



Can Revenue from Legalized Recreational Marijuana Help States Close Budget Gaps?

By: [Jeff Chapman](#), Projects: [State Fiscal Health](#)

Voters in Arizona, Montana, New Jersey, and South Dakota on Nov. 3 legalized recreational marijuana in their states, joining 11 others that already allow regulated use and sale of the drug.

Policymakers in these states pitched legal cannabis in part to bring in much-needed revenue. For example, in New Jersey, Governor Phil Murphy (D) [said](#) the money would “help fund critical priorities like education and infrastructure.” But tax revenue from marijuana has proved uncertain in normal times, and pandemic-driven economic disruptions and consumer behavior shifts may only add to that uncertainty.

As a result, New Jersey and the other states where recreational marijuana is now legal should examine this new tax source—and other budget-balancing actions to be taken during this recession—with both a short- and long-term perspective to help ensure a sustainable fiscal future.

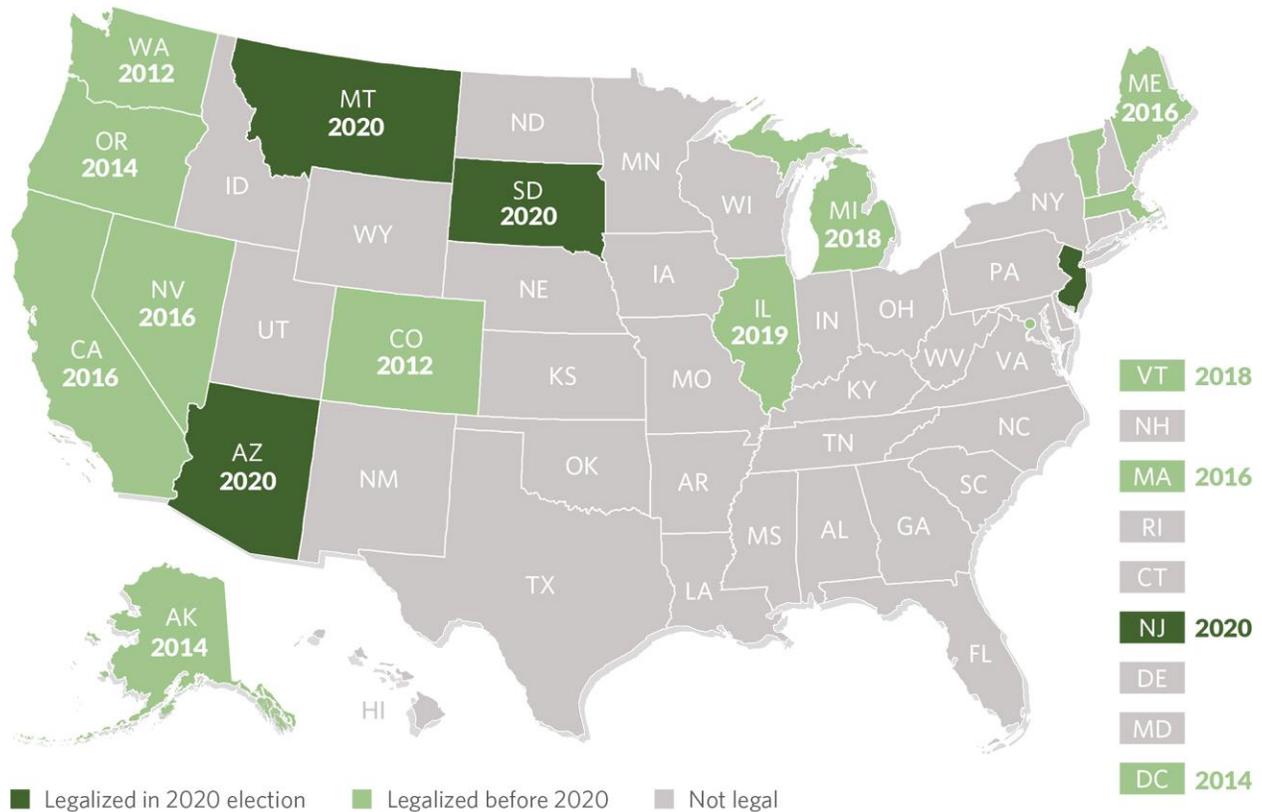
The coronavirus pandemic has created large budget shortfalls in many states, causing some to search for new revenue sources. In the four that just legalized recreational marijuana, projected revenue losses for fiscal year 2021 [range](#) from 2% below initial forecasts in Arizona to 16% in New Jersey. The extent to which this new revenue source can help close those gaps remains unclear.

One of the challenges of legalized recreational marijuana is that the tax revenue is [difficult to forecast](#) because of the lack of historical data. Even Colorado and Washington, the first states to begin legal marijuana sales in 2014, have only a few years of data on which to base projections. (See Figure 1 for details on which states have legalized marijuana and when.)

Figure 1

15 States and the District of Columbia Have Legalized Recreational Marijuana

On Nov. 3, voters in Arizona, Montana, New Jersey, and South Dakota approved the legal use and sale of cannabis



Note: The District of Columbia has legalized recreational marijuana use but not sales.

Sources: National Conference of State Legislatures, "Marijuana Laws," <https://www.ncsl.org/bookstore/state-legislatures-magazine/marijuana-deep-dive.aspx>, and Pew analysis of state ballot measures

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This uncertainty may be compounded by the recession, the first to hit since the sale and use of recreational marijuana has been legal in any state. Although revenue forecasters have historical data on sales and excise taxes for other goods over the business cycle, this is not true for recreational marijuana, which was first legalized well after the official end of the Great Recession more than a decade ago. The 2020 downturn—driven by a disease that has prompted significant shifts in individual behavior—could prove especially difficult for forecasters trying to predict how much states could collect in marijuana taxes.

In addition, states' experiences so far suggest that the initial years may be the most volatile as supply tries to meet demand. Recreational marijuana may provide a burst of revenue upon introduction, but policymakers should not expect consistent growth over the long term. In Colorado, for example, revenue has been volatile in recent months, in large part because of the disruption to the state economy caused by the pandemic. April usually brings an uptick in marijuana revenue, but this year tax collections were down 2% over the previous month. In the following months, however, the state has seen [record-breaking](#) revenue. It is unclear whether this spike is temporary and related to the recession or part of a longer-term trend.

Policymakers can hedge against the uncertainty and volatility of marijuana revenue by budgeting it cautiously. They can put the money toward savings, for example, or spend it after it is collected. If states are considering using the funds for ongoing spending priorities that require sustainable revenue streams, they should be careful about relying too heavily on marijuana taxes. Understanding the short- and long-term effects of budget balancing actions such as these can help officials make decisions that put their states on sound fiscal footing for years to come.

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