SUMMARY OF DEPARTMENT OF FINANCE REVIEW OF SRIA AND DEPARTMENT RESPONSE

Department of Finance comment #1: "[T]he SRIA estimates that total economic impacts would result in a loss of $173 million in hemp market revenues in the first 12-month period following full implementation in 2025 for manufacturers, wholesalers, retail stores and delivery services, and decrease by $897 million in the five-year period following full implementation (2025-2029)."

Department response: The numbers referenced do not reflect the actual estimates of decreases in California hemp market revenues. Below, for clarity, we state the correct numbers for estimates of decreases in revenues collected by all California businesses in the 12-month and five-year time period following implementation of the Proposed Regulations, compared with the AB 45 baseline:

Estimates (as shown in SRIA Table A2.0, p. 108), are as follows:

- Total revenue decrease of $602 million in the first 12 months.
- Total revenue decrease of $3.14 billion in the first five years.

Estimated direct revenue impacts on different categories of California businesses due to the Proposed Regulations, compared with the AB 45 baseline (see SRIA Table A2.0, p. 108):

- Manufacturers: Revenue decrease of $120 million in the first 12 months and decrease of $615 million in the first five years.
- Wholesalers: Revenue decrease of $42 million in the first 12 months and decrease of $227 million in the first five years.
- Carry-out retailers: Revenue decrease of $392 million in the first 12 months and decrease of $2.02 billion in the first five years.
- Food service retailers: Revenue decrease of $47 million in the first 12 months and decrease of $268 million in the first five years.
- All California businesses (sum of four categories): Total revenue decrease of $602 million in the first 12 months and decrease of $3.14 billion in the first five years. (These numbers correspond to the total revenue impacts stated above.)

To clarify further, $173 million and $897 million referenced in the comment are not estimated revenue impacts or total market impacts, but rather Type II (induced) impacts on economy-wide *earnings* (corresponding roughly to corporate profits or net income), one of the estimates estimated by RIMS II models whose results (including impacts on value added and jobs as well as earnings) are shown in SRIA Table 4.2, p. 88.

Type II induced earnings estimates are one of several impacts and indirect economic "ripple effects" reported in the SRIA. Earnings impacts are not typically used as a primary indicator of economic impacts, and are not one of the central results of the SRIA.

Department of Finance comment #2: The Department of Finance requests "a fiscal impact analysis on how the proposed regulation impacts state and/or local government funding and enforcement and compliance costs," and asks to "quantify any possible state revenue impacts, such as losses in sales tax revenue that may result from the business revenue losses."

Department response: The primary fiscal impacts of the Proposed Regulations are losses in tax revenue resulting from revenue losses at businesses in California. These include impacts on sales and use tax revenue, cannabis excise tax revenue, and corporate income tax revenue.

Estimates of retail revenue impacts under the Proposed Regulations, as shown in SRIA Table 3.7, and economy-wide earnings impacts, as shown in SRIA table 4.2, are used to generate estimates of the impacts on state tax revenue.

Tax revenue impacts are calculated assuming a statewide average sales and use tax rate of 8.375% (including the 7.25% state sales tax plus a statewide average local sales tax rate of 1.125%), the current California cannabis excise tax of 19%, and the current California corporate income tax of 8.84%.

Retail revenue estimates are as follows: In the first 12 months after implementation, California retail revenue from hemp food and beverage products decreases by $445 million, and revenue from licensed cannabis increases by $6 million, for a net retail revenue decrease of $439 million. In the first five years after implementation, retail revenue from hemp food and beverage products decreases by $2.37 billion, and retail revenue from licensed cannabis increases by $78 million, for a net retail revenue decrease of $2.29 billion.

Earnings impact estimates are as follows: In the first 12 months after implementation, earnings decrease by $173 million. In the first five years after implementation, earnings decrease by $897 million.

Estimates of tax impacts of the Proposed Regulations, using the above estimates and tax rates as inputs, are as follows:

- Sales and use tax impacts
    - Decrease of ($439 million x 8.375%) = $37 million in the first 12 months.
    - Decrease of ($2.29 billion x 8.375%) = $192 million in the first five years.

- Cannabis excise tax impacts

  - Increase of ($6 million x 19%) = $1 million in the first 12 months.
  - Increase of ($78 million x 19%) = $15 million in the first five years.

- Corporate income tax impacts
  - Decrease of ($173 million x 8.84%) = $15 million in the first 12 months.
  - Decrease of ($897 million x 8.84%) = $79 million in the first five years.

- Total state tax impacts
  - Decrease of $51 million in the first 12 months.
  - Decrease of $256 million in the first five years.

The other fiscal impacts of the Proposed Regulations are limited to CDPH costs of administration, enforcement and other aspects of ensuring compliance with the Proposed Regulations. Given the limited consumer demand for hemp products with no detectable total THC, costs to State enforcement and compliance of enforcing the minimum age of 21 or no-detectable-total-THC standard are negligible.

- Total State Enforcement and Compliance Costs
  - $758,000 per year.

Department of Finance comment #3: "The SRIA states that 100 of the 115 manufacturers are assumed to be eliminated, while it also states that 50 businesses are estimated to need to comply with packaging redesign. The SRIA should clarify the number of manufacturers that would remain active in California and would be required to comply with the proposed regulations."

Department response: The group of 50 businesses that must comply with packaging redesign (at an average cost of about $20,000 per business, and an aggregate cost of $1 million) is not the same group of businesses as the 15 manufacturers (of 115 current manufacturers) that would remain active with the Proposed Regulations in place.

In the California hemp market, as in the national hemp market, many manufacturers and distributors that package hemp products (e.g. gummies or beverages) are out of state and not required to be licensed with CDPH. The majority of the 50 businesses facing relabeling costs due to the Proposed Regulations, at an average of $20,000 per business, are out of state distributors/manufacturers rather than CDPH licensed manufacturers.

Therefore, while there is some overlap between the 15 remaining CDPH-licensed hemp manufacturers and the 50 businesses that must comply with packaging redesign, these are two different and only partially overlapping groups, as some hemp manufacturers produce packaged products that are ready to sell at retail, whereas others do not. In some cases, distributors or retailers package the products, and thus are the businesses that would incur repackaging costs. Of the 15 CDPH-licensed manufacturers remaining in the market, approximately 10 are expected to incur relabeling costs.

These estimates come with a particularly high degree of uncertainty, as the Department did not have access to information about the internal strategies, product assortments, or future contingency plans of hemp manufacturers.

Department of Finance comment #4: "Currently, the SRIA quantifies the total cost as equal to the revenue losses from the elimination of manufacturers, however, the SRIA should also include the total compliance costs for the manufacturers that will need to comply with the proposed regulation (separate from the revenue losses, but as part of the total economic cost analysis, without netting)."

Department response: Neither the age limit of 21 nor the no-detectable-total-THC standard in the Proposed Regulations imposes any costs on businesses manufacturing, distributing, or retailing, aside from the $1 million ($20,000 x 50 businesses, as described in SRIA Section 2.5 and clarified in Section 2 above) in aggregate costs of designing and manufacturing compliant packaging, and phasing out non-compliant packaging.

A small number of non-psychoactive CBD products will likely remain on the California market with the Proposed Regulations in place, resulting in the need for manufacturers of those products to reduce total THC content from current total THC levels (less than 0.3%) to a non-detectable level of total THC.

As discussed in the SRIA, CBD isolate and other cannabinoid isolates that contain no detectable total THC are costly. It is estimated that there were not any pre-existing hemp products in the California market, prior to the Emergency Regulations, that would have reliably complied with the no-detectable-total-THC standard. Many products previously available that were marketed as "CBD" had very low levels of total THC, but would still have been non-compliant with the Proposed Regulations due to trace amounts of total THC that would still be detectable at some level.

To comply with the Proposed Regulations (and Emergency Regulations), manufacturers need to use a purified CBD isolate that eliminates traces of total THC. Given that consumers who buy CBD products do not demand that they have no detectable total THC, producers had no reason to use the purified CBD isolate prior to the Emergency Regulations. Products that would be able to reliably comply with the Proposed Regulations would thus be newly designed products.

The need to use more costly ingredients to comply with the no-detectable-total-THC standard will not result in any direct economic costs to manufacturers, distributors, or sellers. The large majority of producers, distributors, and retailers will not enter the market for such products. In cases where businesses alter existing products to create new no-detectable-total-THC products, it is estimated that such products will be offered at correspondingly higher prices to consumers at the wholesale and retail level; thus economic costs will not be imposed on hemp manufacturers, distributors, or sellers. Products, if any, that may have had non-detectable total THC levels prior to the regulations would not need to change their manufacturing processes and thus would not be expected to change their prices.

At this time, limited consumer demand exists for these new products at the higher price points that would be necessary for businesses (manufacturers, distributors, or retailers) to break even on manufacturing these products. Some businesses may nonetheless choose to manufacture, distribute, or retail no-detectable-total-THC products.

An estimated 100 of 115 businesses in the manufacturing segment will exit the California hemp manufacturing market, either by shutting down their businesses or by moving their businesses to another state. This is where some costs will arise.

Businesses incur certain costs (including legal costs, lease obligations, employee severance, service fees, moving and transportation costs, etc.) when they shut down or leave the California market for another state. In many cases, businesses that close must sell off their assets below market value, resulting in additional economic losses or take their assets out of state. Shut-down and dissolution costs are not currently covered in the SRIA, so estimates are added below.

It is estimated that no retail businesses will shut down as a direct result of the Proposed Regulations because hemp products are not the primary source of income for legal retail businesses in California.

Hemp manufacturing businesses in California vary widely by size, and financial information is not available for private companies (all businesses in the sector are currently private), so these estimates come with an unusually high degree of uncertainty. Closing and shut-down costs are estimated to range between $5,000 and $1 million per business, with an average of about $75,000 per business, for a total of $7.5 million in total costs for the 100 manufacturing businesses that will exit the market due to the Proposed Regulations.