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Selling Pennsylvania's Liquor Stores

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As the state grapples with funding its transportation needs, this may be an opportune time to examine the privatization of some of the government's non-core functions. One such proposal is to sell off the state's liquor stores. This is an idea that is way overdue.

Currently, Pennsylvania is considered a "liquor control state", one of eighteen states (as well as two counties in Maryland) who control the retail and/or wholesale distribution of alcoholic beverages. The other thirty-two states are considered to be "licensure states" who issue licenses to private vendors. Although licensure states do not control the retail or wholesale distribution of alcohol, they often place significant restrictions on their licensees. These restrictions include distance from a place of worship or school, number of licenses available in a municipality or county, and background checks on applicants.

Neighboring states Ohio and West Virginia are also control states while Delaware, Maryland, New York, and New Jersey are licensure states. Neither of the two counties in Maryland, (Montgomery and Worcester) who opted to become control counties share a border with Pennsylvania.

Among the more compelling arguments for the divestiture of the state's liquor stores would be to obtain upfront money, to remove employees from the state agency's payroll, and to reduce the growth in the State's retirement obligations. Currently there are more than 2,900 employees working for the Pennsylvania Liquor Control Board (PLCB). While the salaries of PLCB employees are paid from sales proceeds, they are still eligible for state benefits such as compensated absences that amounted to $24.7 million in FY 2005. They are also eligible to participate in the State Employees Retirement System. The PLCB contributed $2.1 million to the system for its employees. In addition to the benefits costs, PLCB employees have considerable workers' compensation costs for "disability from business-type activities". Employees were owed $15.89 million in FY05—$3.31 million in current accrued expenses and $12.58 million in non-current liabilities.

Control states generally charge higher prices for alcohol products than are seen in licensure states through a greater markup over costs—in addition to the taxes levied. PLCB proceeds pay for operations and contribute "profits" to the general fund. However, higher prices could lead to lower consumption and cause consumers to go elsewhere, which can be a large problem if neighboring states are licensure states, for the product. It can also reflect higher than necessary operations costs for wholesaling and retailing alcohol.

If consumers don't buy alcohol from Pennsylvania State stores, then the Commonwealth loses the mark-up as well as the considerable liquor taxes. The PLCB has recognized this fact and has opened seven "outlet stores" in counties that border neighboring licensure states New Jersey and Maryland (Chester, Northampton, Philadelphia, and York Counties) as well as in counties bordering fellow control states West Virginia (Washington County) and Ohio (Mercer County). The purpose of these outlet stores is to "feature brand-name products in larger quantity bottles at deeply discounted prices." In other words, these stores, opened in 2004-05, were designed to compete with the neighboring states to recoup lost sales. It has obviously worked as sales from these seven stores reached $55.2 million in FY05.

With outlet stores so successful, why not let all Pennsylvanians benefit from competitive pricing? The current system puts those who do not live near these outlets at a disadvantage. Privatizing the retail and wholesale sale of liquor will let all Pennsylvanians enjoy the lower prices competition brings. Indeed, private ownership can bring more consumer friendly stores and better variety. If the PLCB recognizes the importance of being competitive, then why not make the whole system competitive by privatizing it?

Of course the details of such a divestiture will be important. One key question to be answered is how will the licenses be sold? Will they be sold as the stores are currently configured with both wine and spirits or should wine licenses be sold separate from liquor licenses as is done in New York? Another issue to be resolved is whether to auction only the individual licenses and inventory at currently existing stores or also create new license opportunities.

PLCB sales in FY06 were $1.573 billion and sales net of taxes were $1.171 billion. Profits turned over to the general fund were $80 million. If the Commonwealth can sell the state store system for an amount that is more than the present value of $80 million per year, then they should do so. Using a six percent discount rate can put the sale price at $1.2 billion or higher. And with revenues running at $1.6 billion per year the sales price could be much greater, given the cost savings private management can bring.

The $1.2 billion or more could go a long way toward shoring up the state's employee pension plan or to fund badly needed highway repairs. But we won't know its true value until the bids are in. We should be moving ahead with that auction as soon as possible.

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