We Are Nearing the End of Cannabis Prohibition

If the history of alcohol regulation is any guide.

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One constant in history is the law of unintended consequences. As we've learned from hemp's legalization via the 2018 Farm Bill, and with the ongoing push for federal legalization of recreational cannabis, the end of prohibition will not come in one mighty roar, but as a series of regulations that legitimize markets and create entrepreneurial opportunities, as well as tough entry barriers. Simply put, regulation changes everything.

As a relevant case study, we can take a look back at the end of alcohol prohibition. In 1933, Congress passed the 21st Amendment that brought an end to the era of national prohibition of alcohol in America. But the law that repealed national prohibition did not immediately force legalization of the production and distribution of alcohol in every state; Mississippi was dry until 1966. States created their own frameworks for alcohol. One of the consequences of this heterogeneous (yet intensely regulated) marketplace was that it ultimately rested in the hands of a few, and multigenerational fortunes were made.

Competition from small businesses didn't seem possible until the more recent craft brew revolution, and all thanks to the Carter administration's legislation that brought homebrew businesses into existence in 1978. After a gap stretching over

four decades, there was a sudden disruption in this market. Unsurprisingly, the “big alcohol” companies have been feverishly acquiring craft breweries, allowing them to re-consolidate their market shares. During that long period, byzantine regulation of alcohol made competition from smaller players nonexistent, and the current trend in cannabis regulation may be paving a similar path.

Related: Hemp and Cannabis Leaders Weigh In on the Farm Bill

It’s a state issue

The end of green prohibition is being led by individual states, as opposed to the federal government, with each piggybacking off precedent platforms, like Colorado’s five-year-old experiment. The Centennial State, which is known for being friendly to producers and consumers, has taken a pragmatic and practical approach to cannabis regulation. The result has been positive from a revenue, tourism and employment standpoint.

But California, the world’s largest cannabis market, has regulated it to a greater extent, choosing to heavily tax an already tax-inefficient sector (cannabis companies, for example, cannot write off traditional expenses). This approach has softened some of the potential for the cannabis market in California, lowered valuations and has shuttered doors on many cannabis brands and operators. As an unintended consequence, such an aggressive stance seems sub-optimal, and will likely result in diminishing returns to rent capture by the state and the continuation of a black market exporting excess production.

Meanwhile, consumers face higher prices and, due to ongoing consolidation, fewer choices. Until cannabis is a federally legal commodity, brands born in states that slowly legalize the plant will find it very difficult to gain economies of scale by entering other markets without acquiring their way

in, while burning cash every day just to sustain operations.

Hemp is a different story. Now that it is federally legal, investment interest in its main derivatives, like CBD, has exploded. Interestingly enough, the less fun but just as medicinal hemp strain has the potential to become a more valuable and competitive commodity where legal barriers subside and demand increases globally. Still, many of these companies can't market on Instagram or even bank with Chase. Despite hemp's legality, e-commerce is difficult because of lack of payment processors willing to work with CBD, even if it is derived from legal hemp. Companies on both sides of the THC and CBD fence are going to have to evolve and adapt to ever-shifting, state-by-state regulations regardless of federal legalization. Successful companies have to be leaders of product innovation, masters at brand building and execution and friendly to institutional investors and distributors. Capturing market share early and quickly before the majors roll in will be critical for many brands across the spectrum.

Related: Planning to Be a Hempreneur? Here Is What You Need to Know.

The impact of regulation

There are still many unknowns about cannabis regulation and its overall market impact, but how will the new approaches on regulation and taxation impact other industries? For instance, "track and trace from seed to sale" applies to all agricultural, pharmaceutical and food-and-beverage products, and will be a standard and possibly unintended consequence with major ramifications. Cannabis cultivators are being asked to pay taxes on stalk weight as well as dry flower, which artificially raises prices. Will that spillover to other commodities? Cities are levying gross receipts taxes on cannabis businesses. Will that spillover to other

industries, as well?

The federal government has a lot of questions to answer. For instance, which regulatory body oversees cannabis? How will interstate commerce work and will there be international export opportunities? Is there going to be a federal framework for setting state regulations? Will cannabis ever be sold online or sold in convenience stores, like alcohol?

How much more needs to be done?

Cannabis regulation is pioneering the framework for what other industries are going to have to face and argue, but the reality is that the end of prohibition will be lengthy. Depending on where companies can position themselves (and toe the grey areas), adapting to an ever-shifting regulatory environment will be a real task. However, some lobbying will need to be done at the local level to demand treatment as a more traditional industry, because the people have spoken and the normalization of cannabis is here.

Speaking of normalization, a promising, unintended consequence of the end of green prohibition may revolve around other plants with medicinal properties. The explosion in interest (and innovation) in extracting and branding more plant-based compounds is expected to flourish in the coming years. This is especially true as markets begin honing in on extracting other previously villainized substances like Psilocybin and marketing them appropriately.

The ability to generate new intellectual property that revolves around extracting, studying and packaging plant-derived compounds for therapeutic use may be the next sweet-spot market. It will be no surprise if investors begin to get motivated to risk exploration in markets that have recently decriminalized, such as Oakland and Denver. It’s all about the ability for leaders in this space to educate and motivate legislation, for the benefit of the public and for the

economy, and the new plant-based frontier all stems from the legal cannabis generation.

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