

# Intelligence MEMOS



From: Anindya Sen and Rosalie Wyonch  
 To: The Honourable Bill Blair, Parliamentary Secretary to the Justice Minister  
 Date: July 17, 2017  
 Re: **DON'T (OVER) TAX THAT JOINT, MY FRIEND**

The federal government has released draft legislation to legalize and regulate recreational marijuana. Legalization priorities include access to safe and regulated product and the elimination of illegal supply, with tax revenue a less important objective. Indeed, Ottawa is hoping for a [coordinated approach](#) and urging provinces to [keep taxes low](#) in order to minimize contraband product. So how much revenue is actually at stake, what type of taxes should be imposed and how high should they be?

In order to answer these questions we first need to estimate market size. Despite some claims that the legal marijuana market could [exceed \\$20 billion](#), applying [results from Colorado](#) to Canada yields an estimate of roughly 637 to 763 tonnes, which is in line with Parliamentary Budget Office (PBO) estimates of a market size of about 655 tonnes. Employing a per-gram price range of \$7.50-\$8.50 (consistent with PBO estimates) implies a \$4.7 billion to \$6.5 billion retail market, including both legal and illegal suppliers.

The complexity of the market means that federal and provincial governments should not enact excise taxes and instead rely only on ad valorem sales taxes. There are many different strains of marijuana and determining an optimal excise tax rate for each, becomes a complicated administrative process. Using the above price range and applying a GST/HST of 10 percent, combined tax revenues from legal marijuana sales would be \$400 million to \$450 million in 2018 (Figure 1, panel a), far lower than previous estimates of [\\$5 billion](#).

Higher taxes will [not generate increased revenues and will only encourage consumers to switch to illegal supply](#). We estimate that if the pre-tax price of marijuana remains at or below its current level of \$7.50 per gram, a 10 percent GST/HST results in more than 90 percent of the market being legitimate. On the other hand, if the pretax price were to rise to even \$10 a gram, less than half of the market would be regulated. With a 5 percent provincial tax rate (in addition to a 5 percent federal tax) the pre-tax price that results in the largest provincial revenues falls between \$7 to \$9.50 per gram in all provinces (figure 1, panel b).

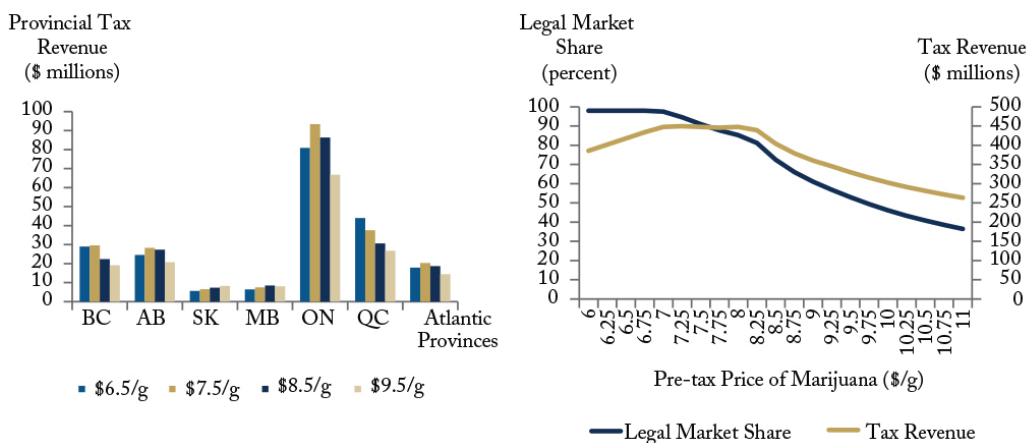
Further, provincial taxes should be uniform across jurisdictions in order to ensure further minimization of black markets. And if the federal and provincial governments do rely on ad valorem taxes then they must also ensure that pre-tax prices are kept low. While this may be accomplished with price regulation, policies must also be designed to facilitate a seamless match between supply and demand. A supply shortage at the outset of legalization, due to a lack of [licensed producers or distributors](#), will put upward

pressure on prices and could serve to entrench the black market to the detriment of both legal suppliers and government revenues.

**Figure 1 Tax Revenue from Legal Marijuana Retail at Various Prices**

Panel a: Regulated Share of the Market and Federal and Provincial Tax Revenue

Panel b: Provincial Tax Revenues (5 percent) at Various Market Prices



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