LEGISLATIVE FISCAL ESTIMATE

[First Reprint]

SENATE, No. 3686

STATE OF NEW JERSEY
218th LEGISLATURE

DATED: JUNE 26, 2019

SUMMARY

Synopsis: Establishes program for cultivation, handling, processing, transport, and sale of hemp; repeals New Jersey Industrial Hemp Pilot Program.

Type of Impact: Annual expenditure increase from the General Fund, State revenue increase.

Agencies Affected: Department of Agriculture, Department of Law and Public Safety, The Judiciary, Department of Corrections.

Office of Legislative Services Estimate

Fiscal Impact	Year 1	Year 2	Year 3
State Expenditure Increase		Indeterminate	
State Revenue Increase		Indeterminate	

- The Office of Legislative Services (OLS) concludes that the bill will result in an indeterminate increase in annual State expenditure arising from new research, planning, administrative, and enforcement responsibilities for the Department of Agriculture (department).

- The OLS estimates that the bill will result in State revenue increases from the collection of application and licensing fees from hemp producers. The bill provides for fees to cover the cost of administering a program to cultivate, handle, process, transport, and sell hemp in the State.

- Additionally, the OLS estimates the bill will result in an indeterminate increase in sales tax, corporation business tax, and gross income tax revenue as it permits the sale of products that are not currently legally produced or sold in the State, including hemp and hemp products.

- The OLS estimates there may be recurring revenue gains from civil or civil administrative penalties associated with the bill. However, as certain violations may constitute an offense under criminal law, the bill may increase the expenditures of the Department of Law and Public Safety, the Judiciary, and the Department of Corrections for prosecuting, trying and possibly incarcerating violators.

BILL DESCRIPTION

This bill would establish a program for cultivation, handling, processing, transport, and sale of hemp to be administered by the Department of Agriculture. The bill would require the department to submit a plan for approval by the United States Department of Agriculture before hemp cultivation and processing may begin in the State. Additionally, the bill would require the department to create an approval process for hemp producers; establish a licensing, testing, and inspection program; establish an appeals process for violators; and establish procedures for the transport of hemp.

The bill would also require the department to maintain relevant information about hemp producers and the land on which hemp is grown, and to submit that information to the United States Department of Agriculture. The department would be required to develop a procedure for the testing of hemp to ensure compliance with federal law including testing by third-party laboratories and producer-owned laboratories if licensed and accredited, to effectively dispose of non-compliant hemp and hemp products, and to perform random annual inspections of hemp producers. The bill allows the department to establish application, licensure, and renewal fees in amounts that are reasonable and necessary to cover the costs of administering and enforcing the State hemp program. The department would be required to develop a corrective action plan for negligent violators of the bill, which would include periodic reports from the hemp producer to ensure compliance with a corrective action plan. If the department determines that a hemp producer has violated the bill with a mental culpability greater than negligence, the department would be required to report the violation to the Attorney General's office and the United States Attorney General's office. The bill would also give the department the authority to establish a schedule of penalties for violations of the bill with a mental culpability greater than negligence that do not conflict with federal law concerning hemp.

The bill would establish a "New Jersey Hemp Farming Fund" which would be credited with (1) all penalties and fees collected by the department pursuant to the bill; (2) moneys appropriated by the Legislature; (3) moneys made available to the department for implementing the bill, including any federal funds; and (4) any return on investment of moneys deposited in the fund. Moneys in the fund would be required to be used for the administration and enforcement of the bill.

FISCAL ANALYSIS

EXECUTIVE BRANCH

None received.

OFFICE OF LEGISLATIVE SERVICES

The OLS estimates that the bill will result in an indeterminate increase in annual State expenditures and an indeterminate increase in State revenue. The OLS cannot quantify this increase due to the unavailability of pertinent information, but estimates a net increase in State revenue.

The bill requires the department to establish a new program to regulate hemp production in the State, to submit that plan to the United States Department of Agriculture, and to engage in ongoing testing and monitoring operations. The federal "Agriculture and Improvement Act of 2018," Pub.L.115-334 (commonly known as the 2018 Farm Bill) was enacted in December 2018. The 2018 Farm Bill significantly expanded the states' ability to regulate hemp production, and legalized the production of a class of products that were previously illegal to possess or sell under federal law. This bill would direct the department to create a program to permit the cultivation of hemp in accord with the provisions of the 2018 Farm Bill.

In order to estimate the potential size of a hemp cultivation program in the State, the OLS used Kentucky, which is widely viewed as a leader in hemp production, as a comparator state. Kentucky approved 1,035 individual applications (out of 1,115 applications filed) to grow hemp in 2019, which included 42,086 acres of land and 2.9 million square feet of greenhouse space. Kentucky has an estimated 75,100 farm operations compared to New Jersey's 9,900, so if individuals in New Jersey apply to be hemp producers at a similar rate per farming operation, the department would receive 146 applications. Kentucky's approved acreage of 42,086 acres represents 0.3% of Kentucky's estimated 12,900,000 farmed acres. At a similar rate, New Jersey, with an estimated 750,000 farmed acres, may be expected to convert 2,447 acres of farmland to hemp production. This calculation does not include the fact that New Jersey farming operations are, on average, less than half the size of a Kentucky farming operation, nor does it differentiate between the different cultivars of hemp that may be grown in the State. Additionally, Kentucky's program in 2019 operated under the provisions of the 2014 Farm Bill which allowed for limited hemp pilot programs. Programs operating under the more permissive 2018 Farm Bill could be much larger. Furthermore, the number of applications to grow hemp in a greenhouse may be largely independent from the number of farming operations in the State, as a greenhouse operation does not have the same soil and climate constraints as a typical farming operation. Further, there may be more applications due to the increased interest in hydroponic growing in the State.

In addition to authorizing the cultivation of hemp, the bill would allow persons to process raw hemp into hemp products. The number of applicants to process hemp is also difficult to estimate, as there are many factors that could increase or decrease the attractiveness of the State to host hemp processing, as with any manufacturing. New Jersey's location, seaports and airports, access to international markets, and well-educated labor force make the State a potentially attractive location for receiving raw hemp materials for processing into hemp products. However, the relative cost of land in the State, the cost of living and wages, and distance from larger agricultural production areas in other states might also decrease the number of applicants to engage in the processing of hemp. Kentucky received a total of 109 new and renewal applications for hemp processors in 2019. Under the assumption that acreage of hemp roughly equates to the number of expected processing applications (1 processor for every 386 acres of hemp), the OLS estimates the State may expect 6 applications for hemp processing, using the assumption that the State may grow 2,447 acres of hemp. Combined with the potential number of hemp cultivation applications, the OLS estimates the State may expect a total of 152 applications for hemp cultivation and processing in the short term, subject to changes as the market matures.

The department will incur initial administrative costs to develop the rules and regulations necessary to implement the provisions of the bill and to submit the rules and regulations to the United States Department of Agriculture. However, the bill provides a mechanism for the program to be revenue neutral over time. The bill explicitly provides that the department may charge application and licensing fees that are reasonable and necessary to cover the costs of administering and enforcing the State hemp program.

The OLS also estimates that there may be an increase in the revenue generated by the corporation business tax, the individual income tax, and the sales tax; however, the amount generated by each of these sources is difficult to estimate. By most measures, the demand for hemp products is growing; reports from the hemp industry estimated a total of $700 million in United States sales in 2016. Hemp products valued at $67 million were imported into the United

States in 2017, which represents a particular area of opportunity for domestic production pursuant to the expanded cultivation programs under the 2018 Farm Bill. Whether the net tax revenue is realized in the corporation business tax, gross income tax, or sales tax will largely depend on the corporate structure of the entities that choose to produce hemp, and the transactional structure of taking hemp from raw materials to market.

A person may not choose to produce hemp over another crop unless that person believes that hemp is a more profitable option. The viability of the hemp market in the State is subject to factors including the price of the commodity on the regional, national, and international market, and environmental factors that may make the product easier or more difficult to grow. Additionally, whether a person grows hemp in New Jersey depends on factors such as the expected yield of hemp cultivated in New Jersey's climate and soil conditions compared to another crop, the price and demand for hemp products, and the individual cultivar and cultivation technique that a person employs. New Jersey growers will also compete with other states' growers as well as growers from France and Canada which already have robust hemp production industries. Without additional data, it is difficult to determine if the State has any relative climate and soil advantages or disadvantages compared to other production areas.

The OLS expects a modest increase in sales tax revenue; however, the net impact is also difficult to gauge. Many types of hemp products (i.e. those made from stalks and non-germinating seeds of hemp) have been legal to sell in the State for many years, despite the fact that growing the hemp plant itself remained illegal. With the increased availability of raw hemp as a result of the changed regulatory structure, the relative costs of manufacturing a product similar to the ones already available for sale in the State is likely to decrease, so one may expect a modest increase in amount of hemp product sales. However, it is unclear if the purchase of these products would be in substitution of other products not containing hemp, or if it represents a more fundamental shift in demand.

Additionally, the State may expect a modest revenue increase from the sale of newly legal products, however this is also difficult to estimate. The bill would legalize the sale of products made from all parts of the hemp plant, not just the non-germinating seeds and stalks as is the case under present law. This includes the legalization of cannabinoids such as cannabidiol (CBD). The increased economic activity attributed to the bill itself is difficult to measure, in part due to the fact that CBD is already widely available for sale in the State at businesses that are likely to be charging sales tax (as opposed to fully illegal markets where no tax is collected). While the explicit legalization of CBD at both the State and federal level is likely to convince some concerned business owners and consumers to enter the market for CBD, it is not clear how much of the total demand for CBD in the State is already met by the presently illegal sales of the product. Additionally, the federal Food and Drug Administration (FDA) has maintained that the addition of CBD to food and animal products violates federal law, despite the widespread marketing of CBD intended for ingestion. While there has not been wide scale enforcement of this prohibition, the FDA has undertaken some enforcement actions, including against New Jersey businesses advertising alleged medical applications of CBD that have not been approved by the FDA. The FDA is presently evaluating its treatment of CBD, and exploring potential pathways for dietary supplements and conventional foods containing CBD to be lawfully marketed. There are many purported health benefits of CBD, and the chemical has the potential to become a part of the pharmaceutical industry. However, at present, the state of the CBD market is legally uncertain at best. The State's legalization of CBD pursuant to this bill, if matched by a concomitant opening of the market by the FDA would be likely to increase sales tax revenues for CBD product sales, and may increase other sources of State revenue by increasing the amount of CBD processed in the State. However, if enforcement increases against CBD retailers, revenues could decrease from their present levels.

Finally, the bill allows for the collection of civil or civil administrative penalties resulting from violations of the bill, to be deposited into the "New Jersey Hemp Farming Fund" created by the bill, which will result in an indeterminate increase in revenue. However, the OLS notes that money in the fund is to be used for the administration and enforcement of the bill, and it is possible that the penalties collected on behalf of the department would be used to offset other costs of the program.

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This legislative fiscal estimate has been produced by the Office of Legislative Services due to the failure of the Executive Branch to respond to our request for a fiscal note.

This fiscal estimate has been prepared pursuant to P.L.1980, c.67 (C.52:13B-6 et seq.).