Testimony of:

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Senate Law & Justice Committee
Senator Chuck McIlhinney, Chair
Senator Jim Ferlo, Chair

Liquor Privatization in Pennsylvania

June 4th, 2013

Good morning Chairman McIlhinney and Chairman Ferlo, and thank you for the opportunity to provide this testimony discussing the governor's plan to privatize the state's wine and spirits delivery system. Thank you for the opportunity to address you today and lend our voice to this important debate. The governor's plan to privatize the delivery of wine and spirits represents an unprecedented opportunity for economic expansion for small businesses statewide, and provides incentives for job creators to launch new operations within the Commonwealth and make historic investments in Pennsylvania's economy.

Core Principles

The governor's plan is founded on the following core principles: increasing convenience so the Commonwealth of Pennsylvania can provide consumers with the type of shopping experience enjoyed in 48 other states; getting the state completely out of the business of selling alcoholic beverages so it can assume its proper role as a regulator rather than a promoter of alcohol; ensuring that Pennsylvania's taxpayers receive the full up-front value for getting the state out of the liquor business; and transitioning to a socially and fiscally responsible private wine and spirits distribution system.

Forward Thinking on Consumer Convenience; A New and Convenient Retail Framework

Pennsylvania is not so unique that our citizens require a state-run liquor distribution scheme to protect them from a convenient shopping experience. The experience in 48 other states shows that we can trust consumers to make their own choices and we can trust the private sector to safely provide consumers with convenience, selection and competitive pricing.

Pennsylvania's state monopoly on wine and spirits distribution and our restrictive licensing structure have created a perplexing retail environment that drives consumers to travel extra distances and visit multiple retail establishments in order to buy the products they want. The governor envisions a commonsense, new and more convenient retail system that resembles those in other states. This vision includes: privately-owned package stores with the products and prices demanded by the market, and adequate licenses are available to permit consumers to purchase wine and beer in the locations where they already shop.

A very limited number of retailers have had a measure of success in adjusting their businesses to work within the restrictions of Pennsylvania's restaurant license system. However, if it is our intent that existing retailers should be allowed to participate in the market, it makes sense to make new types of licenses readily available to accommodate their business models rather than requiring them to adjust to unnecessary limitations and restrictions that do nothing to enhance public safety, consumer convenience or economic development. The governor and I support a licensing structure that takes a rational approach to providing Pennsylvania consumers with the convenient shopping experience they deserve.

Modern Private Wholesale Distribution

The current version of HB 790 (PN 1246) further refined the governor's proposal to protect the value of the businesses operated by current licensees while creating an avenue to reach new customers, market new products and increase private sector profits. This is unlikely if the state retains control of wholesale distribution of wine and spirits. As long as the state retains control of wholesale, the state monopoly will be the ultimate driver of price hikes, the final controller of all product selection in the Commonwealth and the singular limiting factor of how profitable a private retailer will be. All of these factors undermine the priority of providing consumers with the convenience and selection they deserve.

The state-controlled wholesale structure already struggles to adequately supply current licensees. If it has to provide stock to a significantly increased number of retail licensees in the long term, then supply-chain problems would be anticipated. Upgrading the system to adequately supply a privatized retail environment would be time consuming and costly. The sensible option would be to license private wholesalers who have the time-tested business plans to make the retail system deliver meaningful consumer convenience, and who are willing and able to quickly provide the full value for what the wholesale privilege is worth.

Full Value for Pennsylvania Consumers – A Historic Billion Dollars for Public Education

The governor's original proposal and HB 790, PN 1246, both deliver about a billion dollars to Pennsylvania taxpayers while increasing consumer convenience and creating a private sector opportunity, all without a tax increase. Privatization of the entire state liquor monopoly will ensure that the full value of the wine and spirits market becomes an opportunity for the expansion of Pennsylvania businesses and that a historic investment can be made in a public policy initiative – such as a block grant program for our public schools.

The governor's public school funding proposal, called Passport For Learning and embodied in House Bill 1366 introduced by Representative Ryan Aument, will allow investment in our schools at a time they may be choosing between providing for new programs and paying the bill for their spiraling pension obligations. This proposal will aid in capital and program improvements while the struggle continues, helping to relieve pressure on school boards' budgets, and ultimately on homeowners struggling to pay their property taxes.

Boosting Small Businesses and Supporting Consumers

Privatization of Pennsylvania's wine and spirits system creates an unprecedented opportunity for private business expansion. Existing licensees will be able to sell new products and expand to new markets, and retailers should be afforded the ability to provide their current customer bases with increased convenience. Ending the state monopoly will dramatically increase opportunities for small businesses to thrive.

Due to the governor's concern for the impact on existing Pennsylvania businesses, our economic consultants (Public Financial Management) performed an analysis on the level at which HB 790 sets license fees for retailers, including beer distributors. The purpose of the analysis was to determine if the fee levels were appropriate for the profit potential of the privilege being conveyed by the license (i.e., whether the price of the license is worth its value). In many instances, the economic value of the license is <u>two-to-three times greater than the price at which a beer distributor will be able to acquire it</u>. Not only will our beer distributors have a full year to establish themselves as the frontrunners in the retail sales of wine and spirits, but the fee levels set within the current legislation also gives them a powerful economic edge with which to magnify their ability to compete.

Recapturing Revenue from *"Border-bleed"*

There is general agreement that Pennsylvania is currently losing a significant amount of sales to other states. We expect an increase in sales within Pennsylvania due to reclaiming purchases that currently take place across the border due to our neighboring states providing their consumers with greater convenience, selection, and competitive pricing. This border bleed represents a serious loss of economic activity and revenue that Pennsylvania endures year after year. Estimates of the sales volume that Pennsylvania could reclaim vary from almost $100 million to more than $300 million—a more than sufficient reason to privatize & reform our system.

Enhancing Social Responsibility

Privatization and social responsibility are not mutually exclusive. In many ways, Pennsylvania will be better protected against potential harms of alcohol consumption in a private system. Fines and monetary penalties for licensees who violate the Liquor Code would be increased significantly, placing Pennsylvania at or near the highest in the country for serious offenses, and would deter future misconduct rather than maintaining status quo in which licensees view such penalties as simply the cost of doing business. Mandatory minimum license suspensions are imposed for nuisance operators convicted of second or subsequent offenses for sales to minors or VIPs. Further, there is an increase in the maximum criminal fines and prison terms for violations.

In Fiscal Year 2011-2012, the governor authorized a transfer of approximately $21.8 million from the PLCB to the General Fund for enforcement of liquor laws. The governor has committed to an additional $5 million, an increase in funding of 22%.

The body of evidence on consumption shows that there are a multitude of factors that influence consumption rates and alcohol abuse including state enforcement strategies, prices, advertising, family and social environments. Available research demonstrates that enforcement is effective in creating a responsible environment. Many other counter measures have been shown to reduce both alcohol related injuries and drinking and driving, such as stricter enforcement of the minimum legal drinking age and the use of sobriety checkpoints. Further, an increase in sales does not necessarily translate into more alcohol actually consumed. Pennsylvania expects to reclaim sales lost across the border through a more convenient system and competitive pricing, which does not necessarily mean Pennsylvanians will consume more products.

Further, HB 790 will give the Department of Drug and Alcohol Programs an additional $1.5 million, a 75% increase, to expand efforts to educate the public on the harms of alcohol abuse. Prevention is the key. With tougher penalties and better consumer education on the problems of underage and excessive consumption, we will enhance our prevention efforts in Pennsylvania.

Embracing Change

Pennsylvania businesses stand ready to move the Commonwealth into the 21st Century and provide our consumers with the convenience they demand and deserve. Independent polls have shown that: majorities of both parties support ending the state monopoly; six out of ten Pennsylvanians favor privatizing wine and spirits sales; the only group of consumers among which there is more opposition than support is those who never go to the state stores; and a majority of union members support ending state control.

Once again we commend you, Chairmen McIlhinney and Ferlo, for continuing the process of gathering information on the ramifications of privatization of the liquor control system in Pennsylvania. We respectfully continue to request consideration of HB 790, and offer our services to answer questions and provide information as appropriate.

We firmly believe that, together, we can enact comprehensive, bold change in our liquor system before June 30. Thank you.