THREE THINGS STATE REGULATORS AND POLICYMAKERS CAN DO TO SUPPORT LEGAL MAIN STREET CANNABIS BUSINESSES

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ADVOCACY. EDUCATION. COMMUNITY.

Introduction

Cannabis reform is a dramatic, grassroots revolution. It has bipartisan support in divided times.

And, sadly, the legal cannabis markets demanded by countless Americans are on the verge of collapse if common sense, practical reforms are not enacted urgently.

Simply put, if Americans want a healthy cannabis marketplace – reflected in the diverse experiences and backgrounds of its operators, in the local roots of its businesses, and in the array of safe, tested product offerings – reform is necessary now.

A leading indicator for the health of the cannabis industry overall is the viability of small and medium-sized businesses, and so the most essential reforms are those that protect these Main Street Cannabis enterprises. A veteran seeking to help other vets suffering from PTSD or a legacy market operator seeking to transition to the regulated market are not going to be organized as publicly-traded, Wall Street-backed multi-state operators. Likewise, the craft operator or the entrepreneur seeking to sell ultra-premium products with all locally-sourced ingredients are not going to launch as “big businesses” either. Ensuring a future for Main Street Cannabis is the sole hope for a healthy, sustainable and vibrant industry.

Given the exceptional set of challenges facing these markets, there is (for better or worse) no shortage of clearly beneficial reforms to adopt. In this publication, we have identified specific reforms with clear, tangible benefits. While we know that regulators understand the urgency of all these challenges, we also know that input from licensed cannabis businesses on the order of priority in which these challenges are outlined is critical. Without such input, the adoption of timely and effective regulations that protect both the public health of Americans, and sustain the long-term economic viability of Main Street Cannabis will evade us all. This moment is a litmus test. This is the moment to act before the options in these markets are irrevocably altered.

(1) A Thriving Regulated Cannabis Market is a Public Health Imperative

American consumers are going to purchase cannabis, whether they have access to legal cannabis markets or not. The vast majority of these consumers (as well as their loved ones, neighbors and community) want the ability to safely purchase lab-tested cannabis and cannabinoid products from among a field of responsible, regulated businesses – from a public policy perspective, no one gets what they want if regulations effectively prop-up competing cannabis markets that undermine struggling legal industry operators.

For too long, regulated cannabis has been hamstrung by well-intentioned "public health" initiatives that have ironically placed public health at direct risk. *These well-meaning efforts simply ignore reality: if Americans can't buy safe, regulated, lab-tested cannabis products, they will continue to buy cannabis and cannabinoids produced and sold without safeguarding consumer safety and public health.* The greatest public health benefit that can be accomplished by cannabis regulators is bringing purchases into the regulated market.

- Once this reality is accepted, the overwhelming public health benefits of simply bringing purchases into the regulated market becomes clear.
    - Consider the simple recall. Planning for recalls is a mainstay of cannabis regulation.[1]
    - Making products of any type for human consumption always poses potential risks to public health.
    - Protecting public health requires a plan to mitigate and limit any potential harm.
    - If something goes wrong in the supply chain for regulated cannabis products, there's a transparent and reliable process for alerting the public and recalling the products.
    - What happens when there needs to be a public health recall in the unregulated market, as happened with unregulated vapes during the *E.Vali* crisis a few years ago[2]?
    - The continued ability to choose regulated cannabis products over unregulated products can literally mean the difference between life and death – and not just for immunocompromised consumers.

- The benefits of bringing purchases into the regulated market is similarly clear in practice.
    - Consider recent testing in New York.
    - According to media reports, "*About 40% of cannabis products purchased from illicit stores in [New York City] were found to contain harmful contaminants such as E. coli, lead and salmonella.*"[3]
    - Yet New York recently adopted cannabis rule § 129.3(a)(11) that prohibits cannabis marketing from "assert[ing] that cannabis or cannabis products are safe because they are regulated."
    - New York is not alone. For example, Colorado requires a **bolded** warning on product labels that the "product was produced without regulatory oversight for

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[1] *E.g.,* California DCC Regulations § 17226(a) ("Licensees shall establish and implement written procedures for recalling cannabis goods that are determined to be misbranded or adulterated. The recall procedures shall be implemented upon discovery, or notification from the Department, that one or more batches of cannabis goods are adulterated or misbranded. These procedures shall include....").
[2] https://jww.cdc.gov/tobacco/basic_information/e-cigarettes/severe-lung-disease.html
[3] Bloomberg, December 12, 2022.

health, safety, or efficacy."[4]

- *Immediate Action*: Review every existing and potential "public health" cannabis regulation with a recognition of the reality that consumers are choosing between regulated, tested products and illicit and/or unregulated market products produced without regulation or testing. Within this framework, determine whether such an existing or potential "public health" rule actually promotes public health.
  - State packaging and labeling rules that, despite good intentions, fail to educate consumers on the difference between regulated cannabis products and products available through illicit and/or unregulated market purchases threaten public health and should be revised on an emergency basis–especially in those newly legal markets where regulated operators are just standing up their compliant businesses.
  - By the same token, Congress and the FDA have so far abdicated their authority to regulate various analogues of THC derived from hemp, or clarify that the 2018 Farm Bill was not meant to stand-up a market for high-THC hemp product as an end-run around either Congress and the Controlled Substances Act or state cannabis laws and regulations. Regulators that haven't adopted sensible regulations bringing hemp-derived THC and intoxicating cannabinoid products under the purview of state cannabis regulators should do so.
  - Finally, while Congress and the FDA can and should step up and enact appropriate federal regulations on intoxicating hemp-based cannabinoids, that does not mean *existing* pathways under applicable Food, Drug and Cosmetic Act should be applied to cannabinoids or cannabis. As NCIA stated in its presentation to the Cannabis Regulators Association (CANNRA) at its annual stakeholders meeting in June 2023, and as CANNRA Executive Director Dr. Gillian Schauer herself recently testified to Congress, such an alternate pathway (that doesn't make cannabis a pharmaceutical "drug" under the FDCA) is urgently needed to properly regulate potentially intoxicating hemp cannabinoids. This approach is also urgently needed for non-hemp cannabis products to better facilitate an interstate market–and becomes especially urgent in the event cannabis is rescheduled from Schedule I or II to a lower schedule. Ultimately, common sense must prevail and equivalent products should be treated equivalently by the law and those laws should be designed with a cost-benefit analysis designed to promote public health through well-regulated markets. As such, reflexive impulses (however well-meaning) by policymakers to prevent perceived "over-regulation" of hemp cannabinoids must be carefully scrutinized. Where these policymakers come from states that have legal cannabis markets, regulators should endeavor to reach out and educate federal lawmakers.

[4] Colorado Rule 3-1010(D)(2)j()(i).

(2) Recognize the Reality That Americans Will Always Buy Cannabis and Cannabinoid Products from Illicit and/or Unregulated Markets, if Left with No Other Viable Choices

Prior to the national sea change leading to major state cannabis law reforms, policy discussions had assumed that cannabis sales in the illicit market could be stopped through criminalization. Experience demonstrated that was incorrect. More recently, these discussions frequently assumed that standing up *any* regulated market (regardless of the underlying jurisdiction's market's construction and dynamics) is an effective alternate means of controlling cannabis commerce and consumption, rather than setting up regulated markets that prioritize the public health goals discussed above.

- That approach does not reflect market reality or the failure of the War on Drugs to overcome that reality.
    - Cannabis is widely available in every state, city, and town in the nation. Simply put, cannabis "bans" have failed in the United States – whether exercised through criminal prohibitions or local governments refusing to allow regulated businesses to operate in their jurisdictions.
    - The choice isn't between allowing cannabis sales or not allowing them – it's about whether governments will allow consumers to purchase regulated, taxed, and tested cannabis, or force them to purchase unregulated and unsafe cannabis products.

- Yet this false dichotomy persists across a broad range of policy debates.

- Consider, for instance, the prevalence of debates regarding "local control" over retail cannabis sales within municipal borders.
    - Much ink has been spilled, and much time wasted, by localities "demanding" the right to prohibit cannabis sales within their borders.
    - But to make effective policy, those debates must be recast.
    - These are not questions of the availability of cannabis for sale within municipal borders. They are questions of the availability of *tested, taxed, and regulated cannabis* for sale within municipal borders.
        - Of course, that is a policy choice that municipalities could theoretically adopt. But an honest and effective policy debate must be based in reality.
            - Perhaps local officials prefer regulated purchases to occur across the border and to educate consumers on the public health risks of untested, unregulated cannabis purchased within their borders. Perhaps they honestly believe that they can double down on the failed enforcement policies of the War on Drugs and succeed where no other locality in the United States has.

- But by having an honest debate that includes regulator input, voters will be able to hold those lawmakers accountable for their decisions going forward.

- *Immediate Action*: Recognize and include the impact on the existing illicit and/or unregulated markets for cannabis that is not taxed, tested, or regulated in every policy or regulatory decision regarding regulated cannabis. Use the expertise and credibility of state-level leaders to reframe the debate occurring at the local level to reflect reality-based costs and benefits of policy positions.

(3) Revisit Cannabis Industry-Specific Taxes to Promote Competitiveness & Long Term Viability of Main Street Cannabis

An important social good from regulated cannabis markets is the collection of taxes from transactions that would otherwise be untaxed in the illicit (and/or unregulated) market. But the collection of taxes from these transactions is just one of many social benefits from bringing these transactions into the regulated market. Indeed, even when looking solely at this issue from an economic perspective, too often policy discussions around cannabis taxes elide the net revenue loss to states from high cannabis taxes. The legal cannabis industry operates alongside entrenched, untaxed, and unregulated cannabis markets that consumers have long patronized due to the failure of previous prohibition policies. Additional costs associated with running legitimate businesses, including taxes and licensing fees, tilt the economic competitive landscape ever-further towards the illicit and/or unregulated market. This is not to suggest that regulated cannabis should not be taxed. Rather, it is merely to highlight that this competitive landscape must be considered in crafting effective tax rates and that tax policy should evolve as that competitive landscape is evened.

- A recognition of the public health benefits of regulated, tested cannabis reframes crucial questions around taxation.
  - This industry is frequently subject to hefty taxes at the state and local level that are specific to the industry.
    - This includes taxes on production (e.g., cultivation taxes) and taxes on finished products (e.g., excise taxes). The net impact is the same regardless: a material increase in the cost of regulated cannabis that makes regulated cannabis products far less competitive, and suppresses sales by licensed businesses.
    - This dynamic also reduces projected revenue collected by governments from excise taxes, and leaves licensed operators without any meaningful earnings after paying business taxes levied directly on them.
  - Of course, the industry also faces a wide variety of taxes faced by other law-abiding businesses that are not shared by its competitors in the illicit market.

        - These include sales taxes on each retail transaction, frequently layered on top of excise taxes to create "sticker shock" for consumers new to regulated cannabis.
        - They also include the full gamut of taxes paid by other law-abiding Americans: for example, payroll taxes for employee salaries and income taxes for employees and owners, none of whom are being paid "off the books" (as occurs in the illicit market that competes with the regulated market).
        - Legal cannabis businesses are subject to an outdated provision in the U.S. tax code (§280E) that prohibits them from taking most ordinary business deductions. As a result, licensed operators face effective tax rates of 70% or higher while illicit operators rarely pay any federal taxes.
    - Too often the tax debate fails to recognize the basic reality that a wide swath of purchases that previously occurred outside the taxed and regulated market, and are brought into the open by incentivizing sales of regulated products.

- This "tax gap" results in public policy that effectively promotes unregulated operators by giving them a much lower price; this is even more troubling given the often grave public health costs posed by unregulated products.
    - There are self-evident public health benefits to consumers purchasing from the regulated market. Yet too often cannabis tax policy has the unintended effect of driving consumers directly to unregulated, untested products.

- *Immediate Action*: Urge policymakers to review every existing and potential "cannabis" tax to promote the health and efficacy of these regulated markets.
    - Seek adoption of a short-term, medium-term, and long-term tax strategy designed to maximize desired policy outcomes.
        - The tax policies necessary to stand up a newly regulated industry that faces a resurgent and entrenched illicit market are likely to be different than those that may be appropriate for a more mature market. And regulators can provide essential insights to that analysis.
    - Likewise, recognize that operators in the legacy market are not irrational. If the goal of reform is to bring as many legacy operators as possible into the regulated market, it is essential to make the economic case for them to transition.
        - Continuing to operate in the shadows will seem rational to many operators assessing the costs of operating within a highly taxed and regulated new industry.

In Conclusion

Experience has demonstrated that standing up effective, efficient regulated cannabis markets is not easy. Indeed, a significant number of compliant operators in regulated cannabis markets are faltering and at risk of failure. And, of course, the challenges facing industry operators are only heightened for small businesses, particularly equity businesses and Minority/Women-owned Business Enterprises (MWBEs) that lack the deep reservoirs of capital necessary to ride out these challenges.

At NCIA, we are in regular contact with our colleagues at CANNRA and know that there are many policymakers around the nation who are approaching this herculean task with the best of intentions and limited resources. But in the face of the continued economic challenges impacting this nascent regulated industry, policymakers must not lose sight of the positive: experience has demonstrated just how significant a public benefit these regulated markets confer for a set of products that Americans clearly demand.

Again, given the many challenges facing the regulated industry today, there are many steps that could make a tangible positive impact on these markets. In this piece we have highlighted only three examples for policymakers to consider. NCIA is always ready to assist lawmakers and regulators with insights on these challenges and to offer concrete solutions to protect Main Street Cannabis.

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