Spirits Canada

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Members of the House of Commons Standing Committee on Finance
Sixth Floor, 131 Queen Street
House of Commons
Ottawa, ON, K1A 0A6

Dear Members:

Spirits Canada welcomes the opportunity to share the Spirits Industry's policy priorities for the 2017 federal budget.

Spirits Canada is the only national trade association representing the interests of Canadian Spirits manufacturers, marketers, exporters and consumers. There is a tremendous opportunity before us to grow Spirits production, and in particular our signature product, Canadian Whisky, in Canada. Spirits are made from 100% locally grown cereals, with these grains mashed, fermented, distilled and aged in Canada by Canadians.

Growth in Canadian Spirits production directly benefits Canada's farmers without whose labours there can be no local manufacturing. In addition, the Industry's plants and facilities are supported by thousands of small and medium-sized businesses providing critical goods and support services. Policy reforms that would lower the barrier to success would reverberate benefits across the country and help spur new investment and growth.

Moreover, as an export-intensive Industry, Canadian Spirits manufacturing is a key driver of wealth creation for middle class Canadians across the nation.

The attached brief highlights several key barriers to fully achieving the sector's potential, most notably the urgent need to:

#1. Scale back the excessive and punitive excise duty on Spirits; and
#2. Create national scale by eliminating discriminatory provincial alcohol policies.

We would be pleased to elaborate on our brief and recommendations this Fall during the Committee's formal pre-budget consultations.

Sincerely,

Jan H. Westcott
President & CEO

INTRODUCTION

A number of federal impediments to growth and innovation within the beverage alcohol sector should be addressed in the context of the 2017 federal Budget.

Canadian Spirits producers are primary manufacturers, sourcing locally grown barley, corn, rye and wheat from local farms and mashing, fermenting and distilling these premium cereal grains into amongst the highest value-added Canadian process agri-food branded products. And, in the case of the Industry's signature products of "Canadian Whisky" and "Canadian Rye Whisky" these distillates are then aged and matured in small wood barrels for a minimum 3 years, and typically in excess of 6 years, prior to being bottled and sold around the world.

Canadian Spirits production relies on thousands of Canadian cereal grains farmers for a safe and secure source of the finest barley, corn, rye and wheat, the precursor to all great spirits. In addition, tens of thousands of small and medium sized businesses provide essential goods and services to the Industry's production and maturation facilities.

The largest challenge facing the future of the Spirits manufacturing sector in Canada is the relatively low profitability available in Canada versus competing sectors and international benchmarks. This fiscal challenge limits the scope for investment, whether in facility improvements, product innovation, market support or international export development.

Canadian Spirits manufacturers are falling behind international competitors in terms of the scope of new product and packaging innovation, plant and infrastructure investment, new market development and in laying down new distillate (whisky) for maturation. This investment gap is occurring at a time of nearly unprecedented consumer interest in premium whiskies, and in particular, with North American rye whiskies, the absolute forte of the Canadian Spirits Industry.

EXCISE REFORM

The current federal excise duty structure acts as a barrier to investment, reduces the effectiveness of competition, restricts innovation and impedes the growth of international exports.

Federal excise duties should be modernized to better align excise tax rates with actual alcohol contents, as recommended by numerous business, academic, health and alcohol advocacy groups.

Table 1 – Current Federal Excise Duty Rates

Category	Actual Rate	Rate Per LAA	Rate Per Standard Drink*
Spirits	$11.696/laa	$11.696	20 cents
Coolers	$0.295/litre	$4.21	7 cents
Canadian Wine	$0.00	$0.00	0 cents
Other Wine	$0.62/litre	$5.17	9 cents
Beer	$0.3122/litre	$6.24	10.5 cents

*Note: where a standard drink contains 17.05 ml of pure alcohol

The current structure has not kept pace with changes in the market, in consumers' perceptions and drink choices, in manufacturing processes and product innovation. Moreover, the changes to excise rates enacted in 2006 greatly exacerbated the historical tax anomalies and fiscal burdens imposed on various beverage alcohol categories.

Table 2: Federal Beverage Alcohol Excise Revenues 2006-2015

Category	2006 $	Share	2015 $	Share	$ % Change
Spirits	$485.8 M	35.8%	$683.1 M	44.4%	+40.6%
Coolers	$30.1 M	2.2%	$22.3 M	1.4%	-25.9%
Beer	$587.5 M	43.3%	$563.2 M	36.6%	-4.1%
Wine	$252.1 M	18.6%	$271.5 M	17.6%	+7.7%
Total	$1,355.5 M	100%	$1,540.1 M	100%	+13.6%

An estimated $2.20 per laa reduction in the current excise duty rate on Spirits would be necessary to simply return Spirits share of overall federal beverage alcohol excise duty revenues to the level Spirits represented in 2006.

A. Excise Duty Reform Recommendations

1. As a first step in reducing the discriminatory excise duty gap between various beverage alcohol categories, excise duties on Spirits should be reduced to $6.00 per laa on each producer's first 100,000 laa, with all remaining volume subject to a $11.00/laa rate. This step approach proposed for Spirits is similar to excise duty reductions already currently available on beer producers' first 7,500,000 litres of production annually and yet, dramatically less generous than the full exemption from all excise duties granted for Canadian Wines.

2. For greater transparency and to better align excise duties with each product's actual alcohol content, all federal beverage alcohol duties and taxes should be applied based on per litre of alcohol basis (i.e. per laa, not per litre of liquid).

3. An annual report of federal excise duty "tax expenditures" should be published to quantify the cost and value of federal excise duty and tax deviations from the posted benchmark with the individual beneficiaries of the benefit identified.

It is important to note that the United Kingdom reduced their own excise duties on Scotch Whisky and other Spirits by 2%, or by £0.56/laa ($0.97 CND/laa) in their 2015 Budget. In the words of the UK's Chancellor of the Exchequer, the objective of duty cut was "to back one of UK's biggest exports" and "to further support the great British success story, the Scotch whisky industry".

Moreover, according to the U.K.'s HM Revenue and Customs, the duty cut has actually contributed to a £124 million ($215 million CND) increase in Her Majesty's Treasury revenues from Spirits drinks during fiscal 2016 versus the previous year. According to the Scotch Whisky Association's (SWA) CEO, the key lesson from the U.K.'s 2015 excise duty reduction decision is that, "In short, when unnecessarily heavy tax is cut, revenues actually go up, and consumer and industry confidence is boosted."

As the first tax applied on beverage alcohol sold in Canada, federal excise duties are then taxed again and again throughout the product's value chain. In the case of Spirits, these additional provincial and federal taxes are ad valorem in nature, that is, a percentage base tax applied on the price of a product. The result is that the original "modest" additional tax burden on Spirits of approximately 10 cents per standard drink ($1.75 per 750 ml bottle) is magnified to 30 cents per standard drink at retail (more than $5.25 per 750 ml bottle).

Interprovincial Trade

Discriminatory provincial beverage alcohol measures and policies impose very significant costs and inefficiencies onto the Canadian beverage alcohol market. In fact, with the growth in such protectionist measures in recent years, Canada has never been further from achieving a truly Canadian beverage alcohol market; instead we have 10 very distinct provincial beverage alcohol markets.

The "balkanization" of our home market, makes a relatively small, inefficient market even smaller, less efficient, less attractive for investment and less profitable.

The added cost and complexity of marketing and selling in Canada, not only impairs the domestic market, but siphons resources away from international market development.

The Industry's principal export interest of "Canadian Whisky" and "Canadian Rye Whisky" are in direct competition with the world's other great whiskies including Scotch, Irish and American Bourbon in foreign markets.

Introducing, marketing and selling high-value branded consumer goods in foreign markets require very significant financial investment. In the case of newly opened markets, these investments must be funded by one's home market. Excessive fiscal burdens (including federal excise duties) and inefficient provincial markets combine to sap the financial wherewithal from Canadian producers to compete effectively with whisky makers whose home governments and markets provide greater tangible support.

Table 3: Canadian Beverage Alcohol International Exports (2015)

Category	Value	Share
Cider	$42.0 M	4.2%
Wine	$81.9 M	8.3%
Beer	$220.4 M	22.2%
Spirits	$646.4 M	65.3%
Total	$990.7 M	100%

Source: Industry Canada Trade Data Online

Canada's robust trade liberalization agenda has been successful in transforming heretofore largely closed or financially unattractive foreign markets into new opportunities for Canadian businesses. However, domestic policies act as breaks to fully exploiting these new opportunities by severely restricting the financial resources available to develop and exploit them.

In addition to adding costs to businesses, the complex web of provincial policies harm Canadian consumers who are faced with higher prices and less choice than would flow from an open, competitive and market-driven national beverage alcohol marketplace.

Protectionist provincial beverage alcohol policies vary in their nature and scope but, can be generally classified as either preferential market access or outright tax advantages. These measure are often disguised as simple aid and assistance to in-province producers, but their effect is to discriminate against Canadian producers domiciled in another province.

B. Interprovincial Trade Recommendations

1. Time certain phasing out of all current derogations under Canada's Agreement on Internal Trade from non-discrimination obligations. These derogations were intended as interim measures to provide nascent or developing industry sectors the time to adjust to a open and competitive market.

2. Application of standardized and transparent, provincial liquor mark-ups on all out-of-province liquor equal to the lowest mark-up applied on any similar alcohol product manufactured within the province;

3. Investor protection standards at least equal to those conveyed to foreign businesses under NAFTA and CETA.

4. Robust, independent dispute settlement provisions consistent with the goal of Section 121 of Canada's constitution to ensure that products of one province are provided identical treatment as those produced to in-province producers.

Conclusion

Canada is lagging behind key international benchmarks in regards to both innovation and international trade growth. The beverage alcohol sector provides a microcosm of some of the reasons for this performance gap.

Unintended consequences of domestic policies, including federal excise duties and interprovincial trade barriers, conspire to diminish innovation and repress international export growth.

Federal leadership and substantive policy change is required to remove the impediments to unleashing the full force of Canadian beverage alcohol innovation. Innovation that will spur growth domestically and internationally for the benefit of consumers, farmers, producers and the thousands of Canadians dependent on local beverage alcohol manufacturing for their livelihood.

Successful beverage alcohol exporters, ranging from Scotch Whisky, to Mexican Tequila, to Bordeaux wines have supportive governments that value the potential for exports and seek to maximize the opportunity for success. These governments recognize the direct link between success in growing international exports to wealth creation for their middle class.

New investment are required to drive the requisite innovation that is critical to growth in a highly competitive and global market, innovation demanded from today’s beverage alcohol consumer. New products and new brand expressions yes, but also new packaging design, new promotions, new routes-to-market, new communication strategies, and new consumer engagement opportunities.