Keith Van Wagner  
California Department of Public Health  
1415 L Street, Ste. 500  
Sacramento, CA 95814

May 11, 2018  

Dear Mr. Van Wagner:

Thank you for submitting the standardized regulatory impact assessment (SRIA) and the summary (Form DF-131) for the proposed regulations for Manufacturers of Adult Use and Medicinal Cannabis, as required in California Code of Regulations, title 1, section 2002(a)(1). As proposed regulations were not submitted with the SRIA, these comments are based on the SRIA, our understanding of Proposition 64, the SRIA prepared by the Department of Food and Agriculture, as well as other publicly available information.

Proposed regulations establish multiple requirements for manufacturers to be licensed by the state, including labeling and packaging, potency testing, background checks, and various operational requirements such as paying taxes and receiving a local license. The estimated direct cost of compliance for the cannabis manufacturer sector is around $200 million in 2018, with ongoing annual costs of around $140 million, including state and local fees. Local fees are estimated to be $62 million of the 2018 cost, and $50 million of the ongoing costs. Annual state license fees charged by the California Department of Public Health range from $2,000 to $75,000 depending on gross revenue of the manufacturer. Total annual fee revenues to the Department are estimated at $29 million. The Department estimates medicinal and unlicensed retail sales of manufactured cannabis products totaled $1.5 billion in 2017, with manufacturer revenues of $600 million using a seasonal workforce of around 12,000 employees. With legalized adult-use, the retail value is estimated to rise to around $2.6 billion when regulations are fully implemented, with manufacturer revenues of $1 billion. The SRIA estimates that the grams of cannabis oil used by manufacturers increases from 24 million to 27.5 million as consumers become more willing to buy manufactured goods. The increase in revenues is largely due to an increase in average consumer prices. However, there is considerable uncertainty in how manufacturers and consumers will react in the new market. The SRIA notes that these estimates are done using a model that assumes relatively small changes to the current situation.

Finance generally concurs with the methodology used by the Department to estimate impacts of proposed regulations. The SRIA reflects the commendable efforts the Department made to contact affected stakeholders, and to gather information about the costs, benefits, and market conditions in the cannabis industry. The analysis does a good job of laying out the underlying mechanisms of how the regulations will affect the manufacturers and the economy, and the sensitivity analyses included are helpful. This SRIA is unusual in that the baseline must incorporate regulations being developed concurrently by the Bureau of Cannabis Control and by the Department of Food and Agriculture, and the advance discussion with Finance on this issue was appreciated. In these and other areas, such as the assumption that federal policy will be unchanged, the SRIA is clear about the underlying assumptions.
However, there are three areas where further clarification would benefit the public. First, manufacturers have choices about where to locate their business, and to the extent that they concentrate in jurisdictions where local permitting is cheaper, the regulatory costs will be lower. However, if this leads to more concentrated production, the demand for transportation of goods would likely be higher in these areas. Second, the SRIA may be understating the amount of business creation and destruction by assuming many existing, unlicensed manufacturers become licensed. If instead they shut down and new businesses emerge, there would be more turnover. Finally, it is possible that input prices may fall more than the SRIA assumes. While this would hurt cultivator profits, it may help manufacturers and lead to greater expansion in the sector than estimated.

These comments are intended to provide sufficient guidance to outline prospective revisions to the SRIA. The SRIA, a summary of Finance’s comments, and any responses must be included in the rulemaking file that is available for public comment. Finance understands that the proposed regulations may change during the rulemaking process. If any significant changes to the proposed regulations result in economic impacts not discussed in the SRIA, please note that the revised economic impacts must be reflected on the Standard Form 399 for the rulemaking file submittal to the Office of Administrative Law. Please let us know if you have any questions regarding our comments.

Sincerely,

Irena Asmundson
Chief Economist
Department of Finance

cc: Ms. Panorea Avdis, Director, Governor’s Office on Business and Development
    Ms. Debra Cornez, Director, Office of Administrative Law
    Ms. Diana Dooley, Secretary, California Health and Human Services Agency
    Dr. Karen L. Smith, Director and State Health Officer, California Dept. of Public Health
    Ms. Karin Schwartz, Chief Counsel, California Dept. of Public Health
    Dr. Erick Eschker, Humboldt Institute for Interdisciplinary Marijuana Research