Ballot Proposition 207
Smart and Safe Arizona Act
Fiscal Analysis

Estimated Impact

A.R.S. § 19-123E requires the Joint Legislative Budget Committee Staff to prepare a summary of 300 words or less on the fiscal impact of voter-initiated ballot measures. Proposition 207 would legalize the sale and use of recreational marijuana for persons 21 years of age and older. The initiative establishes a 16.0% tax on the sale of recreational marijuana and recreational marijuana products. Marijuana establishments would also pay licensing fees.

The tax and the licensing fees are projected to generate $166 million in annual revenue after the program becomes more fully operational in the next several years.

These monies would be deposited into the Smart and Safe Arizona Fund (SSAF). SSAF monies would first be used to pay administrative costs of certain agencies. The remainder of these monies would then be distributed as follows:

- 33.0% to community colleges
- 31.4% to local law enforcement and fire departments
- 25.4% to the state and local transportation programs
- 10.0% to public health and criminal justice programs
- 0.2% to the Attorney General for enforcement

The regular sales tax would apply to recreational marijuana purchases. Annual state and local sales tax collections on these purchases may reach $88 million in the next several years. These monies would be available for general use.

Due to uncertainty about the level of marijuana sales, the revenue estimates are speculative and subject to change.

The initiative also requires a one-time transfer from the Medical Marijuana Fund of $45 million for the Department of Health Services, a university tuition program, and an impaired driving program.

There could be fiscal costs from increased emergency room visits, hospitalizations, and substance abuse treatment, as well as savings from reduced arrests, prosecutions, and punishment of marijuana offenses. The magnitude of such costs or savings would depend on subsequent funding decisions made by the state government.

Background

The proposition legalizes the sale and consumption of marijuana and marijuana products for adults 21 years of age and older. All sales of recreational marijuana would be subject to a 16.0% retail excise tax. The Department of Health Services would be responsible for licensing and regulating marijuana establishments, agents, and testing facilities.

The initiative would establish the Smart and Safe Arizona Fund, which would receive monies from the 16.0% excise tax as well as licensing and registration fees. Before any distributions are to be made from the fund, state agencies would receive monies based on their self-determined "actual and reasonable" costs associated with certain requirements to implement the initiative:

- DHS: implement and enforce regulation of the recreational marijuana industry.
- Department of Revenue (DOR): collect the 16.0% excise tax on recreational marijuana.

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- The Supreme Court: process expungement petitions for certain marijuana offenses.
- Department of Public Safety (DPS): amend its criminal records based on expungement petitions granted by the Court.
- State Treasurer: administer the Smart and Safe Arizona Fund.

After state agency distributions, the remaining funds would be distributed accordingly:

- 33.0% to community college districts, including:
  - 15.0% divided equally among each district.
  - 0.5% divided equally among each provisional district.
  - 17.5% divided among the districts according to enrollment.
- 31.4% to municipal police and fire departments, divided according to the number of individuals from each department enrolled in the Public Safety Personnel Retirement System.
- 25.4% to the Highway User Revenue Fund.
- 10.0% to the Justice Reinvestment Fund, including:
  - 3.5% to county health departments.
  - 3.5% to DHS for grants to qualified non-profit organizations that provide justice reinvestment programs.
  - 3.0% to DHS to address public health issues affecting the state.
- 0.2% to the Attorney General for enforcement.

The act also mandates a one-time transfer from the Medical Marijuana Fund of $45 million to be distributed as follows:

- $19 million to the Department of Health Services, including:
  - $10 million for the formation of councils and programs to address public health concerns such as teen suicide prevention, maternal mortality review program, improving public health, substance abuse prevention, addressing adverse childhood experiences, the Arizona Poison Control system, the Arizona Health Improvement Program, the Child Fatality Review Team, and the Chronic Pain Self-Management Program
  - $2 million for enforcement of the initiative
  - $4 million for distribution to non-profits to help those petitioning for expungement of minor marijuana offenses
  - $2 million to work with the Department of Economic Security to develop a program to help those from disadvantaged communities own and operate marijuana establishments
  - $1 million for non-profit education and community outreach related to the initiative
- $15 million to the Arizona Teacher's Academy Fund to provide grants to higher education students in exchange for teaching in Arizona schools after graduation.
- $10 million to the Governor's Office of Highway Safety for grants to reduce impaired driving.
- $1 million to the Smart and Safe Arizona Fund.

Currently the Medical Marijuana Fund has a FY 2020 balance of approximately $68 million and DHS projects the balance will grow to $91 million by the end of FY 2021. As a result, the $45 million transfer would reduce the ending balance to an estimated $46 million at the end of FY 2021.

Analysis

There are 11 states that have legalized the recreational use of marijuana. For the purpose of this analysis, the JLBC Staff only used 5 western states for comparison under the assumption that the marijuana markets in these states are closer to the potential Arizona market. Colorado was the first state to legalize, followed by Washington, Oregon, Nevada, and California. Estimated recreational sales from the 5 states (Colorado, Washington, Oregon, Nevada, and California) are displayed in *Table 1.* In some cases, the sales data represents an extrapolation from available tax collection data.

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Table 1

Year	Colorado	Oregon	Washington	Nevada	California
		Estimated Recreational Marijuana Sales Base			
1	$291,864,400	$353,849,600	$185,374,600	$424,892,000	$1,758,620,700
2	577,536,300	403,801,400	530,483,300	552,215,300	
3	861,587,400	554,276,400	911,679,800		
4	1,091,185,400	652,675,100	1,049,664,300		
5	1,213,517,600				
Marijuana Sales Per Capita in 3rd Year	**$156**	**$133**	**$125**		

The tax structures in California, Colorado, and Nevada include an excise tax paid on wholesale transactions. These taxes, though paid at the wholesale level, are assumed to be passed on to consumers through higher retail sales prices. In order to make the sales data for these states more comparable to the structure proposed by the initiative, any taxes paid for wholesale transactions have been subtracted from the overall level of sales for the purpose of our projections.

State sales data from *Table 1* shows that recreational marijuana sales tend to be lower in the first 2 years following legalization and vary substantially between states. The lower sales level and variability in the initial 2 years may be attributable to several factors that are difficult to quantify, including the time needed for regulatory agencies to process initial marijuana licensing applications as well as time for marijuana establishments to expand to their full production and sales capacity. Given the challenges in interpreting sales data from the first 2 years, our analysis focuses projecting recreational marijuana sales for Arizona in the third year following legalization (or calendar year 2023). Due to a variety of factors, however, we cannot estimate with certainty when Arizona would reach the more fully mature level of sales.

Among the western states that have legal recreational marijuana, only Colorado, Washington, and Oregon have 3 full years of sales data available. As a result, our analysis attempts to estimate Arizona's third-year sales based on the third-year sales from each of those states. We calculated the recreational marijuana sales per capita in each of the 3 states based on each state's reported sales in the third year of legalization. The per capita sales in each state ranged from a low of $125 in Washington to a high of $156 in Colorado, with an average of $137 across the 3 states.

To estimate Arizona's recreational marijuana sales base, we multiplied the $137 average per-capita marijuana sales by Arizona's population. In its Medium-Series Population Projections, the Arizona Office of Economic Opportunity (OEO) estimates that Arizona's population will have reached 7.59 million by 2023. Given the $137 estimate for per capita sales, the OEO population estimate implies Arizona would have $1.04 billion of recreational marijuana sales in 2023 (depicted in *Table 2* below).

Arizona marijuana sales may increase further after the third year. States with more than 3 years of sales data have experienced continued growth in years 4 and 5. In Colorado, Oregon, and Washington recreational marijuana sales grew by a weighted average of 20.5% in year 4. In Colorado, the only state with 5 full years of data, sales grew by another 11.2% in year 5. We do not attempt, however, to project past the third year due to the speculative nature of long-run forecasting.

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Revenue Impact

Table 2	
Estimated Revenue Impact of Mature Recreational Marijuana Market	
Estimated Sales Base	**$1,039,606,100**
16% Tax Revenue	**$166,337,000**
Sales Tax - State Government Receipts	
General Fund	$ 38,359,400
Education Sales Tax	6,237,600
Total State Collections	**$ 44,597,000**
Sales Tax - Local Government Receipts	
Counties	$ 8,422,900
Cities	5,198,000
Subtotal - Local Share of State Tax	$ 13,620,900
Direct County Excise Tax	$ 7,277,200
Direct City TPT	22,559,500
Subtotal - Direct Local Sales Tax	29,836,700
Total Local Government Receipts	**$ 43,457,600**
Total Sales Tax	**$ 88,054,600**
Total Tax Collections	**$254,391,600**

Under the initiative, sales of recreational marijuana would be subject to a 16.0% retail excise tax in addition to the state 5.6% sales tax. Based on a projected tax base of $1 billion, total state and local tax collections would be $254 million, including $166 million to the Smart and Safe Arizona Fund.

Another $88 million would be attributed to sales tax levied on recreational marijuana sales. Of this amount, $45 million would be distributed to the state, including a $38 million deposit to the General Fund and $6 million for education programs.

Local governments would receive $43 million from a combination of their share of the state's 5.6% sales tax and their own local sales tax. In terms of the latter, the average weighted county tax rate is 0.7%, which will generate approximately $7 million. The average weighted city tax rate is 2.17%, resulting in an estimated $23 million of new revenue.

Licensing fees would also be deposited in the Smart and Safe Arizona Fund. DHS is authorized to collect an amount of licensing revenue consistent with their "actual and reasonable" costs of revenue. Licenses are to be renewed biennially so this is not an annual revenue stream. All license revenue goes into the Smart and Safe Arizona Fund; however, the JLBC Staff has not included license revenue in the fund estimate because of its highly speculative nature.

Distribution of the Smart and Safe Arizona Fund is outlined in *Table 3* below.

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Table 3	
Distribution of Smart and Safe Arizona Fund	
Agency Distributions	$ 5,000,000
Community Colleges (33%)	53,241,200
Police, Fire, and Sheriff Departments (31.4%)	50,659,800
Highway User Revenue Fund (25.4%)	40,979,600
Justice Reinvestment Fund (10%)	16,133,700
AG Enforcement (0.2%)	322,700
Smart and Safe Arizona Fund	**$166,337,000**

Agency distributions for administrative costs are dispensed before any other distributions and each agency will determine their own funding requirements. The affected agencies have estimated the following expenses:

- DHS: $715,000 for start-up costs and $564,000 for subsequent years.
- The State Supreme Court: between $200,000 and $800,000 annually.
- DPS: $29 million; as described below, we believe the DPS estimate to be substantially overstated.
- Department of Revenue: $1.3 million-$1.7 million annually over the first four years.
- State Treasurer: has not yet provided an estimate.

For purposes of our analysis, we have assumed the total administrative distributions would be $5 million.

We think the DPS estimate for the cost of expungements is overstated. The initiative allows individuals with certain marijuana charges to petition for expungement beginning July 12, 2021. In addition, the original prosecuting agency or the Attorney General may also file an expungement petition on behalf of an eligible individual. However, the initiative places no requirement that these individuals submit a petition for expungement. DPS estimates over 192,000 such charges exist as of June 2020, and if all individuals with such charges on their record petitioned the courts for expungement it would cost more than $29 million on a one-time basis. Other states that had similar expungement programs received significantly fewer petitions. According to a Pew Charitable Trusts, analysis in November 2017, California only had 1,506 applications for expungement its first year of legalization and Oregon saw only 1,206 petitions combined between 2015-2017. Furthermore, the 192,000 estimate includes all convictions for marijuana possession, whereas the initiative provides the expungement option only to those who were convicted of marijuana possession of 2.5 ounces or less.

The initiative does provide a revenue source for DPS administrative costs. The initiative authorizes DPS to collect a "reasonable fee determined by the Director" for costs to "correct the petitioner's criminal history record" unless the individual is indigent.

Causes of Uncertainty

Our estimate of potential tax revenues under the initiative is speculative. States have had extremely varied experiences in the first years of legalization (see *Table 1*). Several factors will impact the magnitude of legalized sales in Arizona, including the number and locations of licensed dispensaries and the degree to which medical marijuana cardholders switch to purchasing products on the retail side.

Number of retail licenses

Under the initiative, the number of available retail licenses would be limited to 10.0% of the number of registered pharmacies in the state, which would be approximately 130. An additional 26 licenses will be issued as part of the Social Equity program, bringing total retail establishments to 156. Although this number may grow slowly over time (as the number of licensed pharmacies expands), it will still stay significantly below most other states that have legalized recreational sales. For example, both California and Oregon currently have over 600 recreational dispensaries, while Colorado has over 570. Nevada, however, the state with the strongest first year sales figures

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relative to its population, only has 70 open dispensaries as of January 2020. If the limited number of retail locations authorized under the initiative is insufficient to meet demand, then current marijuana users may be more likely to continue to purchase illegally or from medical dispensaries, potentially decreasing the size of the legal market. See *Table 4* below for the approximate number of retail dispensaries in each of the comparison states.

Table 4

Marijuana Retailers by State

	Approx. Number of Retailers	**Retailers per Million People**
Colorado	592	103
Nevada	70	23
Oregon	667	158
California	680	17
Washington	565	132
Arizona (estimated)	156	21

Local Control

The proposition grants localities certain regulatory powers regarding marijuana establishments, including the prohibition of such establishments within its jurisdiction. Should localities exercise these powers, it could lower marijuana consumption and thus tax revenue obtained from it.

The initiative prohibits, however, localities from enacting any regulation more restrictive than comparable laws regarding medical marijuana dispensaries. If a jurisdiction allows for marijuana establishments, then it may not make laws which make it unduly burdensome to operate.

Medical Marijuana Market

Under the initiative, the 16.0% retail excise tax only applies to sales of recreational cannabis products. Purchases made by medical cardholders from a licensed medical retailer are currently exempt from this tax. According to the DHS, there are approximately 240,000 current medical cardholders in Arizona. They pay, however, a bi-annual fee of $150 for their card. If these individuals purchase small levels of marijuana each year, they may opt to not renew their card and instead purchase through the recreational market.

Our analysis does not attempt to calculate the percentage of medical cardholders that will switch and is instead based on the actual revenue experience of other states that have legalized recreational sales.

Potential Costs

The proposition may generate indirect fiscal impacts on state agencies based on potential effects of marijuana legalization on health, education, and the criminal justice system. The Centennial Institute completed a study in November 2018 that attempted to estimate costs associated with legalization of recreational marijuana in Colorado. The study estimated total "societal" costs of $1 billion, or approximately $4.50 in costs for every dollar gained in tax revenues, including:

- $470 million for health-related costs, of which $382 million is estimated to be for hospitalizations and emergency room visits associated with marijuana usage;
- $431 million in productivity costs, of which $423 million is estimated to be associated with dropouts from K-12 public schools;
- $121 million in crime costs, of which $87 million is estimated to be associated with probationers being re-incarcerated as a result of marijuana usage; and
- $108 million for traffic costs, of which $84 million is estimated to be associated with accidents caused by impaired drivers.

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The Centennial estimate reflects total costs of marijuana usage in the state, including legal recreational and medicinal use as well as continued illegal use. Some of these costs also represent multiple year impacts. Our fiscal analysis of the proposition instead attempts to measure the annual marginal cost associated with just recreational marijuana legalization. As a result, any annual marginal impact would be lower than the $1.13 billion estimate.

In addition, the Centennial estimates do not always translate into costs incurred by the state. For example, in Arizona, the state only directly finances health coverage associated with individuals enrolled in Medicaid and state employees. To the extent that there would be any increase in hospitalizations or emergency room visits associated with marijuana usage, most of such costs would likely be covered by private health insurance as opposed to the state.

Given that the Centennial Institute study does not attempt to separately estimate marginal costs of recreational marijuana or the costs that would specifically accrue to the state, we cannot directly extrapolate the results of the study to Arizona. We do, however, discuss the potential state fiscal impacts below in terms of health, education, and the criminal justice system below. Since Colorado has the longest experience with a legalized marijuana market, we focus most of our analysis on their outcomes.

Health

According to the World Health Organization, nonmedical cannabis use could result in deleterious effects on physical and mental health. One possible outcome is that marijuana-related hospitalizations and emergency department (ED) visits may increase following recreational marijuana legalization. If these incidents involve Medicaid recipients or state employees, the state would share some of the cost.

Marijuana-related ED visits and hospitalizations did occur prior to recreational marijuana legalization in Colorado but have increased since that time. Based on data from the Colorado Department of Public Safety and the Colorado Department of Public Health and Environment, marijuana exposures, diagnoses, or billing codes were indicated at a rate of 739 per 100,000 ED visits in the 4 years prior to recreational marijuana legalization (2010-2013). By 2017, the rate increased to 1,139 per 100,000 ED visits. Over the same time period, marijuana-related hospitalizations increased from 1,440 per 100,000 hospitalizations to 3,439 per 100,000 hospitalizations. If Arizona were to experience the same proportional increase in ED visits and hospitalizations, AHCCCS general fund costs could potentially increase by $5 million.

Based on the Colorado experience, however, the increased use of the health care system may not be linked solely to legalization. The Colorado Department of Public Health and Environment cautioned, however, that the reporting of marijuana use in ED visit or hospitalization billing codes "does not indicate that marijuana exposure caused the healthcare encounter or caused an adverse health effect." Instead, these codes "identify that marijuana use was discussed in the patient's care during that encounter," which may occur as part of the provider's screening and review of the patient's history. Patients may be more willing to disclose their drug use as a result of legalization.

The Centennial Institute estimate of health impacts also includes $31 million in costs associated with substance use disorder treatment for individuals with marijuana dependency. The $31 million, however, is lower than the Centennial Institute's estimate of marijuana-related substance use disorder treatment expenses in 2013 ($36 million). The proposition also provides funding to DHS and county health programs, which may serve to mitigate health-related impacts.

Education

The Centennial Institute estimates $431 million of productivity-related costs associated with marijuana usage in Colorado. Most of the cost is due to lost wages and criminal justice costs associated with dropouts from K-12 schools that are presumed to be directly related to marijuana. The study noted 245 students were expelled as a result of a marijuana offense and 3,187 students were suspended for a marijuana offense during the 2017-2018

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school year in Colorado. Centennial assumes that all 245 expulsions and one-third of the suspensions ultimately dropout. They further assume that each dropout generates a total lifetime societal cost of $334,716 based on a prior study that calculated the lost income and law enforcement costs associated with students that do not complete high school.

The Colorado Department of Education did not track expulsions and suspension associated with marijuana separately from other drug violations for the full school year until the 2016-2017 school year. As a result, we lack baseline data on these issues prior to legalization in 2014. Since 2016-2017, the department reports that number of marijuana-related suspensions has increased from 3,147 to 3,473, while the number of marijuana-related expulsions declined from 211 to 195.

Given the data limitations, the net effect of recreational marijuana and suspensions and expulsions, and any associated effects on dropout rates, appears to be unclear. As the Centennial study notes, "connecting marijuana use to academic outcomes can be difficult, as there are myriad other factors that can influence these outcomes."

Criminal Justice Impacts

The Centennial Institute estimates that recreational marijuana legalization generates $87 million in costs for the criminal justice system as a result of probationers and parolees failing THC drug tests. In Colorado, marijuana use is only permitted for medical purposes for those on probation or parole. Arizona's initiative, however, establishes that possession or consumption of one ounce of marijuana or less "cannot serve as the sole basis . . . for imposing penalties of any kind under the laws of this state or any locality." As a result, Arizona probation program participants may be less likely to be re-incarcerated based on marijuana usage alone compared with Colorado.

There also could be potential savings to the criminal justice system if the legalization of marijuana possession and consumption reduces marijuana-related arrests and incarceration. A 2019 study funded by the U.S. Department of Justice found that states that have legalized recreational marijuana have seen lower marijuana related arrests and court cases. In addition, the Centennial study notes that marijuana-related arrests in Colorado declined from 12,967 in 2012 to 6,300 in 2017. Over the same time period, marijuana-related court filings declined from 9,923 to 5,528.

The Centennial Institute also estimates there could be costs associated with marijuana-related traffic incidents of $83.7 million, assuming a cost per accident of $25,050 based on an estimate from the Rocky Mountain Insurance Information Association. The Colorado Department of Transportation reports that 69% of marijuana users have driven under the influence of marijuana at least once in the past year and 27% report driving under the influence of marijuana "almost daily." The department does not report, however, comparable data prior to legalization of recreational marijuana. The Centennial study includes data showing the number of fatal car accidents in which a driver tested positive for THC only rose from 5% to 7% between 2013 and 2017.

To the extent that such costs increase following recreational marijuana legalization, the costs would largely be covered by private care insurance policies. If a low-income individual sustained injury in an accident, however, AHCCS costs could increase. The initiative does include a one-time transfer of $10 million from the Medical Marijuana Fund to the Governor's Office of Highway Safety for grants to reduce impaired driving, which may mitigate such impacts.

Other Analyses

Proponents of the initiative estimate that recreational marijuana would generate $300 million in new revenue the first year as well as $3.0 billion in revenue over 10 years. We do not have an estimate over a comparable timeframe given that no state has had legalized recreational marijuana for that length of time and given the speculative nature of long-run forecasting in general. The Arizona Department of Revenue estimates that revenue to the Smart and Safe Arizona Fund will grow to $145 million by the third full year of legalization.

Prepared by Benjamin Newcomb, Economist