

Liquor Privatization Fiscal Analysis (HB 466, PN 521)

Summary

House Bill 466 would privatize the state system of wine and spirits stores, eliminating a dependable revenue stream largely in exchange for one-time license fees.

During the first year after enactment, current beer distributors would have the first opportunity to purchase 1,200 newly created licenses, where they would be able to sell wine, spirits or both, in addition to beer (with package reforms). Also during the first year, grocery stores would be able to purchase a license to sell wine, and retail dispenser eating places (i.e. grocery stores that currently sell beer to go) would have the option to upgrade to a restaurant license for an additional fee.

After the first year, the remaining licenses would be available for private retailers to purchase at higher prices. Also during that time, the Pennsylvania Liquor Control Board (PLCB) would wind down retail operations and close its stores as new ones open. This bill also gives the PLCB the option to sell 600 additional licenses, if it deems necessary, after the first 1,200 are sold - for a total of 1,800 licenses.

The fees for wine and/or spirits licenses vary by group (beer distributors, private licensees and grocery stores) and by county class. There are also additional optional fees for Sunday sales, package reform permits, wine-to-go permits, spirits-to-go permits and higher fees for current restaurant, hotel and club licensees. There are 25 different license fees; however, considering all of the various possible combinations, there could be a much larger number of licensing configurations. (See Tables 1 and 2 for a full detail of one-time fees, as well as annual and biennial renewal fees.)

In addition to selling off the retail system, this bill would divest the wholesale operations of the PLCB. Wholesale licenses would be sold by brand. The bill provides a formula to determine the price of each brand. The formula is intended to value each brand at two-and-a-half years' worth of wholesale profits. Each wholesaler would have exclusive rights to the brands it acquires.

| Table 1: One-Time License Fees | | | | | | | |
|--|-----------------------|--------------------------|---------------------------------|--------------------|-----------------------|------------------------------|--------------|
| County Class | Beer Distributor Wine | Beer Distributor Spirits | Beer Distributor Wine & Spirits | Private Store Wine | Private Store Spirits | Private Store Wine & Spirits | Grocery Wine |
| First or Second Class | \$ 30,000 | \$ 52,500 | \$ 82,500 | \$ 165,000 | \$ 232,500 | \$ 397,500 | \$ 165,000 |
| Second Class A or Third Class | \$ 37,500 | \$ 60,000 | \$ 97,500 | \$ 187,500 | \$ 262,500 | \$ 450,000 | \$ 187,500 |
| Fourth or Fifth Class | \$ 22,500 | \$ 45,000 | \$ 67,500 | \$ 142,500 | \$ 202,500 | \$ 345,000 | \$ 142,500 |
| Sixth or Seventh Class | \$ 15,000 | \$ 37,500 | \$ 52,500 | \$ 120,000 | \$ 172,500 | \$ 292,500 | \$ 120,000 |
| Eighth Class | \$ 7,500 | \$ 30,000 | \$ 37,500 | \$ 97,500 | \$ 142,500 | \$ 240,000 | \$ 97,500 |
| Restaurant or hotel - same as Beer Distributor fee (above) | | | | | | | |
| Other One-Time Fees | | | | | | | |
| Retail Dispenser (primarily selling 6-pack beer to go) Upgrade to Restaurant License: \$30,000 | | | | | | | |

| Table 2: Renewal Fees | | |
|---|-----------|---|
| Permit Type | Fee Price | Annualized Estimate of Total Possible Revenue |
| Annual Renewal Fees | | |
| Sunday Sales Fee for Beer Distributors and Private Wine and Spirits Licensees | \$ 1,000 | \$ 1,800,000 |
| Sunday Sales Fee for Grocery Stores | \$ 1,500 | \$ 1,242,000 |
| Retail Package Reform Permit (beer sold by retailer, restaurant or hotel) | \$ 500 | \$ 7,658,500 |
| Beer Distributor Only Package Permit | \$ 1,000 | \$ 1,264,000 |
| Wine-to-Go (Restaurants and Hotels) | \$ 500 | \$ 1,146,500 |
| Spirits-to-Go (Restaurants and Hotels) | \$ 500 | \$ 1,146,500 |
| Application Renewal Fee for All Current Licensees | \$ 700 | \$ 11,606,700 |
| Biennial Renewal Fees | | |
| Renewal Fee for Beer Distributors and Private Wine and Spirits Licensees | \$ 1,000 | \$ 900,000 |
| Grocery Store Wine Renewal - County Class - 1st, 2nd, 2A, 3rd, or 4th | \$ 4,000 | \$ 1,522,000 |
| Grocery Store Wine Renewal - County Class - 5th, 6th, 7th, or 8th | \$ 2,000 | |
| Wholesale Renewal | \$ 5,000 | \$ 75,000 |
| Total Annualized Revenue | | \$ 28,361,200 |

Fiscal Impact

Contrary to claims from advocates, House Bill 466 does little to address the more than \$2 billion structural budget deficit the commonwealth faces in 2015/16. In fact, the bill exacerbates the long-term structural deficit.

One-Time Revenue/Costs

Only a little over \$166 million in estimated revenue would be available in the first year after enactment. (See Table 3 below.) Even though the one-time revenue might reach \$1 billion over the next two to four years, Pennsylvania would be eliminating a dependable and significant revenue stream worth multiple billions of dollars over the long term.

| Table 3: One-Time Revenue | | | |
|--------------------------------------|------------------------|-----------------|-----------------|
| <i>(\$ in Millions)</i> | | | |
| | Year One FY 2015/16 | Out-Years | Total |
| Beer Distributors - Wine and Spirits | \$ 17.7 | \$ 53.2 | \$ 70.9 |
| Grocery Stores - Wine | \$ 140.0 | - | \$ 140.0 |
| Retail Dispenser Upgrade Fee | \$ 8.9 | - | \$ 8.9 |
| Private Wine and Spirits Stores | - | \$ 145.2 | \$ 145.2 |
| Wholesale | - | \$ 615.3 | \$ 615.3 |
| Total One-Time Revenue | \$ 166.6 | \$ 813.7 | \$ 980.2 |

The bulk of the estimate is based on a great deal of uncertainty. To meet the \$1 billion mark, the sale of wholesale licenses must be worth \$615 million. That assumes that all of the current brands would be purchased by the new wholesalers. However, an earlier report by Public Financial Management (PFM) shows they could be worth as little as \$253 million. Some industry experts have estimated the wholesale

value at approximately \$325 million, which assumes that potential wholesalers will purchase a limited number of lower-end brands, based on experience in other states.

Concerns about the loss of a dependable revenue stream in exchange for one-time revenue are further complicated by one-time costs, most of which are difficult to quantify.

Transition Costs

Implementing the provisions of this bill would result in significant transition costs to the commonwealth and the PLCB, including: separation costs for displaced workers; the administrative burden of divesting the system and liquidating assets, including potential consultant fees; and breaking leases for current retail space. This bill does not address the full extent of what those transition costs would be or how to pay for them. In addition, there will be costs associated with tuition assistance for displaced workers, as provided in the bill.

- Unemployment Compensation Costs and Leave Payouts - About 4,000 employees would lose family-sustaining jobs through privatization of the liquor store system. Advocates of this bill assume private businesses will hire these employees; however, opponents are concerned that many businesses would convert shelf space from one product to another and operate with current employees. An additional concern is that new stores that hire will most likely do so with lower wages and less benefits.
- Career Training and Post-secondary Education Grant – The bill provides displaced employees up to \$2,000 per year, for two years for a cost of \$6 million.
- Reemployment Tax Credit – The bill provides businesses up to \$2,000 per displaced employee, per year, for two years for a cost of \$6 million.

Additionally, there will be revenue lost due to an increase in the discount provided to restaurants, hotels and clubs on purchases from the PLCB (from 10 percent to 14 percent) during the divestiture process, estimated at \$15.2 million per year. Also, with increased alcohol availability, there will be social consequences and increased costs. This bill does nothing to address increased costs for law enforcement and alcohol treatment and prevention. (See Table 4 below.)

The PFM study commissioned under former Gov. Tom Corbett concluded it would cost about \$1.4 billion over five years to fully divest from the retail and wholesale liquor operations, mostly comprised of the separation costs for displaced workers.

| Table 4: Additional One-Time Costs | |
|--|---------|
| <i>(\$ in Millions)</i> | |
| Career Training and Post-secondary Education Grant - up to \$2,000 per displaced employee per year for two years | \$ 6.0 |
| Reemployment Tax Credit - up to \$2,000 per displaced employee per year for two years | \$ 6.0 |
| Discount from LCB to restaurants increased from 10% to 14% | \$ 15.2 |
| Unemployment Compensation and Leave Payouts for Displaced Employees | Unknown |
| Transition Costs (Such as administrative costs) | Unknown |
| Additional Enforcement | Unknown |

Recurring Losses

Once the system is fully divested, the recurring annual net revenue loss would be over \$190 million, largely due to the loss of the PLCB's annual profits transfer to the General Fund (\$80 million) and the PLCB's ability to further maximize profits if given the flexibility to modernize the state store system (estimated at \$125 million). Other losses include: revenue lost due to delinquent tax collections consistent with the experience of other private businesses and a "vendor discount" provided to private businesses for timely remittance of sales taxes. This net loss takes into consideration offsetting new revenue from recurring fees and additional business tax collections. Although the new licensees will be paying corporate income taxes on their profits, the commonwealth would be better off financially to keep the entire profit, rather than collect the taxes on businesses profits. (See Table 5 below.)

Weighing the costs and benefits associated with a short-term cash infusion in exchange for a perpetual revenue stream is critical to consider before selling off an asset that can never be recovered. **Over just a 20-year timeframe, these net annual losses add up to nearly \$4 billion, compared with a one-time cash infusion estimated at \$1 billion, a loss of nearly \$3 billion.** When steady revenue streams disappear, in exchange for a short-term infusion of cash, the long-term structural imbalance grows and further threatens Pennsylvania's credit rating due to the continued use of one-time revenues.

| Table 5: Net Annual Revenue Losses When Privatization is Fully Phased-In <i>(\$ in Millions)</i> | |
|--|-----------------|
| Revenue Losses | |
| Current Annual Profits Transfer from LCB to General Fund | \$ 80.0 |
| Additional Annual Profits Associated with Modernization | \$ 125.0 |
| Sales Tax & Liquor Tax Loss Due to Delinquent/Uncollectable Accounts | \$ 22.3 |
| Vendor Sales Tax Discount to New Licensees | \$ 1.2 |
| Total Annual Revenue Losses | \$ 228.5 |
| Revenue Gains | |
| Maximum Possible Renewal Fees Annualized | \$ 28.4 |
| Additional Tax Revenue from Corporate Net Income Tax & Personal Income Tax | \$ 9.8 |
| Total Annual Revenue Gains | \$ 38.2 |
| Net Annual Revenue Losses | \$ 190.3 |

Disclaimer

The estimates provided in this document and other fiscal notes reflect reasonable assumptions of what could happen if businesses largely take advantage of the provisions in the bill. However, there are many uncertainties associated with the myriad of possible outcomes presented by this bill. Nothing forces businesses to change their current structure or guarantees that businesses will view the price of licenses as a reasonable value. Additionally, no guarantees are associated with the timing of the one-time revenues; however, it is reasonable to assume that the process would take at least two full years and as long as four years for the \$1 billion in revenue to be realized.

Impact on Consumers

Taxpayers are the clear losers with regard to the long-term cost and downside risk associated with this proposal. Businesses are the winners that stand to gain a profit. While advocates claim privatization will lead to lower prices for consumers, opponents argue consumers will most likely see higher prices and less selection.

Statewide, liquor prices would most likely increase to account for the up-front license fees and additional mark-ups at the wholesale and retail level. Prices and selection would vary from store to store and region to region.

While this bill aims to improve consumer convenience, it creates a complicated, disjointed system. The number of licenses and various combinations possible will lead to confusion for customers not knowing which types of products are sold at which stores. **The huge range of license fees, which vary from \$7,500 to \$450,000, will inevitably lead to pricing disparities from county to county across the state.** Operating hours will vary from store to store, as well as product price, selection, store layout, customer service and employee knowledge.

One-Time Revenue Uncertainties

Although there is an estimated \$1 billion in one-time revenue that could be generated under privatization, there are many uncertainties surrounding the assumptions built into this estimate, and there are no guarantees for such revenue.

- Businesses may not take advantage of the opportunities presented by HB 466, and it is impossible to predict future choices made by individual businesses.
- The wide range and mix of possible fees after several years of the divestiture process is difficult to estimate. The estimates contained in this document represent reasonable assumptions associated with businesses taking full advantage of the total number of licenses available where the number is capped. For other permit fees that are not capped, it is assumed that most, but not all, businesses that are eligible would participate.
- The estimates assume that 75 percent of the current beer distributors will purchase a wine and spirits license during the first year, taking advantage of the lower fees and the ability to pay in monthly installments over four years. Uncertainty surrounds whether current beer distributors have the desire or capacity to devote current shelf space to wine and spirits or be able to afford the cost of building expansions. An additional assumption is that distributors purchase both a wine and spirits license although they have the option of just purchasing one. It is unknown how many would choose which option, but it is clear that consumers would still have a disjointed system. While it is possible under this bill to have a one-stop shop for beer, wine and spirits, others would find that some beer distributors would sell only beer, others would sell beer and wine, and others beer and spirits.
- This bill presents beer distributors with a unique incentive to purchase the licenses at a significantly lower price than private businesses. The difference in price for combined wine and spirits licenses ranges from \$202,500 to \$352,500 (depending on county class). It is not clear

whether beer distributors will take advantage of this as an opportunity to sell off their business and build part of the license fee incentive into their own profit.

- The one-time revenue estimates assume that all 1,200 private wine and spirits licenses will be purchased. Currently the PLCB only operates about 600 stores. It is not clear whether the state economy would support twice as many stores, in addition to wine sales at hundreds of grocery stores (estimated at more than 800 stores) and greater availability of alcohol sales at restaurants, hotels, clubs and eating establishments.
- It is uncertain whether retail dispenser eating establishments (stores that sell 6-packs to go) would take advantage of the \$30,000 upgrade fee to become a restaurant license selling all types of alcohol by the glass for on-premise consumption.
- Many uncertainties surround the value of the wholesale system. It is difficult to place a value on such a unique asset, and there are few similar experiences with which to compare.

Modernization Alternatives

Pennsylvania can increase profitability of the liquor stores without privatization, while still improving customer convenience and maximizing pricing benefits to customers. **Several legislative changes could generate at least \$125 million per year in additional profit transfers when fully phased in.** This is a direct benefit to the taxpayers and is a continuing and steady revenue stream that helps reverse the trend of the structural deficit imbalance.

Several examples of consumer convenience and revenue enhancements include: lifting the cap on the number of stores that can be open on Sundays and increasing store operating hours; giving the PLCB flexibility in their pricing and procurement methods; allowing the stores to sell lottery tickets; allowing the PLCB to develop a customer loyalty program; allowing the direct shipment of wine to consumers; increasing fines and fees; and allowing sales to out-of-state consumers.