful of that total population while arbitrarily excluding the majority.

Restorative justice cannot be achieved through licensing preferences, and this practice should be abandoned.

3. **Do not divert relief efforts to unrelated third parties.** Most states with social equity programs have made those programs available to applicants or individuals who suffered no direct damages from discriminatory government action. This dilutes and depletes resources intended to support persons who suffered actual damages.

Typically, states have taken two approaches to social equity. First, they have created licensing preferences for qualified social equity applicants. As detailed in Section IV, these criteria often include individuals who happen to have lived in a geographic area with below average incomes or above average arrest rates. Sometimes applicants meet social equity criteria simply by declaring they will hire entry-level employees who meet these conditions, even if none were ever arrested for a marijuana-related offense. In Virginia, disabled veterans qualify for social equity treatment. Whatever the merits of providing public support to these various groups, granting them preferred treatment under a marijuana licensing system does little to compensate actual victims of the drug war.

Second, states have used a portion of marijuana tax revenues to finance grants to local nonprofits offering job training and other services in designated geographic areas. The beneficiaries of these programs may include some direct victims of the drug war, but no
existing social equity plan restricts these funds for their exclusive benefit. As a result, the public benefits intended as restorative justice measures can be absorbed by third parties. Moreover, without extensive guidelines restricting administrative expense and financial audit requirements, recipient organizations of these grants may use funds inappropriately or dedicate a large portion of grants to salaries of officers and directors.

The beneficiaries of these programs may include some direct victims of the drug war, but no existing social equity plan restricts these funds for their exclusive benefit. As a result, the public benefits intended as restorative justice measures can be absorbed by third parties.

4. **Guidelines for possible payment of damages.** The data and historical record presented in Section II makes clear that the drug war was designed and executed in a discriminatory fashion. This discriminatory government action led to the arrest and imprisonment of millions of Americans, along with lasting collateral consequences. Although governments around the world and throughout history have routinely inflicted arbitrary harms on the citizenry, liberal republics in the Western tradition have sought to empower the individual and restrain the government from inflicting such arbitrary and discriminatory harms.

To be sure, the creation of any new entitlement or publicly financed settlement is rife with complications. Even in cases where governments clearly acted mendaciously toward aggrieved parties, payments offered by those governments as financial compensation are actually remitted by the taxpaying public. Taxpayers were not participants in the offending behavior and may not even have approved of that behavior. Indeed, governments are agents of the public whose behavior may not reflect the wishes of the voters or taxpayers as principals. This raises a difficult question of whether justice can prevail when there is a choice between compensating victims of past government actions or impinging upon taxpayers who may never have consented to those actions.
Regardless, states appear committed to making some form of financial compensation available to drug war victims by taxing legal cannabis products and establishing convoluted bureaucracies to manage benefits. These approaches are distortionary and inefficient, imperiling the success of the regulated market and failing to target benefits toward real victims. To the extent states have determined to embark on a program of financial compensation, they should adhere to the following guidelines.

“If states choose to award financial damages to this population as a restorative justice measure, these payments should be made directly to these victims or their immediate surviving family members and not diluted across a broader population that may have suffered no specific harm.”

**Precedent.** The drug war is an example of a failure to appropriately restrain government that resulted in specific damages to an identifiable population. In tort law, this could be considered the basis for the payment of financial damages to directly affected individuals or their families as compensation. States that intend to offer this relief can point toward comparable precedent within the United States. In 1988, President Ronald Reagan signed the Civil Liberties Act that awarded $20,000 in financial compensation to surviving members of Japanese internment camps during World War II, along with an official apology from him on behalf of the American republic. The Act stipulated that acceptance of payment would be in full satisfaction of all related claims against the United States.\(^{80}\) Similarly, North Carolina passed a law in 2013 awarding compensation to surviving victims of the state’s eugenics program during the period 1929 to 1974.\(^{81}\) This law was soon replicated by Virginia\(^{82}\) and California.\(^{83}\)

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\(^{82}\) State of Virginia, Department of Behavioral Health & Developmental Services, “Victims of Eugenics Sterilization Compensation Program,” https://dbhds.virginia.gov/developmental-services/victims-of-eugenics-

Damages should be paid directly to actual victims. As with victims of Japanese internment and state-run eugenics programs, those who were arrested or incarcerated on marijuana-related offenses are readily identifiable. Criminal records clearly indicate those individuals who were convicted of nonviolent marijuana offenses. If states choose to award financial damages to this population as a restorative justice measure, these payments should be made directly to these victims or their immediate surviving family members and not diluted across a broader population that may have suffered no specific harm.

Damages should not be financed through taxes on legal marijuana products. Any government culpability for participation in the discriminatory drug war should fall on the general credit of the involved government entity. Governments should not seek to burden participants in the market for a specific set of goods to compensate these victims. Participants in regulated marijuana markets already struggle to compete with illicit competitors due to tax-induced price disparities for otherwise similar goods. States should not endanger these emergent markets, nor reduce incentives for legacy suppliers to transition into the regulated market, by imposing additional excise taxes to pay any obligations toward drug-war victims.

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84 Lawrence, note 62.
CONCLUSION

Many commentators have correctly pointed out that the design and implementation of the drug war has been discriminatory toward certain groups. The data reviewed in Part 2 confirms this is true, but provides nuance regarding certain inflection points in the drug war, including passage of the 1994 Crime Bill and state liberalization of marijuana laws in the 2010s. Moreover, the harms suffered by individual victims of these discriminatory actions extend beyond criminal sanctions and include a range of collateral consequences.

States have increasingly displayed an interest in redressing these historical harms by including social equity initiatives within their frameworks for legal marijuana. However, the initiatives brought forth by states to date largely fail to target relief toward actual victims of the drug war and have too often been usurped by completely unintended third parties.

States have increasingly displayed an interest in redressing these historical harms by including social equity initiatives within their frameworks for legal marijuana. However, the
initiatives brought forth by states to date largely fail to target relief toward actual victims of the drug war and have too often been usurped by completely unintended third parties. The failures of state social equity initiatives to date point to a need for an entirely new model of social equity.

States have unnecessarily raised barriers to entry into the legal marketplace and impeded the transition of legacy marijuana suppliers into an orderly market. This basic failure perpetuates the harms of the drug war and undermines legal markets. States should actively seek to minimize barriers to entry in order to facilitate the transition of legacy suppliers into the regulated marketplace.

Once states have ceased creating new harms, they can focus on providing restorative justice to previous victims of the drug war. This should include an automatic expungement for convictions of acts that are no longer crimes. Other restorative justice provisions, which may include the payment of financial damages, should follow tort law traditions that target relief toward actual victims and prevent third parties from diverting and diluting these relief efforts.
ABOUT THE AUTHOR

Geoffrey Lawrence is research director at Reason Foundation. Lawrence has extensive experience within the state-licensed cannabis industry and has served as chief financial officer of multiple cultivation, manufacturing and distribution companies located mainly on the West Coast. He was CFO of the first fully reporting, publicly traded marijuana licensee to be listed on a U.S. exchange, CFO of a startup manufacturer and distributor that was subsequently sold to Lowell Farms (LOWL), CFO of a manufacturer and distributor based in Oakland that he helped take public, and, most recently, CFO of Claybourne Co., a top-3 flower brand in California by market share. Through these roles, Lawrence has raised capital, implemented systems for accounting and inventory control, designed internal control processes, managed monthly and quarterly closings and reporting, managed payroll, accounts payable and accounts receivable, managed compliance with state and local regulations, negotiated contracts, and prepared filings with the U.S. Securities and Exchange Commission.

Lawrence has also served as senior appointee to the Nevada Controller’s Office where he oversaw the state’s external financial reporting. Prior to joining Reason in 2018, Lawrence had also spent a decade as a policy analyst on labor, fiscal, and energy issues between North Carolina’s John Locke Foundation and the Nevada Policy Research Institute. Lawrence is additionally founder and president of an accounting and advisory firm with expertise in the licensed marijuana and hemp industries. Lawrence holds an M.S. and B.S. in accounting, an M.A. in international economics and a B.A. in international relations. He lives in Las Vegas with his wife and two children and enjoys baseball and mixed martial arts.