CANNABIS
PUBLIC POLICY
CONSULTING

License Caps for State Cannabis Programs

1.0 Overview

License caps are limits on the number of cannabis licenses that can be issued within a regulated marketplace. Some states, such as California and Michigan, do not have a cap on cannabis licenses. Other states, such as Arkansas or Washington, limit how many licenses per license category can be issued. There are pros and cons to each licensing model that must be taken into careful consideration. The following document, prepared for the consideration of the Office of Cannabis Management, provides the key arguments and counterarguments in favor of and against adopting cannabis license caps.

2.0 Arguments in Favor of License Caps

2.1 Better control of the market.

Argument: By limiting the number of business licenses issued for each function along the cannabis supply chain, a state can better control the production and sale of regulated cannabis within its jurisdiction. This is especially important in the cannabis industry, wherein regulated operators must compete with a well-established illicit market. Issuing too many licenses too quickly, especially at the cultivation level, can lead to an oversupply of cannabis. Aside from being a significant public relations challenge for regulators, a supply glut runs the risk of a severe decline in retail prices, followed by a market crash and businesses exiting the legal market. Further, when the supply of regulated cannabis significantly outweighs demand, product tends to flow into the illicit market via diversion. Issuing too many licenses without any state mechanism to control supply can inadvertently fuel the illicit market and lead to the failure of many businesses.

Also worth noting is that a handful of states with uncapped markets, such as Oklahoma, Maine, and Michigan, have implemented or strongly considered placing moratoriums on cannabis licenses years into legal sales, effectively setting up a license cap. However, in these instances, the cap is placed too late, to the detriment of industry operators. A moratorium requires legislative approval, a lengthy and cumbersome process. It is better to be proactive than reactive.

Counterargument: The free market will always correct itself, which inevitably means some operators will not survive. Boom-and-bust cycles within the cannabis industry are normal, especially in the beginning years of a regulated market. The role of the government should be to protect public health and safety, not pick winners and losers. With sufficient track-and-trace software and resources for enforcement agencies, the state should be able to identify areas of gray market activity, including supply chain inversion and diversion.

2.2 Ease of administration and enforcement.

Argument: Issuing a limited number of licenses will ensure the total administrative burden is manageable. Without license caps in place, a massive influx of applications could overwhelm the government agency overseeing licensing and lead to significant bottlenecks in the application and licensing process. Further, a limited number of operators makes oversight over the regulated industry easier. Fewer operators means compliance officials can conduct more site inspections and offer more technical assistance, spend more time investigating potential matters of noncompliance, and ensure consumers are accessing safe, lab-tested cannabis products.

Counterargument: A government agency can mitigate potential application and licensing bottlenecks by utilizing efficient software, hiring third-party experts to assist in the application process, and by scaling personnel accordingly. As the number of licensed operators grows, the appropriate government agencies should increase both administrative and enforcement staff as needed.

2.3 Increases the value of a single license.

Argument: Limiting the number of licenses in the regulated cannabis industry increases the inherent value of a single license. Conversely, unlimited licensing means the license itself is worth no more than the initial application and license fees required to obtain it. A limited licensing scheme that makes licenses rare and therefore more valuable gives small and medium-sized businesses a safety net to exit the market, assuming no restrictions on license sales or transfers.

Counterargument: While limited licensing may help a few small and medium-sized businesses by securing them a substantial payout once they sell their business, it is an all-but-guaranteed way to ensure the cannabis marketplace will eventually be controlled by a few large operators. As was the case in several other states, limited licenses tend to sell for exorbitantly high prices on the secondary market and often to multistate operators. Limited licensing schemes are not conducive to a diverse market filled with locally owned businesses of all sizes.

2.4 Helps small and medium-sized businesses by restricting competition.

Argument: Small and medium-sized businesses could benefit greatly from the constrained competition that comes with a limited license model. Less operators means less competition and a higher likelihood of long-term viability for licensed businesses.

Counterargument: Given that licenses are often sold or transferred to large operators who thrive in limited markets, it is unlikely that the industry will remain owned by small and medium-sized local businesses. Most larger operators that can afford to buy out smaller businesses operate in multiple states. Further, limited license markets can lead to higher prices for consumers, as less competition can mean less incentive to lower prices. Limited licenses run the risk of bolstering the existing illicit market and preventing the regulated industry from acquiring any significant market capture.

3.0 Arguments Against License Caps

3.1 Artificially restricts the market.

Argument: Capping the number of cannabis licenses goes against free market principles and artificially restricts the size of the cannabis market.

Counterargument: It is in the best interest of many stakeholders, including licensed operators and the general public, to ensure the rollout and maintenance of the regulated cannabis marketplace is controlled and sustainable. The potential externalities associated with an unwieldy, uncapped market include a supply glut, a market crash, a mass exodus of businesses leaving the industry, and an increase in gray and illicit market activity. A license cap that is not overly restrictive balances pro-business values with goals of protecting public health and safety.

3.2 The government picks winners and losers instead of giving everyone a fair chance at succeeding in the market.

Argument: By implementing license caps, the government is de facto picking winners and losers in the regulated cannabis industry. An uncapped market gives everyone who wants to enter the industry an equal chance to operate a successful cannabis business. Stringent application requirements and review processes can weed out potential bad actors upfront, and the market itself will determine who succeeds and who fails.

Counterargument: The cannabis industry is an exceedingly difficult industry to turn a profit, considering the lack of available institutional funding options, its status as a federally illegal substance, and competition from a robust illicit market. A license cap can ensure that only the most qualified applicants receive a license, which will facilitate stability in the market with viable businesses. Further, a finite number of licenses increases the value of a license, giving operators a financial safety net if they wish to exit the risky industry.

3.3 Bolsters the illicit market

Argument: Restrictive license caps limit the ability of the legal cannabis industry to capture enough market share to successfully displace the illicit market. If there aren't enough regulated supply and retail access points, consumers will continue purchasing from the illicit market.

Counterargument: An appropriate license cap, informed by consumer demand data, should allow for the regulated market to gradually displace the illicit market over time.

3.4 Artificially inflates the value of a license, often leading to buy-outs by large multistate operators and hampering diversity and equity goals.

Argument: License caps create artificial scarcity for cannabis licenses, making them high-value, sought-after commodities that sell for exorbitantly high prices on the secondary market. In some states, such as Florida, a single license can sell for tens of millions of dollars. Because of this, many operators, including social equity applicants or small and medium-sized businesses, end up selling their licenses for a high profit. In certain cases, some people end up applying for a license with the hopes of selling it immediately and actually entering the cannabis market.

Counterargument: The increased value of a license that results from a cap creates a safety net for license holders operating in a high-risk industry. Given the major financial risk associated with operating a cannabis business, small and social equity-owned licensees should be allowed to benefit from selling their license to a larger operator.

3.5 Other similarly situated non-cannabis businesses are not capped.

Argument: Caps do not exist for other industries and businesses, such as restaurants, grocery stores or clothing retailers. Cannabis should not be treated any differently than other similarly situated businesses.

Counterargument: Given the sensitive and highly regulated nature of the cannabis industry, a controlled expansion of the market using license caps will help prevent an unstable market from spinning out of control. Further, other industries, such as restaurants or clothing stores, do not face the same challenges with an illicit market that the cannabis industry does. A cannabis market that expands too quickly runs the risk of diverting product into the illicit market.

4.0 State Licensing Models

State	License Cap?	Cap #	Population (21+ for AU, 18+ for Med)	Max retail density w/ cap	Notes
Arizona (AU)	Yes	169*	5,479,621	1:32,424	Arizona may only issue one cannabis establishment license for every 10 registered pharmacies in the state.
Arkansas (Med)	Yes	40*	2,349,805	1:58,745	N/A
California (AU)	No	N/A	N/A	N/A	Local governments can cap the number of licenses issued within their jurisdiction.
Colorado (AU)	No	N/A	N/A	N/A	Local governments can cap the number of licenses issued within their jurisdiction.
Massachusetts (AU)	No	N/A	N/A	N/A	Local governments can cap the number of licenses issued within their jurisdiction.
Maine (AU)	No	N/A	N/A	N/A	N/A
Maryland (AU)	Yes	<u>179 total</u> 75 retailers 16 growers 32 processors 8 micro-retailers 24 micro-growers 24 micro-processors	4,591,262	1:61,217	N/A
Michigan (AU)	No	N/A	N/A	N/A	N/A
New Mexico (AU)	No	N/A	N/A	N/A	Regulators have the authority to stop issuing licenses in the case that

					"market equilibrium is deficient." Local governments cannot ban cannabis businesses in their jurisdiction.
New Jersey (AU)	Yes*	N/A	N/A	N/A	New Jersey law allows for the Commission to impose a license cap, except for cultivators. New licenses can be issued on the basis of meeting consumer demand and displacing the illicit market.
New York	Yes*	N/A	N/A	N/A	New York law allows for the Board to adopt license caps if needed.
Oklahoma (Med)	No	N/A	N/A	N/A	N/A
Oregon (AU)	No	N/A	N/A	N/A	Oregon placed a 27-month moratorium on cannabis licenses, effective from January 2022 through March 2024. Local governments can cap the number of licenses issued within their jurisdiction.
Virginia (Med)	Yes	5*	6,821,532	1:1,364,306	N/A
Washington (AU)	Yes	556 retailers	5,884,735	1:10,584	N/A

* Indicates vertically-integrated establishments.