Legislative Fiscal Office

Ken Rocco
Legislative Fiscal Officer

Daron Hill
Deputy Legislative Fiscal Officer

900 Court Street NE
H-178 State Capitol
Salem, Oregon 97301
503-986-1828

Budget Information Report

Status of Oregon Marijuana Programs

Background

In November 1998, Oregon voters approved Ballot Measure 67, which allowed the use of marijuana for medical purposes, within specified limits. The Oregon Medical Marijuana Act provides legal protections for qualified patients, requires a physician-written statement of the patient's qualifying debilitating medical condition, allows for a caregiver to provide assistance, and mandates an Oregon Health Authority (OHA) registration system. The Oregon Medical Marijuana Program, within OHA, is totally fee supported. In 2012, the medical marijuana laws were amended to approve medical marijuana dispensaries, including a registry system. There are currently 24 states plus the District of Columbia that have legalized medical marijuana.

As of November 2014, Oregon became one of 4 states (as of the time of this writing), plus the District of Columbia, that have legalized recreational marijuana. Under current law, both medical and recreational marijuana production, processing, and sales are legal under Oregon law, but are subject to a number of laws governing, among other things, regulation and taxation. The primary responsibility for administering and enforcing medical marijuana laws falls to OHA, recreational marijuana laws to the Oregon Liquor Control Commission (OLCC), and collection of marijuana taxes to the Oregon Department of Revenue (DOR).

The following is information on the new recreational marijuana program, as well as recent changes that have been made to the medical marijuana program. Information provided, including fiscal information, is based on what is currently known and has been approved by the Legislature. Given the fact that the program is new both in Oregon and in the other states where recreational marijuana is now legal, there is very little data available on the costs and revenue impacts of such a program. In addition, it is anticipated that the implementing laws will continue to be refined. As a result of these factors, the revenue, expenditure, and distribution estimates will continue to change as well.

Recreational Marijuana Program

In November 2014, Oregon voters approved Ballot Measure 91, which allowed the production, sale, and possession of recreational marijuana by persons over 21 years of age. Ballot Measure 91 included possession limits and prohibited home production of extracts through the use of solvents. It also imposed a tax to be paid by the producer (which was later modified in legislation during the 2015 legislative session) and provided that net recreational marijuana tax revenue would be distributed as follows:

- 40% to the Common School Fund
- 20% to the Mental Health Alcoholism and Drug Services Account
- 15% to State Police
- 20% to local law enforcement agencies to be distributed on the basis of population initially, and in subsequent biennia, by the number of licensees in each municipality

- 5% to the Oregon Health Authority for alcohol and drug abuse prevention, early intervention, and treatment services

The measure specified that OLCC was responsible for:
- licensing of growers, producers, and retail establishments
- ensuring the collection of taxes; investigating and prosecuting violations
- adopting regulations; exercising powers to carry out the initiative
- regulating the use of marijuana for scientific, pharmaceutical, manufacturing, mechanical, industrial or other applications
- adopting rules
- studying and making recommendations pertaining to impaired driving

The measure provided that by January 1, 2016, OLCC had to adopt administrative rules to implement the measure, and two days later was to begin accepting license applications. These specific timelines necessitated that OLCC begin work on implementing the ballot initiative prior to any license fee revenue being available to pay for these costs. As a short-term solution, the agency received permission to borrow start-up costs from the Liquor Fund (which consists of proceeds from the sale of distilled spirits in Oregon), to be repaid with 2% interest by the end of the 2015-17 biennium.

Ballot Measure 91 was a statutory, rather than a constitutional, measure. This distinction allowed the Legislature to make changes to the language of the Measure and to change the program going forward. Such future changes could include modifying the distribution of marijuana tax revenues. For example, the current 40% distribution to the Common School Fund could be changed to go to the State School Fund instead, which provides those funds immediately to the K-12 education system. Currently, 4% of the average balance of the Common School Fund for the preceding three years is distributed to K-12 school districts. The Common School Fund balance is $1.45 billion, so depositing a percentage of the marijuana tax revenues into the Common School Fund will have only a marginal impact on the amount distributed for the benefit of schools. In general, the Legislature has not, to date, made significant changes to the elements of the recreational program as specified in the Measure, but, rather, has provided more specificity about program operations and regulation.

2015 Legislative Action

With the convening of the 2015 Legislative Assembly, a joint legislative policy committee was appointed and passed implementing legislation that formalized the roles of state agencies and local governments in the regulation of recreational marijuana. Changes were also made to laws governing medical marijuana. Major policy issues incorporated into legislation are discussed below.

- HB 3400 outlined the responsibilities and authorities for Oregon's recreational and medical marijuana programs, including specifying the types of licenses to be issued; the amount and circumstances under which marijuana and related products can be grown, processed, stored, delivered, and sold; fees for licensure; enforcement and inspection provisions; and the circumstances under which local governments can adopt regulations pertaining to marijuana including opting out or to tax retail marijuana sales. The bill specified that OHA is responsible for regulating medical marijuana and OLCC for the regulation of recreational marijuana. In addition, OLCC is responsible for packaging, OHA for labeling, and OHA, with the Department of Agriculture (ODA), for testing of marijuana items. The bill also changes the fines and penalties for several infractions and other acts and establishes peace officer authority.

- HB 2041 established a 17% tax on the retail sale of marijuana items beginning January 1, 2016. Retailers are required to submit quarterly returns and tax payments to DOR. The bill also authorized medical marijuana dispensaries to sell limited recreational marijuana product at a tax rate of 25%

upon passage of SB 460, and changed the distribution method by which the local government share is divided.

- SB 460 authorized medical marijuana dispensaries to sell limited recreational marijuana retail product October 1, 2015 through December 2016, as noted above. These sales became taxed at a rate of 25% beginning in January 2016. OHA was tasked with developing and implementing rules, and procuring compliance staff to enforce the law.

- SB 844 created a 15-member task force to study and report on the development of a medical cannabis industry, to be staffed by OHA. The bill also included provisions related to setting aside convictions for marijuana-related criminal offenses and requirements for patient care for medical marijuana cardholders in certain circumstances.

- HB 5047 was the 2015-17 omnibus budget bill for OHA, OLCC, DOR, ODA, and the Department of Human Services (DHS) to administer these laws. In total, the bill included $17.5 million in Other Funds expenditure limitation and 77 positions (54.90 FTE) among the affected agencies. (Additional budget information is available in the table on page 8 titled *2015-17 Major Marijuana Revenues and Expenditures*.)

2016 Legislative Action

Further policy changes were enacted by the Legislature during the 2016 session as discussed below.

- HB 4014 removed a two-year residency requirement for recreational marijuana producers, processors, wholesalers, and retail licensees. In addition, medical marijuana registrants were authorized to transfer their inventory into the OLCC system if they become OLCC licensees. The bill specified that OHA is required to issue a receipt to medical marijuana registry applicants on the same day that an application is received and to approve or deny an applicant within 30 days, as well as to establish a youth marijuana-use prevention pilot program funded with a loan from the Liquor Fund. Certain criminal penalties were also amended by the bill.

- SB 1511 required OLCC to register recreational licensees who produce, process, transfer, or sell marijuana products for medical purposes, subject to certain conditions. It also required OHA to adopt rules allowing for the provision, transfer, and sale of usable marijuana. The measure prohibited taxation of retail sales made to a medical registry cardholder. The bill also expands the base of the tax to include edibles and extracts during the "early start" program.

- SB 1598 made changes to various license types and to land use requirements. It also required OHA to solicit proposals to conduct research for developing public health and safety standards for consumers of marijuana. Most importantly, from a budgetary standpoint, the bill increased the types of workers in the marijuana industry that will require permits, background checks, and associated training.

- SB 1601 allowed medical marijuana card holders to purchase marijuana tax free. To meet legal requirements regarding legislation pertaining to taxation, this bill repealed a number of tax provisions included in the aforementioned bills, and then reestablished the provisions in SB 1601.

- SB 5701 was the 2015-17 omnibus budget bill for the 2016 session. Budgetary adjustments related to the marijuana program and changes were included in this measure. In total, the bill included $6.6 million Other Funds and 12 positions (7.84 FTE) for the affected agencies.

Recent Medical and Recreational Marijuana Program Costs

Since the passage of Ballot Measure 91, Oregon state agencies have been authorized to spend $25 million total funds to implement the regulatory and tax collection processes associated with recreational and medical marijuana, excluding the ongoing costs of the original medical marijuana program. As noted above, OHA, OLCC, and DOR are the agencies with primary responsibility for regulation and tax collection services.

A number of other agencies will have some additional responsibilities and/or costs as a result of the recreational marijuana program. For example, testing standards are the responsibility of ODA, at a cost of approximately $200,000, which is funded through fees for the product testing. DHS also was granted additional Other Funds expenditure limitation and three positions for conducting background checks, and the Department of Justice (DOJ) was authorized to hire staff, including one permanent full-time marijuana civil legal services attorney. Neither DHS nor DOJ receive a direct allocation of marijuana tax revenue for any of their costs, but, instead, receive payment from other state agencies for their services. The Legislature has specified the means of funding for each agency as discussed below or as identified in the table on page 8 titled *2015-17 Major Marijuana Revenues and Expenditures*. Other agencies, including the Oregon State Police, the Judicial Department, local governments, as well as other criminal justice agencies may incur some costs as a result of the statutory changes, but have not received additional funds or budget authority to date given that it is unclear what the effects of the new program will actually be on these organizations.

Oregon Health Authority:

Prior to the passage of Ballot Measure 91 and resulting legislative changes in 2015, there were about 77,000 medical marijuana patients and 345 dispensaries. These programs were managed with 34 positions, mostly associated with the processing of patient applications and renewals. A handful of staff were dedicated to the regulation of dispensaries. For the 2015-17 biennium, the program anticipated fee revenues of about $25 million, of which, about $12 million was for direct and indirect program costs. In addition, excess revenues of $16 million were budgeted to be transferred to other on-going core programs in the area of Public Health, including state support for local public health departments, the Safe Drinking Water Program, Emergency Medical Services, and others.

The legislative changes approved in 2015 extended beyond the recreational program and required significantly more regulation within the medical marijuana program than in the past. In part, this was necessary to control the movement of product between the medical and recreational markets. The 2015 legislation maintained a system where medical marijuana was largely separated from the recreational marijuana market. That is, an individual processor or dispensary could participate in one market or the other, but not both. The one exception was “early start” sales of recreational marijuana by medical dispensaries.

In order to implement the program changes, an additional 25 program positions (19.58 FTE) and 12 positions (3.67 FTE) for information technology support were approved. Additional expenditures for the 2015-17 biennium were expected to be about $7 million. Some revenue loss to the medical marijuana program was expected as dispensaries shifted over to the recreational market. In order to sustain the medical marijuana program over the next several years, a fee increase was implemented for growers, which is expected to generate about $4 million in additional revenue in 2015-17. Fees were also implemented for processors of medical marijuana products. OHA expects to spend down part of its ending fund balances to cover costs of implementing the program changes.

A majority of the additional program staffing is for inspections and enforcement related to medical grow sites, processors, and dispensaries. New staff are also expected to manage the program including policy, rule-making, communication, and education. Other staff will ensure the accountability of tracking and product reporting, including the monitoring and tracking of necessary fiscal and auditing functions, as well as conduct data analysis.

The 2016 legislative changes significantly altered the relationship between medical and recreational marijuana. An individual producer, processor, or dispensary can now choose to participate in both markets, in which case they will be regulated by OLCC. The associated fee revenue will also go to OLCC. OHA estimates that fee revenues could be reduced by as much as $5.6 million during the 2015-17 biennium, as producers, processors, and dispensaries opt to be licensed and registered by OLCC. While the agency would also experience some cost reductions as less regulatory work would be required, it is likely that the revenue reduction would occur sooner than the costs can be reduced. If revenues are inadequate to continue to fund the other core programs in Public Health currently funded with medical marijuana revenues, General Fund could be required to continue these programs, or the programs will need to be reduced or discontinued. In addition to the loss of revenue, OHA will experience increased costs related to some specific program changes to the medical marijuana program. For example, as noted above, OHA is now required to issue receipts to applicants on the same day that the application is received.

Because of the uncertainty of the fiscal impact, no budget adjustments were made to the OHA budget during the 2016 legislative session; however, the agency may request adjustments as a part of its rebalance in the fall of 2016. OHA's budget was increased by $4 million Other Funds for a youth marijuana-use prevention pilot project as required in HB 4014. The one-time funding for this program will be transferred from the Liquor Fund, to be repaid from marijuana tax revenues.

Oregon Liquor Control Commission:

OLCC received legislative authority to fund regulatory start-up costs via a loan from the Liquor Fund, which will be repaid at 2% interest from licensing fees, and, for the 2015-17 biennium, marijuana tax revenue for the balance of unrecovered costs. OLCC incurred approximately $0.9 million in costs during the 2013-15 biennium. The 2015-17 legislatively approved budget authorized the agency to spend an additional $9.5 million Other Funds and approved 37 positions (29.08 FTE) for the marijuana program. At the time the budget was approved, the Legislature anticipated that there would be $5.9 million in marijuana-related license and permit fees, assuming 750 licensees for the biennium. There are several different OLCC marijuana license types and fees, but, for purposes of illustration, marijuana retailers, processors, and wholesalers will each pay an application fee of $250 and an annual license fee of $4,750 in 2016. OLCC is to use this fee revenue first to cover costs related to the marijuana program; remaining costs are to be covered by marijuana tax revenue. As of March 30, 2016, the agency had received 745 submitted applications, with another 1,194 pending some sort of additional action on the part of the applicant, far outpacing initial expectations for the program. It is likely that there will be volatility in the number of applications and licenses for some time given that this is a newly established industry.

The primary cost drivers for OLCC are the number of licensees, necessary technology, and information campaigns. Each license and permit application requires both a review to ensure that fundamental criteria are met and a background check. Those granted a license will need to have their facilities inspected and, once the recreational marijuana system is fully operational, inventories audited. Some of those who are denied a license or permit, or who have penalties assessed against them for non-compliance, will appeal the agency's decision. These appeals necessitate administrative hearings case development and review. Compliance costs account for more than $3.1 million of program expenditures, while program administration (including overhead, financial services, and legal advice from DOJ), accounts for $3.5 million. Another large expenditure, nearly $2 million, is for IT system needs for the new program. OLCC has contracted for an on-line licensing system for marijuana applicants, and has procured an inventory product tracking system for use by all producers, processors, wholesalers, and retailers. The cost of keeping stakeholders and the public informed about legal requirements to enter this industry or to possess and consume the product has also been significant. OLCC staff and IT resources, through an interagency agreement, will support DOR in its tax collection activities related to marijuana.

In addition to the OLCC Liquor Fund being used to cover the upfront costs for OLCC, $4 million from the Fund was transferred to OHA for the pilot youth prevention program established in HB 4014; this amount will be repaid through marijuana tax proceeds.

Department of Revenue:

DOR is responsible for the collection and distribution of recreational marijuana state taxes. Local marijuana taxes, where applicable, are collected by local jurisdictions; however, DOR was granted statutory authority to collect and distribute local taxes in HB 4014 (2016).

DOR's 2015-17 legislatively approved budget related to marijuana totals $3.4 million Other Funds, including 11 positions (6.82 FTE). The 2017-19 cost is estimated to be $2 million Other Funds, after the elimination of program start-up costs. The agency's expenses are funded from gross marijuana tax proceeds. The remainder of marijuana taxes collected will be deposited into the Oregon Marijuana Account and, after OLCC's 2015-17 remaining costs are recovered, available for distribution according to the formula referenced on page 1.

DOR's costs are for program administration, cash management, information technology, accounting, building security, and one-time infrastructure improvements. The largest expense DOR will incur is related to the processing of recreational marijuana cash receipts. Collection will occur only at the agency's Salem headquarters building, and it is anticipated that at least 60% to 80% of marijuana tax receipts will be paid in cash. This is because banks and most credit unions, as well as armored car vendors, remain sensitive to the federal legal environment that continues to classify marijuana as a Schedule I controlled substance. At the present time, banks and armored car vendors are providing needed services; however, recreational marijuana vendors are coming under increased scrutiny by banks due to the large volume of cash deposits with some vendor bank accounts being suspended. The security of both DOR employees and taxpayers remains a concern. DOR has contracted with the Oregon State Police to provide ongoing physical security at DOR's Salem building.

Marijuana Tax Revenue

Originally, it was anticipated that the tax collected would be a privilege tax on producers, but this was modified to a point of sale tax of 17% on marijuana retailers during the 2015 session (HB 2041). It should be noted that there continue to be many unknowns about the new program that make it difficult to estimate how much revenue will be collected, including how many consumers choose to purchase illegally from the gray market rather than from the legal market and the number of consumers who come from other states to purchase product in Oregon. This continues to make it challenging to accurately estimate costs, revenues, and, ultimately, distribution of revenues according to the formula approved as part of Ballot Measure 91. The following table provides the current estimate of marijuana tax revenue distributions for 2015-17, based on projections prepared by the Legislative Revenue Office. (Distributions represent net revenues after administrative costs for DOR have been covered and the Liquor Fund has been repaid.)

2015-17 Marijuana Tax Revenue Distributions		
Common School Fund	40%	1,129,267
Mental Health, Alcoholism and Drug Services	20%	564,634
State Police	15%	423,475
Cities Local Law Enforcement	10%	282,317
Counties Local Law Enforcement	10%	282,317
OHA Alcohol & Drug Prevention	5%	141,158
Estimated Revenue Available for Distribution		**2,823,168**

As discussed above, DOR is responsible for collecting the state tax from retailers. Recreational marijuana taxes are remitted by retail vendors on a quarterly basis; however, by administrative rule, DOR has directed monthly payments in order to accommodate the payment of taxes using cash. Statutory distributions from the Oregon Marijuana Account occur on a quarterly basis.

Medical dispensaries were authorized to sell certain recreational marijuana products ("early start" sales) from October 1, 2015 through December 2016. Medical dispensaries began collecting the 25 percent tax on January 4, 2016. However, based on OLCC registration timelines, DOR has assumed that retail sales, other than "early start" sales, will not begin until the fourth quarter of 2016, when it is anticipated that legal marijuana will be available for sale at licensed retail establishments.

A recreational marijuana tax revenue forecasting process is being developed. DOR is working in coordination with the Department of Administrative Services - Office of Economic Analysis, which does statewide revenue forecasting, and the Legislative Revenue Office. As of this writing, there are two months of recreational marijuana sales data available. Approximately $6.8 million was received during the first two months of "early start" sales of recreational marijuana. This amount is almost half of the $14.75 million in revenue that was anticipated for the entire biennium. It is too soon to know whether revenues will continue at this level or not.

Both OLCC and OHA are authorized to charge and collect fees to offset costs of licensing and enforcement. These costs are not included as part of marijuana tax revenue and are discussed above in the "Recent Medical and Recreational Marijuana Program Costs" section.

As discussed earlier, the Legislature authorized the Liquor Fund to be used to cover a number of initial program costs. These costs are to be reimbursed as marijuana revenue is collected. Based on the 2015-17 legislatively approved budget, the Liquor Fund will be owed an estimated $8.5 million from marijuana tax revenue. Assuming tax and fee revenue projections remain as forecasted and there are no additional agency implementation expenditures, an estimated $2.8 million in marijuana tax revenue remains for the statutory distribution formula as shown in the table above. In addition, sales have significantly exceeded early estimates, so it is clear that both revenue and expenditure estimates and actuals will continue to change and the Legislature will need to address these changes in upcoming sessions until the program stabilizes at some point in the future.

2015-17 Marijuana Major Revenues and Expenditures*

Changes Resulting from 2015 and 2016 Legislation

	2015 Session		2016 Session		TOTAL		
	Taxes	Fees	Taxes	Fees	Dollars	Positions	FTE
REVENUES							
HB 2401 Revenue Impact	10,750,000	-	-	-	10,750,000		
SB 460 Revenue Impact**	3,000,000	-	-	-	3,000,000		
SB 1511 Revenue Impact	-	-	1,000,000		1,000,000		
OLCC	-	4,611,025	-	1,326,199	5,937,224		
OHA	-	7,080,198	-	-	7,080,198		
Total	**13,750,000**	**11,691,223**	**1,000,000**	**1,326,199**	**27,767,422**		
					-		
COSTS					-		
OLCC 2013-15	354,405	-	500,000	-	854,405		
OLCC 2015-17	3,721,908	4,611,025	(208,437)	1,326,199	9,450,695	37	29.08
DOR	1,864,453	-	1,552,807	-	3,417,260	11	6.82
OHA	-	6,693,787	3,974,842	-	10,668,629	39	24.25
DHS		386,411	-	-	386,411	3	2.59
Interest to repay OLCC Liquor Fund	81,526	-	85,328	-	166,854	-	-
Total	**6,022,292**	**11,691,223**	**5,904,540**	**1,326,199**	**24,944,254**	**90**	**62.74**
Tax Revenue Remaining for Distributior	**7,727,708**		**(4,904,540)**		**2,823,168**		
Liquor Fund Repayment with Interest	(4,157,839)		(4,351,733)		(8,509,572)		

* All numbers represent estimates as of February 2016. These numbers include 2013-15 costs and interest repayment costs in addition to 2015-17 costs included in the omnibus budget bills (HB 5047 and SB 5701) referenced in the narrative.

** The revenue statement produced by the Legislative Revenue Office identified a range of $2 to $3 million as the revenue impact for SB 460.