

Considerations for Structuring Legal Cannabis Supply

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Series on Medical Marijuana

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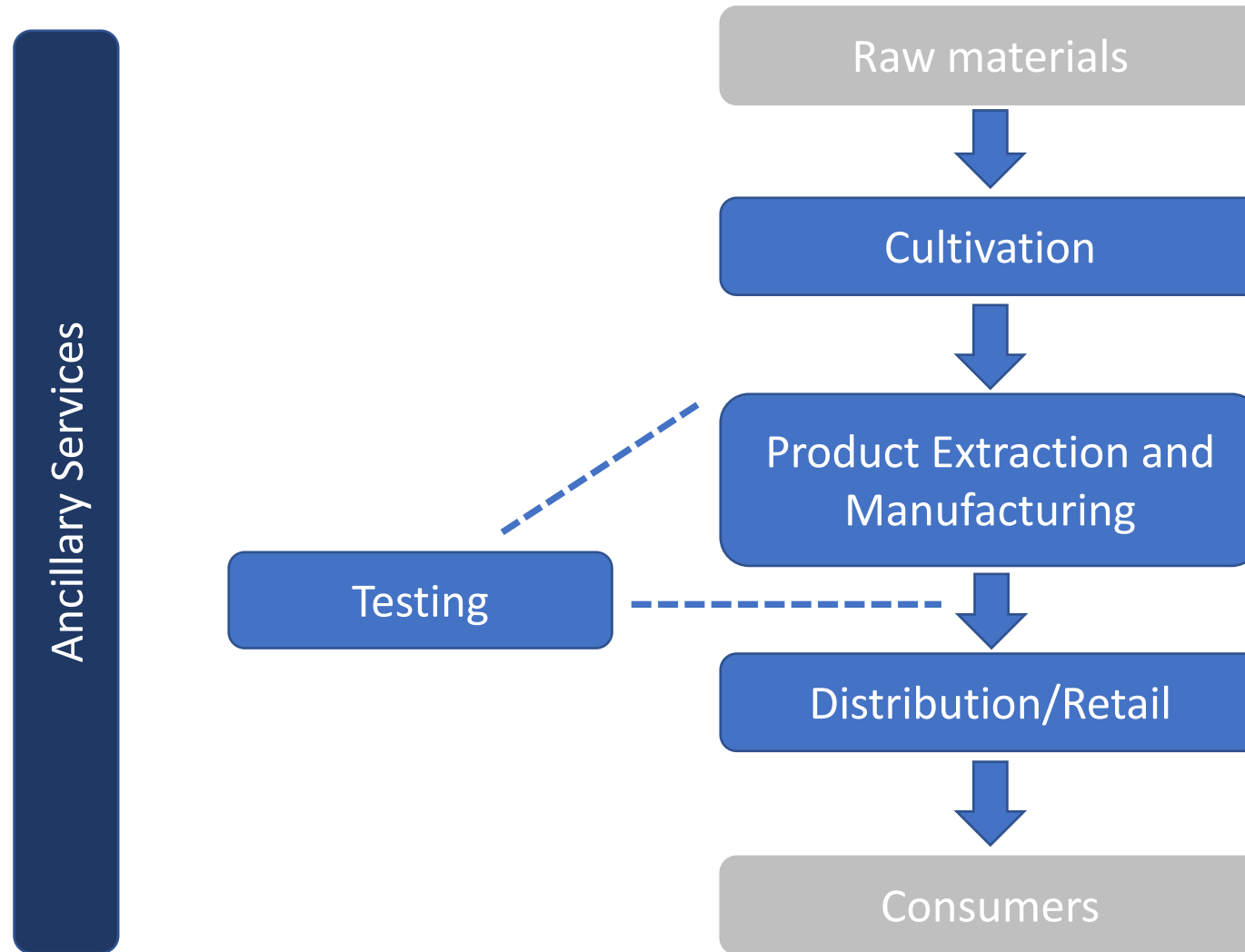
Disclosures

- No connections (financial or otherwise) to the cannabis industry.
- No other conflicts of interest to declare.
- RAND does not have an official position on cannabis policy.

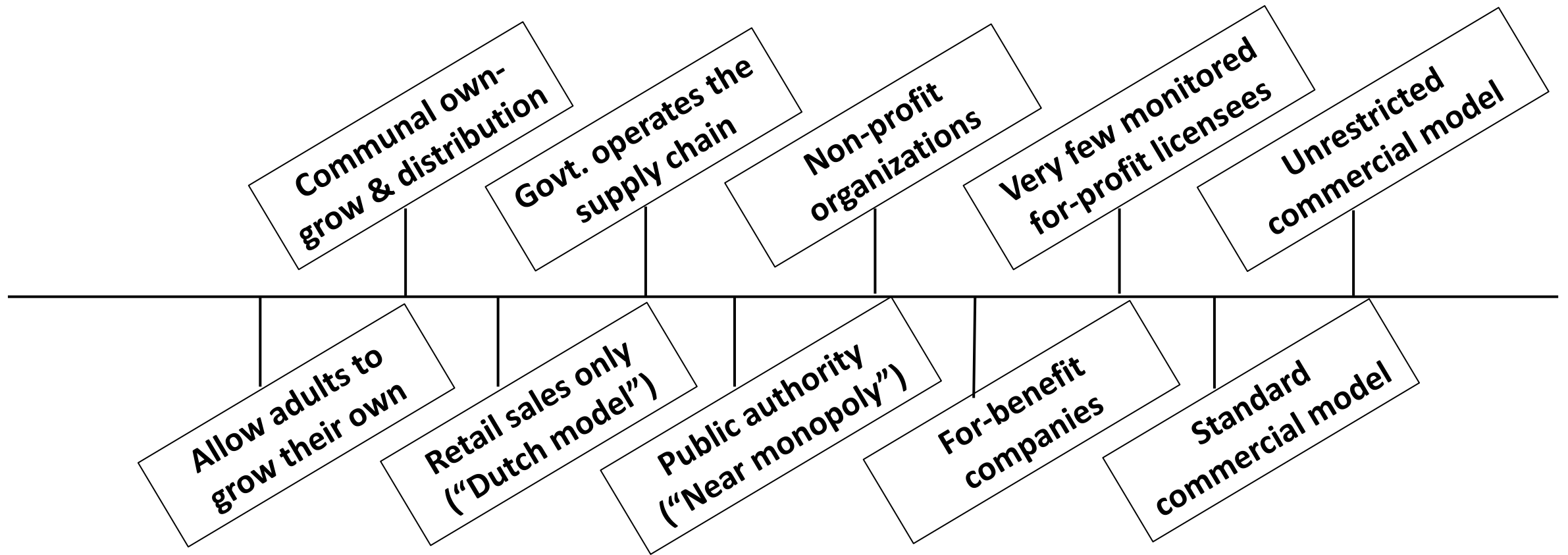
Economic considerations in establishing a legal cannabis industry

- Revenues to the state
 - Taxes
 - Licensing fees
 - Other fees and fines
- Employment and industry growth
 - Cultivators
 - Manufacturers/processors
 - Testing facilities
 - Distributors/retailers
- Mostly discussed regarding nonmedical policies, but matters for medical!

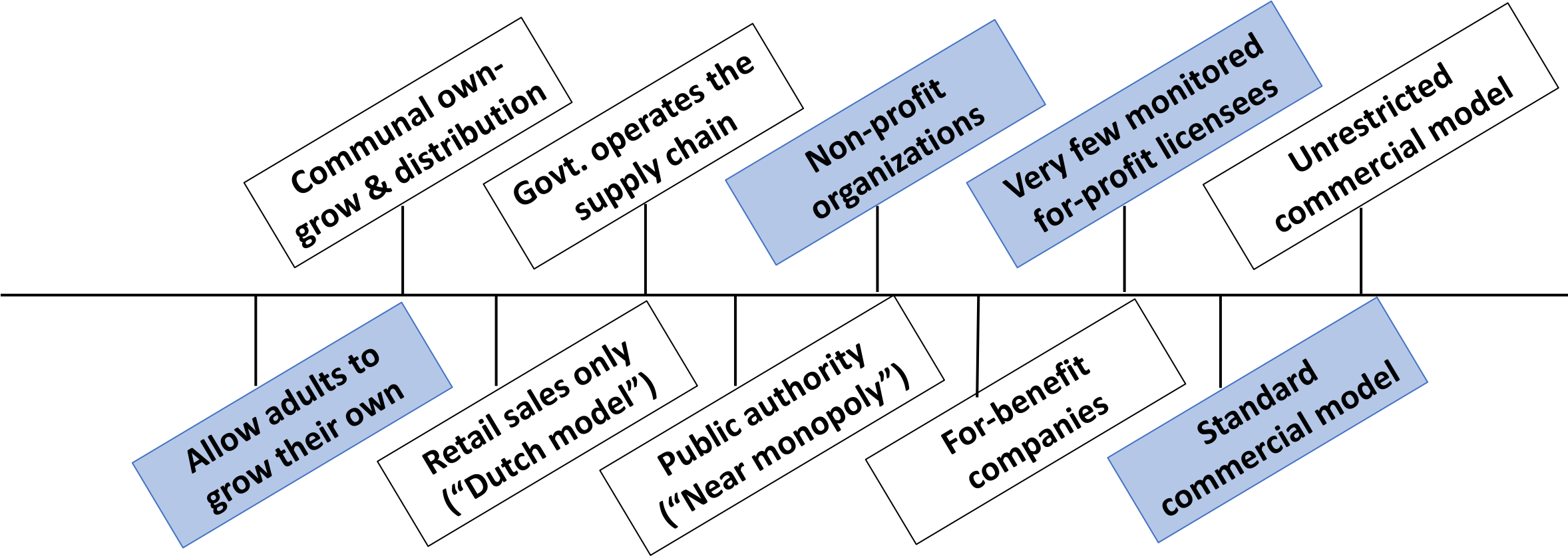
Simplified depiction of industry structure



Range of options for legal supply regimes



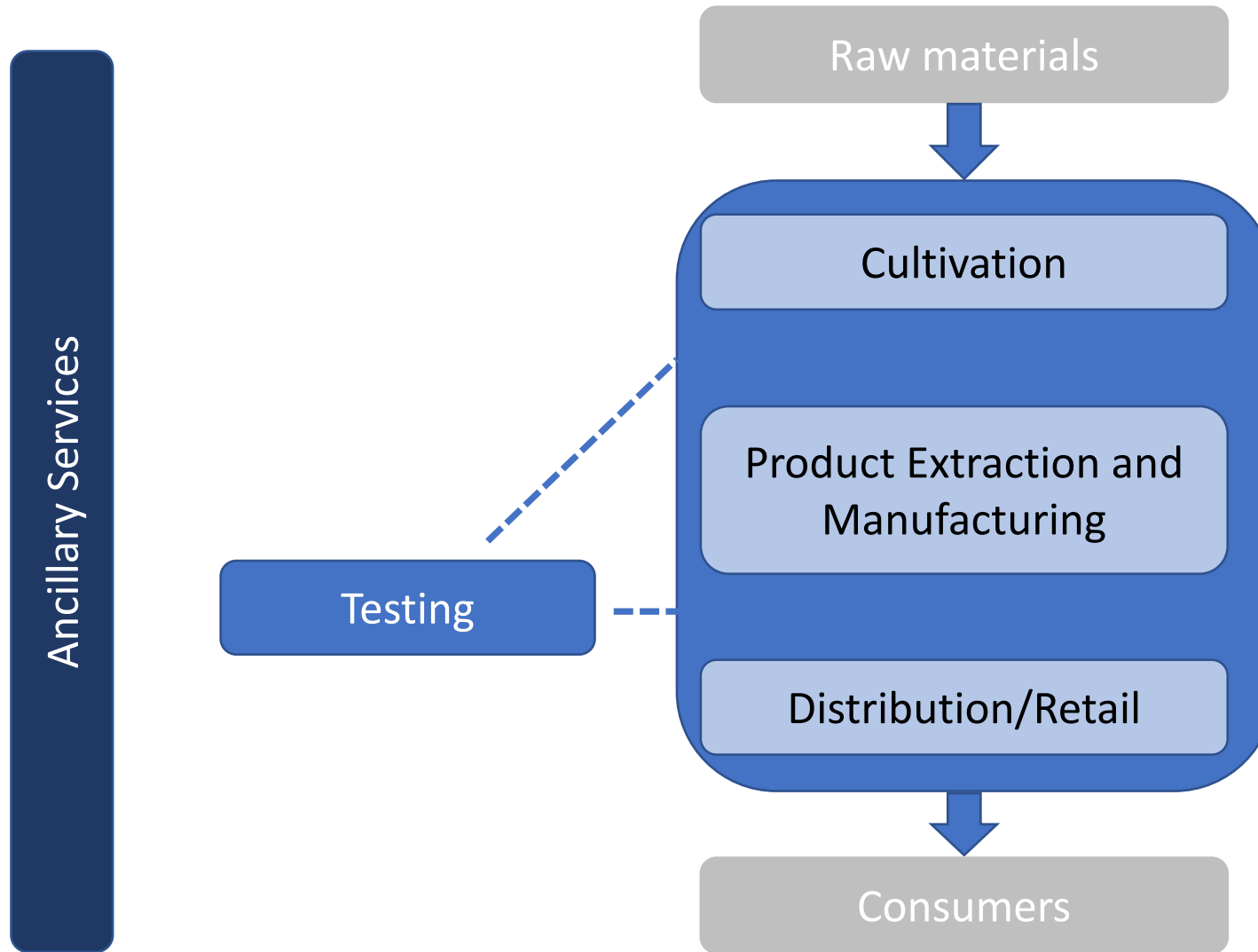
Common options for legal supply regimes in the US



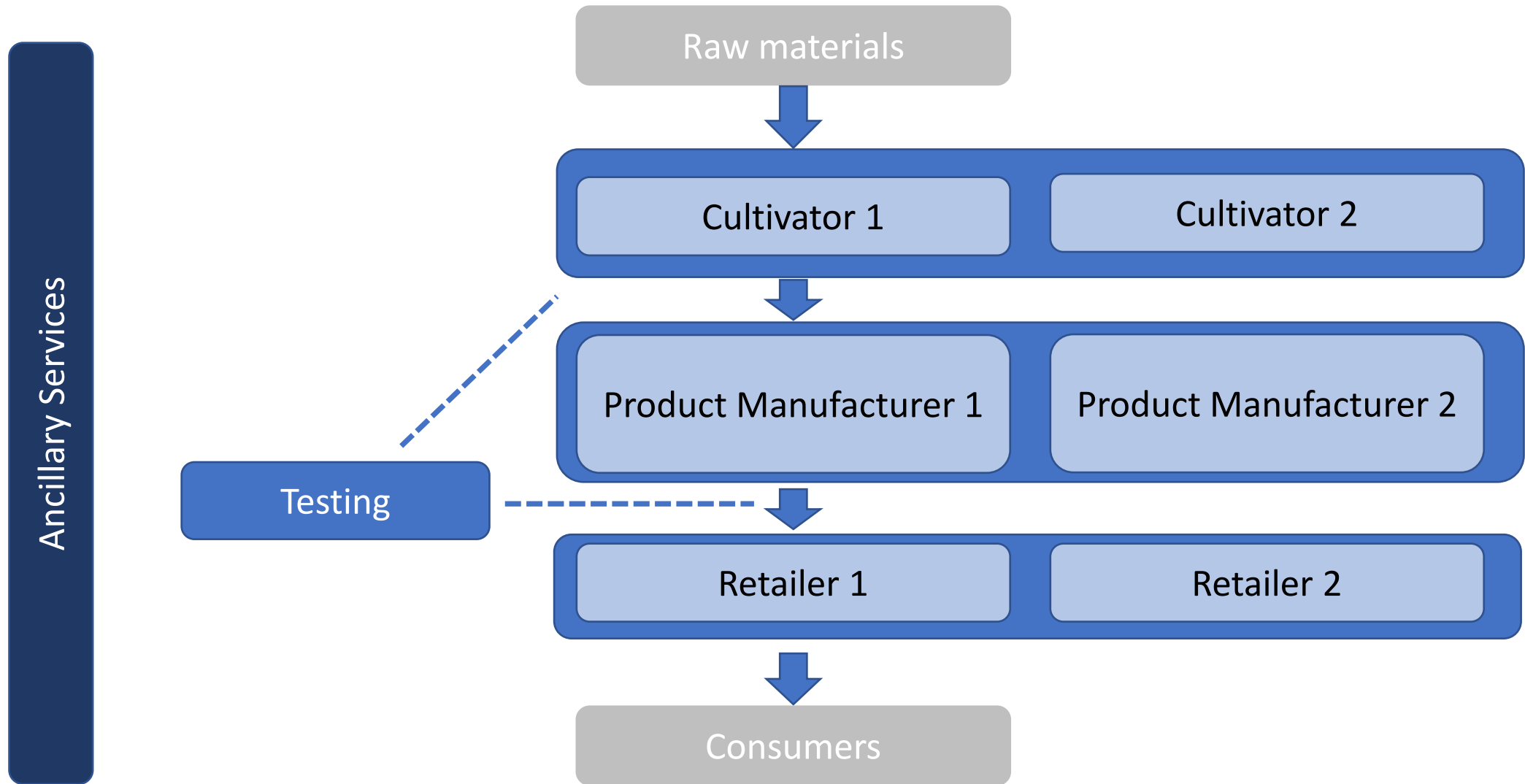
Regulation of market size and structure can be explicit

- Explicit choices *across* supply regimes
 - Allow home cultivation (e.g., MO, AR) or prohibit it (e.g., UT, OH)
 - Require suppliers to be not-for-profit (e.g., medical in NH, DE)
 - State-run stores (being discussed in NH)
 - Caps on number of licenses
- Explicit choices *within* supply regimes
 - Caps on overall market size or business/canopy sizes
 - Bans or limits on vertical integration (e.g., WA, LA)
 - Requirements for vertical integration (e.g., NM, FL)

Vertical integration



Horizontal integration



Tradeoffs of requiring (or encouraging) vertical integration

Pros

- Can discourage sourcing from black-market
- Can improve efficiencies & cost savings
- Can facilitate regulation/monitoring
- Can increase quality control

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Cons

- Can discourage specialization
- Can require large capital outlays
- Can discourage competition (result in monopolization)
- May limit who can enter the market as a supplier

VERTICAL INTEGRATION AND PRODUCTION INEFFICIENCY
IN THE PRESENCE OF A GROSS RECEIPTS TAX

Benjamin Hansen
Keaton S. Miller
Caroline Weber

Working Paper 28478
<http://www.nber.org/papers/w28478>

Struggling cannabis retailer Medmen wants to fix things by keeping it simple



By Alicia Wallace, CNN Business

Updated 8:56 PM ET, Wed February 26, 2020



How Vertical Integration Is Ruining Medical Cannabis In Florida

Mon / May 25th / by [Brett Puffenbarger](#)

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Regulation of market size and structure can be implicit

- Barriers to entry
 - High application and licensing fees
 - Other capital requirements (e.g., proof of assets)
 - Prohibit entry by individuals with certain criminal histories
- Scoring of license applications
 - Award extra points for existing within-state operations (e.g., SC)
 - Require demonstration of expertise specific to medical cannabis (e.g., NC)
- Limits on size of businesses (e.g., HI)
- Licensing structure
 - Different licenses for different cultivation sizes (e.g., CA)
 - Supply structure exceptions for different market actors (e.g., NY)

Important to think through the policy goals

- How big do you want (or need) your market to be?
 - Think about what demand is likely to be
 - Want supply to match up to that as closely as possible
- Who do you want participating in this market?
 - Number of businesses
 - Larger vs. smaller-scale producers
 - Out-of-state (or multi-state operators) vs. within-state businesses
 - Diversity of suppliers

Do the details of the law support that vision?

- Who will gain entry into the market?
 - Requiring vertical integration involves massive start-up costs
 - Start-up costs require pre-existing capital or funding sources
- Who will be able to stay in the market?
 - First-mover advantages
 - Larger firms may have resources to better navigate complex regulatory processes
 - Will market power be concentrated among retailers or producers?
- How will supply structure influence patient outcomes?
 - Prices, access, types of products available
- What will be challenges for enforcement or compliance monitoring?
 - Easier to monitor a smaller number of market actors
 - Concentrated market power may unduly influence regulations

Conclusions

- There are a LOT of decisions that need to be made
 - Copying legislative text from other states or leaving regulatory details ambiguous are themselves decisions (and probably not the best ones)
- Even if economic gains are not the primary goal of a policy change, regulatory features that shape the market merit careful attention
- Think about what you want the market to look like and craft regulations to try to achieve that vision
- Allow flexibility – this is still a nascent industry and things may change

Thank you!

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