

Intelligence MEMOS



From: Anindya Sen and Rosalie Wyonch
To: Canada's Cannabis Regulators
Date: October 15, 2018
Re: **MISSING OUT ON MARIJUANA TAXES**

A large black market combined with supply shortages of legal marijuana will cut potential tax revenues by an estimated \$800 million in the first year of legalization. In our new C.D. Howe Institute [report](#), we find that government revenue forgone to black market activity will likely exceed the amount federal and provincial governments collect, a figure between \$300 - \$600 million.

The federal government has made it clear that a key objective of legalization is the elimination of black markets and their associated criminal activities. Accordingly, federal and provincial governments have agreed to keep marijuana taxes relatively low to keep legal marijuana prices competitive. However, regardless of any significant legal-illegal price differential, a black market will clearly thrive if legal domestic supply is not able to meet demand.

This report estimates the size of the marijuana black market during the first year of legalization. We captured total demand and supply by not only using data on dried flowers, but also by including edibles and edible oils and converting them into dried marijuana equivalents. Our projections indicate that the size of the black market will likely be about 380 tonnes, or at least \$2.5 billion in the first year.

These results also indicate that at current production levels, legal supply will meet only roughly 30 percent to 60 percent of total demand. The loss of tax revenue as a result is quite large — if the entire marijuana market were supplied legally and taxed, the potential revenue from both excise and goods and services taxes would be about \$1.3 billion.

Figure: Tax Losses at Midpoint Demand Estimate and a Before-Tax Legal Price of \$9/g

	Black Market		Supply Shortage	
	Excise Tax Loss	Sales Tax Loss	Excise Tax Loss	Sales Tax Loss
	(\$millions)			
Canada (total)	327.4	367.2	52.0	53.3
British Columbia	35.1	27.4	2.7	2.3
Alberta	22.6		9.9	
Saskatchewan	7.8	5.4	0.9	0.6
Manitoba	9.8	8.3	0.2	0.2
Ontario	97.7	90.7	11.8	11.4
Quebec	55.9	68.4	10.3	12.4
New Brunswick	4.8	6.2	1.2	1.4
Nova Scotia	6.8	7.9	0.9	1.1
Prince Edward Island	1.1	1.2	0.1	0.1
Newfoundland and Labrador	3.9	4.3	0.3	0.4
Territories	0.0		0.7	
Federal Government	81.8	147.3	13.0	23.5

Source: Authors' calculations.

We recommend:

- Provinces should ensure regulations facilitate a competitive and convenient legal retail market.
- The federal government should focus on ensuring that it does not impede production more than is necessary to protect public health so there will be enough legal marijuana to supply these retail outlets.
- In addition, the federal government and Health Canada should develop regulations for edible and concentrated marijuana products. These products are already available on the black market, providing a significant black market competitive advantage since they will not be part of the legal regime, at least at first.

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To send a comment or leave feedback, email us at blog@cdhowe.org.

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