CCPA
CANADIAN CENTRE
for POLICY ALTERNATIVES
SASKATCHEWAN OFFICE

Submission to the Standing Committee on Crown and Central Agencies

Bill No. 1 — The Crown Corporations Public Ownership Amendment Act

Canadian Centre for Policy Alternatives - Saskatchewan Office

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Introduction

The Canadian Centre for Policy Alternatives (CCPA Saskatchewan) welcomes the opportunity to present our views and recommendations to the Standing Committee on Crown and Central Agencies. The CCPA is Canada's leading progressive think tank with offices in Ontario, British Columbia, Saskatchewan, Manitoba, and Nova Scotia. The CCPA is a registered non-profit charity. We depend on the generosity of our more than 12,000 supporters across Canada.

The Saskatchewan Office has been particularly active on the issue of liquor privatization in the province, releasing four major studies in the past four years, including numerous commentary and opinion pieces. It is our informed opinion that Saskatchewan is best served by the continued public ownership and control of retail liquor sales in the province and that *Bill No. 1 — The Crown Corporations Public Ownership Amendment Act* - should not go forward. This submission will focus on two inter-related issues - specifically the ability of the government to remain revenue-neutral under the current privatization proposal and the challenges a privatized liquor retailing environment will pose for the maintenance of government revenues in the future.

Remaining Revenue Neutral under the Current Proposal

The government's proposal calls for selling 40 of the 75 government-owned liquor stores to the private sector and allowing 12 new privately-owned stores to open across the province. If enacted, the number of privately-owned, full-line liquor stores would increase from 4 to 56 and would outnumber the remaining 35 stores still operated by the Saskatchewan Liquor and Gaming Authority (SLGA). Under this proposal, government mark-ups - the tax collected on alcohol sales - will be reduced by 25% in most product categories (See Table 1).[1]

Table 1. Proposed Mark-up Reductions

Product Type	New Classification	Current Mark-up	Proposed Mark-up	Percentage Change
Non-draft Beers	Category 1: Beer ≤ 6.5%	$1.99/L	$1.50/L	-25%
Strong Beers, Coolers and Ciders	Category 2: Beer >6.5%; Non-Beer ≤ 7%	110%	83%	-25%
Non-Fortified Wines	Category 3: Non-Beer >7% to ≤ 14.5%	125%	94%	-25%
Fortified Wine and Spirits	Category 4: Non-Beer >14.5%	167%	125%	-25%

The government further argues that under the proposal, government revenues from liquor sales will not be diminished and will remain revenue-neutral:

> "The new wholesale mark-up is designed to collect approximately the same amount of revenue from each product category as exists today. Even though 40 government liquor stores are being converted to private stores, government revenues would remain constant if the new retail store sales volumes in product categories are consistent to what they are currently."[2]

The assumption underlying the government's argument is that while mark-ups will be diminished by 25%, the cost will be recouped by no longer

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[1] Percentage change is calculated as: (Proposed Mark-up – Current Mark-up)/Current Mark-up. Proposed mark-ups found in: Government of Saskatchewan. The Future of Retailing in Saskatchewan, 2015, p.8; Current Mark-ups found in: Saskatchewan Liquor and Gaming Authority. Pricing Structure and Policy, 1 April 2014, p.5-7.

[2] Government of Saskatchewan. *The Future of Liquor Retailing in Saskatchewan*. November 18, 2015; pg. 8.

owning and operating 40 public liquor stores. In Minister Don McMorris' words:

> "The new markup rate will replace any of the existing discount structures that currently exist for private retailers. While this new rate will be 25 per cent less than the overall markup rate, it will be neutralized by the cost the government currently bears to operate the 40 stores scheduled for conversion and related head office costs and discounts. This change will be revenue-neutral for the province's finances."[3]

To test these assumptions, we compared the the purported savings from privatization versus the purported costs in our most recent report, *Down the Drain: The Saskatchewan Government's Costly Proposal for Liquor Retailing* by David Campanella.[4] As Mr. Campanella explains, the SLGA's savings are fairly straightforward. By closing 40 publicly-owned retail stores, the SLGA will no longer have to pay the annual operating costs of these stores. The SLGA will also save money by no longer giving a discounted mark-up rate or commission to private retailers, who will instead be compensated with the 25% mark-up reduction. Finally, the Saskatchewan government will receive a very modest revenue bump of less than a million dollars per year from the corporate income tax paid by the new owners of the private liquor outlets.[5]

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[3] Don McMorris. "Saskatchewan Liquor and Gaming Authority won't lose revenue with changes." Regina *Leader-Post*. February 22, 2016

[4] David Campanella. *Down the Drain: The Saskatchewan Government's Costly Proposal for Liquor Retailing*. Regina: Canadian Centre for Policy Alternatives - Saskatchewan Office. February, 2016.

[5] For an estimate of corporate income tax revenue from the privatized stores - see Campanella, 2016, 16.

The new costs the SLGA would incur under the proposed changes are similarly straightforward, and they come in two parts. One obvious cost is that the government's plan includes lowering the province's liquor mark-ups by 25%, reducing its cut of alcohol sales. However, there is also a second cost that the government has not appeared to consider - and that is the government's proposal will also lead to higher overall wholesale costs.

Higher Wholesale Costs as a Result of Privatization

Why the government is sure to experience higher wholesale costs for liquor under their proposed plan needs further explanation as it undermines the ability of the government to remain revenue neutral while ensuring the government's promise that current prices will be maintained.[6]

Adding private retailers and removing public stores will create a more fragmented, complex, and in all likelihood costly distribution system. For instance, the SLGA will no longer be the sole agent responsible for deciding how most of the liquor shelves in the province should be stocked and then purchasing that liquor wholesale. Instead, the private retailers, such as major grocery chains, will have control over what does and does not get stocked on their shelves. Therefore, liquor producers and their agents will have to market their product to several different customers, rather than simply the SLGA. Moreover, the SLGA may find its purchasing power and ability to negotiate wholesale prices with the major liquor producers significantly limited as its economy of scale is diminished since it would be operating less than half of the full-line retail stores in the province.

A comparison of the financial performance of each province's liquor board highlights the real and dramatic impact of more private retailers on

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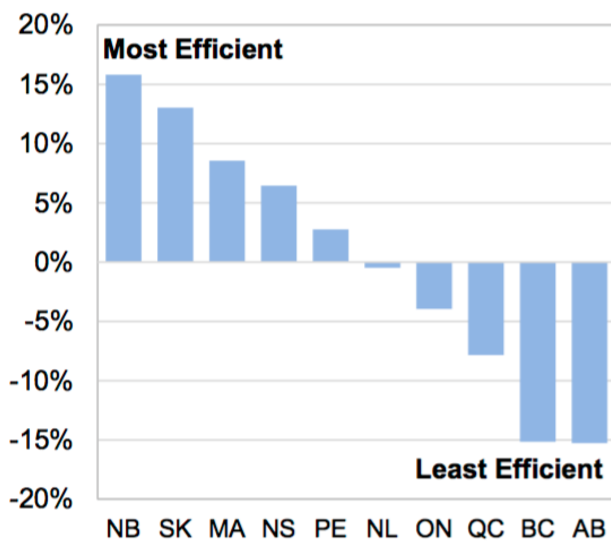
[6] Jennifer Graham. "Saskatchewan Privatizing 40 government-owned liquor stores," *Globe and Mail.* November 18, 2015

wholesale costs. By far the least efficient provinces at managing wholesale costs are those involving the largest number of private retailers (See Figure 1).[7] All the provinces in which liquor sales are fully or mostly handled by government stores and their rural partners had sales revenue increase more than wholesale costs between 2004 and 2013. In Saskatchewan for instance, sales increased 53% over that decade while wholesale costs rose just 40%. Provinces that allow a large number of private retailers to sell limited stock, i.e. Ontario and Quebec, had slightly negative results. And those provinces with the most privatized and fragmented retail systems — Alberta and British Columbia — saw a rise in wholesale costs far outstrip the increase in sales revenue. In British Columbia for instance, sales only increased 48% while wholesale costs rose by 64%.[8]

Figure 1. Change in Sales Less Change in Wholesale Costs by Province, 2004-2013[5]



Alberta's retail system, which has been fully privatized, has struggled mightily. Shortly after privatization, the delivery cost per case rose 72% due

[7] Calculations based on CANSIM Table 183-0017.

[8] David Campanella. *Down the Drain: The Saskatchewan Government's Costly Proposal for Liquor Retailing*. Regina: Canadian Centre for Policy Alternatives - Saskatchewan Office. February, 2016.

to the increased number of smaller shipments resulting from the fragmentation of the distribution system.[9] In 2007, a Price Waterhouse Cooper's report on behalf of the Alberta Gaming and Liquor Commission (AGLC) reported that some suppliers and retailers have "lost confidence in the current model of liquor distribution in Alberta."[10] The overarching finding of the report was that the system suffered from the absence of a central actor responsible for the smooth functioning and profitability of the entire system, which was removed through privatization.

While Alberta is perhaps an extreme example, runaway wholesale costs are also a problem that afflicts British Columbia. BC's liquor retail system is more analogous to the government's proposal for Saskatchewan, as the BC government approved a similar partial privatization whereby private retailers proliferated alongside government-owned stores. From 2002 (the year before the BC government lifted its ban on new private liquor stores) to 2013 (the latest year for which Statistics Canada has data), the wholesale cost of liquor in BC increased on average by 6.0% per year. Therefore, we would expect to see a similar increase in wholesale prices here in Saskatchewan.

If this is the case, the question becomes who will ultimately absorb these wholesale price increases? Minister McMorris has publicly stated that despite privatization, "99 per cent of liquor will be sold at about the same price."[11] So it seems the government is committed to not passing any wholesale price increases along to the consumer. If the government is to absorb these cost increases without raising prices, it will have the obvious

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[9] Nuri T. Jazairi. *The Impact of Privatizing the Liquor Control Board of Ontario.* Prepared for the Ontario Liquor Board Employees' Union. September, 1994.

[10] Price Waterhouse Coopers. *Liquor Warehousing and Distribution in Alberta – Supply Chain Analysis.* Prepared for the Alberta Gaming and Liquor Commission. March, 2007.

[11] Jennifer Graham. "Saskatchewan Privatizing 40 government-owned liquor stores," *Globe and Mail*. November 18, 2015

effect of eroding the government's mark-up. **If Saskatchewan follows the B.C. example of an average 6% wholesale cost increase per year - coupled with the 25% mark-up reduction - we estimate it will diminish government revenues by between $20 to $25 million dollars per year. By 2020, we calculate the government will have lost out on $115 million in potential liquor revenues if this legislation is adopted (See Table 4).**[12]

Table 4. Future Costs of Proposed Privatization

	SAVINGS			COSTS		DIFFERENCE
($M)	Operating Expenses	Discounts and Commissions	Income Tax Revenue	Cost of Sales Increase	Mark-up Decrease	
2016	$10.17	$ 24.42	$0.70	$18.66	$ 37.71	-$ 21.07
2017	$10.33	$ 25.27	$0.72	$19.13	$ 39.20	-$ 22.02
2018	$10.48	$ 26.15	$0.75	$19.62	$ 40.76	-$ 23.00
2019	$10.63	$ 27.06	$0.78	$20.12	$ 42.37	-$ 24.02
2020	$10.79	$ 28.01	$0.81	$20.64	$ 44.05	-$ 25.09
Total	$52.40	$130.92	$3.76	$98.17	$204.10	-$115.20

Creating a New Powerful Political Lobby

The ability of the government to maintain current mark-ups or implement future increases to respond to the rise in wholesale prices must also be considered. One of the profound consequences of liquor privatization that is rarely considered is that it will create a very powerful political constituency that – like any other business lobby – will seek to advance its own economic interests that may not always be in alignment with the public interest. In the contest between government and private sellers on who will

[12] Calculations using data from "SLGA All Stores – Net Income, Total Expenses and Operating Expenses as a Percentage of Sales – 5 Year History," Saskatchewan Liquor and Gaming Authority [Excel spreadsheet], 2015.

ultimately absorb wholesale price increases - the power of this lobby looms large. Alberta's premier liquor lobby group - the Alberta Liquor Store Association (ALSA) has been described by *Calgary Herald* columnist Don Martin as the "the most successful government lobby group in Alberta today." Indeed the lobby has demonstrated its clout and influence on numerous occasions, forcing the government to reverse or rescind policies deemed hostile to ALSA's interests. They forced the Klein government to reverse its decision to allow grocery stores to carry liquor in as little as 72 hours. They successfully lobbied for a ban on all supermarket signage on stand-alone liquor outlets for three years. Most significantly, they managed to convince the Stelmach government to reverse a liquor tax increase that would have added $180 million to public coffers at a time when the Alberta treasury was billions of dollars in debt.

Indeed, as Flanagan and Campanella demonstrate, mark-ups in Alberta were lowered multiple times, due in part to lobbying by the newly formed private liquor industry, and remain lower today than when privatization was first implemented.[13] All of this has led to the Alberta liquor authority capturing the least per litre of alcohol of any of the Western provinces. As University of Regina economic professor Jason Childs concludes, by "privatizing alcohol retailing Alberta created a concentrated group with the incentive and resources to lobby for lower alcohol mark-ups. A diffuse group of consumers, who see themselves as benefiting from government spending, was replaced by a small concentrated group motivated by profits. Such a change begets effective lobbying."[14]

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[13] David Campanella and Greg Flanagan. *Impaired Judgement: The Economic and Social Consequences of Liquor Privatization in Western Canada.* Regina: Canadian Centre for Policy Alternatives and Parkland Institute, 2012.

[14] Jason Childs. *Assessing the Privatization of Retail Alcohol Sales*. Regina: Johnson-Shoyama Graduate School of Public Policy. October, 2015.

B.C's liquor store lobby – Alliance of Beverage Licensees (ABLE) – while not as seasoned as ALSA, has nevertheless also demonstrated its profound influence over that province's government. Since its inception, the Alliance has successfully lobbied to ease restrictions on liquor store re-locations and advertising, delayed new safety requirements for workers, and prevented wine sales in grocery stores despite legislation allowing it.[15] Proposed wholesale price changes proposed by the B.C. government have lowered the mark-ups on beer, and most other first-tier price categories of liquor as well.[16] Similarly, second tier mark-ups for wine have also been reduced due to intense lobbying by ABLE.[17] Not surprisingly, as Childs' notes, British Columbia's liquor authority has also seen its revenue per litre of alcohol decline and then plateau since privatization.[18]

Lest we think these are unique occurrences, the power of liquor lobbies to successfully oppose tax and mark-up increases should not be considered the exception, but rather the rule. For instance, in the United States, the Distilled Spirits Council - the national trade association representing the leading producers and marketers of distilled spirits in the United States - boasts of having successfully defeated 335 out of 364 major alcohol tax

[15] Tom Sandborn. "Working Alone Safeguards Slide." *The Tyee*. March 9, 2009. Jill Drews. "Group trying to stop the sale of wine in BC grocery stores." *News 1130.* September 1, 2015.

[16] The highest beer mark-up has been lowered from $1.75/L to $1.08/L, which fewer producers will now pay. The lowest mark-up on beer has been lowered from $1.04/L to $0.55/L. The mid-level mark-up has been lowered from $1.16/L to a graduated mark-up between $0.56/L and $1.02/L (subject to adjustment). The previous mark-up schedule for beer is included in Ministry of Energy and Mines Liquor Distribution Branch. Briefing Note for Honourable Rich Coleman, 22 May 2012, accessed through FOI Request – EGM-2012-00299, p.6. Current beer mark-up described in: British Columbia Liquor Distribution Branch. Mark-up Schedule: Effective April 1, 2015, 30 January 2015.

[17] "B.C. government reduces wholesale mark-up for wines over $20 a bottle." *British Columbia Liquor Review*. January 30, 2015.

[18] Jason Childs. *Assessing the Privatization of Retail Alcohol Sales*. Regina: Johnson-Shoyama Graduate School of Public Policy. October, 2015

“threats” at the state-level since 2001.[19] That works out to a 92% success rate in opposing new liquor taxes.

While the existence of a private liquor lobby does not foreclose the possibility of maintaining and even increasing liquor taxes in the future, the above demonstrates that they pose a powerful obstacle to legislative change that must be considered in any discussion of privatization. The track record of governments throughout North America in a privatized environment should force the Saskatchewan government to question why it would be immune to the same lobbying pressures that have undermined other governments’ efforts to maintain or increase tax levels on alcohol.

Like any other business, private liquor in Saskatchewan will seek to advance its own economic interests through public policy. The reality is that the particular interests of the private liquor industry will invariably come into conflict with the public interest. Currently, under our public system, concerns such as public health, revenue generation, protection of minors, accessibility and availability can take priority in public policy. Will we be able to continue to make such issues a priority in the face of a financially powerful liquor lobby determined to advance its own interests?

Conclusion

In sum, we believe that the government’s proposal for the privatization of the liquor retailing system cannot remain revenue-neutral as they have claimed. The cost-savings from the privatization of 40 government-owned stores does not equal the loss in revenue from the 25% markup reduction. Furthermore, the privatization of these stores will have the effect of fragmenting the distribution system and undermining the purchasing power of the SLGA. As we have seen in both B.C. and Alberta, this has resulted in

[19] Elaine S. Povich. “Liquor lobby fights off tax increases on alcohol.” Pew Charitable Trust. October 13, 2013.

much higher wholesale cost increases than in provinces that are dominated by public retailing systems. Given the government has promised that liquor prices will remain the same, these cost increases cannot be passed along to the consumer. Instead they will erode the government's markup and diminish revenues by between $20 to $ 25 million dollars per year.

Any attempt to recoup these losses through future liquor tax increases will invariably be met with fierce opposition from the newly organized private liquor lobby as has been the experience of governments throughout Canada and the United States. If the government's proposal cannot meet its own stated requirement of revenue-neutrality and will actually diminish government revenues at a time when the province is facing mounting deficits and slumping revenue, the proposal cannot be considered to be in the public interest and should be withdrawn.

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