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A Toke and a Tax

If governments legalize marijuana, how much revenue can they raise from it?







By *Jeremy Singer-Vine*

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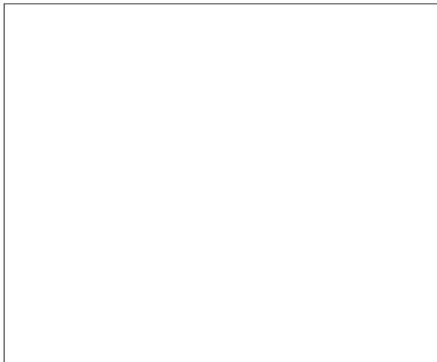


The worse the economy gets, the better marijuana looks—not necessarily for its psychedelic properties, but for its revenue potential. As more cities and states face budget deficits, the idea that legal, regulated marijuana could reel in a bounty of taxes is gaining traction. This development has confounded legalization advocates, rendering [their FAQs](#) nearly irrelevant and plunging them into an unfamiliar debate: OK, say we legalize pot. How should we tax it?

The question is, not surprisingly, popular in California, which has a \$24 billion deficit. In February, one lawmaker introduced a bill to tax and regulate cannabis sales to any adult over 21 at any licensed establishment—and in April, a poll found that [56 percent of Californians supported](#) the idea. In May, Gov. Arnold Schwarzenegger said it was "time for debate" about legalizing and taxing marijuana. Other states facing similar fiscal woes, such as [Illinois](#), are considering [proposals that would legalize and tax](#) either medical or all marijuana. Sensing opportunity, marijuana-reform lobbyists have enticed legislators with promises of fat tax revenues, as high as \$1 billion annually in California.

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Reform advocates are nearly unanimous in support of a marijuana tax similar in structure to taxes on tobacco and alcohol if it coincides with the drug's legalization. "This is the only constituency out there that's going to say, 'Bring it on; tax us,'" says Aaron Houston, director of government relations for the [Marijuana Policy Project](#). But that's about where the agreement ends. The debate has been vicious at board meetings of the [National Organization for the Reform of Marijuana Laws](#). "There's a lot of blood all over the table," says Allen St. Pierre, NORML's executive director. "It's probably one of the most contentious issues that the board takes up."



Tax debates often get heated, but a marijuana tax is particularly divisive because it's so speculative. (After 70-plus years of illegality, little is known about the economics of the drug.) A cannabis tax could be like an excise tax (a point-of-sales tax added to any sales tax, as exists in many places for gasoline, alcohol, cigarettes, and, potentially, [soda](#)), or it could be a



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pricey license to sell the product. Either method would increase the cost to consumers, who would in turn buy less of the product—a public health benefit in either instance. And unless people buy drastically less soda or pot, the government will pocket some extra cash. So far, it seems like a win-win situation.

But there are complications. One is the thriving black market for marijuana, with sales valued, [albeit shakily](#), as high as \$100 billion a year. A high tax could keep the market underground, robbing the government of tax revenue. The theory is that John Q. Pothead would be willing to pay a premium so he can "go to a regulated establishment that can assure some level of safety and labeling," says Houston of the Marijuana Policy Project. But make the premium too high, he says, and users will just go to "that shady guy" on the corner. The problem is that nobody really knows what the optimum premium is.

Speculation aside, there is one place where a marijuana tax is a reality: Oakland, Calif., which taxes sales of medical marijuana at 9.5 percent, the same rate as other goods in Alameda County. (Technically, 20 states require a tax stamp for marijuana sales, but the purpose of that policy is merely to add tax evasion to the list of penalties for drug dealing.) Additionally, the dispensaries pay a 1.8 percent business-receipts tax, as well as payroll taxes, to the city. Richard Lee, president of a "marijuana business school" called [Oaksterdam University](#), says dispensary owners gain legitimacy by paying taxes. "The more we pay, the more the city needs us and wants us," he says.

Still, even a pro-tax professor at a marijuana business school has his limits. When Oakland proposed an even higher business-receipts tax, Lee and other dispensary owners balked.

Jeffrey Miron, a Harvard economist and proponent of broad drug decriminalization, suggests that we look to alcohol and cigarette taxes as a model for a potential cannabis tax. Even with so-called "sin taxes" of up to 90 percent of the total price, illegal markets, once widespread, account for a tiny fraction of total sales. Miron warns that initial marijuana taxes at such a level "would just be a total mess" due to the expansiveness of the black market and ease of growing marijuana at home. Instead he recommends starting with a low tax—perhaps at 25 percent of the total price—and then gradually increasing it.

Of course, these relative numbers beg the question: What will the initial, untaxed price be? According to Lee, marijuana averages about \$300 per ounce in the Bay Area (and the bill currently under consideration in the slate Legislature would tax pot at \$50 per ounce—far higher than Oakland's dispensaries are paying now). A few reform advocates have tried to crunch the numbers. Dale Gieringer, who coordinates NORML's California branch, estimated in 1994 that free-market, untaxed pot would cost just [5 cents to 10 cents per joint](#), a potency-constant measure. Even adjusted for inflation, that's still at least 100 times cheaper than today's marijuana prices, according to Gieringer.

But if history and the proposed soda tax are any guide, marijuana may end up among the most expensive intoxicants. Federal and state health departments have been "nudging" the public for decades to reduce the demand for tobacco, which has decreased roughly [4 percent for every 10 percent increase in price](#). Politicians and economists defend these [Pigovian taxes](#) as balancing the public health costs of cigarettes, as they would for marijuana. (Much of this argument would depend on whether legalizing marijuana causes a rise or a decline in alcohol consumption.)

A steep excise tax would particularly infuriate libertarians, a critical constituency of the reform movement. The general tenet that "the government shouldn't be meddling with our minds, shouldn't be trying to nurture our behavior" extends to marijuana, says David Boaz, executive vice president of the Cato Institute and a former NORML board member.

Whatever they do, governments that tax marijuana will have to balance a trio of related goals—reducing budget deficits, eradicating the black market, and improving public health. Inevitably, one goal will get the short end of the spliff. Harvard's Miron predicts that governments will give priority to reducing deficits in the current round of pot-reform debates. It's not the best argument for legalization, says Miron, who has estimated that U.S. governments could [save almost \\$13 billion annually](#) if they no longer arrested, prosecuted, or imprisoned marijuana buyers or sellers. But in an era of falling tax revenue, it may be the most effective one.

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