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# HB 2015 Testimony
## Oregon House Committee on Revenue

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My name is Beau Whitney and am the founder and Chief Economist at Whitney Economics, a global leader in cannabis and hemp business consulting and economic research. My research going back 7 years covers adult-use, medical and industrial cannabis. I have pioneered work on cannabis demand elasticity, the economic multiplier effects, taxation and policy. I have contributed these insights to multiple state legislatures, congressional delegates and ministry level officials globally.

I am not your typical economist. I have been an Oregon cannabis licensee, served on OLCC rules advisory committees for both cannabis and hemp, have provided inputs into the Office of Economic analysis, and the Oregon President of the National Association of Business Economics and am a long-time member of the American Economic Association. My works have been cited broadly, from The Willamette Law review in a paper written by representative Helm, to an analysis of California tax reduction bill and by Congressman Blumenauer on a bill he sponsored in the U.S. House of Representatives.

I have examined the proposed legislation that would enable counties to increase the local sales tax rates from 3% to a maximum of 10%. Whitney Economics has a policy of generally not taking positions on legislation, but instead examines the potential impact that the legislation would have on the state and industry.

In examining this legislation, I examined the sensitivities cannabis consumers have regarding changes in price, also known as the elasticity of demand, I also leveraged my predictive models that look at the relationship of tax rates on the consumer conversion patterns from the illicit market into the legal market. This predictive model has examined changes to Oregon tax rates before and have a high level of precision, with forecasted effects coming within 1.8% of actual demand.

**Findings and Observations:**

Consumers are highly sensitive to price, in fact, based on a survey of cannabis consumers 77% of consumers use price as a determining factor in their purchases.

Despite testimony to the contrary, elasticity is extremely positive. Examinations of Washington and Colorado are dated, and when examined over time, support the Whitney Elasticity model. The overall cannabis industry has an elasticity of -2.0. Meaning for every 1% change in price, there will be a 2% change of demand in the opposite direction. **With An elasticity in excess of -2.0, the impact of an increase of 7% in taxation would be a demand decrease of 14%. This equates to a decrease in demand of $140,000,000 based on 2020 sales.**

Although the proposed tax rate would suggest a $70,000,000 increase in tax revenues for counties, based on consumer pricing sensitivities and a decreased sales volume, **tax revenues are forecasted to decline by $24,000,000**.

In a recent cannabis jobs report that I co-authored by Leafly, Oregon has between 17,500 – 22,000 cannabis related jobs. **A decline in demand by 14% would decrease labor requirements by 2,350 – 2,800 employees. This equates to $90 million - $107 million in wages.**

Finally, the average revenue per retailer based on a report by the OLCC is roughly $1.4 million per year. An analysis of the retail cost structures, indicate that the economic Threshold of Viability for a retailer to remain in business is $2.4 million. When businesses approach the Threshold of Viability, they generally start making reductions in expenditures and, if they are not able to become or remain profitable, eventually may go out of business. The most common expenses that are reduced is labor and health care expenditures.

**As the full effect of this bill is realized** in the Oregon cannabis economy, with displaced workers or workers without health care, **there will be an increase in state health care expenditures to cover those who are potentially impacted by this change**.

**Summary:**

The impact of this legislation is that sales will decline, tax revenues will be reduced, there will be a potential reduction in employment and an increase in services required of the state, such as healthcare. This will lead to a continued stress in the retail system.

APPENDIX #1:

**Example of Impact of 280e: Federal Taxes Impact Oregon Viability**

| 280e Example of Impact | Normal Business | | 280e Business | Comment |
|---|---|---|---|---|
| Retail Yearly Revenue (Based on National Average) | $2,400,000 | | $2,400,000 | Based on National Average, OR is $1.4M |
| Cost of Goods Sold (COGS = 50%) | $1,200,000 | | $1,200,000 | |
| Ordinary and Necessary Expenses (30%) | $720,000 | | $720,000 | |
| Real Pre-Tax Profit w/o 280e | $480,000 | | $480,000 | |
| ***Taxable Profit*** | ***$480,000*** | | ***$1,200,000*** | Big difference in taxable rates |
| Fed Tax @21% | $100,800 | | $252,000 | Retailers pay 150% more |
| ***Effective tax rate*** | ***21.0%*** | | ***52.5%*** | Effective tax rates approach 60%-70% |
| ***Net Annual Profit (Before State Tax and Debt Service)*** | ***$379,200*** | | ***$228,000*** | |

Cannabis retailers have excessively high federal taxes. This negatively impacts markets throughout the U.S. including Oregon. Whitney Economics is providing the U.S. Congress will an analysis of the effect IRC 280e has on the U.S. market.

 

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APPENDIX #2:

**Example of Current Oregon Retail Cost Structure – Averages are Not Enough to Make Ends Meet**

| **Oregon Cost Structure - A 280e example** | **Annual Numbers** | | **Remainder** | **Comments** |
|---|---|---|---|---|
| Retail Revenue | $1,400,000 | | | **Based on OLCC Average** |
| Product Acquisition Costs | $700,000 | | $700,000 | |
| Labor | $461,000 | | $239,000 | |
| Federal Taxes | $147,000 | | $92,000 | |
| Remainder | $92,000 | | | **$7,700 per month left after only three items:** |
| | | | | **Labor, Federal Taxes and Product Costs** |
| ***Rent*** | ***$90,000*** | | $2,000 | Average of $6 - $10/sq ft |
| ***Property Insurance*** | ***$12,000*** | | ($10,000) | **Already Negative** |
| ***Security*** | ***$9,000*** | | ($19,000) | |
| ***Bank Account*** | ***$6,000*** | | ($25,000) | Hold cash? Get Robbed |
| ***Payroll Taxes (FICA)*** | ***$70,994*** | | ($95,994) | |
| ***Health Care Insurance $6972/employee*** | ***$69,720*** | | ($165,714) | After labor, health care is first cut |
| ***Regulatory License*** | ***$5,000*** | | ($170,714) | Unavoidable |
| | | | | |
| ***State Business Taxes*** | | | | All of these items are below the line |
| ***Marketing / Advertising*** | | | | |
| ***Compliance Costs*** | | | | |
| ***Administrative*** | | | | |
| ***HR*** | | | | |
| | ***$0*** | | $0 | |
| **Net profit** | | | | **Tax increases are putting retailers out of business.** |

Retailers are struggling despite the record sales and record tax revenues. A tax increase will only reduce demand and introduce economic hardship to retailers. This will have a ripple effect throughout the Oregon Market. The top two areas for cost reduction would be labor and health care.

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APPENDIX #3:

**Example of Threshold of Viability: How Much Revenue Does it Take to Give Retailers a Chance?**

The average amount of revenue required to increase potential of survivability is $2.4 million per year. Oregon is current at $1.4 million per year.

| **Minimum Threshold: 280e example** | **Annual Amounts** | | **Remainder** |
|---|---|---|---|
| Retail Revenue | $2,400,000 | | |
| Product Acquisition Costs | $1,200,000 | | $1,200,000 |
| Labor | $461,000 | | $739,000 |
| Federal Taxes | $252,000 | | $487,000 |
| Remainder | $487,000 | | |
| | | | |
| ***Rent*** | ***$90,000*** | | $397,000 |
| ***Property Insurance*** | ***$12,000*** | | $385,000 |
| ***Security*** | ***$9,000*** | | $376,000 |
| ***Bank Account*** | ***$6,000*** | | $370,000 |
| ***Payroll Taxes (FICA)*** | ***$70,994*** | | $299,006 |
| ***Health Care Insurance $6972/employee*** | ***$69,720*** | | $229,286 |
| ***Regulatory License*** | ***$ 5,000*** | | $224,286 |
| | | | |
| ***State Business Taxes*** | | | |
| ***Marketing / Advertising*** | | | |
| ***Compliance Costs*** | | | |
| ***Administrative*** | | | |
| ***HR*** | | | |
| | ***$0*** | | $0 |
| **Net profit** | | | **Remains Positive with Good Management** |

Policy makers must consider federal tax policy when setting local rates. The retail sector needs more demand not less. An increase in taxes will push Oregon retailers farther below the Threshold of Viability