FROM LAZY TAX POLICY TO ECONOMIC GROWTH – NEW APPROACHES TO ONTARIO'S ALCOHOL TRADE

David McGown

Ontario's such a respectable place,
Drinking's no crime, but it's still a disgrace[1]

Introduction

The Economist magazine coined the term "Dutch Disease" in 1977 to describe the unintended consequences for a country of an all-too-easy economic reliance on an abundance of natural resources. Unintended consequences could include a rise in exchange rates or a shift in investment away from more diversified opportunities. Think for a moment about the "diversification" debate that has raged in Alberta for decades. It has always been easier to extract another barrel of petroleum.

Shifting the lens from natural resources to the regulation and taxation of alcohol, Ontario could be said to have the tax equivalent of "Dutch disease." Let's call it the "Calvinist disease."[2]

Calvinist in that it celebrated the willing embrace of regulation and taxation to restrict the sale and consumption of alcohol in Ontario. Regulation limited the times and places where alcohol could be purchased. Taxation increased its cost; a "sin tax" is always an easy way for governments to raise revenue. Rather than encouraging beverage alcohol's contribution to economic growth, and more precisely, to regional economic development, alcohol became a cash cow for the provincial treasury.

The most recent data? The $2.4 billion "dividend" paid by the LCBO into the provincial coffers in 2021 equates to some 13% of the revenue that the Ontario government raises from corporations. It has made for "lazy" tax policy.

After more than one hundred years of trying to balance "less" alcohol with "more" tax revenue, in 2025 Ontario will have an opportunity to recalibrate the province's beverage alcohol industry. The window of opportunity is the 2025 expiration of the "Master Framework Agreement" (MFA) negotiated in 2015 between the government of Ontario and the owners of the Beer Store (TBS).

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1 MacKay, Louis Alexander, "Frankie goes down to the corner," The Ill-Tempered Lover, and Other Poems, Toronto, Macmillan. 1948, p. 47.

2 As a preacher's kid, I know from where I speak...

munk school
OF GLOBAL AFFAIRS & PUBLIC POLICY

In mid-2023, the re-elected Ford government will have to inform the three foreign, majority owners of the Beer Store whether the MFA will be amended, extended, or allowed to expire.

Expiry of the MFA would be the necessary first step towards significant regulatory change that will benefit the Ontario economy, the beverage alcohol industry, and Ontario consumers.

Root causes of Ontario's Calvinist disease

Buried somewhere in a box is my mother's frayed membership card for the Canadian Woman's Christian Temperance Union. A Scots-Presbyterian and minister's wife, she would have signed up long after Ontario brought prohibition to an end in 1927. But her lifelong refusal to use alcohol is illustrative of one traditional perspective on the limitations that Ontario imposed on the sale and consumption of alcohol.

There are two competing narratives regarding Ontario's enthusiastic embrace of liquor regulation.

The first is about the social ills of alcohol and its effect on the family and communities. It emphasizes the political influence of "moral majorities" that influenced politics and resulting policies that led up to prohibition in 1916 and other restrictive measures in the decades that followed.

The second stresses that the regulation of alcohol in Ontario is grounded in political and financial incentives. Liquor licencing was initially the purview of municipal governments and was a source of revenue and an opportunity for local patronage. Brock University professor Dan Malleck notes that the shift to provincial regulation of alcohol in Ontario evolved in earnest after 1876, the year that then-Liberal Premier Oliver Mowat centralized the liquor licencing regime.[3] After 1876, it became an opportunity for provincial revenue and political patronage.

Former Supreme Court Justice Morris Fish titled his 2011 F.R. Scott lecture at McGill University "The Effect of Alcohol on the Canadian Constitution…Seriously." In it, he detailed the important role of liquor disputes as federal and provincial constitutional jurisdiction evolved.[4] He highlighted Premier Mowat's 1876 Crooks Act that transferred liquor licencing to the provincial government from municipalities as a case study of how the province would award liquor licences as a patronage opportunity.[5]

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3 Malleck, Dan, "Why Doug Ford should think twice about changing booze and weed law,". The Conversation, August 15, 2018. https://theconversation.com/why-doug-ford-should-think-twice-about-changing-booze-and-weed-laws-101249.

4 Fish, The Honourable Morris J. "The Effect of Alcohol on the Canadian Constitution…Seriously. F.R. Scott Lecture," McGill Law Journal, V. 57. No.1, September 2011. p. 195.

5 Ibid. p 199.

Whatever the root cause, the circumstances might be summarized as “too many bottles chasing too few drinkers.” In the nineteenth century, low prices (caused by incentives to over supply municipal liquor licences) and public drunkenness (economically incented or morally caused) were seen to be a problem of such consequence that provincial intervention was necessary.[6]

This interventionist sentiment ultimately led to the province introducing the Ontario Temperance Act in 1916, intended to limit the sale and consumption of alcohol during WWI. Two referendums, in 1919 and 1921, entrenched Ontario’s commitment to prohibition, if one defined it as limiting the ability of Ontario citizens to consume alcohol. The manufacturing of alcohol was never prohibited, leading to cross-border trade (more accurately smuggling) to the U.S., nor did the Ontario government want to destroy the province’s grape growing industry, and so native wines were also exempt from the provisions of the Temperance Act.[7]

Canadian historian and columnist Christine Sismondo notes that it was Conservative Premier Howard Ferguson who ended Ontario’s brief fling with prohibition and introduced legislation to establish the Liquor Control Board of Ontario. This 1927 change also left the Premier happy with the prospect of a 10-cent-a-gallon beer tax that was estimated to add $3 million to provincial coffers.[8]

Almost 100 years later, Ontario alcohol policy has remained focused on regulation and taxation, limiting where alcohol can be purchased, focusing on tax revenues from sales, and placing little or no importance on the contribution Ontario’s distillers, brewers, and wineries can make to the provincial economy.

Successive Ontario governments have, of course, tried to introduce reforms over the past several decades. Most recently, the current Progressive Conservative government promised “buck-a-beer”, tailgate parties, and beer and wine in corner stores. They engaged a former Alberta MP, Ken Hughes, as Special Advisor for the Beverage Alcohol Review.

Hughes noted in his 2019 report that “since the 1960’s there have been no less than seven special reviews trying to fix [alcohol regulation].”[9]

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[6] The author would like to thank Dr. Malleck for his time in sharing his perspectives on Ontario’s history and experience with alcohol regulation.

[7] Hallowell, Gerald A., Prohibition in Ontario, 1919-1923. The Ontario Historical Society. 1972. p x.

[8] Sismondo, Christine, “Why can’t Ontarians buy booze in corner stores?”, Macleans, May 24, 2019. https://www.macleans.ca/opinion/why-cant-ontarians-buy-booze-in-corner-stores-blame-the-surveillance-state/.

[9] Report to the Minister of Finance, Ontario Special Advisor for the Beverage Alcohol Review, The Case for Change: Increasing Choice and Expanding Opportunity in Ontario’s Alcohol Sector, May 2019. https://www.fin.gov.on.ca/en/alcohol/report-may2019.html.

The challenges to reform remain significant. They include:

i) International trade commitments that significantly limit government's ability to favour local producers,

ii) Restrictive covenants included in the current Master Framework Agreement,

iii) Continued provincial barriers to inter-provincial trade, and

iv) A provincial government that incents growth in tax revenue over economic growth.

But, at a time when the province struggles with slow economic growth, Ontario could incent innovation in its beverage alcohol industry that would lead to stronger provincial and regional economic development.

The Industry's Present Contribution

Statistics Canada estimates that $25.5 billion worth of alcoholic beverages were sold in Canada in the year ending March 31, 2021, a year over year increase of 4.2%. Of this, net income and other government revenue totaled $13.5 billion, a year over year increase of 5.2%.

In that same year, Ontario sold a total $9.6 billion of alcoholic beverages. Of this amount, $2.4 billion of sales were made through non-government retail outlets. Another $7.1 billion was sold through government liquor and agency stores and these sales generated an estimated $2.6 billion in HST, excise and other provincial taxes.[10]

Each of Ontario's beverage alcohol sub-sectors estimates its contribution to the Ontario economy differently. But it is an industry that in overall terms contributes billions in GDP to the province's economy and supports thousands of jobs.

A breakdown for each sector follows.

Distillers

A 2019 study by the Canadian Centre for Economic Analysis (CANCEA) concluded that Ontario distilleries produce over half of the value of Canadian spirits production, contribute some $500 million to provincial GDP, represent over 4,600 jobs in manufacturing and related industries, and yield exports of $440 million, or 74%

[10] Statistics Canada, Sales of alcoholic beverages by liquor authorities and other retail outlets, by type of outlet (x 1,000). https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1010001301.

of Ontario's total production.[11] It is, in fact, the only beverage alcohol sector where exports are a significant part of the business model. The distillery industry is a significant contributor to local economic growth and to rural job creation, purchasing over $50 million in local agricultural products a year.

In 2018, Ontario received an estimated $344 million in sales taxes and LCBO markups from spirit sales.[12] In a second study, CANCEA estimates that if Ontario could increase its spirits exports by 25%, it would add over $100 million to provincial GDP and create an additional 9,500 jobs.[13]

Wineries

In 2015, Ontario's wineries contributed over $4 billion in direct and indirect economic benefits (revenue, taxes, wages) to the Ontario economy. The industry directly employs almost 11,000 workers in the wine and related (tourism, restaurant, vineyard supply) industries and represents an additional 7,500 indirect and induced jobs. A 2017 economic impact study suggested that for every $1 spent on Canadian wine in Ontario, almost $4 of GDP is generated, which is an impressive multiplier. The number of Ontario wineries increased to 191 in 2021 from 161 in early 2016. Ontario grape growers produced 51.4 thousand tonnes of wine grapes in 2015 valued at $63.5 million.[14] Vintners Quality Alliance Ontario (recently rebranded as the Ontario Wine Appellation Authority) estimated that some 31 thousand tonnes of Ontario grapes were used to produce Ontario VQA wines that same year.[15]

Wineries contributed an estimated $233 million in LCBO markups plus an additional $258 million in provincial tax revenue in 2015. (A 2022 study updating this data is expected to be released in the coming weeks).

Breweries

The Conference Board of Canada estimated in 2016 that the "beer economy" (direct, indirect, and induced benefits) contributed over $5 billion to Ontario's GDP, $1.9 billion in employment income, and supported 52,435 jobs. The study estimated that $1.3 billion in taxes went to the Ontario government.[16] The number of Ontario breweries grew to

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[11] Canadian Centre for Economic Analysis, Research Report: Economic Contributions of distilled spirits manufacturing in Ontario, August 2019, p 2.

[12] Ibid. p 15.

[13] Canadian Centre for Economic Analysis, Research Report: Opportunities and Risks for Distilled Spirits Manufacturing in Ontario, September 2019, p.4.

[14] Grape Growers of Ontario, Annual Report 2016. p. 12.

[15] VQA Ontario, Annual Report 2016. p. 14.

[16] Conference Board of Canada, Brewing Up Benefits: The Economic Footprint of Canada's Beer Industry, January 2018, p. 9.

360 in 2020 from 180 in 2015. Domestic beer sales were essentially flat over that same five-year period. In 2020, over 80% of total beer sales in the province were domestic.[17]

Cideries

A 2021 study prepared by MNP for the Ontario Craft Cider Association estimates that there were 70 craft cideries in the province in 2020. The industry created some 240 direct and 104 indirect jobs and generated $36 million in revenue. It estimates that the Ontario cider industry generated $23 million in direct and indirect contribution to provincial GDP.

Sales forecasts (based on consumer trends) suggest that cider sales could grow by almost 90% in the next three years, leading to an increased GDP contribution of $43 million and an increase in direct employment to 455 full-time equivalents.[18]

Increasing Access for Ontario consumers

Ontario consumers today have more access to their favourite beverage than at any time since the mid-nineteenth century and it continues to grow, if from a relatively low base.

In his F.R. Scott lecture, Justice Fish noted that, back in the day, "the number of taverns per-capita, by today's standards, is astounding. In 1830's Saint John, New Brunswick had one tavern for every 50 people. Toronto, one for every 119 … Montreal lagged far behind at one for every 258."[19]

In a 2019 study, the Retail Council of Canada reported that Ontario had 2,702 retail sales locations where one can purchase alcohol.[20] Still, in a country that has, on average, 5.9 liquor outlets per 10,000 residents, Ontario has just 2.4. If only to bring Ontario up to the national average, Ontario would have to add over 4,000 locations.

In 2021, the LCBO counted 2,924 government and private retail sales outlets.[21] There is something of an urban-rural divide in terms of retail access. Ontario consumers could choose among 677 government-run LCBO stores and 399 LCBO "convenience outlets" in smaller communities. In 2020/2021, the LCBO took in $17 billion in revenue. After expenses, it returned some $2.4 billion as a "dividend" to the Ontario treasury. The LCBO sells over 28,000[22] different domestic and imported products.

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[17] Beer Canada, Ontario Data, https://industry.beercanada.com/statistics/ontario.

[18] Ontario Craft Cider Association, Economic Impact Analysis of the Ontario Craft Cider Industry – 2021 Update, October 2021,p 3-5.

[19] Fish, p 195.

[20] Retail Council of Canada, Retail Perspectives – Alcohol in Ontario: Choice and Convenience means Jobs and Growth, Spring 201,. p 1.

[21] LCBO Annual Report, 2020-2021, p 29.

[22] LCBO, About the LCBO. https://www.lcbo.com/content/lcbo/en/corporate-pages/about.html.

With regards to beer sales, there are 450 grocery stores that now sell beer although fewer than half also sell Ontario wines and ciders. As for wine, Ontario wine is also sold through 292 private wine stores under the name Wine Rack/Wine Store, although some are counted in the 450-grocery channel.

(The private wine distribution channel was a growing part of Ontario wine sales outlets in the 1980s. The 1988 Canada/US Free Trade deal capped these private wine stores as they sold only Ontario wines. These "legacy" retail outlets are protected from legal challenge as long as Ontario does not increase their number. This retail network of trade-protected private wine stores may offer future benefits for the broader distribution of Ontario wines.)

Established in 1927, the Beer Store (TBS) was designed as a single network of stores owned by Ontario brewers to limit where Ontario drinkers could purchase beer. Today, at 424 stores[23], ownership is split among the Canadian subsidiaries of three global brewers – Coors Brewing Co. (Molson's 51%), Anheuser-Busch InBev SA (Labatt 45%) and Sapporo Breweries Ltd. (Sleeman 4%). TBS, as of 2021, accounts for some 63% of all beer sales in Ontario[24] and has the exclusive right to sell beer in 12 and 24 packs.

Spirits, wine, beer, and cider can also be purchased directly from the manufacturer, through ecommerce or sales at an on-site store. In 2021, there were over 600 of these "on-site" retail outlets.[25] Breweries, wineries, and cideries each benefit from lower tax rates on their products sold through their on-site retail outlets than in the LCBO. Ontario distillers receive no similar tax benefit.

More recently, the Ontario government, mid-pandemic, permitted restaurants to sell beer and wine with take-out meals. These so-called "bottle shops" were a financial lifeline for many restaurants dealing with significant reductions in cash flow during lock downs. In December 2020, Ontario announced that these changes would be made permanent. There is, as yet, no official estimate on the number of these newly established retail outlets.

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23 TBS, 2021 Operations Report, p. 4.

24 LCBO, Annual Report 2021, p 30.

25 Ibid. p 29.

Policy Reforms From 2000 To Today

The 2000 Beer Framework Agreement established how the LCBO and the Beer Store would divide up the Ontario beer market for consumers and restaurants.[26] It gave TBS a monopoly on the sale of beer in 12 and 24 packages and on the sale of beer in volume to restaurants. It also provided a set of rules for how the two outlets would divide retail beer sales in smaller municipalities.

More recently, further structural changes were made in a 2015 Master Framework Agreement (MFA) that was the product of the Premier's Advisory Council on Government Assets established by then-Premier Kathleen Wynne and chaired by former TD Financial CEO Ed Clark. "*Striking the Right Balance: Modernizing Beer Retailing and Distribution in Ontario*" recommended grocery store sales of beer, wine, and cider.[27] It placed a ceiling of 450 on new grocery store outlets that could be established in Ontario. It provided for financial compensation to TBS owners should the Ontario government breach its commitments.

Acting on the recommendations of the Hughes Report, in 2019, the new Ontario government led by Premier Doug Ford introduced its "*Bringing Choice and Fairness to the People Act (Bill 115)*" that proposed to terminate the MFA, limit financial penalties, and expand distribution for the sale of beer to convenience stores, big-box retailers, and more grocery stores. However, as the bill was being debated, the cost of termination was estimated to be as high as $1 billion.

Unions representing the Beer Store also spoke of the loss of 7,000 jobs. The owners of the Beer Store emphasized the uncertainty that the business community would face if governments walked away from contractual obligations and threatened legal action. The bill was passed by the Ontario legislature, but it has never come into force.

As things stand, the MFA will terminate in September 2025, at the end of its 10-year term. But, no later than September 2023, the Ford government is obliged to provide the signatories of the contract with notice of its intent to extend, amend, or simply allow the contract to expire.

The expiration of the MFA would be an inflection point for Ontario; an opportunity to rethink how the province wants to regulate the sale and distribution of alcohol.

It would offer an opportunity to shift Ontario's long-standing perspective on beverage alcohol from that of a generator of tax revenue to one of economic growth, regional economic development and increased consumer choice.

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[26] BC Liquor Law, Hughes v. Liquor Control Board of Ontario: 2000 Beer Framework Agreement. http://www.bcliquorlaw.com/hughes-v-liquor-control-board-of-ontario-2000-beer-framework-agreement/.

[27] Province of Ontario, Striking the Right Balance: Modernizing Beer Retailing and Distribution in Ontario, April 2015. https://www.ontario.ca/page/modernizing-beer-retailing-and-distribution and Striking the Right Balance: Modernizing Wine and Spirits Retailing and Distribution in Ontario, February 2016. https://www.ontario.ca/page/striking-right-balance-modernizing-wine-and-spirits-retailing-and-distribution-ontario#section-4.

Implications for bottle recycling in a post-MFA province

The agreement known as the Ontario Deposit Return Program (ODRP) or the "Bag it Back" program, covers the deposit and return of all wine, spirit, cooler and beer containers sold through the LCBO and private wine retail stores. This deposit return regime in 2021 delivered recovery rates of 72%. TBS operates this program in parallel with its own bottle recycling program first established in 1927.

Would the expiration of the MFA put ODRP at risk? The answer is likely not in the short term.

First, TBS has a market share of some 63% of total beer sales in the province. When the ODRP was established in 2007, TBS controlled just over 80% of the total beer market in Ontario. Even with the protections offered by the MFA, its market share has dropped by 17 percentage points. The removal of its monopoly on the sale of beer in 12 and 24 packs and the removal of the limitation on beer retail outlets will not result in an immediate change in consumer behaviour. TBS revenue is not likely to materially decline in the short term.

In addition, ODRP requires TBS to collect the eligible, recyclable material that consumers and commercial customers return. They receive 10.81 cents per unit from the LCBO as a processing fee for this service. In turn, TBS sells a percentage of these products to a third-party recycler. In 2021, TBS earned $87 million in revenue from its recycling program or some 20% of its total annual revenue.

As consumer beer retail preferences shift, TBS may in fact close some of their retail outlets. As its distribution network shifts, TBS as a recycling depot may become less convenient for consumers and Ontario may choose to consider other options than ODRP.

One option would be to eliminate the deposit program entirely and encourage Ontario consumers to redirect these products into the province's blue box program.

One other alternative would be to require the producers of beverage alcohol products to establish a recycling regime consistent with Ontario's new blue box regulatory regime that is based on the principle of "individual producer responsibility (IPR)". IPR requires producers to be responsible and accountable for collecting and managing their products and packaging after consumers have finished using them. Alternatives established by Ontario's Resource Recovery and Circular Economy Act, 2016 include producers collecting and recycling products and packaging themselves or establishing or contracting with producer responsibility organizations (PROs) to help them meet the new requirements.

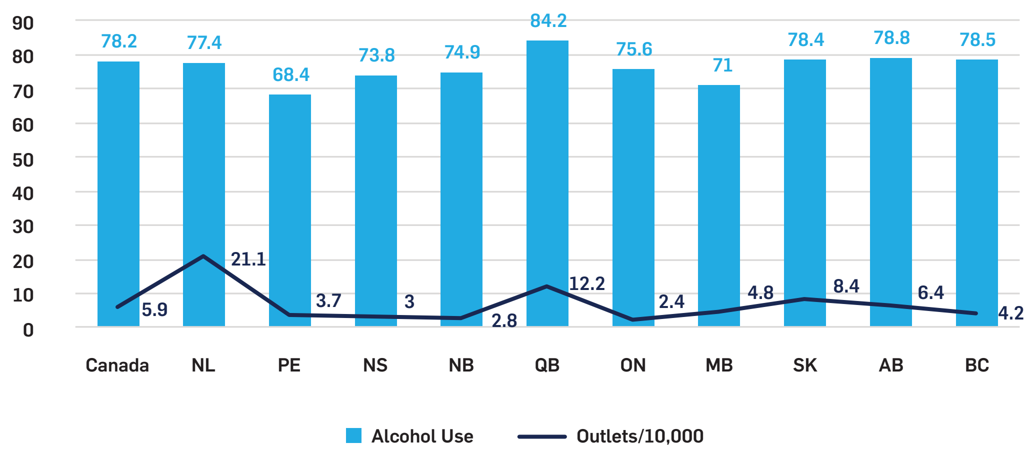
While the current ODRP is an effective and efficient regime, other options are available to producers and consumers that could meet market expectations on both recovery rates and on producer responsibility.

Future Policy Steps

Were Ontario to "reform" its beverage alcohol industry, it would also need to consider unintended consequences on public health. The Canadian Centre on Substance Abuse and Addiction notes that "self-reported alcohol use" across Canada in 2017 ranged from a low of 68% in PEI to a high of 84% in Quebec, with the eight remaining provinces sitting between 70% and 80%.[28]

Cross referencing this to the number of outlets per capita[29], there does not appear to be a correlation between self-reported "use" and the number of alcohol sales outlets. While this data point, in isolation, does not fully reflect underlying concerns over alcohol consumption and public health, an expansion of retail outlets might not be a significant factor in this debate.

Figure 1: Self-reported alcohol use vs. retail outlets per 10,000



More broadly over the years, ambitious reform agendas have been proposed, including the sale of the LCBO.

[28] Canadian Centre on Substance Abuse and Addiction, Canadian Drug Summary, Summer 2019, p 6.

[29] Chart # 5 in Report to the Minister of Finance, Ontario Special Advisor for the Beverage Alcohol Review, The Case for Change: Increasing Choice and Expanding Opportunity in Ontario's Alcohol Sector, May 2019. https://www.fin.gov.on.ca/en/alcohol/report-may2019.html.

The beverage alcohol industry in Ontario is, however, characterized not only by four very different sectors, but also by significant differences in business models in firm size. To corral that industry onto one page and to encourage the Ontario government to significantly shift its regulatory and tax policy direction would likely result in no change at all to Ontario's beverage alcohol regime.

Less ambitious, more practicable reforms could be supported by each of the beverage alcohol sectors and by the Ontario government and would establish the foundation for stronger economic growth.

A suite of four policy changes would help to counter the tax and regulatory morass that Ontario's "Calvinist disease" has fostered over the past century or more. These proposed changes would incent Ontario's beverage alcohol industry to grow and innovate and would shift government's focus from tax revenue alone to the benefit the industry could provide to economic growth and regional development.

First, inform the MFA signatories that the Province will permit the contract to expire in 2025. At the end of the term, the sales and distribution restrictions agreed to by the Ontario government will no longer be applicable.

Ontario can then increase the number of grocery stores that can sell beer and wine, providing more retail choice for consumers. As nothing limits Ontario's ability to permit spirit sales in grocery stores today, this would also be an opportunity to permit distillers access to grocery distribution.

A 2019 Abacus Data poll found that almost 70% of Ontario respondents were satisfied with the selection and shopping experience for grocery retail sales.[30] But 60% of those same respondents supported the sale of spirits in grocery stores.

TBS has an almost 100-year history of selling beer to Ontario consumers. It has a market share of some 63% of total beer sales in the province. The removal of its exclusive right to sell beer in packages of 12 and 24s might affect its sales over time. If, however, TBS provides Ontario beer drinkers with the service and convenience they want at TBS locations that will balance the removal of monopoly rights. As a private (and foreign) owned sales channel, that is likely in the best interest of Ontario brewers, consumers, and the Ontario economy.

With the emergence of "bottle shops" in the Ontario marketplace, Ontario consumers now have greater choice and convenience. The need to expand distribution to convenience stores would no longer be required.

[30] Abacus Data0, Beyond the LCBO? Broad Support for Liberalizing Alcohol Sales in Ontario, February 2019. https://abacusdata.ca/beyond-the-lcbo-broad-support-for-liberalizing-alcohol-sales-in-ontario/.

Second, do not privatize the LCBO. Within the limitations of Canada and Ontario's trade obligations, the LCBO should ensure that it delivers on its mandate to "promote local Ontario products."

The LCBO should retain its role as the "box-store of choice" for the sale of alcohol in the province. That same Abacus Date poll probed consumer perspectives on the LCBO. It found that 40% of respondents shop regularly/occasionally at the LCBO. Over 80% of shoppers were satisfied with the selection. It seems to meet customer expectations, in other words. The expiry of the MFA would permit, but not require, the LCBO to sell beer in 12 and 24 packages.

The Minister of Finance, in his 2020/21 mandate letter to the LCBO, notes that the LCBO has a responsibility to "shape a more sustainable Ontario by promoting local Ontario products."[31] The LCBO does make efforts to support Ontario products, but in a world where government action is constrained by international trade agreements, the Ontario government and the LCBO can still do far more. Among those opportunities: to encourage the expansion of Ontario's smaller craft manufacturers.

A small distiller, vintner, cidery, or brewer faces clear challenges scaling up from farm gate sales to meet the demands of Ontario's big box retailer. This includes the simple need to build brand recognition.

Furthermore, smaller producers are challenged to meet minimum sales quotas established by the LCBO. Low sales and slow turnover lead to the delisting of a product. The business-model interests of the LCBO do not always align well with the capacity of new or small producers.

In this context, the Minister of Finance should instruct the LCBO to establish a second distribution channel, one dedicated to small producers, a "Craft Producer" channel. For a new sales channel to conform to Canada's trade obligations, it would have to be open to any small international producer wanting to sell its product. The sales thresholds for this new "craft" channel would reflect the sales and production capacities of local distillers, wineries, breweries, and cideries. As an intermediate sales channel between "farm gate" and "big box" it would offer a way to build brand recognition, with the opportunity to graduate to the larger LCBO distribution network when ready. Such "small craft" stores would ideally be located or co-located in LCBO stores and in communities where local or craft products today have higher sales.

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[31] Mandate Letter 2021-22 from the Ontario Minister of Finance, Rod Phillips to the Chair of the LCBO.

This would certainly add costs to the LCBO. It would also reduce the dividend paid to government. But it would provide a sales channel for smaller (local and international) producers to build brand, increase sales, and grow jobs, investment and associated regional economic benefits. (Such channels may prove to not be cost-effective for many small, international producers, in fact. This strategy may be a legitimate means, therefore, of boosting small Ontario producers especially.)[32]

Third, one of the basic tenets of tax policy is the concept of tax equity. Similar incomes, products, or services should generally be treated equally by the tax system. But there is no tax equity in the beverage alcohol industry. Ontario can clean up some of the significant tax differences that currently exist within the industry.

a) Distillers are subject to a “spirits basic tax” assessed by Ontario at a rate of 61.5%. This tax is included in the retail price in the LCBO and paid by the consumer. Wineries, breweries, and cideries each pay a similar “basic tax” that is applied to their product when sold in the LCBO. The tax rate for the other producers is significantly less than 61.5%.

b) To add to that inequity, when breweries, wineries, and cideries sell their product at the “farm gate” they are not assessed their “basic tax”. Regulation requires them to sell at the same price as set by the LCBO, and the margin the producer receives from the sale “on-site” is significantly greater than the margin received for a sale through the LCBO.

   Distillers? Regardless of where the consumer purchases the product, the 61.5% tax must be paid. Ontario should change the tax rate for the on-site sale of spirits to bring it more in line with other provincial producers.

c) Wineries and cideries (because apples are a fruit, cider is regulated as “wine”) are each subject to a 6.1% sales tax on sales at their on-site retail stores. This levy is in addition to the HST assessed on the sale of their product.

   Why an additional sales tax? No other product in the province is subject to two different sales taxes.

   Producers explain that the Ministry of Finance is recouping revenue that was lost from this sector when the HST was harmonized. For tax equity reasons, this tax should be eliminated.

[32] The author wishes to thank Jon R. Johnson, Senior Fellow, CD Howe Institute, for his perspectives on Ontario’s options to meet its international trade commitments.

d) One additional change would be for the government to consider classifying “cider” as “beer” for tax purposes. The basic tax for beer is lower than that for wine. Cider is more commonly viewed as a substitute for beer than wine given similar levels of alcohol content. This change would reduce the basic tax rate on cider and boost the margin to producers, providing them with capital to reinvest.

Fourth, for more than 100 years Ontario has treated the beverage alcohol industry as if it were a cash cow. When the Minister responsible for alcohol policy is the Minister of Finance, any change to regulation, distribution, or sales likely will be viewed through the lens of the effect on tax revenue. Put another way, when your job is to maintain or increase tax revenue, alcohol taxes are bound to be a favourite option.

To escape this, Ontario should shift responsibility for alcohol policy to the minister of economic development.

One final consideration: Ontario has evolved from a marginal to a global wine producer over the past four decades.[33] The role the industry has played in the growth of the Niagara region, Prince Edward County, and the north shore of Lake Erie is a case study in regional economic development. The proximity of two of those wine regions to the greater Toronto/Hamilton region has encouraged the significant growth in wine or “agritourism,” bringing more than two million visitors each year to wine country.

Successive governments have encouraged Ontario manufacturers and producers to invest capital to deliver higher value output. The economic return on one acre of Niagara/PEC/North Shore vineland -- producing “premium” Ontario wine that captures employment, retail sales, restaurant sales, and associated “agritourism” benefits -- is an example of an economic cluster in dire need of greater focus and attention.

The Brookings Institute recently identified key factors determining the viability of “cluster-driven” success. Among them are i) a physical centre, ii) building on an existing eco-system that is iii) championed by passionate, dedicated leaders. Brookings also highlighted the importance of collaboration for “industry-driven, university-fueled, government funded”[34] success.

Ontario’s wine industry is characterized by many of these factors. The Province would benefit financially and economically were it to co-create a “cluster focused growth” strategy for this sector in partnership with industry producers.

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[33] OIV, State of the World Vine and Wine Sector, 2021. p. 16.

[34] Donahue, R. Parilla, J. McDearman, B, Rethinking Cluster Initiatives, Metropolitan Policy Program, Brookings Institute, July 2018, p 6.

Conclusion

Ontario faces significant social and economic challenges. Ongoing concerns over public health and the global pandemic have slowed the rebound in the economy. Rising housing prices, homelessness, increased costs of health care, infrastructure investment needs, and rising inflation each compete for scarce financial resources and for the attention of the provincial government.

In this environment, why might a government focus intently on something often considered of marginal importance, like the beverage alcohol industry?

It's simple: the sector is hardly marginal. There would be clear benefits to reforming the sector, for the enjoyment of consumers and for the provincial economy broadly.

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