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Bill 2 Report

Legislators in Colorado have decided that the State has an interest in promoting the development of the wine industry. Consequently, the Colorado Wine Industry Development Act was passed in 1990, creating a fund to subsidize various aspects of the industry (Colorado Wine Industry Development Board).

The money to fund these activities is collected through a series of taxes on sales volume and weight throughout the industry (CRS 12-47-503). The act created a Board of Directors within the Department of Agriculture to manage the Wine Industry Development Fund (CRS 35-29.5-103). The Board is ultimately responsible for allocating funds between research and development, and the promotion and marketing of the Colorado wine industry (CRS 35-29.5-105).

In the State of Colorado, the term *wine* describes "any vinous liquor containing not more than twenty-one percent alcohol by volume and produced in all respects in conformity with the laws of the United States…" (CRS 35-29.5-102). The legal definition of *hard cider* defines it as "an alcohol beverage containing at least one-half of one percent and less than seven percent alcohol by volume that is made by fermentation of the natural juice of apples or pears, including but not limited to flavored hard cider and hard cider containing not more than 0.392 gram of carbon dioxide per hundred milliliters" (CRS 44-3-103). However, the law also states that hard cider "shall in all respects be treated as a vinous liquor except where expressly provided otherwise", which effectively makes the beverage synonymous with wine (CRS 44-3-103). As a result, hard cider producers have been eligible to receive the same benefits as wine producers through the Colorado Wine Industry Development Act, and have been paying similar taxes as well.

SB19-142 will remove hard cider from the definition of wine. In addition, the bill exempts produce used in the production of hard cider from the taxes meant to fund the Colorado Wine Industry Development Fund ("Hard Cider Exemption Wine Industry Development Act"). This report will illustrate how SB19-142 will not only reinforce a market imperfection, but will restrict the beneficiaries of this market failure. It should, therefore, not be passed.

The proposed bill addresses a preexisting government involvement in the wine industry. As it exists today, the Colorado Wine Industry Development program allows for hard cider producers to apply for grants to fund research, development, marketing and promotional efforts. These cider producers pay into the program through levied taxes on production volume. The terms of SB19-142 will change the definition of hard cider in the state not only to discontinue the taxation, but also to prevent these producers from receiving benefits from the program.

However, the issue that needs to be addressed is deeper-rooted, stemming from the question of why the government is involved in the industry at all. What is known is that the government has a legitimate interest in regulating the consumption of alcoholic beverages. Costly unpaid medical bills and public safety risks are among some of the many externalities that can arise as a result of unregulated alcohol consumption (Ward).

According to a study conducted in 2017, alcohol consumption is the leading cause of disability and premature death in people 15 to 49 years of age around the world. The cost of this alcohol-related harm is often passed on to the public through taxes used to subsidize medical expenses. Additionally, impaired judgement when intoxicated poses a substantial cost to the public (Ward). Whether it be a car crash caused by a drunk driver or an intrusive drunken partier, negative effects of alcohol use can burden unwilling market participants. As there are so many ways that overconsumption can lead to uninvolved parties absorbing the burden, the government has a legitimate interest in regulating alcohol.

Also known are the clear benefits of research and marketing efforts to the alcoholic beverage markets. New ideas and technology allow wine producers to continuously evolve and provide product to their customers more efficiently. Unique advertising campaigns and vineyard tours are among many marketing techniques that can boost businesses for wine producers. The Colorado Wine Industry Development program helps producers by providing funding to facilitate these activities and has reported substantial growth in the industry over the past 29 years as a result (Colorado Wine Industry Development Board).

However, these tools for success are universal. A well-funded research team can benefit Google as much as it can benefit a wine producer. A strong marketing campaign can bring in just as many sales for a craft beer company as it can for a wine producer. The government forming a development fund for participants in the wine industry is no different than the government forming a development fund for ski resorts. They both create inefficiencies within their markets. Therefore, instead of preventing a market failure, the Colorado Wine Industry Development Act has created one.

Efficient government intervention in any industry is generally based on whether the industry in question creates any market failures or imposes any externalities. If an industry creates either of these situations, then the government has reason to consider whether intervention is necessary. As there are a number of externalities associated with overconsumption and abuse of alcohol, government interest in the industry typically focuses on consumption quantities. So legitimate policies, such as drinking age and consumption limits, will look to minimize the amount of alcohol consumed by the public.

In contrast, however, the Colorado Wine Industry Development Act looks to increase alcoholic beverage industry revenues through the facilitation of research and promotion of Colorado wines. Rather than limiting alcohol consumption, the development program promotes the industry and increases sales by encouraging consumers to buy Colorado wine. Engagement in these activities is best left up to the discretion of the private market, eliminating the need for government-imposed taxes. If a collective group of industry participants wants the kinds of benefits being offered through the development program, then they can privately collude to the extent permitted by anti-trust laws.

Had the State provided a public good through the development program, then the government would have a legitimate interest in the continued facilitation of the program. A public good is one that is non-rival and non-excludable. Once provided, a public good does not cost more to make available to additional consumers and is nearly impossible to stop someone from consuming (Rosen & Gayer, 54). Only the government can efficiently provide public goods, as the market does not offer any private incentives to produce them (Rosen & Gayer, 63).

However, all the services for which the Colorado Wine Industry Development program provides funding are excludable and rival. Research efforts, if left to the private market, are limited to those with enough funding to support them, making them unavailable to everyone in the market. A promotional billboard can only display one advertisement at a time. If an advertisement for *Company A* is displayed, for example, the billboard cannot be displaying an advertisement for *Company B*, making promotion a rival good. As a result, there are clear incentives within the private market to provide these services.

Current funding of the State-run development program through the imposition of taxes is inefficient and creates deadweight loss. A tax levied on producers in an industry increases the cost of production from what it would be at free-market equilibrium. This additional cost is reflected by product price increases for consumers. With increased product prices and decreased revenues, costs are reflected on consumers, preventing the market from consuming to its full potential. Without a State imposed tax, the market is open to more participants and is able to perform more efficiently overall.

From this perspective, there is no need for SB19-142 on the docket. While there is legitimate reason for government interest in the regulation of alcohol, through the creation of the Colorado Wine Industry Development Fund, the government has created a market failure by using public funds to subsidize wine industry. This is a classic example of redistribution masquerading as a positive externality. Though the program is funded by taxes on industry participants only, the true cost of the additional tax is reflected by increased prices for consumers.

I recommend that the details of 2017 Colorado revised statute Title 35, Article 29.5 be revisited. Discontinuing the development program would abolish a market failure. In turn, there would be no need for SB19-142. Research and development, as well as marketing and promotion can be left up to the private market as is the case with a majority of other industries in the state. This form of government involvement in the wine industry is inefficient and prevents the market from performing to its full potential.

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