



Navigating the Minefield of Cannabis Politics to Arrive at a Sound Fiscal Policy

After decades as a 'fringe' issue, cannabis has now landed squarely in the forefront of most counties' and cities' legislative agendas. California's Medical Cannabis Regulation and Safety Act (MCRSA) was passed in 2015, followed by the Adult Use of Marijuana Act (AUMA) in 2016. Now the Governor and the legislature have merged the two into the Medical and Adult Use of Cannabis Regulation and Safety Act (MAUCRSA), to create a single, unified regulatory framework for this emerging industry. County supervisors and city council members can no longer ignore the subject, and neither can administrators and finance officers.

Unfortunately, when local elected officials take up the issue, they are likely to have a very different discussion than the one that administrators and finance officers might like them to have. Heated discussions about community values, public safety and neighborhood impacts may leave little room for less 'sexy' concerns such as permit fees, cost recovery, staff workload, and impacts on the general fund. How can finance and administrative officers get their concerns in front of their boards or councils in a way that will help them see cannabis regulation not just as a cultural issue, but as a fiscal issue?

Regulatory solutions for dealing with cannabis aren't hard to come by. There is nothing about the regulation of cannabis that is unique to this product or this industry, or that is not already regulated at the State or local level with other, similar products or industries. Unfortunately, obtaining direction from policymakers on how to craft those solutions can often prove difficult. For sixty years, or more, the primary conversation that our society has had around cannabis has been a debate over values, where there are only two possible positions one can take. It's either good or it's bad; You're either for it or against it. Simple, two-sided arguments like this set up a "win or lose" political dynamic for elected officials. And no elected official likes to lose.

Staking out turf on a playing field of values does not help communities move towards solutions. To begin to craft effective regulations for this emerging industry, administrators and finance officers need to help their elected officials shift the dialogue away from an inflexible debate over differing values and move it towards productive conversations about effective regulatory programs, fee recovery, staffing levels and sound fiscal policy.

At the simplest level, there are two directions a county or city can take to deal with the cannabis industry. They can choose to ban it, or they can choose to regulate it. It would be a mistake, though, to conflate these two directions with the "good or bad/for it or against it" dichotomy mentioned above. As with prohibition, a ban has the counter-intuitive effect of supporting the illegal industry by tipping the market in its favor, by driving up prices and profits, and by giving it immunity from taxes, employment laws, permitting requirements and environmental regulation. There are many in the cannabis industry who would prefer that it remain illegal at both the State and local level.

By the same token, regulating the industry should not be taken as being “pro-cannabis”. Regulation helps to protect consumers, public safety, community character, and the environment by zeroing-in on specific issues, impacts and concerns with the industry. Regulation tends to increase costs and complexity for any industry, while free-market competition tends to drive down prices and profits. Being legal is not going to make life any easier for those in the cannabis industry, and it certainly isn’t going to make anyone richer.

One way to move past dogmatic values and towards solutions is to consider the effects that either a ban or regulation might have on specific cannabis-related issues. For example, demand is generally considered to be a constant, which is affected little or not at all by legalization. Consumer demand for cannabis has persisted for decades despite enforced prohibition, yet cannabis users have always found access. Given this, it is unlikely that a local ban will reduce demand.

If demand is unchanged, then a local ban on commercial cannabis businesses will lead to consumers either buying cannabis in neighboring jurisdictions where purchases are legal, or buying it on the black market, as there is no legal alternative to meet existing market demand. With sales of illegal cannabis, there is no way to ensure it is not being sold to minors, that the product is safe, or that it is not being sourced from illegal, black market grows. A legal industry provides users with safe access through regulated, cultivation, distribution, lab testing and dispensaries outlets. A ban does not make the industry go away; it just pushes it back underground. All of the community impacts continue as before, along with all of the costs to government services and public safety, with no resources available other than the general fund.

From a fiscal standpoint, choosing to permit and regulate cannabis businesses at the local level opens up opportunities to reduce general fund liabilities by shifting them onto the regulated industry. The legal, regulated industry pays its own way through fees, thus reducing both the burden on law enforcement and the drain on the general fund.

Permitting fees can be applied to cover the annual costs for processing, inspection and enforcement of the permit’s terms and conditions. Time involved in processing the initial application can be highly variable, and can add substantially to this cost, as can inspections by other agencies such as fire departments. Through regulation, these costs may be borne by the regulated industry, not by the taxpayers generally.

Regulating the industry also presents the opportunity to generate new general fund revenues through taxes on legal, commercial cannabis activities. Though there are a variety of ways to structure cannabis taxes, and a wide range of rates that can be applied, these taxes have the potential to deliver millions of dollars to county or city coffers, which can be used for any public purpose. Commonly, taxes on legal cannabis businesses are used to defray the costs of enforcement against the remaining black market as well as other costs associated with the industry, including environmental cleanup and Health and Human Services programs.

In this way, taking a regulatory approach to cannabis, rather than a prohibitory approach, allows local governments to shift costs away from the general fund, to develop substantial new revenue sources, and to make the legal, regulated industry pay its own way through fees.

Taking a pragmatic, regulatory approach to dealing with cannabis does not require anyone to give up their values. No one has to lose. Ultimately, the reasons for regulating the industry are the same, whether one believes cannabis is “miracle medicine” or the “Devil’s weed”. By getting away from this “good or bad” dichotomy, local governments can exert effective control over the industry, increase public safety, generate new revenue sources and reduce the impact on the general fund.

About HdL

HdL supports local government operations by delivering increased tax revenues, regulatory compliance, and innovative software solutions. The firm employs a team of professionals with expertise in sales tax, property tax, business licensing, transient occupancy tax, cannabis regulation/taxation and economic development.

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