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# Alcohol Retailing Deregulation

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## Implications for Ontario

February 10, 2014

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**A Beer Store Position Paper**  
Foreword by Greg Flanagan, Economist

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## Foreword

by Greg Flanagan

“... claims of retail deregulation delivering lower consumer prices, higher government tax revenues and continued social and environmentally responsible product sale, all at the same time, are simply not credible.”

As an economist who has studied the privatization of retail alcohol sales extensively, I find this paper to be a valuable contribution to the growing literature on beverage alcohol retailing in Canada. The public, and public policy makers, are well served with this type of fact-based informative research showing the reality of the trade-offs inherent in policy decisions regarding any restructuring of the retailing of beverage alcohol.

Too many ill-informed opinions have been expressed on how beverage alcohol is marketed in this country and what the

consequences of retail system change would or could bring. For example, proponents of privatization often argue that privatizing beverage alcohol retailing, or otherwise opening it up to a greater ‘free’ market, will lead to efficiencies and price reductions, all other things constant (for example, public revenue). As this paper shows extremely well—the reality is far different.

Alberta, and to a lesser extent British Columbia, have privatized their beverage alcohol retailing markets. In reviewing the privatization experiences of these two provinces this paper illustrates well the relationships of competition, costs, product prices, and public revenues. For example, it is not possible to have lower product prices and maintain or enhance government revenue. The one is directly related to the other. Therefore, for prices to fall public revenues must be decreased. If public revenues are to be maintained over time then prices must rise.

When Alberta privatized the retailing of alcoholic beverages in 1993 the Klein government planned a revenue neutral tax scheme while promising lower product prices to consumers. It was not to be. The large expansion of retail outlets raised the costs of product distribution, marketing and retailing and to the surprise of the Alberta government, and Alberta consumers, prices increased. The ensuing negative consumer reaction required Alberta to reduce alcohol taxes on three occasions following privatization in an ultimately unsuccessful attempt to stabilize prices.

Since privatization, Alberta's alcohol tax revenues (in real dollar terms) have declined on both a per capita and dollar per litre of alcohol basis. Alberta lost government revenue while consumers paid higher prices. As this paper documents,

tax-adjusted prices are higher on average in Alberta than in Ontario. And despite Ontario having lower prices, its government alcohol tax revenues have increased at a far greater rate.

British Columbia, although only partially privatized, has experienced the same privatization consequences as Alberta: compromised public revenues and higher consumer prices. Why has this happened? The short story is excess capacity: the consumer base is now spread between far too many small and less efficient retail outlets. On average each outlet's sales are a fraction of what they could be in a more regulated/controlled system with fewer points of sale. The unit cost of retailing including product distribution and marketing is high compared to more regulated markets like Ontario and this leads to higher prices.

What about consumer gains from privatization other than price – greater convenience, increased product choice and the like? It is true that in Alberta and BC there are many more and therefore convenient outlets. The hours of operation are extensive with Christmas day being the only day retailers cannot operate in Alberta. But this doesn't necessarily mean convenient in terms of product choice or selection. Product listings in Alberta's central alcohol product warehouse mushroomed following privatization. But that doesn't mean all those products are generally available to all consumers. The average small Alberta liquor retailer can only shelve so many products. Beer and inexpensive wines dominate sales, so the small outlets concentrate on these most marketable products. It becomes expensive to carry many products. If one were to shop the province it is possible to find different prices and reasonable choice. However, the reality for most consumers

is the need to patronize a number of different local retailers to find adequate product choice while at the same time resigning themselves to pay local prices. For many this has proved less convenient and more expensive than what existed before privatization.

Ontario already has a balance of private and public involvement in its alcohol retailing system. The private sector is publicly regulated on all of the important aspects of control: store location, operating hours, days open, and product prices. Responsible sales practices are more easily administered and enforced and the system has a highly effective environmental management system. Importantly, the controlled number of retail sales outlets means efficiencies are realized creating the lowest price/highest public revenue possibility. While provincial uniform pricing regulation makes for common prices in urban, rural and remote areas, a practice that undoubtedly benefits rural consumers, price competition between beer producers in what The Beer Store calls the “beer commons” keeps wholesale costs and consumer prices low. The benefits of competition are realized and the cost advantages and efficiencies of a controlled retail system are achieved for the benefit of consumers, government and alcohol producers.

Public policy is difficult. It should be based on solid fact-based research but also has to respond to citizen’s wishes. Political parties come with philosophical perspectives that guide their policy direction. There is some controversy as to the balance between evidence based policy and ideology. In 1993, the sale of the Alberta Liquor Control Board’s retail assets and the privatization of the retailing market were pursued mostly due to ideology; an ideology based on small government, low

taxes, and free market economics. There was little public consultation and not much critical analysis. In the end, Alberta gave up control of the market, and public revenue was reduced. The benefits of the change were more stores (albeit with more limited selection) and a broader base of available alcohol products. Lower prices were not one of the benefits.

Once a regulated alcohol retailing system is privatized it is extremely difficult and expensive to reverse – perhaps impossible. Therefore, great care needs to go into the consideration of policy changes in this market – a market whose products are not just some other consumer good.

The consumption of beverage alcohol can have significant impact on social wellbeing. Its sale is also an important source of government tax revenue. This paper brings considerable fact-based insight to the potential consequences of deregulating Ontario’s current system of alcohol retailing. By empirically analyzing the impacts of retail deregulation in other provinces this paper demonstrates in an effective and compelling way that claims of retail deregulation delivering lower consumer prices, higher government tax revenues and continued social and environmentally responsible product sale, all at the same time, are simply not credible. Those outcomes have never been experienced elsewhere and they are unlikely to be experienced here in Ontario.

In short, policy makers need to ask themselves: Is it so difficult to access alcoholic beverages in Ontario that creating greater convenience through privatization is worth the price to both consumers and taxpayers?

## Executive Summary

“... actual deregulation initiatives have resulted in higher consumer prices and lower government revenues as a proliferation of retail outlets has driven up overall system costs.”

The issue of alcohol sales in corner stores and gas stations is once again in the news in Ontario. Proponents of deregulated alcohol sales claim that deregulation will lower consumer prices, increase product choice, generate higher government revenues while at the same time improving responsible sales practices.

While such claims may sound enticing, a review of the deregulation experiences of other North American jurisdictions shows that this combination of outcomes has never been realized anywhere in practice. In fact, increased availability of alcohol in jurisdictions that have deregulated liquor retailing has been accompanied by significant increases in consumer prices, a general reduction in product selection and lower government alcohol tax revenues.

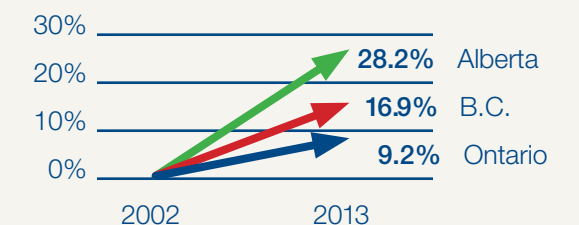
The following paper compares the performance of Ontario’s existing beverage alcohol retail system across a variety of factors to liquor retailing systems that have undergone varying degrees of retail deregulation with a particular focus on Alberta and British Columbia given the robustness of available data on those markets. Factors examined include expected impacts on consumer prices, government revenues, product selection, availability of liquor and responsible sales practices.

**Key findings of this research include the following:**

### Consumer Prices

- *The evidence is overwhelmingly clear that deregulation of liquor sales in Alberta, and B.C. resulted in higher cost and less efficient retailing systems that drove price increases to consumers – not price decreases.*
- *According to Statistics Canada data, retail alcohol prices in Alberta have increased by 67% since 1993 more than double both the national average increase of 32% and the increase in Ontario of 28%.*
- *Statistics Canada data also shows that in the last decade retail alcohol prices in Alberta increased at almost three times the rate of Ontario (28.2% vs 9.2%) and retail prices in B.C. increase at 80% faster than the rate in Ontario (16.9% vs 9.2%).*

**PERCENTAGE CHANGE ALCOHOL PRICES (PURCHASED AT RETAIL) 2002-2013**



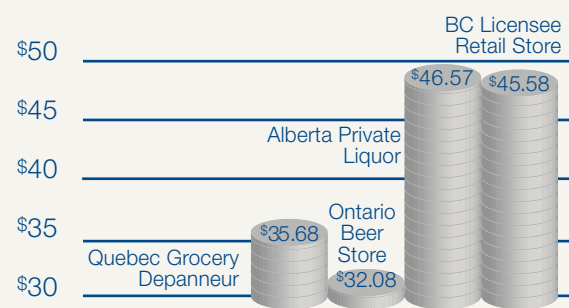
- Current average Beer Store beer prices are over \$10 less per case than those of private retailers in Alberta or B.C.
- Quebec is the only province in Canada that has beer prices comparable to Ontario's and if Ontario's beer taxes were the same as those in Quebec (Quebec beer taxes are less than half those of Ontario), Ontario beer prices would be lower:
  - The cost to the government of implementing Quebec beer taxes in Ontario would be \$350 million annually.

### Average 24 Pack Prices (Bottles) from May 2013 IPSOS Reid Survey

#### Average 24 Pack Price



#### Price with Ontario Beer Tax



## Government Tax Revenues

- Deregulation of alcohol sales in Alberta has resulted in a significant decline in

provincial government alcohol tax revenues since 1993:

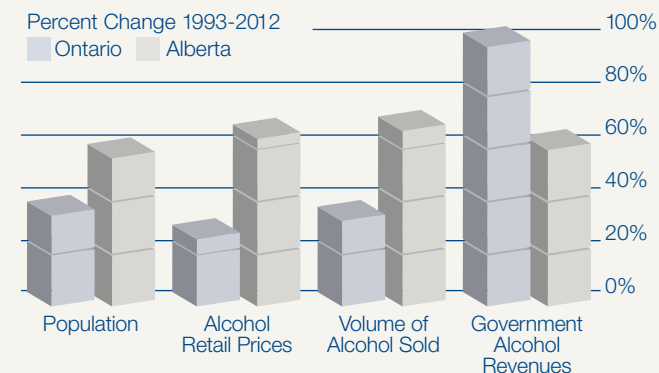
- 35% decline in alcohol tax revenues per litre of absolute alcohol (LLA) sold (measured in constant dollars) despite higher consumer prices;
- Alcohol tax revenue as a percentage of liquor sales value dropped from 40% in 1993 just prior to deregulation to 25% today;
- Partial deregulation of alcohol sales in B.C. also resulted in a decline in government tax revenues per LAA (measured in constant dollars) despite a number of tax increases and higher consumer prices.

- Ontario's current beverage alcohol retailing system outperformed both Alberta and B.C. in government revenue growth in the periods following full and partial deregulation in those provinces.

- Ontario generates over \$1.2 billion more from alcohol sales annually than it did in 1992;

- If Ontario liquor revenue trends had following those in Alberta, the cost to the provincial treasury would have been \$5.4 billion over the last two decades.

### Ontario versus Alberta 1993 to 2012



## Product Selection

- Deregulation in Alberta significantly increased the total number of alcohol products made available for retailers to purchase at the province's central distribution warehouse, but selection at individual retail stores varies significantly and is much less than in Ontario and hence consumers must shop around to find particular products.
- Private liquor retailers in other jurisdictions (i.e. Alberta, B.C. and Quebec) typically carry fewer beer products than Beer Store outlets in Ontario.

	Urban Stores	Rural Stores
Quebec Convenience Store	105-170 brands	50-80 brands
Alberta Liquor Store	70-150 brands	60-90 brands
B.C. Licensed Retail Store	120-240 brands	130-150 brands
The Beer Store	280-330 brands	110-180 brands

## Availability of Alcohol

- Adopting Alberta or Quebec retailing systems would mean over 10,000 liquor retail outlets in Ontario (up from existing 1,800);
- Public opinion research by Ipsos Reid indicates that most Ontario residents are not supportive of paying higher alcohol prices for greater alcohol availability;
  - 81% of Ontarians are satisfied with the existing beverage alcohol retailing system;
  - 67% of respondents indicated that they would be more likely to oppose the sale of liquor in convenience stores if they had to pay 15% to 20% more for alcohol products.

## Responsible Sales Practices

- Concerns about sales practices by private retailers in both Alberta and B.C. prompted both governments to increase related monitoring and enforcement (incurring additional costs). This is also true of several U.S. states with

### U.S. state and B.C. Minor Compliance Check Program Results

State/Province	Year(s)	Type of Licensee	Failure Rate (sale to minor)
New York	2011-2013	Retailers	41.7 %
Illinois	2009-2013	Retailers & Licensees	21.4 %
Arizona	2003-2012	Retailers & Licensees	30.7 %
Michigan	2006-2011	Retailers & Licensees	14.9 %
Ohio	2012-2013	Retailers & Licensees	21.4 %
Washington	2011	Failure Rate Government Stores	5.7 %
		Failure Rate Private Retailers	22.7 %
British Columbia	2011-2013	Failure Rate Government Stores	6.0 %
		Failure Rate Private Retailers	21.5 %

deregulated alcohol markets. The results associated with these enforcement programs demonstrate that compliance with sale to minors laws decrease significantly in deregulated retailing environments.

- In Ontario, independent private retailers would be unlikely to match current Ontario responsible sales practices, even with increased government spending on monitoring and enforcement.

## Environmental Performance

- Unlike other provinces which have deregulated alcohol sales, Ontario does not have a comprehensive deposit return/depot system for returning beverage containers including beverage alcohol containers. Changes to alcohol retailing in Ontario, therefore, will have more significant implications for container recycling and reuse than other provincial jurisdictions.

- The beverage alcohol containers currently collected through the Beer Store's deposit return system are equivalent to half the tonnage of materials collected through the entire municipal blue box system. Because this packaging is managed outside the municipal waste system municipal taxpayers avoid \$40 million in annual waste management expenses.

- It is unlikely this system could be sustained under a convenience store liquor retailing model. Hence, if beverage alcohol containers had to be managed through municipal waste channels municipal taxpayers would be saddled with an incremental \$40 million a year in cost.

## General Study Conclusions

Contrary to what several proponents of deregulated liquor retailing assert, there are no magic bullets related to Ontario's beverage alcohol system that will increase government revenues while simultaneously reducing consumer prices and expanding selection and access. The current combination of high liquor taxes and government liquor board retailing has led some observers to conflate high prices with government controlled liquor retailing. In fact, existing government regulated retailing systems such as Ontario's represent relatively efficient retailing models for a product for which the majority of the public expects some form of social control.

Moving to a deregulated retail market will undoubtedly increase the number of retail selling locations, but it will also significantly increase costs and destroy the economic efficiencies inherent in Ontario's current alcohol retail system. This effect will drive up consumer prices, reduce government tax revenues or generate some combination of both these changes.

Promises about lower consumer prices and windfall tax revenues for government from deregulated alcohol sales are simply not supported by any evidence. Actual deregulation initiatives have increased consumer prices while severely restricting the ability of governments to maximize revenues from alcohol sales.

While some Ontario consumers may prefer the convenience of alternate liquor retailing models such as Quebec's, few are aware that Ontario beer commodity taxes are \$3.50 (bottles) to \$5.69 (cans)

per case higher than those in Quebec. The significance of this for potential beer sales in Ontario corner and grocery stores is that Ontario consumers will not get Quebec beer prices unless the Ontario government lowers beer taxes to match those in Quebec.

Ontario currently generates approximately \$3 billion dollars annually from alcohol sales (including retail sales tax revenues). This is one of the single largest revenue streams for the province after personal income tax and it helps to fund various provincial services such as hospitals and schools. The serious revenue and consumer pricing implications associated with radical changes to Ontario liquor retailing system make potential changes far more problematic than proponents of deregulated liquor sales would suggest.

Successive governments, regardless of their political orientation, have all shared one thing in common when it comes to beverage alcohol retailing in Ontario, the more they reviewed the current liquor retailing system, the less interested they were in radical change. Political reluctance to radically alter Ontario's current system is understandable in light of the consumer price impacts associated with actual deregulation in other jurisdictions and the relatively broad support for, and satisfaction with, the current system from Ontario consumers, taxpayers and social interest groups.

Maintaining the existing liquor retailing model, however, does not mean that it cannot be improved. Both the LCBO and the Beer Store retailing environments have changed significantly over the past few decades. Recently, the Beer Store announced \$30 million in retail investments to open 13 new stores and renovate 61 others in 2014. The Beer Store remains

committed to working with the government and LCBO to explore ways to improve liquor retailing without jeopardizing the many benefits of the existing retail system. The Beer Store has also long supported the concept of LCBO-Beer Store joint ventures as one way to enhance consumer convenience and improve system efficiency and government revenue performance without driving up consumer prices.

The experience of deregulation initiatives in other jurisdictions suggests that the best way to improve liquor sales in Ontario is through continued evolution of the existing system, not radical alteration. Jurisdictions which have moved to deregulated markets have created marginal improvements in consumer access at the cost of higher prices, declining government revenues and a deterioration of socially responsible sales practices. This does **not** seem like a prescription for success in Ontario.

A few decades ago, Ontario consumers filled out prescription like slips and received alcohol in brown bags when they purchased alcohol at the LCBO. Today the provincial liquor retailing system is fully modernized and responsive to consumer demands. At the same time alcohol is marketed and sold responsibly while the province generates significant alcohol tax revenues that grow steadily year after year. Rather than jeopardize this growing revenue stream, the province should explore options for retail improvements in the context of the existing system which effectively balances consumer needs, government priorities and public concerns.



## Introduction

The issue of retail liquor sales is once again in the news in Ontario. While media coverage often characterizes the issue as a question of whether retail liquor sales should be “privatized” (most likely due to the dominant position of the government owned Liquor Control Board of Ontario – LCBO), Ontario’s beverage alcohol retail system, like many in Canada, is already characterized by a mix of government and private sector retailers. The Beer Store, Ontario winery retail stores and LCBO authorized agency stores, all privately owned operations, collectively account for about 37 percent of liquor sales by value in the province.<sup>1</sup> While government agencies regulate all provincial alcohol sales, government owned and operated LCBO stores only account for 65 percent of alcohol sales by value in the province.

While private sector liquor retailers are active in most provinces, their sales volumes and the degree to which the government regulates the number of outlets varies significantly from province to province. In Alberta, for example, the number of private liquor stores is

completely unregulated. Any person who meets the government’s basic licensing requirements can set up a liquor store subject only to municipal zoning requirements. This is also generally true of wine and beer sales in grocery and corner stores in Quebec where again the number of selling locations for alcohol is not directly controlled or regulated. In other jurisdictions (e.g. British Columbia or West Virginia), governments have regulated the number of retail liquor outlets, even those operated by private businesses.

While much of the debate around retail alcohol sales to date has focused on ideological considerations (i.e. government shouldn’t be in the liquor business) or consumerist motivations such as increasing convenience and accessibility or the general belief that deregulation will produce lower prices, less consideration has been given to the different costs and economic efficiencies associated with deregulated retailing systems and the implications of these factors for consumers, government and the general public.

In this regard, the debate over the future of Ontario’s beverage alcohol retailing system requires a thorough assessment of the costs and benefits associated with the current regulated or controlled retail market, where the government maintains control over the number, type and location of retail locations, and the costs and benefits associated with more deregulated retail systems where accessibility to alcohol is completely a function of market dynamics and where selling locations tend to proliferate and overall system costs are higher (i.e. lower overall system efficiency).

Proponents of deregulated alcohol retailing models often suggest that prices will drop, government revenues will increase and accessibility to alcohol

<sup>1</sup> Based on sales data from *LCBO Annual Report 2012* and TBS sales data.

products will significantly improve if the government deregulates alcohol sales.<sup>2</sup> However, the actual experience of jurisdictions which have fully or partially deregulated alcohol sales and moved towards retail models characterized by many more selling locations per capita suggests there are significant economic and consumer trade-offs associated with the move toward these models, especially when government wishes to maintain and even grow its alcohol tax revenues.

In the view of the Beer Store, public policy decisions about beverage alcohol retailing should be based on the best information available, especially the deregulation experiences of other jurisdictions, and not misconceptions about what should or might happen in theory if the government moves to a deregulated alcohol retail market.

The Beer Store takes this position because time and time again, actual deregulation initiatives have resulted in higher consumer prices and lower government tax revenues as a proliferation of retail outlets has driven up overall system costs. Deregulation initiatives have also been shown to increase regulatory costs as governments attempted to sustain responsible sales practices at the growing number of new retail outlets (e.g. Alberta and British Columbia).

While Ontario could move to a completely deregulated or a less regulated retail market and produce an increased number

of selling locations, the question remains as to whether it is in the best interests of Ontario consumers and taxpayers to do so. It is with the hope of clarifying what taxpayers and consumers can actually expect with deregulation of Ontario alcohol sales that this paper was written.

There are clear trade-offs to be made in any move to a higher cost and less economically efficient retail model. The Beer Store believes it is important that these trade-offs be objectively assessed and that any public policy decision to move towards a different retail system be made with a clear understanding of the resulting consequences of those trade-offs.

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## Ontario's Liquor Retailing System

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There are currently over 1,800 retail alcohol outlets in Ontario. The Liquor Control Board of Ontario (LCBO), an Ontario crown corporation, operates 634 stores which account for approximately 95% of spirit sales, 87% of wine sales and about 20% of beer sales. LCBO sales, excluding harmonized sales tax and deposits, totaled \$4.9 billion in fiscal 2013 (including wholesale and retail sales).<sup>3</sup>

The Beer Store, authorized to operate under the Liquor Control Act, operates 448 stores which account for approximately 75% of retail beer sales. The Beer Store also sells and delivers beer to licensed establishments, LCBO stores and agency stores, and collects beverage alcohol containers for either recycling or, in the case of refillable beer bottles, reuse. It is

owned by Ontario's three longest operating breweries, Labatt, Molson Coors and Sleeman.<sup>4</sup> In 2013, 100 different brewers sold more than 400 brands and more than a thousand products at the Beer Store.<sup>5</sup> Excluding sales taxes and deposits, Beer Store sales totaled \$2.7 billion in calendar year 2012.<sup>6</sup>

Ontario wineries operate 472 winery retail stores which are limited to selling "Ontario wine" produced by the winery. With sales of \$232 million in fiscal 2012, these stores accounted for about 13% of Ontario wine sales by volume. Although 292 of these stores are located off manufacturing sites, new winery retail stores can only be located at a winery's manufacturing location.<sup>7</sup>

In smaller and remote communities liquor is sold in combination with other goods by private sector retailers operating as LCBO agents and TBS Retail Partners. These 219 agency/Retail Partner stores account for approximately 3% of provincial retail liquor sales.

Total alcohol sales in Ontario were worth approximately \$7.1 billion in Fiscal 2013<sup>8</sup> (excluding sales taxes).<sup>9</sup> Of this approximately

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<sup>2</sup> See "Privatizing liquor sales will benefit Ontario consumers", editorial *Windsor Star*, Feb 25, 2013; "Indeed Convenient", editorial, *The Globe and Mail*, Monday, July 8, 2013. "Allowing private liquor stores to Ontario's mix could add \$1B, says B.C. industry spokesperson: Ontario could see of a windfall of \$1 billion if adopted British Columbia's mix of private and publicly operated liquor stores." *Toronto Star*, May 9, 2013

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<sup>3</sup> *LCBO Quarterly Financial Report, Fourth Quarter F2012/ F2013*, page 5. Total LCBO sales include sales to agency stores, licensees and TBS.

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<sup>4</sup> TBS Financial Statements are available online at its website. Shareholders include Labatt Brewing Company, a subsidiary of Anheuser-Busch InBev; Molson Coors Brewing Company; and Sleeman Breweries Ltd., a subsidiary of Sapporo International.

<sup>5</sup> Products or stock keeping units refer to beer packages available for sale. For example one brand selling in bottle six-pack, twelve-pack and twenty-four pack package configurations would be considered three products.

<sup>6</sup> TBS Financial Statements 2012.

<sup>7</sup> Under terms of trade agreements with the European Union and United States, new Ontario winery retail stores can only be opened at Ontario winery manufacturing sites.

<sup>8</sup> Fiscal year references to the government of Ontario are fiscal years which represent the 12-month period ending March 31st of each year.

<sup>9</sup> Cross selling between the LCBO and TBS has been factored out to arrive at this estimate.

\$5.7 billion is associated with retail sales. Excluding sales tax revenue, Ontario collected approximately \$2.28 billion from the sale of alcohol products in Fiscal 2013 with a net income at the LCBO projected to be \$1.711 billion (inclusive of beer taxes collected by LCBO on LCBO retail beer sales and wholesale sales of imported beer to the Beer Store and licensees) and taxes on domestic wine and beer sales outside the LCBO system totaling \$569 million.<sup>10</sup> Sales taxes related to alcohol sales, including those at licensed establishments, equate to approximately \$750 million per year<sup>11</sup> bringing Ontario's annual liquor revenues to just over \$3 billion annually.

## Key Characteristics of the Ontario Liquor Retailing Model

### Liquor Control Board of Ontario

The LCBO is a classic government owned liquor retailing monopoly. Although it competes to a certain extent with both the Beer Store and winery retail stores for customers, these competing retailers do not stock a full range of alcohol products. As such the LCBO is the only full product range liquor retailer for most Ontarians.

<sup>10</sup> See LCBO press release June 17, 2013: [http://www.lcbo.com/lcbo-ear/media\\_releases/content?content\\_id=2421](http://www.lcbo.com/lcbo-ear/media_releases/content?content_id=2421)In Ontario. For estimate of beer and wine taxes see Ontario Budget 2013: A Prosperous and Fair Ontario, Budget Papers, page 222.

<sup>11</sup> The Ontario government does not publish information on sales tax revenue related to alcohol sales specifically. This figure has been estimated by TBS based on estimates of retail sales at LCBO, TBS and winery retail stores and the estimated value of liquor sales at licensed establishments.

The LCBO determines what it sells and in conjunction with suppliers determines what prices those products sell for.<sup>12</sup> Like most provincial liquor boards the LCBO has a uniform pricing policy meaning that any particular alcohol product will sell for the same price at every single outlet in the province. In Ontario uniform pricing is also a legislative requirement for all beverage alcohol retailers meaning that for products sold in both the LCBO and the Beer Store or winery retail stores the retail price to the consumer for the same product will be the same in both types of outlets.

Compared to privatized or deregulated liquor retailing alternatives, liquor board monopolies generally share a number of defining characteristics: there are fewer outlets per capita; efficient distribution; uniform pricing within the jurisdiction (i.e. no price variation between retail outlets in remote versus urban areas); more consistent product selection at retail locations; effective responsible sales procedures and higher paid unionized staff. In the case of the LCBO, which has made significant investments in its retail system over the last two decades, one might also add that Ontarians have access to a more upscale retail shopping environment than normally associated with privatized beverage alcohol sales.

### The Beer Store

Although sometimes referred to as a monopoly the Beer Store might be more accurately described as a “beer commons”. Unlike a classic monopoly,

<sup>12</sup> Suppliers will quote prices to the Board, which are then subject to standard Board markups associated within each category. While suppliers are free to change prices on a monthly basis, the Board has final authority over whether that price change is accepted or rejected (or amended).

the Beer Store does not control market access, product selection or product prices.

The Beer Store is unique in that it operates as a completely open retail and wholesale system. Any brewer in the world can list whatever beer product they want in which ever Beer Store outlet they choose. Brewers are also free to set their own selling prices subject only to basic LCBO price approval requirements (i.e. compliance with legislated minimum and uniform pricing requirements). Provincial regulation allows brewers to change beer prices on a weekly basis.<sup>13</sup>

The open nature of the Beer Store combined with pricing freedom for individual brewers has created a highly competitive beer pricing market. Typically the Beer Store processes hundreds of price changes every month and the average retailing selling price in the system has only increased by 2.8% since 2003 while the general rate of Ontario inflation over the same period was approximately 20%. While Ontario's uniform pricing regulation precludes price competition between beer retailers such as the LCBO and the Beer Store, price competition between individual brewers and brands within the Beer Store system is significant. Furthermore, lower priced products are not restricted to larger outlets in urban centres, but are available at all Beer Store locations throughout the province, hence rural consumers benefit as much as urban consumers.

As a beer commons, the Beer Store has many of the characteristics associated with a classic regulated alcohol retailing system: fewer outlets per capita; efficient

<sup>13</sup> See Ontario Regulation 116/10 (under *Liquor Control Act*) sections 11 & 12.

distribution model; more consistent product selection between outlets; effective socially responsible sales practices and higher paid unionized retail staff. But while the Beer Store system may embody many of the characteristics of a regulated retail model it is a misnomer to suggest that its structure inhibits or limits price competition. The Beer Store has extensive price competition between brands within its system and with its open listing policy, has an ease of access that surpasses that found in classic deregulated systems.

### Winery Retail Stores

Ontario wine stores, in particular, offsite winery retail stores, like the Beer Store, are somewhat unique. These stores which sell only domestic wine produced by the owner winery are often located adjacent to a grocer. With sales restricted to domestic wine, they, like Quebec grocery and corner store wine sales (restricted to Quebec bottled wine), are technically in violation of Ontario's obligations under international and interprovincial trade agreements. However, they have been grandfathered under existing trade agreements.

The most significant issue related to these outlets in relation to changes to Ontario's retailing system is that Ontario cannot increase the level of discrimination (vis a vis foreign products) associated with its retail system without increasing Ontario's vulnerability under trade agreements. For example, if Ontario attempted to implement a policy like Quebec's where only Ontario-bottled wine or beer could be sold in corner or grocery stores, such a change could generate a trade challenge which Ontario (or Canada) would be unlikely to win.





# Deregulation and Consumer Liquor Prices

variable tax rates as well as the variations in manufacturing, distribution and retailing costs in those jurisdictions. This is especially true in Canada where alcohol taxes are among the highest in the world ranging from 40% to over 70% of retail price. Adopting a retail model present in one jurisdiction and expecting to achieve prices similar to that jurisdiction without also adopting that jurisdiction's alcohol tax rates is not a realistic expectation.

Prices in Canadian provinces are generally higher than those in the U.S. not because of inefficiencies in regulated Canadian retail models or the often alleged lack of retail price competition, but rather because of the significant differences in state versus provincial taxes.

For example, a comparison of state liquor tax rates in New York, Michigan and Ontario (Table 1) shows that state taxes for wine and beer products are only 2 to 5 percent of the rates in Ontario and between 14% and 25% of the Ontario rate for spirits.

Proponents of deregulated liquor retailing in Ontario often point to prices in neighbouring jurisdictions with grocery or corner store sales, such as Quebec or New York state, to argue that alcohol prices will drop if the retail systems present in these other jurisdictions were adopted in Ontario (i.e. the belief that retail competition will result in lower prices).

However, differences in liquor prices between jurisdictions are affected by

**Table 1: Comparison of New York, Michigan and Ontario Liquor taxes (excluding sales tax)**

	State Tax	Ontario Tax <sup>14</sup>	Difference between Taxes
<b>New York</b>			
Beer (24 Cans)	\$0.33	\$9.95	Ontario tax 30 times higher
Wine 750ml	\$0.06	\$3.37	Ontario tax 56 times higher
Spirits 750ml	\$1.34	\$9.78	Ontario tax 7 times higher
<b>Michigan</b>			
Beer (24 Cans)	\$0.47	\$9.95	Ontario tax 21 times higher
Wine 750ml	\$0.11	\$3.37	Ontario tax 30 times higher
Spirits 750ml	\$2.49	\$9.78	Ontario tax 4 times higher

<sup>14</sup> See Appendix A for details of Table 1 tax rate calculations.

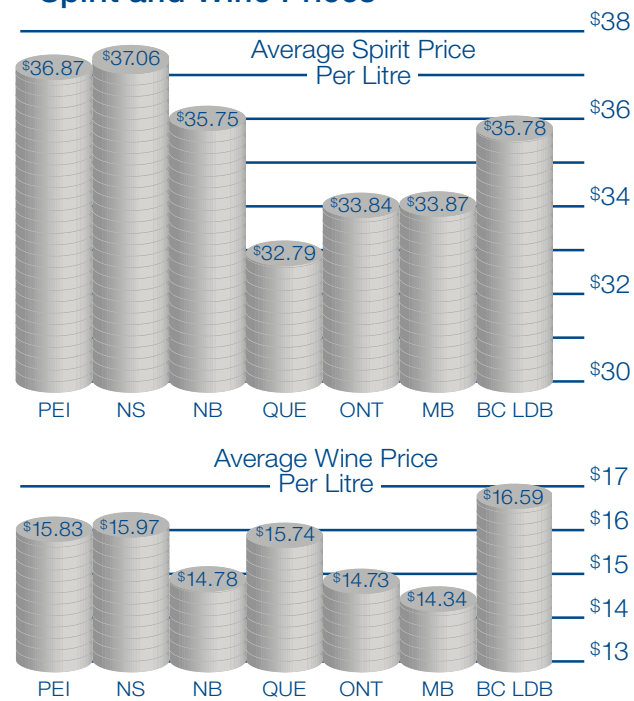
This tax differential is also in a significant factor in comparing beer prices between Ontario and Quebec. While Societe des Alcools (SAQ - the Quebec liquor board) markups on wine and spirits products are similar to those applied by the LCBO, the Quebec beer tax on beer sales in grocery and corner stores is less than half that of the beer tax collected in Ontario. For example, Quebec's basic beer tax on 24-cans is \$4.26 while the equivalent taxes in Ontario total \$9.95 – Ontario's taxes are 134% higher. Ontario taxes on refillable bottles are approximately 85% higher than the equivalent Quebec taxes.

Ontario, like many provinces, is also a uniform pricing jurisdiction, meaning that any alcohol product by law must sell for the same price throughout the entire province.<sup>15</sup> Uniform pricing requirements generally benefit rural and northern consumers as there is no price differential paid by those consumers in relation to urban consumers.

Differences between taxation and pricing policies mean that alcohol price comparisons between jurisdictions are not straightforward. Information on prices in privatized retail systems is more difficult to obtain as prices vary from retail location to retail location. A comparison of volume weighted average selling prices for wine and spirits at different Canadian liquor boards shows that current LCBO prices are very competitive in comparison to other provinces.

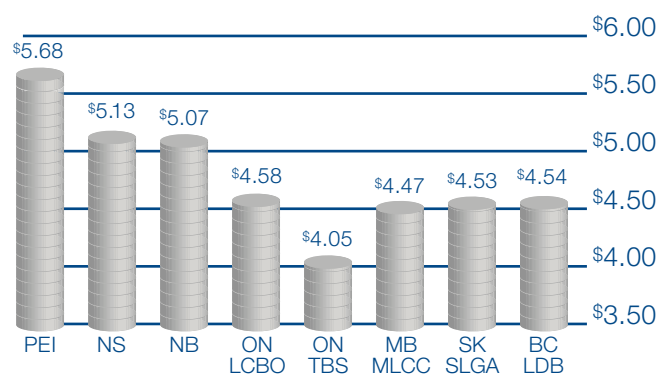
<sup>15</sup> In Ontario uniform pricing at retail is required by section 3(1)(i) of the *Liquor Control Act* which states that the Board has the power "to fix the prices at which the various classes, varieties and brands of liquor are to be sold and, except in the case of liquor sold through an outlet designated by the Minister of National Revenue under the Excise Act (Canada) as a duty free sales outlet, such prices shall be the same at all government stores;"

**Chart 1: Average Liquor Board Spirit and Wine Prices<sup>16</sup>**



While LCBO volume weighted average selling prices are not the lowest in either category, they rank second lowest among liquor boards in average prices for both wine and spirits. With respect to beer prices, as Chart 2, below, illustrates, Beer Store prices are lower than those for any provincial liquor board.

**Chart 2: Liquor Board Beer Prices: Volume Weighted Average Prices**



<sup>16</sup> Average prices obtained from provincial liquor board annual reports for Fiscal 2012. LCBO prices from Quarterly Financial Report for Fiscal 2012.

To add further clarity to the inter-provincial beer price comparison, the Beer Store commissioned Ipsos Reid, in May of 2013, to conduct a survey of private beer retailers in Quebec, Alberta and B.C. The survey found that Beer Store prices were significantly lower than those found at private retailers in Alberta and B.C.<sup>17</sup>

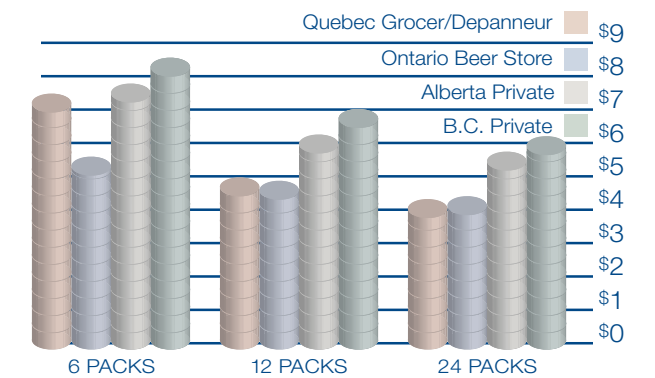
In the case of Quebec, where no uniform pricing law exists and prices vary widely from retailer to retailer, some larger grocery retailers were found to have prices on some products that were lower than Ontario prices. However, prices in many other Quebec retailers were found to be higher and as a result the average selling price in Quebec was found to be similar to the average selling price in Ontario despite Ontario having a significantly higher beer tax rate.

As can be seen from the price data in Chart 3 liquor board beer prices in other provinces are 10% to 40% higher than those at the Beer Store, while private retailer prices in Alberta and BC are 30% to 51% higher than those at the Beer Store. While Quebec prices for 24 packs were slightly lower than those for the Beer Store (1.5% less) that differential is far less than the tax differences between the two provinces.

Chart 4 shows the same comparison of prices at independent alcohol retailers in Quebec, Alberta and BC with those at the Beer Store with prices normalized for taxation rates. Prices surveyed in Quebec,

<sup>17</sup> See Ipsos Reid CNB: *Beer Pricing and Brand Availability Study*, June 2013. Survey conducted May 2013. Ipsos Reid collected hundreds of price samples from various brands from 30 retailers in Que, AB and BC. For example, Quebec prices for 6, 12 and 24 packs respectively are based on the average price of 82, 298 and 177 samples respectively from different retailers in that province.

**Chart 3: Average Beer Prices Private Retailers (Per Litre)**

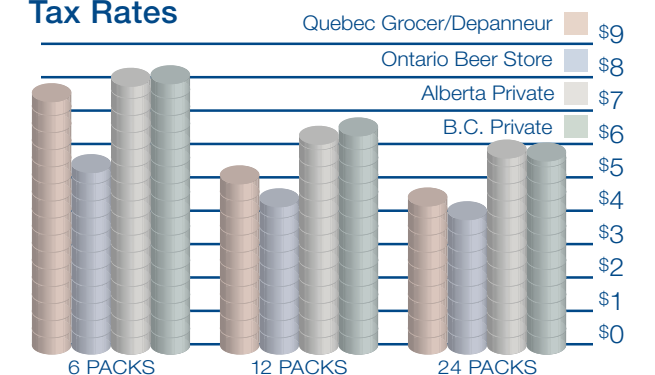


Alberta and B.C. were recalculated with Ontario beer tax rates instead of the relevant provincial tax.

Normalization of tax rates is important in comparing prices between jurisdictions in order to assess whether Ontarians are getting competitive prices from the existing retail system. For example, beer tax rates in B.C. are higher than those in Ontario so part of the difference in beer prices between the two jurisdictions is not a function of the different retailing systems, but the variation in provincial tax rates.

Similarly, Quebec and Alberta both have beer tax rates that are lower than Ontario's and consequently, unadjusted price comparisons between these jurisdictions are distorted by the variations in beer tax rates if they are not adjusted.

**Chart 4: Average Beer Prices Private Retailers (Per Litre): Prices with Ontario Tax Rates**



As can be seen from Chart 4, once prices are normalized for tax rates, Quebec 24 and 12 pack prices are 11% to 15% more than those in Ontario and surveyed 6 pack prices are 37% higher than average Beer Store prices.

A central point of debate regarding deregulation of alcohol sales in Ontario is what the impact of deregulation would be on consumer prices. As the above comparison of Canadian beer prices illustrates, Ontario's system is currently delivering significantly lower retail beer prices than every province in Canada other than Quebec. However, once Quebec prices are normalized for the variation in provincial tax rates, they are also higher than beer prices in Ontario (in other words if the provincial tax rate in Quebec was the same as that in Ontario, current retail prices in Quebec would be higher than those in Ontario).

## Consumer Price Impacts of Deregulating Liquor Sales

In Canada, the province of Alberta privatized the Alberta Liquor Control Board (ALCB) retail system in 1993. The number of retail alcohol outlets in the province jumped from 202 in 1993 to over 500 a year later and has since expanded to 1,300.<sup>18</sup>

<sup>18</sup> Between September 1993 and March 1994, the ALCB shut down 202 ALCB stores as it granted private licenses to stand alone liquor stores. By the time the last government store had closed, retail licenses had been granted to 535 private operators. Since that time the number of private liquor stores has grown to approximately 1,300. A number of private wine and beer stores that were operating in Alberta also converted to full liquor stores during the transition. Source "A New Era in Liquor Administration: The Alberta Experience" Alberta Liquor Control Board and "Quick Facts Liquor – April 2013", Alberta Liquor and Gaming Commission, available online at <http://www.aglc.gov.ab.ca>

British Columbia also implemented a partial deregulation initiative between 2002 and 2008 by doubling the number of private beer and wine stores (called licensee retail stores (LRS)) and allowing these stores to sell not only beer and wine but also spirits.<sup>19</sup> While the BC Liquor Distribution Branch (the government owned retail system) did shut down some government liquor stores during this period, the combined number of LRS and government liquor stores increased from 514 in 2002 to 853 by 2008.

Virtually all of the studies that reviewed these two retail deregulation initiatives found an increase in consumer prices associated with an increase in the number of alcohol outlets:

West, Fraser Institute, 2003:

- Alberta retail liquor prices up 8.5% (1993-1996), wholesale prices down 3.4%;<sup>20</sup>

Flanagan, Canadian Centre for Policy Alternatives, 2003:

- Alberta retail liquor prices have increased by more than CPI for other Alberta goods;<sup>21</sup>

Consumers Association of Canada, 2003, 2006:

- Despite lower taxes Alberta private store prices are higher than BC Liquor

<sup>19</sup> Between 2002 and 2006, the number of LRS stores in B.C. increased from 290 to 654.

<sup>20</sup> West, Douglas, *The Privatization of Liquor Retailing in Alberta*, Fraser Institute Digital Publication January 2003, p 49-50.

<sup>21</sup> Flanagan, Greg, *Sobering Result: The Alberta Liquor Retailing Industry Ten Years After Privatization*, Canadian Centre for Policy Alternatives and Parkland Institute, June 2003, p 31.

Distribution Branch (LDB) stores;<sup>22</sup>

- Estimate that BC consumers will pay 10% to 20% more for alcohol with Licensee Retail Store (LRS) expansion – BC LRS expansion has caused consumers to pay millions more for alcohol;<sup>23</sup>

Boyd, University of Saskatchewan Business School, 2011:

- Alberta private retailer prices 18% higher than Saskatchewan Liquor and Gaming Authority (SLGA) stores prices;<sup>24</sup>

Campanella, Flanagan, Canadian Centre for Policy Alternatives, 2012:

- Alberta and BC private retailer prices higher than SLGA and BC LDB prices;
- BC LRS mean store prices 18% more on average than BC LDB stores.<sup>25</sup>

The repeated findings that liquor prices increased with deregulation in Alberta are also consistent with Statistics Canada data with respect to consumer price changes for alcohol purchased at retail. Since 1993, Alberta ranks number one in the change in the consumer price index related to alcohol purchased at stores.

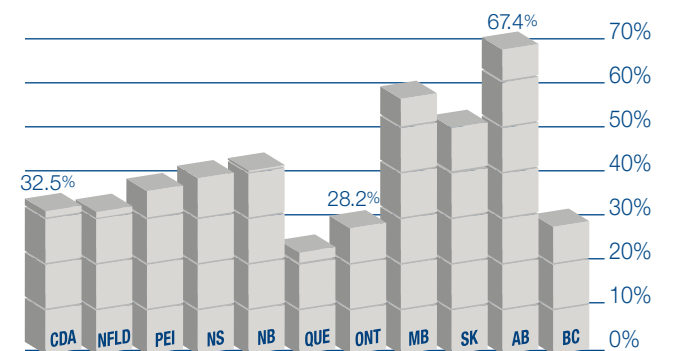
<sup>22</sup> Consumers Association of Canada, *Privatization of BC's Retail Liquor Store System: Implications for Consumers*, May 2003.

<sup>23</sup> Ibid, p 6, Consumers Association of Canada, *British Columbia's Liquor Distribution System: "Does it work for Consumers?"*, March 2006, p 2, 6-8.

<sup>24</sup> Boyd, Colin, "Alberta Liquor is not cheaper", Special to the *StarPhoenix* (Saskatoon), January 11, 2011.

<sup>25</sup> Campanella, David and Flanagan, Greg, *Impaired Judgement: The Economic and Social Consequences of Liquor Privatization in Western Canada*, Canadian Centre for Policy Alternatives and Parkland Institute, December 2012, p 10-11.

Chart 5: Change in Liquor Prices at Retail 1993-2013 Statscan



Since 1993, retail alcohol prices in Alberta have increased by over 67% or more than double the national average around 32.5%.<sup>26</sup> While it is true that the general CPI change for Alberta during this period is also higher than the national average, the gap in Alberta CPI for alcohol purchased at retail of 34.9 percentage points is far larger than the 14.9% gap between general Alberta CPI and national CPI.<sup>27</sup> Alberta's higher general CPI increase does not explain its disproportionately higher increase in alcohol prices.

It is important to note that changes in retail prices can also be affected by taxation changes. However, Alberta government taxation revenues have not kept pace with other Canadian jurisdictions since deregulation. One study analyzing per capita alcohol taxes has concluded that Alberta lost \$1.5 billion as a result of

<sup>26</sup> Chart 5 Source: Statistics Canada, pulled from CAMSIM Table 326-0021 available online at <http://www5.statcan.gc.ca/cansim>.

<sup>27</sup> In Canada nationally, alcohol retail prices have increased at a rate below general CPI changes, a 32.5% increase for retail alcohol compared to a 43.5% general CPI increase. In Alberta retail alcohol prices have increased faster than the province's general CPI change between 1993 and 2012 – 67.4% increase in comparison to a general CPI change of 58.4%.



privatization between 1993 and 2011.<sup>28</sup> While the exact revenue impact of moving to an open liquor market can be debated, in both Alberta and B.C., governments lowered alcohol tax rates shortly after permitting an expansion of retailing outlets.

The Alberta government, in response to wide-spread consumer complaints about rising liquor prices following privatization was forced to lower its initial revenue-neutral post-privatization per litre tax rates on multiple occasions between August 1994 and January 1996.<sup>29</sup> These reductions cost the Alberta treasury approximately \$95 million annually (based on 1994 volumes) or about 20% of ALCB liquor revenues at that time.

Another consumer impact associated with Alberta's post-privatization markup structure relates to lower priced and premium priced products. As part of its privatization initiative, Alberta converted its percentage liquor board markups to per litre charges. In products with a wide variation in retail price such as wine and spirits the conversion to a per litre charge represented a shift in taxation from higher priced products to lower priced goods.<sup>30</sup>

Virtually all of the products that dropped in price following Alberta privatization

were high-end wines and spirits such as champagnes and single-malt whiskies. West reviewed 144 products from a 1996 Westridge price survey in comparison to the 1993 ALCB price catalogue and found price drops for only 9 products in three categories (scotches, other liquors (such as brandy) and other wines (such as champagnes). While one champagne product dropped in price by 29% following privatization, 94 percent of the products surveyed increased in price.<sup>31</sup>

While not all of the ALCB premium product markup reductions associated with conversion to flat tax may have been passed onto to Alberta consumers, there is little question that the flat tax induced markup increases associated with lower priced wine and spirit products, which were passed onto consumers in the form of higher prices.

In terms of consumer price impacts, in addition to higher consumer prices overall, Alberta's new liquor taxation structure ensured that price increases would be disproportionately skewed toward lower priced wines and spirits. In this sense, the post-privatization ALCB markup structure was regressive in comparison to the previous ALCB markup structure in that it disproportionately increased prices for price sensitive consumers.

In B.C. the Liquor Distribution Branch (BCLDB) did not introduce a flat tax for wine and spirits in conjunction with expanded private sales, but like Alberta it did lower overall markup rates for private sector retailers. The BCLDB discount provided to private liquor stores was increased shortly after expanding private

<sup>28</sup> See Campanella and Flanagan, p 14.

<sup>29</sup> In August 1994 the ALCB reduced its post-privatization per litre markups by 11% to 29% depending upon the product category. The Board also implemented a 10% surcharge on higher priced products, which was gradually reduced to zero over an 8 month period ending in May 1995. In January 1996, the ALCB reduced its per litre markups by approximately 3% in each product category.

<sup>30</sup> For example the conversion from a 159% percentage markup to a \$14.95 per litre spirit markups dropped the ALCB markup on a 750ml bottle of single malt scotch that previously retailed for \$90 by \$40 per bottle (from \$55 to just over \$11 per bottle). In products like beer, that have far much less price variation between premium and discount products the compressing effect of the flat tax was far less pronounced.

<sup>31</sup> West, p 48.

sales. The discount increased from 10% of LDB selling price to 12% in 2002, 13% in 2005 and 16% in 2007. This increase in the LDB discount effectively reduced the markup it collected on sales through private liquor stores. For example, on an average priced one litre bottle of spirits the LDB currently collects about \$5.00 less in markups than it does on its own sales. The Consumers Association of Canada has estimated these tax reductions cost taxpayers millions on an annual basis. As Bruce Cran, President Consumers Association of Canada points out:

Why then does the BC Government deem it necessary to provide the private stores an additional 3% discount totaling tens of millions annually. These millions are coming directly out of the Provincial Budget. What are we being deprived of to raise this multi-million handout, hospital beds? knee replacements?<sup>32</sup>

In both jurisdictions private sector retailers were successful in lobbying for lower government taxes as necessary to mitigate rising retail price impacts.

The retail price impacts associated with an expansion of liquor retailing in Alberta and B.C. are consistent with a more recent deregulation initiative in Washington State. The rise in retail prices associated with closure of government liquor stores came as a shock to many consumers who supported private liquor sales on the

mistaken assumption that deregulation would result in lower not higher prices. In fact, the exact opposite is what occurred. Following retail deregulation, Washington state liquor prices increased and, as a result, the neighbouring Oregon Liquor Control Commission posted a 30% to 35% increase in sales at its government stores close to the Washington state border.<sup>34</sup>

Study after study has made it clear that controlled alcohol markets deliver lower cost and more efficient retailing models when compared to deregulated alternatives.<sup>35</sup> A combination of factors drive up costs associated with deregulated alcohol sales:

- 1) more points of sale;
- 2) increased distribution costs as liquor must be delivered to many more outlets;
- 3) higher per unit selling costs as total liquor sales volume is spread over more selling outlets resulting in less volume sold per store;
- 4) the requirement to fund new retailer margins; and,
- 5) higher marketing costs for liquor manufacturers and agents as hundreds of independent retailers must be contacted to get listings and retail shelf space.

<sup>34</sup> Oregon Liquor Control Commission Revenue Presentation to the Oregon State House Revenue Committee, February 14, 2013. The Oregon Liquor Control Commission estimated its products had a 30% price advantage in relation to private liquor retailers in Washington state post-privatization versus a 5% to 10% advantage prior to privatization.

<sup>35</sup> See Flanagan, Campanella and Flanagan, Boyd.

These factors collectively create more costly and less efficient retailing systems that generate price increases for consumers.

As the author of *Sobering Result* points out about Alberta:

“The private retail liquor market has evolved into one where there is considerable inefficiency in the form of excess capacity, duplication, and redundancy, particularly in urban centres. This inefficiency generates considerably higher costs of retailing, even though wages are at one-half compared to other jurisdictions.”<sup>36</sup>

Colin Boyd, a University of Saskatchewan business professor, has noted that while Alberta’s population increased post-privatization, its population per liquor store decreased with the rapid expansion of retail outlets: “Prices are higher with private, stand-alone liquor stores because higher total overhead costs must be passed on to the consumer.”<sup>37</sup>

In this context, privatization of liquor retailing has compromised the ability of governments to maximize revenues associated with beverage alcohol sales. Deregulation in Alberta created downward pressure on ALGC markups as both private sector retailers and consumers expressed concerns about the high price of alcohol.

While Quebec’s retailing system has not undergone significant change in many years, its grocery store retailing system for beer and wine is often promoted as a model which will both lower prices and enhance consumer convenience. However, the Quebec corner/grocery store retail

<sup>36</sup> Flanagan, p 45-46.

<sup>37</sup> Boyd, “Alberta Liquor is not Cheaper ...

model has all the same economic cost issues as those outlined above for Alberta – total volume sold is spread over thousands of small retailers leading to higher per unit selling costs and higher product distribution costs.

Furthermore, as noted earlier, the tax differential between Quebec and Ontario for beer products is significant and it is economically impossible for a corner/grocery store retail model in Ontario to deliver the same prices as those found in Quebec without the Ontario government also adopting the same beer tax rate as Quebec. The cost of implementing Quebec beer taxes in Ontario would be \$350 million on an annual basis. In the absence of such a significant tax reduction, Ontario’s beer prices are likely to increase in a move to a grocery and corner store retailing model, not decrease.

## Conclusions

### Deregulation and Consumer Prices

- The evidence is overwhelmingly clear that deregulation of liquor sales in Alberta, B.C. and Washington State resulted in higher cost and less efficient retailing systems that drove price increases to consumers.
- A move to a more costly and less efficient deregulated liquor sales system will result in higher, not lower, consumer prices unless significant tax reductions occur to compensate for increased retail and distribution costs:
  - The cost of implementing Quebec beer taxes in Ontario would be \$350 million annually;
  - The cost of implementing New York State beer taxes in Ontario would be \$750 million annually.

<sup>32</sup> Press Release, Consumers Association of Canada, January 8, 2007.

<sup>33</sup> See “Liquor Buyers Cross State Line: Price went up-not down-after Washington State Ended Control of booze sales”, *Wall Street Journal*, September 3, 2012; “Liquor Privatization: The Fallout” *SeattleMet*, August 21, 2012. January 8, 2007.



# Deregulation and Provincial Government Liquor Revenue

## Current Ontario Liquor Revenues

As noted earlier, the Ontario government collected just under \$2.3 billion in alcohol revenues in Fiscal 2013 excluding sales tax revenues related to alcohol sales. This revenue is generated by a combination of LCBO profit transfers and beer and wine taxes collected in relation to the Beer Store and winery retail store sales.

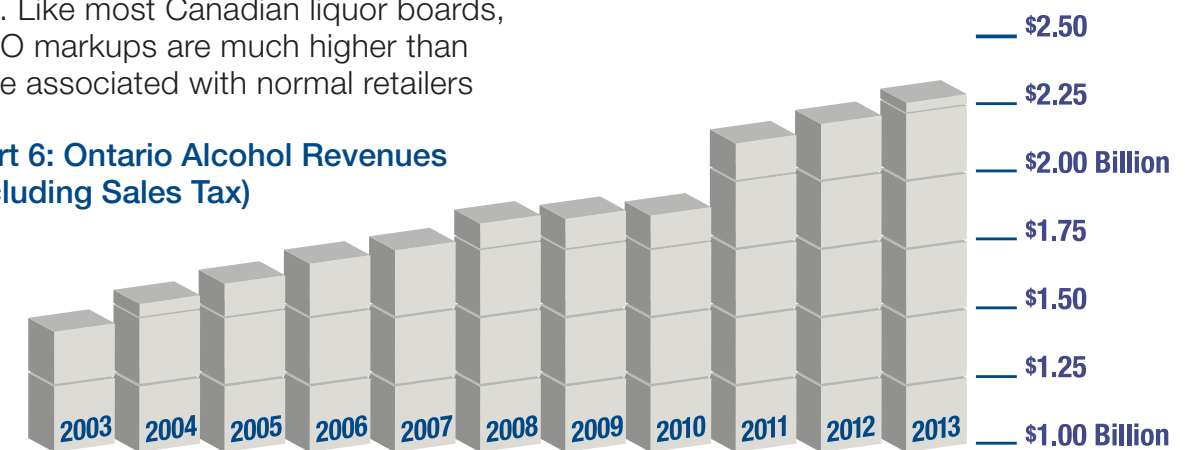
The LCBO collects markups and fees on all products that it sells (both retail and wholesale). Its transfer to the government represents the net profit of the agency once its operating expenses have been paid. Like most Canadian liquor boards, LCBO markups are much higher than those associated with normal retailers

(for example 147% on some product categories) and essentially constitute a tax on alcohol sales.

Beer and wine taxes in relation to the Beer Store and winery retail store sales are consumer taxes set under the *Alcohol and Gaming Regulation and Public Protection Act, 1996*. These taxes are pre-collected by manufacturers and remitted directly to the Ministry of Finance by breweries and wineries.

As can be seen from Chart 6 below, combined annual LCBO net income and beer and wine taxes have grown by approximately 55% over the last decade or by more than \$800 million.<sup>38</sup>

Chart 6: Ontario Alcohol Revenues (Excluding Sales Tax)



<sup>38</sup> Chart 6 Source: Ontario Budgets, 2003-2012. Please note revenues for fiscal years 2003 to 2007 includes AGCO licensing fees as well as beer and wine tax revenues.

## The Impact of Deregulation on Government Revenues

Proponents of deregulated liquor markets often suggest that maintaining government revenues is simply a matter of setting appropriate tax rates. In this view, the government takes its existing alcohol revenue stream, principally derived from the operation of its provincial liquor board system and sets new tax rates for the deregulated system at a level that will generate the same overall net revenue (i.e. profit) it received when it owned and operated the liquor retailing business.

While it is understandable that governments would want to maintain their revenue stream, the practice of converting total liquor board profits into taxes when deregulating into a privately operated store system, is tantamount to government exiting the business but keeping the profit as if it still owns the business while at the same time expecting someone new to invest in the business and generate their own profit. Under this approach there are effectively two parties trying to profit from the business. While the appropriateness of this practice can undoubtedly be questioned, the conversion of liquor board markups to taxes has seldom been as straightforward as the above description might suggest.

Secondly, most government liquor boards have been successful in growing revenues over time. As such, any legitimate assessment of the government revenue implications associated with deregulating a controlled alcohol market needs to consider the question of what government revenues that deregulated system will generate over time compared to what the controlled market would have generated

if the government had maintained its existing liquor retailing system.

## Alberta's Deregulation and Government Revenues

In this regard, Alberta, Canada's most studied privatization initiative, provides some useful insight. Prior to privatization, Alberta in 1993 generated alcohol revenues of \$427.6 million annually. In the two decades following retail deregulation that figure grew to \$687 million by 2012.<sup>39</sup> This increase in government revenues over time is cited by some deregulation proponents as evidence that Alberta has not only maintained but increased its liquor revenues.<sup>40</sup>

While it may be true that Alberta has increased its alcohol tax revenues since it deregulated liquor retailing in 1993, this on its own isn't sufficient evidence to suggest that the de-regulation exercise itself was responsible for the revenue growth. Obviously had Alberta not deregulated in 1993 its alcohol tax revenues still would have increased due to a variety of other factors including population and sales growth, price inflation and changes in per capita consumption (i.e. the amount of alcohol people on average consume).

The question therefore is: Did retail deregulation in the Alberta market enable the government to make more or less tax revenue than what it would have made

<sup>39</sup> ALCB, "A New Era...", and AGLC Annual Report 2012, p 29.

<sup>40</sup> This conclusion of revenue neutrality is supported by a Fraser Institute study on privatization which focused primarily on aggregate government revenues from 1992 to 1996. See West, p 57.

had the retail deregulation initiative not been enacted?

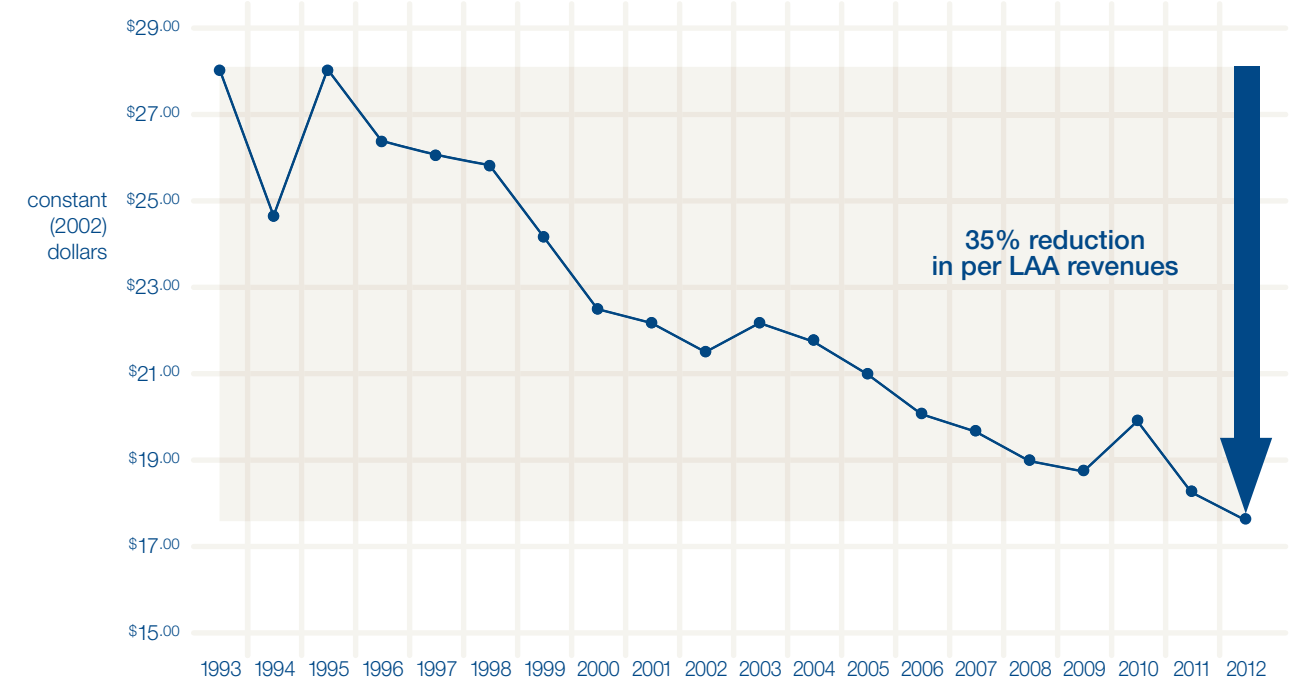
In this regard, a legitimate way to measure the government's revenue efficiency associated with deregulation is by reviewing its revenue per litre of absolute (LAA) alcohol sold. This measure indicates how much revenue the government generates in relation to the amount of alcohol consumed. Significant changes in consumption patterns driven by such factors as population change which can dramatically affect overall revenues will not significantly increase or decrease this measure.

With respect to this measure, according to Statistics Canada data, the Alberta government in 1992 collected \$23.89 for every litre of absolute alcohol sold in the

province, the year prior to privatization. In 2012, that figure was \$24.11 representing an increase of 0.9%. This 0.9% increase stands in stark contrast to the national average increase in per LAA provincial government alcohol revenues of 42.7%.<sup>41</sup> Other provincial governments were able to grow revenues during this period in a way that matched or exceeded inflation.

Alberta on the other hand, saw a sharp drop in its per LAA revenues in relation to inflation. As Chart 7 indicates, Alberta's per LAA revenues in constant dollars dropped significantly following deregulation of its government retailing monopoly.

Chart 7: Alberta Revenue per Litre of Absolute Alcohol (LAA) sold



Source for Chart data from CAMSIM Tables, 183-0017, 183-0019 & 326-0021

<sup>41</sup> Source Statistics Canada CAMSIM Tables 183-0017, 183-0019.



As noted earlier, this drop in government revenues on a per LAA basis in real dollars was not accompanied by any significant savings for consumers in terms of retail prices. On the contrary, as noted in section 2, Albertans have experienced higher alcohol price increases since deregulation than any other province in Canada even though government's share of the selling price through tax has actually declined in real terms.

## Alberta in Comparison to Ontario

A comparison of Alberta and Ontario government alcohol revenues since 1992 shows that while Alberta's demographic and economic changes should have supported a greater increase in government alcohol revenues, it has not kept pace with Ontario in terms of growing government revenues.

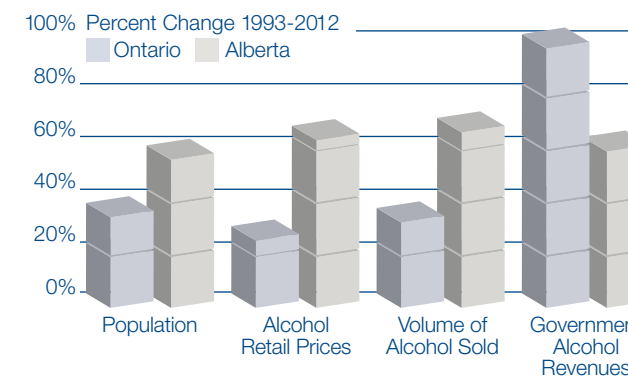
As Chart 8 indicates, in the last two decades, Alberta's population has grown faster than Ontario's, alcohol prices have increased more than those in Ontario and the overall rate of consumption has also increased at a much faster rate.<sup>42</sup> Despite

all of these changes, Ontario alcohol revenues have grown significantly faster than those in Alberta.

Comparing alcohol revenues on a per litre of absolute alcohol basis also shows a dramatic difference between the two provinces. While Ontario has been able to grow its alcohol revenues on a per litre of absolute alcohol basis over the past two decades, even in constant dollars, Alberta's revenues on a per LAA basis, as noted earlier, have dropped by over 35% in the two decades following deregulation.<sup>43</sup> To contextualize how significant this difference in revenue performance is, one can calculate the revenue implications for Ontario if its alcohol revenue stream had followed Alberta's pattern.

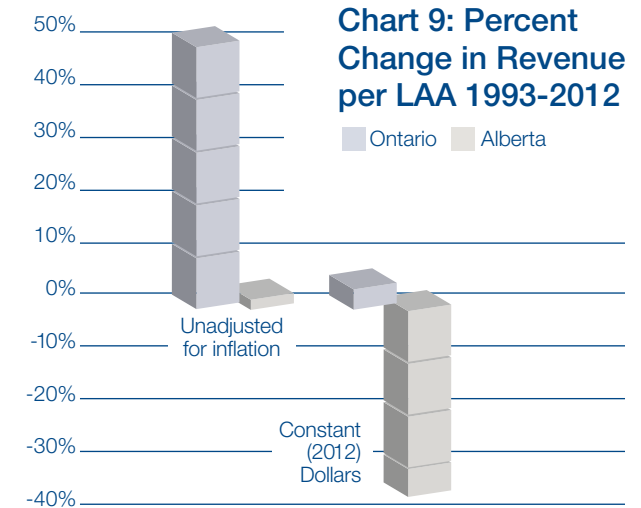
If Ontario government per litre of absolute alcohol revenues had followed the same trend as Alberta in the last two decades, the cost to the Ontario treasury would have been \$5.4 billion in 2002 dollars (see Appendix A for calculations). A revenue loss of this magnitude speaks to the significant government revenue implications associated with fundamental

**Chart 8: Key Alcohol Related Metrics 1993-2012**



<sup>42</sup> Source for Chart 8 data Statistics Canada CAMSIS tables 051-0001, 326-0021, 183-0019 & 183-0017.

**Chart 9: Percent Change in Revenue per LAA 1993-2012**



<sup>43</sup> Source for Chart 9 data from Statistics Canada CAMSIS tables 183-0019, 183-0017 & 326-0021.



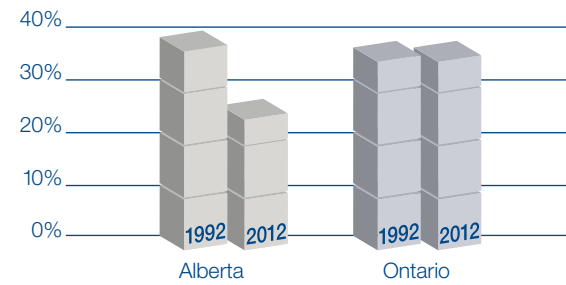
change to the beverage alcohol retailing system.

Most studies on Alberta privatization cite an adverse impact on government revenues associated with privatization over time.<sup>44</sup> The most recent of these, *Impaired Judgement*, points out that Alberta's per capita revenues from liquor sales have, when adjusted for inflation, dropped by 20% since 1993. The authors estimate the cost of deregulating Alberta's liquor retail system to be \$1.5 billion between 1993 and 2011.<sup>45</sup> In other words, if Alberta had held its per person alcohol revenues constant between 1993 and 2011, it would have netted an additional \$1.5 billion in government revenues.

As noted earlier, Alberta liquor tax rates were cut a number of times following retail deregulation. While tax rates were subsequently increased in 2002 they still remained below the tax rates in effect immediately following deregulation.<sup>46</sup> In its April 2009 Budget, the Alberta government implemented increases to AGLC markup rates that were predicted to generate an additional \$180 million for the government in the next fiscal year.<sup>47</sup> However, higher markups were abandoned by July of that year, due to a backlash from consumers and retail store operators.<sup>48</sup>

As Chart 10 indicates, Alberta government net revenues as a percentage of alcohol

**Chart 10: Government Revenue as a Percentage of Alcohol Sales 1992-2012**



sales value dropped significantly from 1992 to 2012, from 39% prior to privatization to 25% twenty years later. Ontario's liquor retailing system in comparison maintained government revenues at comparable levels. Government net revenue declined slightly from 37.2% in 1992 to 36% in 2012.<sup>49</sup>

Alberta's new retailing system created the rationale for the adoption of per litre markup rates and the consumer price impacts associated with a proliferation of outlets and the resulting costs and inefficiencies created by that proliferation affected the province's ability to increase those rates over time. Other provinces also have various alcohol charges that are collected on a per litre basis and many of these have been increased in the last decade.<sup>50</sup> Alberta's most recent attempt to increase AGLC markups, however, was rolled back because of public and retailer reaction to paying more when alcohol prices were already among the highest in the country.

As noted earlier, Alberta's post-deregulation

consumer price index for alcohol products has risen faster than any other province since deregulation even though provincial revenues associated with those products in inflation-adjusted terms are declining. In other words, since moving to an open alcohol market, Albertans have paid the largest increase in alcohol prices in the country despite the fact that provincial government revenues related to those products have declined significantly both in relation to other provinces and in relation to Alberta liquor revenues prior to deregulation.

These results show that Alberta's new retail system has strongly suppressed the ability of the provincial government to maximize alcohol related revenues. As a proliferation of alcohol outlets increased overall system costs and drove up consumer prices, government attempts to extract more revenue from alcohol sales have met with significant political resistance from both consumers and retailers. The inefficiencies and costs in the system have simply left the government with little room to capture more of the selling price through taxation.

While proponents of deregulated liquor retailing might argue that expanded access has significantly increased overall liquor sales and is therefore responsible for significant increases in alcohol consumption in Alberta, the magnitude of the decline in Alberta government revenues on a per LAA basis is so large that even if there has been some volume growth related to deregulation, in overall terms, that growth has not been significant enough to mitigate the significant downturn in government revenues associated with the initiative.<sup>51</sup>

In conclusion, the data strongly suggests that if Alberta had not deregulated

retail liquor sales, consumers would likely be paying lower prices and the province would be netting over a billion dollars on an annual basis or 40% to 50% more than it makes today. Increased accessibility, as measured by the number of selling locations, came at a price. A more costly retail system generated higher prices for Alberta consumers and lower tax revenues for government.

## Expansion of Private Retail Store Sales in British Columbia

As noted earlier, in 2002 the British Columbia government significantly expanded the number of private retail licenses available in the province and permitted those outlets to sell spirits as well as beer and wine. These stores known as licensee retail stores (LRS) increased from 290 in fiscal year 2002 to 654 by fiscal 2008.<sup>52</sup> During this period, the Liquor Distribution Branch (LDB), (a Division of the Ministry of Finance), closed 25 of its 224 government stores. Overall the number of combined liquor outlets increased from 514 to 853 over six years and the number of retail outlets selling spirits increased from 224 to 853.<sup>53</sup>

<sup>44</sup> See Flanagan, Campanella and Flanagan, Laxer & Jazairi.

<sup>45</sup> Campanella and Flanagan, page 14.

<sup>46</sup> Alberta's post-privatization AGLC per litre markups for spirits, wine and beer were initially \$14.95, \$4.35 and \$1.06 respectively. These were lowered to \$12.50, \$3.05 and \$.88 by Sept 1997. In April 2002, they were increased to \$13.30, \$3.45 and \$.98 respectively.

<sup>47</sup> Alberta Budget 2009, p 58.

<sup>48</sup> See "Alberta loses liquor advantage", Calgary Herald, April 9, 2009, "Alberta no longer king of beers", National Post, May 22, 2009, "Premier cuts liquor taxes", Edmonton Journal, July 7, 2009. Premier Stelmach had also promised during the 2008 election that there would be no new taxes.

<sup>49</sup> Source for Chart 10 Estimates: ALCB/AGLC Annual Reports; LCBO Annual Reports. TBS estimated Alberta 2012 retail markups based on historical price survey data.

<sup>50</sup> For example, Ontario's basic beer tax is indexed for inflation and increased every year on March 1, 2012. In 2012, Quebec increased its per litre beer tax on grocery/corner store sales by \$.10/litre on 25%. Over the last decade, Saskatchewan has increased in beer per litre charges 8 different times. B.C. increased liquor markups by approximately 3% in 2005, including an increase to its per litre charges on beer.

<sup>51</sup> Even if one assumed that all of the change in per capita consumption in Alberta since privatization was related to privatization, i.e. the 9.5% increase between 1993 and 2012 was due solely to privatization and reduce annual liquor volumes accordingly, the differential between 1993 revenue per LAA levels and those actually experienced would still be \$2.34 billion dollars.

<sup>52</sup> British Columbia Liquor Distribution Branch Annual Reports cover the 12-month periods ending March 31st of each year. For example, Fiscal 2008 covers the 12 months ending March 31, 2008.

<sup>53</sup> BC LDB Annual Reports F2002 to F2008. Initially, the B.C. government planned to privatize its entire retail network, but opted for partial privatization shortly thereafter. Including wine stores and onsite manufacturing stores the total number of alcohol outlets in BC increased from 787 in 2002 to 1,294 in 2008. Some of this growth would have been attributable to new wineries opening rather than the change in government policy related to liquor sales.

In BC all liquor sales are legally made through the LDB including wholesale sales to the LRS stores. Prior to the 2002 initiative, the LDB provided LRS stores with a reduced LDB mark-up on products wholesaled by the LDB to the LRS channel. This mark-up or tax reduction (i.e. the LRS discount) was calculated as 10% of the LDB's normal retail selling price. Shortly, after the announced expansion of LRS stores, the LRS mark-up/tax reduction was increased from 10% of the normal LDB retail selling price to 12% of the retail price. That LRS mark-up/tax reduction was further increased in 2005 to 13% of LDB retail price and again to 16% of LDB retail price in January 2007. As a result of these mark-up/tax reductions the government has been making less revenue from the LRS channel over time.

In November 2007, the government declared a moratorium on the granting of new licensee retail stores although stores in various stages of the application process were still permitted to open.<sup>54</sup>

LRS sales as a percentage of total LDB sales more than doubled between 2002 and 2008 growing from just under 16% to just over 32%. While the LDB did realize some savings during this period reflected in its closure of 25 outlets, their direct operating expenses still increased by 10.4% despite the fact that sales through its directly operated stores were relatively flat.<sup>55</sup> In other words, the LDB'S ability to generate significant savings was limited as 90% of its retail system was retained as the LRS network was expanded significantly.

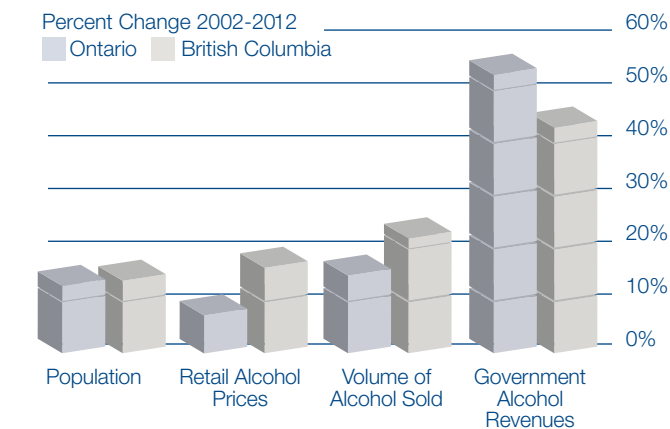
<sup>54</sup> See BC Liquor Control and Licensing Branch Licensing Policy Manual April 2013 Update, Section 15, pages 10-11 for a history of LRS licensing changes. Recently, the government has indicated that the LRS moratorium will be lifted as of July 1, 2022.

<sup>55</sup> See BC LDB Annual Reports F2002 to F2008.

Progressively more generous LDB discounts for LRS stores in combination with a major expansion in the number of LRS outlets significantly increased the total aggregate value of the discount provided to the overall LRS channel from an estimated \$28 million in 2002 to over \$138 million in 2008.<sup>56</sup> Not surprisingly, LDB net income as a percentage of sales declined from 35.5% to 32.0% during this period.

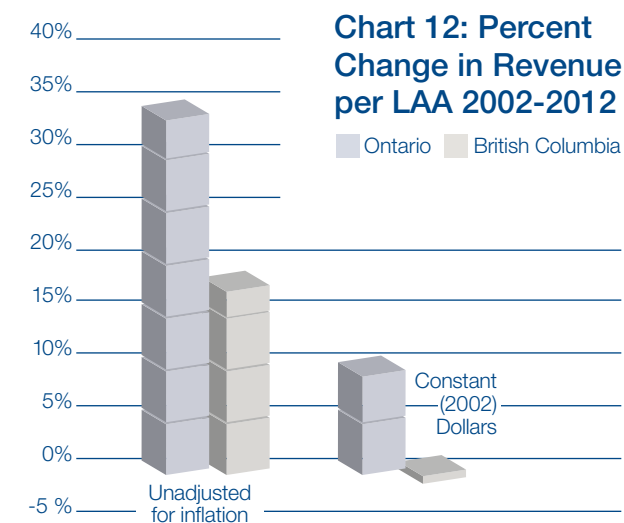
While a number of factors affect LDB net income, most of the LDB changes that took place during this period should have supported an improvement in net income, not a decline. For example, the LDB increased general alcohol markups in 2005 by an average about 3% across all product lines. Instead of an increase in net income normally associated with such markup changes, these changes simply mitigated the decline in net income associated with rapidly rising LRS sales on which government tax revenues were lower owing to the above referenced increased discounts (i.e. mark-up reductions) for the LRS channel.

**Chart 11: Key Alcohol Related Metrics 2002-2012**



<sup>56</sup> LRS discounts were estimated by applying applicable discount rates to annual LRS sales values reported in LDB Annual Reports.

As Chart 11 indicates, as was the case with Alberta, BC, following partial deregulation of alcohol sales, outperformed Ontario in a number of key metrics that should have generated higher government alcohol revenues: population growth, retail price increases and volume growth. However, despite all these factors, Ontario government alcohol revenues actually grew faster than B.C.'s during this period increasing by 53.4% versus 43.3% in B.C..<sup>57</sup> As was the case in the Ontario-Alberta comparison, the province of Ontario experienced superior revenue growth from alcohol sales while its consumers benefitted from lower price increases.



With respect to government revenue generated on a per litre of absolute alcohol basis, Ontario revenue growth also outperformed BC during the period following B.C. expansion of retail alcohol sales. While the trend is less pronounced than one experienced in Alberta, in constant dollars, the change in BC per LAA revenues was still negative in the

<sup>57</sup> Source for Chart 11 calculations Statistics Canada data pulled from CAMSIM tables 051-0001, 326-0021, 183-0019 & 183-0017.

ten years since the expansion of the LRS system.

In both the case of Alberta and B.C., Ontario's current retailing system generated a higher rate of government revenue growth than alternate retailing models characterized by a significant expansion in the number of retail outlets.

## Conclusions Deregulation and Government Alcohol Revenues

- Deregulation of alcohol sales in Alberta resulted in a significant decline of 35 per cent in government per LAA alcohol related revenues (measured in constant dollars) despite higher consumer prices.
- Partial deregulation of alcohol sales in B.C. also resulted in a slight decline in government revenues per LAA (measured in constant dollars) despite LDB markup increases and higher consumer prices.
- Ontario's current beverage alcohol retailing system outperformed both Alberta and B.C. in government revenue growth in the periods following full and partial deregulation in those provinces.



# Deregulation and Product Selection

## Current Ontario System

As noted earlier, the LCBO operates 634 stores. Access to the LCBO system is governed by a category management system. The LCBO has a general product list of around 3,400 items and purchases thousands of alcohol products annually through its Vintages program.<sup>58</sup> The LCBO issues product need letters regularly to identify its needs for both the general list and Vintages program and reviews supplier submissions on an ongoing basis.<sup>59</sup>

Product selection at the LCBO varies by store type. LCBO stores are divided into half a dozen categories based on their annual sales volumes. Some products are “force listed” into LCBO stores by the category management process. Other products are listed at the discretion of the store manager.

<sup>58</sup> The LCBO F2011 Annual Report identifies 3,381 regular listings, p 87.

<sup>59</sup> The LCBO F2011 Annual Report identifies 11,911 consignment and private stock listings, p 87. Agents can also order non-LCBO listed products for sale to consumers and licensed establishments through consignment and private stock system operated by the Board.

The largest LCBO stores will carry every product on the LCBO's general list and hundreds of additional Vintages products. Over 40% of stores are classified as Image stores or larger (meaning they run Image promotions). These stores will stock a majority of products on the general list and many will have 400 to 500 Vintages products or between 2,000 and 3,500 products available. Smaller LCBO stores will have fewer products, but even most small LCBO stores will stock more than a 1,000 alcohol products.

The Beer Store sells more than 400 brands of beer from 100 different brewers and over 1,000 home consumer beer selling units.<sup>60</sup> Larger Beer Store outlets typically stock around 600 beer selling units with the smallest Beer Store stores stocking around 200 selling units. Average selling unit availability per store is around 500.

The Beer Store has an open listing policy meaning any brewer in the world can stock whatever beer packages they choose at whatever Beer Store store they choose subject only to LCBO quality assurance approvals and payment of one-time Beer Store listing fees. Brewers choose the number of stores they sell in and set the prices for which their products sell.

## The Impact of Deregulation on Product Selection

In Alberta deregulation entailed a transition from a general list managed by the Alberta Liquor Control Board (ALCB), similar to the current LCBO process, to a privatized

consignment warehouse process. The ALCB privatized its wholesaling function by contracting its central warehouse out to a private operator and allowed any liquor manufacturer in the world to stock products at this warehouse (subject to consignment storage fees) to be made available to private liquor retailers. Product selection at private liquor stores is determined by store operators who are lobbied by liquor manufacturer agents to order their products from the AGLC's consignment warehouse.

The impact of deregulation on product selection in Alberta has been reviewed by a number of studies. The aggregate number of products available in Alberta under the new system increased significantly from around ALCB 3,200 skus to over 10,000 products available through the AGLC's consignment warehouse.<sup>61</sup> Product selection at individual stores prior to deregulation ranged from 600 to 700 skus in smaller ALCB stores up to 1,500 to 1,600 skus in larger ALCB stores (plus additional specialty listings).<sup>62</sup>

Following deregulation, based on a survey of 100 private retailers West found that the average number of products available per Alberta liquor store increased by over 10%. However, when product selection was assessed on a regional basis, West found that product selection per store declined in Calgary and Edmonton, but increased slightly in the rest of the province.<sup>63</sup>

<sup>61</sup> West, p 10. Prior to privatization, the ALCB had just under 2,000 products available on its catalogue list and another 1,200 available through a private agent ordering program.

<sup>62</sup> Ibid, p 5.

<sup>63</sup> Pre-privatization sku counts per ALCB store for Calgary, Edmonton and the rest of the province were 1,369, 1,380 and 824 respectively. The equivalent private liquor store averages for those areas following privatization based on a 1996 survey were 1,284, 1,142 and 847 respectively.

One aspect of product selection that has not been reviewed in detail is the variation in product selection associated with various retail systems. In Alberta, given that listings are a function of individual store owner decisions, product selection will vary more significantly between stores than is currently the case in Ontario. For example, in the recent May 2013 Ipsos Reid survey which sampled 50 popular beer products (15 brands in various package sizes) in Alberta, store selection ranged from 5 to 35 of those products with an average selection of around 25 products.<sup>64</sup> In Ontario, such products would be found in over 90% of beer stores.

With respect to B.C.'s expansion of LRS stores, a 2006 study by the Consumers Association of Canada concluded that there is less product selection at B.C. LRS stores than government run LDB stores.<sup>65</sup>

With respect to beer sales and the average number of beer brands available at Alberta private liquor retailers, as can be seen in Table 2 (opposite), the May 2013 Ipsos Reid survey found that in urban areas liquor stores typically stocked between 70 and 150 beer brands. In rural areas there were fewer products with typical product selection of 60 to 90 beer brands. This availability is about half the comparable range of brands available in Ontario Beer Store outlets for both urban and rural locations.

Ontario stores also stock a broader range of beer products than private liquor stores in B.C. and grocery and depanneur outlets in Quebec. Beer Store urban stores stock between 280 and 330 beer brands per outlet versus a typical range of brand

<sup>64</sup> Based on data from Ipsos Reid Survey, 2013.

<sup>65</sup> See *BC Liquor Distribution System: "Does it work for Consumers"*, CAC, 2006.

selection at urban Quebec convenience stores of 105 to 170 brands per store. Although beer brand selection in typical private B.C. liquor stores was higher than that of either Quebec or Alberta retailers, brand availability was still less than the range available at Beer Store outlets, especially in urban areas.<sup>66</sup>

**Table 2: Typical Beer Brands Per Store by Jurisdiction\***

Jurisdiction	Urban	Rural
Quebec C-Store	105-170	50-80
Ontario TBS	280-330	110-180
Alberta	70-150	60-90
B.C. LRS	120-240	130-150

\* From Ipsos Reid, May 2013 survey. 70 % to 80% or more of stores surveyed contained brand counts within the identified range.

## Conclusions Deregulation and Product Selection

- *Deregulation in Alberta significantly increased the overall number of alcohol products available through the province's central distribution warehouse however:*

- *Consumers may have to shop around to find particular products as the availability of products at any particular store varies significantly;*

- *With respect to beer, Beer Store outlets typically stock a larger selection of products than private liquor retailers in other provinces.*

<sup>66</sup> Based on data from Ipsos Reid Survey, 2013.



# Deregulation and Availability of Alcohol

## Current Ontario System

As noted in the introduction, Ontario's liquor retailing system is characterized by a mix of government and private retailers. As Table 3 shows, there are over 1,800 outlets where alcohol is available in Ontario. The number of people per outlet in Ontario is significantly higher than

provinces with deregulated markets like Quebec and Alberta. That said, outlets in Ontario tend to be significantly larger in size and as noted in the previous section tend to carry a wider selection of brands and pack sizes.

**Table 3: Ontario Alcohol Outlets<sup>67</sup>**

	2008	2009	2010	2011	2012
TBS Stores	440	437	442	445	447
LCBO Stores	604	607	611	617	634
LCBO Agency Stores & TBS Retail Partners	216	216	216	217	219
Winery retail stores	429	439	448	464	479
On-site Distillery and Brewery Stores	42	44	47	46	48
<b>Total</b>	<b>1,731</b>	<b>1,743</b>	<b>1,764</b>	<b>1,789</b>	<b>1,827</b>

<sup>67</sup> Source for all locations other than TBS outlets is LCBO Annual Reports.

Given deregulation's likely impacts on government revenue and consumer prices, an important question related to consumer convenience and deregulation is: What is the value that consumers place on availability of alcohol and how should that availability be assessed? Is it more convenient to have a larger number of products available at fewer stores, or a smaller number of products available at more stores? Is a 15% increase in retail prices and reduced government alcohol revenues over time a tradeoff supported by most Ontario consumers and taxpayers?

To provide some insight on this question, the Beer Store engaged Ipsos Reid in May 2013 to poll Ontario residents about their attitudes toward alcohol sales. Among the poll highlights were the following:

- 81% of Ontarians are satisfied with the existing beverage alcohol retailing system;
- 64% of respondents felt the number of alcohol outlets was just right (8% felt there were too many outlets);
- 66% of respondents mistakenly thought the price of alcohol would stay the same or go down if convenience stores were allowed to sell alcohol products;
- 67% of respondents indicated that they would be more likely to oppose the sale of liquor in convenience stores if they had to pay 15% to 20% more for alcohol products.<sup>68</sup>

The polling numbers suggest that Ontarians are relatively supportive of the existing beverage alcohol retailing system and do not support a move to convenience store

<sup>68</sup> See Ipsos Reid, *Convenience Store Public Opinion Survey, June 2013*.

sales if it results in higher prices.

## Impact of Deregulation on Availability of Alcohol Products

It should be noted that deregulation of retail liquor sales does not necessarily have to entail a change to the number of alcohol retailing outlets. In 1990 the State of West Virginia replaced state-run liquor stores (wine and beer was already available in grocery and corner stores) with private sector retailers through a bidding process in which businesses bid for 10-year licences for the right to sell liquor in defined geographic areas.<sup>69</sup> This was also the general approach recommended by the Ontario Beverage Alcohol System Review (BASR) panel to the Ontario government in 2005<sup>70</sup> and attempted by Quebec in 1985 but abandoned when the government did not receive bids on half of its licenses<sup>71</sup>.

The West Virginia program, BASR recommendations and the failed Quebec initiative, all shared maximizing government revenues as a primary objective. However, these types of licensing schemes, where the government retains tight control over the number of retail outlets (and pricing within those outlets), are not what most proponents of deregulation mean when they argue that moving to a deregulated retail market will improve consumer convenience, choice and prices.

<sup>69</sup> See West Virginia Alcohol Beverage Control Administration *F2012 Annual Report* for history of licensing changes.

<sup>70</sup> See *Strategy for Transforming Ontario's Beverage Alcohol System: A Report of the Beverage Alcohol System Review Panel*, July 2005. Panel was established by the Ontario government.

<sup>71</sup> Lauzon, Leo-Paul, *Socio-Economic Analysis: Societe des Alcools du Quebec: Privatization Proposals*, January 1994, p 4.

In that regard, there seems to be little question that the Alberta and B.C. deregulation initiatives increased the number of locations where people could purchase alcohol. As noted earlier, initial deregulation in Alberta replaced 204 government stores with over 500 independent liquor stores. Today there are over 1,300 private stand-alone liquor stores open in Alberta.<sup>72</sup>

Similarly in B.C., over six years, the system was transformed from one with 224 government liquor stores and 290 LRS stores selling beer and wine, 514 outlets in total, to a system with over 853 outlets where a full range of beer, wine and spirit products is available in all outlets. A 66% increase in the number of liquor outlets.

With respect to Quebec's retailing model, which features the availability of beer and wine in corner and grocery stores with spirit sales restricted to the government operated SAQ, it should be noted that only wine bottled in Quebec is permitted for sale in corner and grocery stores – all other imported wine is only available for sale in the SAQ operated stores. This policy is designed to support a provincial bottling industry and is a barrier to both interprovincial and international trade, but one that has been grandfathered in various trade agreements related to beverage alcohol sales in Canada.<sup>73</sup> In that market the exact number of selling locations is hard to determine precisely but it is generally believed to contain

<sup>72</sup> Alberta Liquor Quick Facts April 2013, AGLC.

<sup>73</sup> See 2003 Agreement between the European Community and Canada on trade in wine and spirit drinks, Annex VIII, Article 2 (c); North American Free Trade Agreement, Annex 312.2, Article 5 (c) and Canadian Agreement on Internal Trade (2012 Consolidated Version) Chapter Ten, Article 1011 (b).

8,800 retail selling locations comprised of 806 SAQ locations (including agency stores) and approximately 8,000 grocery and convenience stores.

If Ontario allowed wine in corner stores but tried to restrict sales to Ontario produced wines, it would undoubtedly generate an international trade dispute, in which a favourable ruling for Ontario would be highly unlikely.

## Conclusions Deregulation and Availability of Alcohol

- *Deregulation in Alberta and B.C. made alcohol more available throughout the province, but at significantly higher prices for consumers:*
  - *There are now six times as many private stand-alone liquor stores in Alberta as there were before privatization;*
  - *BC liquor outlets increased by 66%;*
- *Adopting Alberta's liquor retailing model would likely mean over 10,000 liquor stores in the province of Ontario;*
- *Adoption of Quebec's retailing model would also mean thousands of alcohol points of sale in Ontario, but as noted earlier, Quebec's beer taxes are significantly lower than Ontario's and in the absence of a tax reduction to compensate for the added costs associated with thousands of new selling locations, prices would increase;*
- *Ipsos Reid polling indicates most Ontario residents are not supportive of paying higher prices for greater alcohol availability.*

As part of **our commitment** to the responsible sale of alcohol, we...

**ID 25**

Please be prepared to show your ID.



## The Impact of Deregulation on Responsible Sales Practices

### Current Ontario System

Currently both the Beer Store and LCBO staff request photo ID from any person who appears to be 25 or under and staff refuse service to anyone who appears to be intoxicated. Both organizations utilize staff training, mystery shopping programs and managerial performance reviews to ensure responsible sales practices.

In fiscal year 2012 the LCBO challenged 6.3 million customers and refused service to 290,000 individuals. In calendar 2012, the Beer Store challenged 3.5 million customers and refused service to 67,000 individuals. The majority of service refusals at both the Beer Store and the LCBO were for failure to show proper age identification.<sup>74</sup> Both organizations also partner with social

<sup>74</sup> See LCBO website: Today's LCBO: Social Responsibility and Key Part of Our Mandate; See TBS Website: Social Responsibility is a cornerstone of our business.

interest groups and help fund and deliver responsible messaging campaigns.<sup>75</sup>

Social interest groups and health researchers concerned about alcohol related problems strongly support the current Ontario retailing model. Recently a number of university health professionals partnered with the Centre for Addiction and Mental Health (CAMH), the Centre for Addictions Research B.C. and Mothers Against Drunk Driving (MADD) in a systematic and comprehensive review of provincial policies directed at reducing the health and social harms associated with alcohol consumption. The fourteen researchers ranked Ontario number one in terms of current policies that reduce alcohol harms.<sup>76</sup>

A recent MADD policy backgrounder sums up social interest group support for the current Ontario retailing model:

Provincial liquor boards provide society with a reasonable measure of control

<sup>75</sup> The LCBO works with Mothers Against Drunk Driving (MADD) on a number of responsible use campaigns such as "Deflate the Elephant" and "Talk to your kids about alcohol". For a number of years, TBS has worked with Arrive Alive, Drive Sober, which encourages responsible consumption, smart party planning and the use of designated drivers and taxis for persons consuming alcohol. Both organizations also work with a number of local charities and community groups in fundraising initiatives. In F2012, LCBO customers and employees helped raise \$6.2 million for various charities. In 2012, the TBS union, staff and customers raised \$1.7 million through Returns for Leukemia and addition funds for a number of smaller charities and community groups.

<sup>76</sup> See *Strategies to Reduce Alcohol-Related Harms and Costs in Canada: A Comparison of Provincial Policies*, released March 2013. One of the Report recommendations is to "maintain government monopolies by preventing the further privatization of alcohol sales channels and uphold a strong responsibility mandate", page 2. These conclusions are consistent with 2007 recommendations by the National Alcohol Strategy Working Group, including representation from Health Canada, which recommended maintaining government control of liquor sales. See *Reducing Alcohol-Related Harm in Canada: Toward a Culture of Moderation: Recommendations for a National Strategy*, April 2007, page 16.

over alcohol pricing and accessibility, and thereby effectively manage alcohol consumption and alcohol-related harm. At the same time, provincial liquor boards offer customers high levels of service, quality and selection, along with a strong commitment to social responsibility which benefits consumers and non-consumers alike.<sup>77</sup>

A recent CAMH survey by Ontario students highlights one of the reasons why support from social interest groups for Ontario's current liquor retailing model is relatively high. Only 2.6% of students surveyed who used alcohol indicated that they were able to buy alcohol at a liquor store and only 1.2% of those students indicated they were able to purchase alcohol at a beer store. This compares to 15.6% of student respondents who indicated they were able to purchase cigarettes at corner stores or gas stations.<sup>78</sup>

## The Impact of Deregulation on Responsible Sales Practices

The effects of deregulated retail systems versus regulated systems on alcohol-related concerns in the community have been reviewed and debated extensively in the literature. Proponents of deregulation view more alcohol outlets as a positive change, while social interest groups concerned about alcohol problems, generally view an increase in the number of outlets and greater availability through longer hours as contributing to an increase in overall alcohol consumption and alcohol-related problems. These include such

<sup>77</sup> *Provincial Liquor Boards: Meeting the Best Interests of Canadians: MADD Canada Policy Backgrounder.*

<sup>78</sup> *Drug Use Among Ontario Students 1977-2013, Ontario Student Drug Use & Health Survey, Centre for Addiction and Mental Health, page 245.*

issues as incidents of drinking and driving; alcohol-related deaths, diseases, accidents and violence; fetal alcohol syndrome and increases in other social problems such as crime and underage drinking.

While there are a number of points of view on these issues, most researchers acknowledge that the relationship between availability and overall consumption is complex and that availability intersects with various other demographic, economic, cultural and environmental factors that affect consumption. Many of the studies on changes in availability and impacts on alcohol-related problems involve complicated statistical methodologies and are subject to interpretation regarding cause and effect.<sup>79</sup>

A number of studies have reviewed privatization in Alberta and other North American jurisdictions and concluded that there was no significant increase in overall alcohol consumption associated with a significant increase in retail availability.<sup>80</sup> These studies have been contested by others which have drawn the opposite conclusion: finding that increased alcohol outlets have contributed to both an increase in overall consumption and/or an increase in alcohol-related

<sup>79</sup> For example, are changes in drinking and driving statistics a result of changes in alcohol availability or other factors such as better or worse enforcement, reporting processes or other factors affecting consumption. How do researchers determine what the trend line in any jurisdiction would have been in the absence of a change in availability? Are trends in other jurisdictions related to a lack of a change in alcohol availability or other factors?

<sup>80</sup> Studies which found no statistically significant increase in overall alcohol consumption associated with an increase in alcohol availability include Trolldal, *Addiction*, May 2005 (Alberta); Trolldal, *Alcoholism Clinical and Experimental Research*, March 2005 (Quebec), Smart, *Alcohol Alcohol*, 1986 (Quebec); Fitzgerald, Mulford, *British Journal of Addiction*: 87, 1993, (Iowa).

problems.<sup>81</sup> These differing results have generated academic debates about statistical methodologies and highlight some of the difficulties in determining cause and effect when dealing with complex societal variables.<sup>82</sup>

In the view of the Beer Store, historical changes to retail availability do not appear to have generated significant changes in long-term overall consumption patterns.

Concerns about deregulating retail alcohol sales, however, relate not simply to changes in physical availability, but also the sales practices associated with independent retailers. In this regard, even relatively small changes in overall consumption might generate increases to alcohol-related problems if it is easier for younger consumers or intoxicated consumers to obtain alcohol.

While the academic debate related to overall consumption and availability is likely to continue, the experience of both Alberta and B.C. provide strong evidence that the expansion of liquor outlets in both provinces stimulated a deterioration of responsible sales practices and a corresponding increase in government's enforcement costs to mitigate those issues.

<sup>81</sup> Studies which found an increase in overall alcohol consumption and/or an increase in alcohol-related problems associated with an expansion of retail outlets include Wagenaar, Holder, *Journal of Alcohol Studies*, 1991 (Iowa, West Virginia); Flam Zachman & Mann, (Alberta), Stockwell et al, *Addiction*, 2010, (British Columbia); Hahn et al, "Effects of Alcohol Retail Privatization ...", *American Journal of Preventative Medicine*, 2012 Literature review of 17 different studies.

<sup>82</sup> Given the various variables which affect alcohol consumption and sales, it can be difficult to isolate cause and effect with respect to assessing the impact of retail changes on consumption. For a discussion of methodological issues associated with alcohol consumption studies see Davies "A Review of Studies on Liquor Control and Consumption".

## Alberta

With the expansion of retail outlets in Alberta, the responsibility for responsible service practices transitioned from government liquor store employees to private sector retailers and their staff. One of the concerns about this transition highlighted by researchers is that private retailers potentially have a profit motive related to alcohol sales that conflicts with the broader social benefits of restricting sales to minors or intoxicated patrons.<sup>83</sup>

In Alberta, the AGLC requires retailers to ask for identification if the patron appears to be 25 or younger (the same policy in place in Ontario). However, Alberta has had to progressively increase its monitoring and enforcement costs to ensure better compliance with this policy.

Shortly after deregulation, an Edmonton television station filmed under-age persons successfully obtaining alcohol at a number of private sector liquor stores. In response, the AGLC raised retailer fines for violations of responsible service practices.<sup>84</sup> This scenario was repeated in 2002 when another news network sent minors to five liquor stores and found that all of the retailers failed to ask for age identification.<sup>85</sup> Once again, the AGLC increased monitoring and conducted its own study of 255 liquor stores of which 208 or 82% failed to ask younger patrons for ID even though retailers were warned in advance of the audit.<sup>86</sup>

The repeated problems with service to minors forced the AGLC to further

<sup>83</sup> See Flanagan, p 18, Campanella and Flanagan, p 22, Laxer et al, p 19.

<sup>84</sup> Flanagan, p 19.

<sup>85</sup> Campanella and Flanagan, p 23.

<sup>86</sup> *Ibid*, p 23



expand its compliance testing, staff and responsible service messaging. A new AGLC Social Responsibility Division was created and was successful in improving retailer compliance with ID checks. Over a four year period, from 2002 to 2006, retailer compliance with ID checks improved from an initial 23% to 80%.<sup>87</sup> The AGLC, however, continues to warn industry associations and individual retailers about the timing of upcoming audits.<sup>88</sup>

Alberta's experience highlights the fact that government monitoring and enforcement costs will likely increase if the province moves to an open retailing market. Currently, the Alcohol and Gaming Commission of Ontario (AGCO) and municipal police forces, spend little if anytime monitoring retail sales practices. This is because both the LCBO and the Beer Store have internal policies and measures in place which effectively address the issue. Even with increased AGCO spending, however, Alberta's experience raises the question of whether responsible sales practices in a deregulated retail market in Ontario would be as strong as those currently in place.

## British Columbia

B.C.'s experience with independent private retailers and service to minors has been similar to Alberta's. In B.C., the Liquor Control and Licensing Branch (LCLB) regulates the sale of liquor by

<sup>87</sup> Ibid, p 24.

<sup>88</sup> Ibid, p 24, The most recent AGLC Annual Report states that a "special inspection program found 83 percent of establishments serving liquor requested proof of age from young people". The AGLC does not distinguish between liquor retailers and bars and restaurants with respect to this statistic. p 20.

<sup>89</sup> The LCLB is currently a branch of the Ministry of Energy, Mines and Natural Gas as is the Liquor Distribution Branch which runs B.C. government liquor stores. The LCLB also licenses liquor manufacturers, Ubrews and UVin operators and issues special occasion permits.

licensed establishments and retailers.<sup>89</sup> During the government's expansion of LRS licenses, the LCLB ran a number of Compliance Check Programs between 2003 and 2009.

In its first stage of operations (2003 – 2005) stores were scored on whether they asked for two pieces of ID from persons who appeared to be under the age of 25. Compliance at LRS stores ranged between 15% and 27% for three years of data versus a compliance rate of 57% and 60% for government stores.<sup>90</sup>

In 2007, the LCLB changed checking requirements from focusing on checking for ID for persons under the age of 25 to focusing on checking for ID when verifying age. Initially results improved for both government stores and LRS outlets with compliance increasing to 77% for government stores and 36% for LRS locations, but in the following year compliance at government and private sector stores dropped to 56% and 26% respectively.<sup>91</sup>

Given the ongoing problems with sales practices, the B.C. government amended the *Liquor Control and Licensing Act* to provide authority for the use of minors in compliance checking programs. Under a new LCLB Minors as Agents Program,

<sup>90</sup> *Minors as Agents Program 2011/2012 Annual Report*, B.C. Liquor Control and Licensing Branch, page 2. Youthful looking patrons (i.e. persons who were old enough to legally purchase liquor, but who looked young) purchased liquor to determine if retailers, both public and private were checking for age ID.

<sup>91</sup> Ibid.

<sup>92</sup> Under the program, retailers are given a notice of contravention when they have sold liquor to a minor operating under the program. Once received retailers can plead guilty or contest the contravention and request a hearing. Regulations establish a fine of \$7,500 to \$10,000 for a first offence or a suspension of 10 to 15 days. If a second contravention is found to occur in the same year, the penalty schedule provides for a suspension of 20 to 20 days. In practice, the LCLB has implemented fines of \$7,500 for first offences.

retailers are subject to fines and potential suspensions for selling alcohol to minors. In its first full year of operation, the Program tested approximately 51% of all LRS stores and 50% of all government stores.<sup>92</sup>

With the threat of more substantial penalties, compliance with the new program in its first two years of operation has been better for both LRS and government run stores, with 94% of government stores and 78.5% of LRS stores refusing service to minors.<sup>93</sup> While compliance improved, government run stores still performed much better with respect to responsible sales practices than did LRS retailers.

B.C. industry associations have questioned the fairness of the LCLB's sting-like operations,<sup>94</sup> but as with Alberta, the move to privatized retailing gave rise to concerns about responsible sales practices that required additional government monitoring and inspections. As the authors of *Impaired Judgement* concluded, private sector operators, despite improvement, were still outperformed by their government equivalents:

...even in the context of improved behaviour overall, public stores have nevertheless demonstrated a superior ability to uphold liquor laws prohibiting sales to minors. Private retailers, those motivated by individual profit over public good, have not performed as well.<sup>94</sup>

## U.S. Jurisdictions

The experience of both Alberta and British Columbia, characterized by new

<sup>93</sup> *Minors as Agents Program 2011/2013 Annual Report*, B.C. Liquor Control and Licensing Branch, pages 6-7.

<sup>94</sup> See "Underage liquor agents seen by store owners as entrapment", Ian Bailey, *The Globe and Mail*, June 10, 2012.

<sup>95</sup> Campanella and Flanagan, p 26.

investments in enforcement initiatives and underage compliance checks in relation to private alcohol sales is similar to the experience of many U.S. jurisdictions which allow private sector alcohol sales.

Over the last two decades, several U.S. states have passed laws enabling law enforcement officials to utilize persons who are under the legal drinking age to purchase liquor for the purposes of testing retailer and licensee compliance with underage service restrictions – so-called "Agents as Minors Programs".

Typically, an underage agent, without proper age identification, working with liquor authority officials or local police or both, will enter a liquor retailer or other licensee and attempt to purchase liquor. In many states agents are obligated to be truthful about their age if asked or use their own ID. One state, Oregon found that 50% of private retailers that sold to minors did so after checking ID which indicated the person was not of legal drinking age. If the agent is successful, the retailers or other licensees will be subject to the disciplinary sanctions imposed by that state.

Many states publish information on the failure rates associated with minor compliance check programs. Table 4 (next page) summarizes the results of compliance testing in several U.S. jurisdictions in the last few years.

New York state which only began to establish minors compliance testing in 2009, recorded retailer failure rates of 42% in the hundreds of retailers visited in sting operations between 2011 and 2013.

Washington state which recently privatized its government liquor stores tested both its own government stores and private sector retailers (which sold wine and beer)

**Table 4: U.S. state and B.C. Minor Compliance Check Program Results<sup>96</sup>**

State/Province	Agency	Year(s)	Type of Licensee	Businesses Tested	Failure Rate (sale to minor)
New York	New York State Liquor Authority	2011-2013	Retailers	1,129	41.7 %
Illinois	Illinois Liquor Control Commission	2009-2013	Retailers & Licensees	6,398	21.4 %
Georgia	Dept of Licensing & Regulatory Affairs	2008-2012	Retailers & Licensees	21,806	17.6 %
Arizona	Dept of Liquor Licenses & Control	2003-2012	Retailers & Licensees	3,412	30.7 %
Michigan	Department of Revenue (Liquor & Tobacco)	2006-2011	Retailers & Licensees	11,008	14.9 %
Ohio	Dept of Public Safety	2012-2013	Retailers & Licensees	1,782	21.4 %
Oregon	Oregon Liquor Control Commission	2009-2011	Retailers & Licensees	5,902	21.3 %
Washington	Washington State Liquor Control Board	2011	Retailers	2,129	5.7 %
			Failure Rate Government Stores		
			Failure Rate Private Retailers		
British Columbia	Liquor Control & Licensing Branch	2011-2013	Retailers		6.0 %
			Government Liquor Stores	183	
			Private Liquor Stores	670	
California	Dept of Alcoholic Beverage Control	2003-2012	Retailers & Licensees	47,066	17.1 %

<sup>96</sup> Sources: New York, NYSLA media advisories, 2011-2013, available at [www.sla.ny.gov](http://www.sla.ny.gov); Illinois, see ILCC Monthly Compliance Reports, available at <http://www.state.il.us/lcc/MonthlyComplianceReports.asp>; Georgia, see Georgia Department of Revenue Annual Statistical Report FY2012, p 68; Arizona: see DLLC Annual Reports, 2007 -2012, Covert Underage Buyer Program Statistics; Colorado, statistics from Department of Revenue Liquor and Tobacco Enforcement Division Compliance Check Record Search available at <https://www.colorado.gov/apps/dor/mip/searchCCR.jsf>; Michigan: See Department of Licensing and Regulatory Affairs, Annual Legislative Reports, Liquor Control Commission (Controlled Buy statistics), 2006 – 2011; Ohio, See Ohio Department of Public Safety, 2012 Annual Report, p 21; Oregon, see OLCC Public Safety and Services Programs Annual Report Calendar 2011, Minor Decoy statistics; Washington WSLCB Annual Reports, 2007-2011; California: See State of California Fact Sheet: Minor Decoy Program, available at <http://www.abc.ca.gov/forms/ABC511.pdf>.

and other licensees. From 2007 to 2011, government liquor stores outperformed private sector licensees by a significant margin in relation to compliance with underage drinking laws.

As Table 4 illustrates, in 2011, 94.3% of government stores refused service to minors versus 77.3% of private licensees. The gap in performance was even greater in 2010 with 95% of government stores refusing service to underage agents, versus 76% of private sector licensees. These results are very similar to the split between private sector retailers and government stores associated with testing in British Columbia.

The results of compliance checking in several U.S. states suggest that responsible sales practices in deregulated liquor retail systems are not as strong as those associated with controlled beverage alcohol markets. The Ontario government would likely need to make significant new investments in enforcement and monitoring capabilities if it privatized or deregulated liquor sales.

## Conclusions Deregulation and Responsible Sales Practices

- Concerns about sales practices by private retailers in both Alberta and B.C. prompted both governments to increase related monitoring and enforcement (incurring additional costs). This is also true of several U.S. states with deregulated alcohol markets. The results associated with these enforcement programs demonstrate that compliance with sales to minors laws decrease significantly in deregulated retailing environments.

- In Ontario, independent private retailers would be unlikely to match current Ontario responsible sales practices, even with increased government spending on monitoring and enforcement.

# EMPTY RETURNS

Greener...

One container at a time

## Environmental Performance

While many of the issues related to deregulation of retail liquor sales are similar to those in Alberta and B.C., moving to a deregulated retail market in Ontario raises some issues which are unique. Perhaps the most significant of these relates to environmental performance.

Ontario, unlike, Alberta, B.C. and Quebec, does not have a universal deposit return system in place for all beverage containers, other than those containing alcohol. The Beer Store collects 92% of beer containers sold and is contracted to the Province under the Ontario Deposit Return Program (ODRP) to collect wine, spirit and cooler containers sold at LCBO and Ontario winery retail stores. When these two programs are combined, the Beer Store returns system diverts approximately 450,000 tonnes of packaging from landfills annually or about 50% of what the entire provincial Blue Box system collects. By keeping alcohol packaging out of the municipally operated waste stream the Beer Store deposit return system saves

Ontario municipal taxpayers an estimated \$40 million dollars on an annual basis.<sup>97</sup>

Deregulation of liquor retailing in Alberta did not have significant implications for beverage alcohol container returns. ALCB containers were collected through a pre-existing bottle depot system for all beverage containers that was relatively unaffected by the change to beverage alcohol retail sales. While there is some return of empty beer, wine and spirit containers to liquor retailing locations in B.C. (e.g. LDB stores and LRS stores), that province's beverage container management system, with province-wide depots, was also not significantly affected by partial deregulation.

In Ontario, replacing the LCBO and Beer Store systems with independent retailers raises the issue of how liquor containers would be collected and recycled. Grocery and corner stores would likely lobby to have liquor containers collected in the Blue Box as they did with soft drinks. The Blue Box, however, is not designed to work with refillable containers (65% of domestic beer containers) and is far less effective with respect to recycling glass and aluminum containers than the Beer Store deposit return system.<sup>98</sup>

Significant changes to how empty beverage alcohol containers are managed could have implications not only for beverage alcohol manufacturers and the environment, but also for other Ontario

manufacturers, such as Owens Illinois and Owens Corning, which rely on a predictable supply of high quality glass feedstock provided through the Beer Store recycling system to feed their glass and fiberglass manufacturing facilities in Ontario.

In the absence of the details associated with a potential deregulation initiative it is difficult to determine how beverage alcohol container recycling might be affected, but it is a significant issue that should be considered in any assessment of moving to a deregulated liquor retailing market.

Given the cost effectiveness and efficiency of the current system, it seems unlikely that an alternate retailing model (and subsequent container management system) would generate any improvements in environmental performance or be as cost effective.

Furthermore, any increases in container management costs associated with an alternate retailing model would ultimately be passed through to consumers in the form of higher prices. In short, the management and recycling of empty liquor containers is another significant component of the overall cost of the retail liquor system. Those costs will also rise in a deregulated retail system further exacerbating overall system cost increases that will adversely affect selling prices.

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## Other Issues

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While it is not the purpose of this paper to review every issue related to alcohol sales and potential changes to Ontario beverage alcohol retailing system, there are additional issues that other privatization studies have identified in relation to deregulation initiatives that Ontario policy makers may wish to consider in relation to this issue. These include such issues as the impact of the beverage alcohol retail system on employment, crime rates and municipal functions.

With respect to employment, several studies have noted the increase in employment in relation to the expansion of Alberta's liquor retailing system as a positive attribute of deregulation.<sup>99</sup> Others have noted that there are fewer employees per store and that relatively well paid career positions have been replaced by low wage part-time and transient positions.<sup>100</sup>

With respect to crime, it appears that there was an increase in liquor store

robberies following an expansion in the number of liquor outlets in Calgary,<sup>101</sup> but some have argued that this may have been partially due to the lack of prevention measures on the part of new operators.<sup>102</sup> That said, what is known today is that Statistics Canada data ranks convenience stores and gas stations as having the highest incidence of robberies compared to all other locations tracked.

Polling indicates that more than half of Ontarians expect crime to increase if liquor sales are expanded to convenience stores.<sup>103</sup> The addition of highly taxed alcohol products to these locations combined with their current sale of highly taxed tobaccos products and limited security measures in many locations would almost certainly make them an even greater target for robberies and other crime.

There is no doubt that the deregulation of liquor retailing would necessitate additional enforcement measures and resources, such as an increased police presence, to ensure that new types of outlets are not a more attractive target to criminal activity. Given that many policing functions are municipally funded, many municipalities would face increased costs associated with changes such as selling liquor through convenience or grocery stores.

Currently the physical location of liquor retailing outlets does not generate many issues in Ontario. Churches, community

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<sup>97</sup> See *85 Years of Environmental Excellence: The Beer Store Responsible Stewardship 2011-2012* (Annual TBS Report to Waste Diversion Organization).

<sup>98</sup> ODRP implementation increased Ontario glass diversion by 60,000 tonnes on an annual basis or 50% due to higher return rates for LCBO containers and more efficient use of collected materials. See TBS Responsible Stewardship Reports 2009 to 2012.

<sup>101</sup> See West, p 63.

<sup>102</sup> See Sobering Result p 14-15, West p 64-65.

<sup>103</sup> See UFCW 12R24 Press Release, "Media Backgrounder Beer, Wine and Liquor Sales", December 19, 2013. Polling conducted by Pollara Research between Nov. 13-17 found that 56% of Ontarians thought crime would increase if liquor was sold in convenience stores and gas stations.

<sup>99</sup> See West p 14, ALCB, p 59-60.

<sup>100</sup> Laxer et al, p 14.

centres and schools can all object to new liquor stores being located within a kilometer of their locations and in practice most liquor outlets are not located near schools, playgrounds or community centres. However, potential deregulation and expansion of the number of liquor retailing outlets in Ontario may raise new issues with respect to liquor outlet locations especially convenience stores located near schools which tend to be hang out locations for teens.

Would, for example, a change which permitted the sale of liquor in grocery stores and corner stores include any restrictions related to the sale of liquor at gas stations or at convenience stores located proximate to schools? Given the integration of convenience stores with gas stations a decision to permit liquor sales at corner stores would, in the absence of such restrictions, mean the sale of liquor at hundreds of Ontario gas stations. For example, a recent *Globe and Mail* newspaper article, regarding Couche-Tard, one of Ontario's largest convenience store operators, noted that 75% of their North American outlets also sell gasoline.<sup>104</sup>

Finally, many consumers who support the sale of liquor in grocery or convenience stores, do not necessarily realize that such a change would result in an elimination of existing retailers such as offsite winery retail stores and the Beer Store and a potential elimination of the LCBO or at least a significant reduction in the number of existing LCBO retail outlets. In other words, it is not a matter of simply adding additional retail choices to the existing

system but a fundamental change to the nature of the system itself.

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## Conclusions

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Contrary to what several proponents of deregulated liquor retailing assert, there are no magic bullets related to Ontario's beverage alcohol system that will increase government revenues while simultaneously reducing consumer prices and expanding selection and access. The current combination of high liquor taxes and government liquor board retailing has led some observers to conflate high prices with government controlled liquor retailing. In fact, existing government regulated retailing systems such as Ontario's represent relatively efficient retailing models for a product for which the majority of the public expects some form of social control.

Moving to a fully deregulated market, as did Alberta, will undoubtedly increase the number of retail selling locations, but it will also significantly increase costs and destroy the economic efficiencies inherent in Ontario's current system. This effect will drive up consumer prices, reduce government tax revenues or generate some combination of both these changes. Partial deregulation, like that implemented in British Columbia, will also reduce the efficiencies of the existing system (although perhaps to a lesser extent) and similarly drive up consumer prices or reduce government revenues.

Other retailing models, such as franchising or licensing existing LCBO store operations

to private sector bidders, will do nothing to improve consumer access and essentially amount to a form of increased taxation through imposition of retailer bidding fees that will ultimately be passed on to consumers in the form of higher prices.

Complicating the issue of deregulation in Ontario is the lack of a universal deposit return system for all beverage containers which raises the question of how 450,000 tonnes of beverage alcohol container packaging will be managed in a deregulated system, who will pay for it and what any added cost to manage containers will mean for consumer prices.

At the end of the day, if the primary driver for those advocating for deregulation is the achievement of lower consumer prices, a more prudent, less disruptive and more certain approach would be to reduce current levels of taxation. Alternatively, if the objective of the process is to improve government revenues the more certain and prudent approach would be to improve the substantial efficiencies of the current system. Given the Ontario government's currently challenged financial position the second approach seems the most reasonable. It would preserve Ontario's already competitive position nationally on consumer prices while enabling the government to increase much needed tax revenues without the risks and job losses inherent in complete system reform.

### **An Alternative Approach to Alcohol Retailing for Ontario**

Over the last few decades, governments from across the political spectrum have reviewed radical changes to Ontario's liquor retailing system. Successive governments, regardless of their political orientation, have all shared one thing in

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<sup>104</sup> See "Couche-Tard subsidiary to purchase 36 stores in the U.S.", *Globe and Mail*, November 15, 2013. The article noted that of Couche-Tard's 6,198 North American convenience stores, 4,678 also sell gasoline and other fuels.

common when it comes to beverage alcohol retailing in Ontario, the more they reviewed the current liquor retailing system, the less interested they were in radical changes.<sup>106</sup>

Political reluctance to radically alter Ontario's current system is understandable in light of the actual consumer impacts associated with deregulation in other jurisdictions and the relatively broad support for, and satisfaction with, the current system from Ontario consumers, taxpayers and social interest groups.

That said, maintaining the foundation of the current system, does not mean that Ontario's liquor retailing system be static. Over the last few decades the retailing system has evolved. The LCBO has spent millions of dollars upgrading stores throughout its network and greatly expanded typical product selection in all alcohol categories. The Beer Store has also invested significantly to improve its system including the conversion of many outlets to self-serve stores and its modernization continues with new store formats and overall store network expansion. Winery retail stores have increasingly partnered with local grocers to provide enhanced convenience.

The Beer Store has long supported the concept of LCBO-Beer Store joint ventures as one way to enhance consumer convenience and improve system efficiency and government revenue performance without driving up consumer prices. Under this concept, the LCBO and the Beer Store would share costs associated with building new locations, reducing costs for both the LCBO and the Beer Store. Consumers would benefit with access to a full range of alcohol products at a single location which also accepted container returns. The benefits of the existing system would be maintained while product selection and consumer convenience are improved.

The experience of deregulation initiatives in other jurisdictions suggests that the best way to improve liquor sales in Ontario is through continued evolution of the existing system, not radical alteration. Jurisdictions which have moved to deregulated markets have created marginal improvements in consumer access at the cost of higher prices, declining government revenues and a deterioration of socially responsible sales practices. This does seem like a prescription for success in Ontario.

A few decades ago, Ontario consumers filled out prescription like slips and received alcohol in brown bags when they purchased alcohol at the LCBO. Today the provincial liquor retailing system is fully modernized and responsive to consumer demands. At that same time alcohol is marketed and sold responsibly while the province generates significant alcohol revenues that grow steadily year after year. Rather than jeopardize this growing revenue stream, the province should explore options for retail improvements in the context of the existing system which effectively balance consumer needs, government priorities and public concerns.

<sup>106</sup> David Petersen's Liberal government reviewed the issue of beer and wine in corner stores in 1985 and rejected it after Parliamentary Committee feedback on the issue. A review of potential privatization of the LCBO, was part of Mike Harris's Common Sense election platform, but the government, once elected, never moved forward with a review or radical changes to the LCBO system. Dalton McGuinty's Liberal government established the Beverage Alcohol System Review (BASR) Panel to recommend potential changes to the liquor retailing system in 2005, but more or less shelved BASR's recommendations on the day they were released. Even Bob Rae's NDP government reviewed potential changes to beverage alcohol retailing in the early 1990s following a GATT (now WTO) ruling that found several Ontario retail practices (and other policies) to be a violation of international trade law. All of these reviews ended with political decisions not to radically alter Ontario beverage alcohol retailing system.

## Appendix A Tax Rate Calculations **Table 1 (page 17)**

Ontario tax rates for wine and spirit products calculated using the average LCBO wine and spirit price for fiscal 2013, applying the domestic LCBO markup of 140% for spirits and an LCBO wine markup of 70% for wine (blend of import and domestic markup) and subtracting 16% of pre-sales tax price to approximate LCBO operating expenses for those products. Beer taxes are set under the Alcohol Gaming and Regulation and Public Protection Act, 1996, apply to non-LCBO beer sales, and are remitted directly by brewers to the Ministry of Finance. The LCBO collects equivalent charges with respect to beer sold through its system.

Source for U.S. tax rates Federation of Tax Administrators and U.S. Tax Foundation (Michigan Spirits). Gallon tax rates were converted to per litre rates in Canadian currency using Bank of Canada exchange rate of \$.95 (in place July 9, 2013). U.S. dollar per gallon state taxes used were New York: Spirits: \$6.44; Wine \$.30; Beer \$.14; Michigan: Spirits: \$11.92; Wine \$.50; Beer \$.20. Note Michigan is a controlled state for the purposes of spirit wholesaling. The U.S. Tax Foundation calculated a Michigan spirits tax rate using a methodology developed by the Distilled Spirits Council of the United States.

### Ontario Tax Calculations

Product Size	Wine 750ml	Spirits 750ml	Beer 24 Cans 8520ml
<b>Average LCBO Price F2013</b> (from Quarterly Financial Report - 4th Qtr F2013) Excluding Sales Tax and Deposit	\$9.84	\$22.73	na
<b>Environmental Levy</b> \$.0893/non-refillable container	\$0.0893	\$0.0893	\$2.1432
<b>Bottle Levy</b> Spirits \$.38/l; Wine \$.29/l, Beer \$.176/l	\$0.2175	\$0.2850	\$1.4995
<b>Wine Levy (Wine only) \$1.62/l</b>	\$1.2150	na	na
<b>Basic Tax (Beer Only) - \$.7402/l</b>	na	na	\$6.3065
<b>Markup 140% Spirits/70% Wine</b>	\$3.4251	\$13.0408	na
<b>Total Revenue</b>	\$4.9469	\$13.4151	\$9.9492
<b>Estimate LCBO Expenses (16%)</b>	\$1.5744	\$3.6368	TBS Sale
<b>Net Provincial Tax</b>	<b>\$3.37</b>	<b>\$9.78</b>	<b>\$9.95</b>



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