LIQUOR PRIVATIZATION

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PENNSYLVANIA HOUSE DEMOCRATIC POLICY COMMITTEE
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Good morning. I am Nathan Benefield, Director of Policy Research for the Commonwealth Foundation. We are a nonprofit, independent public policy research and educational institute based in Harrisburg.

My testimony will focus on three areas: an explanation of how to consider up-front and annual revenues from privatization, the social impacts of privatization, and the benefits of privatization for Pennsylvanians.

Some have questioned the amount of the upfront windfall the state would receive from auctioning off licenses for wine and spirit sales by citing the license prices in other states. This is not an apt comparison. For starters, Pennsylvania state stores sell both wine and spirits, or hard liquor; most other states had control only over spirits. Further, Pennsylvania has far fewer retail stores than most other states per capita, with just over 600 outlets. While last year's proposal from Rep. Mike Turzai would auction of 750 retail licenses, Pennsylvania would need about 3,000 liquor stores just to be at the national average.

The number of liquor licenses to be offered will undoubtedly affect the price of the licenses, as well as the degree of competition among stores and options for consumers—and therefore should be carefully considered by legislators debating privatization.

In 2010, West Virginia received bids as high as $675,000 for liquor licenses. The licenses were for spirit sales only, and expire after 10 years (Rep. Turzai's plan offered perpetual licenses, with annual processing fees). West Virginia also offers more than twice as many liquor outlets per capita as Pennsylvania; if Pennsylvania were to match West Virginia, the state would offer almost 1,500 licenses.

Potential Initial Revenue from Privatization*

	Price of Licenses	Number of Licenses	Total
Retail Licenses		750 (Tuzai Bill)	$450,000,000
	$600,000 (per license)	1,482 (WV per-capita rate)	$889,200,000
	(Based on WV 2010)	3,000 (national average per-capita)	$1,800,000,000
Wholesale Licenses	Based on prior valuations which estimate value to be equal to retail value	100 (Turzai Bill)	$450,000,000
Inventory and Equipment	PLCB Annual Report (6/30/2010)		$320,356,421
		Total (Low Estimate)	**$1,220,356,421**
		Total (Medium Estimate)	**$1,659,556,421**
		Total (High Estimate)	**$2,570,356,421**

* For illustrative purposes only, CF recommends a formal valuation.

Privatization in Pennsylvania could also entail more than just licensing retail stores, but offer licensing for wholesale operations—that is, the distribution of wine and spirits to restaurants and bars. The value of wholesale licenses could be equal to that of the retail stores. Privatization would also involve selling off the entire inventory of the state liquor stores. As of June 30, 2010, according to the PLCB the inventory on hand plus the value of assets of the state stores was $320 million.

We will never know the true value of privatization until taking up competitive bids for licenses—and legislators should work to ensure that privatization involves an open and competitive bidding process—and we also recommend commissioning a financial assessment to get a clear estimate of the of the value.

There is the idea that state stores provide $500 million each year to the state. However, most of this revenue (about $400 million) is from state alcohol taxes and state sales taxes. The rest—considered "state stores profits"—is really just based on the markups of liquor, or an implicit tax on consumers at the government-run stores.

This revenue would be replaced by taxes under a license plan. Lawmakers will set tax rates—either using the current liquor tax structure or replacing it with a different alcohol tax, such as a gallonage tax—and can set the rate to match current revenues from taxes and state store markups.

General Fund Revenue from State Liquor Stores, 2010-11

	Current	Under Privatization
Johnstown Flood Tax (18%)	$297,700,000	Discontinued?
State Sales Tax (6%)	$92,489,000	Continued
State Stores "Profit" (consumer markup)	$105,000,000	Discontinued
Gallonage Tax	$0	Tax Shift?
CNI Tax and Other Businesses Tax Revenue	$0	Additional
Annual License Fees for Liquor Stores	$0	Additional
Total	$495,189,000	???

Source: Governor's Executive Budget, 2010-11, February 2010

Additionally, by relying on private vendors, the state will collect corporate income taxes and other business taxes from operators, that government stores don't pay. And by improving service, selection, and reducing prices, Pennsylvania can recapture some of the revenue and economic activity lost to other states through "border bleed."

Second, there is the idea that Pennsylvania's control system provides the best protection against underage drinking and alcohol abuse. Yet data from the National Survey on Drug Use and Health[1] rank Pennsylvania middle-of-the-pack, or worse, on rates of underage drinking and binge drinking. According to Mothers Against Drunk Driving (MADD), Pennsylvania ranks 30th[2] in DUI-related accidents per capita (1 being best, or fewest DUI-accidents). In contrast, neighboring New Jersey, has ***three times*** the number of liquor stores (in a state two-thirds as populous and much more geographically concentrated than Pennsylvania) and only has about one-third the number of alcohol-related traffic fatalities.[3]

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[1] http://www.oas.samhsa.gov/2k8State/Ch3.htm#Fig3-1
[2] http://www.madd.org/drunk-driving/campaign/state-ranking/
[3] http://www.commonwealthfoundation.org/policyblog/detail/how-many-state-liquor-stores-should-pennsylvania-have

In fact, the Pennsylvania Liquor Control Board's own 2009 report to the General Assembly[4] (ordered by Act 86 of 2006) concluded that the state's college-age student drinking rates are near the national average, and high school drinking rates are **higher** than the U.S. average. If state control of liquor sales were a driving factor in underage drinking, alcohol abuse, or drunk driving, Pennsylvania should be number one or two on every measure, but this is clearly not the case.

Dr. Antony Davies, an associate professor of economics at Duquesne University along with John Pulito authored a study commissioned by Commonwealth Foundation[5] on the social impacts of liquor control.

In this study, Davies and Pulito looked at all states over sixteen years, and compared the incidence of underage drinking and underage binge drinking across states with different degrees of alcohol control. They found no relationship between alcohol control and underage drinking, no difference in the incidence of underage binge drinking among the four levels of control and found that states with the most stringent controls have higher DUI fatality rates.

Davies and Pulito conducted a separate study[6], currently under peer review, of forty-nine states over twenty-one years looking only at DUI fatalities, controlling for differences in other state alcohol laws. This study also concluded that control states had higher alcohol-involved fatality rates among the legal age population.

Dr. Davies also compiled a review of the existing academic literature[7] on privatization. The studies detailed in the literature review submitted provide conflicting stories as to the relationship between privatization and social outcomes. Some studies link liquor control with lower consumption, underage drinking, and DUI rates. Others studies find the opposition relationship, and some find no relationship whatsoever.

Finally, the debate over privatization is a question of whether government should be in the liquor business, and what is in the best interest for Pennsylvania consumers and residents.

Privatization will give Pennsylvanians better services, lower prices and greater selection on alcoholic products. The current monopoly forces Pennsylvanians to pay up to 50 percent more for liquor than in other states—many of which offer a variety of wines not available in the Commonwealth, and allow wine bought online to be delivered to your door. Customers' selection is about to get even more limited, as the PLCB is in the process of cutting 400 wine and spirit products from its shelves.

The limited hours, limited selection, standardized stores, and limited number of stores are not providing the type of services customers want. It is no surprise that across the state borders in New Jersey, Delaware, Ohio, Maryland, and other states, there are liquor stores with better selection and prices catering to Pennsylvanians.

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[4] http://www.portal.state.pa.us/portal/server.pt/document/737800/act_85_of_2006_-_2009_report_pdf?qid=19920825&rank=1
[5] http://www.commonwealthfoundation.org/docLib/20091029_StateStores(Pulito).pdf
[6] http://www.commonwealthfoundation.org/docLib/20110214_WorkingPaper.pdf
[7] http://www.commonwealthfoundation.org/docLib/20110201_PrivatizationLitReview.pdf

When the Pennsylvania Liquor Control Board (PLCB) was organized in 1933, Governor Gifford Pinchot stated that the purpose of the Board was to "discourage the purchase of alcoholic beverages by making it as inconvenient and expensive as possible." That is still the system we have today, and that is why Pennsylvanians want and desire better. The latest Quinnipiac University Poll found that 65%[8] of Pennsylvania voters (including more than 60 percent of Republicans, Democrats, and Independents) favor privatizing the liquor stores to help balance the state budget.

Ironically, in response to the push for privatization, the Pennsylvania Liquor Control Board has started to imitate the best practices of private retailers. From spending $90,000 per store in advertising last year, implementing an impractical "wine kiosk" program to sell wine in grocery stores, operating "wine boutiques" connected with BYOB restaurants and spending hundreds of thousands to upgrade its website, the agency puts far more effort into *pushing* alcohol sales than in controlling the market.

In fact, the Commonwealth Foundation recently obtained a PCLB proposal billed as an "alternative to privatization." This ill-advised scheme would allow the LCB to issue $1 billion in bonds, tied to its revenue. To generate revenue needed to pay for this new debt, the LCB would engage in "market-based pricing;" be exempt from state civil service laws and procurement rules; increase fees for bars, restaurants, hotels, clubs and the like; sell lottery tickets; issue coupons to customers; and expand the hours for wine kiosks.

In short, the PLCB wants to operate the way private retailers would.

Getting state government out of the sales business and allowing the PLCB to focus on enforcement of alcohol laws is a good fiscal policy, good social policy and good economic policy.

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[8] http://www.quinnipiac.edu/x1327.xml?ReleaseID=1558