

Testimony prepared for the Maryland General Assembly
House Cannabis Referendum and Legalization Workgroup
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First, I would like to thank the Speaker for organizing this workgroup and the chair for organizing today's session. I'd also like to thank the workgroup for the opportunity to testify today and to provide answers to your questions. My name is John Hudak, and I am a senior fellow in governance studies and the deputy director of the Center for Effective Public Management at the Brookings Institution in Washington, DC. I would like to begin by noting that the views expressed here are my own, based on my own research, and do not reflect any institutional views of Brookings.

At the request of the staff and leadership of the workgroup, I am going to speak about three specific topics related to cannabis legalization: taxation, regulation, and licensing. I will note these are inherently interconnected issues, but I will speak about them today as separate verticals.

However, throughout my testimony, there will be a few common themes that the workgroup should take to heart. First, cannabis legalization and regulation is an exceptional complex series of interrelated policy choices and should never be seen as a light switch that is simply flipped on. I know the members of this workgroup—several of whom I have previously testified before—know this, but it is important for your fellow members and constituents to understand this to be the case. Second, and in that theme, cannabis regulation is a process that takes time, careful consideration, significant cooperation and coordination, and perhaps most importantly patience. Third, for each policy choice that the legislature and regulatory agencies settle on, there are tradeoffs between competing views and available outcomes. Anyone who comes before this workgroup and tells you that all of your goals are achievable and straightforward is selling snake oil. Often in the regulation of cannabis, there are competing outcomes, and hard choices must be made by the relevant policy makers.

Tax Policy

Cannabis tax policy in those states that have chosen to reform their laws for adult-use has had mixed results. Some states work hard to design taxation systems they see as effective, while others have taken what I call the dartboard approach—pick a random number for excise and/or sales taxes and proceed with that. Obviously, I would strongly advise the workgroup against the latter. While that may be apparent to each of you, it has not been so clear to your colleagues in other states.

Cannabis tax policy is about more than a round number. States want cannabis tax and fee revenue to fund the regulatory system itself so that traditional state appropriations will not be

needed. States typically want funding for what they consider potential post-legalization externalities—such as increases in the demand for mental health and addiction services, police retraining, driver education regarding DUID, funding for youth use prevention programs in schools, etc. In addition, I know from prior workgroup hearings on this issue that in Maryland, like other states, there is a desire to use some portion of cannabis tax revenue to advance social equity and criminal justice reform efforts.

So, there are obviously multiple uses for cannabis tax and fee revenue, and of course, there will not be enough to fund every program that everyone in the legislature wants. Nor, it's important to note, will the legalization of cannabis solve all of a state's budget woes. To that end, setting public expectations around what cannabis revenue can and cannot do is absolutely essential.

However, while there are multiple reasons that motivate states to institute high taxes or layer taxes, there are also reasons to keep taxes low. One that stands out is an effort to displace or eliminate the black market for cannabis. If tax rates are too high, the price of cannabis will be significantly higher in the legal market than in the black market, and consumers will behave accordingly. Similarly, the traditional black market is not the only option for Marylanders. Virginia has legalized cannabis and as dispensaries open, many Marylanders will be able to take a short drive to buy cannabis across the border. The same is true with New Jersey, and the gifting market in the District of Columbia. There is also bipartisan support in Pennsylvania for legalizing adult use cannabis and if it does, the vast majority of Marylanders would not need to travel far to purchase legal cannabis in that state. Thus, as Maryland considers tax policy, it must also consider the tax policies of neighboring or nearby states who provide Marylanders with alternative options to their own domestic market.

Once again, these are all competing choices. You cannot fund all the public programs you want with cannabis tax revenue while simultaneously displacing the black market in significant ways or convincing Marylanders to purchase at home.

Cannabis Regulation

Cannabis regulation is the backbone of any system. It dictates the rules of the game, helps determine winners and losers, significantly affects the price of cannabis to the consumer, and plays a critical role in having policy match public expectations. Members of the legislature, as well as your constituents who support cannabis reform, want a few basic items to be true of a regulated system. They want a safe, consistent supply with appropriate checks for adulterants, potency, mold, and unsafe additives. They want that product to be reasonably available to adults who choose to purchase it and for the price to be reasonable. They do not want the adult-use system to impact Maryland's medical cannabis system in ways that keep the state's most vulnerable residents from access to their medicine. They want identification checks at dispensaries, as well as consumer education about use, abuse, and safety. They also want a closed loop supply chain in which product isn't falling off the back of trucks and being diverted to gray or black markets.

The regulatory choices the legislature makes and, just as important, the authority the legislature delegates to regulatory agencies will determine the ability of the state to meet those public expectations. That determination will affect whether Maryland residents see cannabis reform as a successful endeavor or one that they regret.

In addition, as with tax policy, choices over regulations come with costs and benefits. As legislators and, later, for regulators, it is critical to ask whether each regulatory decision is vital, whether it is an efficient means to achieve the desirable policy end, and whether it contradicts or complicates other regulatory choices. Each layer of regulation produces a cost that is ultimately passed on to a consumer. I do not intend that to signal that regulations are a net negative or overly costly. It is important to be clear that a lack of regulations also incur social costs—drugged driving, unsafe products, mislabeled items, youth use, etc. Instead, thinking about building as many efficiencies into the regulatory system as possible should be the primary goal of this work.

Related to such efficiencies, policy makers must also avoid unnecessary regulatory complexity. A regulatory landscape that makes it difficult for business owners and consumers to operate within the market generates direct and indirect costs. The direct costs are obvious—additional staff must be hired, staff must work longer hours, and each costs money, effectively generating an additional tax on the consumer through increased prices. At the same time, regulatory complexity is easier to navigate and digest for larger, better funded, better staffed companies with significant experience. Smaller, less well funded, less experienced business owners may struggle to operate and succeed. And we know those business that will face such struggles will be disproportionately women-owned, minority-owned, and/or be run by new entrepreneurs.

Ultimately, regulatory policy is social equity policy, and the choices you make in designing a regulatory system directly impacts how equitable your system will be in operation. To achieve greater balance and parity, the legislature should lead from the start and ultimately charge a potential regulatory agency to foster an environment of cooperation, patience, and education, especially for new business owners, small business owners, and business owners from non-traditional backgrounds.

Licensing Policy

Cannabis operator licensing can be among the more controversial aspects of reform policy. Most states ultimately end up in litigation with prospective companies who applied for licenses and were denied. Licensing also sits at the core of states' social equity programs, an effort to draw more diverse ownership into the cannabis space. Thus far, states' efforts in the latter area have been mixed in terms of success.

Challenges around designing licensing policy are numerous, and in these opening remarks I will touch on a few. The core problem centers on who receives a license and how the process of selecting licensees is designed. Some states have had very open and public deliberative processes with clear statements of criteria and scoring procedures. Other states have been

closed and been subject to allegations of unfair treatment and corruption. Still other states have operated on a continuum in between those two extremes. Transparency at every stage of the licensing process is essential. Those charged with designing criteria, scoring applications, and making final determinations should not have any vested interest in cannabis companies, and they should have judgment and a commitment to fairness that is beyond reproach.

As Maryland learned the hard way in its initial round of licensing in the medical cannabis program, early mistakes are difficult to overcome. A first round of licensing provides companies with a first mover advantage that subsequently disadvantages other companies that apply for licenses later. Taking time and approaching the process with care and diligence will save the state headaches later, including costly litigation.

In addition, the costs of licensure have direct effects on who can enter the industry. License application costs and licensure fees that are too high will box out most potential applicants. We have seen in states that have high barriers to entry, the cannabis industry is dominated by owners who are disproportionately white, male, and already wealthy. Such a situation can create biases toward multi-state operators as well. We have also seen that in states with application costs and licensure fees that are too low, the market will be flooded with operators who produce cannabis in too high of quantities, vastly outstripping demand and driving down the cost of cannabis to a level that is unsustainable for a business. Too often licensing policy designers ignore non-process elements—like fee levels—that have just as big of an impact on the industry.

Another area in which licensure policy can become so complicated that it harms business owners and their ability to get up and running involves intergovernmental relations. When licensing policy is spread across state, county, and/or municipal governments, it takes significant coordination to ensure that each different regulatory system is harmonized and can work together. We have examples from states where that type of cooperation was lacking, and it caused significant delays or other regulatory challenges for business owners trying to open up shop.

The final area I will discuss as a potential landmine in the cannabis licensing space involves initially relying on the existing medical market to support the adult-use market. This is a process commonly used in the states, but as I have noted above, such policy choices come with costs and benefits. Relying on the existing medical market allows regulators greater familiarity with those operating in the industry. Especially early on, that type of familiarity can be beneficial for enforcement. Similarly, relying on the existing medical market can and surely will increase the speed by which the adult-use market can be stood up and functional, delivering product to dispensary shelves faster.

At the same time, reliance on the existing medical market comes with potential challenges. It can stymie social equity and industry diversity efforts, especially when the existing market lacks a level of social equity ownership and diversity that the state would like to see. It also provides that first mover advantage I spoke about above, making it more difficult for those who enter

the adult-use space later to be as successful than the well-established firms. Finally, in some states, aggressive steps needed to be taken in order to protect the supply chain for medical patients, as operators preferred to sell products to the adult-use market at higher prices than the medical market, raised prices on medical patients because demand was dramatically outpacing supply early on, or faced the real risk of medical cannabis product shortages.

Ultimately, these licensing decisions are complex balances of competing needs, just like choices over taxation and regulation. I hope my comments today have helped illuminate the need for careful, thoughtful planning that examines competing interests and outcomes. I also hope the workgroup will take to heart my warning at the start of this session that those who may promise that you can achieve all goals efficiently are not providing a full accounting of the realities of regulating adult-use cannabis.

Thank you for your time, and I look forward to your questions.