2017/18
BUDGET BRIEFING
Report on Key Issues
HOUSE APPROPRIATIONS COMMITTEE (D)
JOE MARKOSEK, DEMOCRATIC CHAIRMAN
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House Bills 991, 438, 975 and 1075

Liquor privatization can take shape in many forms. This privatization package consists of four bills, which would each privatize a portion of the system over time. House Bill 991 would allow for private retail stores to operate in conjunction with the current system. House Bill 438 would allow for spirits-to-go, much like the recent changes allowing wine-to-go by restaurant and hotel licensees. House Bill 975 would privatize the wholesale and retail system for wine (but not spirits). Finally House Bill 1075 would divest the wholesale and retail wine and spirits system through a ten-year lease, followed by full divestiture.

House Bill 991 (Harris)

HB 991 would create a new retail system for selling wine and spirits for off-premise consumption, which would run parallel to the current retail stores operated by the Pennsylvania Liquor Control Board. Licenses would be available to any retailer, including beer distributors, restaurants, grocery stores, convenience stores, gas stations, big box stores and specialty stores.

Wholesale Subsidization and Profit Loss

This bill is designed to put the PLCB out of the retail business via “competition;” even force PLCB to subsidize that competition and its own demise.

PLCB would be required to sell products to retailers at a markup of no more than 15 percent of the price originally paid by PLCB. This artificially set pricing rule would not allow PLCB to fully recoup its costs of doing business, forcing direct profit loss. Competing retail stores would be able to undercut PLCB retail prices since their wholesale purchase would be partially subsidized by PLCB. Because retail operations also require less overhead costs than wine and spirits shops (i.e. they can use existing shelf space and employees subsidized by other products), PLCB retail profits would further deteriorate.

Tax Revenue Loss

Lower retail prices would directly result in less tax revenue. However, there are no available benchmarks or standards to predict the shift in market share from PLCB to private retailers, so it is difficult to estimate the fiscal impact of this bill. An example of a potential impact on revenue, however, would assume a 10 percent lower retail price by private retailers that would constitute half of market share. Under this assumption, state revenue could drop about $28 million from liquor and sales taxes, which are currently estimated to generate $550 million from liquor sales in 2017/18.

PLCB profit losses and tax revenue losses are reductions to General Fund revenues, which means services to citizens would be eliminated if taxes are not increased. Filling the gap with higher taxes means taxpayers would be subsidizing the private liquor system.

Creating a Loophole

The artificially set markup of 15 percent is also concerning because this price is substantially lower than the price restaurants pay (which is a 10 percent discount from the PLCB retail shelf price). This would incentivize restaurants to switch to the new retail license, further deteriorating PLCB’s profits from sales to restaurants.

A Store on Every Corner

HB 991 allows one retail location for wine and spirits for every 6,000 residents in a county, with a minimum of 15 retail locations per county. PLCB now operates 601 retail stores, but the bill would allow up to 2,383 additional retail locations. Republican estimates assume 40 percent of possible licenses would be sold in the first year, or 953 locations, for $300 million in one-time 2017/18 revenue, according to published accounts.

Republican estimates for an endowment account assume an additional $160 million in one-time revenue in 2018/19 from additional locations. The impact of such assumptions translates into almost 1,500 new locations at an average price of about $315,000 per license.

The following table shows the current number of PLCB stores in each county, the total number of retailers allowed by this bill, and the number of retailers per county assumed by Republican estimates.

In some cases, such as Philadelphia, Republican estimates assume that the number of retail locations will more than triple (from the 50 current stores to more than 159 total, with a potential of more than 300). In other cases, such as rural areas, sales are so low that some counties barely can sustain one current store.

PA Wineries Suffer – Selection Suffers

This bill has an extremely low requirement for the number of individual products carried by a retailer (200 each for wine and spirits in 1st through 4th class counties; 100 each in 5th through 8th class). Current PLCB stores carry 3,000 products in the smallest stores; 5,000 to 7,000 in average stores; up to 10,000 in premium collection stores; and around 30,000 products through PLCB special orders.

Consumers will clearly see a dramatic decline in selection. Local PA wineries and distilleries will not receive the same shelf space and promotion that they are receiving now from PLCB. This also hurts small business producers from other states whose products are sold by PLCB in Pennsylvania. Retailers will choose to sell cheap, high volume products rather than to offer specialty or premium products.

Enforcement, What Enforcement?

This bill provides no funding for enforcement. The significant increase in the number of locations will cause current enforcement resources to be spread too thin which could lead to higher crime rates and incidences of under-age drinking.

Unachievable Revenue Estimates

The current marketplace supports about 600 retail stores for wine and spirits, some of which barely turn a profit. Act 39 of 2016, allowing restaurant licensees to sell wine-to-go, has only resulted in about 400 locations opting to obtain the expanded wine permit (of a possible 11,000 establishments). In light of these numbers, there is very little certainty Republican estimates would hold since they assume license purchases by some 1,500 additional retailers. This bill is mainly aimed at grocery stores (requiring a minimum of 5,000 square feet) assumes more than half of all grocery stores in the state will opt to sell wine and spirits.

According to Republican estimates for recurring revenue to an endowment account, there would be $100 million in recurring revenue on top of current PLCB profit transfers. For this to happen, however, **Pennsylvanians would have to consume almost twice as much liquor as they do now**. Needless to say, this would have detrimental effects on public health and safety.

Number of Stores Selling Wine and Spirits To-go Allowed by House Bill 991							
County	Current Number of PLCB Stores	Total Stores Allowed by HB 991	Assumed Number of New Stores to Hit Republican Revenue Estimate	County	Current Number of PLCB Stores	Total Stores Allowed by HB 991	Assumed Number of New Stores to Hit Republican Revenue Estimate
Adams County	1	17	10	Lackawanna County	12	35	21
Allegheny County	75	204	124	Lancaster County	19	90	55
Armstrong County	4	15	9	Lawrence County	5	15	9
Beaver County	9	28	17	Lebanon County	4	23	14
Bedford County	2	15	9	Lehigh County	16	61	37
Berks County	12	69	42	Luzerne County	19	53	32
Blair County	5	21	13	Lycoming County	7	19	12
Bradford County	4	10	6	Mckean County	4	15	9
Bucks County	35	104	63	Mercer County	6	19	12
Butler County	9	31	19	Mifflin County	1	15	9
Cambria County	10	22	13	Monroe County	9	28	17
Cameron County	1	15	9	Montgomery County	38	137	84
Carbon County	4	11	7	Montour County	1	15	9
Centre County	6	27	16	Northampton County	15	50	31
Chester County	24	86	52	Northumberland County	4	15	9
Clarion County	4	15	9	Perry County	1	15	9
Clearfield County	5	15	9	Philadelphia County	50	261	159
Clinton County	1	15	9	Pike County	2	15	9
Columbia County	2	15	9	Potter County	2	15	9
Crawford County	4	15	9	Schuylkill County	9	24	15
Cumberland County	10	41	25	Snyder County	1	15	9
Dauphin County	15	46	28	Somerset County	4	15	9
Delaware County	21	94	57	Sullivan County	1	15	9
Elk County	2	15	9	Susquehanna County	3	15	9
Erie County	15	46	28	Tioga County	3	15	9
Fayette County	7	22	13	Union County	2	15	9
Forest County	2	15	9	Venango County	3	15	9
Franklin County	5	26	16	Warren County	2	15	9
Fulton County	1	15	9	Washington County	10	35	21
Greene County	2	15	9	Wayne County	3	15	9
Huntingdon County	2	15	9	Westmoreland County	23	59	36
Indiana County	4	15	9	Wyoming County	1	15	9
Jefferson County	4	15	9	York County	13	74	45
Juniata County	1	15	9	**Total**	**601**	**2,383**	**1,454**

House Bill 438 (Reese, Turzai)

Spirits Expanded Permits

HB 438 allows restaurant and hotel licensees to apply for expanded permits to sell up to four bottles of spirits for off-premise consumption. This would mirror Act 39 of 2016, which allowed these licensees to sell wine to-go. So far, Act 39 has resulted in about 400 expanded wine permits, predominantly at grocery stores with restaurant licenses.

Total Giveaway

A similar permit for spirits would be somewhat less popular among restaurant licensees due to lower demand, lower correlation with food preparation, and higher incidences of theft and underage drinking. Even if the 400 licensees with expanded wine permits opted for the expanded spirits permit, it would not raise $1 million in license fees.

HB 438 is designed to undermine PLCB profits. Additionally, this is not a pressing matter of citizen concern (there are no citizen or consumer groups rallying at the Capitol to buy tequila at the grocery store). The fee also does not reflect the market value of the asset nor the transition costs of PLCB to implement this bill, if it becomes law.

House Bill 975 (Turzai)

"Free the Wine"

HB 975 would privatize the wholesale and retail operations for wine sales (not spirits). PLCB would continue as the wholesaler and retailer for selling spirits and it would be allowed to sell wine at retail, although retail wine sales would occur alongside private retail wine sales. PLCB retail wine would be purchased from private wholesalers.

This bill does not cap the number of retail wine licenses. The initial licensing fee would be $250,000 and the annual renewal fee: two percent of gross receipts. The wholesaler initial fee is 10 percent of the cost of goods sold with annual renewal fees of five percent of gross receipts.

Profit Loss

This bill is designed to spin off the most profitable brands to private wholesalers and retailers, leaving the PLCB to compete with the least profitable parts of the business, brands and regions of the state.

While this bill would produce one-time and ongoing fee revenue, the fees would be offset by losses to the current profit transfers to the General Fund. The magnitude of General Fund profit losses cannot be determined at this time. However, it is clear the current estimates of profit transfers would significantly decline.

Tax Problems

This bill appears to keep sales and liquor taxes in place, since it doesn't specifically change any tax rates. However, the bill is not clear if the liquor tax would be imposed on the wholesale or retail price, and the language appears to conflict with state law about imposing the liquor tax. Since the wholesaler is required to remit liquor taxes, it appears the levy is imposed on the wholesale price. In this case, the General Fund would lose about $25 million per year.

House Bill 1075 (Turzai)

Wholesale Divestiture

HB 1075 would divest the wholesale operations of wine and spirits by leasing to wholesalers for 10 years at which time the wholesale system would be divested with annual license fees due.

The wholesaler initial fee is 10 percent of the cost of goods sold with annual renewal fees of five percent of gross receipts. After the 10-year lease period the annual fee would be five percent of gross receipts.

Profit and Tax Loss

Similar to HB 975, this bill is designed to spin off the most profitable portion of PLCB. Although new fees would be generated, PLCB would not be able to meet current estimates of profit transfers to the General Fund.

This bill appears to impose the liquor tax at the wholesale level instead of the retail level, which means a significant loss of tax revenue to the General Fund (potentially more than $50 million.

Stranded Costs of Privatization

PLCB has many investments, obligations and debt which are amortized over a period of time. None of the privatization proposals would force private businesses to take on any of these debts or obligations, which would become stranded costs. The obligations do not disappear, which means other commonwealth agencies, the General Fund, and, ultimately, taxpayers, would end up subsidizing these payments over the long term.

The largest stranded cost of the PLCB is the unfunded pension debt of $450 million, which would most likely be absorbed by other commonwealth agencies and employees paying into the State Employees' Retirement System. PLCB provided the following list of stranded costs:

$450 million Pension Liability

- This is the PLCB's share -- based on calculations by actuaries or outside consultants and allocated by the comptroller's office -- of the commonwealth's unfunded liability for pension obligations.

$400 million - OPEB Liability

- This is PLCB's allocated share of the commonwealth's unfunded liability for postemployment obligations to employees (final calculation would be determined by actuaries and allocated by the comptroller's office prior to June 2018).

$47 million - Workers Compensation

- This is PLCB's share -- based on calculations by outside consultants and allocated by the comptroller's office -- of the commonwealth's liability for its ongoing workers compensation liability.

$49 million in transfers to other agencies

- $26 million to Pennsylvania State Police for liquor enforcement (statutorily required).
- $3 million to the Department of Drug & Alcohol Programs (statutorily required).
- $20 million to other commonwealth agencies that bill PLCB for services provided, including comptroller's office, Office of Administration, Department of General Services, auditor general's office, Civil Service Commission, payroll operations, and treasury.

$46 million - Unemployment Compensation benefits

- While the duration of UC eligibility will vary by employee, this estimate assumes all employees would qualify for eligibility and reach the maximum payout duration of 26 weeks. Also assumes that privatization will result in the elimination of all retail positions and a significant percentage of administrative positions.
- The average salary for full- and part-time employees is used to determine the "high quarter" and calculate average weekly UC benefits. Specifically, $42,213 was used as the salary for full-time permanent positions and $24,000 was used as the salary for part-time permanent positions.

$40 million - Unamortized Fixed Assets

This represents the book value of unamortized fixed assets that have already been procured or purchased, including IT equipment, software and software licenses with little or no value to any other agency.

$20 million - Compensated Absence Liabilities

- This is the aggregate value of accrued employee annual and sick leave that would be due and payable upon termination from employment (contractual liability).

$10 million - Stranded Inventory

- This is an estimate of potentially unsaleable products in PLCB's inventory due to damage during the transition, unsold product at stores after the transition, or inventory "shrinkage" following final inventory audits.

$3 million - Unamortized lease obligations

- This represents an estimate of existing lease obligations to reimburse landlords for the cost of improvements made to "rebranded" store locations. This figure would increase over time as more rebrands are initiated.

$3.1 million - Grants

- $1.1 million in alcohol education grants currently provided by PLCB.
- $2 million to PA industry boards ($1 million to PA Wine Marketing & Research Program Board and $1 million to PA Malt & Brewed Beverages Industry Promotion Board - statutorily required.

Funding ongoing licensing/regulatory functions from license fees and fines

- While license fee and fine revenue (approx. $26 million, including surcharges) cover the current costs of operating licensing, OALJ and the Office of Chief Counsel (approx. $20 million), additional revenue may be necessary if these areas need additional support. Fees may need to be further increased if the intent is that a post-privatization PLCB should be self-sufficient and not need General Fund support.

House Appropriations Committee (D)

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