REPORT OF
PRICE WATERHOUSE CONSULTING

A Study of Virginia's Existing Liquor Distribution System

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

SENATE DOCUMENT NO. 35

COMMONWEALTH OF VIRGINIA
RICHMOND
1993

Preface

During the 1992 session of the General Assembly two bills, Senate Bill 85 and Senate Bill 249, introduced the idea of using pilot private liquor sales to evaluate Virginia's existing liquor distribution system. Some members of the General Assembly suggested that a thorough study be performed prior to introducing private liquor sales in Virginia. Senate Bill 249 was passed by indefinately during the 1992 session and Senate Bill 85 was carried over to the 1993 session.

In February 1992, Governor Wilder directed ABC to initiate a study of the privatization of liquor sales in Virginia. Attention was to be given to revenue levels, service to urban, suburban, and rural areas, control over the distribution and sale of liquor, effective enforcement of ABC laws, retail prices, employment considerations, and the need for additional regulatory resources. In April 1992, ABC contracted with Price Waterhouse to perform an objective, detailed and comprehensive study of the advantages and disadvantages of privatization. In December 1992, the final report was provided to Governor Wilder.

On January 15, 1993 the study was presented to the Senate Rehabilitation and Social Services Committee along with a brief response from the Department of Alcoholic Beverage Control. At a subsequent meeting on January 22, 1993, several members of the committee requested further information about the potential effects of privatization on local business taxes. Also at this meeting, the committee voted to change the language of Senate Bill 85 to provide for the automation of the Price Waterhouse report as a senate document. The concept of a pilot program for private liquor sales was removed from the bill.

Included in this package are the Price Waterhouse Report and an addendum that includes ABC's briefing papers from the January 15th meeting and the analysis of BPOL and Merchant's Capital taxes.

Dr. George M. Hampton
Chairman
Department of Alcoholic
Beverage Control

March 8, 1993

Virginia Department of
Alcoholic Beverage Control

Study of Virginia's Existing Liquor Distribution System

FINAL REPORT

November 16, 1992

Price Waterhouse

STUDY OF VIRGINIA'S EXISTING LIQUOR DISTRIBUTION SYSTEM
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November 13, 1992

Ms. Rita Henderson
Deputy Director for Administration
Department of Alcoholic Beverage Control
2901 Hermitage Road
Richmond, VA 22330

Dear Ms. Henderson,

We are pleased to present the final report for the Study of Virginia's Existing Liquor Distribution System. We trust that this final report meets your expectations and will be useful to you as you consider different policy options.

Our analysis of both privatization options was based on various key assumptions. The assumptions we used in the analysis are conservative in nature. However, we believe that it is important to point out that should assumptions made for the analysis change, the results presented in this report would change as well.

We want to thank you for all your help throughout the development of this report. We also want to acknowledge all the help and assistance we received from numerous officials at ABC. Everyone to whom we talked was always willing to answer our questions.

If you have any questions about this report please call Dr. Paul Lawrence or Dr. Fred Laughlin at (202) 296-0800.

Very truly yours,

Price Waterhouse

EXECUTIVE SUMMARY

On February 10, 1992, Governor Wilder requested that the Virginia Department of Alcoholic Beverage Control (ABC) study the existing state-run system of liquor distribution and compare it to private sector liquor distribution systems at the wholesale and retail levels. Price Waterhouse was engaged to examine the following two possible options for liquor distribution:

- Partial Privatization — the state privatizes the retail function, but retains the wholesale function of liquor distribution
- Full Privatization — the state privatizes both the retail and wholesale functions of liquor distribution

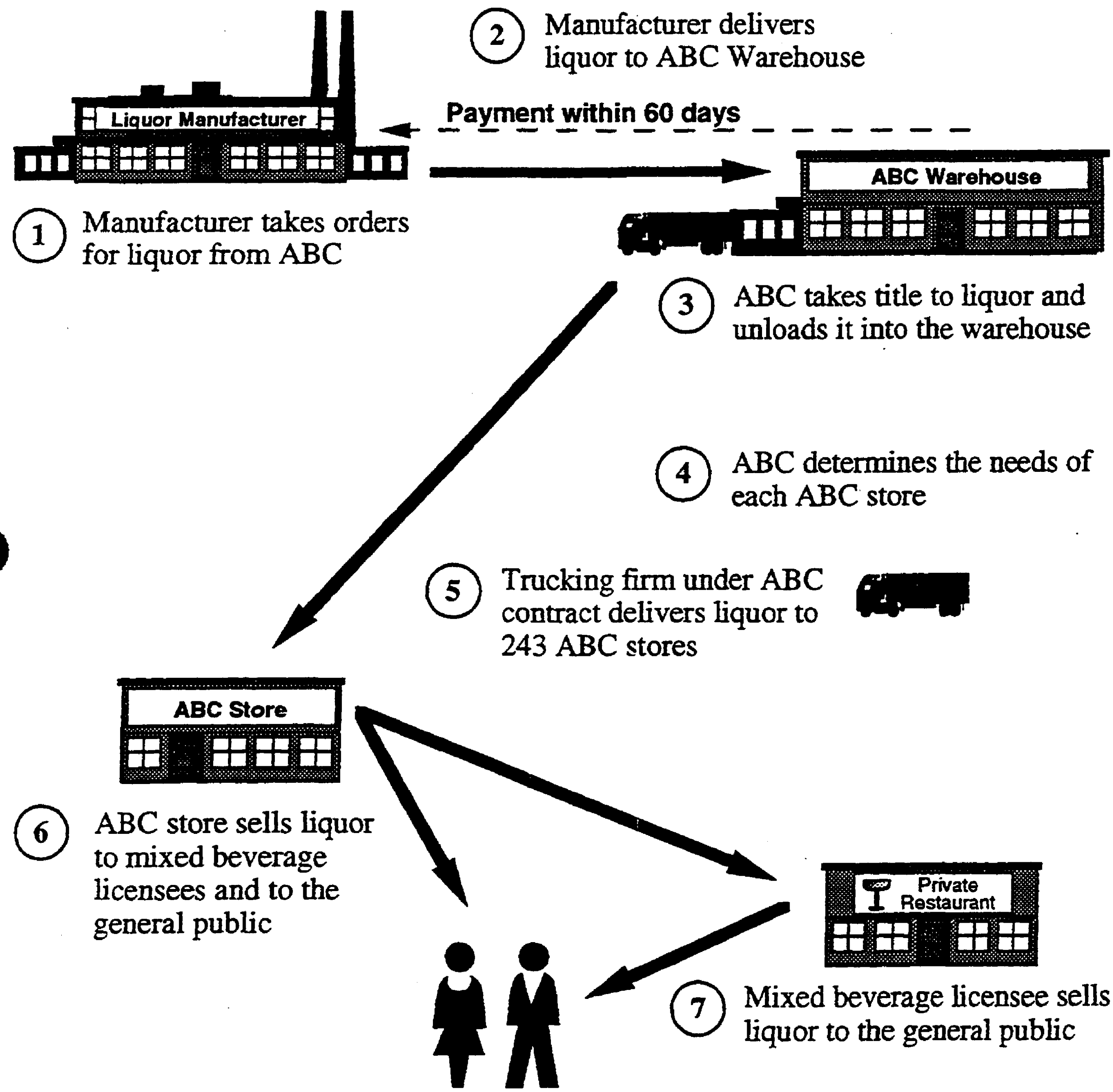
We identified and compared Commonwealth and private sector roles and specified how these roles would be carried out in each privatization scenario. Using these reference points, we compared the current ABC operations to the operations of both partially and fully privatized systems to identify the impacts that privatization would have.

A. Overview of Current System

Exhibit ES-1 presents an overview of the current system of liquor distribution in the Commonwealth. As presented in this exhibit, ABC is responsible for both the wholesaling and retailing of liquor in the Commonwealth under the current system.

Exhibit ES-1

Overview of the Current System of Liquor Distribution in Virginia



Enforcement - ABC maintains a staff of special agents and auditors to monitor licensees.

Mark-up - State wholesale/retail mark-up: 50.5 percent
State excise tax: 20 percent

B. Summary of the Impact of Privatization

In Exhibit ES-2 we summarize the quantitative impacts of partial and full privatization.[1] We assume a revenue neutral scenario in which the state would tax and/or mark-up liquor at a level that would generate the current level of net revenue from liquor sales. The current level of revenue is based on state excise tax revenue and net profits from ABC store sales in fiscal year 1992. The 4.5 percent sales tax on liquor, instituted on July 1, 1992, is not included in the fiscal 1992 revenue figure. Therefore, in order to have a direct comparison between our estimates of the impacts of privatization and data from the current system, we do not include the sales tax in our analysis. In Exhibit ES-3 we summarize the impact of privatization on the distribution of money to the General Fund and local governments. In Exhibit ES-4 we summarize the major impacts of privatization on employment and control.

C. Partial Privatization

Under partial privatization, we estimate that revenue neutrality could be maintained with a 35.9 percent state wholesale mark-up, a 20 percent state excise tax, and a resulting 13 percent increase in prices. Apparent consumption (sales) would decline by approximately six percent, primarily due to the increase in prices. Finally, partial privatization would result in a decrease in the number of ABC employees from the current actual level of 1,023 to 393 employees.[2] Most of the positions to be eliminated come from the Stores Division.

[1] For the Executive Summary, we use estimates for the second year of privatization because of the many one-time costs and cost-savings associated with privatization. One-time costs include former employee benefits that continue for one year, sick/annual leave liability, unemployment obligation, counseling, and vehicle purchases for additional special agents hired. One-time costs total $10.9 million under partial privatization and $11.8 million under full privatization. One-time cost savings include inventory sales and land and buildings sales. One-time cost savings total $10.3 million under partial privatization and $10.5 million under full privatization.

[2] ABC has 1,175 appropriated full-time positions, but is staffed at a level of 1,023 full-time employees.

Summary of the Impact of Privatization of Liquor Sales in Virginia

Assuming a Revenue Neutral Scenario *

	Current **	Partial Privatization	Full Privatization	Comments on Partial and Full Privatization Estimates
Average Cost per Bottle	$4.70	$4.70	$4.70	assumed constant
State Mark-Up	50.5%	35.9%	N/A	estimate of 35.9% derived for revenue neutrality; includes warehouse charge
State Excise Tax	20%	20%	$3.10	estimate of $3.10/bottle (or $15.43/gallon) derived for revenue neutrality
Wholesaler Mark-up	N/A	N/A	25%	estimate of industry average
Retailer Mark-up	N/A	25%	25%	estimate of industry average
Price (avg. price/bottle)	$8.49	$9.59	$11.23	derived using cost per bottle, mark-ups, and excise tax
Sales (millions of gallons)	7.29	6.83	6.12	derived assuming 0.5 price elasticity and modest cross-border activity
Gross Sales (millions)	$308.3	$325.5	$341.9	derived from price and sales estimates
<u>Other Revenue (Add):</u>				
License Fees (millions)	$6.11	$10.24	$10.32	assumed increase in license revenue
Other Cost Savings	N/A	N/A	1.75	assumed trucking contract is eliminated under full privatization
Other Revenue	2.87	2.87	2.87	assumed constant
<u>Expenses (Less):</u>				
Cost of Goods Sold (millions)	$170.68	$159.71	$143.25	computed from cost of goods and sales
Wages and Benefits	39.69	14.00	12.02	assumed decrease in the number of employees
Other Operating Expenses	15.39	8.33	5.88	assumed elimination of lease payments, decrease in operating expenses
Retailer Share of Revenue	N/A	65.11	68.38	retailer revenue based on estimated mark-up
Wholesaler Share of Revenue	N/A	N/A	35.81	wholesaler revenue based on estimated mark-up
Net State Revenue (millions)	$91.48	$91.48	$91.48	gross sales plus other revenue, less expenses
State Excise Tax Revenue	$51.26	$43.64	$91.48	amount of net state revenue derived from the 20% state excise tax
Net Profits	$40.22	$47.84	N/A	amount of net state revenue derived from the state mark-up on liquor

* A revenue neutral scenario assumes that the state will tax and/or mark up liquor at a level that generates the current level of net revenue from liquor sales. Cross-border activity may make it more difficult for the state to maintain revenue neutrality.

** Current system numbers are from fiscal year 1992 annual report data.

Exhibit ES-3

Distribution of Alcohol-Related Revenue
(in millions)

Liquor Distribution System	Total Revenue	Profits: * Localities	General Fund	Excise Taxes: General Fund
Current System	$91.48	$15.19	$24.59	$51.26
Partial Privatization	$91.48	$21.04	$26.80	$43.64
Full Privatization	$91.48	$0.00	$0.00	$91.48

* The General Fund portion of profits includes the following reimbursements:

$10.9 million for the treatment and rehabilitation of alcoholics by the Dept. of Mental Health

$220 thousand for services provided by other state agencies

$5.2 million for cost savings measures

This money ($16.3 million) is deducted from net profits. The remaining profits ($23.5 million) are distributed between the local governments (2/3, or $15.2 million) and the General Fund (1/3, or $7.8 million). The General Fund portion of the profits includes this 1/3 share and the above reimbursements. We assume that these reimbursements would be the same under partial privatization.

Source: VA ABC 1992 Annual Report

Exhibit ES-4

Summary of the Impact of Privatization of Liquor Sales in Virginia

Estimates of Employment and Control Impacts

	Partial Privatization	Full Privatization
Net Change in Number of State Employees	− 630	− 713
Impact on State Unemployment	negligible	negligible
Change in Number of Special Agents	+ 36	+ 46
Number of Retail Liquor Licensees *	5,000	5,000
Number of On–Off Premise Liquor Licensees **	1,005	1,005
License Quotas	none	none
Restrictions on License Applicants	Must meet the minimum food sales/ inventory and other requirements currently in effect for beer and wine retail sales	Must meet the minimum food sales/ inventory and other requirements currently in effect for beer and wine retail sales
Education Programs	unchanged	unchanged

* Retail liquor licensees may include grocery stores, convenience stores, drug stores, and certain filling stations, many of which already have licenses to sell beer and wine. Private liquor stores meeting the food sales and other licensing requirements may also engage in the retail sale of liquor.

** On–off premise licensees are establishments that could sell liquor for either on– or off–premise consumption.

1. Overview of Model

Exhibit ES-5 presents an overview of a partially privatized system of liquor distribution in Virginia. Under partial privatization, ABC would perform the wholesale function of liquor distribution in the Commonwealth, while the private sector would perform the retail function.

2. Financial Analysis

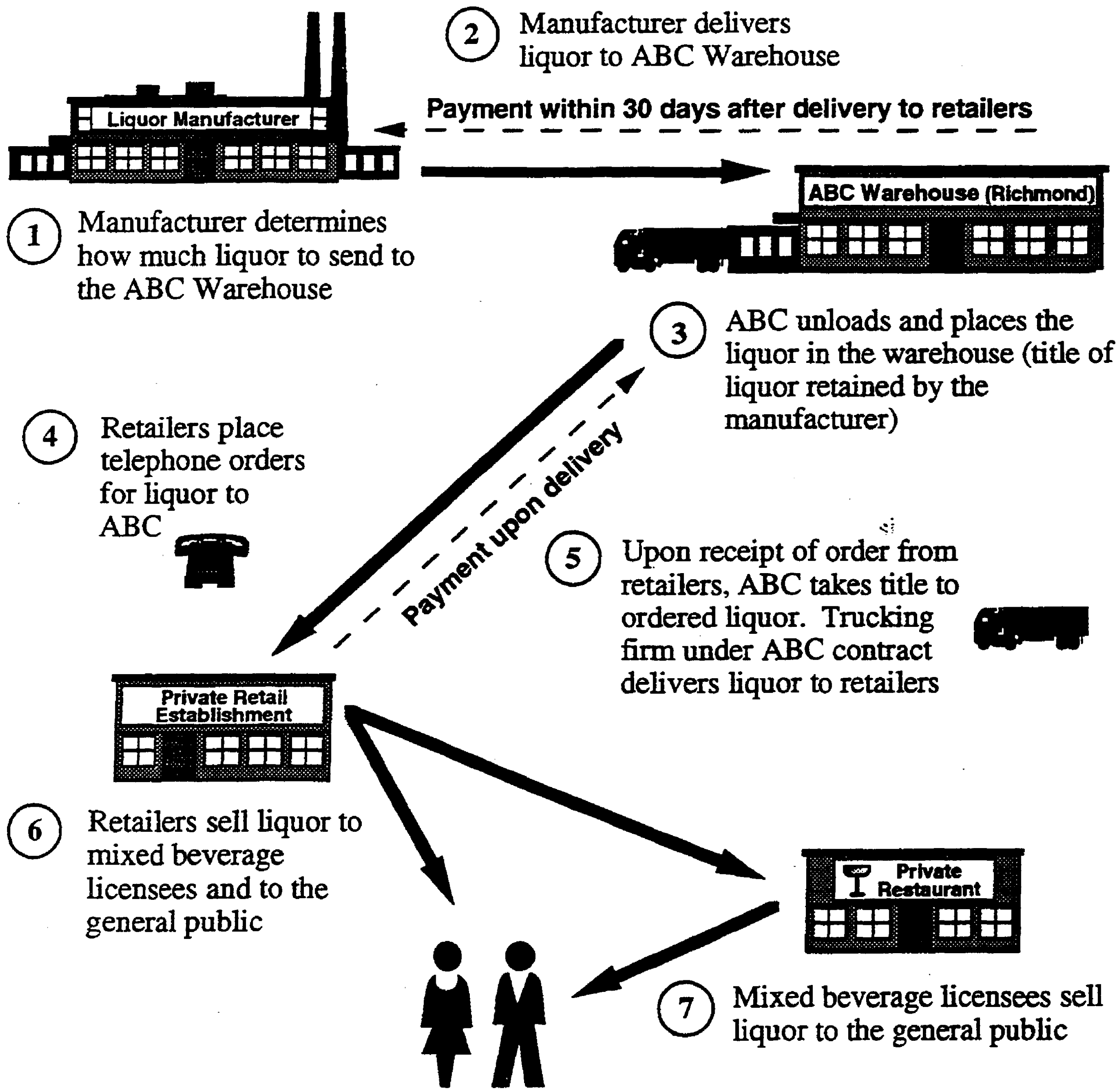
The state wholesale mark-up and excise tax rate in a revenue neutral scenario would be comparable to those in other partially privatized states. Because prices would not increase significantly in a revenue neutral scenario, we assume that revenue neutrality could be maintained under partial privatization. However, given that prices do increase, Virginians living near the border may choose to purchase more liquor in other states. To the extent that this cross-border activity occurs, maintaining revenue neutrality could be more difficult.

Although net revenue could remain constant under partial privatization, the composition of this revenue would change. State excise tax revenue would decrease by approximately $7.6 million, while net profits would increase by $7.6 million. Each of these revenue sources provides revenue to different areas. Excise tax revenue is distributed to the General Fund, while profits are divided between the General Fund and localities after statutory adjustment.[3] Thus, under partial privatization, net contributions to the General Fund would decrease (net profits distributed to the General Fund would be less than the $8 million decrease in excise tax revenue), while money distributed to local governments would increase. Under partial privatization, the state

[3] Statutory adjustment money is deducted from profits prior to distribution to the General Fund and localities. The majority of the money for statutory adjustments is distributed to the Department of Mental Health for the treatment and rehabilitation of alcoholics.

Exhibit ES-5

Overview of a Partially Privatized System of Liquor Distribution in Virginia



Enforcement - ABC increases staff of special agents and auditors to monitor a likely increase in the number of liquor retail establishments

Mark-up -	State wholesale mark-up:	35.9 percent
	State excise tax:	20 percent
	Private retail mark-up	25 percent

may choose to undertake measures to ensure that the revenue being distributed to each area remains constant.

3. Employment and Facilities Analysis

The number of state employees working for ABC would decrease significantly under partial privatization. Table ES-1 presents our estimates of the positions eliminated and added under partial privatization. Most of the positions to be eliminated (627 out of the 677 eliminated positions) come from the Stores Division. Given the nature of the eliminated positions, most of the employees who lose their jobs would not likely find other state government positions. However, those that are laid-off would probably be able to find other private sector retail jobs. Even if laid-off state employees remain unemployed, the state unemployment rate would not increase significantly and those laid-off would be distributed widely throughout the state.[4]

In addition to eliminating positions, partial privatization would require additional positions, as presented in Table ES-1. Most of the additional positions would be gained by the Regulatory Division, which is responsible for enforcement activities. Although there are several types of downsizing costs, such as unemployment and paid leave obligations, the savings from salaries and wages paid over time outweigh significantly these costs associated with downsizing. One-time downsizing costs associated with partial privatization total $10.9 million, while savings in wages and benefits total $25.7 million annually.

[4] As of August 1992, the number of people in Virginia's labor force was 3.4 million, and the number of unemployed was 220,000, yielding an unemployment rate of 6.38 percent. The 677 positions eliminated under partial privatization would increase the unemployment rate by 0.2 percent, if the laid-off employees remained unemployed.

Table ES-1

Estimated Net Change in Positions by Division under Partial Privatization

	Current	Partial Privatization	Net Change
Administration	10	10	0
Secretary to the Board	4	4	0
Public Affairs and Educational Services	6	6	0
Internal Audit	3	3	0
Accounting	26	34	+ 8
Hearings	8	11	+ 3
Human Resources	13	9	- 4
Management Info. Systems and Data Processing	31	31	0
Merchandising	79	71	- 8
Purchasing and Support	36	14	- 22
Real Estate	20	6	- 14
Regulatory	153	189	+ 36
Research and Planning	7	5	- 2
Stores	627	0	- 627
Total	**1,023**	**393**	**- 630**

Many of the facilities currently in use by ABC would not be needed under a partially privatized system. These facilities include state stores, both owned and leased, land owned by ABC, and equipment. Under phased-in partial privatization, ABC could coordinate a withdrawal from the existing leases without any significant lease-breaking expenses. All property and equipment that is no longer needed would be declared surplus and filed with the Department of General Services to be redistributed to the state or sold to the public.

4. Control and Regulation

In our interviews with interested groups throughout the Commonwealth, such as MADD, PTA, DISCUS, NABCA, and several Virginia legislators, control was often highlighted as the major advantage of the current system. Approximately three-quarters of those whom we interviewed brought up control as a specific advantage of the current system. Most of the concerns raised about a privatized system of liquor distribution involved the loss of control that could occur.

Furthermore, in our survey of Virginia residents, the reasons most commonly given for keeping the current system were that the current system maintained control, limited accessibility, and kept the amount of underage drinking at a low level, as presented in Table ES-2.

Table ES-2

Survey of Virginia Residents

Question: How do you feel about keeping the current system?

Strongly Approve	39.9 percent
Somewhat Approve	23.5 percent
Strongly Disapprove	16.4 percent
Somewhat Disapprove	13.1 percent
Don't Know	6.9 percent

Among those Virginia residents who either strongly approve or somewhat approve of the current system, the most common reasons given are:

• Maintains Control/Limits Accessibility to Alcohol	54 percent
• Keeps Underage Drinking Low	24 percent

Therefore, while partial privatization appears feasible economically for the Commonwealth, policymakers will need to weigh the economics of partial privatization against these concerns before making a decision to change the present liquor distribution system.

D. Full Privatization

Under full privatization, revenue neutrality would require Virginia to institute a state excise tax of $15.43 per gallon (approximately equal to 53 percent of the estimated wholesale price), which is more than 300 percent higher than the average license state excise tax of $3.49 per gallon. This excise tax, along with the wholesale and retail mark-ups, would result in a 32 percent increase in prices. Primarily due to this price increase, apparent consumption would decrease by an estimated 16 percent. The number of state employees working for ABC would decrease by 713 under full privatization. As with partial privatization, most of the eliminated positions are in the Retail Stores Division.

1. Overview of Model

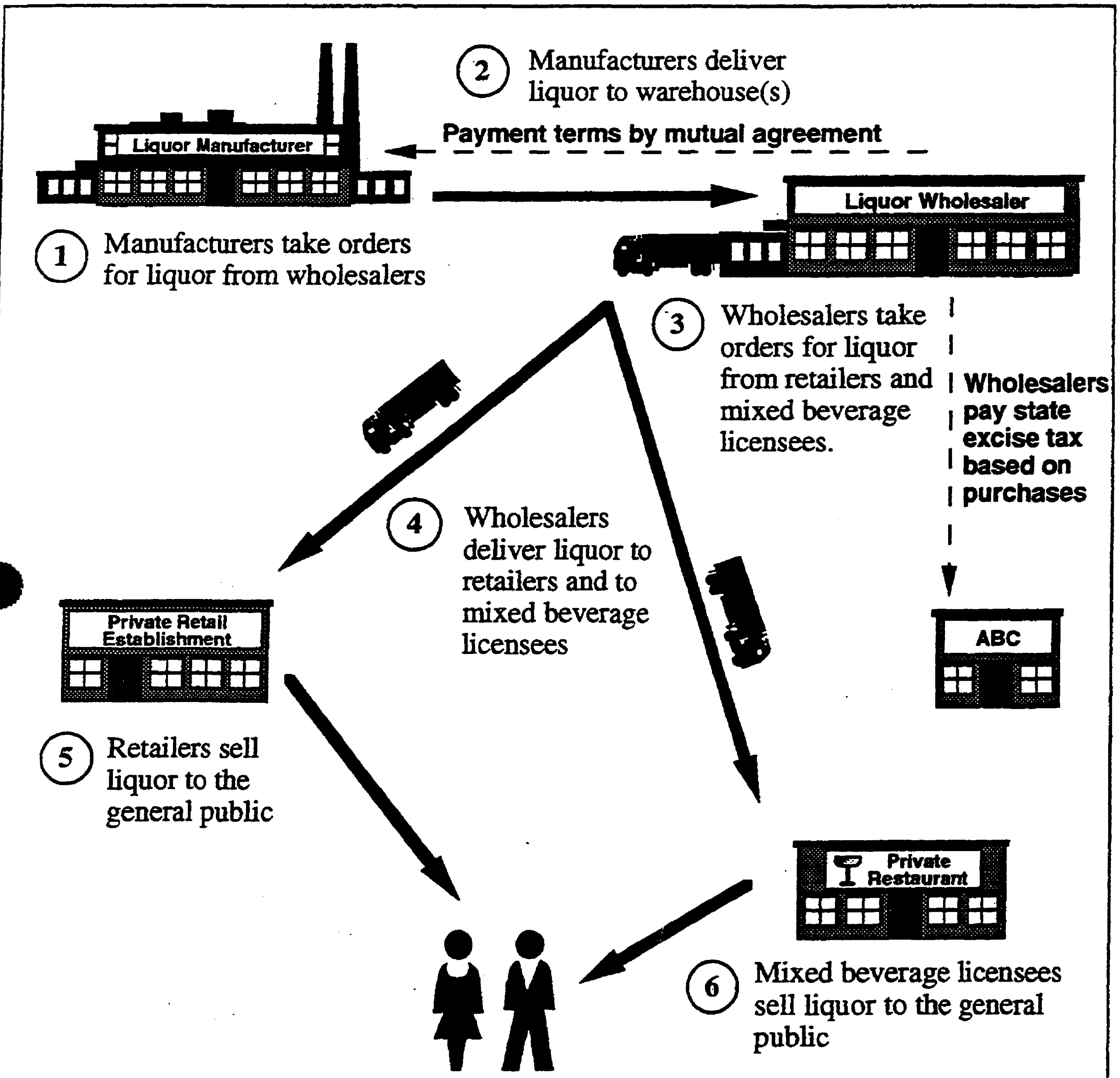
Exhibit ES-6 presents an overview of a fully privatized system of liquor distribution in Virginia. Under full privatization, ABC would primarily be involved in licensing and enforcement activities. The private sector would perform both the wholesale and retail functions of liquor distribution.

2. Financial Analysis

It is not certain whether revenue neutrality could be maintained under a fully privatized system. In order to maintain revenue neutrality, the state would have to implement an excise tax of $15.43 per gallon (or approximately 53 percent of the estimated wholesale price), which is 165 percent higher than the current rate of 20 percent. Prices would increase by 32 percent to an average of $11.23 per bottle. Because of this price increase, Virginians living near the border of a lower-taxed jurisdiction may purchase more of their liquor in other states. Such cross-border activity may cause sales to decline more than initially estimated, fuelling further the price increase that results from full privatization. As the price of liquor continues to increase,

Exhibit ES-6

Overview of a Fully Privatized System of Liquor Distribution in Virginia



Enforcement - ABC increases staff of special agents and auditors to monitor a likely increase in the number of liquor retail establishments

Mark-up -	State excise tax:	$15.00/gallon
	Private wholesale mark-up	25 percent
	Private retail mark-up	25 percent

it appears less likely that the state could maintain revenue neutrality under a fully privatized system.

Under full privatization, net state revenue would be derived solely from state excise taxes. Under the current system, all excise tax revenue is distributed to the General Fund, while net profits are distributed between the General Fund and localities. Thus, under full privatization, money distributed to the General Fund would increase, while money distributed to localities would decrease. Furthermore, money distributed to the Department of Mental Health for the treatment and rehabilitation of alcoholics would be eliminated because the money currently comes entirely from net profits. If the state were to decide that revenue to localities and to the Department of Mental Health should remain constant under full privatization, measures would have to be taken to change the current revenue distribution system.

3. Employment and Facilities Analysis

The number of state employees working for ABC would decrease significantly under full privatization, as presented in Table ES-3. However, the majority of positions eliminated would also occur under partial privatization. Full privatization results in an incremental elimination of 83 positions over partial privatization. Most of the positions to be eliminated (627 out of the 767 eliminated positions) come from the Stores Division. Though most of the laid-off employees would likely not find other state government positions, they would probably be able to find other private sector retail jobs. As is the case under partial privatization, even if laid-off employees remain unemployed, the state unemployment rate would not increase significantly and laid-off employees would be distributed widely throughout the state.

In addition to eliminating positions, full privatization would require additional positions, as presented in Table ES-3. Most of the additional positions would be gained

Table ES-3

Estimated Net Change in Positions by Division under Full Privatization

	Current	Full Privatization	Net Change
Administration	10	10	0
Secretary to the Board	4	4	0
Public Affairs and Educational Services	6	6	0
Internal Audit	3	3	0
Accounting	26	26	0
Hearings	8	16	+ 8
Human Resources	13	9	- 4
Management Info. Systems and Data Processing	31	31	0
Merchandising	79	0	- 79
Purchasing and Support	36	6	- 30
Real Estate	20	0	- 20
Regulatory	153	199	+ 46
Research and Planning	7	0	- 7
Stores	627	0	- 627
Total	**1,023**	**310**	**-713**

by the Regulatory Division, which is responsible for enforcement activities, and the Accounting Division, which is responsible for auditing and other accounting functions. Although there are several types of downsizing costs, such as unemployment and paid leave obligations, the savings from salaries and wages paid over time significantly outweigh these costs associated with downsizing. One-time downsizing costs associated with full privatization total $11.8 million, while savings in wages and benefits would total $27.7 million annually.

Most of the facilities currently in use by ABC would not be needed under a fully privatized system. These facilities include state stores, both owned and leased, land owned by ABC, and equipment. Under phased-in full privatization, ABC could coordinate a withdrawal from the existing leases without any significant lease-breaking expenses. All property and equipment that is no longer needed would be declared surplus and filed with the Department of General Services to be redistributed to the state or sold to the public.

4. Control and Regulation

As mentioned previously, control of liquor distribution and consumption is a key concern of many groups in the Commonwealth, and is the reason that many of those we surveyed and interviewed gave for retaining the current system. In contrast to partial privatization, revenue neutrality may not be obtainable under full privatization because of the significant price increase needed. Therefore, as policymakers compare a fully privatized system to the current system of liquor distribution, they will need to consider concerns about control and the uncertainty surrounding a revenue neutral scenario.

E. Conclusion

Price Waterhouse conducted this study to determine the impact of both partial and full privatization of Virginia's liquor distribution system on the Commonwealth, the private sector, and consumers. From a financial standpoint, it appears that the state could maintain revenue neutrality under partial privatization, while maintaining revenue neutrality would be more uncertain under full privatization.

According to our survey of Virginia residents, there is not overwhelming support among residents of the Commonwealth for privatizing the current system, as presented in Table ES-4. Furthermore, a large majority of residents strongly or somewhat disapprove of a privatized liquor distribution system in which liquor is sold in grocery stores and convenience stores, as well as in privately-owned liquor stores. In fact, the majority of residents appear to approve of the current system of liquor distribution. One of the reasons often cited for approval of the current system is that it provides for control over the distribution and consumption of liquor.

As part of this study, we examined how other states handle alcohol. From our examination of five license states, it appears that license states are able to control the distribution of liquor. Based on their experiences, we believe that it would be possible to maintain control under a privatized system of liquor distribution. However, there would probably always be questions about whether a privatized system has the level of control of a state-run system. Virginians still may perceive a privatized system as being characterized by less control than the current system. Therefore, efforts to evaluate the feasibility of privatization will need to weigh carefully the quantifiable benefits and costs against the other, less quantifiable concerns of the citizens of the Commonwealth.

Table ES-4

Survey of Virginia Residents

Question: How do you feel about allowing liquor to be sold only in privately-owned licensed liquor stores?

Strongly Approve	18.6 percent
Somewhat Approve	20.5 percent
Strongly Disapprove	36.4 percent
Somewhat Disapprove	15.3 percent
Don't Know	8.9 percent
Refused	0.4 percent

Question: In addition to liquor being sold through privately owned, licensed liquor stores, how would you feel if liquor were also allowed to be sold in grocery stores and convenience stores?

Strongly Approve	9.5 percent
Somewhat Approve	13.1 percent
Strongly Disapprove	58.8 percent
Somewhat Disapprove	15.1 percent
Don't Know	3.4 percent
Refused	0.1 percent

In the performance of this study, we talked to many ABC employees, reviewed documents, and viewed ABC operations. While it was not our primary mission to identify possible areas in which ABC could be more efficient, we indicated that if such areas for improvement were identified, we would report them. From our interaction with ABC over four months, we were not able to identify any areas that obviously could be made more efficient. To the extent that areas for improvement could be identified and successfully addressed, full and partial privatization would probably be less appealing alternatives to the current system.

I. INTRODUCTION

A. Background and Objectives

At the end of Prohibition in 1933, states were faced with the question of how to handle the sale of alcoholic beverages. Some states chose to control the distribution of alcohol through involvement in the wholesale distribution, and in many cases the retail merchandising, of alcohol. These states are called control states. Others decided to license those engaged in alcohol distribution (license states). Recently, some control states have considered privatizing all or part of their state-run liquor distribution operations.

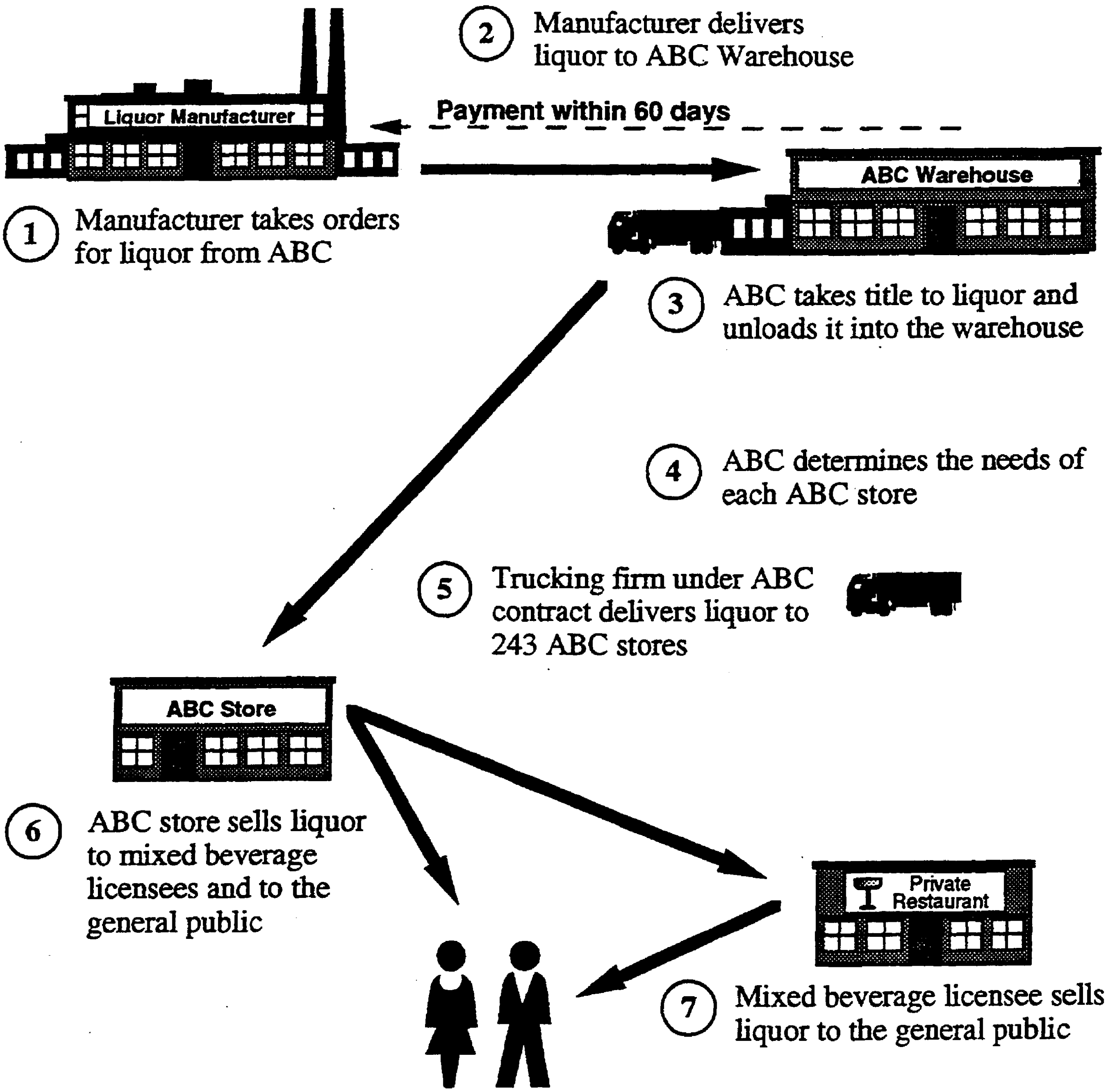
Virginia is one of eighteen control states. The merchandising activities currently conducted by the Virginia Department of Alcoholic Beverage Control comprise one central warehouse, 243 state retail liquor stores and nearly 1,200 full-time state employees. Virginia's liquor distribution system generated over $40 million in net profits in fiscal year 1992, in addition to the approximately $50 million generated through alcoholic beverage excise taxes. In Exhibit I-1 we present an overview of the current system of liquor distribution.

On February 10, 1992, Governor Wilder requested that the Virginia Department of Alcoholic Beverage Control (ABC) study the existing state-run system of liquor distribution and compare it to private sector liquor distribution systems at the wholesale and retail levels. Price Waterhouse was engaged to examine these two possible options for liquor distribution:

- Partial Privatization — the state privatizes the retail function, but retains the wholesale function of liquor distribution

- Full Privatization — the state privatizes both the retail and wholesale functions of liquor distribution

Overview of the Current System of Liquor Distribution in Virginia



Enforcement - ABC maintains a staff of special agents and auditors to monitor licensees.

Mark-up - State wholesale/retail mark-up: 50.5 percent
State excise tax: 20 percent

For each privatization option, we identified and compared Commonwealth and private sector roles and specified how these roles would be carried out. Using these reference points, we compared the current ABC operations to the operations of both partially and fully privatized systems to identify the impacts that privatization would have. Areas of impact examined in this study include the following:

- Price
- Revenues
- Taxes
- Employment
- Facilities
- Sales and Consumption
- Service
- Costs
- Safety
- Retailing
- Wholesaling
- Licensing
- Distribution System
- Enforcement
- Control and Regulation

B. Project Approach

Our approach to determine the impact of privatization was to formulate models of privatized distribution and compare them to Virginia's current system of liquor distribution. In order to formulate these models, we first reviewed ABC studies and the most recent financial and operational data available. We also interviewed ABC officials in all relevant divisions and functional areas.

In addition to interviewing ABC officials, we interviewed industry groups, religious groups, non-profit groups and associations, and Virginia legislators to get their perspectives on the current system and possible privatized systems of liquor distribution. We interviewed a total of 36 representatives from these various groups. We also conducted a survey of approximately 700 Virginia residents over 21 years of age to gather the views of Commonwealth residents on the current system and a private liquor distribution system. Finally, we talked to officials in five control and five license states in order to compare their liquor distribution systems. Iowa and West Virginia, states that have recently partially privatized their liquor distribution systems, were among the states in this comparison.

We used all of the information collected in order define the issues associated with privatization. In addition, this information aided us in formulating specific estimates of the impacts of privatization.

C. Organization of this Report

The remainder of this report is organized as follows:

- Section II: Partial Privatization — We discuss the impacts of partially privatizing Virginia's liquor distribution system through the following analyses:
  - Financial Analysis
  - Employment and Facilities Analysis
  - Consumption Analysis
  - Private Sector Retail Analysis
  - Control and Regulation
- Section III: Full Privatization — We discuss the impacts of fully privatizing Virginia's liquor distribution system. Where appropriate, our model of full privatization is identical to our partial privatization model. Therefore, this section builds on our partial privatization analysis and has the same organization as Section II.

- Section IV: Conclusion — We summarize the results of the analyses of partial and full privatization.

- Appendix A: Survey of Virginia Residents — We discuss the results of a survey taken of residents throughout the Commonwealth regarding their view of liquor distribution.

- Appendix B: Comparison of Liquor Distribution Systems — We discuss important features of liquor distribution systems in various control and license states.

- Appendix C: Comparison of Virginia ABC and Other Retail Businesses — We compare ABC's operations to other retail businesses that do a substantial portion of their business in the Commonwealth.

II. PARTIAL PRIVATIZATION

In this section we discuss the impacts of partially privatizing Virginia's liquor distribution system. Our discussion is divided as follows:

- Overview of a Partially Privatized System — We identify and compare Commonwealth and private sector roles in a partially privatized system and specify how these roles will be carried out.

- Financial Analysis — We examine the net financial contribution of ABC activities to the state under the present system and the effects of partial privatization on this contribution.

- Employment and Facilities Analysis — We estimate various costs and cost savings from employment and facilities changes that result from partial privatization.

- Consumption Analysis — We examine various trends in alcohol consumption and factors affecting the level of consumption.

- Private Sector Retail Analysis — We analyze the various aspects of the private sector retail market, such as the number of stores and licenses.

- Control and Regulation — We discuss the impacts of partial privatization on the control over distribution and consumption of liquor and the legal requirements that result from privatization.

Overview of a Partially Privatized System

A. Overview of Partially Privatized System

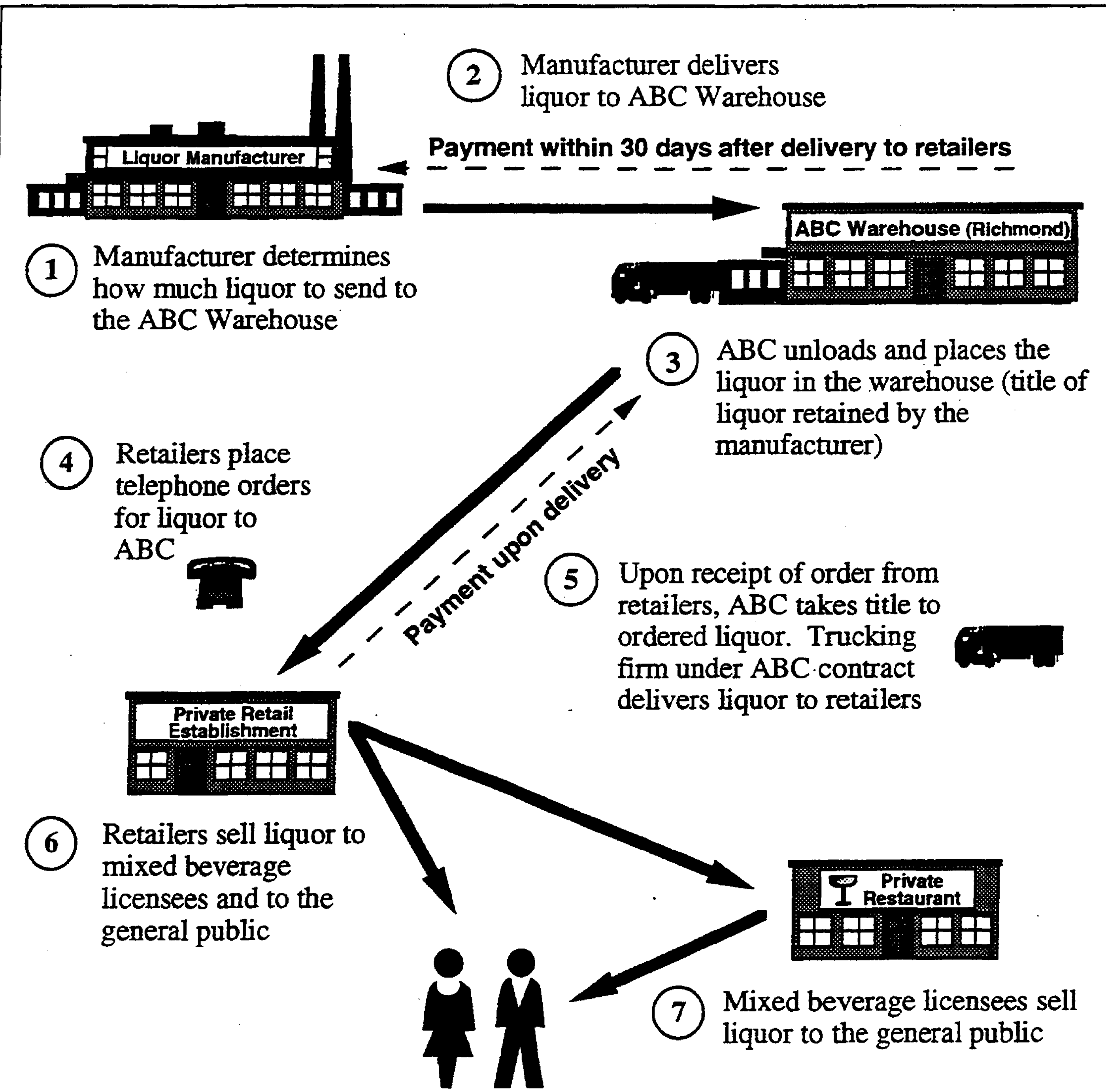
In Exhibit II-1 we present an overview of a partially privatized system of liquor distribution in Virginia. Under a partially privatized liquor distribution system, qualified private retail establishments would sell liquor by the bottle for off-premise consumption. A qualified establishment would be required to maintain certain sales and inventory levels of various grocery items in order to be permitted to sell liquor. Private retail establishments selling liquor may include liquor-only stores, grocery stores, convenience stores, and drug and proprietary stores. Mixed beverage licensees, such as restaurants and bars, would continue to be able to sell liquor for off-premise consumption with the proper license.

ABC would create a new retail liquor license under partial privatization. To obtain this new license, an applicant would be required to undergo an investigation conducted by ABC. This investigation would be substantially similar to that currently conducted by ABC prior to the awarding of beer and wine licenses. A fee would be charged for a retail liquor license, and there would be no restrictions on the number of liquor licenses that may be issued. Only Virginia residents would be qualified to hold retail liquor licenses.

There would be a transition period to implement a partially privatized system. During this time, arrangements would be made to terminate existing leases on ABC stores. The ABC store properties owned by ABC would be turned over to the Department of General Services for auction. The money received for these properties would then be turned over to ABC.

Merchandise inventory in the stores and warehouse would be run down during this transition period. ABC would cease ordering those items that do not sell well and

Overview of a Partially Privatized System of Liquor Distribution in Virginia



Enforcement - ABC increases staff of special agents and auditors to monitor a likely increase in the number of liquor retail establishments

Mark-up -	State wholesale mark-up:	35.9 percent
	State excise tax:	20 percent
	Private retail mark-up	25 percent

would focus on getting rid of existing inventory. Merchandise not sold by the end of the transition period would either be brought back to the warehouse or sold from the stores at a deep discount.

The Virginia ABC would remain the only wholesaler of liquor in Virginia, maintaining its existing central warehouse in Richmond. State warehousing employees would be responsible for unloading manufacturers' trucks, picking retailers' orders, and compiling pallets to be shipped to retailers. Warehousing would be converted to a modified bailment system. Under this system of bailment, the liquor manufacturer would be responsible for maintaining proper levels of inventory in the ABC warehouse. The manufacturer would retain title of the liquor until an order for the liquor is placed by private retailers. When retailers place their orders through an automated telephone system, the state would take title of liquor ordered.

A trucking firm would deliver liquor to retailers on a regular schedule. The trucking contractor would not take title of the liquor, but would be responsible for breakages and shrinkages. Retailers would pay for goods in full before delivery, while the state would make payments, within 30 days of taking title to liquor, to manufacturers for liquor delivered to retailers. The time between manufacturers' deliveries to the ABC Warehouse and manufacturers' receipt of payment for merchandise delivered would depend on when retailers place orders for specific merchandise. At a minimum, manufacturers would not receive payment until 30 days after the initial shipment of liquor to ABC. The state wholesale mark-up, excise tax, and per-case delivery charge would be included in the wholesale price charged by the state to retailers.

Mixed beverage licensees, which are establishments selling liquor for on-premise consumption, would obtain liquor from private retail stores holding liquor licenses. These establishments would be able to negotiate individual arrangements with private retailers to buy liquor and would face no other restrictions on where they could buy liquor.

The Virginia ABC would continue to enforce administrative alcoholic beverage laws under partial privatization. Other alcohol-related infractions, such as drunk driving and underage consumption, would continue to be handled primarily by state and local police. With the addition of retail liquor licensees, it would be necessary to augment existing enforcement programs. For license holders who violate Virginia liquor laws, fines and penalties would be assessed. Other efforts, such as cooperation with the Department of Motor Vehicles aimed at reducing the use of false identifications, would continue under partial privatization. Current laws regarding the location of retail establishments selling beer and wine would also apply to establishments selling liquor (for example, liquor stores could not disrupt the activities of a school or church).

Alcohol education programs would remain intact under a partially privatized system. These programs are targeted at specific audiences and cover a wide range of issues, including student programs, server training, and programs for law enforcement officers.

Financial Analysis

This section contains the following:

- Net Financial Contribution of ABC Activities to the Commonwealth Under the Current System
- Partial Privatization: A Constant Mark-Up Scenario
- Partial Privatization: A Revenue Neutral Scenario
- Partial Privatization: A Price Neutral Scenario
- Financial Analysis Conclusions

B. Financial Analysis

In this section we describe the impact on state revenue that would result from the proposed privatization of retail stores. We begin with a discussion of the net financial contribution of ABC activities to the state under the present system. We then estimate the impact of partial privatization on this contribution level, assuming that the tax and mark-up structure remain constant. Using this as a reference point, we adjust the mark-up to determine the impact of partial privatization under a revenue neutral scenario and a price neutral scenario.[1]

1. Net Financial Contribution of ABC Activities to the Commonwealth under the Current System

State revenue from ABC operations currently is derived from two major sources: a state excise tax on alcohol and a mark-up on liquor sold in ABC stores. Between the tax and mark-up, the state derived approximately $91 million in fiscal year 1992 from ABC operations. As of July 1, 1992 a 4.5 percent retail sales tax was instituted for liquor. However, because it is a recent development and not incorporated into the data we used for this analysis (FY 1992), the sales tax is not included in this analysis so we can have a straight comparison. Below we detail the breakdown and distribution of this $91 million.

[1] A revenue neutral scenario assumes that the state will tax and/or mark-up liquor at a level that generates the current level of net revenue from liquor sales. A price neutral scenario assumes that the state will tax and/or mark-up liquor at a level that generates the current average price for liquor. .

a. Current Mark-up and Tax Levels

Virginia has a 46.5 percent mark-up on liquor sold in ABC stores and a warehouse handling charge of one dollar per case.[2] ABC has estimated that the total mark-up rate, including the 46.5 percent mark-up and the handling charge, and adjusted for rounding, would be approximately 50.5 percent.[3]

Virginia also has a 20 percent state excise tax on distilled spirits. In calculating the retail price of alcohol, ABC first applies the mark-up to the manufacturer's price of alcohol, then applies the 20 percent excise tax. The example in Table II-1 illustrates the procedure used by ABC to compute the retail price.

Table II-1

Example of a Tax and Mark-Up Application

Cost of Goods Sold for a 750 ML Bottle Case	$45.30
Plus Standard Handling Charge	$1.00
Subtotal	**$46.30**
Times ABC calculation based on mark-up and number of bottles/case	0.12208
Subtotal	**$5.6523**
Rounded to Next Highest $0.05 Multiple	$5.70
Plus 20 percent State Excise Tax	$1.14
Subtotal	**$6.84**
Shelf Bottle Price (Rounded to Next Highest $0.05 Multiple)	**$6.85**

[2] As of July 1992, 750 ML and liter bottles have a 46.5 percent mark-up; 1.75L bottles have a 40 percent mark-up, 375ML bottles have 60 percent mark-up, and 200ML and 50ML bottles have 70 percent mark-up.

[3] We took this estimate from a study performed by Virginia's Department of Planning and Budget and ABC entitled "Department of Alcoholic Beverage Control Privatization Issues," December 1991, p. 7.

b. Current Financial Contribution of ABC Activities to the State

As presented in Exhibit II-2, net profits were approximately $40.3 million in fiscal year 1992, while state excise tax revenue was $51.2 million. Therefore, in order to remain revenue neutral, a partially privatized system must yield approximately $91 million in net revenue to the state.

The net profits from ABC operations are distributed between the state's General Fund and local governments, while revenue generated from the excise tax is distributed just to the General Fund. In Exhibit II-3 we present the distribution of liquor-related revenue in fiscal year 1992. One-third of the profits is distributed to the General Fund, while the other two-thirds are distributed to the localities. However, before distribution, statutory adjustments are made to net profits. In fiscal year 1992, these adjustment amounted to approximately $16 million. The majority of the money from these adjustments is distributed to the Department of Mental Health for the treatment, cure, and rehabilitation of those who abuse alcohol.

Exhibit II-2

Current Financial Contribution of ABC Activities to the State

(in thousands)

	Fiscal Year 1992
Operating Revenues:	
Charges for Sales	$257,049
Licenses	6,105
Other	2,467
Total Operating Revenue	$265,621
Operating Expenses:	
Cost of Sales	170,676
Personal Services	30,715
Employee Benefits	8,971
Continuous Charges (insurance, rentals, utilities)	7,385
Contractual Services	4,941
Supplies and Materials	1,311
Other	1,750
Total Operating Expenses	$225,749
Operating Income	$39,872
Nonoperating Revenues	413
Net Profit	**$40,285**
State Excise Tax Revenue	**$51,260**
Total Contribution to the State	**$91,545**

Source: VA ABC 1992 Annual Report data

Distribution of Alcohol-Related Revenue

(in millions)

Revenue Source	General Fund	Localities	Total
State Excise Tax on ABC Store Sales	$51.26	N/A	$51.26
Profits *	$24.59	$15.19	$39.78
Total Contributions	**$75.85**	**$15.19**	**$91.04**

Note: Total Contributions in this exhibit differ from other exhibits in this report. Per ABC procedure, profits on this exhibit are figured in accordance with the Code of Virginia (profits of $39.78 million), whereas profits on other exhibits are figured in accordance with GAAP (profits of $40.2 million).

* The General Fund portion of profits includes the following reimbursements:

$10.9 million for the treatment and rehabilitation of alcoholics by the Department of Mental Health
$220 thousand for services provided by other state agencies
$5.2 million for cost savings measures

This money ($16.3 million) is deducted from net profits. The remaining profits ($23.5 million) are distributed between local governments (2/3, or $15.2 million) and the General Fund (1/3, or $7.8 million). The General Fund portion of profits includes this 1/3 share and the above reimbursements.

Source: VA ABC 1992 Annual Report

2. Partial Privatization: A Constant Mark-Up Scenario

In this section, we estimate the net financial contribution of ABC operations to the Commonwealth in a partially privatized system with a constant mark-up. We begin by using the mark-up and tax rates that are currently in place as an initial point of reference for this analysis. We then adjust the mark-up to derive both a revenue neutral scenario and a price neutral scenario.

a. Prices

Under a partially privatized system, the state would continue to mark-up at the wholesale level only, while private retailers would add an additional mark-up at the retail level. In order to estimate average retail prices paid by consumers, we estimated the average mark-up used by private sector retailers. We estimate that retailers would mark-up their merchandise an average of 25 percent. This figure is an estimate of the industry average, although there is some variation in specific retail mark-up levels.[4]

As a starting point for our analysis, based on the current state wholesale mark-up, the state excise tax level, and the average retail mark-up, we estimate that the average retail price in a partially privatized market would be $52.83 per gallon, as presented in Table II-2. Using the 1991 average gallon per bottle (0.20), this price translates to roughly $10.62 per bottle, 25 percent higher than the current retail price of $8.49 per bottle.

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[4] A 1989 survey conducted by the Iowa Alcoholic Beverages Division of over 400 retailers showed an average markup of 23.5% at the consumer level. ABC conversations with license state retailers have yielded similar results.

Table II-2

Price Impact of Partial Privatization
Constant Mark-Up Scenario

	Current	Partial Privatization: Constant Mark-Up
Average Cost of Goods	$23.40	$23.40
State Wholesale Mark-up	50.5%	50.5%
State Excise Tax	20.0%	20.0%
Retailer Price Per Gallon	N/A	$42.26
Retailer Mark-Up	N/A	25.0%
Retail Price per Gallon	**$42.26**	**$52.83**
Retail Price per Bottle	**$8.49**	**$10.62**

b. Net Revenue Effects under a Constant Mark-Up Scenario

Assuming a price elasticity of 0.5, the 25 percent increase in prices that results from privatization would yield a 12.5 percent decrease in sales.[5] As presented in Exhibit II-4, sales are estimated to decline from the current level of 7.29 million gallons, by approximately 910,000 gallons, to a level of 6.38 million gallons. Although the gross sales level increases by approximately $28 million, a portion of gross sales money would

[5] In order to project demand at different prices from those currently observed in Virginia, we estimate the price elasticity for liquor, i.e., the reaction of consumers to changes in price. The elasticity assumed here is the mid-point of estimates found in independent studies of spirits consumption. An elasticity at this level implies that if the price increases by 10 percent, demand will decrease by 5 percent.

Partial Privatization: Price and Sales Effects
Constant Mark–Up Scenario

	Fiscal Year 1992	Partial Privatization: Constant Mark–Up
Average COGS per Gallon	$23.40	$23.40
Wholesale Markup (includes warehouse charge)	50.5%	50.5%
State Excise Tax	20%	20%
Retailer Price per Gallon	N/A	$42.26
Retailer Markup	N/A	25%
Retail Price per Gallon	$42.26	$52.83
Retail Price per Bottle	$8.49	$10.62
Sales (millions of gallons)	7.29	6.38
Sales (millions of dollars)	**$308.26**	$337.16

go to both retailers and the state. Therefore, an increase in gross sales does not necessarily mean that revenue to the state would also increase.

In order to estimate the net contribution of ABC activities to the state in a partially privatized system, we incorporated various costs and cost savings associated with privatization that would occur. When employment and other operating costs are adjusted for partial privatization and are incorporated into the analysis, net contributions to the state from ABC operations actually increase from their current level by $19 million in the first year of privatization.

Because there are several one-time-only costs and cost savings, such as equipment sales, we also calculated the impact of partial privatization in the second year. For the sake of convenience, we have neither assumed that the cost of goods increases nor that consumption decreases in year two of partial privatization. As presented in Exhibit II-5, net contributions to the state from ABC would be $111 million in the second year of privatization, approximately $20 million more than the current contribution level. Thus, a partially privatized system that assumes a constant mark-up scenario would not be revenue neutral. In fact, this scenario would actually increase revenue from its current level.

3. Partial Privatization: A Revenue Neutral Scenario

We have established a starting point for our analysis by examining the impact of privatization under a constant mark-up scenario, which assumes both a constant mark-up and excise tax. Using the same mark-up and tax rate that are used in the current system, contributions to the state from ABC operations actually increase with partial privatization. However, retail prices would increase significantly due to the levying of a private retail mark-up in addition to the state excise tax and wholesale mark-up levels. The state could lower the mark-up that it places on wholesale merchandise, from its

Partial Privatization: Constant Mark-Up Scenario

	Fiscal Year 1992	Partial Privatization: Year 1	Partial Privatization: Recurring
Average COGS per Gallon	$23.40	$23.40	$23.40
State Wholesale Mark-up (includes warehouse charge)	**50.5%**	**50.5%**	**50.5%**
State Excise Tax	20%	20%	20%
Retailer Price/Gallon	N/A	$42.26	$42.26
Retailer Markup	N/A	25%	25%
Retail Price per Gallon	$42.26	$52.83	$52.83
Retail Price per Bottle	$8.49	$10.62	$10.62
Sales (millions of gallons)	7.29	6.38	6.38
Sales (thousands of dollars)	$308,260	$337,160	$337,160
Other Revenue (Add):			
License Fees (thousands)	$6,105	$10,238	$10,238
Other Cost Savings from Privatization		10,300	
Other Revenue	2,867	2,867	2,867
Expenses (Less):			
Cost of Goods Sold (thousands)	$170,675	$149,351	$149,351
Employment	39,686	24,677	14,003
Other Operating Expenses	15,388	9,118	8,331
Retailer Share of Revenue		67,432	67,432
ABC Contributions to State	**$91,483**	**$109,987**	**$111,148**
State Excise Tax Revenue	$51,377	$44,955	$44,955
Net Profits	$40,107	$65,032	$66,193
Net Revenue Change from Privatization		**$18,503** *	**$19,664** *

* This scenario results in an increase in revenue. Therefore, it is not revenue neutral

current level of 50.5 percent, to a level that results in both revenue neutrality and only slightly higher prices.

As presented in Exhibit II-6, the state could lower its mark-up to 35.9 percent and maintain revenue neutrality. The lower mark-up would result in a retail price of $47.69 per gallon, a 13 percent increase from the price level in the current system. Table II-3 outlines the price impact of partial privatization under a revenue neutral scenario.

Table II-3

Price Impact of Partial Privatization
Revenue Neutral Scenario

	Current	Partial Privatization: Revenue Neutral Scenario
Average Cost of Goods	$23.40	$23.40
State Wholesale Mark-up	50.5%	35.9%
State Excise Tax	20.0%	20.0%
Retailer Price Per Gallon	N/A	$38.15
Retailer Mark-Up	N/A	25.0%
Retail Price per Gallon	**$42.26**	**$47.69**
Retail Price per Bottle	**$8.49**	**$9.59**

Partial Privatization: Revenue Neutral Scenario

	Fiscal Year 1992	Partial Privatization Year 1	Recurring
Average COGS per Gallon	$23.40	$23.40	$23.40
State Wholesale Mark-up (includes warehouse charge)	**50.5%**	**35.9%**	**35.9%**
State Excise Tax	20%	20%	20%
Retailer Price/Gallon	N/A	$38.16	$38.16
Retailer Markup	N/A	25%	25%
Retail Price per Gallon	$42.26	$47.69	$47.69
Retail Price per Bottle	$8.49	$9.59	$9.59
Sales (millions of gallons)	7.29	6.83	6.83
Sales (thousands of dollars)	$308,260	$325,532	$325,532
Other Revenue (Add):			
License Fees (thousands)	$6,105	$10,238	$10,238
Other Cost Savings from Privatization		10,300	
Other Revenue	2,867	2,867	2,867
Expenses (Less):			
Cost of Goods Sold (thousands)	$170,675	$159,712	$159,712
Employment	39,686	24,676	14,003
Other Operating Expenses	15,388	9,118	8,331
Retailer Share of Revenue		65,106	65,106
ABC Contributions to State	**$91,483**	**$90,324**	**$91,484**
State Excise Tax Revenue	$51,377	$43,404	$43,404
Net Profits	$40,107	$36,620	$48,079
Net Revenue Change from Privatization		**($1,160) ***	**$0 ***

* This scenario is revenue neutral by year two. Year one revenue includes one-time costs.

In addition to lowering prices, the revenue neutral mark-up level would be comparable to other partially privatized states' wholesale mark-ups. The average mark-up for the other partially privatized states — Iowa, West Virginia, Michigan, Mississippi, and Wyoming — is approximately 34 percent. Exhibit II-7 presents the excise taxes and mark-ups for each of these states.

4. Partial Privatization: A Price Neutral Scenario

Partial privatization would result in a 13-percent price increase, assuming a revenue neutral scenario. The state could lower the mark-up that it places on wholesale merchandise from the current level, and the level assumed for the revenue neutral scenario, to a level that results in price neutrality, as presented in Table II-4. Because the mark-up would have to be lowered from the revenue neutral level, a price neutral scenario would not be revenue neutral.

Alcohol Mark–Ups and Taxes in Partially Privatized States

State	Markup	Other Charges and Excise Taxes *
Iowa	50.0%	$0.50/case withdrawal charge; $0.20/bottle split case charge; $0.05/bottle deposit
Michigan	51.0%	$0.25/case delivery charge; 12% excise tax 1.85% alcoholism tax (off–premise only)
Mississippi	24.5%	3% alcoholism tax; $1.65/case freight; $2.50/gallon excise tax; 6% wholesale tax
West Virginia	25.0%	$1.05/case distribution fee
Wyoming	17.6%	$2.75/case freight; $0.95/gallon excise tax
AVERAGE MARK–UP	33.6%	

* Doesn't include general sales taxes

Source: Distilled Spirits Council of the United States, Tax Briefs 1992

Table II-4

Price Impact of Partial Privatization
Price Neutral Scenario

	Current	Partial Privatization: Price Neutral Scenario
Average Cost of Goods	$23.40	$23.40
State Wholesale Mark-up	50.5%	20.4%
State Excise Tax	20.0%	20.0%
Retailer Price Per Gallon	N/A	$33.81
Retailer Mark-Up	N/A	25.0%
Retail Price per Gallon	**$42.26**	**$42.26**
Retail Price per Bottle	**$8.49**	**$8.49**

As presented in Exhibit II-8, the state wholesale mark-up that results in price neutrality would be 20.4 percent. Under a price neutral scenario, sales would remain at their current level of 7.29 million gallons. Revenue to the state would decrease from the current level. In the first year of privatization, revenue would decrease by approximately $26 million, or 28.4 percent. In the second and out-years of privatization, revenue would fall from its current level by $24.8 million, or 27.1 percent.

Partial Privatization: Price Neutral Scenario

	Fiscal Year 1992	Partial Privatization Year 1	Partial Privatization Recurring
Average COGS per Gallon	$23.40	$23.40	$23.40
State Wholesale Mark–up (includes warehouse charge)	**50.5%**	**20.4%**	**20.4%**
State Excise Tax	20%	20%	20%
Retailer Price/Gallon	N/A	$33.81	$33.81
Retailer Markup	N/A	25%	25%
Retail Price per Gallon	$42.26	$42.26	$42.26
Retail Price per Bottle	$8.49	$8.49	$8.49
Sales (millions of gallons)	7.29	7.29	7.29
Sales (thousands of dollars)	$308,260	$308,260	$308,260
Other Revenue (Add):			
License Fees (thousands)	$6,105	$10,238	$10,238
Other Cost Savings from Privatization		10,300	
Other Revenue	2,867	2,867	2,867
Expenses (Less):			
Cost of Goods Sold (thousands)	$170,675	$170,687	$170,687
Employment	39,686	24,677	14,003
Other Operating Expenses	15,388	9,118	8,331
Retailer Share of Revenue		61,652	61,652
ABC Contributions to State	**$91,483**	**$65,531**	**$66,692**
State Excise Tax Revenue	$51,377	$41,101	$41,101
Net Profits	$40,107	$24,430	$25,591
Net Revenue Change from Privatization		**($25,952)**	**($24,791)**

5. Financial Analysis Conclusions

Summary of Conclusions from Financial Analysis:

- A partially privatized model that uses the current state excise tax and mark-up levels would result in significantly higher prices and a greater financial contribution to the state from ABC operations.
- A partially privatized model that is revenue neutral would require a state wholesale mark-up of 35.9 percent, resulting in a price increase of approximately 13 percent.
- The state wholesale mark-up in a partially privatized system that is revenue neutral would be comparable to state wholesale mark-ups in other partially privatized states.
- A partially privatized model that is price neutral would require a state wholesale mark-up of 20.4 percent, resulting in a $25 million, or 27.1 percent, decrease in revenue.

It appears that it would be possible for the state to remain revenue neutral under a partially privatized system with a slight increase in prices. However, given that prices do increase, Virginians living near the border of lower-taxed jurisdictions may choose to purchase more liquor in other states. To the extent that such cross-border activity occurs, maintaining revenue neutrality could be more difficult. Because the price neutral scenario would result in a decrease in revenue to the state under partial privatization, we utilize a revenue neutral scenario for the remainder of our analysis.

Employment and Facilities Analysis

This section contains the following:

- Employment and Organizational Analysis
- Facilities

C. Employment and Facilities Analysis

1. Employment and Organizational Analysis

In this section we present our estimates of employment costs and cost savings generated through partial privatization and outline the resulting organization and responsibilities of the ABC. The employment issues that we address in this section focus on state employees affected by partial privatization.

a. Background and Procedures

Privatization of retail liquor operations would reduce significantly the total employment of the ABC. Presently, a majority of ABC employees is involved directly in the operation and support of ABC retail stores. With the elimination of these operations from the state's responsibilities, many job classifications would be eliminated completely and others reduced significantly in number.

The employment issues to be addressed in this analysis are as follows:

- Full and Part-Time Employment — We estimate the changes to full-time salaried positions and part-time wage positions by identifying ABC jobs eliminated and ABC jobs created.

- ABC Benefits Obligations — We estimate ABC's employee benefits obligations and unemployment benefits liability.

- Training and Counseling — We examine opportunities and state obligations for training, placement, and counseling of displaced employees.

1. Current Employment at ABC

The ABC has 1,175 full-time appropriated positions, of which 1,023 are currently staffed. In Exhibit II-9 we present a chart of the current full-time salaried positions by division.

In addition to the full-time salaried positions, the ABC has approximately 795 part-time employees, most of whom are employed by the Stores Division.[6] These employees are employed on an as-needed basis and are not considered permanent employees of the ABC. Consequently, all part-time positions related to retail store operations would be immediately eliminated under partial privatization. The following analysis applies only to full-time salaried employees. We discuss part-time employees later in this section.

Many of the employees affected by partial privatization, particularly employees in the Stores Division, are distributed widely throughout the state. The locations of tne retail stores around the state distribute employment to many of the cities and counties in Virginia. This geographic distribution affects the probabilities of placement for the employees in the affected job classifications. For example, employees located in the Richmond area have a significantly higher probability of being placed in another state or ABC position because of the large state government and ABC presence in Richmond. Similarly, the large private sector presence in the Richmond and Northern Virginia areas would increase the probability of private sector placement for those employees located in these areas.

Many of the eliminated ABC positions fall in job classifications used exclusively by the ABC within the state government (e.g., Store Clerk, Store Manager). The

[6] Total part-time, full-time equivalent (FTE) positions is approximately 376.

ABC Salary Positions by Division Under Current System*

Division	Positions	Salaries	Benefits
Administration	10	$457,053	$137,116
Secretary to the Board	4	$125,600	$37,680
Public Affairs and Educational Services	6	$140,687	$42,206
Internal Audit	3	$110,005	$33,002
Human Resources	13	$377,323	$113,197
Hearings	8	$215,623	$64,687
Regulatory	153	$4,381,780	$1,314,534
Accounting	26	$561,120	$168,336
Management Info. Systems and Data Processing	31	$925,799	$277,740
Purchasing and Support	36	$706,893	$212,068
Research and Planning	7	$197,751	$59,325
Real Estate	20	$467,340	$140,202
Stores	627	$14,379,626	$4,313,888
Merchandising	79	$1,627,356	$488,207
Totals	1023	$24,673,956	$7,402,188

* This chart reflects the most recent data available as of August 17, 1992.

elimination of these classifications, coupled with the skill levels of many of these employees, reduces significantly the probability of their successful placement in other state government positions. However, partial privatization may lead to the creation of new jobs in the private sector due to new private liquor stores or to existing stores that may experience an increase in business.

2. Layoff and Placement Process

In order to understand fully the impact of privatization on employment, it is necessary to review the layoff and placement process. A range of possible outcomes exists for each employee facing the elimination of his or her position. This range of outcomes depends partly on the factors described previously—skills, job classification, seniority, and location—and partly on the individual preferences and choices of the employees.

In order to determine the probable impact of partial privatization on employment, we outlined the downsizing process. In Exhibit II-10 we describe possible outcomes faced by an employee whose position is eliminated. The following is a general outline of the downsizing process:

- Notification of Position Elimination — Employees affected by a downsizing are provided at least two weeks written notice prior to the elimination of their position.

- Preferential Employment Registration — All full-time employees targeted for layoff would be registered in the Preferential Employment Program for employment opportunities within the state government's executive branch. Employees would be eligible for preferential employment for a period of 12 months from the effective day of the layoff. Employees in part-time positions would not be eligible for preferential employment.

Effects of Position Elimination Under Partial Privatization

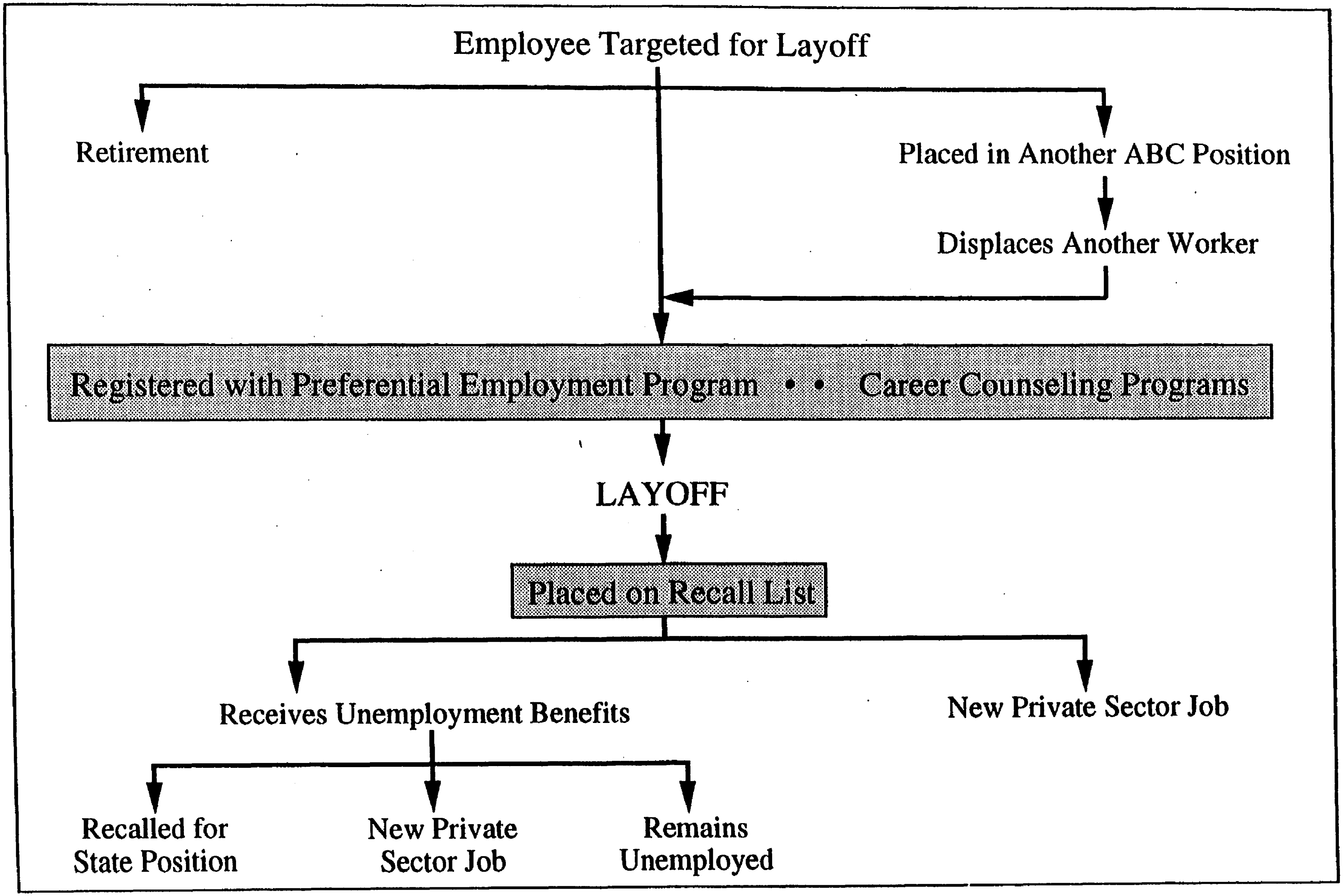

Exhibit II-10

- Early or Regular Retirement — Some employees may be eligible for regular retirement and would be given this option. However, in 1991 state employees were given the option for early retirement under an incentive program approved by the Governor.[7] Most ABC employees that were eligible took advantage of this incentive program in 1991. Therefore, the costs associated with early or regular retirement are not significant unless a new incentive program is offered to ABC employees.

- Placement in Another ABC Position — An attempt must be made to place all employees targeted for lay off in another position within the ABC. The outcome of the process involves a determination of the placement opportunities for each individual employee, taking into account the employees' preferences for available positions, their qualifications, and length of service. This process involves placing employees targeted for layoff in any vacant positions, or in any positions for which they are fully qualified, and have seniority over the employee currently in that particular position.

- Career Counseling — Employees would be eligible to attend several career counseling programs currently offered by the Commonwealth of Virginia's Personnel and Training Department. These programs are designed to help employees who are targeted for layoff. Skills such as resume writing, interviewing, networking, and state employment processes are taught.

- Layoff — Employees either not accepting placement opportunities, or employees without placement opportunities, would face being laid-off from their positions. Most laid-off employees would be eligible to receive unemployment benefits.

- Recall from Layoff — Suitable positions in state employment may be available after an employee has been laid-off. Employees would then be recalled from lay-off and given the opportunity to accept any available positions for which they may be eligible. Employees would remain on the recall list for 12 months after the elimination of their position. Employees would only be eligible for placement for positions in the state executive branch.

[7] House Bill 1499 granted employees with 25 years of service and at least 50 years of age 5 years of bonus service. Employees were eligible for this early retirement incentive from July 1, 1991 to October 1, 1991.

- New Position in the Public or Private Sector — At any point in the process, employees may find new positions in the public or private sector.

The opportunities available to ABC employees registered in the Preferential Employment Program depend upon the employment situation of the state government. From fiscal year 1990 to fiscal year 1992, state employment within the state's executive branch dropped at an average annual compound rate of 1.29 percent. Judging from our interviews with the Virginia Department of Personnel and Training, we do not expect state employment to increase in the near future and it may continue to decline at this same rate. A continued decline in state employment levels reduces further the probability of ABC employees finding jobs through the Preferential Employment Program.

The Virginia Department of Personnel and Training has compiled data on the number of state employees rehired by the state government following a lay-off. Over the last two years, the average number of employees laid-off by the Commonwealth has been approximately 280 employees and approximately 25 percent of these employees have been rehired. However, the number of displaced employees under partial privatization would be more than 150 percent above this average figure. Under these circumstances, we estimate that very few laid-off ABC employees would have opportunities for placement in a state government position over the 12 month period following a lay-off.

b. Employment and Downsizing Costs and Cost savings Analysis

This section presents the estimated changes to employment, wages and benefits, unemployment payment obligations, and other costs incurred due to the employment changes associated with partial privatization. In Exhibit II-11 we summarize all costs and cost savings resulting from changes in employment. Each of these is described below.

Summary of ABC Employment Costs and Cost Savings Estimates Under Partial Privatization

Description	Year 1	Total Recurring
Salaries and Wages Eliminated	$22,081,199	$22,081,199
Salaries Added	($1,186,577)	($1,186,577)
Benefits Eliminated	$5,144,295	$5,144,295
Benefits Added	($355,974)	($355,974)
Estimated Unemployment Obligation	($5,071,944)	$0
Benefits (Continued for 1 year)	($3,302,168)	$0
Estimated Education Obligation	($67,700)	$0
Paid Leave Obligations	($2,231,682)	$0
Net ABC Employment Savings	**$15,009,449**	**$25,682,943**

Note: Figures in parentheses represent added costs to ABC under partial privatization and are subtracted from cost savings.

1. Changes to Total Employment

a. Employment Reductions

We determined the number of full-time salaried positions to be eliminated due to downsizing from job classification descriptions and through departmental responsibilities related to retail operations. In Exhibit II-12 we present the estimated full-time salaried positions lost by each division under partial privatization. The three general categories of employment eliminations are the following:

- Direct Eliminations — include those job classifications that would be eliminated due to their function. This includes such categories as ABC Store Manager, ABC Store Assistant Manager, Store Clerk, etc.
- Related Eliminations — include positions eliminated due to their relation to the directly eliminated classifications. This would include support personnel whose classifications were not eliminated, but whose particular positions were eliminated.
- General Eliminations — include positions that are not directly eliminated based on their function, but are part of the downsizing that would occur. For example, central office personnel could decline overall due to the reduction in the responsibilities of the ABC.

Stores Division

As a result of partial privatization, all ABC retail operations would be eliminated, which would result in the elimination of the Stores Division. Currently, the Stores Division is staffed with approximately 627 employees, all of whom would be laid-off under partial privatization.

Estimated ABC Positions Lost By Division Under Partial Privatization

Division	Positions	Salaries	Benefits
Human Resources	4	$116,099	$34,830
Purchasing and Support	22	$431,990	$129,597
Research and Planning	2	$56,500	$16,950
Real Estate	14	$316,525	$94,958
Stores	627	$14,379,626	$4,313,888
Merchandising	8	$202,395	$60,718
Totals	677	$15,503,135	$4,650,941

Real Estate Division

The Real Estate Division would also be eliminated under partial privatization because the majority of the division's responsibilities involve the acquisition and maintenance of ABC retail stores. We estimate that 14 of the 20 positions within the Real Estate Division are associated with retail store acquisition functions and therefore, would be eliminated. Only those positions that are responsible for the maintenance of the warehouse would be required under partial privatization. With the elimination of the Real Estate Division, these 6 positions could be placed under the control of the Purchasing and Support Division.

Merchandising Division

Under partial privatization, the responsibilities of the Merchandising Division would change significantly. Functions relating to stocking the retail stores, purchasing liquor inventory, and point of sale maintenance would be eliminated. Maintenance functions would be performed by the Purchasing and Support Division, therefore eliminating the Maintenance Shop positions. We estimate that the Merchandising Division would lose approximately 20 positions as a result of partial privatization.

The implementation of the telephone ordering system would create additional responsibilities for the Merchandising Division. New positions would include systems operators and new management positions. Additionally, a number of new warehouse personnel may be needed to service additional orders received from the many new licensees. We estimate that partial privatization would increase the staffing of the warehouse portion of the Merchandising Division by 12 positions. Given the loss of 20 positions, as explained above, partial privatization would result in an overall net loss of approximately 8 positions.

Purchasing and Support Division

The Purchasing and Support Division would experience a significant reduction in its workload and responsibilities under partial privatization. The elimination of the Stores Division would have the most significant impact on the Purchasing and Support Division's required staffing level. A majority of services performed by the Purchasing and Support Division is provided to the Stores Division. These services include equipment inventory and purchasing, printing services, materials management, and transportation. From analysis of job descriptions and interviews with ABC officials, we estimate that the staffing level would be reduced by approximately 60 percent, from 36 positions to 14 positions under partial privatization.

Human Resources Division

Under partial privatization, the staffing of the Human Resources Division would be reduced. We estimate that with the reduction in employment from 1,023 positions to 393 positions, the staffing level of the Human Resources Division would be reduced by approximately 60 percent, from 13 positions to 9 positions.

Research and Planning Division

The number of positions in the Research and Planning Division would be reduced as a result of partial privatization. We estimate that approximately 2 of the 7 positions in the Research and Planning Division are committed exclusively for research and analysis related to retail store operations. These positions would no longer be needed under partial privatization.

Part-Time Employment

Immediately upon implementation of any lay-off process, all part-time employees would be laid off first. These employees are located throughout the state and float from one store to another, depending on ABC's current needs. In total, the ABC currently employs approximately 795 part-time employees, 777 of whom are employed by the Stores Division. We estimate that under partial privatization, all 795 part-time employees would be laid-off.

b. Employment Additions

Given the changed nature of ABC operations, we assume that a number of positions would be added in order to accommodate new responsibilities and activities. These position additions, salaries, and benefits are summarized by division in Exhibit II-13. The added positions are similar in nature to current positions in the general offices of the ABC, in terms of geographic location, skill levels, and pay ranges. We used these similarities to estimate the salaries and benefits associated with the added positions.

Regulatory Division

We estimate that the responsibilities of the Regulatory Division would increase due to the estimated increase in the number of licensees. Currently, the ratio of retail licenses to ABC Regulatory Agents is approximately 168 (16,000 retail licenses divided by the 95 Regulatory Agents currently employed). We estimate that ABC would need an additional 36 Regulatory Agents over the current level of 95 to properly manage an increase of approximately 6,000 retail licenses under partial privatization.

The recently established Financial Investigations Section is currently staffed with two positions. This section is tasked with investigating tax evasion, money laundering, and other fraudulent activities associated with the sale of alcoholic beverages. Due to the methods and techniques used by the financial investigations unit, it is unclear

Estimated ABC Positions Gained By Division Under Partial Privatization

Division	Positions	Salaries	Benefits
Hearings	3	$80,859	$24,258
Regulatory	36	$933,066	$279,920
Accounting	8	$172,652	$51,796
Totals	47	$1,186,577	$355,974

Management Information Systems and Data Processing

With the elimination of the Stores Division, the responsibilities of the MIS/DP Division would be reduced by approximately 40 percent. However, we estimate that MIS/DP Division would be required to manage additional responsibilities associated with the addition of new retail liquor licenses. These responsibilities would include technical support of the new telephone ordering system and the production of new management reports. Overall, we estimate that the staffing level of the MIS/DP Division would remain unchanged under partial privatization — 31 positions would be required.

2. Changes to Wages, Salaries, and Benefits Paid

We calculated the changes to wages, salaries, and benefits obligations using our estimates of changes in the number of positions at ABC under partial privatization. We calculated salaries of eliminated full-time positions using salary reports provided by the ABC.

We determined the total salary costs for each division and calculated an average salary estimate for each division by dividing the number of employees in each division by the total salary cost for each division. We calculated total salary cost savings by multiplying the number of positions eliminated in each division by that division's average salary estimate.

We estimated wages for part-time employment from monthly wage reports provided by the ABC. In the month of July 1992, part-time employees worked a total of 71,148 hours and received $548,171.90 in regular earnings. Approximately 795 part-time employees were employed by ABC in July and received average hourly wages of approximately $7.70. Under partial privatization, all of these part-time positions would whether this section would be able to continue operations under a partially privatized system.[8]

Accounting Division

Under partial privatization, the Accounting Division would experience a significant increase in accounting tasks due to the addition of new retail liquor licensee accounts. However, the elimination of the Stores Division would decrease the division's responsibilities that are associated with maintaining detailed financial records for 243 ABC retail stores. Overall, we estimate that the staffing level of the Accounting Division would need to increase by approximately 30 percent over the current level of 26 to properly manage the significant increase in the number of licensees.

Hearings Division

We believe that, with an increase in the number of retail licensees, a corresponding increase in the number of administrative hearings proceedings would result. Therefore, we estimate that the 37 percent increase in the number of retail licenses issued would require three additional positions in the Hearings Division.

c. Other Employment Issues

Internal Audit Division

With the elimination of the Stores Division, the Internal Audit Division would experience a significant reduction in financial audits and internal operating efficiency reviews. However, partial privatization would require the division to expand reviews of the Accounting and Regulatory Divisions. We estimate that the staffing of the Internal Audit Division would, therefore, not change as a result of partial privatization.

[8] The methods and techniques used by the Financial Investigations Section to analyze fraud are classified and are not discussed in this report.

be eliminated. These part-time wages are included in the salaries and wages line item that is presented in Exhibit II-11.

We determined benefits obligations for salaried employees by using the average benefit payment rate for ABC employees, which is approximately 30 percent of salaries and wages. Part-time employees receive no benefits, except for the ABC's obligation to contribute 50 percent of the employee's FICA obligations.

3. Unemployment Benefits Obligations

We calculated unemployment benefits using the percentage of employees expected to reach the layoff stage in the process of position elimination. We estimated this percentage by using information about state government and ABC employment opportunities, which have been discussed previously.

By order of the Governor, all state agencies must reimburse the Virginia Employment Commission (VEC), dollar-for-dollar, for the agency's share of unemployment benefits paid to a laid-off employee. Because the ABC reimburses the VEC for every dollar that a laid-off ABC employee collects, no payroll tax is assessed of ABC for unemployment insurance. Thus, there is no cost to the ABC for unemployment benefits unless an employee actually files a claim and receives benefits.

In order to determine unemployment benefits, we estimated the number of eligible full and part-time employees. We assume that all full-time employees subject to lay-off would be eligible for the maximum unemployment benefits of $208 per week for 26 weeks, and would file a claim with the Virginia Employment Commission to collect benefits. Because many part-time employees may work for other employers and may not file for unemployment benefits, we assumed that 50 percent of those laid-off would file a claim and collect unemployment benefits. For these employees, we used an average benefit rate of $136.50 per week for 26 weeks because many part-time employees may not qualify for the maximum benefits.

4. Other Costs

In Exhibit II-11, we have included the following types of costs associated with employment downsizing:

- Continued Benefits — State employees facing a lay-off have the option to continue state contributions to their benefits plans for up to 12 months following their lay-off. We assume that all employees would continue their benefit contributions, obligating the ABC to continue their contribution. We estimated continued benefits by applying the state benefit rate, less FICA contributions, to the employees annual wage figure.

- Paid Leave Obligations — ABC employees whose positions are terminated and who are not rehired by the state would compensated for 100 percent of their accumulated annual leave balances and 25 percent of their accumulated sick-leave balances. For purposes of this analysis, we assume that the ABC would compensate all employees who are laid-off. We estimated paid leave obligations from accumulated leave reports provided by the ABC.

- Training and Counseling — Training and counseling costs are the costs of providing career counseling by the Virginia Personnel and Training Department to those laid-off employees choosing to participate. We estimated training and counseling costs using the average cost of training one employee for a two day course offered by the Personnel and Training Department. We assumed that all full-time employees would choose to participate.

c. Reorganization Analysis

Some of the divisions in the ABC, as is clear from the above employment analysis, would be eliminated or reduced in size as a result of partial privatization. In Exhibit II-14, we present the current organization of the ABC, highlighting the eliminated divisions and indicating changes in divisional responsibilities. Thus, a possible organizational structure for ABC under partial privatization would simply entail using the current departmental organization, absent the missing divisions. We present this possible organizational structure in Exhibit II-15.

d. Non-Quantifiable Impacts on Employment

Some of the significant impacts of partial privatization on employment and employees cannot be assigned a cost in terms of dollars. This section outlines the qualitative impacts of partial privatization on employment.

1. Layoff and Placement Process

Although we discussed the lay-off and placement process above, the magnitude of the task warrants a discussion in this section. Each employee must be analyzed individually to determine his or her placement options and rights. In turn, each employee must consider these options and make a choice. Assuming the employee chooses to exercise his or her placement rights, another ABC employee would be displaced. The determination of all these placement chains and outcomes individually is an extremely burdensome task. The individual nature of the process, as well as the preferences of each employee, complicates the process. Conceivably, costs could be assigned to the time required of the personnel staff and to the benefits paid to other displaced workers. However, the complexity of this analysis, as well as the statewide

Virginia Department of Alcoholic Beverage Control

Possible Organizational Structure Under Partial Privatization

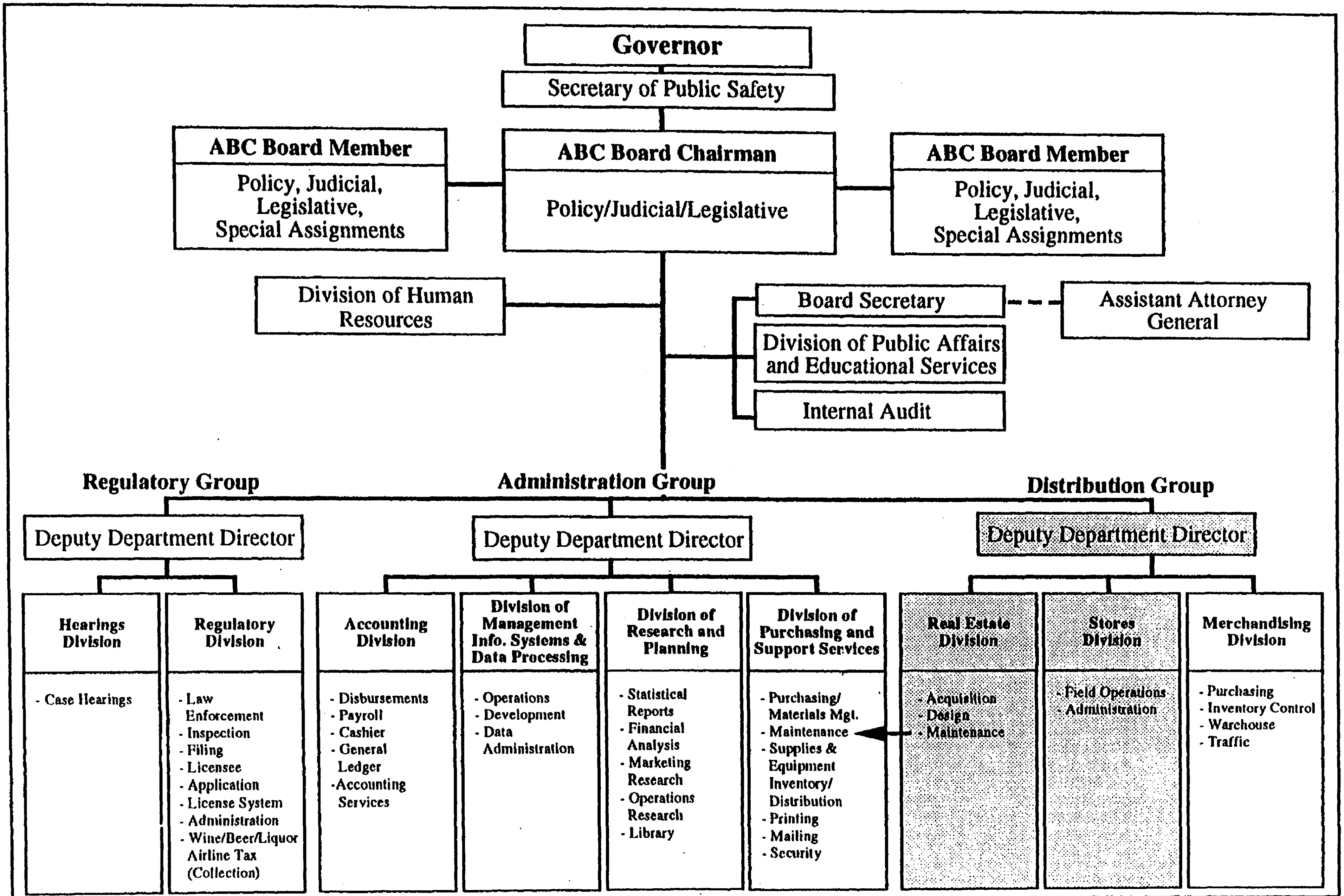

Exhibit II-14

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Note: Shaded areas represent divisions eliminated under partial privatization.

Possible Organization with Remaining Divisions
Under Partial Privatization

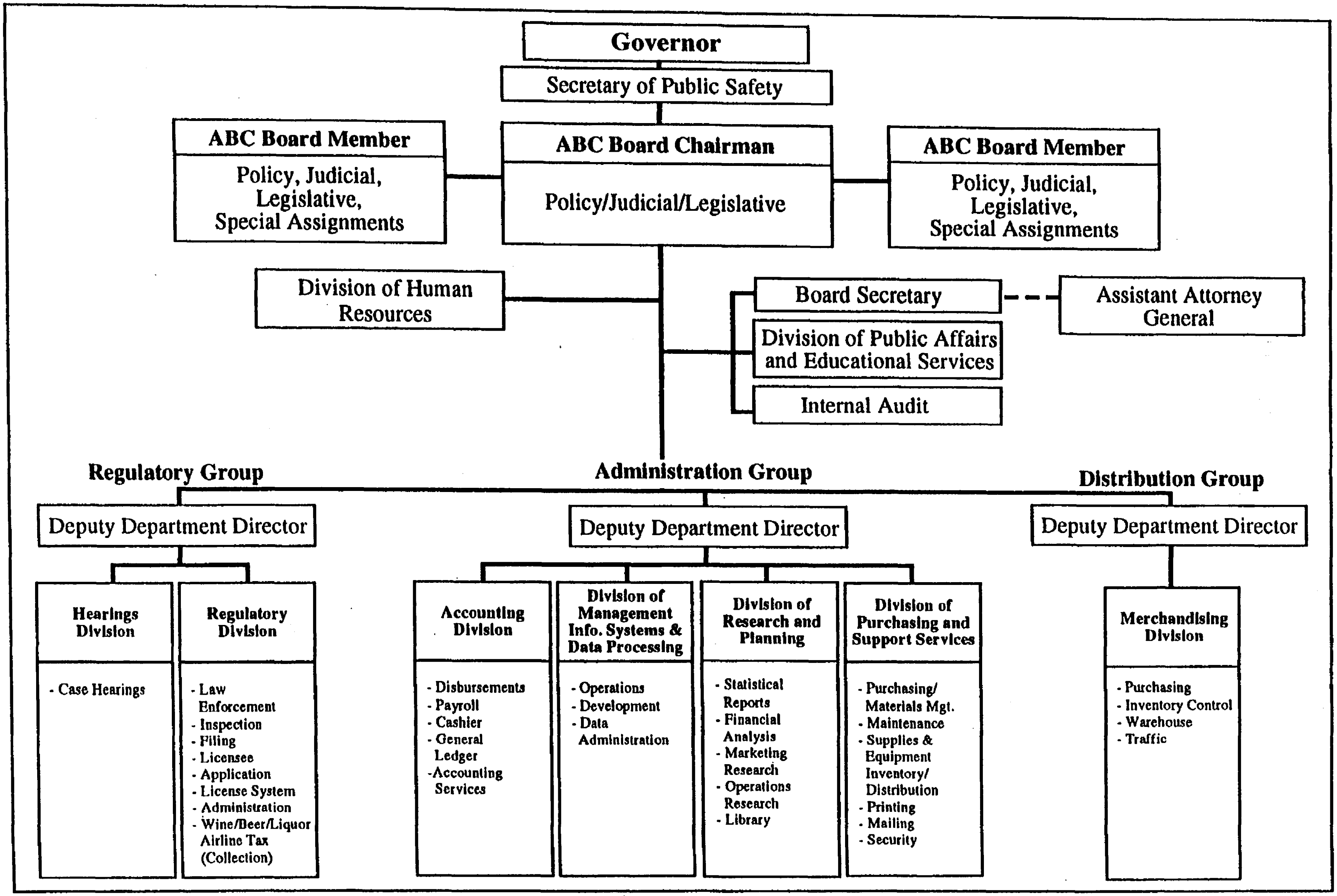


Exhibit II-15

nature of the effects, make it difficult to analyze here. Additionally, many of the classifications that would be eliminated under partial privatization have very few placement opportunities.

2. Retraining and Education Options

In order to facilitate the adjustment process, the state could introduce legislation to fund additional retraining and education efforts to aide employees targeted for lay-off. The counseling programs previously discussed are currently the only options available from the state of Virginia to targeted employees.

The ABC has acknowledged that numerous internal training programs are offered to employees. The Educational Reimbursement System is a program established by the ABC that reimburses employees for job-related or required courses from institutions such as undergraduate universities and trade schools. In our interviews with ABC personnel, officials stated that the program is currently unable to handle the magnitude of the training and counseling associated with a major lay-off due to limited funding. Under partial privatization, the state could appropriate additional funds to ABC training programs to aide in the retraining of employees targeted for a lay-off.

e. Summary of Employment Impact Conclusions

Our analysis of the employment impact leads to the following conclusions:

- The savings from salaries and wages paid over time are significantly larger than the costs associated with downsizing.

- The nature of the current employment of the ABC leaves the affected employees at risk of not being placed in other state government positions. The skill levels, position classifications, and geographic location of eliminated jobs affect the chances of placement.

- Many non-quantifiable impacts may result from the downsizing under partial privatization. These include the difficulties involved in determining placement rights, retraining, and counseling options.

2. Facilities

Many of the facilities in use by the ABC would not be needed as a result of partial privatization. The majority of facilities currently used by the ABC function almost solely for the purpose of retail liquor merchandising. These facilities include all ABC store locations leased and owned by the state. Additionally, state-owned equipment used within the stores and in support of store operations would no longer be needed. The central office and warehouse, and the eight district offices, which are not generally related to retail store operations, would still be necessary under partial privatization.

a. Leases

The ABC currently leases the sites for 224 retail stores and 5 district offices, and owns the property for 19 stores and 3 district offices. Under partial privatization, the leased and owned stores would no longer be needed. All ABC store leases have an escape clause stating explicitly that if ABC's retail store operations discontinue, the lease may be broken at any time with at least three months' notice. Under these circumstances, we estimate that the time needed for implementation of partial privatization would allow the ABC to coordinate a withdrawal from the existing leases without any significant lease breaking expense. In Table II-5 we present the estimated lease cost savings that would result from partial privatization. The state currently leases five district offices, all of which would still be required under partial privatization.

Table II-5

Estimated Lease Cost Savings Under Partial Privatization

Annual Lease Expense (Stores)	$5,297,867
Estimate of Lease Breaking Expense (If leases are phased out)	$0
Total Lease Cost Savings	$5,297,867

b. Land and Buildings

Under partial privatization, ABC would no longer need the 19 retail locations. These properties would be declared surplus and filed with the Department of General Services to be redistributed or sold. The surplus land and buildings would be offered to other state agencies or localities that could established a need for the property. Officials at ABC and the Virginia Department of General Services indicate that it is unlikely that any state agency or locality would be able to establish a need for a retail store location.[9] Therefore, we estimate that the 19 retail store properties would be sold at auction to the general public.

[9]If a state agency or locality established a need for an ABC property, it is unlikely that ABC would be remitted any funds. If some of the properties are claimed by other state agencies or localities, our estimates of cost savings from the sale of surplus properties would be reduced.

The proceeds from the sale of the 19 retail store properties would be collected by the Virginia Department of General Services and remitted to ABC. Because ABC is the original funding source of these properties, the Department of General Services indicates that ABC would be remitted all proceeds from the sale of the surplus properties.

The total assessed value of the land and buildings for all 19 stores is $10,415,740. This assessment was performed first by Marshall Stephen Valuation Service for the Virginia Department of General Services in 1985 and is adjusted on a yearly basis. The assessed value gives an estimate of the replacement value of the properties. While the assessed value of the land and buildings may not accurately predict what some party would be willing to pay, it is an estimate of the benefit to the ABC from selling its property. We assume that the assessed value of the land and buildings equals approximately the resale value of the property. In Table II-6 we present the estimated land and buildings cost savings under partial privatization.

Table II-6

Estimated Land and Buildings Cost Savings Under Partial Privatization

	Estimated Resale Value
Land	$7,360,225
Buildings	$3,055,515
Total Land and Buildings	$10,415,740

c. Equipment and Vehicles

As a result of partial privatization, all equipment related to the operation and support of ABC's retail store operations would no longer be needed and would be declared surplus under the process explained above. In addition, a number of vehicles would need to be purchased to support additions to the Regulatory Division. In Table II-7 we present the equipment and vehicle costs and cost savings.

Table II-7

Equipment and Vehicle Cost and Cost Savings Under Partial Privatization

Description	Estimated Resale Value
Equipment	$431,055
Vehicles Purchased	($546,804)
Total Equipment and Vehicle Cost	($115,749)

* Figures in parentheses represent costs to the ABC.

The equipment listed in Table II-7 is directly related retail store operations and includes cash registers, safes, shelving, and furniture. ABC values this equipment at the current book value (i.e., purchase price minus depreciation). Although current book value may not be an accurate estimate of the resale value, it is an estimate of the benefit to the ABC associated with selling the equipment. All equipment would be declared surplus and filed with the Department of General Services for handling as described above.

Under partial privatization a number of new vehicles would need to be purchased to support the new Regulatory staff positions discussed earlier. The Regulatory Division currently owns and operates approximately 166 vehicles. We estimate that an additional 36 vehicles would be needed at a cost of $546,804. We based this cost estimate on recent vehicle purchases made by the Regulatory Division.

d. Operational Cost Changes Under Partial Privatization

In Exhibit II-16, we present the total operational cost savings that would be achieved under a partially privatized system. As indicated in the discussion above and in the exhibit, the largest source of non-employment operational cost-savings ($8.9 million per year) would be realized by terminating leases on ABC stores and eliminating all other store-related operating costs. While other divisions may not be cut entirely, reductions in personnel allow for reductions in operating funds that would have gone to support those personnel or functions.

Operational Cost Savings and Additions Under Partial Privatization

	FY 1992 Budget			Percent Reduction (Addition)	Cost Savings
	Budget	x		% Reduction	= Cost Savings
Research and Planning	$26,260	2/7	==>	28.57%	$7,503
Human Resources	$278,530	4/13	==>	30.77%	$85,702
Merchandising	$262,665	8/79	==>	10.13%	$26,599
Purchasing and Support	$114,750	22/36	==>	61.11%	$70,125
Real Estate	$465,400	14/20	==>	70.00%	$325,780
Stores	$8,925,925	627/627	==>	100.00%	$8,925,925
Accounting	$54,830	8/26	==>	-30.77%	($16,871)
Hearings	$48,330	3/8	==>	-37.50%	($18,124)
Merchandising	(additional non-employment-related expenses)				($2,109,688)
Regulatory	$1,020,819	36/153	==>	-23.50%	($240,193)
Total Cost Savings					**$7,056,758**
One-Time Cost Addition (Telephone Ordering System)					**$250,000**

Notes: In the percent reduction column, the figures presented are:
# of positions removed in a division / total # of positions in division

Fiscal Year 1992 figures are divisional budgets less personnel expenses, which are accounted for elsewhere.

Divisional Operational Expense Additions and Deletions

Under partial privatization, operational costs may be eliminated or cut back in the following divisions:

- Research and Planning
- Human Resources
- Merchandising
- Purchasing and Support Services (including Duplicating Services)
- Real Estate (including Office Building Services)
- Stores

Operational costs may increase in the following divisions:

- Accounting
- Hearings
- Merchandising (non-employment related costs)
- Regulatory

To estimate cost savings in divisions that would be reduced, but not cut entirely, we apportioned the cost-savings based on the percentage reduction in staff. For example, if four positions were being eliminated from a group of ten, four-tenths (or forty percent) of the operating expenses could also be eliminated from the non-payroll-related operating budget of that group.

Telephone Ordering System

If the state maintains control of liquor wholesaling, retailers would need to be able to order alcohol from the state. The system we envision requires the installation and operation of a touchtone telephone ordering system. Initial inquiries indicate that costs would amount to approximately $250,000 for purchase, customization, and installation in the first year of off-the-shelf telephone ordering hardware and software used for wholesale and distribution in other industries. This does not include the telephone charges for the toll-free 800 number that would be used to handle the calls.

In addition, we estimate that toll-free charges would total approximately $500,000 per year, based on an assumption of 5,000 licensees calling approximately once per week, spending an average of seven minutes placing an order. Under our model of partial privatization, there would probably be less than 5,000 licensees calling in orders to the state. Those retail businesses with several stores across the state would probably handle their orders through a central distribution center, rather than through each individual store.[10]

Our estimate of the cost for toll-free calls is based partially on the "AUDREY" telephone ordering system used by liquor retailers in Michigan and on inquiries to private firms that deal with such large-scale telecommunications systems. After the first year, recurring costs would also include approximately $15,000 in annual maintenance expenses. The total annual operating costs for the telephone ordering system would therefore be $515,000.

State Contract for Trucking Liquor to Retail Licensees

Other additional charges would include an increase in trucking costs due to a likely increase in the number of liquor retail establishments that would require deliveries. Currently, the Swift Transportation Company uses large 40- and 45-foot tractor-trailers to transport liquor from the state warehouse in Richmond to the 243 ABC stores around the state.

If the number of establishments selling liquor were to increase, 40-foot tractor-trailers would likely be too large to make deliveries to many establishments. Therefore, smaller trucks and a greater number of trips would be required. This would

[10] The retail businesses in our Comparison of ABC and Other Retail Businesses (Appendix C) all use central distribution facilities, at least to a certain degree, to distribute merchandise to stores in the Commonwealth.

also increase the number of drivers necessary to handle these trips. Smaller trucks, a greater number of trips, and an increase in the number of drivers would all serve to increase the cost to the state of delivering liquor orders to retailers.

Under the current system, the average cost per case delivered to ABC stores is approximately $0.64, resulting in $1.8 million per year in trucking expenses. Some partially privatized states contract with private trucking companies to deliver liquor from their warehouses to retailers. For example, in Iowa, the state adds $1.29 per case to the price charged retailers to cover trucking costs. In West Virginia, the liquor handling charge is $1.05 per case.

In selecting a distribution system under a partially privatized system, we chose from two options:

- Central Warehouse — The state could maintain a central warehouse and either use a state trucking contract to distribute merchandise or allow retailers to pick up merchandise from the warehouse.

- Wholesale Stores Throughout the Commonwealth — The state could establish wholesale stores located strategically throughout the Commonwealth. Under this system, retailers would purchase and pick up their merchandise at these establishments.

Under the central warehouse option, it would probably not be feasible for all retailers to pick up their merchandise from the warehouse, according to our conversations with ABC officials. Therefore, under this option, the state would contract with a trucking firm to distribute merchandise to retail licensees. The advantages of this option are that it would be less costly and duplicative to operate than numerous wholesale stores throughout the state. However, wholesale stores may be more efficient in distributing merchandise to licensees that are located relatively far from the central warehouse.

Because of cost considerations, we assume that Virginia would adopt the central warehouse distribution system, which is similar to distribution systems in other partially privatized states (such as Iowa and West Virginia). Such a distribution system is also similar to those of other major retailers in the Commonwealth (see Appendix C, Comparison of ABC and Other Retail Businesses for more information about other retailers' distribution systems). Because of the likely increase in the number of retailers under partial privatization, we estimate that delivery costs in Virginia would almost double from their current level to approximately $1.25 per case delivered. All private sector retailers would be assessed the same shipment charge, regardless of their location. We estimate that the increased per-case charge would result in total trucking contract costs of $3.4 million per year, an increase of $1.6 million.

Although there is a large increase in the number of retail liquor licensees, we do not estimate that the trucking contractor would be responsible for delivering liquor to all of the estimated 5,000 retailers.[11] As can be found in our comparison of ABC and other retailers in the Commonwealth (Appendix C), all of the Virginia retailers in our analysis have central distribution centers that make deliveries to individual retailers throughout the Commonwealth. We anticipate that the state trucking contractor would make deliveries to these distribution centers, where appropriate, rather than to individual retailers.

e. Merchandise Inventory

The average value of merchandise inventory in the stores and warehouse in fiscal year 1992 was $21 million and $16 million respectively, for a total average merchandise inventory of $37 million. The ABC receives inventory from the manufacturers at the

[11] Licensees that sell liquor for both on- and off-premise consumption would buy liquor from retail liquor licensees, similar to licensees that sell liquor only for on-premise consumption.

central warehouse location and assumes ownership once the merchandise is unloaded. Manufacturers are paid for their merchandise within 60 days. As of June 30, 1992, ABC owed manufacturers approximately $20 million. Therefore, the net value of the inventory currently owned by ABC is approximately $17 million.

Under phased-in privatization, ABC would undertake measures to both change the composition of its inventory and get rid of existing inventory during the period in which privatization is implemented. ABC would only order more popular brands of liquor and would no longer order more unpopular products that do not sell very well.[12] In addition to ordering only more popular products, ABC would scale back the quantity of merchandise ordered in order to ensure that the merchandise ordered would all be sold during the transition period. Merchandise not sold by the end of the transition period would either be brought back to the warehouse or sold from the stores at a deep discount, whichever is more cost-effective.

f. Vacating Retail Stores

ABC would incur significant labor and shipping expenses throughout the process of vacating the 243 retail stores. This process would involve dismantling and removing store fixtures and equipment in each retail store. We estimated the labor expense based on similar costs incurred by the Real Estate Division in the past. On average, the Real Estate Division has dispatched a crew of three mechanics, three assistant mechanics, and one painter for three days in order to thoroughly dismantle a retail store. Based on the salary and benefits expenses of these positions, we estimate that the cost to the ABC for dismantling all 243 retail stores would total approximately $537,303.

[12] Customers could still special order products that would no longer be carried by ABC during the implementation of partial privatization.

3. Summary of Employment and Facilities Costs and Cost Savings

In Exhibit II-17 we present a chart that summarizes the costs and cost savings associated with changes in employment and facilities under partial privatization.

Exhibit II-17

ABC Cost and Cost Savings Summary Under Partial Privatization

ABC Added Expenses	Year 1	Recurring
Salaries Added	($1,186,577)	($1,186,577)
Benefits Added	($355,974)	($355,974)
Unemployment Liability	($5,071,944)	$0
Benefits Liability (Up to 12 months)	($3,302,168)	$0
Estimated Education Obligation	($67,700)	$0
Vacating Retail Stores	($537,303)	$0
Paid Leave Obligations	($2,231,682)	$0
Telephone Ordering System	($250,000)	($515,000)
Trucking Contract	($1,594,688)	($1,594,688)
Equipment and Vehicles	($115,749)	$0
Added Operating Expenses	($275,188)	($275,188)
Subtotal	**($14,988,973)**	**($3,927,427)**

ABC Eliminated Expenses	Year 1	Recurring
Eliminated Salary and Wages	$22,081,199	$22,081,199
Eliminated Benefits	$5,144,295	$5,144,295
Eliminated Operating Expenses	$9,441,634	$9,441,634
Eliminated Lease Payments	$5,297,867	$5,297,867
Sale of Land and Buildings	$10,415,740	$0
Added Licensing Fees	$4,132,875	$4,132,875
Subtotal	**$56,513,610**	**$46,097,870**
NET ABC SAVINGS	**$41,524,637**	**$42,170,443**

Note: Figures in parentheses indicate costs to ABC under partial privatization

Consumption Analysis

This section contains the following:

- Background of Liquor Consumption
- Cross-Border Activity
- Evidence of Cross-Border Activity
- Cross-Border Activity and Privatization

D. Consumption Analysis

Alcohol consumption has been declining for some time, both in the United States and Virginia. Under a privatized system, whether it is partially or fully privatized, we would expect this to continue. The increased prices that would likely accompany a partially or fully privatized system that is revenue neutral would make it increasingly attractive for Virginians to purchase alcohol in neighboring states. Below, we further discuss these trends in the sale of liquor and the implications of Virginians travelling outside the state to purchase liquor.

1. Background of Liquor Consumption

There is a national trend toward declining sales of liquor in the United States. Over the period 1980 to 1990, U.S. sales declined from 449 million gallons to 374 million gallons. This is a decrease of 16.7 percent or an average decline of 1.81 percent per year. Per capita sales of liquor are declining at an annual rate of 2.67 percent, as presented in Table II-8.

Table II-8

Apparent Consumption of Distilled Spirits, U.S.

(in gallons per capita)

1980	1.98
1990	1.51

Average decline per year: 2.67 percent

Source: Distilled Spirits Council of the United States

In Virginia, the average decrease in apparent per capita consumption of liquor over the past ten years was nearly one-third greater than the national average. Between 1980 and 1990, per capita apparent liquor consumption in Virginia decreased by an average of 3.52 percent per year, as presented in Table II-9.

Table II-9

Apparent Consumption of Distilled Spirits, Virginia

(in gallons per capita)

1980	1.76
1990	1.23

Average decline per year: 3.52 percent

Source: Distilled Spirits Council of the United States

Virginians, along with other consumers, are changing their drinking habits in response to the health and social implications of alcoholic beverage consumption, the 21-year-old legal drinking age, and the stricter drunk driving laws.

2. Cross-Border Activity

When adjacent or nearby states levy different excise taxes on specific products, the same product costs more in one state than in the neighboring state. The result of this price differential is a market distortion—residents in the higher-tax state have an incentive to purchase the items at a lower price across the border in a lower-tax state. Via this "cross-border activity," lower-priced items from out-of-state are substituted for higher-priced, in-state items.

There are several factors, in addition to price differentials, that can influence the level of cross-border activity. Through our experience in conducting cross-border studies for several states, we have determined that the following five principal factors influence cross-border activity:

- Tax Rate Differential — Generally, a higher state tax implies a higher retail price and, in turn, a greater tendency for consumers to seek out alternatives to paying the higher price.
- Population Density — Given a price differential, the presence of large populations along the border of a lower-tax jurisdiction tends to increase the occurrence of cross-border activity. This is particularly true when large numbers of daily commuters cross borders to work in a neighboring state.
- Accessibility — Major roads and frequent commuters travelling between jurisdictions are factors that increase the accessibility to lower-taxed goods, thereby increasing the likelihood of cross-border activity.
- Risk of Detection — Lower levels of law enforcement tend to decrease the risk of detection and correspondingly increase the likelihood of cross-border activity, all other factors being equal.
- Cost of Participation — Lower costs associated with vehicle miles, gasoline, and time, as well as the penalties for participating, make cross-border activity more profitable and, therefore, more likely to occur.

In this section we explain each of these factors in detail and how they may influence the level of cross-border activity in Virginia.

a. Tax Rate Differential

A relatively high state tax rate on a product causes the retail price of that product to also be relatively high. When consumers face high prices, they may consider alternatives to paying full retail, in-state prices. Generally, the higher the tax and the higher the price, the higher will be the frequency of cross-border activity, assuming that other factors also indicate an environment conducive to cross-border activity. The increased cross-border activity may involve crossing a state or jurisdictional boundary. As illustrated in Table II-10, Virginia's excise tax and related mark-up is higher relatively than those of many of its neighbors.

Table II-10

Overview of State Tax Rates on Liquor

State	State Excise Tax
Virginia	20% excise tax, plus 4.5% sales tax (after mark-up of 46.5% and $1 handling fee) Equivalent to $7.04/gallon tax and $11.82/gallon mark-up based on average price per gallon
District of Columbia	$1.50/gallon, plus 6% sales tax
Kentucky	$1.92/gallon, no sales tax off premise (plus $0.05 per case and 9% wholesale tax)
Maryland	$1.50/gallon, plus 5% sales tax
North Carolina	75.3684% mark-up (includes excise tax, local and state mark-ups)
Tennessee	$4.00/gallon, plus 5.5-8.25% sales tax and $0.15/case wholesale tax
West Virginia	5% municipal tax and 6% sales tax plus 25% mark-up and $1.05/case distribution fee

Note: There may be additional taxes not listed above, which apply to the sale of liquor in these states.

Source: Tax Briefs, The Distilled Spirits Council of the United States, January 1992.

In addition, Virginia has several federal installations throughout the state that have Class 6 package stores. These stores are not subject to the same mark-ups, sales taxes, or excise taxes as ABC stores and, therefore, they can generally offer lower prices. Consequently, they could result in a loss of alcohol-related revenue to the state. Currently there are 49 major military installations in Virginia, some of which are likely to have Class 6 stores on the premises. There are 254,097 military personnel employed in the state, including active duty, civilian, and reserve and national guard personnel.[13] In addition, there are 668,000 veterans living in Virginia who could have access to these lower prices.[14] Therefore, approximately, 900,000 Virginians, or 14 percent of the total population, may potentially have additional access to lower-priced liquor.

b. Population Density

Population density is an important factor that motivates cross-border activity. A populated area near the border of a lower-taxed jurisdiction can be expected to generate a high level of cross-border activity, particularly *casual* cross-border activity. Generally, in areas with large border populations, a proportionately large number of people would be expected to work in neighboring states. The larger the border population and, therefore, daily commuter population, the higher the expected level of cross-border activity.

If barriers separating the jurisdictions are few, the level of cross-border activity can be expected to be even higher. Even if a relatively small percentage of a densely populated area takes part in cross-border activity, out-of-state businesses in bordering counties can experience significant sales increases. The greater the percentage of a

[13] Source: Virginia Statistical Abstract, 1989.

[14] U.S. Bureau of the Census, *Statistical Abstract of the United States: 1991* (111th edition) Washington, DC, 1991.

state's population that lives near the border of a lower-tax state, the greater the expected loss of revenues for that state.

Significant border populations, particularly on the Virginia-Maryland-District of Columbia border, could be an indicator of extensive cross-border activity. Furthermore, more than one-half of Virginia's population resides in a county or city that border or is within 30 miles of a neighboring jurisdiction. In Exhibit II-18 we present the population in each county that borders another jurisdiction.

Although many counties surround the six jurisdictions that border Virginia (Maryland, District of Columbia, West Virginia, Tennessee, Kentucky, and North Carolina), we do not believe that cross-border activity would be prevalent in all of these counties. First, not all of the counties near the border are particularly accessible to the nearby jurisdiction. Second, many jurisdictions that border Virginia are not densely populated, nor are they major metropolitan areas. For example, a resident living in Virginia Beach would probably have little incentive to travel across the border to North Carolina because of the distance required and the relatively rural character of the part of North Carolina that borders this area of Virginia. Specifically, as presented in Exhibit II-19, we believe that three areas in the state are characterized by the incentives that lead to cross-border activity:

- <u>Northern Virginia</u> — surrounds both the District of Columbia and Maryland. Northern Virginia includes the counties of Arlington, Fairfax, Loudoun, Prince William, and Stafford and the cities of Alexandria, Fairfax, Falls Church, Manassas, and Manassas Park.
- <u>Bristol</u> — Bristol encompasses area in both Virginia and Tennessee. This area includes Scott and Washington counties and Bristol city.
- <u>Eastern Shore</u> — Much of the area along the Eastern Shore is more accessible to the state of Maryland than Virginia. This area includes Northampton and Accomack counties.

Population of Virginia by County and Independent City

County	Population	County	Population
Accomack *	31,703	Goochland	14,163
Albemarle	68,040	Grayson *	16,278
Alleghany *	13,176	Greene	10,297
Amelia	8,787	Greensville *	8,853
Amherst	28,578	Halifax *	29,033
Appomattox	12,298	Hanover	63,306
Arlington *	170,936	Henrico	217,881
Augusta *	54,677	Henry *	53,942
Bath *	4,799	Highland *	2,635
Bedford	45,656	Ilse of Wight	25,053
Bland *	6,514	James City	34,859
Botetourt	24,992	King and Queen	6,289
Brunswick *	15,987	King George	13,527
Buchanan *	31,333	King William	10,913
Buckingham	12,873	Lancaster	10,896
Campbell	47,572	Lee *	24,496
Caroline	19,217	Loudoun *	86,129
Carroll *	26,594	Louisa	30,325
Charles City	6,282	Lunenburg	11,419
Charlotte	11,688	Madison	11,949
Chesterfield	209,274	Mathews	8,348
Clarke *	12,101	Mecklenburg *	29,241
Craig *	4,372	Middlesex	8,653
Culpeper	27,791	Montgomery	73,913
Cumberland	7,825	Nelson	12,778
Dickenson *	17,620	New Kent	10,445
Dinwiddie	20,960	Northampton *	13,061
Essex	8,689	Northumberland	10,524
Fairfax *	818,584	Nottoway	14,993
Faunquier	48,741	Orange	21,421
Floyd	12,005	Page	21,690
Fluvanna	12,429	Patrick *	17,473
Franklin	39,549	Pittsylvania *	55,655
Frederick *	45,723	Powhatan	15,328
Giles *	16,366	Prince Edward	17,320
Gloucester	30,131	Prince George	27,394

* Denotes county that is on the border or within 30 miles of a border.

Population of Virginia by County and Independent City

County	Population	Independent City	Population
Prince William *	215,686	Alexandria *	111,183
Pulaski	34,496	Bedford	6,073
Rappahannock	6,622	Bristol *	18,426
Richmond	7,273	Buena Vista	6,406
Roanoke	79,332	Charlottesville	40,341
Rockbridge	18,350	Chesapeake *	151,976
Rockingham *	57,482	Clifton Forge	4,679
Russell	28,667	Colonial Heights	16,064
Scott *	23,204	Covington	6,991
Shenandoah *	31,636	Danville *	53,056
Smyth	32,370	Emporia	5,306
Southampton *	17,550	Fairfax *	19,622
Spotsylvania	57,403	Falls Church *	9,578
Stafford *	61,236	Franklin	7,864
Surry	6,145	Fredericksburg	19,027
Sussex	10,248	Galax	6,670
Tazewell *	45,960	Hampton	133,793
Warren	26,142	Harrisonburg	30,707
Washington *	45,887	Hopewell	23,101
Westmoreland	15,480	Lexington	6,959
Wise *	39,573	Lynchburg	66,049
Wythe	25,466	Manassas *	27,957
York	42,422	Manassas Park *	6,734
		Martinsville	16,162
		Newport News	170,045
		Norfolk	261,229
		Norton	4,247
		Petersburg	38,386
		Poquoson	11,005
		Portsmouth	103,907
		Radford	15,940
		Richmond	203,056
		Roanoke	96,397
		Salem	23,756
		South Boston	6,997
		Staunton	24,461
		Suffolk	52,141
		Virginia Beach *	393,069
		Waynesboro	18,549
		Williamsburg	11,530
		Winchester	21,947

* Denotes county that is on the border or within 30 miles of a border.

Counties and Cities Likely to be Characterized by Cross-Border Activity

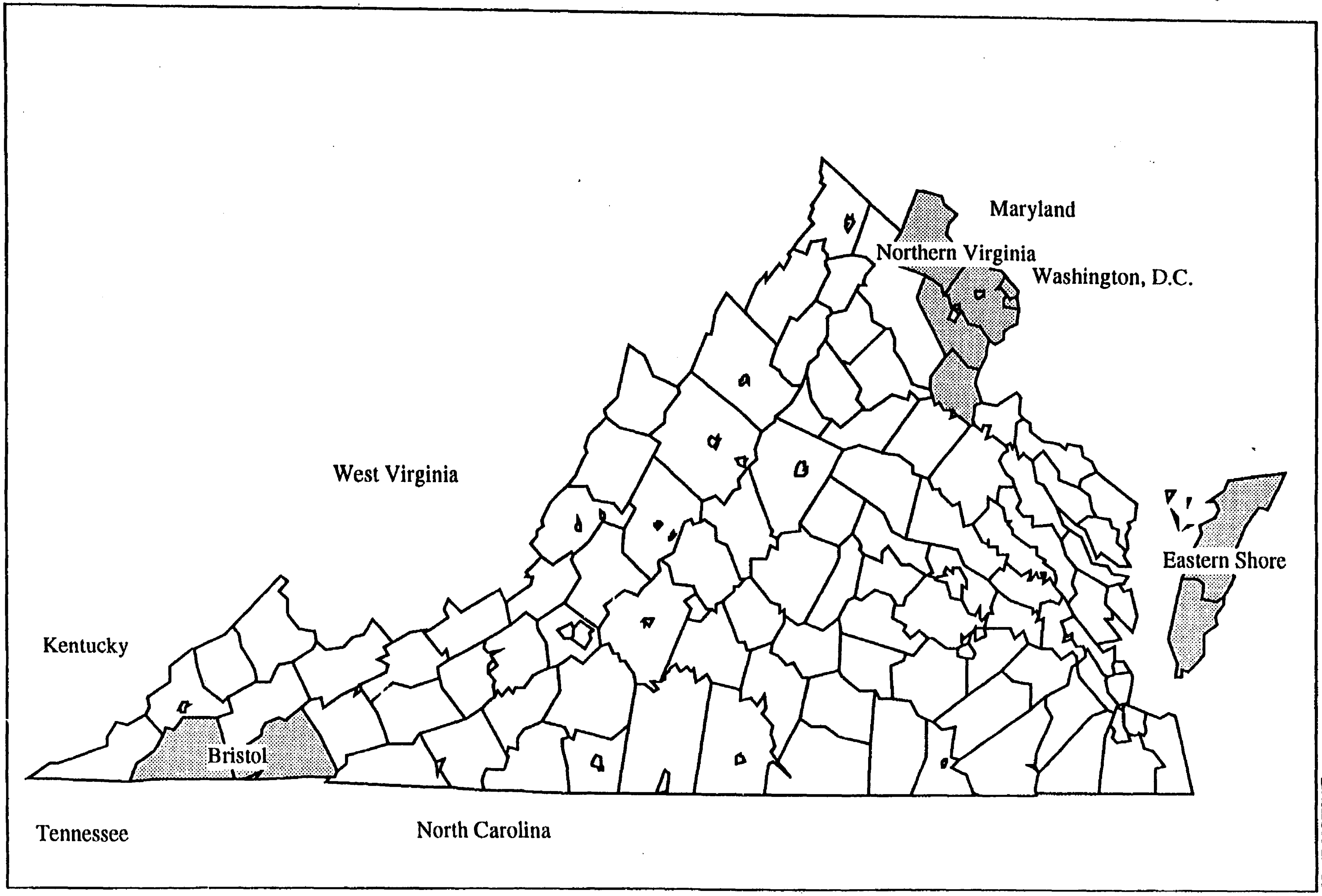


Exhibit II-19

Approximately 1.66 million Virginians live in these areas with cross-border activity potential — over 1.5 million of these residents live in Northern Virginia. Therefore, it appears that 27 percent of the 6.2 million Virginia residents are likely to engage in cross-border activity.

c. Accessibility

Accessibility to lower-tax areas is a factor in motivating cross-border activity when a border area has convenient highways, or its residents travel frequently back and forth, as in the case of commuters. With the other incentives held constant, an increase in the access to lower-taxed products would be expected to increase the level of cross-border activity. An example of convenient access would be the ability of commuters to buy relevant products during lunch breaks at work.

Virginians have ready access to alcohol in neighboring jurisdictions. As presented in Table II-11, in 1980, a significant number of Virginia residents worked in the District of Columbia and Maryland, where taxes on liquor are lower.[15] Because the population in the area has increased significantly, we believe that the commuter population in the Metropolitan Washington, D.C. area has also increased since 1980. This means that these Virginia residents have daily access to lower-priced liquor without having to make a special trip.

[15] As of November 12, 1992, figures on commuter traffic from the 1990 Census had not yet been released.

Table II-11

Virginia Residents Working in Neighboring Jurisdictions

Virginia residents working in Maryland	31,255
Virginia Residents working in D.C.	155,212
Virginia residents with daily access to lower-taxed spirits in the D.C. region	186,467

Source: U.S. Bureau of the Census, Commuter Traffic, 1980.

There are many conditions in Virginia that are conducive to cross-border alcoholic beverage activity. The following are the three areas that are particularly accessible to significant levels of cross-border liquor activity:

- The Interstate 95 and Beltway region connecting Maryland, the District of Columbia, and Virginia — The highly populated Washington, D.C. area forms the eighth largest metropolitan statistical area in the United States with 3.9 million residents.

- The Eastern Shore connecting Virginia and Maryland — A convenient, main highway, Route 13, connects Virginia's Accomack county with the state of Maryland

- Southwestern Virginia at the Tennessee border in Bristol — Bristol is a city that stretches across the Virginia-Tennessee border, allowing particularly free-flowing access to a neighboring state

d. Risk of Detection

When the risk of detection is low because of limited enforcement procedures or the absence of border checks, cross-border activity is more likely to occur. Ths risk of detection is one of the most important factors in motivating *organized* cross-border activity. Many goods are especially difficult to trace. For example, the U.S. Bureau of Alcohol, Tobacco, and Firearms generally does not get involved unless cross-border cigarette activity surpasses 300 cartons (60,000 cigarettes). Many states have laws placing limits on the amount of certain products that can be legally transported across state lines, but state-level enforcement is limited. *Casual* cross-border activity is relatively risk-free because residents are free to cross jurisdictional boundaries without being subject to border inspection.

e. Cost of Participating

The cost of participating in cross-border activity includes important considerations such as time and fuel costs. Other factors that weigh into the cost of participating include the level of a state's gasoline tax, the distance required to travel, and the potential penalties for being caught (e.g., if the risk of detection is lower, the cost of participating is also lower). The cost of participating in cross-border activity appears particularly insignificant in the Northern Virginia area.

3. Evidence of Cross-Border Liquor Activity

Table II-12 presents per capita sales of liquor in Virginia's surrounding jurisdictions. Per capita consumption in the District of Columbia is more than three times larger than the consumption in Virginia. Two possibilities may explain these sales differences:

- District of Columbia residents drink over 200 percent more liquor per capita than residents of Virginia
- The District of Columbia experiences a significant degree of cross-border activity, selling a large portion of its liquor to out-of-state consumers.

We believe that the District of Columbia's high sales (the highest per capita in the nation) can be attributed partially to the large number of Virginians purchasing liquor in the District.

Table II-12

Per Capita Sales of Liquor, 1990

State	Gallons Per Capita (Rank in U.S.)
Virginia	1.23 (36)
District of Columbia	4.05 (1)
Kentucky	1.14 (42)
Maryland	1.88 (10)
North Carolina	1.29 (32)
Tennessee	1.19 (40)
West Virginia	0.83 (50)
U.S. Weighted Average	1.51

Source: State Departments of Revenue and Distilled Spirits Council of the U.S. (DISCUS).

4. Cross-Border Activity and Privatization

Under a partially privatized system, we estimate prices would increase approximately 13 percent, utilizing a revenue neutral scenario. This price increase could subsequently augment the current incentives for Virginia residents to participate in cross-border liquor activity, which would result in some loss of revenue to the state. Although incentives to participate in cross-border activity would increase, we do not estimate that prices would increase enough to jeopardize revenue neutrality, particularly given the assumed increase in accessibility to liquor in Virginia under partial privatization. However, a more significant price increase could jeopardize revenue neutrality.

4. Cross-Border Activity and Privatization

Under a partially privatized system, we estimate prices would increase approximately 13 percent, utilizing a revenue neutral scenario. This price increase could subsequently augment the current incentives for Virginia residents to participate in cross-border liquor activity, which would result in some loss of revenue to the state. Although incentives to participate in cross-border activity would increase, we do not estimate that prices would increase enough to jeopardize revenue neutrality, particularly given the assumed increase in accessibility to liquor in Virginia under partial privatization. However, a more significant price increase could jeopardize revenue neutrality.

E. Private Sector Retail Analysis

In this section we discuss the impact of partial privatization in terms of the following:

- License revenues
- Overview of retailers
- Employment and wages generated
- Retail profits

1. License Revenues

a. Background and Requirements

Under partial privatization, there would be a significant increase in the number of retail licenses issued by the ABC. This increase would occur due to the creation of a new license classification that would permit the off-premise retail sale of liquor.

We assume that the requirements for off-premise sale of liquor would remain similar to the current requirements for the off-premise sale of beer and wine. Currently, retailers must sell $2,000 of food per month, and have $2,000 of food in inventory at all times in order to qualify for a license to sell beer and wine off-premises. For purposes of this analysis, we assume that the current minimum food requirement would apply to retailers for the off-premise sale of liquor.

b. Licenses Fees

As with other alcoholic beverage retailers licensed by the ABC, liquor retailers would be charged a license fee. We examined license fees in numerous non-control states that allow the off-premise sale of liquor to develop an estimate for an off-premise liquor license fee in Virginia. The average retail liquor license fee charged by states that allow the off-premise sale of liquor by private retailers is approximately $750, as presented in Exhibit II-20. For purposes of this analysis, we assumed that this average license fee would be charged to retailers in Virginia in a partially privatized system.

Restaurants in Virginia that currently pay as much as $1,500 (based on seating capacity) for a mixed beverage license would not be expected to pay the full $750 for the additional permit to sell liquor for off-premise consumption. We estimate that the license fee for restaurants that currently offer beer, wine, and liquor for on-premise consumption would be charged a license fee of $375 (i.e., 50 percent of the $750 off-premise fee) to sell liquor off-premise.

c. License Revenue Derived from Off-Premise Licensees

In order to estimate license revenue derived from off-premise licensees, we first estimated the number of off-premise licensees under partial privatization. To estimate the number of liquor licenses in Virginia under partial privatization, we examined liquor licenses on a per capita basis. We examined the number of retail liquor licenses issued in various license states in order to develop an estimate of the number of off-premise liquor licenses in Virginia under partial privatization. The states included in our analysis allow liquor to be sold in grocery and drug stores. For our analysis, we used data on the number of off-premise liquor licenses issued to retailers.

License Fees for Off–Premise Retail Liquor Licenses in License States

State	Average Fee for Off–Premise Retail Liquor License
Alabama	$750
Alaska	$750
Arizona	$50
Arkansas	$2,400
California	$400
Colorado	$500
Connecticut	$425
Delaware	$500
D.C.	$2,000
Florida	$881
Georgia	$100
Hawaii	$1,230
Illinois	$75
Indiana	$355
Iowa	$4,125
Kansas	$550
Kentucky	$400
Louisiana	$75
Maryland	$1,150
Massachusetts	$1,100
Minnesota	$550
Mississippi	$900
Missouri	$100
Nebraska	$150
New Jersey	$1,050
New Mexico	$750
New York	$734
North Dakota	$1,100
Oklahoma	$600
Rhode Island	$450
South Carolina	$600
South Dakota	$375
Tennessee	$500
Texas	$300
Wisconsin	$275
Wyoming	$900
Average License Fee	**$754.16**

To develop an estimate of average off-premise liquor licenses per capita, we divided the number of liquor licenses in the states we examined by the corresponding state population. We averaged these per capita liquor license estimates and multiplied this average figure by Virginia's state population to estimate the number of licenses in Virginia under partial privatization. In Table II-13 we present our calculations that estimate the number of off-premise liquor licenses in Virginia under partial privatization.

Table II-13

Estimate of Off-Premise Liquor License Revenue Under Partial Privatization

Number of Off-Premise Licenses	
Average of Per Capita Off-Premise Liquor Licenses (per thousand people)	.7880
Estimate of 1992 Population in Virginia (in thousands)	x 6,355
Estimate of Off-Premise Liquor Licenses in Virginia Under Partial Privatization	**5,008**
License Revenue Derived from Off-Premise Liquor Licenses	
Average Off-Premise Liquor License Fee	$750
Estimate of Off-Premise Liquor Licenses	x 5,008
Off-Premise Liquor Licenses Revenues	**$3,756,000**

Using the methodology described above, we estimate that approximately 5,008 off-premise liquor licenses would be issued to retailers such as grocery stores, drug stores, and liquor stores. Revenue derived from the issuance of these licenses would total approximately $3.8 million. In Table II-14 we present the number of retail licensees in other license states, as well as Michigan, a partially privatized state.[16] We believe that our estimate is comparable to the number of licensees in other states, particularly given that most of the other states in this table impose specific quotas on the number of retail liquor licensees.

In Virginia, there are currently 6,723 wine and beer off-premise licensees, which include grocery stores, drug stores, marina stores, delicatessens, and specialty shops.[17] Our estimate of 5,000 retail licensees assumes that approximately 75 percent of these wine and beer licensees would apply for a liquor license under partial privatization. This percentage does not account for the fact that there would probably also be liquor-only stores in a partially privatized system. Therefore, approximately 75 percent of current wine and beer off-premise licensees would also be retail liquor licensees under partial privatization.

Using our estimate of the average number of licensees per thousand people, we estimated the number of retail licensees in each county and independent city under partial privatization, as presented in Exhibit II-21. While rural area would have fewer establishments selling liquor for off-premise consumption than urban or suburban areas, there would be more retail liquor establishments in rural, urban, and suburban areas than there are in the current system. We estimate that each county and city would have at least one store licensed to sell liquor for off-premise consumption. Establishments

[16] See Appendix B, Comparison of Liquor Distribution Systems, for more detailed information on licensees in five control and five license states. Massachusetts is not included here because licenses are issued by individual local jurisdictions.

[17] According to 1992 VA ABC annual report data.

Estimated Number of Retail Liquor Licensees by County and Independent City

County	Population	Number of ABC Stores	Number of Retail Licensees
Accomack	31,703	3	25
Albemarle	68,040	2	53
Alleghany	13,176	0	10
Amelia	8,787	1	7
Amherst	28,578	2	22
Appomattox	12,298	1	10
Arlington	170,936	4	133
Augusta	54,677	2	43
Bath	4,799	1	4
Bedford	45,656	0	36
Bland	6,514	0	5
Botetourt	24,992	1	19
Brunswick	15,987	2	12
Buchanan	31,333	1	24
Buckingham	12,873	1	10
Campbell	47,572	1	37
Caroline	19,217	1	15
Carroll	26,594	1	21
Charles City	6,282	0	5
Charlotte	11,688	1	9
Chesterfield	209,274	5	163
Clarke	12,101	1	9
Craig	4,372	0	3
Culpeper	27,791	1	22
Cumberland	7,825	0	6
Dickenson	17,620	1	14
Dinwiddie	20,960	0	16
Essex	8,689	1	7
Fairfax	818,584	17	637
Fauquier	48,741	1	38
Floyd	12,005	0	9
Fluvanna	12,429	0	10
Franklin	39,549	2	31
Frederick	45,723	1	36
Giles	16,366	1	13
Gloucester	30,131	2	23

Estimated Number of Retail Liquor Licensees by County and Independent City

County	Population	Number of ABC Stores	Number of Retail Licensees
Goochland	14,163	1	11
Grayson	16,278	0	13
Greene	10,297	0	8
Greensville	8,853	0	7
Halifax	29,033	1	23
Hanover	63,306	2	49
Henrico	217,881	10	170
Henry	53,942	2	42
Highland	2,635	0	2
Isle of Wight	25,053	1	19
James City	34,859	0	27
King and Queen	6,289	0	5
King George	13,527	1	11
King William	10,913	0	8
Lancaster	10,896	1	8
Lee	24,496	0	19
Loudoun	86,129	3	67
Louisa	30,325	1	24
Lunenburg	11,419	2	9
Madison	11,949	1	9
Mathews	8,348	1	6
Mecklenburg	29,241	4	23
Middlesex	8,653	1	7
Montgomery	73,913	2	58
Nelson	12,778	2	10
New Kent	10,445	0	8
Northampton	13,061	2	10
Northumberland	10,524	1	8
Nottoway	14,993	2	12
Orange	21,421	2	17
Page	21,690	2	17
Patrick	17,473	1	14
Pittsylvania	55,655	2	43
Powhatan	15,328	0	12
Prince Edward	17,320	1	13
Prince George	27,394	0	21

Estimated Number of Retail Liquor Licensees by County and Independent City

County	Population	Number of ABC Stores	Number of Retail Licensees
Prince William	215,686	5	168
Pulaski	34,496	1	27
Rappahannock	6,622	0	5
Richmond	7,273	1	6
Roanoke	79,332	3	62
Rockbridge	18,350	0	14
Rockingham	57,482	0	45
Russell	28,667	0	22
Scott	23,204	1	18
Shenandoah	31,636	2	25
Smyth	32,370	0	25
Southampton	17,550	1	14
Spotsylvania	57,403	0	45
Stafford	61,236	1	48
Surry	6,145	0	5
Sussex	10,248	2	8
Tazewell	45,960	3	36
Warren	26,142	1	20
Washington	45,887	1	36
Westmoreland	15,480	2	12
Wise	39,573	3	31
Wythe	25,466	1	20
York	42,422	2	33

Estimated Number of Retail Liquor Licensees by County and Independent City

Independent City	Population	Number of ABC Stores	Number of Retail Licensees
Alexandria	111,183	3	87
Bedford	6,073	1	5
Bristol	18,426	1	14
Buena Vista	6,406	1	5
Charlottesville	40,341	3	31
Chesapeake	151,976	3	118
Clifton Forge	4,679	1	4
Colonial Heights	16,064	1	12
Covington	6,991	1	5
Danville	53,056	3	41
Emporia	5,306	1	4
Fairfax	19,622	2	15
Falls Church	9,578	2	7
Franklin	7,864	1	6
Fredericksburg	19,027	4	15
Galax	6,670	0	5
Hampton	133,793	6	104
Harrisonburg	30,707	2	24
Hopewell	23,101	2	18
Lexington	6,959	1	5
Lynchburg	66,049	5	51
Manassas	27,957	1	22
Manassas Park	6,734	0	5
Martinsville	16,162	1	13
Newport News	170,045	4	132
Norfolk	261,229	8	203
Norton	4,247	1	3
Petersburg	38,386	2	30
Poquoson	11,005	0	9
Portsmouth	103,907	5	81
Radford	15,940	1	12
Richmond	203,056	14	158
Roanoke	96,397	5	75
Salem	23,756	1	18
South Boston	6,997	1	5
Staunton	24,461	1	19
Suffolk	52,141	3	41
Virginia Beach	393,069	7	306
Waynesboro	18,549	1	14
Williamsburg	11,530	1	9
Winchester	21,947	1	17

Table II-14

Number of Off-Premise Licensees in Various States

State	Number of Retail Liquor Licensees
Michigan *	4,012
Indiana **	1,633
Louisiana	3,121
Maryland ***	1,137
Missouri	4,136

* Michigan places a quota on the number of off-premise retail licensees: 1 license for every 3,000 in population.

** Indiana places a quota on the number of liquor, beer and wine package store permits: 1 permit for each 5,000 persons.

*** Local boards issue a specific number of retail licenses for an election district — may be increased for demonstrated need and accommodation of community.

selling liquor for off-premise consumption could include grocery stores, convenience stores, drug stores, certain filling stations, liquor-only stores, or restaurants that are currently licensed to sell liquor for on-premise consumption.

According to Exhibit II-21, Fairfax County would have 637 establishments selling liquor for off-premise consumption. This estimate is comparable to the number of food, drug, and service station retail establishments that currently operate in Fairfax County. These establishments could qualify to be retail liquor licensees under partial privatization. As presented in Table II-15, there are 794 food and drug establishments and service stations in Fairfax County. In addition to these types of establishments, there could be liquor-only type stores. The total number of existing retail establishments, and the number of estimated retail liquor licensees, are also similar for other counties in Virginia.

Table II-15

Number of Retail Establishments in Fairfax County

Type of Establishment	Number
Food Store	413
Gasoline Service Stations	283
Drug Stores and Proprietary Stores	98
Total	**794**

Source: County Business Patterns, 1989: Virginia.

d. License Revenue Derived from On-Premise Licensees

In addition to off-premise liquor licenses, we estimate that approximately 35 percent of the establishments that hold on-premise liquor licenses would apply for off-premise liquor licenses. We based this estimate on the percentage of establishments in Virginia that currently hold licenses to sell beer and wine for off-premise consumption, in addition to on-premise consumption (i.e., 35 percent of all establishments that hold an on-premise license also hold an off-premise license). Given that 2,793 establishments currently hold on-premise liquor licenses, we estimate that

1,005 of these establishments would apply for an off-premise liquor license.[18] At a cost of $375 per license, we estimate that revenue derived from on-premise licensees would total $376,875, as presented in Table II-16.

Table II-16

Estimate of On-Premise Liquor License Revenue Under Partial Privatization

Number of On-Premise Licensees that Apply for an Off-Premise License		
Wine/Beer On-Off Premise Licenses in Virginia		2,018
Total Wine/Beer On and On-Off Premise Licenses in Virginia	÷	5,640
Percentage of On-Premise Licensees Who Hold Off-Premise Licenses		36%
* * * *		
On-Premise Liquor Licenses in Virginia *		2,793
Percentage of On-Premise Licensees Who Hold Off-Premise Licenses	x	36%
Number of On-Premise Licensees that Apply for an Off-Premise License		1,005
License Revenue Derived from On-Premise Licensees		
Off-Premise Liquor License Fee for On-Premise Licensees		$375
Estimate of On-Premise Licensees that Apply for an Off-Premise License	x	1,005
Off-Premise License Revenues from On-Premise Licensees		$376,875

* Includes restaurants, caterers, and clubs that sell liquor for on-premise consumption.

[18] Establishments holding on-premise liquor licenses include restaurants, caterers, and clubs.

As presented in Table II-17, we estimate that total retail liquor license revenue under partial privatization would be $4.1 million. Given the current license revenue level of $6.1 million, total license revenue would be $10.2 million under partial privatization.

Table II-17

Total Off-Premise Liquor License Revenue Under Partial Privatization

License Revenue Derived from Off-Premise Licensees	$3,756,000
License Revenue Derived from On-Premise Licensees	$376,875
Total Off-Premise Liquor License Revenue	$4,132,875

2. Overview of Retailers

Below we present an overview of the retail market likely to develop in Virginia following partial privatization.

a. Selection of Merchandise

Selection of merchandise would likely remain at least as extensive as it is in the current system, given the experiences of Iowa and West Virginia. Iowa now lists over 1,100 products, 200 more than it listed before privatization. However, the number of different products in any particular store may be lower, particularly in the smaller, rural stores. In West Virginia, the number of products available through the state has increased from 850 to 1,700 with the implementation of privatization. Given that ABC already carries a price list with nearly 1,400 items, the selection of merchandise available for sale may not increase dramatically with privatization.

Although the list of products may remain as extensive as it is under the current system, partial privatization may create variances in the selection of merchandise throughout Virginia. ABC stocks a wide selection of liquors, some of which are not as profitable as others. Retailers in the private sector may not have the incentive to stock unprofitable merchandise, reducing the selection of liquor in Virginia, particularly in rural areas. The transfer of warehouse operations to a modified bailment system would place the manufacturers in control of the selection of merchandise available to retailers.[19] Manufacturers would have little incentive to stock the ABC warehouse with merchandise that is unprofitable or not demanded in significant quantities. Therefore, consumers in a partially privatized system may have to place an increased number of special orders in order to get liquor products that are not carried in private retail stores.

[19] ABC would maintain the master list of liquors able to be sold in Virginia.

b. Hours of Operation

Most ABC stores open at 10:00 a.m. and close between 6:00 p.m. and 9:00 p.m., Monday through Saturday. All stores are closed on Sunday. Off-premise beer and wine licensees can sell beer and wine from 6:00 a.m. to 12 midnight, seven days a week. Hours of operation for off-premise liquor licensees would likely be similar to those of beer and wine licensees. Under partial privatization hours of operation would likely increase from their current level of 48 to 66 hours per week to 126 hours per week.

The experiences of Iowa and West Virginia support our assumption of increased hours of operation under partial privatization. In both Iowa and West Virginia, hours of operation increased upon the implementation of partial privatization. Before privatization in Iowa, state stores were generally open from 12:30 p.m. to 6:00 p.m. in rural areas and 10:00 a.m. to 9:00 p.m. in metropolitan areas. Under Iowa's partially privatized system, stores may be open from 6:00 a.m. to 2:00 a.m., Monday through Saturday, and 10:00 a.m. to 12 midnight on Sundays. According to state officials, retail stores in Iowa generally do not choose to remain open until 2 a.m., however. In West Virginia, retail stores are allowed to be open 137 hours a week, but the average is 76.5 hours of operation per week.

c. Retail Sector Pricing Patterns

In liquor retail markets there is a great deal of observed variation in retail prices, some of which can be attributed to competitive differences among retailers. Retailers in suburban areas and medium-sized cities may have lower prices than retailers located in dense, urban areas or less-populated, rural areas. Difference in location within a metropolitan area, such as a downtown area versus a more residential shopping area, may also contribute to differences in price levels. In addition, the proximity of competitors can affect the observed price level. Finally, some stores may undertake a discount pricing strategy, while others may set prices higher in order to specialize or offer more services.

The implication of these pricing patterns is that the majority of the population in the state may have a lower-than-average price available to them. Consumers living within range of a medium-sized or larger city would likely have access to a store with discount prices. However, some consumers would not live within range of a discount store, and would likely pay the average price or a higher price for liquor.[20] Consumers living in the Northern Virginia, Richmond, and Norfolk areas would likely experience some discount pricing. The population in these areas constitutes approximately 61.2 percent of the total Virginia population.[21] Therefore, the majority of Virginians would probably have access to some discount pricing in private retail stores.

The variation in retail prices and pricing strategies complicates this analysis. While this variation would work to the benefit of many Virginia consumers, consumers in areas with fewer stores would be less likely to benefit from competitive pricing. However, the tax and mark-up levels set by the state are likely to have a greater impact on prices than variation in retail pricing strategies.

d. Acceptance of Credit

ABC stores currently accept credit cards, in addition to cash, as a form of payment for alcohol. Given that many private sector retailers accept credit cards, it appears likely that private retail stores selling liquor would accept credit cards as well.

[20] The willingness of consumers to drive greater distances in order to gain savings in price has been examined in other studies and found to be significant. This implies that to a certain extent, consumers will go farther than the nearest store to make their purchases.

[21] The total Virginia population was 6.2 million in 1990. The Richmond area population was 866,000; the Norfolk/Virginia Beach/Newport News MSA population was 1.4 million; the Northern Virginia population was 1.5 million, for a total of 3.8 million living in areas where discount liquor pricing could be expected.

e. Availability and Price of Liquor Under Partial Privatization: A Selected Comparison

In changing over from a control system of liquor distribution to a license system, two of the most visible changes to the consumer would the availability and price of liquor. We discuss elsewhere the anticipated change in the number of establishments selling liquor. Below, we discuss changes in the selection of liquors available at private sector establishments and how prices might be affected under such a system.

To examine these issues in Virginia, we conducted an informal telephone survey of businesses in the two states that have recently privatized the retail sale of liquor: West Virginia and Iowa. Before we began, we asked the Merchandising Division of Virginia ABC to name several types of liquor that would fall into the following three categories under a potential privatized system:

- Easy to find
- Somewhat difficult to find
- Very difficult to find

Virginia ABC estimated that the following liquors fell into these categories:

- Easy to find — Smirnoff Vodka #21, Jim Beam Bourbon, Jack Daniel's Old No. 7 Black Label Whiskey, and Aristocrat Vodka.
- Somewhat difficult to find — Mattingly & Moore Bourbon, Old Crow Bourbon, Bourbon Supreme Rare, Gilbey's Vodka, and Gordon's Vodka.
- Very difficult to find — Elmer T. Lee Bourbon, Glenmore Vodka, Skol Vodka, Burnett's Vodka, Booker's Bourbon, Benchmark Bourbon, and Martel V.S. Cognac.

Based on ABC's response, we selected the following five types of liquor to include in our survey, with at least one type of liquor for each of the above categories:

- Jim Beam Bourbon (750ml)
- Mattingly & Moore Bourbon (750ml)
- Gilbey's Vodka (1.75l)
- Glenmore Vodka (1.75l)
- Elmer T. Lee Bourbon (750ml)

We contacted ten retail stores in each state, some in larger cities, some in smaller towns. We asked each store whether it carried our selection of liquor and, if so, the price it charged to consumers for the liquor. We present the results of our informal survey in Table II-18.

Table II-18

Results of Informal Telephone Survey

	VA ABC Price	West Va. Average	Places Available*	Iowa Average	Places Available*
Jim Beam Bourbon (750ml)	$8.65	$7.93	10	$7.34	10
Mattingly & Moore Bourbon (750ml)	$7.15	$6.97	3	$7.63	4
Gilbey's Vodka (1.75l)	$12.90	$10.38	9	$14.43	9
Glenmore Vodka (1.75l)	$15.25	n/a	0	n/a	0
Elmer T. Lee Bourbon (750ml)	$16.35	n/a	0	n/a	0

* Number of places in which liquor type was available out of ten stores surveyed.

Based on anecdotal evidence, we believe that under a privatized system of liquor distribution, the following would likely take place:

- Selection of Liquor — Private retailers in smaller cities or localities would be less likely to have a large selection of liquor in their stores than retailers in large cities. According to this evidence, it is likely that private sector liquor retailers, particularly those in more rural areas, would not carry the full line of products offered for sale through the Virginia ABC under a partially privatized liquor distribution system.

- Retail Pricing — Much like with other retail product lines, the consumer may have the opportunity to shop for liquor in discount stores that employ aggressive pricing strategies. Liquor in these types of establishments would cost less than in specialty shops.

- Emergence of Larger Stores to Supplement Stores with Smaller Selection — In West Virginia, one retail store chain that sells liquor has opened separate shops specializing in the sale of liquor. These stores typically carry much more than the main retail stores, but are located only in populated areas where demand is higher.

- Level of Stock Carried Relative to Stock Available for Purchase — Regardless of their location (e.g., rural, suburban, or urban), private retailers will be unlikely to carry the full state list of products available for sale.

- Prices of Various Brands of Liquor — It is possible that more popular brands of liquor (e.g., Jim Beam Bourbon) would be sold at a lower price than under a state control system. Other liquors not sold in as high a volume might cost less under a state control system. This is because states tend to use the same mark-up system for all brands of liquor. Private retailers are more likely to apply different mark-ups to different products. They are likely to employ more aggressive pricing strategies for popular, high volume brands, while charging higher prices for those brands that are not sold in as high of a volume.

This informal survey was not intended to be statistically valid, but rather was intended to provide some primary data related to selection to reinforce our hypotheses about what would happen to selection and price under a privatized scenario.

3. Employment and Wages Generated

We estimated private sector employment and wages generated under partial privatization by examining the number of jobs, average compensation, and total retail sales of food stores, and drug and proprietary stores, in the state of Virginia.[21] We based our estimates on retail food stores and drug/proprietary store sectors because retail liquor sales in Virginia under partial privatization would most likely be composed of these two sectors.

a. Employment

In Table II-19 we present the procedure we used to develop our estimate of private sector employment generated under partial privatization. This procedure involves determining the number of employees who would be employed to support private sector liquor retailing. Our estimate is based on the amount of retail sales that each employee within that sector supports. To develop this estimate, we used total employment in the food stores and drug and proprietary stores sectors and divided employment by the total sales in these sectors. This calculation yields the retail sales generated by each employee. Using this calculation, we can estimate the employment generated through the increase in sales that results from food and proprietary stores selling liquor. We develop our calculation of employment generated below.

As illustrated in Table II-19, we first estimate total retail sales of liquor in Step 1. From our calculations (which use figures developed in the financial analysis section), we estimate that total retail sales of liquor would total approximately $325.6 million. In Step 2 we estimate the amount of sales each employee generates in the food store and drug/proprietary store sectors in Virginia. Based on our calculations, we estimate that

[21] The SIC Code for food stores is 54, and the SIC code for drug and proprietary stores is 591.

each employee in the food store and drug/proprietary store sector generates approximately $104,000 in retail sales.

Table II-19

Procedure Used to Estimate of Private Sector Employment Generated Under Partial Privatization

1. Estimate the level of retail liquor sales in Virginia under partial privatization:*

Number of Gallons Sold (in millions)	6.83
Retail Price per Gallon	x $47.69
Total Retail Sales of Liquor (in millions)	$325.532

2. Estimate retail sales per employee in the retail food store and drug/proprietary store sector:**

Total Retail Sales	$9,332,067,000
Total Number of Employees	÷ 90,079
Retail Sales per Employee	$103,599

3. From Step 1 and Step 2 above, we total employment generated under partial privatization.

Estimate from Step 1	$325,532,000
Estimate from Step 2	÷ $103,599
Number of Jobs Supported by Liquor Sales in Virginia Under Partial Privatization	3,143

* Assuming a revenue neutral scenario

** Source: U.S. Bureau of the Census, County Business Patterns, 1987
U.S. Bureau of the Census, Census of Retail Trade, 1987

Using the estimates calculated in Step 1 and Step 2, we estimate that the $326 million in retail liquor sales would generate 3,143 ($325,532 divided by $103,599) jobs in Virginia under partial privatization.

b. Wages

We based our estimates of wages generated under partial privatization on average wages in the food stores and drug/proprietary store sector. As presented in Table II-20, we estimated that annual wages generated under partial privatization would total approximately $36.2 million.

Table II-20

Estimate of Wages Generated in Virginia Under Partial Privatization

Total Annual Wages	$1,038,503,000
Total Number of Employees	÷ 90,079
Average Annual Wages Per Employee	$11,529
Estimate of Total Employment	3,143
Average Annual Wages	x $11,529
Total Annual Wages Generated Under Partial Privatization	$36,235,647
Personal Income Taxes	$1,723,101

Source: U.S. Bureau of the Census, County Business Patterns, 1987
U.S. Bureau of the Census, Census of Retail Trade, 1987

As presented in Table II-20, we estimate that average annual wages per employee in the food store and drug/proprietary store sector are approximately $11,529. We calculated average annual wages per employee by dividing total annual wages in these sectors by the total number of employees. Total annual wages are calculated by multiplying our estimate of 3,143 employees in these sector by the average annual wages per employee.

Using a tax rate of approximately 4.76 percent, we estimate that personal income taxes collected by the state of Virginia from employees in private sector retail sales would total approximately $1,723,101. However, the initial impact of partial privatization would eliminate many ABC positions, creating a net loss of approximately $950,705 in personal income taxes to the state of Virginia.

5. Retail Profits

We estimated retail profits based on a net profit margin of 5 percent. As previously discussed, we estimate that under partial privatization approximately 6.83 million gallons of liquor would be sold in Virginia, yielding annual net profits to retailers of approximately $16.3 million.

Table II-21

Net Profits in Retail Sector Under Partial Privatization

Estimate of Total Retail Sales (in thousands)	$325,532
Estimate of Net Profits	$16,277
Estimate of Corporate Taxes	$977

Control and Regulation

This section contains the following:

- Introduction
- Control
- Legal Issues

F. Control and Regulation

1. Introduction

Thus far, we have focused largely on the economics of partial privatization. In addition to the economics, we have examined the issue of control. Because alcohol can be viewed as a potentially dangerous and addictive substance, some would argue that there is a compelling public interest for state involvement in liquor distribution. One of the main purposes of the Virginia Department of Alcoholic Beverage Control is to control the distribution and consumption of alcohol. In this section, we address some of the issues associated with control and how privatization might impact these issues. We conclude this section by looking at some of the legal issues associated with partial privatization.

2. Control

In our interviews with industry groups, religious groups, non-profit groups and associations, and Virginia legislators, the issue of control was highlighted as the major advantage of the current system. However, control appears to be a multi-faceted concern that encompasses several issues. In this section, we define the issues that were most often associated with control in our interviews and highlight the concerns, questions, and problems raised regarding control in a privatized system. Finally, we analyze these concerns and problems, largely through an examination of experiences in other partially privatized and license states.

a. Control Issues

Throughout our interviews, several issues associated with control came up repeatedly:

- Safety — Level of alcohol-related crime, including driving under the influence of alcohol. Enforcement of laws relating to the public safety currently rests primarily with state and local police.
- Education — Education of the general public and teenagers about various alcohol-related issues, and training of sales personnel and servers to ensure compliance with ABC laws and regulations.
- Enforcement — Licensee activities (processing and investigating license applications and monitoring licensee operations) and some criminal violations (underage drinking, public intoxication).
- Consumption — Impact of a particular liquor distribution system on alcohol consumption.
- Accessibility — Factors such as the number of stores, their location, and hours of operation.

Participants in our survey of Virginia residents raised some of the above issues when asked about their opinion of a privatized system of liquor distribution, as presented in Table II-22. Of those who strongly or somewhat disapprove of a system of privately-owned liquor stores, the reasons that the majority cite are that there would not be enough control and that liquor would be too accessible.

Table II-22

Survey of Virginia Residents

Question: **What concerns, if any, do you have about liquor being sold in privately-owned, licensed liquor stores, rather than in state-run ABC stores?**

Not enough control/too accessible	57.1%
No concerns	37.3%
Underage drinking	33.3%
Don't know	14.1%
Other	10.8%
Prices too high	10.1%
Against drinking	8.9%
Street crime	8.6%
Alcohol consumption increase	8.5%
Alcoholism increase	5.7%
Drunk driving increase	5.7%
Domestic violence	2.8%
Loss of state revenue	2.8%
Too many liquor stores	2.1%
License problems	1.6%
Store Appearance	1.0%
Monopoly	1.0%
ABC employees would lose jobs	0.8%
Refused	0.8%

Note: Survey participants could give more than one answer.

b. Safety

Interviewees generally highlighted the following two issues when referring to the safety aspect of control:

- General crime and violence
- Driving under the influence

In regards to general crime and violence, there was concern that liquor stores are often associated with violence. Along those same lines, it was thought by some that privatization would bring an increase in the number of crimes.

Private liquor stores were viewed by some to be candidates for hold-ups. In contrast, the current "somber" atmosphere in state stores discourages criminal activity, according to some. In addition to an increase in general crime, some thought that privatization could result in an increase in drinking and driving. This view was prevalent among those who thought privatization would result in increased alcohol consumption.

It is not certain whether alcohol-related crimes would necessarily increase under partial privatization. As presented in Exhibit II-22, the difference between control and license states in DUI arrest rates and alcohol-related arrest rates is not statistically significant.[23] It appears from these statistics that the method of liquor distribution in a state is not strongly related to the level of alcohol-related crime. However, despite the fact that alcohol-related crime may not necessarily increase, there could still be the perception among Virginians that a partially privatized system is less safe than the current system due to the concerns described above.

[23] We took these data from a 1992 performance audit of the Pennsylvania Liquor Control Board. In the report, analysis of variance was used to test the statistical significance of differences between control and license states in public health and safety rates. The report found no statistically significant differences (at a 0.05 level of significance) between control and license states for seven indicators of health and safety risks.

Per Capita Rates of Public Health and Safety Risks

(per 100,000 population)

Measures	National Average	Control States	License States	Virginia
Alcohol-Related Traffic Fatalities, 1989	8.73	8.53	8.84	7.49
DUI Arrests, 1989	537	555	528	761
Alcohol-Related Arrests, Other Than DUI, 1989	752	712	775	1339
Alcohol-Related Homicide	7.29	5.90	8.00	8.30
Alcohol-Related Suicide	12.74	13.30	12.50	13.30
Death from Alcoholism	2.26	2.00	2.40	2.50
Death from Cirrhosis	10.83	10.20	11.20	10.30

Source: Performance Audit: Pennsylvania Liquor Control Board, Pennsylvania General Assembly, Legislative Budget and Finance Committee, May 1992

Iowa's experience with partial privatization seems to support the statistics presented in Exhibit II-22. Iowa does not appear to have had an increase in alcohol-related crimes since privatizing the retail sale of liquor. After-hours sales are generally only a problem with on-premise establishments and retailers are not usually open until 2:00 a.m., the hour at which alcohol sales must cease. In addition, the Alcoholic Beverages Division of Iowa has not seen a proliferation of armed robberies in stores selling liquor since privatization.

c. Education

Those whom we interviewed raised the issue of education largely in regard to the training of personnel in a private system. Many of the ABC personnel go through formal training programs, such as Training for Intervention Procedures by Servers of Alcohol (TIPS), and there was concern that employees in private industry would not be as trained to comply with ABC laws and regulations. Interviewees generally did not seem concerned with changes in education of the general public in a privatized system.

Under partial privatization, alcohol-related education programs would remain in place. Because ABC currently has extensive public education activities, we estimate that education programs for the general public would remain unchanged from the current system and, therefore, would not require any additional resources. However, with the creation of a retail liquor license, resources for programs like TIPS would need to be increased. Money for these programs would be appropriated to ABC by the state. However, education expenses currently represent a relatively small proportion of the operating budget and we do not expect that education resources would increase significantly relative to other portions of the budget under partial privatization. In addition, ABC could initiate user fees for these programs to defray their costs if necessary to maintain revenue neutrality.

Education programs have not changed dramatically in Iowa with the implementation of privatization. In Iowa, the money allocated towards education and prevention programs has remained relatively stable and has been more dependent on the availability of funds rather than the type of liquor distribution system in place. Training of servers is community-specific and, as such, varies across the state depending on the emphasis placed on training by a community. Based on the experience of Iowa, it would appear that education resources are not dependent on the type of liquor distribution system in place.

d. Enforcement

The issue of enforcement was raised by many interviewees as a serious concern that they had about a private system, largely because of the potential for increased underage consumption and the selling of alcohol to intoxicated persons. Some thought that stores in a private system have a greater incentive to break the law (e.g., selling alcohol to minors and to intoxicated people) because of their profit motive and their perceived continuous efforts to increase profits.

Those who were concerned with enforcement thought that strict controls and monitoring would have to implemented in order to minimize underage buying and overconsumption. Part of this increased enforcement effort would probably require an increase in special agents, some thought, particularly since some thought that ABC already has difficulty meeting the needs of enforcement in the bars.

Although enforcement was a concern of many, not everyone to whom we talked thought that enforcement would be a greater problem under a private system. Those holding this view thought that the state would not lose control through privatization if adequate laws and regulations were in place currently, and if requirements imposed in a private system were the same as in the current system. It was thought, however, by some that the enforcement system would be more effective if run by a state liquor commission rather than by state or local police.

As presented earlier in Exhibit II-22, there is not a statistically significant difference between control and license states in the rate of alcohol-related arrests other than DUI. In general, a state's liquor distribution system does not appear to be strongly related to the rate of alcohol-related crime in the state, or the corresponding level of enforcement effort. Therefore, it is difficult to predict whether alcohol-related crime, and enforcement effort needed to combat this crime, would necessarily have to increase in a privatized system.

Even though it is not certain whether alcohol-related crimes would necessarily increase under partial privatization, we estimate that the number of special agents in the Regulatory Division of ABC would increase by 30 employees in a partially privatized system. We estimate an increase in this division because of the increase in the number of licensees and the need to effectively monitor new retail liquor licensees. Through this increase, ABC would be able to keep the same number of Regulatory Agents per retail license as it has in the current system. Responsibilities of special agents would remain similar to those in the current system and would include:

- Inspecting and providing personal assistance to licensees
- Collecting license fees
- Working with other law enforcement agencies to enhance prevention and reduce violations and criminal activities

In addition to the above responsibilities, special agents would be engaged in periodic monitoring of licensees to ensure compliance with ABC laws and regulations under partial privatization.

e. Consumption/Sales of Alcohol

We did not find a general consensus among our interviewees on the impact that privatization would have on consumption. For those who thought consumption would increase, it was largely because of increased availability, advertising, and willingness of private sector employees to sell to consumers. Those thinking that consumption would not increase pointed out that there is no higher degree of alcohol dependency in license states and that ABC does not currently control the consumption of alcohol, only the point of purchase. It was also thought by some that people would not drastically change their consumption patterns, even if prices were to decline, or increase.

The 1992 performance report of the Pennsylvania Liquor Control Board found no statistically significant difference between per capita consumption rates in control and license states. As presented in Table II-23, the national average per capita consumption of alcohol in 1989 was 1.88 gallons, average control state per capita consumption was 1.77 gallons, and average license state per capita consumption was 1.95. Per capita consumption for Virginia was 1.79 gallons. Therefore, existing evidence does not appear to support the notion that privatization would necessarily lead to significantly higher per capita alcohol consumption.

Table II-23

Apparent Per Capita Consumption of Alcohol, 1989

	National Average	Control States	License States
Per Capita Consumption of: *			
Beer, Wine, and Spirits	1.88	1.77	1.95
Wine and Spirits Only	0.82	0.75	0.86

* In gallons of absolute alcohol

In addition to the above statistics, the experience of Iowa appears to show that privatization would not necessarily cause an increase in the consumption of alcohol. Adult per capita consumption in Iowa was 1.02 gallons in fiscal year 1986, the year before privatization occurred. For fiscal years 1988 and 1989, per capita consumption was 1.0 gallons and 0.97 gallons, respectively. Iowa allows retail stores to offer samplings and tastings of distilled spirits on premises and retailers may advertise and offer coupons and/or rebates to consumers. Though retailers are able to advertise and use other promotion efforts, per capita consumption has been on the decline in Iowa since privatization.

f. Accessibility

In our interviews we found some concern that accessibility to alcohol in a private system would be greater than in the current system, resulting in decreased control over liquor consumption. In the current system, some thought that it was more difficult for minors and intoxicated persons to have access to alcohol. Some thought that ABC stores are viewed as "imposing places" — stores tend to be orderly and have at least two clerks. This appearance of control deters minors from trying to buy liquor, some thought.

Other reasons given for the increase in accessibility in a private system include a growth in the number of stores and their hours of operation. Some thought that the state currently can better control the situation because there are fewer stores, but under privatization an increase in the number of stores would occur. Some thought "there would be a liquor store on every corner." In addition to the increased number of stores, there was concern that stores would be open too many hours, giving underage drinkers increased opportunity to buy alcohol.

Increased accessibility in a privatized system also seems to be a concern of Virginia residents. As mentioned previously, of those who strongly or somewhat disapprove of a privatized system, 57.1 percent think that liquor would too accessible. Furthermore, disapproval of privatization increases significantly when grocery and convenience stores are included, in addition to privately-owned liquor stores, in the liquor distribution system, as presented in Table II-24.

Table II-24

Survey of Virginia Residents

Question: **How do you feel about liquor being sold in privately-owned, licensed liquor stores rather than in state-run ABC stores?**

Strongly disapprove	36.4%
Somewhat disapprove	15.3%
Somewhat approve	20.5%
Strongly approve	18.6%
Don't know	8.9%
Refused	0.4%

Question: **In addition to liquor being sold through privately-owned, licensed liquor stores, how would you feel if liquor were allowed to be sold in grocery stores and convenience stores?**

Strongly disapprove	58.8%
Somewhat disapprove	15.1%
Somewhat approve	13.1%
Strongly approve	9.5%
Don't know	3.4%
Refused	0.1%

Accessibility to alcohol, as defined by the number of stores and hours of operation, would likely increase in a partially privatized system. The degree to which accessibility would increase depends on state regulations in a private system. In Iowa, privatization has resulted in twice the number of stores selling liquor and longer hours of operation. Before privatization, Iowa had 220 state stores open from 12:30 p.m. to 6:00

p.m. in rural areas and from 10:00 a.m. to 9:00 p.m. in urban areas. Iowa currently has nearly 440 private stores selling liquor that can be open from 6:00 a.m. to 2:00 a.m. Monday through Friday and 10:00 a.m. to 12 midnight on Sundays.

West Virginia has not had a great increase in the number of stores because the state has restricted the number of stores in its private system (while 214 stores are permitted, 156 stores are currently operating). Private stores are open an average of 76.5 hours per week out of the 137 hours allowed by the state, which is longer than the operating hours were when the state owned retail stores.

In the current system, ABC stores are open an average of 48 to 66 hours per week. Under partial privatization, we estimate that establishments with retail liquor licenses would be able to operate the same number of hours as current holders of beer and wine retail licenses. These licensees are permitted to sell alcoholic beverages from 6:00 a.m. to 12 midnight, seven days a week (for a maximum of 126 hours per week). Furthermore, as mentioned in a previous section, we estimate that 5,000 establishments would be licensed to sell liquor for off-premise consumption under partial privatization, a significant increase from the current number of 243 ABC stores.

g. Summary

The existing statistical evidence from both license and control states appears to suggest that there is not a strong relationship between the type of liquor distribution system in a state and the level of alcohol-related crime and per capita alcohol consumption. Therefore, it is not certain that privatization would necessarily lead to an increase in crime or an increase in alcohol consumption. It does appear, however, that privatization would lead to an increase in the accessibility to alcohol.

Depending on whether alcohol-related crime is related to accessibility to liquor or liquor consumption, alcohol-related crimes, such as burglary, may or may not increase under partial privatization. However, because it would be characterized by increased accessibility, a partially privatized system may appear to some Virginians to have less control than the current system, even if this increased accessibility does not lead to a corresponding increase in alcohol-related crime or consumption. According to our survey of Virginia residents, most Virginians appear to like the current system of liquor distribution, as presented in Table II-25. Of those who strongly or somewhat approve of the current system, the reasons that the majority cite for their approval are that the system maintains control and limits accessibility, as presented in Table II-26.

Table II-25

Survey of Virginia Residents

Question:	**How do you feel about keeping the current system?**	
	Strongly disapprove	16.4%
	Somewhat disapprove	13.1%
	Somewhat approve	23.5%
	Strongly approve	39.9%
	Don't know	6.9%
	Refused	0.1%

Table II-26

Survey of Virginia Residents

Question: **What do you like about the current system of ABC stores?**

Maintains control/limits accessibility	53.9%
Underage drinking low	23.6%
Don't know	21.7%
Against drinking	9.3%
State earns revenue	5.1%
Prices low	4.7%
Other	3.4%
Convenient/accessible	3.2%
Street crime low	2.5%
Uncertainty involved in change	2.0%
Alcohol consumption low	1.7%
Domestic violence/disputes low	1.5%
Uniform pricing in all stores	1.3%
Drunk driving low	1.3%
Service	0.8%
Refused	0.6%
Alcoholism low	0.3%

Note: Survey participants could give more than one answer.

3. Legal Issues

This section addresses various legal issues involved in the implementation of a partially privatized system. We analyze these issues as they might relate to Virginia under partial privatization.

a. Virginia Under a Partially Privatized System

Below, we describe several issues areas that would require legal or regulatory consideration under partial privatization. Prior to discussing these areas, it must be noted that there is a wide range of alcoholic beverage rules and regulations among the states. Perhaps the best indicator of the regulatory disposition of the Commonwealth regarding these issues can be found by examining the existing laws currently in effect for beer and wine sales. Below, we discuss some of the issues to be considered under a partially privatized system.

Advertising

ABC would first have to decide whether it would want to regulate liquor advertising at all. If so, advertising considerations might include point-of-sale displays, posters, shelf displays, free samples and giveaways, signage allowances (e.g., restrictions on sidewalk and outdoor ads and signs, neon signs). Consideration must also be given as to whether ABC would regulate the types of media permitted for advertising (e.g., newspaper ads stating sale prices, magazine ads, type of language allowed, billboards).

Credit

If ABC were to determine it necessary to regulate the use of credit as it relates to the sale of liquor, it would need to consider what types of credit retailers may be able to extend to customers, and whether checks may be accepted as payment.

Licensing Requirements

Decisions would have to made about what requirements ABC would set for its liquor retail licensees. Regulations would need to be detailed for the newly created license class of liquor retailer. Under partial privatization, we assume the same requirements would be applied to liquor retailers as are currently applied to beer and wine retailers.

License Fees

Under a partially privatized system, current requirements regarding the revenue generated by license fees would have to be addressed. According to ABC, license fee revenue may only total as much as the cost of administering the licensing program. Under partial privatization, we assigned retail liquor license fees that are below the national average, yet that would generate a surplus of revenue beyond the costs of administering the licensing program.

Hours of Operation

ABC would need to decide whether to limit the hours during which liquor could be sold. Currently, wine and beer cannot be sold between the hours of 12 midnight and 6 a.m. Under partial privatization, we assume the same restricted hours would apply to liquor sales. We assume that if the 12 a.m. to 6 p.m. hours rules were to be extended to include liquor, the market would regulate itself as to the hours that retailers would actually be selling liquor.

Relationship Between Manufacturers and Retailers

A decision would be made by ABC as to whether any relationship may be established between liquor manufacturers and liquor retailers. If it were permitted, ABC would then determine what type of relationship would be acceptable.

b. Summary of Legal Issues

With the retail sale of liquor in the private sector, there would be a number of market forces at work. The Commonwealth would need to make a decision as to how much it would want to control and regulate those market forces, the tangible effects of which are described above.

III. FULL PRIVATIZATION

In this section we discuss the impacts of fully privatizing Virginia's liquor distribution system. Where appropriate, our model of full privatization is identical to our partial privatization model. Therefore, this discussion will build on our analysis of partial privatization and will not reiterate the following issues discussed in our partial privatization analysis:

- Financial Analysis — The net financial contribution of ABC activities to the state under the present system
- Employment and Facilities Analysis — The placement and lay-off process, unemployment obligations
- Private Sector Retail Analysis — Overview of retailers
- Control and Regulation — Safety, education, consumption, and accessibility issues of control

We have organized our analysis of full privatization similarly to our partial privatization analysis. Our discussion of full privatization is divided as follows:

- Overview of a Fully Privatized System — We identify and compare Commonwealth and private sector roles in a fully privatized system and specify how these roles will be carried out.
- Financial Analysis — We examine the effects of full privatization on the net financial contribution of ABC activities to the state.
- Employment and Facilities Analysis — We estimate various costs and cost savings from employment and facilities changes that result from full privatization.
- Private Sector Retail Analysis — Where different from partial privatization, we analyze various aspects of the private sector retail market.

- Private Sector Wholesale Analysis — We analyze the various aspects of the private sector wholesale market, such as the number and size of wholesalers.

- Control and Regulation — Where different from partial privatization, we discuss the impacts of full privatization on the control over distribution and consumption of liquor and the legal requirements that result from full privatization.

Overview of a Fully Privatized System

A. Overview of a Fully Privatized System

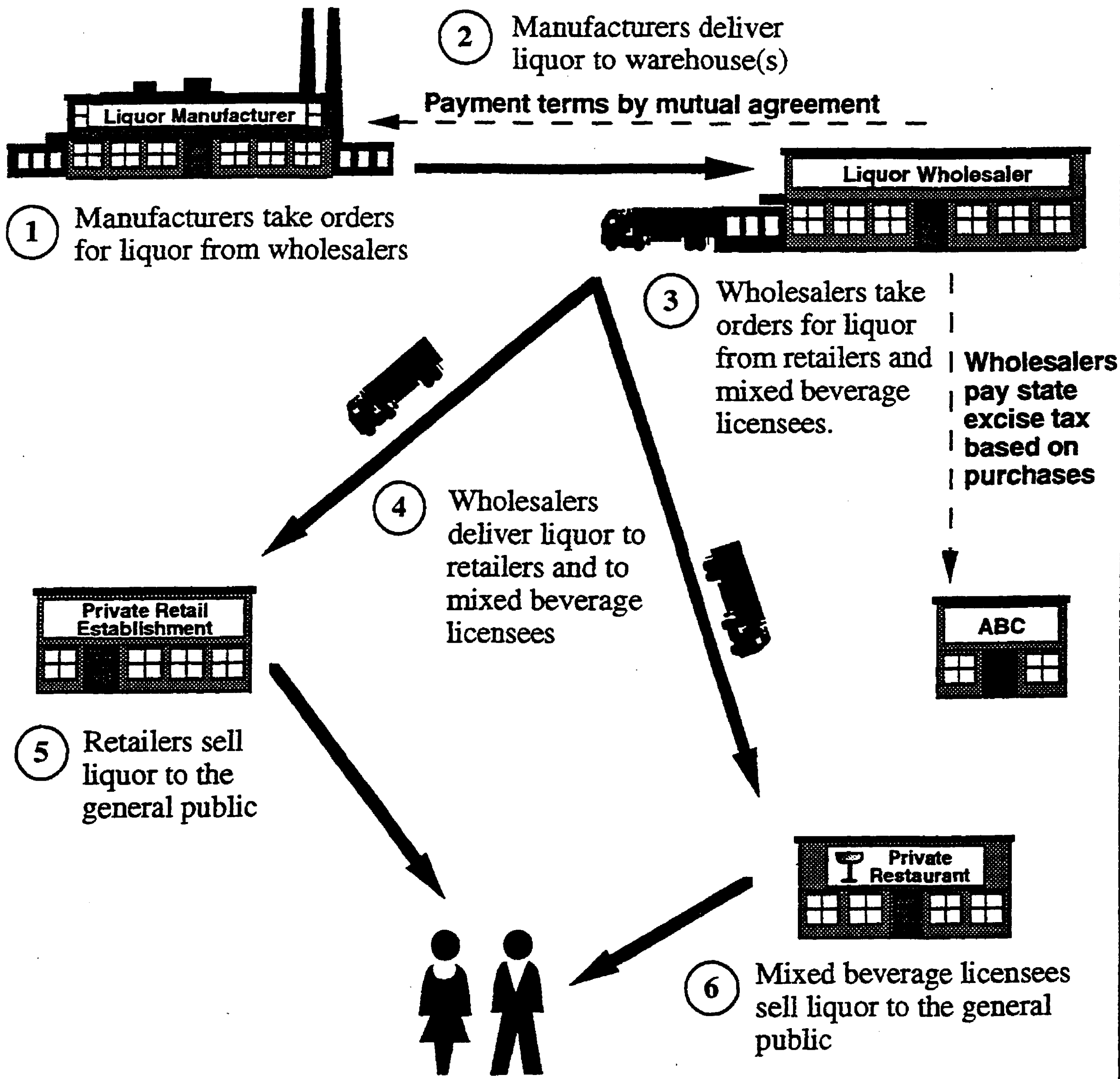
In Exhibit III-1 we present an overview of a fully privatized system of liquor distribution. Under a fully privatized liquor distribution system, liquor would be sold by the bottle for off-premise consumption in qualified private retail establishments. Qualified establishments would be the same as under a partially privatized system.

New retail and wholesale liquor licenses would be created. To obtain either of these new licenses, an applicant would be required to undergo an investigation substantially similar to that currently conducted prior to the awarding of beer and wine licenses. A fee would be charged for a retail or wholesale liquor license. There would be no restriction as to the number of liquor licenses that may be issued. Retail and wholesale liquor licensees would be required to be residents of Virginia.

State excise taxes would be assessed at the wholesale level. Rather than the current ad valorem state excise tax, excise taxes would be a per unit tax under full privatization. Mixed beverage licensees would obtain liquor from holders of Virginia wholesale liquor licenses. These licensees would be able to negotiate individual arrangements with wholesale licensees to buy liquor. There would be no other restrictions on where a mixed beverage licensee could buy liquor.

The Virginia ABC would continue to enforce administrative alcoholic beverage laws. Other alcohol-related infractions, such as drunk driving and underage consumption, would continue to be handled primarily by state and local police. With the addition of retail liquor licensees, it would be necessary to augment existing enforcement programs. For license holders who violate Virginia liquor laws, fines and penalties would be assessed. Other efforts, such as cooperation with the Department of Motor Vehicles aimed at reducing the use of false identifications, would continue unchanged.

Overview of a Fully Privatized System of Liquor Distribution in Virginia



Enforcement - ABC increases staff of special agents and auditors to monitor a likely increase in the number of liquor retail establishments

Mark-up -	State excise tax:	$15.00/gallon
	Private wholesale mark-up	25 percent
	Private retail mark-up	25 percent

Financial Analysis

This section contains the following:

- Full Privatization: A Constant Tax Scenario
- Full Privatization: A Revenue Neutral Scenario
- Full Privatization: A Price Neutral Scenario
- Financial Analysis Conclusions

B. Financial Analysis

In this section we describe the impact on state revenue that would result from full privatization. We begin by estimating the in..., ..ct of full privatization on the financial contribution of ABC activities to the state, assuming that the excise tax under full privatization would equal the sum of the current tax and mark-up ("constant tax scenario"). Using this scenario as a reference point, we then adjust the excise tax to determine the impact of full privatization under a revenue neutral scenario and a price neutral scenario.

1. Full Privatization: A Constant Tax Scenario

A constant tax scenario assumes a state excise tax on liquor that is equal to the sum of the current excise tax and mark-up (70.5 percent). We use this scenario only as an initial point of reference for this analysis. We do not assume that this scenario would necessarily be the outcome of full privatization. We derive an estimate of the excise tax in a revenue neutral scenario and a price neutral scenario subsequently in this section.

a. Prices

Under a fully privatized system, the state would not apply a mark-up to distilled spirits. Private wnolesalers and retailers would add mark-ups at the wholesale and retail levels, while the state would apply its excise tax on alcohol at the wholesale level. We estimate that wholesalers would mark-up their merchandise by an average of 25 percent.[1] We estimate that retailers would mark up their merchandise an average of 25

[1] We derived this mark-up using a comparison between national data on wholesale dollar volume and retail dollar volume. We also consulted various trade publications.

percent. This figure represents the industry average, although there does tend to be some degree of variation in specific retail mark-up levels.[2]

Table III-1

Price Impact of Full Privatization
Constant Tax Scenario

	Current	Full Privatization: Constant Tax Scenario
Average Cost of Goods	$23.40	$23.40
Wholesale Mark-up	50.5%	25.0%
State Excise Tax	20.0%	70.5%
Retailer Price Per Gallon	N/A	$49.87
Retailer Mark-Up	N/A	25.0%
Retail Price per Gallon	**$42.26**	**$62.34**
Retail Price per Bottle	**$8.49**	**$12.53**

Based on the average wholesale mark-up, the constant state excise tax we use as a starting point for our analysis, and the average retail mark-up, we estimate that the average retail price in a fully privatized market would be $62.34 per gallon, as presented in Table III-1. This price is 48 percent higher than the current retail price of $42.26 per gallon.

[2] A 1989 survey conducted by the Iowa Alcoholic Beverages Division of over 400 retailers showed an average retail mark-up of 23.5%. ABC conversations with license state retailers have yielded similar results.

b. Net Revenue Effects under a Constant Tax Scenario

Assuming a price elasticity assumption of 0.5, the 48 percent increase in prices that results from privatization would yield a 24 percent decrease in sales.[3] As presented in Exhibit III-2, sales are estimated to decline from the current level of 7.29 million gallons, by approximately 1.7 million gallons, to a level of 5.56 million gallons. Gross sales increase from their current level of $308 million, by approximately $39 million, to $347 million. Although gross sales increase, the money would be divided between the state, private wholesalers, and private retailers in a fully privatized system. Therefore, an increase in gross sales in a fully privatized system would not necessarily mean that the state is receiving more money from alcohol sales.

In order to estimate the net contribution of distilled spirits sales to the state in a fully privatized system, we incorporated various costs and cost savings associated with privatization that would occur in the first two years.[4] When employment and other operating costs are adjusted for full privatization and are incorporated into the analysis, net contributions to the state from liquor sales actually increase from their current level by $18 million in the first year of privatization.

Because there are several one-time-only costs and cost savings, such as equipment and property sales, we also calculated the impact of full privatization in the second year. For the sake of convenience, we have neither assumed that the cost of goods increases nor that consumption decreases in year two of full privatization. As presented in Exhibit III-3, net contributions to the state from ABC would be $111 million in the second year

[3] In order to project demand at different prices from those currently observed in Virginia, we use a price elasticity assumption — or the reaction of consumers to changes in price — for alcohol. The elasticity used here (.5) is the mid-point of estimates found in independent studies of spirits consumption. An elasticity at this level implies that if the price increases by 10 percent, demand will decrease by 5 percent.

[4] These cost and cost savings estimates are derived in detail in subsequent sections.

Full Privatization: Price and Sales Effects
Constant Tax Scenario

	Fiscal Year 1992	Full Privatization: Constant Tax
Average COGS per Gallon	$23.40	$23.40
Wholesale Markup	50.5%	25%
State Excise Tax	20%	70.5%
Retailer Price per Gallon	N/A	$49.87
Retailer Markup	N/A	25%
Retail Price per Gallon	$42.26	$62.34
Retail Price per Bottle	$8.49	$12.53
Sales (millions of gallons)	7.29	5.56
Sales (millions of dollars)	**$308.26**	**$346.70**

Full Privatization: Constant Tax Scenario

	Fiscal Year 1992	Full Privatization: Year 1	Recurring
Average COGS per Gallon	$23.40	$23.40	$23.40
Wholesale Mark-up	50.5%	25%	25%
State Excise Tax	**20%**	**70.5%**	**70.5%**
Retailer Price/Gallon	N/A	$49.87	$49.87
Retailer Mark-up	N/A	25%	25%
Retail Price per Gallon	$42.26	$62.34	$62.34
Retail Price per Bottle	$8.49	$12.53	$12.53
Sales (millions of gallons)	7.29	5.56	5.56
Sales (thousands of dollars)	$308,260	$346,698	$346,698
Other Revenue (Add):			
License Fees (thousands)	$6,105	$10,320	$10,320
Other Cost Savings from Privatization		12,159	1,748
Other Revenue	2,867	2,867	2,867
Expenses (Less):			
Cost of Goods Sold (thousands)	$170,675	$130,139	$130,139
Employment	39,686	23,786	12,017
Other Operating Expenses	15,388	6,419	5,882
Retailer Share of Revenue		69,340	69,340
Wholesaler Share of Revenue		32,535	32,535
ABC Contributions to State	**$91,483**	**$109,827**	**$111,721**
Net Revenue Change from Privatization		**$18,343 ***	**$20,238 ***

* This scenario results in an increase in revenue. Therefore, it is not revenue neutral

of privatization, approximately $20 million more than the current contribution level. Thus, a fully privatized system that assumes a constant tax scenario would not be revenue neutral. In fact, this scenario would actually increase revenue from its current level.

2. Full Privatization: A Revenue Neutral Scenario

We have established a starting point for our analysis by examining the impact of full partial privatization under a constant tax scenario, which assumes an excise tax equal to the sum of the current tax and mark-up. However, using the same mark-up and tax rate found in the current system results in an increase in contributions to the state from the sale of liquor under full privatization. In addition, retail prices would increase significantly due to the levying of private retail and wholesale mark-ups, and the state excise tax.

The state could lower the tax levyed on wholesale merchandise, from 70.5 percent, to a level that results in both revenue neutrality and reduced prices than those estimated under a constant tax scenario. Before we derive the revenue neutral excise tax, however, we discuss advantages and disadvantages of a per-unit excise tax as compared to the current ad valorem excise tax.

a. Per-Unit Versus Ad Valorem Excise Taxes

There are two general types of excise taxes that the Commonwealth could levy on liquor:

- Per-Unit Tax — a flat rate (in dollars or cents) tax levied on a specific unit of a commodity.

- Ad Valorem Tax — a proportional tax levied on a specific commodity as a percentage of its price.[5]

Under the current system, the Commonwealth levies an ad valorem type tax on liquor. The main reason for structuring an excise tax as an ad valorem tax rather than a per-unit tax is that real revenue collections generally remain constant.[6] Another reason for levying an ad valorem tax is that the tax amount imposed changes without periodic adjustments by elected officials.

Despite the fact that an ad valorem tax generates a relatively constant stream of revenue, there are three general weaknesses that would characterize an ad valorem tax system under full privatization:

- The tax is burdensome to effectively administer.
- The tax allows more opportunities for tax evasion.
- The tax discriminates between similar products.

1. Burden of Administration

The objective of a tax collection system is to achieve high compliance and collect all tax revenues while minimizing the administrative cost to the state. Enforcement is an integral element of effective excise tax administration. Enforcement can be enhanced if the tax is easily verified. For excise taxes, verification is often accomplished by comparing information from different sources regarding the volume shipped and the volume of a commodity in inventory. Such sources include manufacturers' shipping

[5] Price can refer to either the wholesale price — the price paid by the retailer when purchasing from a wholesaler — or the retail price — the price paid by consumers when purchasing from a retailer.

[6] An ad valorem tax increases the tax amount as the commodity's price increases, thus compounding the overall price increase to the consumer.

receipts, wholesaler sales and inventory records, and state inspections/audits of wholesalers' inventories.

The burden of collecting this volume data is a major factor in the overall ease of administration of an excise tax. This burden differs between per-unit and ad valorem tax systems. In a per-unit system the quantity of the commodity sold (e.g., gallons, cases, etc.) is reported directly on the tax returns and this volume of taxable sales is multiplied by the tax per unit to determine total tax liability. The volumes reported by the taxpayer can be verified through the sources of information outlined above.

In an ad valorem system, it is much more burdensome to collect volume data. Generally, total taxable sales revenue (in dollars) is reported to the state on the tax return. Sales revenue is then multiplied by the percentage tax rate to determine the total tax liability. Verifying the tax liability under an ad valorem system is more difficult because the state needs to collect price data in order to calculate volume from the reported sales revenue (price * volume = revenue). This volume can then be verified through various sources of information, such as manufacturers' shipping receipts, inventory records, etc. The basic difference between an ad valorem and a per-unit system, therefore, is that the tax liability in an ad valorem tax system is based in the price of a commodity rather than the specific number of units sold.

2. Opportunities for Tax Avoidance

As indicated above, the effective administration of an ad valorem excise tax requires the collection of more information than is required under a per-unit tax system. If the state spends the extra resources to collect the price and volume data, their costs of administration would increase substantially. Furthermore, the inherent difficulties in collecting accurate price data would still result in enforcement problems. However, if the state were to fail to collect this information, there would likely be a lack of tax compliance and greater opportunities for tax avoidance.[7]

An ad valorem excise tax places an administrative burden on the enforcement process that can result in a lack of compliance by taxpayers. If taxpayers perceive a relaxed compliance environment, they are more likely to under-report their tax liability. Thus, one result of the administrative difficulties of an ad valorem excise tax system under full privatization would be the decreased likelihood of tax compliance.

3. Tax Discrimination

An ad valorem system taxes the price of a commodity, while a per-unit system taxes the consumption of the commodity. An ad valorem tax could result in different tax amounts on the same quantity of a commodity. Because of this potential difference, the ad valorem excise tax discriminates between low and high-priced brands of a commodity. Because tax liability under a per-unit tax system is based on the volume of a commodity that is sold, and not the prices of the commodity, a per-unit system does not discriminate between low and high-priced brands of a product. An example of this discrimination of presented in Table III-2.

[7] Tax avoidance is failing to pay taxes that are legally due.

Table III-2

Example of Discrimination in an Ad Valorem Tax System

PER UNIT TAX OF $0.10 PER UNIT

	Price per Unit	Tax	Price + Tax
Brand A	$0.50	$0.10	$0.60
Brand B	$1.00	$0.10	$1.10

One unit of each brand is sold, yielding a tax revenue of $0.20

AD VALOREM TAX OF 20% OF PRICE

	Price per Unit	Tax	Price + Tax
Brand A	$0.50	20%	$0.60
Brand B	$1.00	20%	$1.20

Because of Brand B's higher Price + Tax, consumers may purchase two units of Brand A and zero of Brand B, yielding a tax revenue of $0.20.

The government may find that an ad valorem system does not lead to increased tax revenue. In the top half of Table III-2, we assume consumers purchase one unit of both Brand A and Brand B. With a flat tax of 10 cents per unit, the total tax collected would be 20 cents. If a 20 percent ad valorem tax were levied instead with the expectation of increasing the tax yield to 30 cents, the higher tax-inclusive price of Brand B could induce consumers to shift to Brand A. Assuming in this example that two units of Brand A and no units of Brand B are sold, a tax of 20 cents would be collected, the same as the amount collected in the flat tax system.

b. Revenue Neutral Excise Tax Level

As presented in Exhibit III-4, all of the license states have per unit excise taxes rather than ad valorem taxes. Because of the weaknesses of an ad valorem tax system that we have discussed above, it would seem likely that under a fully privatized system Virginia's tax structure would consist of a per-unit, rather than the current ad valorem, excise tax. Therefore, in estimating the tax rate in a revenue neutral scenario, we use a per unit tax instead of the ad valorem type tax that is currently in place. However, we also present an ad valorem estimate of the per unit tax that we derive in order to compare the tax in a revenue neutral scenario to the current one.

As presented in Exhibit III-5, the state could decrease the tax that it places on alcohol to $15.43 per gallon and maintain revenue neutrality. This per unit tax is approximately equivalent to a 53 percent ad valorem tax levied at the wholesale level. As presented in Table III-3, the lower tax rate would result in a retail price of $55.85, a 32 percent increase from the price level in the current system. In order for the state to remain revenue neutral in a fully privatized system, it appears that prices would have to increase significantly. In addition, the tax rate would be much higher than either the average or highest per unit excise tax in any of the license states.

License State Excise Taxes

State	Per Gallon Tax Rate	Other Taxes *
Alaska	$5.60	
Arizona	$3.00	
Arkansas	$2.50	10 percent on-premise gross receipts tax
California	$3.30	
Colorado	$2.28	
Connecticut	$4.50	
Delaware	$4.55	
District of Columbia	$1.50	
Florida	$6.50	
Georgia	$3.78	3 percent local optional excise tax
Hawaii	$5.75	
Illinois	$2.00	
Indiana	$2.68	0.3 percent gross income tax
Kansas	$2.50	8 percent enforcement tax; 10 percent gross receipts tax
Kentucky	$1.92	9 percent wholesale tax
Louisiana	$2.50	
Maryland	$1.50	$0.015/gallon for each 1 proof over 100 proof
Massachusetts	$4.05	$4.05/proof gallon over 100 proof; 0.57 percent gross receipts tax
Minnesota	$5.03	8.5 percent alcohol sales tax; $0.01 bottle tax
Missouri	$2.00	
Nebraska	$3.00	
Nevada	$2.05	
New Jersey	$4.20	
New Mexico	$3.94	0 - 5 percent local excise tax
New York	$6.44	$1.00/gallon additional tax in NYC
North Dakota	$2.50	7 percent alcohol beverage sales tax
Oklahoma	$5.56	12 percent gross receipts tax; $1.00/bottle enforcement tax
Rhode Island	$3.75	
South Carolina	$2.72	9 percent surtax; case charges for both wholesalers and retailers
South Dakota	$3.93	2 percent tax on wholesaler purchases
Tennessee	$4.00	15 percent on-premise tax; $0.15/case wholesale tax
Texas	$2.40	6.25 percent off-premise; 14 percent on-premise
Wisconsin	$3.25	
AVERAGE TAX	**$3.49**	
HIGHEST TAX	**$6.50**	
LOWEST TAX	**$1.50**	

* Doesn't include general sales taxes

Source: Distilled Spirits Council of the United States, Tax Briefs 1992

Full Privatization: Revenue Neutral Scenario

	Fiscal Year 1992	Full Privatization: Year 1	Full Privatization: Recurring
Average COGS per Gallon	$23.40	$23.40	$23.40
Wholesale Mark-up	50.5%	25%	25%
State Excise Tax	**20%**	**$15.43**	**$15.43**
Retailer Price/Gallon	N/A	$44.68	$44.68
Retailer Mark-up	N/A	25%	25%
Retail Price per Gallon	$42.26	$55.85	$55.85
Retail Price per Bottle	$8.49	$11.23	$11.23
Sales (millions of gallons)	7.29	6.12	6.12
Sales (thousands of dollars)	$308,260	$341,883	$341,883
Other Revenue (Add):			
License Fees (thousands)	$6,105	$10,320	$10,320
Other Cost Savings from Privatization		11,975	1,748
Other Revenue	2,867	2,867	2,867
Expenses (Less):			
Cost of Goods Sold (thousands)	$170,675	$143,247	$143,247
Employment	39,686	23,786	12,017
Other Operating Expenses	15,388	6,419	5,882
Wholesaler Share of Revenue		35,812	35,812
Retailer Share of Revenue		68,377	68,377
ABC Contributions to State	**$91,483**	**$89,405**	**$91,484**
Net Revenue Change from Privatization		**($2,078) ***	**$0 ***

* This scenario is revenue neutral by year two. Year one revenue includes one-time costs.

Table III-3

Price Impact of Full Privatization
Revenue Neutral Scenario

	Current	Full Privatization: Revenue Neutral Scenario
Average Cost of Goods	$23.40	$23.40
Wholesale Mark-up	50.5%	25.0%
State Excise Tax	20.0%	$15.43
Retailer Price Per Gallon	N/A	$44.68
Retailer Mark-Up	N/A	25.0%
Retail Price per Gallon	**$42.26**	**$55.85**
Retail Price per Bottle	**$8.49**	**$11.23**

3. Full Privatization: A Price Neutral Scenario

Full privatization would result in a 32-percent increase in prices, assuming a revenue neutral scenario. The state could lower the excise tax that it places on liquor from the current level, and the level assumed for the revenue neutral scenario, to a level that results in price neutrality, as presented in Table III-4. Because the excise tax would have to be lower than the tax that results in revenue neutrality, a price neutral scenario would not be revenue neutral.

Table III-4

Price Impact of Full Privatization
Price Neutral Scenario

	Current	Full Privatization: Price Neutral Scenario
Average Cost of Goods	$23.40	$23.40
Wholesale Mark-up	50.5%	25.0%
State Excise Tax	20.0%	$4.56
Retailer Price Per Gallon	N/A	$33.81
Retailer Mark-Up	N/A	25.0%
Retail Price per Gallon	**$42.26**	**$42.26**
Retail Price per Bottle	**$8.49**	**$8.49**

As presented in Exhibit III-6, the state excise tax that results in price neutrality would be $4.56 per gallon. This per unit tax is approximately equivalent to a 15.6 percent ad valorem tax levied at the wholesale level. Under this scenario, revenue to the state would decrease significantly. In the first year of privatization, revenue would decrease by nearly $63.3 million, or 69.2 percent. In the second year and out-years of privatization, revenue would fall from its current level by $61.2 million, or 66.9 percent.

Full Privatization: Price Neutral Scenario

	Fiscal Year 1992	Full Privatization: Year 1	Full Privatization: Recurring
Average COGS per Gallon	$23.40	$23.40	$23.40
Wholesale Mark-up	50.5%	25%	25%
State Excise Tax	**20%**	**$4.56**	**$4.56**
Retailer Price/Gallon	N/A	$33.81	$33.81
Retailer Mark-up	N/A	25%	25%
Retail Price per Gallon	$42.26	$42.26	$42.26
Retail Price per Bottle	$8.49	$8.49	$8.49
Sales (millions of gallons)	7.29	7.29	7.29
Sales (thousands of dollars)	$308,260	$308,260	$308,260
Other Revenue (Add):			
License Fees (thousands)	$6,105	$10,320	$10,320
Other Cost Savings from Privatization		11,975	1,748
Other Revenue	2,867	2,867	2,867
Expenses (Less):			
Cost of Goods Sold (thousands)	$170,675	$170,687	$170,687
Employment	39,686	23,786	12,017
Other Operating Expenses	15,388	6,419	5,882
Wholesaler Share of Revenue		42,672	42,672
Retailer Share of Revenue		61,652	61,652
ABC Contributions to State	**$91,483**	**$28,208**	**$30,286**
Net Revenue Change from Privatization		**($63,276)**	**($61,197)**

4. Financial Analysis Conclusions

The following conclusions summarize the results of our financial analysis:

- A fully privatized model that uses a state excise tax equal to the sum of current tax and mark-up levels would result in greater financial contributions to the state from liquor sales and significantly higher prices.

- A fully privatized model that is revenue neutral would result in a price increase of 32 percent.

- A fully privatized model that is revenue neutral would require an excise tax that is much higher than excise taxes in any of the license states.

- A fully privatized model that is price neutral would require a state excise tax of $4.56 per gallon, resulting in a $61.2 million, or 66.9 percent, decrease in revenue.

Based on our analysis, it is not certain whether revenue neutrality could be maintained under a fully privatized system. Because prices would increase significantly, Virginians living near the border of a lower-taxed jurisdiction may purchase more of their liquor in other states. Such cross-border activity may cause sales to decline more than initially estimated, fuelling further the price increase that results from full privatization. As the price of liquor continues to increase, it appears less likely that the state could maintain revenue neutrality under a fully privatized system. Because a price neutral scenario would result in a significant decrease in revenue to the state under full privatization, we utilize a revenue neutral scenario for the remainder of our analysis of full privatization.

Employment and Facilities Analysis

This section contains the following:

- Employment and Organizational Analysis
- Facilities

C. Employment and Facilities Analysis

1. Employment and Organizational Analysis

In this section we present our estimates of employment costs and cost savings generated through full privatization and outline the resulting organization and responsibilities of the ABC. The employment issues that we address in this section focus on state employment and employees affected by full privatization.

a. Background and Procedures

Privatization of retail and wholesale operations would reduce the total employment of the ABC significantly. The majority of ABC employees are directly involved in the operation and support of ABC retail and wholesale activities. With the elimination of retail and wholesale operations, many job classifications would be eliminated completely and others reduced significantly in number.

The employment issues to be addressed in this analysis are as follows:

- Full and Part-Time Employment — We estimate the changes to full-time salaried and part-time wage positions by identifying state jobs eliminated and state jobs created.
- State Benefits Obligations — We provide an estimate of the ABC's employee benefits obligations and unemployment benefits liability.
- Training and Counseling — We examine opportunities and state obligations for training, placement, and counseling of displaced employees and discuss options for minimizing the negative impact of privatization on ABC employees.

1. Current Employment at ABC

The ABC has 1,175 full-time appropriated positions, of which 1023 are currently staffed. In Exhibit III-7 we present a chart of current full-time salaried positions by division.

In addition to the full-time salaried positions, the ABC has approximately 795 part-time employees, most of whom are employed by the Stores Division. These employees are employed on an as-needed basis and are not considered permanent employees of the ABC. Consequently, all part-time positions related to retail store operations would be immediately eliminated under full privatization. The following analysis applies only to full-time salaried employees. We discuss part-time employees later in this section.

Many of the employees affected by full privatization, particularly employees in the Stores Division, are distributed widely throughout the state. The Merchandise Division, which operates the warehouse and all wholesale activities, is located in Richmond at the central office complex. The locations of the retail stores around the state distribute employment to many of the cities and most of the counties in Virginia. This geographic distribution affects the laid-off employees' probability of placement. For example, employees located in the Richmond area have a significantly higher probability of being placed in another state or ABC position because of the large state government and ABC presence in Richmond. Similarly, the large private sector presence in the Richmond and Northern Virginia areas would also increase the probability of private sector placement for those employees located in these areas.

Many of the eliminated ABC positions fall in job classifications used exclusively by the ABC within the state government (e.g., Store Clerk, or Store Manager). However, full privatization may lead to the creation of new jobs in the private sector.

ABC Salary Positions by Division Under Current System*

Division	Positions	Salaries	Benefits
Administration	10	$457,053	$137,116
Secretary to the Board	4	$125,600	$37,680
Public Affairs and Educational Services	6	$140,687	$42,206
Internal Audit	3	$110,005	$33,002
Human Resources	13	$377,323	$113,197
Hearings	8	$215,623	$64,687
Regulatory	153	$4,381,780	$1,314,534
Accounting	26	$561,120	$168,336
Management Info. Systems and Data Processing	31	$925,799	$277,740
Purchasing and Support	36	$706,893	$212,068
Research and Planning	7	$197,751	$59,325
Real Estate	20	$467,340	$140,202
Stores	627	$14,379,626	$4,313,888
Merchandising	79	$1,627,356	$488,207
Totals	1023	$24,673,956	$7,402,188

* This chart reflects the most recent data available as of August 17, 1992.

For example, potential new liquor stores would need store managers, assistant managers, and store clerks to operate the new businesses. In addition, new wholesale businesses would need employees with warehouse, distribution, and merchandising skills. This potential demand for new employees in the new retail and wholesale businesses may increase the placement opportunities of some employees.

b. Employment and Downsizing Costs and Cost savings Analysis

Below we present the estimated changes to employment, salaries and wages, benefits, unemployment payment obligations, and other costs incurred due to the employment changes associated with full privatization. In Exhibit III-8 we summarize all costs and cost savings resulting from changes in employment. Each of these is described below.

1. Changes in Divisional Employment Levels

a. Employment Reductions

We determined the number of full-time salaried positions to be eliminated due to downsizing from job classifications descriptions and through departmental responsibilities related to retail and wholesale operations. In Exhibit III-9 we present the ABC positions lost by division as a result of full privatization. There were three general categories of eliminated employment:

- Direct Eliminations — include those job classifications that would be eliminated due to their function. This includes such categories as ABC Store Manager, ABC Store Assistant Manager, Store Clerk, and Warehouse Worker.

Summary of ABC Employment Costs and Cost Savings Estimates Under Full Privatization

Description	Year 1	Total Recurring
Salaries and Wages Eliminated	**$23,955,314**	**$23,955,314**
Salaries and Wages Added	($1,533,021)	($1,533,021)
Benefits Eliminated	**$5,706,529**	**$5,706,529**
Benefits Added	($459,906)	($459,906)
Estimated Unemployment Obligation	**($5,558,664)**	**$0**
Benefits (Continued for 1 year)	($3,701,354)	$0
Estimated Education Obligation	**($76,700)**	**$0**
Paid Leave Obligations	($2,432,562)	$0
Employment Savings	**$15,899,636**	**$27,668,916**

Key: Figures in parentheses represent costs to ABC under full Privatization

Estimated ABC Positions Lost By Division Under Full Privatization

Division	Positions	Salaries	Benefits
Human Resources	4	$116,099	$34,830
Purchasing and Support	30	$589,078	$176,723
Research and Planning	7	$197,751	$59,325
Real Estate	20	$467,340	$140,202
Stores	627	$14,379,626	$4,313,888
Merchandising	79	$1,627,356	$488,207
Totals	767	$17,377,250	$5,213,175

- Related Eliminations — include positions eliminated due to their relation to the directly eliminated classifications. This would include support personnel whose classifications were not eliminated, but whose particular position is eliminated.

- General Eliminations — include positions that are not directly eliminated based on their function, but are part of the downsizing that would occur. For example, the number of central office personnel could decline overall due to the reduction in the responsibilities of the ABC.

Stores, Real Estate, and Merchandising Divisions

Under full privatization, the Distribution Group, which consists of the Stores Division, Real Estate Division, and the Merchandise Division, would be eliminated. Total staffing within the Distribution Group totals 726.

Research and Planning

ABC would no longer need the marketing analysis and business strategy services provided by the Division of Research and Planning under full privatization. The Division, which consists of seven positions, would be eliminated.

Purchasing and Support

We estimate that, with the elimination of all retail stores and warehouse operations, the Purchasing and Support Division could perform the necessary support functions for the central and district offices with approximately six positions. This would require the elimination of 30 positions within the Division associated with these retail store and warehouse functions.

Human Resources

Under full privatization, the staffing of the Human Resources Division would be reduced. We estimate that with a reduction in employment from 1,023 positions to 310 positions, the Human Resources Division would need to maintain a staffing level of approximately 9 positions, the same level recommended under partial privatization.

Part-Time Employees

Upon implementation of any lay-off process, all part-time employees would be laid-off first. These employees are located throughout the state and float from one store to another, depending on ABC's current needs. In total, the ABC employs approximately 795 part-time employees, 777 of whom are employed by the Stores Division. We estimate that under full privatization, all 795 part-time employees would be laid-off.

b. Employment Additions

Given the changed nature of ABC operations, we estimate that positions would be added to accommodate new responsibilities and activities. We summarize these position additions, wages, and benefits in Exhibit III-10. These positions are similar in nature to positions in the general offices of the ABC in terms of geographic location, skill levels, and pay ranges. We used these similarities to estimate the wages and benefits associated with these positions.

Regulatory Division

Under full privatization, we estimate that the workload of the Regulatory Division would increase significantly. In addition to new retail licenses, we estimate that approximately 75 new wholesale liquor licenses would be issued. Currently, approximately 157 wholesale beer and wine licenses are issued by the ABC. Under full privatization, control over liquor distribution would rely largely on effective monitoring of licensees. We believe that an additional 10 Regulatory Agents would be required to ensure the implementation of an effective monitoring system. Overall, we estimate that 46 Regulatory Agents would be needed over the current level of 95 as a result of full privatization.

Hearings Division

Under full privatization, the staffing level of the Hearings Division would need to be increased. We assume that the increase in the number of retail and wholesale licensees and the increase in regulatory agents would result in an increase in the number of administrative hearings proceedings. We estimate that approximately eight positions in the Hearings Division would be needed due to the increased workload resulting from full privatization.

2. Other Employment Issues

Management Information Systems and Data Processing Division

The elimination of the Distribution Group would reduce the workload of the MRS/DP Division by approximately 40 percent. However, we estimate that the increased responsibilities associated with supporting the systems involved with managing the additional 6,000 retail and 75 wholesale licensees would require additional staffing. Overall, we estimate that the staffing of the MRS/DP Division would remain unchanged at 31 positions under full privatization.

Accounting Division

Under full privatization, responsibilities associated with maintaining accounts payable for liquor merchandise would be eliminated. Additionally, the Accounting Division's responsibilities associated with the Stores, Merchandising, and Real Estate Divisions would be eliminated. However, full privatization would increase accounting tasks associated with managing accounts receivables for the additional 6,000 retail and 75 wholesale licensees. Overall, we estimate that the Accounting Division would remain at the current staffing level of 26 under full privatization.

Estimated ABC Positions Gained By Division Under Full Privatization

Division	Positions	Salaries	Benefits
Hearings	8	$215,623	$64,687
Regulatory	46	$1,317,398	$395,219
Totals	54	$1,533,021	$459,906

Virginia Department of Alcoholic Beverage Control
Possible Organizational Structure Under Full Privatization

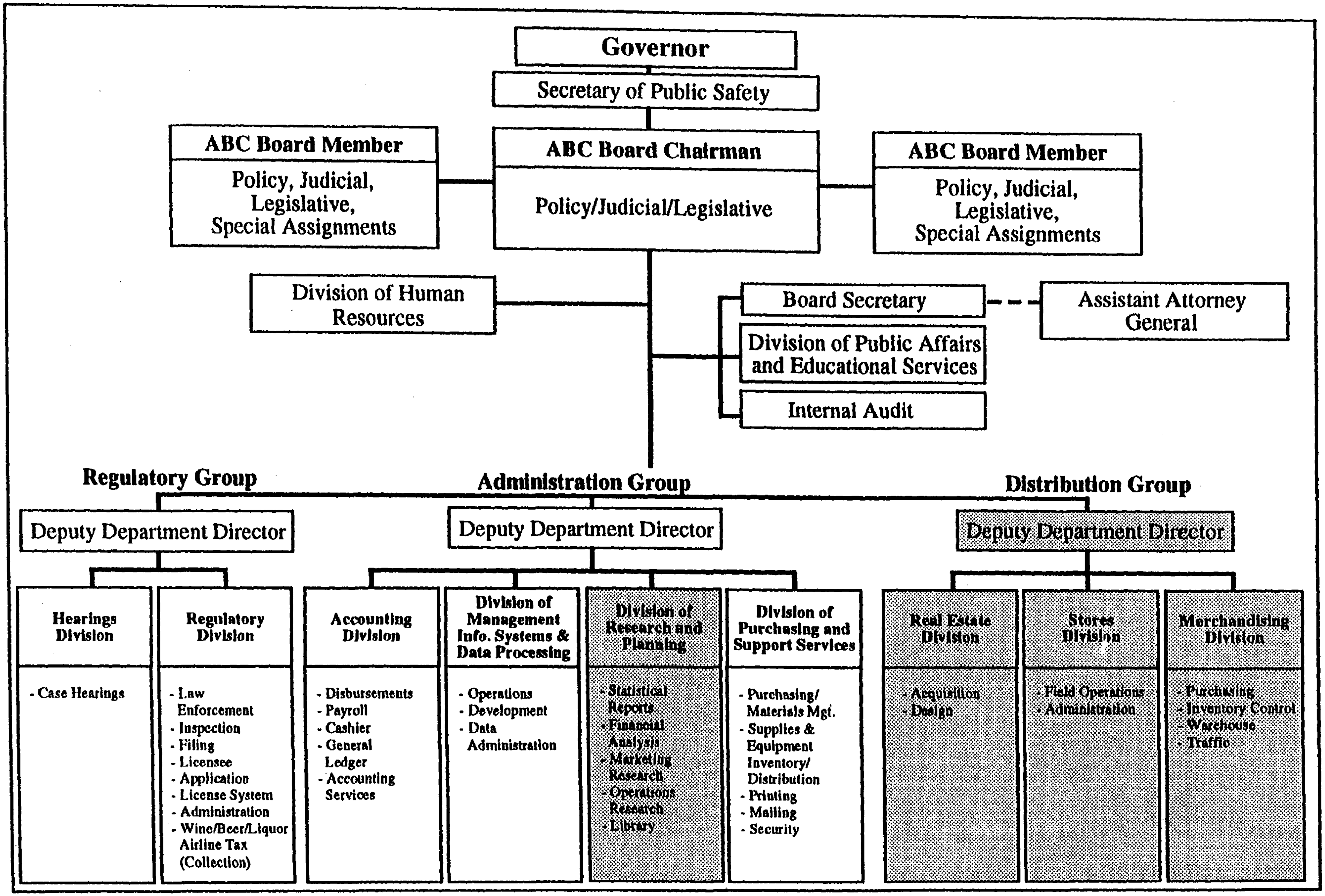


Exhibit III-11

Va ABC Rept LAND 8/92
MS&E FEAS

Note: Shaded areas represent divisions eliminated under full privatization

Operational Cost Savings and Additions Under Full Privatization

	FY 1992 Budget			Percent Reduction (Addition)	Cost Savings
	Budget	x		*% Reduction* =	*Cost Savings*
Research and Planning	$26,260	7/7	==>	100.00%	$26,260
Human Resources	$278,530	4/13	==>	30.77%	$85,702
Merchandising	$262,665	79/79	==>	100.00%	$262,665
Purchasing and Support	$114,750	30/36	==>	83.33%	$95,625
Real Estate	$465,400	20/20	==>	100.00%	$465,400
Stores	$8,925,925	627/627	==>	100.00%	$8,925,925
Hearings	$48,330	8/8	==>	-100.00%	($48,330)
Regulatory	$1,020,819	46/153	==>	30.07%	($306,960)
Total Cost Savings					**$9,506,286**

Notes: In the percent reduction column, the figures presented are:
# of positions removed in a division / total # of positions in division

Fiscal Year 1992 figures are divisional budgets less personnel expenses, which are accounted for elsewhere.

d. Summary of Employment Impact Conclusions

Our analysis of the employment impact associated with full privatization leads to the following conclusions:

- The savings from salaries and wages paid over time are significantly larger than the costs associated with downsizing.
- The nature of the current employment of the ABC leaves the affected employees at risk of not being placed in other state government positions. Particularly, the skill levels, position classifications, and geographic location of eliminated jobs affect the chances of placement.

Table III-5

Estimated Lease Cost Savings Under Full Privatization

Annual Lease Expense (Stores)	$5,297,867
Estimate of Lease Breaking Expense (if phased-out)	$0
Total Lease Cost Savings	$5,297,867

b. Land and Buildings

Most of the property owned by the ABC, including the 19 store locations would no longer be needed under full privatization and would be declared surplus and filed with the Department of General Services to be redistributed or sold.

The total assessed value of the land and building for all 19 stores is $10,415,740. The assessed value gives an estimate of the replacement value of the properties. While the assessed value of the land and building may not predict accurately what some party would be willing to pay, it is an estimate of the benefit to the ABC from selling its property. As discussed in Section II, the Virginia Department of General Services would auction the property and remit the proceeds (assumed equal to the assessed value of the property) to the ABC.[8]

[8] If a state agency or locality established a need for an ABC property, it is unlikely that ABC would be remitted any funds. If some of the properties are claimed by other state agencies or localities, our estimates of cost savings from the sale of surplus properties would be reduced.

c. Equipment and Vehicles

The equipment and assets directly related to retail store operations, including cash registers, safes, shelving, and furniture, would no longer be needed under full privatization and would be declared surplus through the process explained above. In addition to the store equipment, equipment such as forklifts, pallet trucks, tools and accessories would be declared surplus property. This equipment is valued using the current book value provided by the ABC, as presented in Table III-7. Although current book value may not be an accurate estimate of the resale value, it is an estimate of the benefit to the ABC associated with selling the equipment.

Table III-7

Equipment and Vehicle Cost and Cost Savings Under Full Privatization

Description	Estimated Resale Value
Equipment	$655,797
Vehicles	$48,241
Vehicles Purchased	($698,694)
Total Equipment and Vehicle Cost	($5,344)

* Figures in parentheses represent costs to the ABC.

which privatization is implemented. ABC would only order more popular brands of liquor and would no longer order more unpopular products that do not sell very well.[9] In addition to ordering only more popular products, ABC would scale back the quantity of merchandise ordered in order to ensure that the merchandise ordered would all be sold during the transition period. Merchandise not sold by the end of the transition period would be sold to the new wholesale liquor licensees at a discount.

f. Vacating Retail Stores

ABC would incur significant labor and shipping expenses throughout the process of vacating the 243 retail stores. This process would involve dismantling and removing store fixtures and equipment in each retail store. We estimated the labor expense based on similar costs incurred by the Real Estate Division in the past. On average, the Real Estate Division has dispatched a crew of three mechanics, three assistant mechanics, and one painter for three days in order to thoroughly dismantle a retail store. Based on the salary and benefits expenses of these positions, we estimate that the cost to the ABC for dismantling all 243 retail stores would total approximately $537,303.

3. Summary of Employment and Facilities Costs and Cost Savings

In Exhibit III-14 we present a chart that summarized the costs and cost savings associated with changes in employment and facilities under full privatization.

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[9] Customers could still special order products that would no longer be carried by ABC during the implementation of partial privatization.

Private Sector Retail Analysis

This section contains the following:

- License Revenues
- Employment and Wages Generated
- Retail Profits

D. Private Sector Retail Analysis

In this section we discuss the impact of full privatization on potential private sector retailers. We discuss this impact in terms of:

- License revenues
- Employment and wages generated
- Retail profits

1. License Revenues

Our estimates for the number of licenses, license fees, and license revenues are identical to our estimates presented in our partial privatization section. We estimate that approximately 6,000 new retail liquor licenses would be issued by ABC under full privatization, generating approximately $4.1 million in license revenues.[10]

[10] Includes both off-premise and on/off-premise liquor licensees.

2. Employment and Wages Generated

We present our estimates of employment, wages, and personal state income taxes generated under full privatization in Table III-8. We estimate that the total gallons of liquor sold under full privatization would be approximately 90 percent of total gallons sold under partial privatization. Therefore, we estimate that full privatization will support approximately 90 percent of the jobs estimated under partial privatization. Total annual wages for these 2,829 retail jobs are estimated to be approximately $33 million, generating approximately $1.6 million in state income taxes.[11]

Table III-8

Estimated Employment and Wages Generated Under Full Privatization

Number of Jobs	2,829
Total Annual Wages	$32,615,541
State Income Taxes	$1,550,955

Using a tax rate of approximately 4.76 percent, we estimate that personal income taxes collected by the state of Virginia from employees in private sector retail sales would total approximately $1,550,955. However, the initial impact of full privatization would eliminate many ABC positions, creating a net loss of approximately $1,020,214 in personal income taxes to the state of Virginia.

[11] Derived assuming average annual wages per employee of $11,529 and a 4.76 percent income tax rate.

3. Retail Profits

In Table III-9 we present estimated net profits to retailers under full privatization. We estimated retail profits assuming a retail net profit margin of 5 percent for liquor retailers. Our estimate of corporate taxes is calculated based on a corporate tax rate of six percent. As previously discussed, we estimate that under full privatization approximately 6.12 million gallons of liquor would be sold in Virginia, yielding average annual net profits to retailers of approximately $17 million, and approximately $1 million in corporate taxes to the state.

Table III-9

Estimated Net Profits in Retail Sector Under Full Privatization

Estimate of Total Retail Sales (in thousands)	$341,883
Estimate of Net Profits (in thousands)	$17,094
Estimate of Corporate Taxes (in thousands)	$1,026

Private Sector Wholesale Analysis

This section contains the following:

- Number of Liquor Wholesalers
- License Revenues
- Employment and Wages Generated
- Wholesale Profits

E. Private Sector Wholesale Analysis

In this section we estimate the impact of full privatization on potential private sector wholesalers. We discuss this impact in terms of the resulting wholesale market, the size of potential wholesalers, employment and wages generated, and wholesaler profits. All discussions of wholesale activity included here pertain only to the wholesale liquor segment of the market.

1. Number of Liquor Wholesalers

Wholesale markets in license states have recently followed trends toward consolidation resulting in fewer, but larger, wholesaling operations. The wholesale beer and wine market in Virginia reflects these trends in consolidation. In addition, we expect that many existing beer and wine wholesalers in Virginia would distribute liquor products, which would limit further the total number of liquor wholesalers in Virginia under full privatization.

Manufacturers, assessing the new wholesale liquor market in Virginia, would most likely award franchises to established beer and wine distributers in Virginia. These wholesalers would be selected by manufacturers to distribute brands in exclusive territories. Although the sizes of these territories would range from city-wide to state-wide areas, we expect that consolidation would occur over time. This consolidation would result in increasingly larger territories being awarded to wholesalers by manufacturers. Therefore, large wholesale establishments would distribute most of the liquor in Virginia. Small wholesalers would probably develop to specialize in and distribute smaller liquor brands or import lines, but would be responsible for only a small percentage of total wholesale liquor sales.

We examined the characteristics of beer and wine wholesale establishments in Virginia to estimate the number and size of potential liquor wholesalers under full privatization. There are approximately 64 beer wholesalers and 31 wine wholesalers in Virginia.[12] Many of these wholesalers distribute both beer and wine products, as is reflected in the number of licenses issued by ABC (89 beer wholesale licenses and 68 wine wholesale licenses).

In Virginia, approximately 22 of the 95 beer and wine wholesalers discussed above employ 68 percent of all beer and wine wholesale employees in Virginia. Considering the significant size and potential distribution efficiencies of these 22 establishments, we estimate that establishments within this group of large wholesalers would distribute the majority of wholesale liquor in Virginia under full privatization.

Overall, we estimate that approximately 75 liquor wholesalers would initially service the Virginia liquor market. Of these, approximately five to ten large wholesalers would emerge to distribute the majority of wholesale liquor. Many smaller wholesalers would emerge to serve smaller segments of the liquor market in Virginia.

2. License Revenues

We derive our estimate of the number of wholesale liquor licenses in Virginia under full privatization from our estimate of the number of wholesalers in Virginia under full privatization. We estimate that approximately 75 liquor licenses would be issued by the ABC to the wholesalers discussed above.

Currently, ABC's wholesale license fee structure for beer and wine wholesalers consists of three prices (based on the number of cases sold annually): $730, $1,100, and

[12] Source: Bureau of Census, County Business Patterns, 1989

$1,430. Since these fees are similar to wholesale fees in other license states, we assume that ABC would maintain a similar price structure for wholesale liquor licenses in Virginia under full privatization. We estimate that ABC would charge an average wholesale fee of $1,100 and would receive approximately $82,500 in liquor license revenue ($1,100 x 75).

3. Employment and Wages Generated

Our estimates presented in Table III-10 were derived using the same methodology developed in the previous section on partial privatization. As presented below, we estimate that private wholesale liquor sales in Virginia would support approximately 722 jobs. These 722 jobs would generate approximately $20.3 million in annual wages and $965,719 in state income tax revenue.

Table III-10

Estimated Wages Generated by Wholesale Liquor Sales

Average Annual Wages in Beer, Wine, and Distilled Beverages Sector*	$28,128
Wholesale Employment Estimate	x 722
Estimate of Annual Wholesale Wages	$20,308,416
Estimate of State Income Taxes	$965,719

* Source: Bureau of the Census, Census of Wholesale Trade, 1987.

Note: Estimate adjusted for inflation.

4. Wholesale Profits

In Table III-11 we present estimates of net profits in the wholesale market under full privatization. Using our estimates of total wholesale sales, and an average wholesaler net profit margin, we estimate that wholesalers would receive approximately \$9.0 million in net profits, generating approximately \$541,418 in corporate taxes.

Table III-11

Estimated Net Profits in Wholesale Sector Under Full Privatization

Estimate of Total Wholesale Liquor Sales (in thousands)	\$179,059
Estimate of Net Profits (in thousands)	\$8,953
Estimate of Corporate Taxes (in thousands)	\$537

Control and Regulation

This section contains the following:

- Control
- Legal Issues

F. Control and Regulation

In this section we build on our analysis of control in a partially privatized system through a discussion of how control may change under full privatization. We then discuss legal issues that could arise under full privatization.

1. Control

As mentioned in our analysis of partial privatization, the issue of control was highlighted as a major advantage of the current system in our interviews with interested parties throughout the Commonwealth and in our survey of Virginia residents. Although the issues surrounding control may not change under full privatization, the perceived magnitude of the issues may change. Given that the state would be involved in enforcement and licensing activities, rather than either the wholesaling or the retailing of liquor, Virginians may perceive there to be less control under full privatization than either the current system or a partially privatized system. Therefore, even if full privatization does not lead to a loss of control, as defined by increases in alcohol-related crimes and alcohol consumption, there may always be a perception of lost control under full privatization because the state would no longer have possession of liquor at any point in the distribution process.

Many Virginians appear to think that control is greater when the state plays a "hands-on" role in liquor distribution. With full privatization, there would be much less of a "hands-on" role for the state. Rather, the state would be involved in monitoring the process of liquor distribution through an increased number of regulatory agents. Although such a monitoring system may provide a level of control seen in other states, questions would likely linger about the degree to which liquor distribution would be controlled in a fully privatized system.

Ensuring Payment of the Excise Tax

Although most issues of control would be similar under both full and partial privatization, there would be an additional issue under full privatization that the Commonwealth would have to address. Because the state would no longer be as involved directly in the collection of state excise taxes, the state could have less control over the collection of revenue from excise taxes under full privatization. Under partial privatization, state excise taxes would be incorporated into the price that the state, as the only wholesaler of liquor, charges to private retailers. Because of the state's direct involvement in liquor distribution, it would be difficult (if not impossible) for retailers to avoid paying liquor-related excise taxes owed to the Commonwealth.

Because the state would not be involved directly in the distribution of liquor under full privatization, actions would need to be taken in order to ensure that private sector retailers and wholesalers pay excise taxes owed to the state. Under our model of full privatization, wholesalers would be required to pay a per unit tax on the liquor they receive from manufacturers. Because the tax that we propose is a per unit tax rather than an ad valorem tax, the state would not have to be concerned about the value of merchandise delivered to private sector wholesalers. Rather, the state would need to determine whether the level of taxes paid was commensurate with the amount (in gallons) of liquor delivered by the manufacturer to wholesalers.

In order to monitor the amount of liquor delivered to wholesalers, the state would need to institute reporting requirements of both manufacturers and wholesalers. Manufacturers would be required to report all shipments to wholesalers in Virginia and wholesalers would be required to report all inventory entering their warehouses, with taxes based on the amount of liquor shipped.

The ABC could create a special form that would ease the reconciliation of information from both of these sources. This form would include instructions to the wholesaler on computing tax liability and would allow for standardized information reporting. Such a form, designed for the reconciliation of information received from manufacturers and wholesalers, could facilitate the development of an automated processing system.

In the course of reconciling forms received from manufacturers and wholesalers, discrepancies would likely be found. Initial discrepancies could probably be corrected by wholesalers. Uncorrected discrepancies or continued problems with reconciliation would result in an inspection and audit of wholesalers by ABC. The information reported to ABC would be used to check against records kept by wholesalers in the event of an audit. Periodic audits, even in the absence of reporting and reconciliation errors, would be used to reduce problems with reconciliation. Our proposed increase of 16 employees in ABC's Accounting Division would be used largely to ensure that the appropriate level of excise taxes is being paid to the Commonwealth.

In addition to reporting requirements, other actions could be taken to ensure payment of taxes by private sector wholesalers. Wholesalers could be bonded at a level set by the Commonwealth and commensurate with their tax payments to ensure a stable stream of tax payments to the Commonwealth. Some penalty would be established for late payment of taxes. The Commonwealth could also use a possible loss or suspension of wholesaler license rights as a method of ensuring payment. Specific guidelines would need to be established as to what infractions would result in suspensions and full revocations of licenses. Finally, clear guidelines for the remittance of tax payments could reduce delinquency problems — some states use wire transfer payments to ensure prompt payment of tax liabilities.

2. Legal Issues

Were Virginia to move to full privatization, the following issues specific to the wholesaling of liquor would have to be addressed:

- At-Rest Laws — At-rest laws require out-of-state manufacturers to sell to locally licensed wholesalers and not directly to retailers.
- Primary Source Laws — Primary source laws ensure that wholesalers purchase alcoholic beverages from the primary American supply source.
- Price Affirmation Laws — Price affirmation laws require a manufacturer to sell its product to wholesalers within a state at a price no higher than is charged to other wholesalers in other states, including the control states.
- Price Posting Laws — Price posting laws require manufacturers and/or wholesalers to file a monthly schedule of prices with the state alcoholic beverage authority.
- Franchised Territories Laws — Franchised territories laws detail the obligations of the manufacturer and the franchisor. This law protects the interests of both parties by ensuring that the wholesaler is not terminated arbitrarily and allows the manufacturer to control and market its products by selecting wholesalers, assigning brands, and designating geographical territories.

Each one of these laws defines and structures the private liquor wholesaling market. These laws are present in many of the license states and would need to be adopted in some form in Virginia.

In addition to these very specific laws, Virginia would need to address the three issues discusses below.

a. Manufacturer-to-Wholesaler and Wholesaler-to-Retailer Relationships

Manufacturer-to-wholesaler and wholesaler-to-retailer relationships would require regulatory consideration. As indicated above, the issue of franchise termination is significant in the liquor industry. Franchise security laws have been enacted in 15 of the 32 license states to prohibit arbitrary termination of wholesaler services by manufacturers.

Issues regarding wholesaler-to-retailer relationships would also require regulation. For instance, manufacturers and wholesalers are generally not permitted to have an ownership interest in a retail establishment. Likewise, retailers are generally not permitted to have an ownership interest in a licensed wholesale house.

b. Licensing Revenues

According to ABC, license fees charged cannot exceed the cost of administering the licensing program. We envision that a fully privatized system would include liquor wholesale license fees that would generate revenue. Thus, present regulations would need to be changed.

c. Wholesaler Services

An additional area requiring the Commonwealth's attention is the distribution services wholesalers provide retailers in connection with liquor. Private wholesalers perform a range of functions contingent upon state law. In order to define the scope of wholesale distribution rights and responsibilities under a fully privatized scenario, a series of questions would need to be answered:

- Under what circumstances are wholesalers allowed to give retailers signs, samples, and free goods?
- What types of advertising materials and specialties (i.e., product displays, wine racks, point of sale coasters) are wholesalers permitted to furnish retail licensees?
- Are wholesalers allowed to set up advertising displays for licensees?
- Are wholesalers allowed to give discounts in the form of alcoholic beverages or cash to retailers who purchase a certain quantity?
- Are wholesalers allowed to extend credit to retail licensees?
- Are there any specifications regarding the days and hours during which wholesalers are allowed to deliver alcoholic beverages to retail licensees?

A fully privatized liquor distribution system would involve private organizations functioning as liquor wholesalers. This significant change from the present system would require that Virginia address many issues. However, given that all license states have already worked through these issues, Virginia has much evidence and experience to draw upon in making these decisions.

IV. CONCLUSION

Price Waterhouse conducted this study to determine the impact of both partial and full privatization of Virginia's liquor distribution system on the Commonwealth, the private sector, and consumers. In this section, we summarize the findings of our study and outline major impacts of the privatization of liquor distribution. We present a summary of the impacts of privatization in Exhibit IV-1.

A. Partial Privatization

We have analyzed many aspects of a partially privatized liquor distribution system. In summary a partially privatized system would feature:

- An average price increase of 13 percent in a revenue neutral scenario.
- The elimination of 677 full-time and 795 part-time state government positions.
- Retail sale of liquor for off-premise consumption in licensed grocery stores, convenience stores, drug stores, certain filling stations, and private liquor stores that could sell liquor from 6:00 a.m. to 12 midnight, seven days a week (for a maximum of 126 hours per week).
- Reduced presence of government in the retail liquor market.
- Efforts to "control" the consumption and distribution of liquor that feature periodic monitoring of licensees versus possession of liquor by the state until the point of retail sale.

Most of the above issues are relatively straightforward. However, the issue of control is not as easy to quantify as most of the other issues in this analysis. Furthermore, throughout our interviews and our survey of Virginia residents, we were told repeatedly that control was a major advantage of the current system of liquor distribution. Although it probably would be possible to control the distribution of liquor

Summary of Privatization Impacts

	Current System	Partial Privatization	Full Privatization
Revenue to State	$91.5 million	$91.5 million	uncertain
State Employment	1023 full-time 795 part-time	393 full-time 0 part-time	310 full-time 0 part-time
Average Price Level	$8.49	$9.59	$11.23
Control:			
State Possession of Liquor	constant	reduced	eliminated
Monitoring/Auditing of Licensees	constant	increased	increased
Government Presence	involved in retail and wholesale markets	reduced in retail market	reduced in retail and wholesale markets
Private Sector Employment	constant	increased	increased
Retail Hours of Operation per Week	48 to 66 hours	up to 126 hours	up to 126 hours
Private Retail Liquor Licensees	none	5000	5000
Private Wholesale Liquor Licensees	none	none	75

as other license and partially privatized states do, Virginians still may perceive a partially privatized system as being characterized by less control than the current system. Therefore, efforts to evaluate the feasibility of partial privatization will need to weigh carefully the quantifiable benefits and costs with the other, less quantifiable concerns of the citizens.

B. Full Privatization

In addition to analyzing a proposed partially privatized system of liquor distribution, we have analyzed many aspects of a fully privatized liquor distribution system. In summary a fully privatized system would feature:

- An average price increase of 32 percent in a revenue neutral scenario.
- The elimination of 767 full-time and 795 part-time state government positions.
- Retail sale of liquor for off-premise consumption in licensed grocery stores, convenience stores, drug stores, certain filling stations, and private liquor stores that could sell liquor from 6:00 a.m. to 12 midnight, seven days a week (for a maximum of 126 hours per week).
- Wholesaling of liquor by an estimated 75 private sector wholesalers.
- Reduced presence of government in the wholesale and retail markets for liquor.
- Efforts to "control" the distribution and consumption of liquor that feature periodic monitoring of licensees rather than possession of liquor by the state until the point of retail sale.

In contrast to partial privatization, revenue neutrality may not be obtainable under full privatization because of the significant price increase needed. This price increase may cause Virginians who live near the border of lower-taxed jurisdictions to purchase their liquor in other states. Such cross-border activity may cause sales to decline more than initially estimated, which would result in an even greater price increase. As prices increase, the probability of Virginia maintaining revenue neutrality under full privatization would decrease. Therefore, as policymakers compare a fully privatized system to the current system of liquor distribution, they will need to consider concerns about control and the uncertainty surrounding a revenue neutral scenario.

SURVEY OF VIRGINIA RESIDENTS

In this Appendix we present the results of a telephone survey of Virginia residents 21 years of age or older conducted during July 1992. We have organized this Appendix into the following sections:

- Overview of Results
- Background and Objectives
- Detailed Findings
- Survey Methodology
- Copy of the Survey

A. Overview of Results

This survey measured the opinions of approximately 700 Virginia residents regarding two scenarios of liquor distribution:

- a proposed system of privately-owned, licensed liquor stores
- the current system of state-owned and operated ABC liquor stores

Approximately two-fifths (40 percent) of Virginia residents approve of a system of privately-owned liquor stores. Virginians are less likely to approve of a privatized system in which grocery and convenience stores are permitted to sell liquor — about one-quarter of those surveyed approve of such a scenario. Younger, more-educated, urban, and male residents of Virginia are more likely to view a private system of liquor distribution with approval. Those approving of a private liquor distribution system cite more competition, less government, lower prices, and more liquor stores/more accessibility to home as their principal reasons for approval. The slight majority who disapprove of a private liquor distribution system cite lack of control, increased accessibility, and increased underage drinking as their major reasons for disapproval.

The majority of Virginia residents (63.4 percent) approve of the current system of liquor distribution. Of those approving of the current system, the most common reasons given for approval are that the current system maintains control/limits accessibility to alcohol and keeps underage drinking low. Older, less-educated, rural, and female residents are more likely to be among those who approve of the current system. The 30 percent of residents who disapprove of the current system cite government involvement, excessively high prices, and limited hours/Sunday closures as reasons for disapproval. The most commonly suggested improvements to the current system are more enforcement of alcohol laws and increased hours, although most residents either have no suggestions for improvement or do not know what improvements they would make.

B. Background and Objectives of Survey

The purpose of the survey was to collect Virginia residents' opinions on various scenarios for the sale and distribution of alcohol in the state of Virginia. The survey was specifically designed to measure opinions of Virginia residents regarding two scenarios for the sale of liquor in Virginia: the current system of state-owned and operated ABC liquor stores, and a proposed system of privately-owned, licensed liquor stores. In addition to asking about privately-owned liquor stores, the survey also asked Virginians about their opinion of liquor being sold in grocery and convenience stores.

We conducted telephone interviews of 703 Virginia residents. We questioned the residents who participated on the following general issues:

- A proposed system of privately-owned and operated, licensed liquor stores in Virginia
- Reasons for approval of a proposed system of privately-owned and operated, licensed liquor stores in Virginia
- Concerns, if any, about a proposed system of privately-owned and operated, licensed liquor stores in Virginia
- A proposed system of privately-owned liquor stores in which liquor is sold in grocery and convenience stores, in addition to being sold in privately-owned, licensed liquors
- The current system of state-owned and operated ABC liquor stores
- Reasons for approval of the current system of state-owned and operated ABC liquor stores
- Concerns, if any, about the current system of state-owned and operated ABC liquor stores
- Liquor purchasing behavior

We grouped questions about the different scenarios of selling alcohol into two question "blocks" (i.e., questions about private liquor stores, or questions about the current state ABC system). In order to eliminate any bias due to the ordering of the questions, we administered these question "blocks" in random order.

C. Detailed Findings

1. A System of Privately-Owned and Operated Liquor Stores

We questioned residents about a scenario that involves changing over from the current state system of ABC liquor stores to privately-owned and operated liquor stores.

In this scenario, we informed residents that liquor would be sold only through licensed stores and that grocery and convenience stores would not be permitted to sell liquor.

a. Overall Results

As presented in Exhibit A-1, about one-half of Virginia residents (52 percent) either strongly disapprove or somewhat disapprove of liquor being sold only through privately-owned liquor stores. The larger share of Virginia residents, more than one-third (36 percent), strongly disapprove of this scenario. In contrast, two-fifths of Virginia residents (39 percent) either strongly approve or somewhat approve of liquor being sold only through privately-owned liquor stores. Approval of this scenario is evenly split between those residents who strongly approve (19 percent), and those who somewhat approve (20 percent).

b. Profile of Survey Respondents with Strong Opinions of a Privatized System

Older Virginia residents are more likely to strongly disapprove of privately-owned liquor stores than younger residents. Almost one-half of Virginia residents over age fifty (49 percent) strongly disapprove of privately-owned and operated liquor stores, while just over one-quarter of the respondents between the ages of 21 and 35 (27 percent) strongly disapprove of this scenario.

In addition to being strongly disapproved by older residents, a system of privately-owned and operated liquor stores is more likely to be disapproved by residents living in rural areas than those living in urban areas. Only one-third of the urban residents (33 percent) strongly disapprove of privately-owned liquor stores, compared to almost one-half of the rural residents (45 percent) who strongly disapprove.

Survey of Virginia Residents

Question: How do you feel about allowing liquor to be sold only in privately-owned, licensed liquor stores?

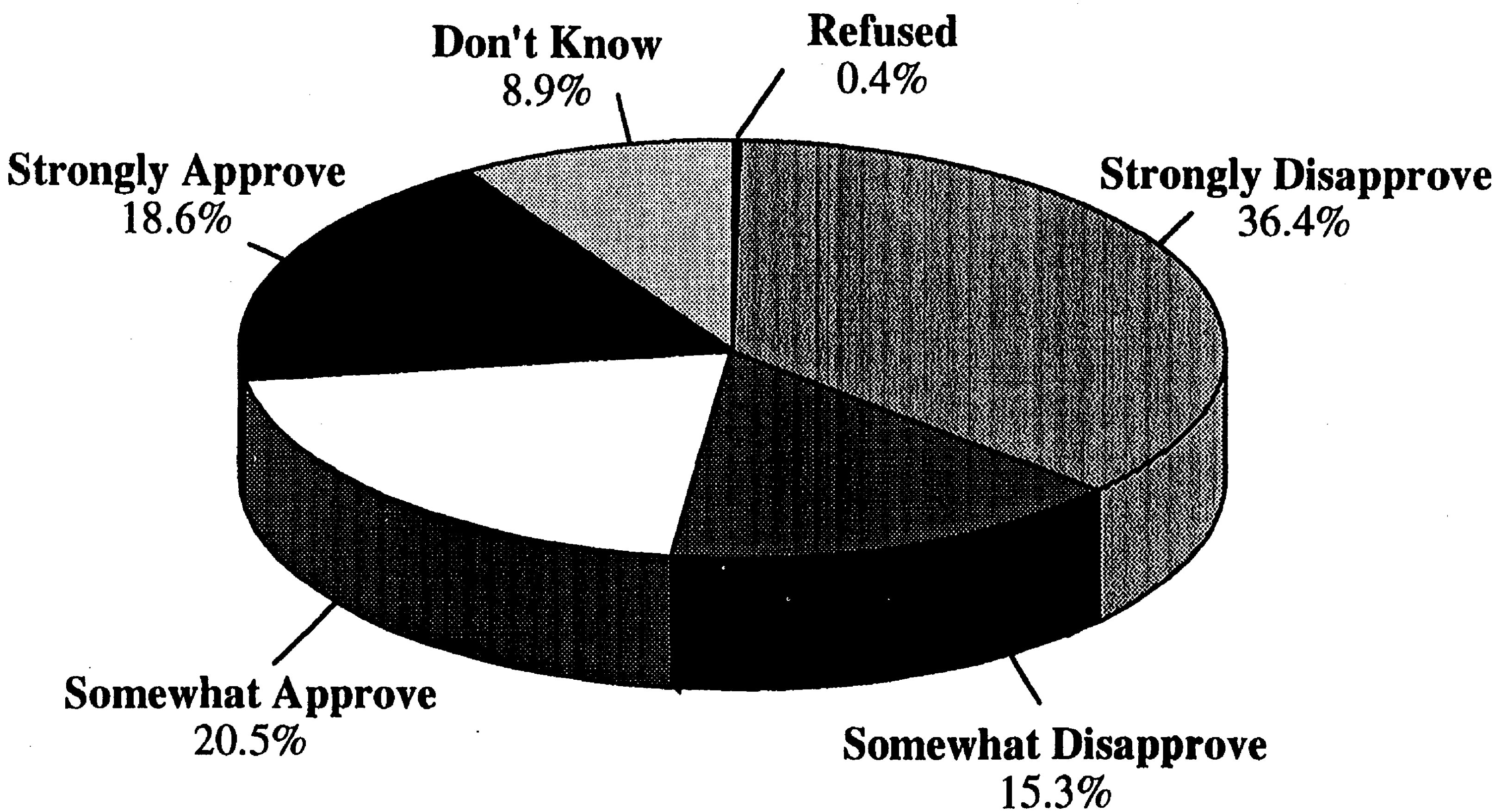


Exhibit A-1

Virginia residents with lower levels of education are more likely to strongly disapprove of privately-owned liquor stores. Almost one-half of all Virginia residents who do not have a high school diploma (49 percent) strongly disapprove of privately-owned and operated liquor stores. Less than one-third of the Virginia residents who have attended at least some college (32 percent) strongly disapprove of privately-owned liquor stores.

Virginia residents who have visited private liquor stores outside of Virginia are more likely to strongly approve of private liquor stores in Virginia than those residents who have not. More than one-in-four residents who have visited out-of-state liquor stores (26 percent) strongly approve of private liquor stores in Virginia, while less than one-in-ten residents who have not visited out-of-state liquor stores (9 percent) strongly approve of this scenario.

Finally, male Virginia residents are more likely to strongly approve of private liquor stores in Virginia than female residents. One-quarter of male residents (25 percent) strongly approve of private liquor stores compared to about one-tenth of female residents (12 percent).

c. Reasons for Approval of Privately-Owned Liquor Stores

Of those Virginia residents who either strongly approve or somewhat approve of liquor stores being privately-owned and operated, the most common reasons for approval include:

- More Competition (43 percent)
- Less Government (39 percent).
- Lower Prices (17 percent)
- More Liquor Stores/More Accessible to Home (14 percent)

d. Concerns about Privately-Owned Liquor Stores

Of those Virginia residents who either strongly disapprove or somewhat disapprove of privately-owned liquor stores, the most common reasons given for either strong or moderate disapproval are:

- That a private system may not provide enough control/liquor may be too accessible (57 percent)
- This scenario may lead to underage drinking (33 percent)

Almost two-fifths (37 percent) of those Virginia residents who either strongly disapprove or somewhat disapprove of privately-owned liquor stores did not specify concerns with this proposed scenario.

2. A System of Privately-Owned Liquor Stores with Grocery and Convenience Stores Selling Liquor

In this scenario, we asked residents their opinions about a system of privately-owned, licensed liquor stores in which grocery and convenience stores were also permitted to sell liquor.

a. Overall Opinions

As presented in Exhibit A-2, about three-quarters of Virginia residents (74 percent) either strongly disapprove or somewhat disapprove of liquor being sold in grocery and convenience stores, with the largest portion (59 percent) strongly disapproving of this system of liquor distribution. In contrast, only a quarter of Virginia residents either strongly approve (13 percent) or somewhat approve (10 percent) of the sale liquor in grocery and convenience stores.

Survey of Virginia Residents

Question: In addition to liquor being sold through privately owned, licensed liquor stores, how would you feel if liquor were also allowed to be sold in grocery stores and convenience stores?

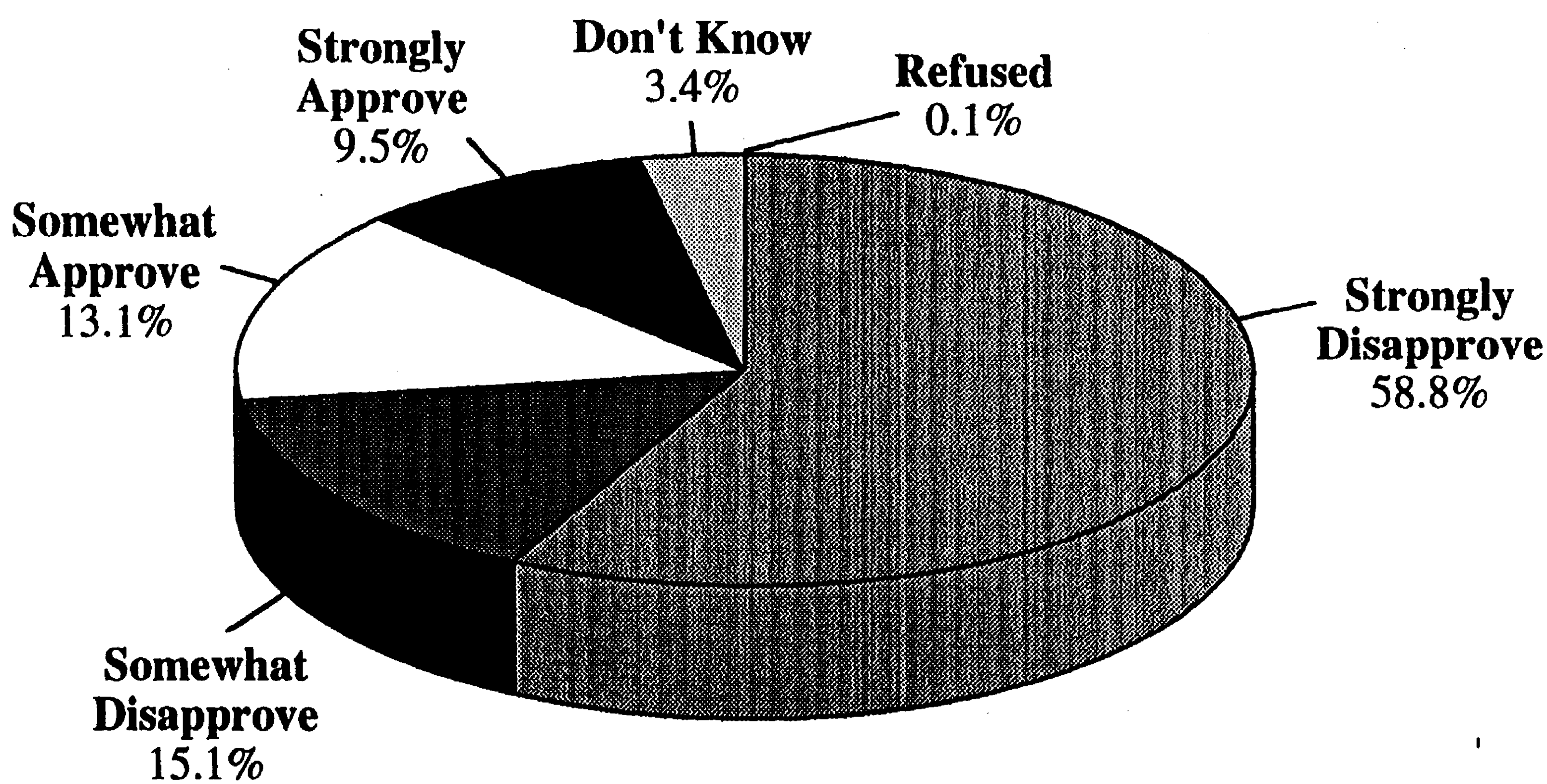


Exhibit A-2

b. Profile of Survey Respondents Having Strong Opinions of a Privatized System in which Grocery and Convenience Stores Sell Liquor

Older Virginia residents are more likely to strongly disapprove of liquor being sold in grocery and convenience stores. While less than one-half of Virginia residents between 21 and 35 years (45 percent) strongly disapprove of this scenario, almost three-quarters of Virginia residents over age fifty (73 percent) strongly disapprove of liquor being sold in grocery and convenience stores.

Although the majority of Virginia residents strongly disapprove of liquor being sold in grocery and convenience stores, residents with higher levels of education are less likely to strongly disapprove of this scenario. Approximately one-half of those Virginia residents who have attended at least some college (52 percent) strongly disapprove of liquor being sold in grocery and convenience stores, while approximately two-thirds of Virginia residents who have not attended college strongly disapprove of this scenario.

3. The Current System of ABC Stores

We questioned residents about a scenario that involves keeping the current state system of state-owned and operated ABC liquor stores. In general, the majority of Virginia residents appear to approve of the current system of liquor distribution.

a. Overall Opinions of the Current System

As presented in Exhibit A-3, nearly two-thirds of Virginia residents (63 percent) either strongly approve or somewhat approve of the current system of state-owned and operated ABC liquor stores. Two-fifths of all Virginia residents (40 percent) strongly approve of the current system. Three out of ten Virginia residents (30 percent) either

Survey of Virginia Residents

Question: How do you feel about keeping the current ABC system?

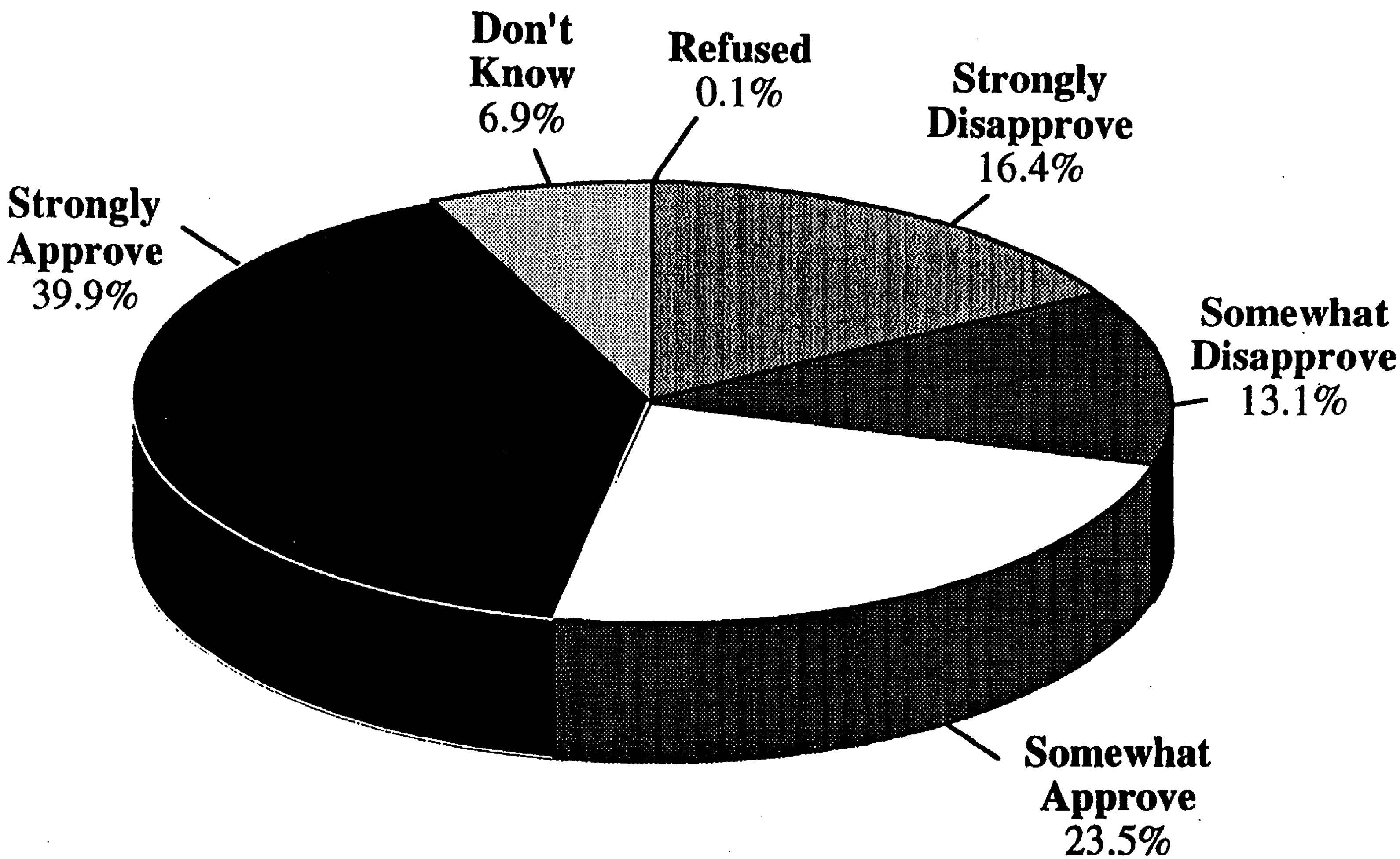


Exhibit A-3

strongly disapprove (17 percent) or somewhat disapprove (13 percent) of the current system of ABC stores.

b. Profile of Survey Respondents Having Strong Opinions about the Current System

Older Virginia residents are more likely to strongly approve of the current system of ABC stores. Almost half of Virginia residents over age fifty (48 percent) strongly approve of the current system of ABC liquor stores, while just over one-third of the respondents between 21 and 35 years (34 percent) strongly approve of the current system.

Virginia residents who are less educated are more likely to strongly approve of the current system of ABC stores. Only one-third of Virginia residents who have been to college (36 percent) strongly approve of the current system, while almost one-half of Virginia residents with high-school diplomas (47 percent) strongly approve of this scenario. About two in five adults who have not completed high school (41 percent) strongly approve of the current system of ABC stores.

Female Virginia residents are more likely to strongly approve of the current system of state-owned ABC stores than male residents. Over two-fifths of female residents (44 percent) strongly approve of the current system, compared to only about one-third of male residents (36 percent) who strongly approve.

c. Concerns About the Current State System of ABC Stores

Of those disapproving of the current system of liquor distribution, the most common reasons given for either strong or moderate disapproval are:

- Government Involvement (44 percent)
- Prices Too High (15 percent)
- Limited Hours/Not Open on Sunday (10 percent)

Almost one-quarter (23 percent) of those disapproving of the current system have no concerns, while about one-eighth of these residents (15 percent) say they are against drinking altogether.

d. Reasons for Approval of the Current System

Among those Virginia residents who either strongly approve or somewhat approve of the current system, the most common reasons given are:

- Maintains Control/Limits Accessibility to Alcohol (54 percent)
- Keeps Underage Drinking Low (24 percent)

Of those Virginia residents who either strongly approve or somewhat approve of the current system of ABC stores, about one-in-ten (9 percent) say they are against drinking altogether.

e. Suggested Improvements in Service or Control to the Current System

Of all Virginia residents surveyed about the current state system of ABC stores, the top two suggestions for improvement in service or control are:

- More Enforcement of Alcohol Laws (13 percent)
- Increased Hours (8 percent)

Almost two-thirds of all Virginia residents say they are either satisfied with the current state system (35 percent), or they do not know what improvements they would make to the current state system of ABC stores (28 percent).

4. Liquor Purchasing Behavior

In this section we present a profile of the liquor purchasing patterns of the Virginia residents who participated in the survey.

a. Frequency of ABC Patronage

Almost one-half of the Virginia residents surveyed (47 percent) have not visited an ABC store within the last year. More than four-fifths of the Virginia residents surveyed (82 percent) have not visited an ABC store more than once every three months in the last year. About one-in-five of the Virginia residents surveyed (18 percent) have visited an ABC store at least once a month in the last year. Very few Virginia residents (3 percent) have visited an ABC store once a week or more in the last year.

b. Frequency of Out-of-State Patronage

More than one-half of the Virginia residents represented in the survey (56 percent) have visited a private liquor store outside the state of Virginia. The states most commonly frequented by Virginia residents are:

- Maryland (23 percent)
- District of Columbia (12 percent)
- New York (8 percent)
- Florida (7 percent)

Over half of the Virginia residents who have visited an out-of-state private liquor store (52 percent) did so longer than one year ago. Only about one-in-fifty Virginia residents visiting out-of-state private liquor stores (2 percent) did so within the week that they were surveyed.

D. Survey Methodology

The sample of Virginia residents was compiled from a random digit dial (RDD) sample of Virginia household telephone numbers provided by Survey Sampling, Inc. Household telephone numbers were generated, at random, from Virginia counties in one of three density categories: Urban, Suburban, and Rural. Urban is defined as city/county areas with more than 85,000 households, suburban is defined as city/counties with 20,000 to 85,000 households, and rural is defined as city/counties with less than 20,000 households.

Once we made contact, we selected individual respondents within a household using a systematic selection procedure, which sets quotas by gender. The survey results, which yielded a nearly equal number of male respondents (50.3%) and female respondents (49.7%), indicate that the selection criteria were effective.

We administered the survey using a Computer Assisted Telephone Interviewing (CATI) system. This system allows on-line data entry, data verification, and logical consistency checks to be conducted as the interview is administered. We pre-tested the questionnaire on randomly selected Virginia adults to evaluate question content and clarity. The Price Waterhouse Survey Research Center staff conducted these interviews between July 16 - 28, 1992

We weight the data by the number of households in each city/county density category to correct for differences between the sample distribution and the actual distribution of households across the state of Virginia. By weighting the results in this manner, we can produce estimates from the sample which should hold true for all Virginia residents regardless of the city/county density of the sampled household.

We completed a total of 703 interviews. The margin of sampling error is +/- 4 percentage points for overall results based on the total sample. The recommended allowance for sampling error for the density subgroups, and for the difference between sample subgroups, will be larger than the margin of error for overall results.

We tabulated a database from the 703 completed interviews using Statistical Analysis Software (SAS). Our analysis of the survey results includes:

- Overall tabulations of the responses to each survey question
- Cross tabulations of each question by seven analysis variables (age, sex, ethnicity, education, density category, Virginia region, and visits to out-of-state liquor stores)

We divided the Virginia residents represented by the survey equally into the following age groups: 21 to 35 years (35%), 35-50 years (35%), and 50 years or older (30%). Almost one-half of the Virginia residents represented in the survey are between the ages of 21 and 40 years of age. Just over one-tenth of the Virginia residents surveyed are age 65 or older. Virginia residents represented by this survey are evenly divided between male (50%) and female (50%) residents.

Almost ninety percent of the Virginia residents represented in the survey have graduated from high school. This figure includes Virginia residents who have gone on to attend college, or have obtained a higher degree. Specifically, about one-third of Virginia residents in the survey (34%) have graduated from college. Only about one-tenth of the Virginia residents (11%) represented by the survey have not completed a high school education.

Over 80 percent of the Virginia residents represented by the survey describe themselves as White, while less than fifteen percent describe themselves as Black. Other races constitute about two percent of the Virginia residents surveyed. The other races given include: Asian/Pacific Islander, Native American Indian, and Hispanic.

E. Survey

In this section we present the official survey used to question Virginia residents. The survey appears in the original form that was used by those who conducted it.

VIRGINIA ABC SURVEY OF STATE RESIDENTS

Hello, my name is ________________ from the Price Waterhouse Survey Research Center. We are conducting a survey of Virginia residents about the sale of liquor in Virginia and I would like to speak with the youngest male, 21 years or older, who is now at home. (IF NO MALE, ASK: May I please speak with the oldest female, 21 years or older, who is now at home?)

IF PARTICIPANT OTHER THAN ONE WHO ANSWERED PHONE:

> Hello, my name is ________________ from the Price Waterhouse Survey Research Center. We are conducting a survey of Virginia residents about the sale of liquor in Virginia.

This survey will take about 5 minutes and your answers will be held in strict confidence. Before we continue, are you at least 21 years of age?

SURVEY BEGINS HERE:

I'm going to describe to you two options of selling liquor in Virginia. Some people believe that the state should continue to operate its ABC Stores as the only place to buy liquor. Other people believe that the state should turn the sale of liquor over to the private sector. I will describe each of these options and then I'll ask your opinion of each.

CATI: QUESTIONS 1-2 WILL BE ROTATED RANDOMLY

1. One/Another option is to allow individuals and/or companies to open their own liquor stores, as opposed to the current system in which the state owns and operates liquor stores, known as ABC stores. For this option, liquor would be sold only through privately-owned, licensed liquor stores. How do you feel about this option? Do you

    1 Strongly disapprove
    2 Somewhat disapprove
    3 Somewhat approve
    4 Strongly approve
    8 DON'T KNOW
    9 REFUSED

IF RESPONDENT ANSWERED 3 OR 4 IN QUESTION 1, PROCEED TO QUESTION 1A. THEN PROCEED TO QUESTIONS 1B AND 1C.

IF RESPONDENT ANSWERED 1,2, OR 5 TO QUESTION 1, PROCEED TO QUESTIONS 1B AND 1C.

1A. Why do you approve/strongly approve of this option?

INTERVIEWER: DO NOT READ THIS LIST

HIGHLIGHT ALL THAT APPLY

    1 More Competition
    2 Less Control
    3 Lower Prices
    4 Less Government
    5 More Convenient Hours
    6 More Liquor Stores/More Accessible to Home
    7 Other ______________
    8 DON'T KNOW
    9 REFUSED

1B. What concerns, if any, do you have about this option?

INTERVIEWER: DO NOT READ THIS LIST

HIGHLIGHT ALL THAT APPLY

1 Underage Drinking
2 Street Crime
3 Domestic Violence and Disputes
4 Alcoholism Increase
5 Alcohol Consumption Increase
6 Drunk Driving Increase
7 Not Enough Control, Too Accessible
8 Prices Too High
9 Against Drinking
10 Other ________________
11 NO CONCERNS
88 DON'T KNOW
99 REFUSED

PROCEED TO QUESTION 1C

1C. In addition to liquor being sold through privately-owned, licensed liquor stores, how would you feel if liquor were allowed to be sold in grocery stores and convenience stores? Would you...

INTERVIEWER READ LIST

1 Strongly disapprove
2 Somewhat disapprove
3 Somewhat approve
4 Strongly approve
8 DON'T KNOW
9 REFUSED

2. One/Another option we are studying is to keep the current system. That is, the state would continue to own and operate all liquor stores, currently known as ABC stores. Although you can buy beer and wine in many types of stores, you can buy liquor, such as gin and vodka, only in state-owned and operated ABC stores. How do you feel about keeping the current system? Do you

1 Strongly disapprove
2 Somewhat disapprove
3 Somewhat approve
4 Strongly approve
8 DON'T KNOW
9 REFUSED

IF RESPONDENT ANSWERED 1 OR 2 IN QUESTION 2, PROCEED TO QUESTION 2A. THEN PROCEED TO QUESTION 2C.

IF RESPONDENT ANSWERED 3 OR 4 IN QUESTION 2, PROCEED TO QUESTION 2B. THEN PROCEED TO QUESTION 2C.

2A. What concerns, if any, do you have about the current system of ABC stores?

INTERVIEWER: DO NOT READ THIS LIST
HIGHLIGHT ALL THAT APPLY

1 Underage Drinking
2 Street Crime
3 Domestic Violence and Disputes
4 Alcoholism Increase
5 Alcohol Consumption Increase
6 Drunk Driving Increase
7 Not Enough Control, Too Accessible
8 Prices Too High
9 Government Involvement
10 Limited Hours/Not Open Sunday
11 Not Enough Stores/Near Home
12 Against Drinking
13 Other _______________
14 NO CONCERNS
88 DON'T KNOW
99 REFUSED

2B. What do you like about the current system of ABC stores?

INTERVIEWER: DO NOT READ THIS LIST

HIGHLIGHT ALL THAT APPLY

1 Underage Drinking low
2 Street Crime low
3 Domestic Violence and Disputes low
4 Alcoholism low
5 Alcohol Consumption low
6 Drunk Driving low
7 Maintains Control, Limits Accessibility
8 Prices Low
9 Uncertainties Involved in Change
10 Against Drinking
11 Other ____________
88 DON'T KNOW
99 REFUSED

2C. What improvements in service or control, if any, would you make to the current state system of ABC stores?

INTERVIEWER: DO NOT READ THIS LIST

HIGHLIGHT ALL THAT APPLY

1 Increase Hours
2 Decrease Hours
3 More Locations
4 Fewer Locations
5 Increase Prices
6 Decrease Prices
7 Clerks Provide Better Service
8 More Selection
9 More Enforcement of Alcohol Laws
10 Other ____________
11 SATISFIED WITH CURRENT SYSTEM
88 DON'T KNOW
99 REFUSED

I would now like to ask you a few questions that will be used to compare your responses to those of other participants in the survey.

3. What is the highest grade of formal schooling that you have ever completed?

INTERVIEWER READ LIST

1 8th grade or less
2 9th, 10th, or 11th grade
3 high school diploma/graduate
4 some college
5 college degree
6 post-graduate studies/degree
8 DON'T KNOW
9 REFUSED

4. In the last year, about how often did you visit an ABC store?

INTERVIEWER READ LIST

1 About once a week or more
2 About twice a month
3 About once a month
4 About once every three months
5 About once every six months or less
6 Never
8 DON'T KNOW
9 REFUSED

5. Have you ever visited a private liquor store outside the state of Virginia?

1 Yes
2 No
8 DON'T KNOW
9 REFUSED

IF RESPONDENT ANSWERED 1 TO QUESTION 5, PROCEED TO QUESTIONS 5A AND 5B.

5A. In what state did you most recently visit a private liquor store?

INTERVIEWER DO NOT READ LIST

1 Maryland
2 D.C.
3 West Virginia
4 North Carolina
5 Tennessee
6 Kentucky
7 Other_____________
8 DON'T KNOW
9 REFUSED

5B. How recently did you visit this store? ____________

INTERVIEWER READ LIST

1 Within the past week
2 Within the past month
3 Within the past three months
4 Within the past six months
5 Within the past year
6 Longer than 1 year ago
8 DON'T KNOW
9 REFUSED

6. What is your age? ____________

7. What is your race? Are you white, black or another race?

INTERVIEWER: DO NOT READ THIS LIST
HIGHLIGHT RESPONDENT'S ANSWER

1 White
2 Black
3 Asian/Pacific Islander
4 Native American Indian
5 Other
8 DON'T KNOW
9 REFUSED

This concludes our survey and I would like to thank you very much for your assistance in this survey. Have a nice day/night.

INTERVIEWER
Was the respondent male or female?

1 male
2 female

CATI: __________ GENDER

__________ COUNTY/CITY

__________ DENSITY FACTOR

COMPARISON OF LIQUOR DISTRIBUTION SYSTEMS

In this appendix, we discuss important features of liquor distribution systems in various control and license states. The states in our comparison were selected based on discussions with the Virginia ABC, requirements set forth in the RFP, and an examination of factors that made comparison with Virginia particularly relevant. These factors included population, geographical size, proximity to Virginia, and apparent consumption.

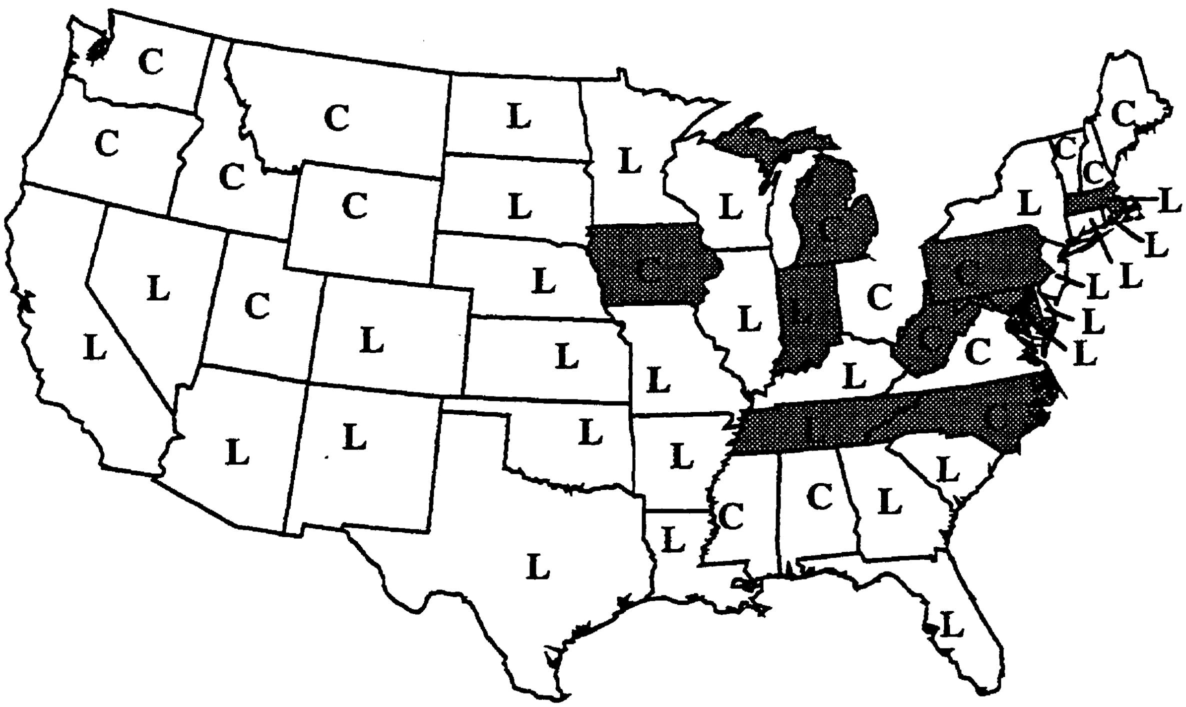
After selecting the states for our comparison, we collected information on each state from annual reports, relevant studies, alcohol industry sources, and legal documents. After reviewing this information, we interviewed retailers, wholesalers, and state officials who we believed could provide us with insight into the workings of their state's distribution system.

Thirty-two of the fifty states, and the District of Columbia, are "open" or "license" states. The remaining eighteen states are "control" states. Exhibit B-1 presents the division between control and license states and highlights the ten states included in our study.

On the following pages we present data on the states that we have included in our comparison:

- Exhibits B-2 through B-5 present an overview of the consumption patterns of the states included in our comparison
- Exhibit B-6 presents an overview of the alcohol-related revenues of the states included in our comparison
- Exhibits B-7 and B-8 present revenue per wine gallon of distilled spirits and spirit collections per capita respectively

Surveyed License and Control States



C **Control States - 18**

L **License States - 32**

Surveyed Control States	Surveyed License States
Iowa	District of Columbia
Michigan	Indiana
North Carolina	Maryland
Pennsylvania	Massachusetts
West Virginia	Tennessee

Total Consumption of Distilled Spirits
(1990)

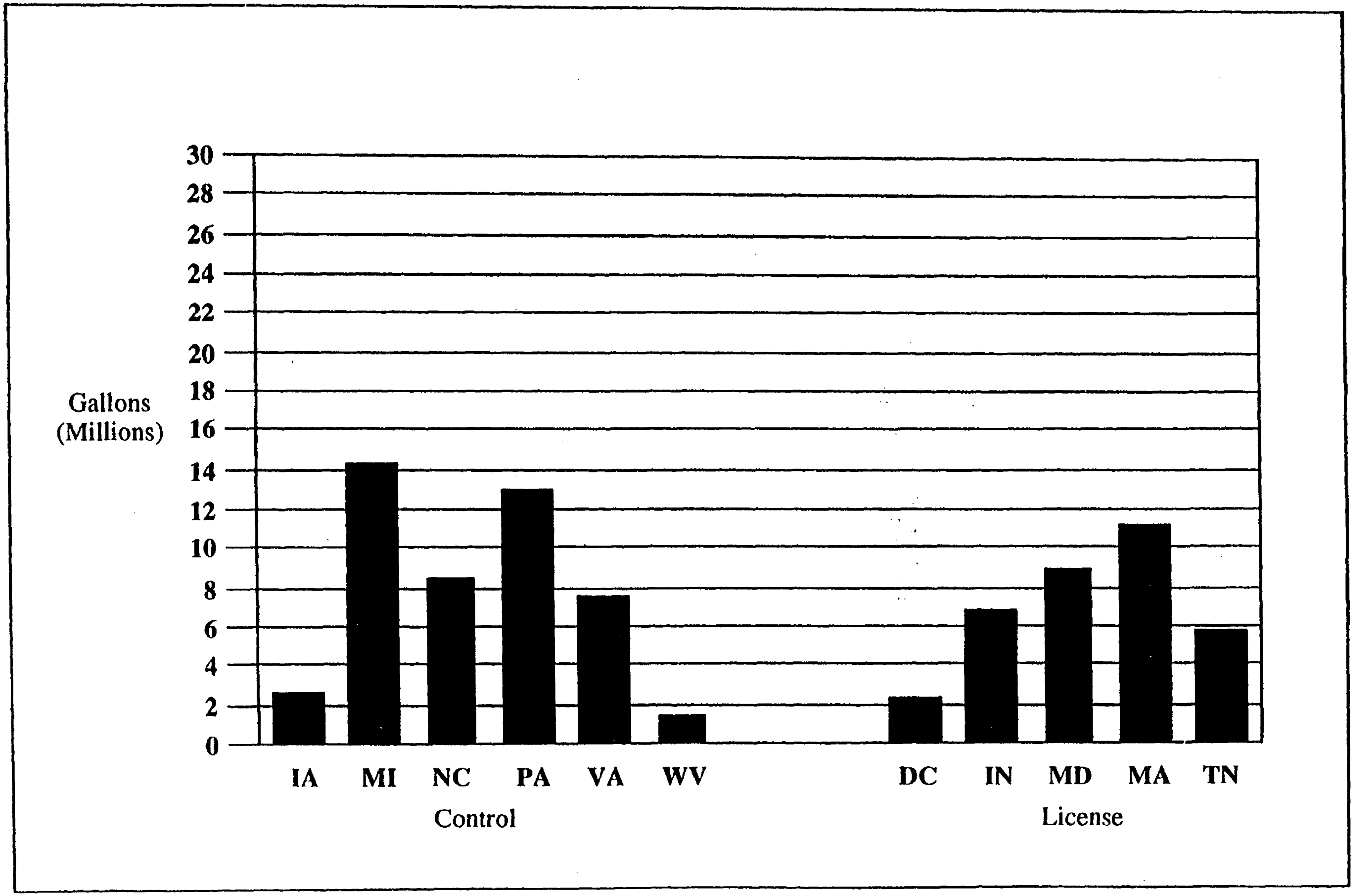


Exhibit B-2

Apparent Per Capita Distilled Spirit Consumption

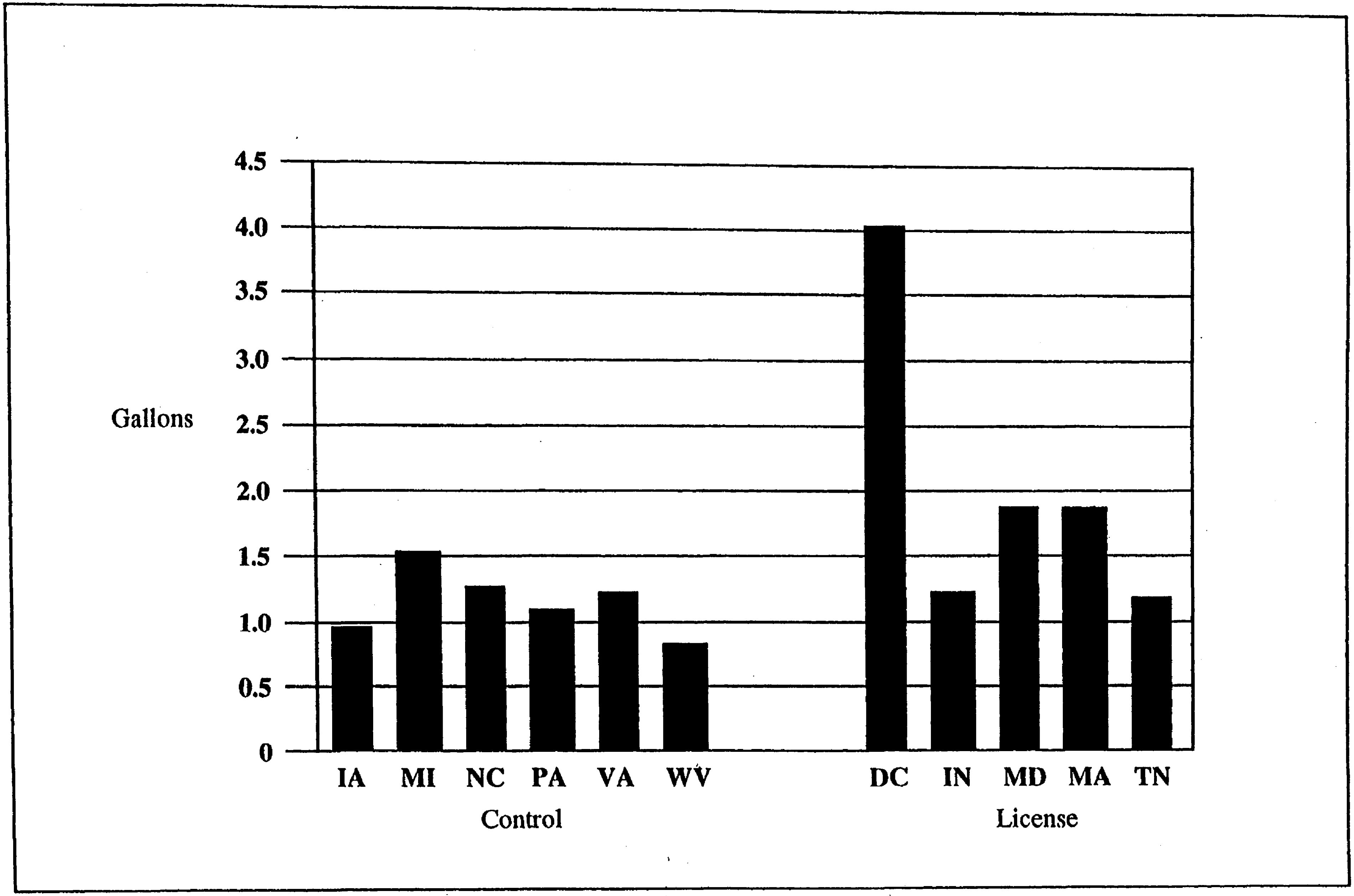


Exhibit B-3

Apparent Per Capita Wine Consumption

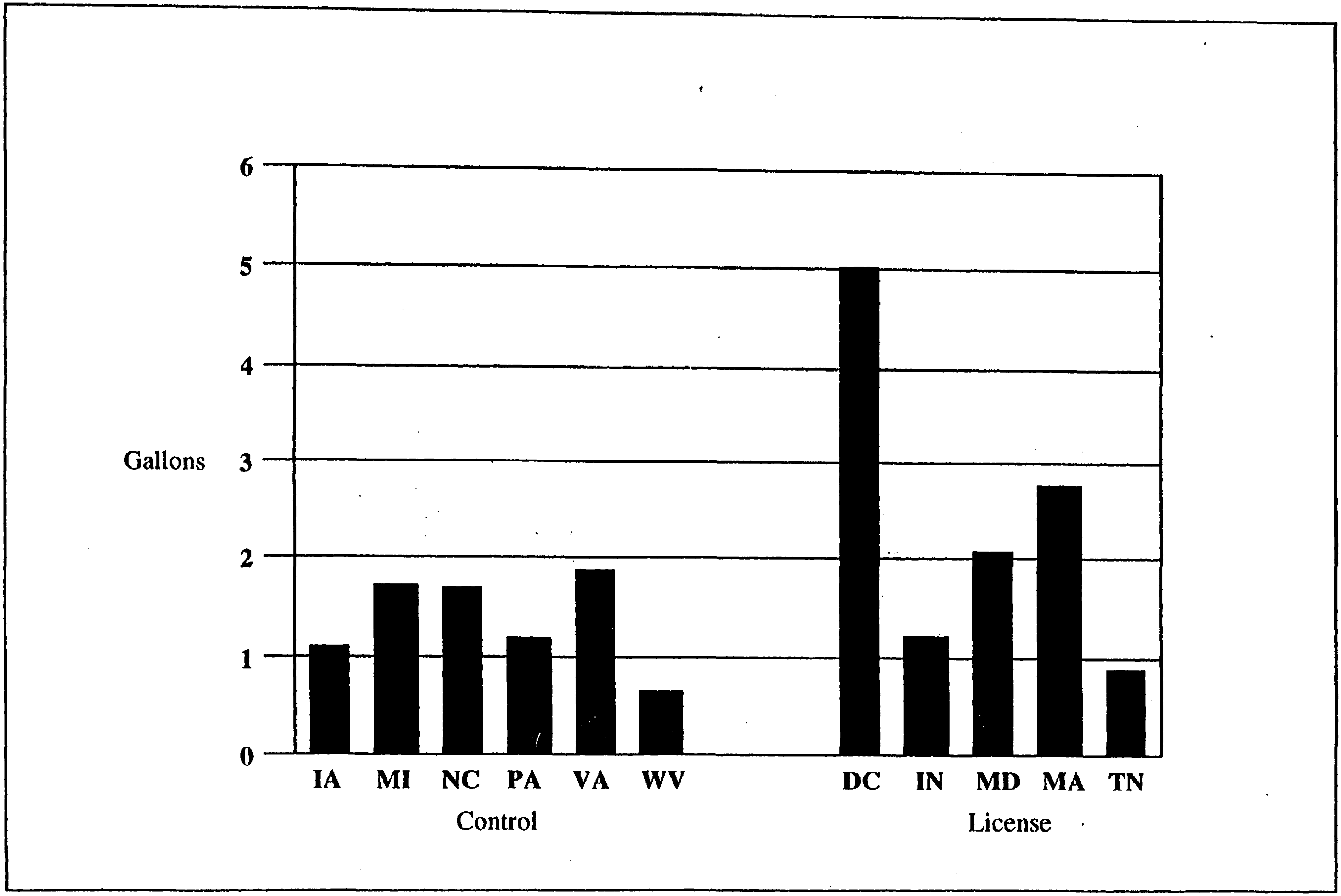


Exhibit B-4

Apparent Per Capita Beer Consumption

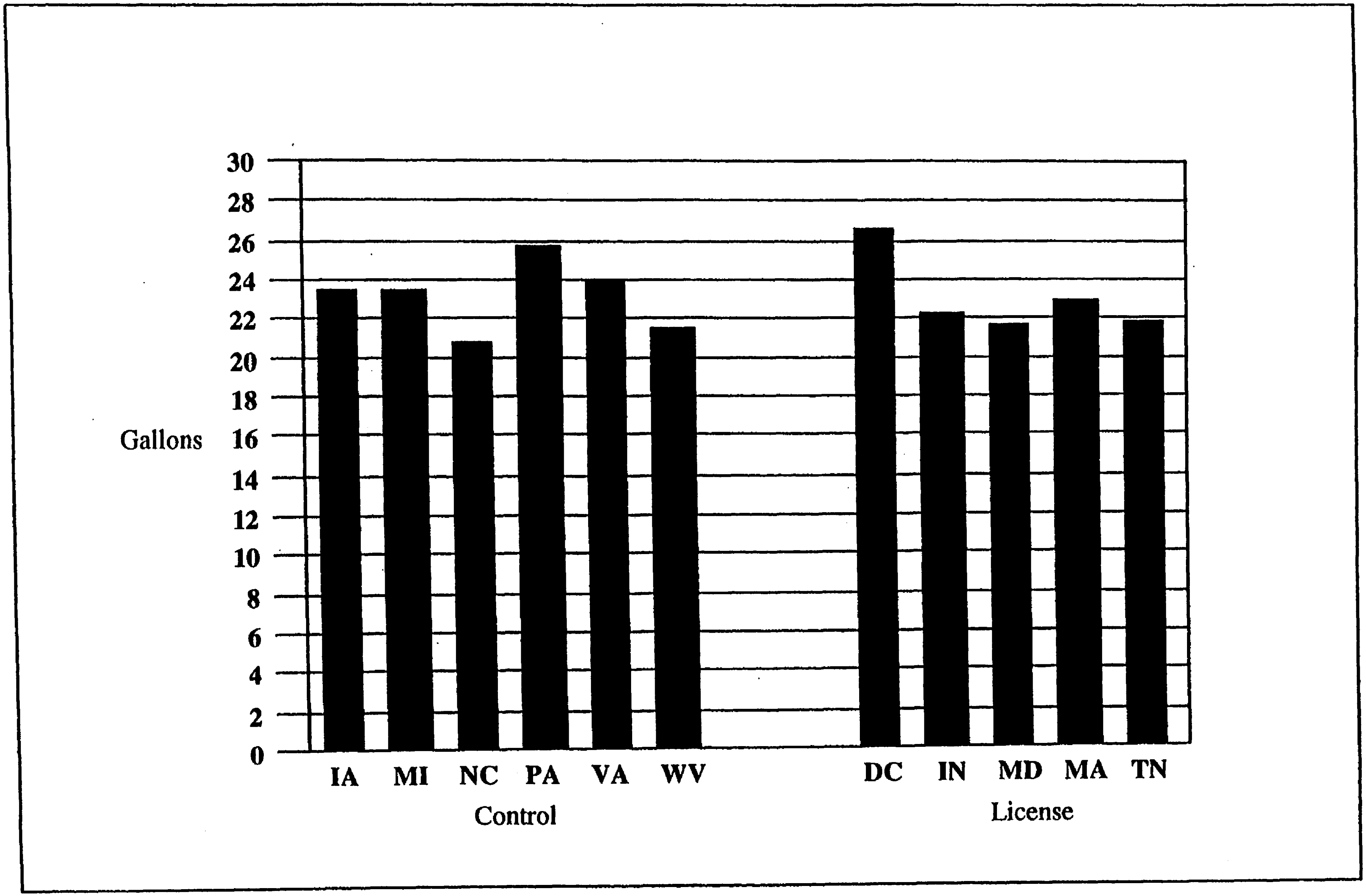


Exhibit B-5

State Collections

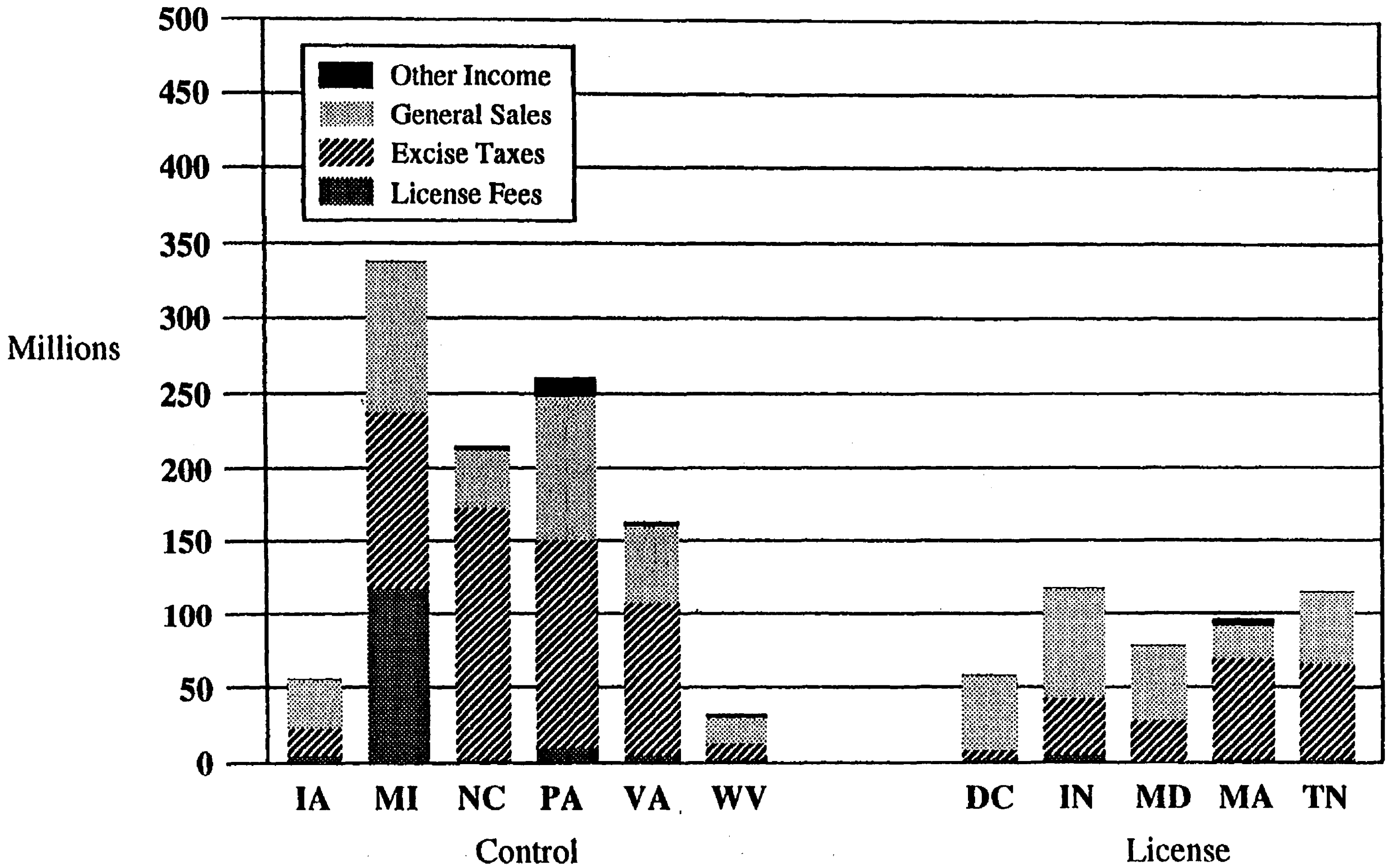


Exhibit B-6

State Revenue Per Wine Gallon of Distilled Spirits (1990)

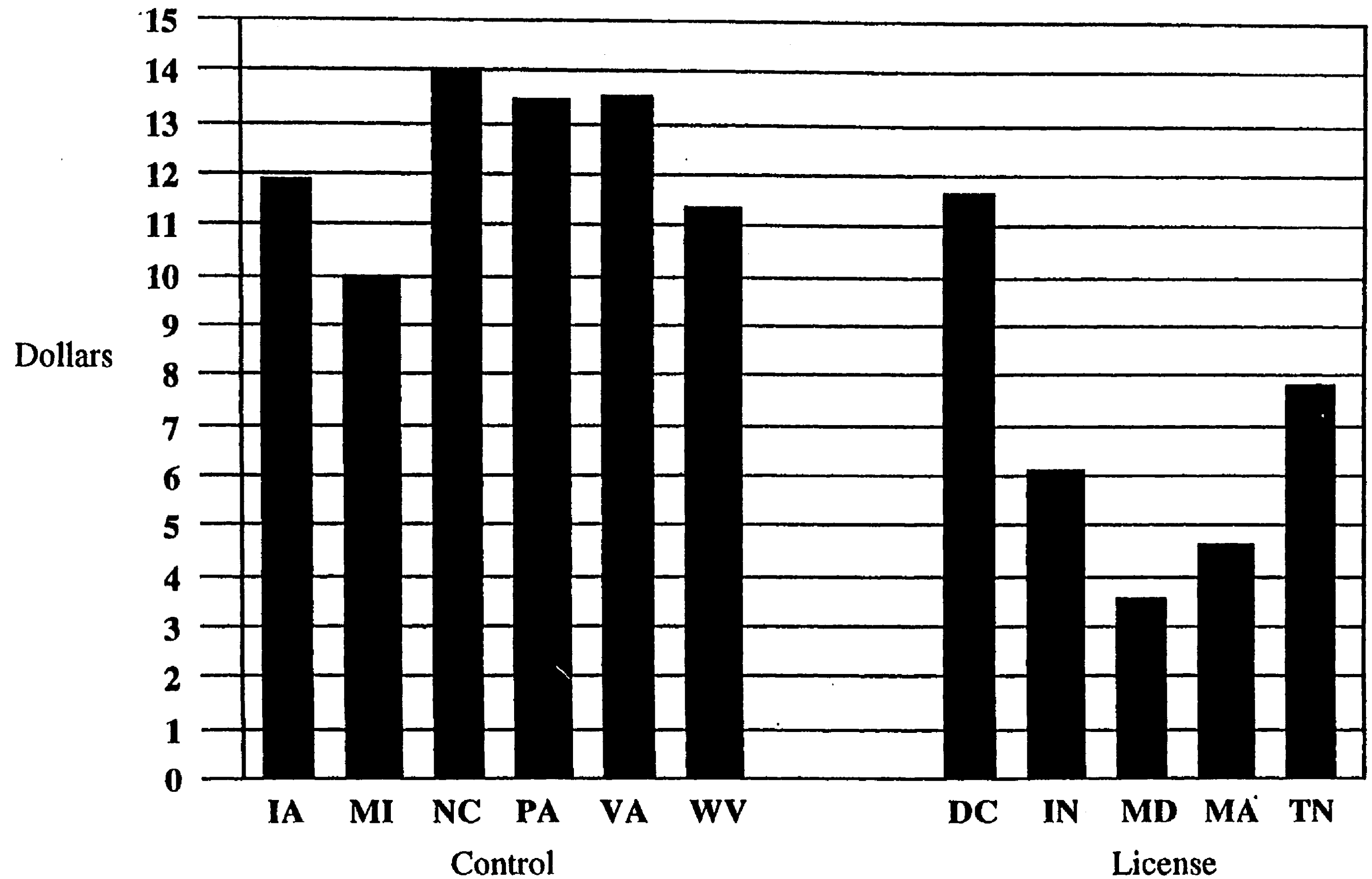


Exhibit B-7

Spirit Collections Per Capita
(1990)

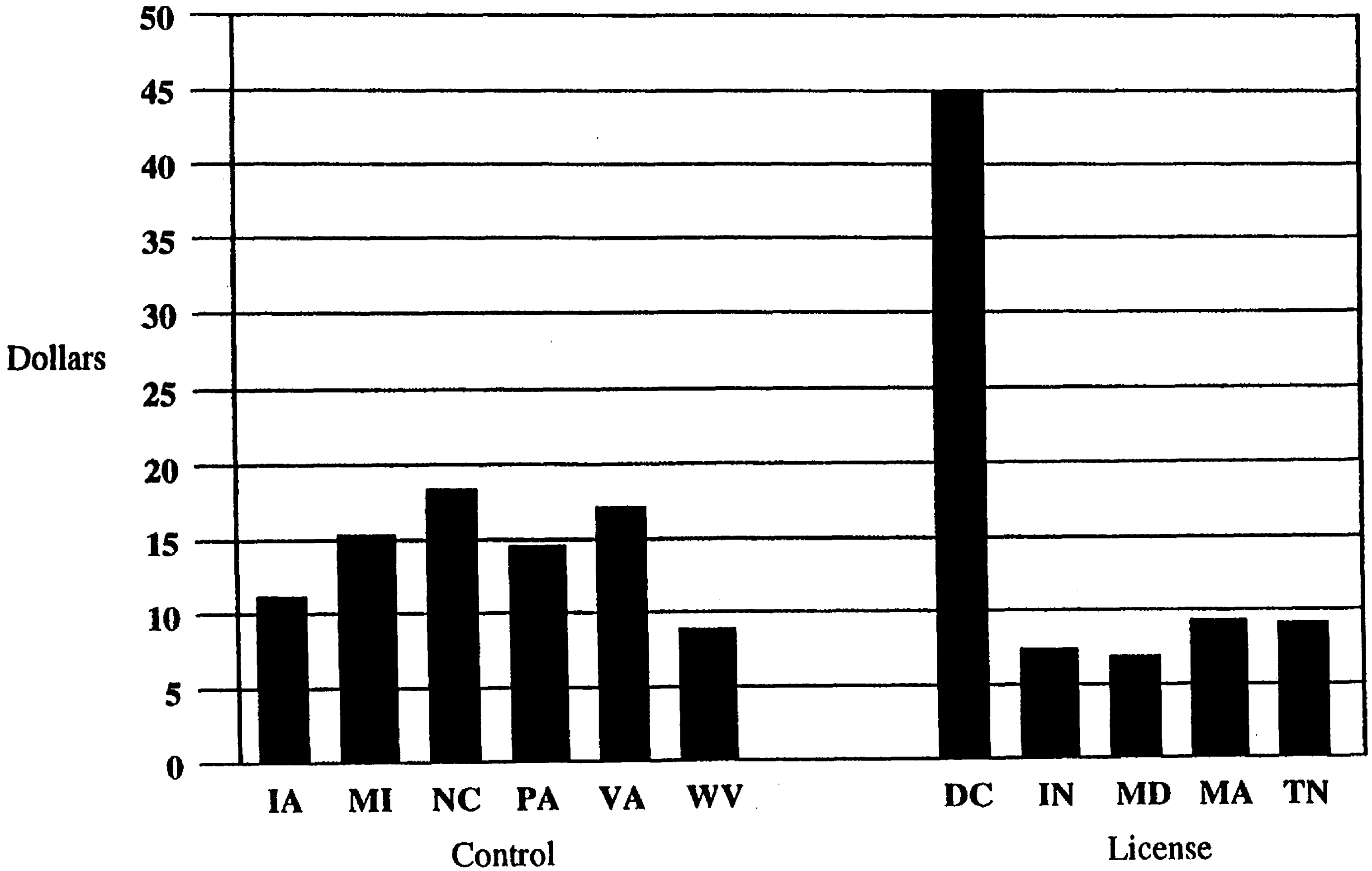


Exhibit B-8

The remainder of the appendix is organized as follows:

- Control States
- License States
- Privatization Effort Analysis

Control States

A. Control States

This section includes a general description of the operations observed in control states. Eighteen of the fifty states are "control" states. These states assume the direct control of distribution at the wholesale and, in many cases, the retail level by selling alcoholic beverages through a system of state-operated stores. Each of the five surveyed control states maintain control at the wholesale level. Two of the surveyed states — North Carolina and Pennsylvania — carry this state control through to the retail level. In Iowa, Michigan, and West Virginia, private licensees provide liquor at the retail level.

We observed the following general characteristics in control states:

- Each control state has its own Liquor Control Board or Liquor Commission. These state boards or commissions approve or select the products offered for sale in the state liquor stores and designate the price at which distilled spirits and alcohol are sold. Products are generally selected on the basis of established sales volume standards for type of alcoholic beverage, size, and price range

- Liquor inventory in Iowa, North Carolina, and West Virginia is under a bailment system. Through bailment, distillers or vendors retain ownership of the liquor even though it is physically located in the state's warehouse. The state does not take possession of the liquor until it leaves the warehouse to go to the state stores or private retailers. Three of the surveyed states — Iowa, North Carolina, and Pennsylvania — contract out both warehousing and trucking services

The remainder of this section is organized into individual control state descriptions that present an overview of operations, regulation, enforcement, tax collection, and consumption.

Iowa

Administration

Iowa Department of Commerce, Alcoholic Beverages Division

Licensing

Total Licenses	9,118
Retail	8,712
Off-Site Liquor	399
Other Retail	8,313
Wholesale	102
Other	304

State Retail Outlets	0

Employment

Administrative Personnel	24
Enforcement Investigators	1
Store Personnel	0
Warehouse and Transport Personnel	0

Revenue Summary ($1,000)

Net Profit	22,910
License Fees	5,395
Excise Taxes	16,017
Sales Taxes	33,227
Other Income	77

Population (1,000)	2,834
Geographic Size (sq km)	145,752
Per Capita Spirit Consumption (rank)	.97 (49)

1. Iowa

The Alcoholic Beverages Division (ABD) was organized in 1987 as one of nine regulatory Divisions in the Department of Commerce. As mandated by the same legislation, ABD disbanded its retail operations on March 1, 1987. Although Iowa closed state-owned liquor stores and licensed private outlets to sell distilled spirits, ABD remained the sole wholesaler of liquor in the state. Iowa also became the first control state to divest itself of its retail operations.

a. Operations

ABD collects excise taxes on alcoholic beverages and issues several classes of licenses, permits, and special and manufacturer's permits. In 1981, ABD built a Liquor Distribution Center to house both the administrative and warehousing components of ABD. The warehouse measures 150,000 square feet and can accommodate approximately 600,000 cases of product.

In 1987, ABD's liquor inventory was placed under a bailment system. Through bailment, distillers retain ownership of the liquor even though it is physically located in ABD's warehouse facility. Distillers are responsible for maintaining adequate inventory levels in ABD's warehouse to fill upcoming orders. An employee in ABD's customer service department told us that Iowa's bailment system "works well and is efficient".

The state maintains a contract with a trucking company, the Jones Operations and Management Company, to deliver alcohol to Class E (off-site) licensees. The company makes deliveries to licensees on a weekly or semi-weekly basis and charges the state a flat rate per case delivered. Consumers and on-site licensees purchase alcohol at an unregulated price from off-site licensees.

ABD consists of three departments:

- Licensing and regulation — Employs 13 people to issue licenses and monitor licensees

- Products and customer service — Employs 7 people to oversee purchasing, customer service, and order entry

- Operations management — Employs 4 people to prepare ABD's budget, manage real estate, issue policy and procedures, and conduct inventory management

b. Regulation

ABD's licensing and regulation department issues licenses to manufacturers, retailers, clubs, hotels, commercial establishments, and common carriers dealing in alcoholic beverages. The state issues two categories of license:

- Class E — for off-site consumption of alcohol. These licensees are charged a 50 percent markup by the state and then sell spirits to retail consumers and on-site licensees. Class E licenses are available to anyone for $750 to $7,500 per year (depending on the size and location of the store)

- Class C — for on-site consumption of alcohol. Class C licensees purchase alcohol from any Class E licensee and sell to the public at an unregulated price. Class C licenses are available for $195 to $2,190 per year

In addition, ABD conducts Administrator's and Hearing Board Appeal Hearings, and provides information to licensees, permittees, and the general public. In 1991, ABD processed 9,118 licenses including 102 wholesale beer and wine permits and 8,712 retail licenses totalling approximately $5.4 million in license fee revenues.

c. Enforcement

ABD is primarily a regulatory agency and does not employ investigators to enforce the state's alcohol-related laws. The Department of Public Safety along with state and local law enforcement agencies are responsible for enforcing the rules and regulations regarding liquor distribution.

The Department of Public Safety oversees liquor law enforcement, defined as sale to minors, after-hours operations, or driving while intoxicated. To enforce these laws, the state conducts "sting" operations and responds to public complaints. Generally, the state concentrates its resources on larger violations of the liquor code (described by one enforcement official as "white collar crime"), and local officials enforce smaller violations. In addition, ABD can bring administrative charges against licensees for alleged criminal violations of the state liquor code.

d. Tax Collection

The Administrative Services Division of the Department of Commerce collects excise taxes on alcoholic beverages. A tax is imposed on manufacturers for the sale of beer and wine manufactured or imported and sold at wholesale in the state. ABD also employs four auditors whose primary responsibility is auditing beer and wine wholesalers and distilled spirit retailers.

Table B-1 presents tax rates and revenues for FY 1990. The tax on beer is $5.89 per 31-gallon barrel, prorated for lesser amounts. Wine is taxed at $1.75 per gallon or fraction. Every beer and wine manufacturer holding a permit must submit a report detailing the number of barrels of beer or gallons of wine sold during the month to the Department of Revenue on or before the 10th of each calendar month. The beer and wine tax is payable to the Alcoholic Beverages Division of the Department of Commerce by permittees or manufacturers at the time the monthly reports are submitted.

Table B-1

1990 Iowa Revenue Summary

Revenue Source	Tax Rate	Revenue ($1,000)
Net Profit		$22,910
License Fees		$5,395
Excise Taxes:		$16,017
Common carrier tax	$7.00/gal	$7
Spirits under 5%	$0.19/gal	$24
Wine under 5%	$0.19/gal	$264
Wine over 5%	$1.75/gal	$3115
Beer	$5.89/bbl	$12,607
Sales Taxes	4.0%	$33,227
Other Income		$77
State Total		$77,626

e. Consumption

Since privatization, the number of retail liquor outlets and their hours of operation have increased. However, gallonage of distilled spirits sales dropped 7.8 percent from 2,645,946 gallons in 1989 to 2,631,100 gallons in 1990 (the latest years for which such data are available). In the same period, total funds that the state generates have increased from $45,454,967 to $52,237.569. Despite the decrease in total sales, there has been a slight increase in apparent per capita spirit consumption from 0.96 gallons per capita to 0.97 gallons per capita.

Michigan

Administration

Michigan Liquor Control Commission

Licensing

On-Premise	8,431
Off-Premise	18,131

Employment

Commissioners	5
Management Support	34
Merchandising	350
Warehouse	45
Licensing and Enforcement	127
Total	556

Revenue Summary ($1,000)

Net Profit	39,238
License Fees	11,754
Excise Taxes	121,943
Sales Taxes	98,841
Other Income	629

Population (1,000)	9,240
Geographic Size (sq km)	250,738
Per Capita Spirit Consumption (rank)	1.55 (23)

2. Michigan

The Michigan Department of Commerce, Liquor Control Commission (MLCC) controls the sale of distilled spirits by serving as the sole wholesaler in the state. MLCC also enforces licensee compliance with the Michigan Liquor Control Act.

a. Operations

MLCC consists of five full-time members appointed by the Governor. Two commissioners (one Democrat and one Republican) oversee adjudicatory hearings regarding licensee matters. The other three commissioners (one Democrat, one Republican, and one from the governor's party) oversee administrative and policy matters and serve as a board of appeals. A business manager oversees the day-to-day operation of MLCC's five divisions and 688 personnel:

- Licensing and Enforcement — The licensing personnel administer the application and approval process. The enforcement personnel spend approximately 70 percent of their time conducting background investigations and 30 percent of their time ensuring licensee compliance with the Michigan Liquor Control Act

- Financial Management — The finance personnel are responsible for accounts payable and receivable and for auditing wholesalers and state liquor stores

- Executive Services — The executive services personnel provide research and analysis for the commissioners, draft policy changes, and schedule and administer MLCC's hearings

- Purchasing — The purchasing personnel oversee licensee orders

- Operations — The operations personnel maintain the state's three warehouses and 69 state liquor stores

Michigan is a control state that operates on a modified bailment system. The state maintains three warehouses and 69 state liquor stores (or sub-warehouses). Liquor is delivered to retailers from the state liquor stores. The state liquor stores do not conduct any sales to consumers.

Manufacturers (or their representatives) are responsible for stocking the state's three warehouses. Licensees place their order either on a computerized system (which accounts for 80 percent of licensee orders) or manually and a private trucking firm (under contract to the state) makes a delivery to the state liquor store. Any breakage or shrinkage that occurs in transit is the responsibility of the trucking firm.

Upon delivery to the state liquor store, retailers must arrange for delivery to their place of business (they may either hire a trucking firm or pick it up themselves). MLCC arranges deliveries to retailers in the metropolitan Detroit area through a contract that it maintains with a private trucking firm.

Retailers pay the state when they receive the product. At the current time, the state does not accept credit for payment. Michigan licensees, by statute, receive a 17 percent discount on their purchases of spirits and are then required to sell those products for the manufacturer's price plus a 51 percent markup plus all appropriate taxes.

b. Regulation

The state awards retail liquor licenses on a quota system.[1] The number of licenses are established by state law. The state issues licenses upon payment of fees and the filing of the required bond. Licenses expire April 30 following the date of issuance. Part-year licenses may be granted for a portion of the fee. Spirit manufacturer's licenses

[1] There is no limit on the number of beer and wine licenses, nor is there a limit on certain liquor licenses (e.g., those awarded to resorts).

are $10,000 per year. Off-site liquor licenses are $600 per year. In 1991 the state issued 32,213 retail licenses and 1,444 manufacturer's and wholesaler's licenses.

c. Enforcement

MLCC's enforcement officers do not have full police powers and only enforce violations of the Michigan Liquor Control Act. MLCC does help to fund local law enforcement activities by returning 55 percent of the retail license fees collected (totalling $5,053,930 in FY 1991). In addition, 3.5 percent of the retail license fee income is devoted to alcoholism programs (totalling $322,630 in FY 1991) and 41.5 percent is devoted to licensing and enforcement (totalling $3,825,477 in FY 1991).

MLCC investigators are assigned throughout the state. Because MLCC's investigative staff is small, the primary responsibility for enforcement of Michigan's liquor laws rests with local, county, and state law enforcement officers. The Commission does serve as a quasi-judicial agency within the state government by determining whether state laws have been broken by licensees. Fines received from violation hearings are allocated to the General Fund. In FY 1991, there fines totalled $677,673.

d. Tax Collection

Table B-2 presents tax rates and collections for 1990, the latest year for which such data are available. Specific taxes in Michigan on spirits are payable to the Liquor Control Commission at the time of sale by MLCC.

The state imposes an 8 percent tax on the retail sale of distilled spirits. MLCC collects an additional 4 percent tax and 1.85 percent tax on spirits sold for consumption off-site. MLCC collects a 4 percent tax on spirits sold for consumption on-site. The 4 percent tax for on or off-site consumption is the Tourism and Convention Facility Promotion Tax.

Table B-2

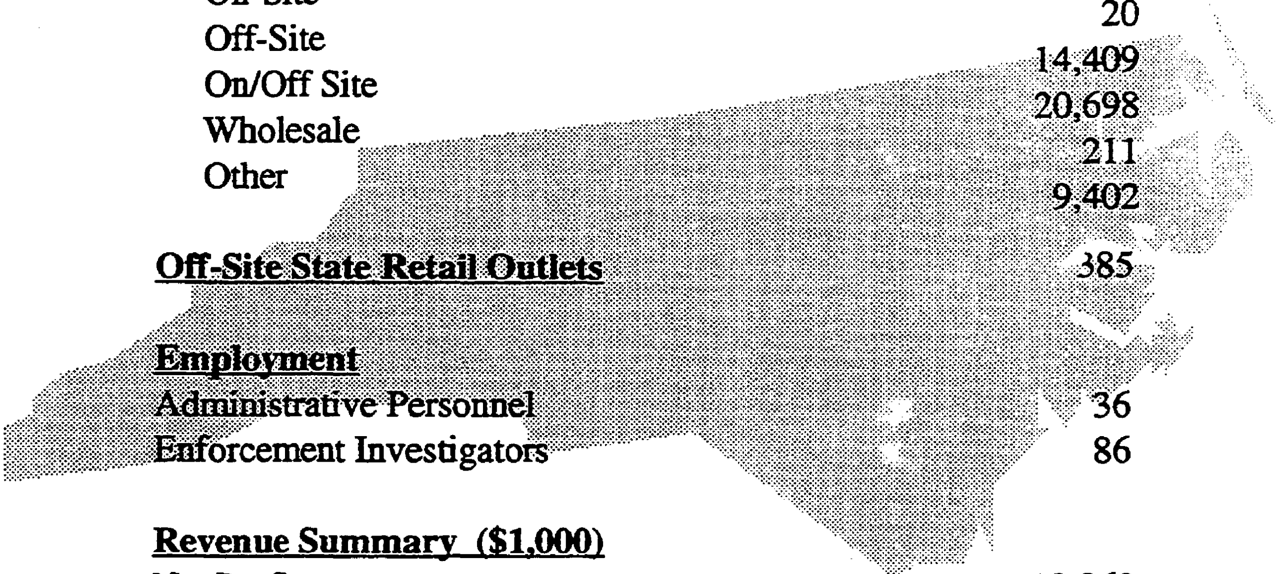
1990 Michigan Revenue Summary

Revenue Source	Tax Rate	Revenue ($1,000)
Net Profit		$39,238
License Fees		$11,754
Excise Taxes:		$121,943
Specific liquor tax	8%	$40,974
Promotion tax	4%	$20,487
Off-premise liquor	1.85%	$7,409
Mixed spirits tax	$0.48/ltr	$968
Native wine	$0.01/ltr	$8,544
Other wine	$0.48/ltr	
Beer	$6.30/bbl	$43,562
Sales Taxes		$98,841
Other Income		$629
State Total		$272,406

e. Consumption

Gallonage of distilled spirits increased from 6,381 thousand gallons in 1989 to 6,423 thousand gallons in 1990 (the latest years for which such data are available). Over the same time period, per capita consumption decreased slightly from 1.55 gallons per capita to 1.53 gallons per capita.

North Carolina



Administration

North Carolina Alcohol Beverage Control Board

Licensing

Total Licenses	44,720
Retail	39,695
On-Site	20
Off-Site	14,409
On/Off Site	20,698
Wholesale	211
Other	9,402

Off-Site State Retail Outlets	385

Employment

Administrative Personnel	36
Enforcement Investigators	86

Revenue Summary ($1,000)

Net Profit	18,869
License Fees	2,855
Excise Taxes	169,978
Sales Taxes	40,500
Other Income	3,254

Population (1,000)	6,487
Geographic Size (sq km)	136,413
Per Capita Spirit Consumption (rank)	1.29 (32)

3. North Carolina

The North Carolina Department of Commerce, Alcohol Beverage Control Commission (ABCC) administers the sale of alcohol in the state. The Department of Crime Control and Public Safety, Division of Alcohol Law Enforcement (ALE) enforces the state's alcohol-related laws.

a. Operations

ABCC consists of one full-time Chairman and two Associate Commissioners appointed by the Governor. Its 36 employees are organized into four sections:

- Administrative
- Legal
- Audit
- Beer/Wine Permits

The Commission exercises general control over the state's liquor operations. ABCC administers alcoholic beverage permits. The Department of Revenue administers liquor taxes and licenses. ABCC must grant a permit before the Department of Revenue issues a license. ALE investigates all permit applications. One of 154 county or municipal alcohol beverage control boards (ABC boards) operates all retail outlets.

ABC boards stock local stores with products approved by ABCC and charge ABCC's designated price. Consumers and on-site retail permittees purchase alcohol from a designated ABC store at designated prices.

b. Regulation

ABCC issues permits to qualified distillers, wineries, breweries, wholesalers, importers, retailers, salesmen, and vendor representatives. In 1991, ABCC issued 44,720 permits, including 265 manufacturer's and wholesaler's permits and 19,007 on-site retail permits. After a prospective permittee submits a permit application, ALE investigates the applicant's criminal record, financial history, and, as appropriate, whether the proposed site will fulfill ABCC's regulations.

c. Enforcement

ABCC performs duties of a general administrative or regulatory nature. ALE is responsible for enforcing North Carolina's liquor laws and regulations. ALE's 86 field agents monitor over 19,000 outlets. Some of the enforcement officials that we interviewed believe that the state has not provided ALE with adequate personnel to carry out their mission. ALE's staff level has remained constant since 1972, even though its responsibilities have grown to include retail sales of liquor by the glass in 1980 and the 21-year old drinking age in 1986. However, all North Carolina law enforcement officials are charged with enforcing the state's alcohol-related laws. ALE officials who we interviewed told us that ALE coordinates a significant amount of its enforcement activities with other state and local agencies.

One official that we interviewed said that enforcement was a greater problem in control states than in license states because the control state's officials must enforce ABCC laws and regulations in addition to the standard prohibitions against underage drinking, drunk driving, and serving to intoxicated persons.

State officials told us that North Carolina has been a leader in implementing programs to enforce the state's control of alcohol. According to these officials, North Carolina's programs have served as a model for other states. They include:

- Sale to Minors — Established in 1983, this program recruits people under 17 to attempt to purchase alcohol from permittees. The state files charges against those caught in the program and administrative proceedings are taken against the permittees. Approximately 300 permittees (24 percent of the total investigated) were caught in this program in FY 1992

- Sale to Intoxicated Persons — Established in 1985, this program is conducted by observing retailers suspected of making such sales. The program results in 150-160 charges per year

State officials believe that their enforcement programs are among the best in the nation. They believe ALE has devoted its limited resources to oversee programs that effectively limit violations of the alcohol code in the state.

d. Tax Collection

An excise tax is levied on the sale of malt beverages and wine and on the retail price of liquor sold in ABC stores at the time of sale to the end user. Table B-3 presents excise taxes and fees collected.

Wholesalers and importers of malt beverages and/or wine file a monthly report by the 15th day of the month following the month in which tax liability accrues. The report details the sales records for the month, indicates the amount of tax due, and lists separately any nontaxable transactions. Excise tax payment must accompany the report. In addition, the percentage tax on liquor is due by the 15th of the month following the month in which the tax was collected and is payable by the local ABC board to the Secretary of Revenue.

Wholesalers and importers of malt beverages and/or wine may deduct 4 percent from the amount payable as a discount to cover losses due to spoilage, breakage, and expenses incurred in preparing reports.

Table B-3

1990 North Carolina Revenue Summary

Revenue Source	Tax Rate	Revenue ($1,000)
Net Profit		$18,869
License Fees		$2,855
Excise Taxes:		^169,978
Rehabilitation bottle tax	$0.01-0.05/btl	$2,011
Bottle tax	$0.01-0.05/btl	$2,011
Wine not over 24%	$0.24/ltr	$2,552
Wine 6% to 17%	$0.21/ltr	$6,376
Beer	$15.00/bbl*	$68,148
Mixed beverages	$15.00/4 ltrs	$9,124
Spirits	28.0%	$70,893
Spirits (local markup)	3.5%	$8,864
Sales Taxes†	3.0%	$40,500
Other Income		$3,254
State Total		$235,456

* Beer is taxed at $15.0/bbl in containers of 7.75 gal. or more; $0.53376/gal. in smaller containers.

† No sales tax is paid on spirituous liquor sold in liquor stores.

e. Consumption

Gallonage of distilled spirits sales increased 0.6 percent from 8,488,000 gallons in 1989 to 8,537,000 gallons in 1990 (the latest years for which such data are available). In 1990, revenue from the sale of liquor, mixed beverages, and wine totalled $235,456,000. Net profits totalled $18,869,000. Over the same period, per capita consumption of spirits decreased slightly from 1.31 gallons per capita to 1.29 gallons per capita.

Pennsylvania

Administration
Pennsylvania Liquor Control Board

Licensing	
Total Licenses	22,000
Retail	18,428
Wholesale	1,518
Other	2,054
State Retail Outlets	683
Employment	
Administrative Personnel	704
Enforcement Investigators	21
Store Personnel	3,576
Revenue Summary ($1,000)	
Net Profit	64,779
License Fees	10,516
Excise Taxes	139,942
Sales Taxes	96,190
Other Income	12,476
Population (1,000)	12,002
Geographic Size (sq km)	117,347
Per Capita Spirit Consumption (rank)	1.10 (44)

4. Pennsylvania

The Pennsylvania Liquor Control Board (PLCB) was established by the state legislature in 1933 following the repeal of Prohibition. Pennsylvania is the nation's largest control state. If the agency were eligible for a place in *Fortune* magazine's annual survey of the nation's largest businesses, it would rank 580th nationally.

a. Operations

Charged with controlling the manufacture and sale of alcohol and malt beverages, PLCB manages a system of 683 state retail outlets for the sale of spirituous liquor, wine and beer. The Department of Revenue, through the Bureau of Cigarette and Beverage Taxes, administers the excise tax. Both the Liquor Control Board and the Department of Revenue make and enforce regulations regarding the administration of alcoholic beverage tax laws. The State Police Bureau of Liquor Control Enforcement oversees the enforcement of the State's alcohol-related laws. The PLCB employs a total of 4,280 individuals — 704 administrative staff and 3,576 retail staff. Exhibit B-9 presents the organization of PLCB's main operating units:

- The Director of Administration oversees the Bureau of Licensing, which employs 159 people responsible for maintaining records, evaluating licensee applications, and investigating licensees
- The Director of Marketing oversees the Bureau of Logistics and the Bureau of Retail Management. The Bureau of Logistics employs 40 people to oversee the state's wholesaling function. The state operates three warehouses and contracts out both warehousing and trucking functions. The contractor is responsible for the shipment, storage, ordering, and delivery of the product to the Pennsylvania state stores. The Bureau of Retail Management employs 95 people to oversee the state's 683 retail stores. The Bureau oversees retailers in three geographic regions

Organization of the Pennsylvania Liquor Control Board

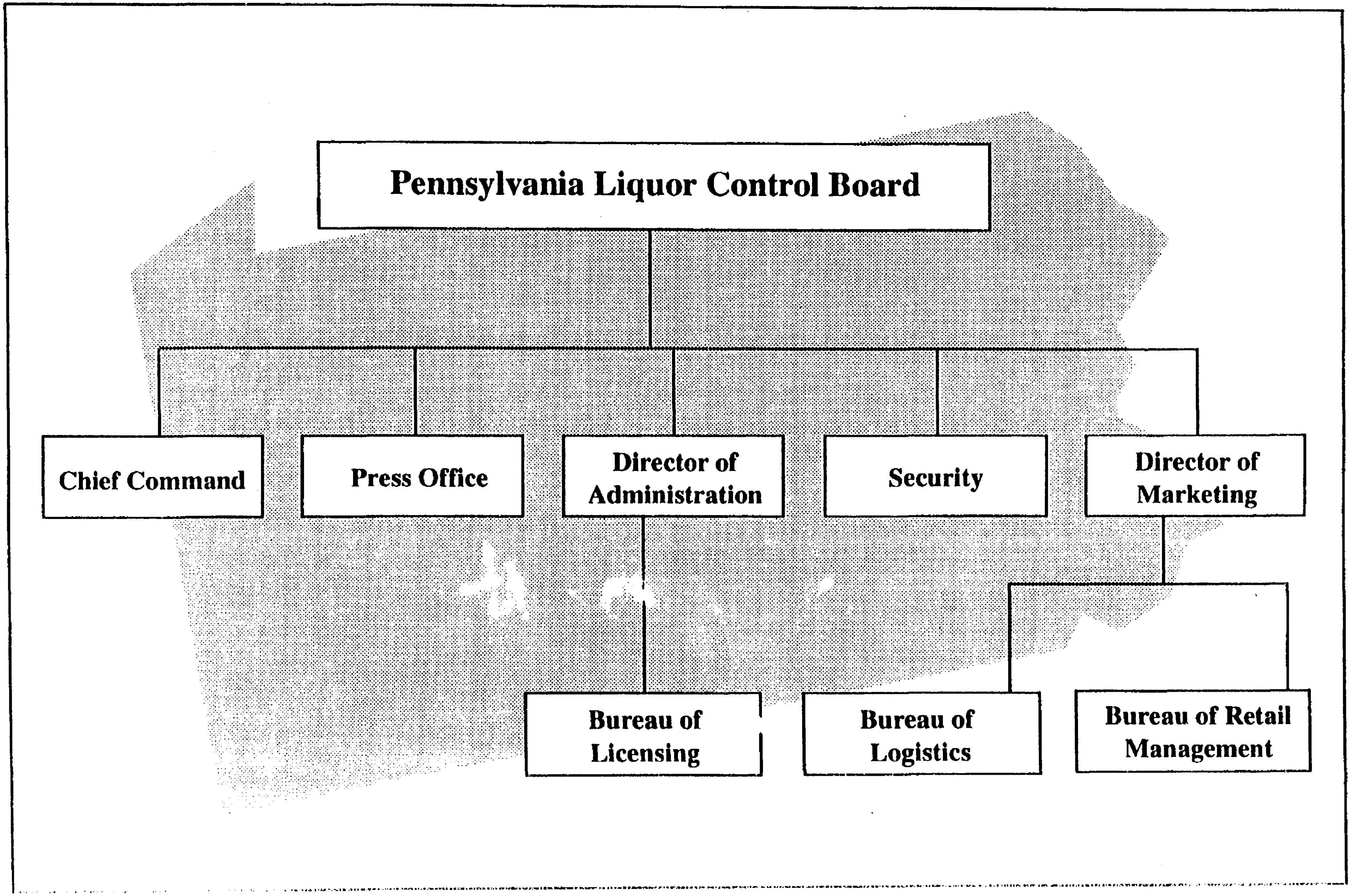


Exhibit B-9

b. Regulation

PLCB administers and issues manufacturer's permits, wholesaler's and retailer's licenses and permits, and malt beverage licenses. The Board is authorized to fix the wholesale and retail prices at which liquor and alcohol are sold in state liquor stores. In 1991, PLCB issued approximately 17,715 retail liquor licenses, including 11,634 restaurant licenses, 1,755 hotel licenses, 3,581 club licenses, and 16 municipal golf course licenses. Retail licensees purchase distilled spirits from the nearest PLCB retail store.

c. Enforcement

The Pennsylvania legislature shifted enforcement authority to the Pennsylvania State Police in 1987. The same legislation mandated the creation of a Bureau of Administrative Law Judges, an autonomous body within PLCB that is responsible for hearing liquor enforcement cases brought by the Pennsylvania State Police.

The Bureau of Liquor Control Enforcement has nine district offices located throughout the state. Each office is staffed by a supervisor and one or two liquor enforcement officers. Unlike other states, the Bureau's enforcement officers do not have full police powers, although state officials told us that they are trying to acquire such status.

Enforcement officials who we interviewed told us that they have become more aggressive, receive better training, and are more professional since the State Police gained authority to enforce alcohol-related laws and regulations. In the same period, the state's liquor code has become more stringent and undercover operations have increased.

In our interviews with enforcement officials, they told us they believe that it is easier to enforce the state's laws and regulations in a control state than in a license state.

They believe, for example, that state stores are much less likely than private stores to sell to minors or intoxicated persons. According to these officials, one reason for this is that the people who work in state-owned stores are state employees and are likely to be fired if they are caught violating the state's laws. An indication of the control exerted by state stores is that the state receives very few complaints about the selling practices of state stores (one or two per year).

d. Tax Collection

Excise taxes are imposed on liquor, wine, and beer. Table B-4 summarizes state revenues in the latest year for which such data are available. Each manufacturer is subject to tax on all malt beverages manufactured and sold in Pennsylvania. Consequently, each manufacturer must file a tax report with the excise tax payment for the preceding month by the 15th day of each month. The tax report must show the quantities of distilled spirits, wines and malt beverages manufactured and stored and the amount of the tax due for the month for which the return is filed.

In addition, an 18 percent liquor store sales tax is imposed on the net price of all liquors sold by the PLCB. On or before the 15th day of each month, the PLCB must submit a statement of receipts from sales of liquor or taxes collected during the preceding fiscal month to the Department of Revenue.

Table B-4

1990 Pennsylvania Revenue Summary

Revenue Source	Tax Rate	Revenue ($1,000)
Net Profit		$64,779
License Fees		$10,516
Excise Taxes:		$139,942
Malt beverage	$2.48/bbl	$27,541
Distilled spirits	$1.00/gal	$1
Rectified spirits (native)	$0.30/gal	$1
Rectified spirits	$1.30/gal	
Wine	$0.00005/gal	$35
Ad valorem	18%	$112,364
Sales Taxes	6%	$96,190
Other Income		$12,476
State Total		$323,903

e. Consumption

Gallonage of distilled spirits dropped 2.4 percent in 1990 (the most recent years for which such data are available). Revenue from the sale of distilled spirits and wine totalled approximately $323,903,000. Per capita spirit consumption has decreased from 1.13 gallons per person to 1.10 gallons per person in 1990. Pennsylvania ranks 44th in the nation in per capita spirit consumption but 16th in per capita beer consumption. The state ranks 35th in alcohol-related deaths and 29th in deaths from alcohol-related suicide.

West Virginia

Administration

Alcohol Beverage Control Administration

Licensing	
Off-Site Retail	119
Other	3,110

Employment	
Administration	44
Enforcement	25
Warehouse	20

Revenue Summary ($1,000)	
Wholesale Sales	24,498
Representative Fees and Permits	32
Private Club License Fees	1,497
Sales of Retail Operations	15,223
Other	809

Population (1,000)	1,877
Geographic Size (sq km)	62,759
Per Capita Spirit Consumption (rank)	.83 (50)

5. West Virginia

The West Virginia Legislature created the West Virginia Alcohol Beverage Control Administration (ABCA) in 1935. During its first 56 years, ABCA functioned as the exclusive wholesaler and retailer of liquor in the state. In 1991, the state privatized its retail function and combined oversight responsibility for beer, wine, and liquor in the ABCA.

a. Operations

ABCA consists of three main groups organized into six divisions of 89 people:

- Administration — There are 44 people who conduct ABCA's day-to-day administrative operations. Their roles include payroll/personnel, purchasing, accounting, and data processing
- Enforcement — The state's 25 enforcement investigators inspect licensees and investigate violations of the state's liquor code
- Warehouse — 20 people work in the state's bailment warehouse. Their responsibilities include loading trucks for deliveries to licensees and tracking breakage and shrinkage

West Virginia operates its wholesale function on a modified bailment system. Manufacturers deliver spirits to the state warehouse where state workers unload the delivery and oversee warehouse operations. Off-site licensees telephone orders to the warehouse; 95 percent of the orders are paid through electronic funds transfer (EFT). The state takes two days to process orders and has a contract with a trucking company to make deliveries to retailers for $1.05 per case. The state charges retailers a 25 percent markup over the manufacturer's price.

There are two warehouse personnel who spend all of their time tracking breakage and shrinkage claims. If a retailer calls the warehouse with a claim, these personnel investigate the claim, assign responsibility for the claim (to the licensee, the trucking company, the state, or the manufacturer) and, as appropriate, pay the licensee and collect from the responsible party.

On-site retailers may purchase alcohol at an unregulated price from a store within its market zone or in a contiguous zone. The state monitors where on-site licensees purchase alcohol by periodically auditing the purchase statements of on-site licensees and reconciling the retailer's purchase site with the retailer's authorized purchase sites.

b. Regulation

West Virginia privatized the retail sale of liquor in the state by auctioning a limited number of licenses to people interested in serving as retailers. The Retail Licensing Board divided the state into 98 market zones, and determined the number of licenses to issue for each market zone.

The state then auctioned two categories of off-site retail licenses: Class A licenses allow the licensee to open more than one store in a particular market zone and Class B licenses allow the licensee to open one store in a particular market zone. Licensees retain sole right to conduct off-site sales of alcohol in the state for ten years, after which time the state will re-bid the licenses. Currently, the state has successfully bid 156 out of 215 licenses. In addition to the auction price, the state charges an annual fee of $1,500 and $500 to Class A and B licensees respectively.

c. Enforcement

The ABCA's enforcement division is responsible for enforcing the state's alcohol-related laws and regulations. The division's 25 investigators are assigned to an area where they inspect new licensees and investigate possible violations of the liquor code including underage drinking, after-hours operation, and repouring.

The enforcement division's investigators conduct operations on their own and with the assistance of local law enforcement. They conduct their activities as a result of public complaints or other information they receive that indicates a licensee might be violating the law. To combat violations of the state's liquor code, the enforcement division runs sting operations as necessary and has recently developed a program that helps licensees to identify fake IDs.

The state officials who we interviewed told us that fines are a "significant" part of ABCA's revenues. Fines collected totalled $107,000 in FY 1991, for some 300 violations of the liquor code, mostly underage drinking.

d. Tax Collection

Liquor licensees must report every 30 days on amounts of alcohol manufactured, sold, or kept in stock. Off-site liquor licensees must also identify the amount of sales tax on sales of liquor to on-site licensees. Although most states, including West Virginia, typically exempt the sale of goods intended for resale from state sales taxes, liquor sales in West Virginia incur the state sales tax twice — upon sale from the off-site licensee to the on-site licensee and upon sale from the on-site licensee to the consumer.

Excise taxes on the sale of distilled spirits are collected as part of the state's 25 percent markup. Table B-5 presents tax rates and revenues in West Virginia.

Table B-5

West Virginia Revenue Summary

Revenue Source	Tax Rate	Revenue ($1,000)
Net Profit		$11,084
License Fees		$2,663
Excise Taxes:		$9,491
Wine	$1.00/gal	$1,081
Beer	$5.50/bbl	$6,788
Bottle tax	$0.15-0.40/btl	$1,622
Sales Taxes*	6%	$18,927
Other Income		$2,130
State Total		$44,294

* No sales tax is paid on spirituous liquor sold in liquor stores.

e. Consumption

Consumption decreased slightly from 1,305,000 gallons in 1989 to 1,298,000 gallons in 1990 (the latest years for which such data are available). The state officials who we interviewed told us that they believed privatization had not had a significant impact on consumption in the state. Over the same period, per capita consumption increased from 0.77 gallons per capita to 0.83 gallons per capita.

License States

B. License States

This section provides a general description of the operations of license states. These states control the sale and distribution of alcoholic beverages through the regulation and licensing of private manufacturers, wholesalers, and retailers.

We observed the following general characteristics in license states:

- License states are characterized by a three-tier distribution system intended to eliminate the manufacturer's control over the retailer. The three levels of manufacturer, wholesaler and retailer are separate and independent of each other. The manufacturer must sell only to the wholesaler, and the wholesaler must sell only to the retailer. Likewise, the retailer must buy only from the wholesaler, and the wholesaler must buy only from the manufacturer. The three tiers are preserved by at-rest laws. All five of the surveyed license states require an out-of-state manufacturer to sell to a locally licensed wholesaler, and not directly to a retailer through an at-rest law. At-rest laws require all merchandise shipped into a state to be consigned and delivered to a wholesaler.

- All of the surveyed license states, with the exception of Massachusetts, have what is known as a primary source law. Primary source laws prohibit nonresident suppliers from selling to wholesalers in the state unless the supplier is the primary American supply source for the brand of wine or distilled spirit.

- In the District of Columbia, Maryland, and Tennessee, suppliers are permitted to enter into franchise arrangements with specific wholesalers to restrict the distribution of their products. These laws are not currently enforced in the District of Columbia and Maryland.

- Indiana and Maryland have dual systems for liquor licensing. In these states, each municipality, city, or town has its own licensing authority. In Indiana, each country has a three member board that reviews all retail license applications and makes a recommendation to the state commission. In Maryland, a county board of license commissioners awards retail licenses.

- All of the surveyed license states require potential licensees to meet general requirements. For example, applicants seeking alcoholic beverage licenses must be at least 21 years old and of good moral character.

The remainder of this section is organized into individual license state descriptions that present an overview of their operations, regulation, enforcement, tax collection, and consumption.

District of Columbia

Administration

Alcoholic Beverage Control Board

Licensing

Off-Site	756
On-Site	885
Wholesale	9

Employment

Board Members	5
Investigators	9
Administrative Support	13

Revenue Summary ($1,000)

License Fees	2,223
Excise Taxes	6,315
Sales Taxes	49,836

Population (1,000)	638
Geographic Size (sq km)	177
Per Capita Spirit Consumption (rank)	4.05 (1)

1. District of Columbia

The District of Columbia has lower taxes than the other jurisdictions in our study but collects more revenue per gallon of spirits sold and more revenue per capita than any license state included in our study. In addition, the District of Columbia has the highest rates of consumption in the country.

a. Operations

The Alcoholic Beverage Control Board (the Board) has 5 members, 9 investigators, and 13 support staff. The Board is responsible for issuing licenses and enforcing the District's alcohol-related laws and regulations. The Department of Finance and Revenue is responsible for collecting alcohol-related taxes and license fees.

b. Regulation

The District has 21 categories of licenses, which must be renewed every two years. The District does not set quotas on the number of licenses, but licensees and prospective licensees must pass a screening process that provides members of the community with significant opportunities to prevent license awards and renewals. For example, a license application (or renewal) may be rejected if one-half of the registered voters who live within a 600 foot radius of the licensee sign a petition objecting to the licensee's operations. Table B-6 presents the different licenses issued by the District.

Management of the District's licensing is fragmented. Neither the Board nor the Department of Finance and Revenue is certain of the number of licenses in the city. One official who we interviewed told us that the most recent year for which they were certain of the number of licenses was 1988. As a result, the District cannot be certain that licensees are paying required fees and taxes or that retailers serving alcohol are actually licensed.

Table B-6

District of Columbia Licenses

Class	Type	Cost Per Year
A	Manufacturers distillery/winery	$6,000/$1,500
B	Manufacturers brewery	$5,000
A	Wholesale liquor	$4,000
B	Wholesale beer and wine	$2,000
A	Liquor off-site	$2,000
B	Beer and wine off-site	$1,000
C/R	Liquor (Restaurant)	$500-$4,000
C/T	Liquor (Tavern)	$500-$4,000
C/N	Liquor (Nightclub)	$500-$4,000
C/H	Liquor (Hotel)	$500-$4,000
C/X	Liquor (Other)	$500-$4,000
D/R	Beer and Wine (Restaurant)	$300-$3,500
D/T	Beer and Wine (Tavern)	$300-$3,500
D/N	Beer and Wine (Nightclub)	$300-$3,500
D/H	Beer and Wine (Hotel)	$300-$3,500
D/X	Beer and Wine (Other)	$300-$3,500
E	Medicinal License	$100
G	One-Day Permit	$100/day
	Solicitors' License	$250
	Private Club Consumption License	n/a

c. Enforcement

The Board's nine investigators review licensee applications, respond to complaints, and monitor licensees for daily compliance with the Board's regulations. According to the Federal Bureau of Investigation, the District reported 2,833 DUI arrests and 0 arrests for violation of the District's liquor laws and public drunkenness in 1990.

d. Tax Collection

Licensees file tax returns with the District's Department of Finance and Revenue on a basis determined by their size. Class C licensees also file a quarterly statement with the Board in which they report alcohol receipts and expenses and food receipts and expenses. Table B-7 presents a summary of the District's tax rates and revenues for 1990.

Table B-7

District of Columbia Revenue Summary

Revenue Source	Tax Rate	Revenue ($1,000)
License Fees		$2,223
Excise Taxes:		$6,315
Spirits	$1.50/gal	$4,200
Wine 14% or less	$0.40/gal	$640
Wine over 14%	$0.40/gal	$100
Sparkling wine	$0.45/gal	$170
Beer	$2.25-2.75/bbl	$1,205
Sales Taxes	6% off-premise, 9% on premise	$49,836
Other Income		$0
State Total		$58,374

e. Consumption

Consumption in the District of Columbia is the highest in the country. From 1989 to 1990 (the most recent years for which such data are available), per capita spirit consumption increased from 3.72 gallons per capita to 4.04 gallons per capita. However, not all of this alcohol is consumed by the District's residents. Some of the consumption is due to tourism and visits from residents of the District's suburbs in Maryland and Virginia. In addition, low liquor prices in the District attract off-site purchases from higher cost areas like Virginia and Montgomery County, Maryland (a control county).

Indiana

Administration

Indiana Alcoholic Beverage Commission

Licensing	
Total Licenses	9,436
Retail	6,894
Wholesale	113
Other	2,429
Employment	
Commission Members	3
Administrative Personnel	27
Excise Police	54
Revenue Summary ($1,000)	
License and Other Fees	6,092
Sales Taxes	76,272
Excise Taxes	35,289
Population (1,000)	5,556
Geographic Size (sq km)	94,328
Per Capita Spirit Consumption (rank)	1.23 (35)

2. Indiana

The Alcoholic Beverage Commission (ABC) was organized as an independent department of the executive branch of the state government by the Indiana legislature in 1933.

a. Operations

ABC has four members, a Chairman, a Vice Chairman, and two Commissioners who are empowered by state law to regulate and limit the manufacture, sale, possession, and use of alcohol and alcoholic beverages. Composed of three divisions — Administration, Enforcement, and Judicial — ABC is staffed with 81 employees including 54 investigators, also called excise police.

Each county in the state has a three-member board that reviews license applications and makes recommendations to ABC. The board advertises each application and submits public comments to the state board.

b. Regulation

ABC regulates the alcoholic beverage industry and is responsible for the issuance or denial of all alcoholic beverage licenses. In 1992, ABC issued 9,436 licenses including 113 wholesale licenses and 6,894 retail licenses. The number of certain licenses are limited through the implementation of a population quota. The present ratio is one Beer and Wine Wholesaler permit for each 1,500 persons and one Liquor, Beer and Wine Package Store permit for each 5,000 persons. In addition, Indiana requires beer sales from the brewer to wholesaler to retailer to be made on a cash basis.

c. Enforcement

ABC's excise police have the direct responsibilities of enforcing the alcoholic beverage laws, annually investigating alcohol permittees, and educating the public and the permittees in all phases of the laws. The excise police operate from eight District posts located throughout the state. During 1991, the enforcement division arrested 3,802 minors, arrested 573 adults (for public intoxication and purchasing for minors) and issued 816 premise citations.

The excise police devote approximately 60 percent of their time to conducting criminal enforcement activity (e.g., underage drinking, public intoxication). The State Police have lead responsibility for enforcing drunk driving laws. The state officials who we interviewed told us they believe that Indiana is more successful than comparable states in enforcing its laws (particularly underage drinking). The state conducts planned programs consisting of enforcement and education efforts.

The excise police's enforcement efforts include Operation SUDS (Stop Underage Drinking Sales), which targets events and locations where sales to minors are likely to occur. The excise police receive money from the Federal government to conduct its enforcement of the state's laws that relate to sales to minors. One official told us that these grants, although small in size, are an important contribution to the enforcement division's operating budget.

According to the officials who we interviewed, the excise police's education efforts include a program to train permit holders how to identify false IDs and turn away underage drinkers. The excise police also have good relations with Indiana's alcohol industry. They hold a well-attended meeting every Tuesday in which officers meet with industry officials to discuss issues of mutual concern.

An additional activity of the State Excise Police is enforcing Indiana's at-rest and primary source laws. Indiana's at-rest law does not specify the length of time the wholesaler must retain possession of alcoholic beverages before they are transported to the retailer. This allows wholesalers more flexibility in meeting retailer's demands. In addition, Indiana's primary source law provides an audit trail for excise tax collection by requiring that a copy of each supplier's invoice be sent to the Department of Revenue and ABC.

d. Tax Collection

Indiana imposes an excise tax on beer, wine, liquor, and malt liquor. The excise tax is assessed on a gallonage basis and fixed with regard to volume or alcohol content. The collection and enforcement of taxes are administered by the Indiana Department of Revenue. The state excise taxes on alcoholic beverages totaled approximately $35.3 million in 1990 (the most recent year for which such data are available). The tax is levied at the rates detailed in Table B-8.

Persons liable for an Indiana excise tax must file a monthly return with the Department of Revenue on or before the 20th day of the month following the month in which tax liability accrues. Excise tax payment must accompany the monthly return.

Both the Department of Revenue and the state excise police monitor compliance with the state's tax laws. The excise police focus their efforts on ensuring that retailers purchase alcohol from state wholesalers. The state's wholesalers maintain a "no ship list" of retailers who are delinquent in the payment of bills, and the excise police use this list to find on-site retailers who might be making illegal purchases of alcohol.

Table B-8

1990 Indiana Revenue Summary

Revenue Source	Tax Rate	Revenue ($1,000)
License Fees		$6,092
Excise Taxes:		$35,289
Spirits and wine over 21%	$2.68/gal	$18,423
Native wine	$0.27/gal	$3,134
Table wine	$0.47/gal	
Beer	$0.115/gal	$14,732
General Sales Taxes:		$76,272
Sales tax	5.0%	$72,823
Gross income tax	0.30%	$3,449
Other Income		$0
State Total		$117,653

e. Consumption

Gallonage of distilled spirits has decreased from 6,872 thousand gallons in 1989 to 6,841.9 thousand gallons in 1990 (the latest years for which such data are available). In 1990, ABC generated $117,653 thousand in revenue through the collection of licenses and excise and sales taxes. Operating expenses totaled approximately $3.2 million. Per capita spirit consumption in Indiana has decreased slightly from 1.24 gallons per capita in 1989 to 1.23 in 1990. Indiana ranks 35th in per capita spirit consumption, 37th in alcohol-related traffic fatalities, 40th in deaths from alcoholism, and 36th in DUI arrests.

Maryland

Administration

Alcohol and Tobacco Tax Division, Comptroller of the Treasury

Licensing	
Off-Site	1,977
On-Site	712
On- or Off-Site (Hotels and Restaurants)	2,398
On- or Off-Site (Taverns and Generally)	1,474
On- or Off-Site (Baltimore City)	628
Employment	
Administration	30
Auditing and Investigation	41
Enforcement	14
Revenue Summary ($1,000)	
License Fees	332
Excise Taxes	26,456
Sales Taxes	50,525
Other Income	18
Population (1,000)	4,622
Geographic Size (sq km)	32,135
Per Capita Spirit Consumption (rank)	1.88 (10)

3. Maryland

The Alcohol and Tobacco Tax Division of the Comptroller of the Treasury is responsible for oversight of the distribution of alcohol in Maryland. Each of Maryland's 23 counties, Baltimore City, and the City of Annapolis regulate the retail sale of alcohol. With the exception of Montgomery County, which is a control county, the state and its counties license private firms to purchase alcohol from manufacturers, sell it to retailers, and then sell it to consumers.

a. Operations

Responsibility for oversight of the distribution and sale of alcohol in Maryland is divided between the state (for wholesalers and producers) and the counties (for retailers).

At the state level, there are three sections in the Alcohol and Tobacco Tax Division (85 employees) who are responsible for administration of laws relating to the sale and distribution of alcohol (these are set forth in Article 2B of the Maryland Code):

- Administration — 30 employees carry out administrative functions and issues and monitor the licenses issued by the state. This section also monitors compliance with the state's franchise and primary source laws
- Auditing and Investigation — 41 employees investigate license applications and periodically audit licensees
- Enforcement — 12 of its 14 employees are agents who inspect licensees to ensure compliance with state laws, watch for untaxed shipments, search for illegal stills, conduct liquor inspections, and review report requirements with licensees

At the county level, a Board of License Commissioners awards retail licenses. State and local police enforcement units are given responsibility to enforce prohibitions against underage drinking, drunk driving, and serving to intoxicated persons.

b. Regulation

Upon receipt of a license application, the state's auditing and investigation section ensures that the applicants do not have a criminal record and are not delinquent in the payment of state and local taxes. Retail licensees must be residents of the county in which their license will be effective. One retail licensee that we spoke with noted that while the state and local license boards will withhold a license for non-payment of even small amounts of state and local tax (e.g., under $2.00), the state does not investigate licensees for non-payment of even large amounts of federal tax.

In Maryland, local boards issue a specific number of retail licenses for an election district. If there are more applications than licenses available, the local board will award a license to the applicant that they believe will best accommodate the public's interests. The board may choose one retailer over another based on criteria such as the location and type of establishment planned by the prospective licensee. Although the boards can increase the number of licenses for the demonstrated need and accommodation of the community, there is not an unlimited availability of licenses (or retail outlets). At the state level, however, wholesale licenses are available to all qualified applicants. There are five main categories of license available in Maryland, which vary in cost per year, as indicated in Table B-9.[2]

[2] Within a particular license category, cost per year is proportional to the size of the operation (for a wholesaler or manufacturer) and the size of the population served (for a retailer).

Table B-9

Maryland License Types and Fees

License Type	Range of Annual Fee
Manufacturer	$500-$1,500
Wholesaler	$200-$1,500
Beer retailer	$25-$50
Beer and wine retailer	$35-$60
Beer, wine, and liquor retailer	$75-$2,000

c. Enforcement

Responsibility for enforcing the state's alcohol laws rests upon (1) the enforcement section of the Alcohol and Tobacco Tax Division, (2) the state police, and (3) local police. There are no well-defined responsibilities for each of the three entities. As a result, there is no safeguard against duplication or neglect of law enforcement responses to a given issue. One official we interviewed said that, compared to states with a centralized enforcement responsibility, Maryland does not coordinate information and make efficient use of its resources. He said that the state is not always aware of potential enforcement actions at the local level and vice versa. We have collected data on the incidence of drunk driving in several different states. The data show that Maryland ranks 10th in per capita spirit consumption and 11th in DUI arrests.

Unlike some states' enforcement personnel, the Alcohol and Tobacco Tax Division's 12 agents have full police powers. State enforcement officers are assigned a geographic area and are expected to check the operations of the retail licensees in their area every one to two years. In FY 1991, they reported 75 criminal violations, confiscated 926 gallons of alcohol, and conducted 2,648 retail dealer inspections. Their responsibilities include investigation of:

- Illicit manufacture of alcohol
- Transportation of untaxed alcohol
- Unlicensed sale of alcohol
- Licensee fraud (e.g., refilling, tampering)

Local police conduct investigations such as underage drinking and sale to intoxicated persons. Some of the state's larger political subdivisions (e.g., Baltimore City, P.G. County) have their own dedicated alcohol investigators, while smaller counties (e.g., Allegany County) use their regular police force to enforce the state's alcohol code. The state police force will also use cadets in the police academy to check retailers' compliance with underage drinking laws.

d. Tax Collection

Licensees remit license fees and taxes to the state. Table B-10 presents state tax rates and revenues in the latest year for 1990 (the latest year for which such data are available). Retailers must file tax returns by the 26th day of the month after which sales were made. Manufacturers and wholesalers must file tax returns by the 11th day of the month after which sales were made. To ensure that licensees remit the correct amount of taxes due, the state's auditing and investigation division's four audit teams investigate applications for wholesale licenses and periodically audit wholesale licensees and permit holders. In FY 1991, they conducted 264 audits of 196 licensees and 2,710 permittees.[3]

Table B-10

1990 Maryland Revenue Summary

Revenue Source	Tax Rate	Revenue ($1,000)
License Fees		$332
Excise Taxes:		$26,456
Spirits	$1.50/gal	$13,639
Wine	$0.40/gal	$4,018
Beer	$0.09/gal	$8,800
Sales Taxes	5.0%	$50,535
Other Income		$18
State Total		$77,341

The state recently repealed the requirement for distilled spirits to have a state tax stamp. The state officials that we interviewed believe that the repeal of this requirement will lower the assessed value of liquor sold in the state. In addition, state revenues collected for beer and distilled spirits will go, in their entirety, to the general fund, as of July 1, 1992. Previously, the state had shared revenues with localities. In FY 1991, these disbursements totaled $8,668,433.

[3] This does not include 51,398 vehicle identification cards issued by the Division.

e. Consumption

In Maryland, spirits, wine, and beer may be purchased from retail outlets other than package stores. Counties may issue four categories of retail licenses that permit on-premise, off-premise, and on- or off-premise consumption of beer wine, and liquor.

In FY 1991, apparent consumption of alcoholic beverages was 101,831,491 gallons of beer, 8,695,048 gallons of distilled spirits, and 9,456,147 gallons of wine. The state's per capita spirit consumption has decreased from 1.94 gallons per capita in 1989 to 1.88 gallons per capita in 1990 (the latest years for which such data are available).

Massachusetts

Administration

Massachusetts Alcoholic Beverages Control Commission

Licensing

Total Licenses	11,477
Manufacturer's	19
Wholesaler's	94
Other	11,364

Employment

Total State Employment	24*
Administrative Personnel	15
Enforcement Investigators	9

Revenue Summary ($1,000)

License and Other Fees	$1,119
Operating Budget	988
Excise Tax Collected	60,285

Population (1,000)	5,890
Geographic Size (sq km)	21,456
Per Capita Spirit Consumption (rank)	1.93(7)

* Massachusetts is a dual licensing state. Employment includes only commission headquarters personnel.

4. Massachusetts

The Alcoholic Beverages Control Commission (ABCC) was created in 1933 by the Massachusetts legislature following the repeal of prohibition. ABCC regulates the business of manufacturing, importing, exporting, storing, transporting, and selling alcoholic beverages. It also supervises the quality, purity, and alcoholic content of alcoholic beverages.

a. Operations

ABCC has one full-time Chairman and two part-time Associate Commissioners who are appointed by the governor. ABCC performs three basic functions: licensing and administration, judicial, and enforcement. ABCC has 24 employees including the Chairman, Associate Commissioners, and 9 investigators.

To accommodate budget cuts, ABCC has cut its staff by one-third since 1988. In that period, its budget has been cut 41 percent, from $1,469,305 to $870,703. In its 1991 annual report, ABCC officials said that they believe the decrease in staffing has decreased its ability to enforce the law and collect required license and permit fees.

b. Regulation

Massachusetts has a dual system for liquor licensing. At each biennial election, in every city or town in the state, the question of whether alcoholic beverages are to be sold in that city or town is submitted to the voters. Each city or town that has voted to permit the sale of alcoholic beverages (21 of the state's 351 cities and towns are dry) has its own licensing board. These local boards or commissions are the sole licensing authorities for hotels, restaurants, clubs and package stores within their communities.

While the local authorities issue the actual licenses, each license must also be approved by ABCC, which conducts a background investigation of the applicant.

ABCC is the sole issuing authority for alcoholic beverage licenses to manufacturers (distillers, wineries, and importers, rectifiers, railroads, airlines, ships and ship chandlers). It is also the sole issuing authority of liquor transportation permits for express or trucking companies, ships, railroads, airlines and liquor retailers. It licenses salespersons employed by manufacturers, wholesalers and importers.

In 1991, ABCC issued 11,477 permits and licenses including 94 wholesaler's licenses and 19 manufacturer's licenses. Quotas for retail licenses are set by state law.

c. Enforcement

ABCC employs an investigatory staff, which is charged with ensuring that those involved in the alcoholic beverage industry comply with Massachusetts law and ABCC rules and regulations. To ensure compliance, they investigate complaints and make frequent on-site visits to, and inspections of, retailer, wholesaler, and importer premises. Investigators interview license applicants, investigate their financial status and check their corporate and police records, if any. They are required to visit newly-licensed establishments to assure the premises comply with applicable statutes and codes.

Licensed establishments are inspected whenever complaints are received as well as an occasional routine inspections. When apparent violations are found, a report is submitted to the Commission, and a formal hearing is conducted. Investigators are required to prepare the evidence and prosecute their cases before the Commission.

As a result of budgetary cutbacks, the number of investigators has been reduced from 46 to 9 within the past five years. At present, investigators mainly respond to situations rather than monitor situations and changing trends. Prior to the cut back, a specific number of ABCC investigators were placed throughout the state, and routinely visited assigned establishments. According to the officials that we interviewed, investigators were knowledgeable of new situations and problems and were better able to enforce ABCC rules and regulations. For example, investigators routinely visited licensed establishments to ensure that intoxicated patrons would not be served further alcoholic beverages.

Despite recent cutbacks to enforcement, the ABCC has been proactive in terms of liquor legislation and regulation. According to a legal counsel with the ABCC, the increase in the national drinking age from 18 to 21 left an entire class of citizens in Massachusetts who had been drinking and were unable to drink after the legislation was enacted. Massachusetts has a large student population totaling approximately 400,000, and yet has a rather small number of drunk driving fatalities. This is attributed to the great emphasis that has been placed on preventing drunk driving in recent years by both the ABCC and state law enforcement agencies. For example, the state police frequently organize road blocks, and jail sentences, and insurance penalties for drunk driving offenses have been strengthened. Additionally, the ABCC adheres to a specific formula regarding disciplinary action taken against violators of ABCC rules and regulations. A first offense warrants a fine, the amount of which is determined by the establishments liquor profits. A second offense requires the suspension of the liquor license, and a third offense, revocation.

d. Tax Collection

Massachusetts imposes an excise tax upon manufacturers, wholesalers, and importers of alcoholic beverages. The excise tax rates levied on wine and liquor products in 1990 (the latest year for which such data are available) are depicted in Table B-11. Each licensed manufacturer, wholesaler, and importer must keep an accurate account of all alcoholic beverages and alcohol sold within the state of Massachusetts. On the 20th day of each month, the manufacturer, wholesaler, or importer must submit a report covering all sales and importations made during the previous month to the Commissioner of Revenue.

Table B-11

1990 Massachusetts Revenue Summary

Revenue Source	Tax Rate	Revenue ($1,000)
License Fees		$1,284
Excise Taxes:		$68,617
Spirits over 50%	$4.05/proof gal	$343
Spirits 15%-50%	$4.05/gal	$43,489
Spirits 15% or less	$1.10/gal	$880
Alcohol	$4.05/gal	$0
Wine	$0.55/gal	$8,941
Sparkling wine	$0.70/gal	$729
Beer	$3.30/bbl	$14,233
Cider	$0.03/gal	1
Sales Taxes		$26,653
Meal and alcohol beverage tax	5.0%	$23,925
Gross receipts tax	0.57%	$2,727
Other Income		$343
State Total		$96,897

e. Consumption

Consumption of distilled spirits sales dropped 5.8 percent from 12,342,800 gallons in 1989 to 11,623,200 gallons in 1990 (the latest years for which such data are available). At the same time, per capita consumption decreased from 2.87 gallons per capita to 2.68 gallons per capita.

Tennessee

Administration	
Alcoholic Beverage Commission	
Licensing	
Distillery Operations	2
Winery Operations	15
Wholesale Outlets	18
Retail Outlets	526
Liquor-by-the-Drink Outlets	1,213
Nonresident Liquor Seller's Permit	372
Employee Permits	18,677
Special Occasion Permits	162
Employment	
Commission Members	3
Enforcement Agents	32
Office Staff	17
Revenue Summary ($1,000)	
License Fees	1,437
Excise Taxes	62,852
Sales Taxes	50,606
Population (1,000)	4,895
Geographic Size (sq km)	109,158
Per Capita Spirit Consumption (rank)	1.19 (40)

5. Tennessee

In 1963, the Tennessee State Legislature created the Alcoholic Beverage Commission (ABC). ABC oversees the sale and distribution of alcohol throughout the state.

a. Operations

ABC has 52 employees who perform administrative and enforcement duties. The breakdown of staff responsibilities is as follows:

- 3 Commission Members, one from each Grand Division of the state
- 32 Agents working in 10 field offices
- 17 Office Staff who oversee licensees and perform administrative tasks

b. Regulation

The state issues five different categories of license. With the exception of liquor-by-the-drink licensees, license applications must be approved by the Commissioners:

- Distillery Operations — There are two licensed distilleries in the state: Jack Daniels Distillery in Lynchburg and Dickel Distilling Company in Tullahoma
- Winery Operations — There are 15 licensed wineries in Tennessee
- Wholesale Outlets — The state has 18 wholesale outlets. They must be located in municipalities with a population of over 100,000 people

- Off-Site Retail Outlets — There are 526 off-site retail outlets that may open in counties or municipalities with a population over 12,000 if approved by referendum. They are limited in number by the political subdivision that authorizes them. The authorizing subdivision may charge licensees a fee that is in addition to the state's license fee

- Liquor-by-the-Drink Retail Outlets — Once a jurisdiction has provided authority to sell alcoholic beverages off-site, it may also authorize retailers to sell alcoholic beverages for consumption on-site. There are 16 municipalities and 2 counties that have authorized a total of 1,213 liquor-by-the-drink retail outlets These licenses may be approved by ABC's Director

In addition to the five license categories, the state grants the following permits:

- Employee Permits — Employees of distillers, wholesalers, retailers, and liquor-by-the-drink licensees are required to obtain permits from ABC to engage in the sale of alcoholic beverages

- Special Occasion Permits — The state issues these permits to charitable, non-profit, or political organizations that are located in political subdivisions that have authorized liquor stores

- Nonresident Liquor Seller's Permit — This is required by any manufacturer, distillery, winery, importer, broker, or person who is not a resident of the state and sells or distributes alcoholic beverages to Tennessee wholesalers

State enforcement agents conduct inspections of new license applications and licensee renewals. In FY 1991, agents made 529 renewal and 52 new inspections of off-site retail outlets, 1,123 renewal and 196 new inspections of liquor-by-the-drink outlets, 1 new inspection of a wholesale premise, and 14 renewal and 1 new inspection of wineries. In FY 1991, agents inspected a total of 250 locations for new licenses and 1,666 renewal licenses.

c. Enforcement

ABC is in charge of enforcing the state's alcohol-related laws and regulations. Its 32 agents are responsible for enforcing the state's alcohol and drug laws. Agents do not have full police authority and, while they may take administrative actions against licensees who violate state laws, they do not have the authority to enforce laws that are not related to alcohol and drugs.

The officials that we interviewed told us that most of the state's enforcement actions are reactive, resulting from complaints made by citizens or local law enforcement officials. If the state receives complaints against licensees (e.g., serving underage or intoxicated drinkers), ABC officials might run a "sting" operation against them.

The state's political subdivisions (i.e., counties and municipalities) are responsible for regulating the distribution of beer. Local police departments retain jurisdiction over monitoring a beer licensee's compliance with state laws. Although state officials believe that their enforcement mechanisms are effective, they do believe that their inability to regulate the distribution of beer in some cases prevents its distribution from being as carefully monitored as that of wine and distilled spirits.

d. Tax Collection

Table B-12 presents Tennessee's revenues for FY 1991. ABC collects license fees and the Department of Revenue collects and administers the payment of the state's sales and excise taxes. The state imposes a 15 percent tax on sales of liquor-by-the-drink and a 15 cents per case charge for each case sold at wholesale. To ensure that licensees pay the appropriate amount of excise taxes, the Department of Revenue periodically audits licensees.

Table B-12

1990 Tennessee Revenue Summary

Revenue Source	Tax Rate	Revenue ($1,000)
License Fees		$1,437
Excise Taxes:		$62,852
Spirits	$4.00/gal	$22,556
Wine	$1.10/gal	$4,705
Beer	$3.90/bbl	$12,824
Native wine	$1.10/gal	$0
Enforcement tax	$0.15/case	$557
Gross receipts taxes:		
Mixing bars	15.0%	$227
Mixed drink privilege	15.0%	$21,983
Sales Taxes	5.5%	$50,606
Other Income		$0
State Total		$114,895

e. Consumption

Total consumption in Tennessee decreased from 6,872,800 gallons in 1989 to 6,841,900 gallons in 1990 (the latest years for which such data are available). Over the same time period, the state's per capita spirit consumption increased slightly from 1.18 gallons per person to 1.19 gallons per person.

Privatization Effort Analysis

C. Privatization Effort Analysis

In this section, we present a discussion of privatization efforts that have taken place in other states. In privatizing the retail sale of spirituous liquor, states must address a number of issues, including:

- Divesting assets — State alcohol control boards have made a significant investment in inventory and either own or lease property for retail locations. Both would sold if operations were privatized.

- Developing a new distribution system — The logistics of any alcohol distribution system can become complex. The state must decide whether to privatize wholesale or retail functions (or both) and must decide how it will monitor the process.

- Maintaining service to state residents — The experiences of consumers after privatization are varied. Overall, selection and price seem to have increased and service to some rural areas has decreased. States are interested in privatizing while minimizing the potential downside.

- Controlling the distribution of alcohol — States that privatize are often concerned that their enforcement officials will lose some or all of their ability to enforce the state's alcohol-related laws and regulations.

All of the states that we compare in this privatization effort analysis have private retail operations but have retained control of the wholesale function. Below, we discuss the experiences of Iowa, Michigan, and West Virginia in addressing the concerns that arise with privatization.

1. Iowa

Iowa privatized its liquor retail function on Monday, March 1, 1987. The state stores closed on Saturday, February 27, 1987 and returned their inventory to the state warehouse in Des Moines. The warehouse had started accepting orders from retailers on February 15, 1987. The new stores opened as scheduled on Monday, March 1, 1987.

The officials that we interviewed told us that ABD would have preferred to let its state stores sell their inventory to new (private) retailers at a discount, but the state law that ordered the privatization forbid the stores from selling to retailers at a discount and from making deliveries to the new licensees. As a result, it was easier for the retailers to order from the warehouse than it was to buy their stock from existing stores.

Some retailers chose to place their stores in the same location that the state stores had occupied. These retailers did buy their stock from the state store. In addition, according to state officials, these stores have tended to succeed because consumers already knew the site as a liquor store. The state profited from this type of arrangement. When the state owned the property, it was given a lessee; and when the state leased the property, it was able to transfer the lease to the new retailer.

Independent owners operate about 63 percent of the retail stores in Iowa. State officials that we interviewed told us that they believe their 50 percent markup does not give chain-owned stores a competitive advantage. All off-site retailers, regardless of size, pay the same price for the distilled spirits that they purchase. Larger retailers cannot arrange bulk-sale discounts. As a result, state officials told us they believe that there is not an inherent advantage in operating several liquor stores. In some states, larger retailers are able to negotiate favorable prices with wholesalers. In Iowa, retailers compete on the price they charge consumers not the price they pay — they all pay the same amount for the product that they sell.

In terms of service, the state officials that we interviewed told us that retail prices are seven percent higher (in real terms) than they were before privatization. There are twice the number of stores, and they are open longer hours (the only requirement is that they be closed from 2 a.m. to 6 a.m.).

One consultant's study indicated that some rural areas might not be served as well as they were before privatization — there are fewer stores in rural areas. Throughout the state, however, a greater number of state residents live closer to a liquor store than they did before privatization. Stores have tended to open in the more densely populated areas.

Privatization in Iowa seems to have created a tradeoff between service to geographic regions and service to the population. Although there are fewer stores in certain rural areas, more state residents have better access to off-site retail stores than they had before privatization.

According to the fiscal year 1990 annual report published by the Alcoholic Beverages Division, ABD generated an additional $20 million in net revenue over the amount projected if the state had continued to operate state liquor stores during the three-year period after retail privatization. Furthermore, since fiscal year 1990, total funds generated from the sale of alcohol have increased. Therefore, it would appear, according to ABD data, that ABD has been able to maintain a steady stream of state revenue since privatizing state retail liquor stores.

As a control state, Iowa still approves every product offered for sale within the state. The same study that measured privatization's effect on rural service also examined the range of products offered by off-site retailers. According to the officials that we interviewed, the state lists 200 more products than it listed before privatization. The consultant's study, however, indicated that the number of products in any particular store has decreased. Although certain consumers might not be able to find a particular product at their local liquor store, overall, Iowa residents appear to have a greater selection than they had before privatization.

2. Michigan

The private sector operates retail stores in Michigan. If the state were to privatize, it would turn its wholesale function over to the private sector. Although there have been repeated calls for privatization in recent years, the state has not yet acted upon any of those calls.[4]

Governor John Engler was elected in 1990 on a platform that called for privatizing any state operations that could be privatized. After two years in office, there has been considerable debate about privatizing MLCC, but no action has been taken to actually privatize Michigan's wholesale operations. There has been some talk of the costs of such a move and their likely effects on consumers, but according to the officials that we interviewed, these discussions have been held at a political level.

In April 1990, Price Waterhouse issued a report that estimated the cost of privatizing the state's operations under three different scenarios. Our report estimated that revenue-neutral privatization would require an increase in price and would eliminate almost 500 positions from MLCC.

MLCC is currently considering an alternative to the privatization of its wholesale function. This alternative would replace the state's three warehouses and 69 state liquor stores with several distribution centers. State personnel would oversee these centers, but

[4] In 1986, the state did stop selling liquor at its state liquor stores (which serve as wholesalers), but, according to the officials who we interviewed, prior to 1986 the state liquor stores did not sell a great deal of liquor to consumers anyway.

MLCC would contract out some or all of the distribution and delivery services. This plan would retain MLCC's control over pricing and the licensee discount.

3. West Virginia

During FY 1991, ABCA held three bid processes (August 1990, January 1991, and May 1991) that resulted in the sale of 96 of 98 market zones and 156 out of 214 privately owned franchises.[5] ABCA continues to control wholesale operations, oversee the retail licensing process, and enforce the state's alcohol-related laws and regulations.

To close the state stores, ABCA sent close-down teams to each store to take a physical accounting of the store's inventory and fixed assets. The stores were allowed to sell their inventory to the new retailers at a discount (retailers purchased about 80 percent of the state's inventory in this manner). The state stores' fixed assets were sold through the state's procurement process. One state official who we interviewed told us that the procurement process created some difficulties because retailers who intended to open in the same site as a state store were not guaranteed access to the shelves, cash registers, and other equipment that they would have liked to acquire.

In opening the new stores, licensees could choose their own location and did not have to hire the state's employees. The state did develop a preference system to assist in the hiring of the state stores' former employees.

As described above, the privatized system has approximately the same number of stores as existed under the state-run system. The state officials that we interviewed told us that service to state residents remains at about the same level as it did prior to

[5] The state had successfully auctioned franchises in all 98 market zones, but some retailers withdrew their bids after determining that they had planned to locate their outlets outside of a "wet" municipality in a "dry" county.

privatization, but that service will increase noticeably as soon as all the franchises are sold.

As in Iowa, the number of products listed by the state has increased markedly since privatization. The state now lists 1,700 products, compared to 850 products before privatization.

West Virginia has not conducted a detailed study of the impact that privatization has had on prices in the state. The state and private sector officials who we interviewed told us that they believe prices are lower than they were before privatization. One interviewee told us that the prices paid by on-site licensees before privatization were $1.00 to $1.50 per bottle more expensive than they were in Ohio (a neighboring control state). Since privatization, the prices paid by on-site licensees have decreased to the point where they are about the same as they are in Ohio.

Under a privatized system, prices are set by competitive forces. Prices might be higher in areas where there are fewer stores (and less competition) than they are where there are several stores located near each other. For example, prices in rural areas might be higher than prices in urban areas. The rural retailers that we interviewed charged an average of $12.68 for a 750 ml bottle of Jack Daniels. Their prices ranged from $10.95 to $13.59. The urban retailers that we interviewed charged an average of $11.30 for a 750 ml bottle of Jack Daniels. Their prices ranged from $9.59 to $12.39.

Since privatization, prices in areas near other states have attracted out-of-state residents (or cross-border activity). One Charles Town retailer who we interviewed told us that his prices attracted customers from Maryland and Virginia (where prices were higher than they are in West Virginia).

A final area of service affected by privatization is hours of operation. Private sector retailers have an incentive to stay open the number of hours necessary to earn the greatest profit. One state official whom we interviewed told us that the private stores are open longer hours than the state-owned stores were before privatization. In West Virginia, retailers stay open an average of 76.5 hours per week, out of the 137 hours that the state allows them to stay open.

It is uncertain whether West Virginia has been able to maintain a steady stream of state revenue since privatizing state retail stores. According to the fiscal year 1991 annual report published by ABCA, operating profits decreased by approximately $1.5 from FY 1990 to FY 1991, while net profits increased from $9.7 million to $23.7 million. Because net profits for 1991 include $15.2 million in revenue from the ten-year franchise sales, which is a one-time financial gain to the state, it is difficult to determine whether West Virginia will be able to maintain revenue neutrality in subsequent years.[6]

4. Summary

Virginia could learn from other states' experiences with privatization as analysis of the privatization issue is undertaken in the Commonwealth. First, the Commonwealth's objectives in choosing a particular liquor distribution system need to be clearly defined. For instance, is the principal objective of the liquor distribution system in the Commonwealth to control the distribution of liquor through physical possession of liquor by the state? Or is the principal objective of the Commonwealth to get the state out of the liquor business? Once such objectives are defined, the Commonwealth can then make a decision on whether to change the current system.

[6] As of November 2, 1992, the ABCA annual report for FY 1992 was not yet available. Such data is necessary to determine whether revenue neutrality was maintained with privatization.

If the Commonwealth decides to privatize, it would appear, from other states' experiences with privatization, that Virginia should institute a phased-in privatized system, rather than trying to privatize over a weekend or a very short period of time. A privatized system of liquor distribution would probably be implemented more successfully over a period of time. Through phased-in privatization, the state could sell its existing inventory of liquor, rather than bringing it back to the central warehouse.

It seems from the privatization experiences of other states that if Virginia decides to privatize, the state should attempt to minimize its role in the privatization process. In other words, the Commonwealth would probably be more successful implementing a privatized liquor distribution system if it were to let the private sector develop more or less on its own. The state's role should probably be directed more towards the monitoring and oversight of a private liquor distribution system rather than micromanagement of the private sector.

COMPARISON OF VIRGINIA ABC AND OTHER RETAIL BUSINESSES

1. Introduction and Methodology

We compared ABC's operations to other retail businesses that do a substantial portion of their business in the Commonwealth. Retailers were selected because they tend to be involved in activities similar to those undertaken by ABC, such as wholesale and distribution.

We selected the following companies for this comparison:

- Safeway — a major supermarket chain with 147 stores in Maryland and Virginia
- Giant — a major supermarket chain with 105 stores in the metropolitan Washington, DC area
- Food Lion — a major supermarket chain with 181 stores in Virginia
- Rose's — a chain of general merchandise discount stores with 53 stores in Virginia
- Trak Auto — a chain of discount automobile parts and accessories stores with 96 stores in Virginia
- Rite Aid — the nation's largest drugstore chain with 175 stores in Virginia
- Hechinger — a chain of building material and home improvement stores with 28 stores in Virginia

The data used here are from 1991 or 1992 annual reports and form 10-K reports filed with the Securities and Exchange Commission. Most of the financial data are taken from the annual reports, while the personnel data and qualitative data (such as distribution information) are taken from 10-K reports. The level of detail in the 10-K reports varies considerably among the businesses examined here. Therefore, the comparison of distribution methods is presented separately.

The following criteria are used to compare ABC and other retail businesses:

- Relative employment measures — such as employees per $1 million of net sales and operating profits
- Sales to assets and sales to working capital — a proxy for how hard total assets and working capital are being put to use
- Operating costs to sales — the relative level of a firm's general and administrative expenses
- Inventory turnover — measured by dividing cost of goods sold by average inventory

2. Results of Comparison

As presented in Exhibit C-1, ABC has the highest profit margin of any business, and employs fewer employees per $1 million of sales and profit than any other company. The difference between ABC and other retailers is particularly significant in the number of employees per $1 million of profit.

The differences between ABC and other retailers are not as great for the other criteria (e.g., operating costs to sales, inventory turnover, sales to assets, and sales to working capital). Food Lion has the lowest relative operating costs, while ABC and the other businesses have operating costs to sales ratios of the same relative magnitude (ranging from 21 to 25 percent). Although ABC's sales to total assets is much higher than that of any other retailer in this analysis, ABC's inventory turnover is similar to that of Giant's. Safeway has the highest sales to working capital, while ABC, Giant, and Food Lion all have sales to working capital of the same relative magnitude.

Comparison of ABC and Other Retail Businesses

Retailer	Net Sales (millions)	Number of Employees	Employees/ $1 Million of Sales	Operating Costs (millions)	Operating Costs to Sales	Operating Profits (millions)	Profit Margin	Employees/ $1 Million of Profit
ABC	255	1,136	4.45	55.29	21.7%	32.14	12.6%	35.35
Safeway	15,119	110,100	7.28	3557.30	23.5%	433.30	2.9%	254.10
Giant	3,490	24,800	7.11	875.35	25.1%	169.37	4.9%	146.42
Food Lion	6,439	53,583	8.32	855.81	13.3%	479.72	7.5%	111.70
Rose's	1,381	18,000	13.04	314.97	22.8%	35.82	2.6%	502.48
Trak Auto	320	3,700	11.58	71.41	22.3%	5.44	1.7%	679.90
Rite Aid	3,748	30,490	8.13	781.91	20.9%	242.80	6.5%	125.58
Hechinger	1,608	17,000	10.57	355.09	22.1%	51.10	3.2%	332.67

Operating Profits = Net Sales - Cost of Goods Sold - Operating Costs

Profit Margin = Operating Profits/Net Sales

Comparison of ABC and Other Retail Businesses

Retailer	Number of Outlets	Outlets in VA		Avg Sq Ft per Outlet	Inventory Turnover	Total Assets (millions)	Net Working Capital (millions)	Sales to Assets	Sales to Working Capital
ABC	242	242		2,400	11.89	40.01	7.20	6.38	35.44
Safeway	880	147	*	47,100	8.87	5181.20	134.40	2.92	112.49
Giant	157	105	**	39,236	11.84	1251.34	108.35	2.79	32.21
Food Lion	881	181		25,516	6.04	1992.19	267.25	3.23	24.09
Rose's	232	53		51,630	3.25	409.77	182.72	3.37	7.56
Trak Auto	317	96	**	5,500	3.41	144.57	48.03	2.21	6.65
Rite Aid	2452	175		7,700	3.53	1734.48	723.20	2.16	5.18
Hechinger	117	28		56,274	4.10	936.77	320.65	1.72	5.01

* In Eastern Division, which includes Maryland and Virginia.

** Includes stores in metropolitan Washington, DC area.

Inventory Turnover = Cost of Goods Sold/Average Inventory

Net Working Capital = Current Assets - Current Liabilities

Sales to Assets = Net Sales/Total Assets

Sales to Working Capital = Net Sales/Net Working Capital

According to the criteria used here, ABC compares favorably to the other businesses in this comparison. However, several factors, aside from ABC's actual operations, may contribute to this favorable comparison:

- ABC is in a more profitable line of business than most (if not all) of the businesses examined here.
- The nature of the liquor business (nominal space and personnel needs) lends itself to high profit margins, particularly in comparison to grocery retailers.
- ABC is a monopoly controlled by the state and, as such, does not face the same competitive pressures that the other retailers face. As a monopoly, ABC may be able to mark up its merchandise higher than it otherwise could in a more competitive situation.

3. Results of Distribution Comparison

As presented in Exhibit C-2, all of the companies in this comparison rely on central warehouses/distribution centers, at least to some degree, to distribute products to individual retailers. Because of their larger size, most retailers have more and/or larger distribution facilities than ABC. However, the mechanics of distribution for all of the companies in this analysis appear to be similar to ABC's. For the most part, retailers seem to rely on large central warehouses for the distribution of their merchandise.

Hechinger and Rose's stores do not rely solely on central distribution facilities. Hechinger stores are serviced in part by the central warehouse, while Home Quarters and Triangle stores (39 out of the 117 total outlets) are served directly and exclusively by suppliers. Rose's stores receive 30 percent of their merchandise directly from suppliers and 70 percent from Rose's distribution and consolidating facilities. Trak Auto generally purchases merchandise directly from a large number of manufacturers and suppliers, eliminating the need to use independent wholesalers. Orders for inventory are

Wholesale and Distribution for ABC and Other Retail Businesses

Retailer	Number of Outlets	Avg Sq Ft per Outlet	Number of Warehouses/ Distribution Centers	Location of Warehouse(s)	Avg Sq Ft per Warehouse
ABC	242	2,400	1 central warehouse	Richmond, VA	254,178
Food Lion	880	25,516	9 warehouses/ distribution facilities	Salisbury, NC	Phase I:*
				Dunn, NC	750,000
				Prince George County, VA	
				Elbree, SC	Phase II:
				Green Cove Springs, FL	1,200,000
				Plant City, FL	
				Clinton, TN	
				Greencastle, PA	
				Roanoke, TX	
Giant	157	39,236	3 distribution ctrs	Landover, MD	1,200,000
			1 dry grocery warehouse	Jessup, MD	760,000
			1 frozen food warehouse	Jessup, MD	138,000
Hechinger's	117	56,274	1 distribution ctr	Landover, MD	640,000

* Based on the number of stores services by the warehouse; 3 are phase I and 6 are phase II.

Wholesale and Distribution for ABC and Other Retail Businesses

Retailer	Number of Outlets	Avg Sq Ft per Outlet	Number of Warehouses/ Distribution Centers	Location of Warehouse(s)	Avg Sq Ft per Warehouse
Rite Aid	2452	7,700	1 principal distribution ctr	Shiremanstown, PA	350,000
			4 distribution ctrs	Rome, NY	291,000
				Nitro, WV	280,000
				Melbourne, FL	228,000
				Winnsboro, SC	265,000
Rose's	232	51,630	1 central warehouse	Vance County, NC	860,000
			1 consolidating warehouse	Vance County, NC	130,000
			2 leased warehouses	Wilmington, NC	30,000
				Henderson, NC	84,000
Safeway	880	47,100	1 central warehouse (in Eastern Division)	Landover, MD	700,000
Trak Auto	317	5,500	1 distribution ctr	Landover, MD	210,000
			1 warehouse	Bridgeview, IL	176,000
			1 distribution ctr	Ontario, CA	317,000

transmitted directly from each store to computers located at the three distribution centers, where items are assembled and packaged for delivery.

Addendum to
Price Waterhouse's
Study of Virginia's Existing Liquor Distribution System
Completed December 1992

Includes:

1. Briefing Materials Used Before Senate Rehab. Committee 1/15/93
2. Additional Analysis on the Impacts of Privatization on BPOL and Merchant's Capital Taxes

Prepared By

VABC

VIRGINIA DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL

VIRGINIA DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL

Briefing Document

Concerning the Study of Virginia's
Existing Liquor Distribution System
Completed by Price Waterhouse
December 1, 1992

Presented to
Senate Rehabilitation Committee
January 15, 1993

Agenda

1. **The Starting Point: The Current System**
   Resources used by ABC
   Revenues Returned to the State & Localities

2. **Background Information**
   Why was this study performed?
   How was Price Waterhouse selected?

3. **The Scope and Methodology of Price Waterhouse's Study**

4. **The Results of the Price Waterhouse Study**

5. **ABC's Response: Points for Consideration**

6. **Questions and Concluding Remarks**

The Starting Point: The Current System

Service Provided

- ❒ Currently operate 244 retail stores throughout the state
- ❒ Currently list approximately 1,500 different products
- ❒ Store inventory and shipments are forecast and supplied through a central distribution center located in Richmond
- ❒ Maximum store hours range from 10:00 a.m. to 9:00 p.m. Monday through Saturday including most holidays
- ❒ All stores accept credit cards as of July 1, 1992

Resources Used

- ❒ 1,083 Maximum employable limit
  - 739 in Distribution
  - 189 in Regulatory
  - 155 in Administration
- ❒ Annual appropriation of approximately $227 million in non-general fund moneys ($170 million for merchandise for retail, $57 million for operations and regulation)
- ❒ ABC serves as the source of its own appropriation. Much like a private business, the revenues generated from sales are used to offset expenses. While the General Fund does not provide direct funding, revenues and expenses are regulated through the appropriations process.

Overview of the Current System
(Continued)

Revenues Returned

- ❒ ABC returns revenue to the state in three ways
  Sales tax revenue
  Profits from operations
  Other taxes such as malt beverage, wine tax, & 20% tax on distilled spirits

- ❒ For Fiscal Year 1993, ABC expects to generate for the Commonwealth approximately $156 million in profits and taxes:
  $40 million in profits from operations (GF & Localities)
  $11 million in sales tax revenues (GF)
  $52 million in 20% tax on distilled spirits (GF)
  $38 million in malt beverage taxes (GF)
  $15 million in wine taxes (GF & Localities)

Background Information

- During the 1992 General Assembly, several bills were introduced calling for pilot private liquor stores in Virginia. Some members of the General Assembly thought that a thorough study should be performed before considering the introduction of private liquor sales in Virginia.

- In February 1992, the Governor's office directed ABC to initiate a study of the privatization of liquor sales in Virginia. Attention was to be given to:

  Revenue levels to the state and localities
  Service to urban, suburban, and rural areas
  Control over the distribution and sale of liquor
  Effective enforcement of ABC laws
  Retail prices throughout the Commonwealth
  Employment considerations
  Need for additional regulatory resources

- Through a competitive bid process, ABC selected Price Waterhouse as the outside consultant for this study. Their charge was to prepare an independent, objective, detailed and comprehensive study of the advantages and disadvantages of the privatization of liquor sales in Virginia.

The Scope of the Study

- Price Waterhouse was to compare the existing liquor distribution system to considerations of:

  - The privatization of only the retail function (partial)
  - The privatization of both the wholesale and retail functions (full)

- Assess the impacts of privatization on:

  - the price of liquor in Virginia
  - the consumption of liquor in Virginia
  - revenues to localities and the General Fund
  - state and private sector employment
  - licensing considerations
  - utilization of state facilities
  - service to urban, rural and suburban areas
  - enforcement of ABC laws and regulations
  - public safety issues such as alcohol related crime & accidents, DUI's, etc.

- Assess the general environment for changing the existing system of liquor distribution in Virginia

The Methodology of the Study

- Conduct a statistically valid survey of Virginians to gather the publics view of private liquor sales
- Interview representatives from public and private agencies as well as members from state and local government.
- Analyze privatization efforts in others states such as Iowa and West Virginia and relate this information to Virginia's situation
- Review operations and control-related issues in other states, both open and control (five each)
- Develop models to assess the impacts of partial and full privatization on state and local revenues, state and private sector employment, the number of off-premise licensees and expected consumption levels
- Interview appropriate ABC personnel as needed

Results of the Price Waterhouse Study

Survey Results

- According to the survey, approximately 65% of Virginians contacted favored keeping the current ABC system.

- Approximately 80% of those favoring the current system felt that the current system maintained control, limited accessibility, and kept the amount of underage drinking at a low level.

- Approximately 39% of those surveyed approved of privately owned liquor stores but only 23% approved of selling liquor in grocery or convenience stores.

Employment

- State government employment would be reduced by 630 under partial privatization or by 713 people under full privatization and would not be expected to change the Commonwealth's unemployment rate significantly.

- Private sector employment would generate approximately 3,100 jobs under partial privatization and 3,900 under full privatization.

Number of Establishments

- Based on open states similar to Virginia, approximately 6,000 off-premise establishments selling liquor would be expected under either full or partial privatization.

- Included in this figure are grocery stores, convenience stores, drug stores and certain filling stations, many of which already sell beer and wine. Also included were approximately 1,000 on-premise licensees that would choose to sell off-premise as well.

Results of the Price Waterhouse Study

Fiscal Impacts

- ❐ Under partial privatization, an effective wholesale mark-up of 35.9% (compared to existing effective retail and wholesale mark-up of 51%) was necessary to achieve neutrality. Under full privatization, a tax of $15.43 per gallon sold would be necessary for revenue neutrality. Private retailers would be expected to apply a 25% mark-up in both cases.

- ❐ Price Waterhouse concluded that revenue neutrality appeared to be achievable under partial privatization. A $4.1 million increase in license fees and a reduction in operating expenses of approximately $32 million would offset the reduction in taxes and profits.

- ❐ Under full privatization the conclusion was that revenue neutrality was more uncertain. Again, increases in license fees of $4.2 million and expenses reductions of $39 million would offset lower revenues.

Customer Service Impacts

- ❐ Retail prices would be expected to rise by 13% under partial privatization and 32% under full privatization.

- ❐ Private retailers would be less likely to carry the full product line as maintained by current state-run operations.

- ❐ A wide range of pricing strategies would be evident from aggressive discounting to high priced specialty shops.

- ❐ Geographic variations in service and pricing would be expected.

Results of the Price Waterhouse Study

Control and Safety Impacts

- ❐ Accessibility to the product would likely increase because of an increase in the number of outlets and an increase in the hours of operation.

- ❐ From the examination of five states, Price Waterhouse concluded that it was possible to maintain control over the sale of alcohol but cautioned about public perception of control.

- ❐ Price Waterhouse was not able to find statistically significant differences between open and control states on such issues of DUI arrests, traffic fatalities, homicide and health-related issues. While not statistically significant, they did caution that there could still be the perception that the system is less safe.

ABC's Response to the Study

General Comments

- ❐ Overall, ABC is pleased with the efforts of Price Waterhouse in analyzing such a complex issue.

- ❐ The Department was pleased to find that its operations compared favorably to private sector retailers operating within the Commonwealth.

- ❐ Given the time and resources constraints of the project, however, some points warrant further consideration and clarification. For example,

Service to Urban, Suburban, and Rural Areas and the Impacts on Retail Prices

- ❐ Service to urban areas would likely increase while service in rural areas would be expected to be reduced. Evidence from Iowa's recent privatization, for example, shows fewer outlets in rural areas with higher prices and limited product lines.

Control and Enforcement Issues

- ❐ ABC recently started a financial investigations section to identify possible instances of money laundering, tax evasion and food/alcohol ratio compliance in licensed establishments. One key investigative tool is the ability to verify purchase records of licensed establishments by comparing them to state store sales records. Licensees having the capability to purchase from other sources reduces ABC's ability to accurately monitor purchases.

ABC's Response to the Study

Impacts on Revenues and Prices

- ❑ The study estimated that one-time savings of $10.3 million and one time costs of $10.9 would occur under partial privatization. Under full privatization, one time savings and costs were estimated to be $10.5 million and 11.8 million, respectively.

- ❑ Using typical license fees from other states, $4 million in license fees would be generated from 6,000 new licenses issued annually.

- ❑ After all savings and costs are considered, the study indicated that maintaining the retail price currently charged by ABC would result in revenue reductions of $24 million under partial privatization and $61 million under full privatization.

- ❑ To avoid on-going revenue losses, the study indicated that prices would be expected to increase by 13% under partial privatization and 32% under full privatization.

- ❑ The study stated that the average retail price would be expected to rise from $8.49 to $9.59 under partial privatization and $11.23 under full privatization.

- ❑ Maintaining revenues, with the increased prices, is contingent upon consumers <u>not</u> switching to alternative sources or products such as neighboring states, military installations, bootlegging, or lower priced merchandise such as wine and beer and lower quality, less profitable liquor products.

ABC's Response to the Study

Impacts on Revenues and Prices (Continued)

- ❒ Maintaining revenues assumes that there would be no short-fall in the 6,000 licenses projected in the study.
- ❒ Legislative restrictions such as limiting the hours or days of sale or limiting the number establishments in a locality reduces expected profit levels of private retailers and potentially the number of those seeking licenses.

Anticipated Revenues While Maintaining the Retail Price to the Consumer

Current System	$91 Million
Partially Privatized System	$67 Million
Fully Privatized System	$30 Million

Analysis of Privatization on Local BPOL and Merchant's Capital Taxes

Estimated Local Taxes from Liquor Sales

Total Anticipated Annual Gross Recipts (incl. Sales Tax)	$335,000,000
Anticipated Annual Gross Recipts Per Outlet	$68,987
Total Anticipated Annual Cost of Merchandise	$160,000,000
Anticipated Value of Inventory per Outlet for Jan 1	$4,942

BPOL Tax Estimates

County	Number of Retail Licensees	Projected Dollar Sales Per Locality	Tax Rate Per $100 of Gross Receipts	BPOL Revenue
Albemarle	53	3,656,301	0.2	$7,313
Alleghany	10	689,868	0.1	690
Amelia	7	482,908	0.05	241
Arlington	133	9,175,247	0.2	18,350
Augusta	43	2,966,433	0.2	5,933
Botetourt	19	1,310,750	0.1	1,311
Caroline	15	1,034,802	0.15	1,552
Chesterfield	163	11,244,852	0.2	22,490
Clarke	9	620,881	$25 Fee	225
Cumberland	6	413,921	0.05	207
Dinwiddie	16	1,103,789	0.16	1,766
Fairfax	637	43,944,605	0.17	74,706
Fauquier	38	2,621,499	*	2,621
Frederick	36	2,483,526	0.2	4,967
Gloucester	23	1,586,697	*	1,587
Goochland	11	758,855	*	759
Greene	8	551,895	0.15	828
Greensville	7	482,908	0.16	773
Henrico	170	11,727,759	0.2	23,456
Henry	42	2,897,446	*	4,346
Isle of Wight	19	1,310,750	0.12	1,573
James City	27	1,862,644	0.2	3,725

King George	11	758,855	0.1	759
Loudoun	67	4,622,117	*	4,622
Mathews	6	413,921	0.1	414
New Kent	8	551,895	0.2	1,104
Nottoway	12	827,842	0.05	414
Powhatan	12	827,842	$30 Fee	360
Prince George	21	1,448,723	0.15	2,173
Prince William	168	11,589,786	0.17	19,703
Roanoke	62	4,277,183	0.2	8,554
Rockbridge	14	965,815	0.13	1,256
Spotsylvania	45	3,104,407	*	3,104
Surry	5	344,934	*	517
Warren	20	1,379,736	0.12	1,656
York	33	2,276,565	0.2	4,553
Alexandria	87	6,001,853	0.2	12,004
Bedford	5	344,934	*	431
Bristol	14	965,815	0.2	1,932
Buena Vista	5	344,934	0.2	690
Charlottesville	31	2,138,591	*	4,277
Chesapeake	118	8,140,445	0.2	16,281
Clifton Forge	4	275,947	0.2	552
Colonial Heights	12	827,842	0.15	1,242
Covington	5	344,934	0.2	690
Danville	41	2,828,460	0.2	5,657
Emporia	4	275,947	*	552
Fairfax	15	1,034,802	0.2	2,070
Falls Church	7	482,908	0.19	918
Franklin	6	413,921	*	1,200
Fredericksburg	15	1,034,802	0.2	2,070
Galax	5	344,934	0.2	690
Hampton	104	7,174,629	*	14,349
Harrisonburg	24	1,655,684	0.2	3,311
Hopewell	18	1,241,763	0.2	2,484
Lexington	5	344,934	0.2	690
Lynchburg	51	3,518,328	0.2	7,037
Manassas	22	1,517,710	0.1	1,518

Manassas Park	5	344,934	0.15	517
Martinsville	13	896,829	0.2	1,794
Newport News	132	9,106,260	*	35,514
Norfolk	203	14,004,325	0.2	28,009
Norton	3	206,960	0.2	414
Petersburg	30	2,069,605	0.24	4,967
Poquoson	9	620,881	0.15	931
Portsmouth	81	5,587,932	*	11,176
Radford	12	827,842	0.135	1,118
Richmond City	158	10,899,918	0.375	40,875
Roanoke	75	5,174,012	0.2	10,348
Salem	18	1,241,763	0.2	2,484
South Boston	5	344,934	0.2	690
Staunton	19	1,310,750	0.2	2,621
Suffolk	41	2,828,460	0.2	5,657
Virginia Beach	306	21,109,967	0.2	42,220
Waynesboro	14	965,815	0.2	1,932
Williamsburg	9	620,881	0.2	1,242
Winchester	17	1,172,776	0.2	2,346
Total BPOL Tax				**$504,103**
Merchants Capital Tax				
	Number of	**Projected**	**Effective Tax Rate**	
	Retail	**Inventory**	**Per $100 of**	**MC**
County	**Licensees**	**Per Localility**	**Inventory**	**Revenue**
Amherst	22	108,731	0.79	$859
Appomattox	10	49,423	0.85	420
Bedford	36	177,924	0.44	783
Bland	5	24,712	0.73	180
Brunswick	12	59,308	1.2	712
Buchanan	24	118,616	0.2	237
Buckingham	10	49,423	1	494
Campbell	37	182,867	1.05	1,920
Carroll	21	103,789	0.69	716
Charles City	5	24,712	2.8	692

Charlotte	9	44,481	0.32	142
Craig	3	14,827	0.88	130
Culpeper	22	108,731	0.9	979
Dickenson	14	69,193	1.05	727
Essex	7	34,596	1.88	650
Floyd	9	44,481	0.53	236
Fluvanna	10	49,423	1.55	766
Franklin	31	153,213	1.08	1,655
Giles	13	64,250	1.2	771
Grayson	13	64,250	0.67	430
Hanover	49	242,175	0.26	630
Highland	2	9,885	0.2	20
King and Queen	5	24,712	0.65	161
King William	8	39,539	0.78	308
Lancaster	8	39,539	1	395
Lee	19	93,904	0.38	357
Louisa	24	118,616	0.65	771
Lunenburg	9	44,481	0.48	214
Madison	9	44,481	0.86	383
Mecklenburg	23	113,674	0.73	830
Middlesex	7	34,596	0.44	152
Montgomery	58	286,656	1.21	3,469
Northampton	10	49,423	0.63	311
Northumberland	8	39,539	1.2	474
Orange	17	84,020	0.4	336
Page	17	84,020	0.3	252
Patrick	14	69,193	1.05	727
Pittsylvania	43	212,521	0.83	1,764
Prince Edward	13	64,250	0.7	450
Pulaski	27	133,443	1.06	1,414
Richmond	6	29,654	1.75	519
Rockingham	45	222,405	0.53	1,179
Russell	22	108,731	1.15	1,250
Scott	18	88,962	0.72	641
Shenandoah	25	123,558	0.6	741
Smyth	25	123,558	0.6	741

Southampton	14	69,193	0.5	346
Stafford	48	237,232	0.5	1,186
Sussex	8	39,539	1	395
Tazewell	36	177,924	0.86	1,530
Westmoreland	12	59,308	0.5	297
Wise	31	153,213	1.28	1,961
Wythe	20	98,847	0.71	702
Total Merchants Capital Tax				**$38,405**
Localities with Neither Tax				
Accomack	25		None	
Bath	4		None	
Halifax	23		None	
Nelson	10		None	
Rappahannock	5		None	
Washington	36		None	
	36			
Grand Total BPOL & MC Taxes				**$542,508**
*** Localities have variable rates, best estimate used.**				

Potential Revenue Impacts from Privatization

Assumptions:

- Modifications to the Code are made to preserve General Fund and locality revenue divisions
- Revenue Neutrality is maintained over the long-term

General Fund Revenues (FY93)

- **Current Situation**

State tax on spirits of 20%	$52,000,000
Share of ABC profits	$21,000,000
Sales Tax	$11,000,000

- **Under Partial Privatization**

State tax on spirits of 20%	Maintained*
Share of ABC profits	Maintained*
Sales Tax	Unknown
Potential Increase in Personal Income Taxes	$700,000
Potential Increase in Corporate Income Taxes	$900,000

Locality Revenues

- **Current Situation**

Share of ABC Profits	$19,000,000

- **Under Partial Privatization**

Share of ABC Profits	Maintained*
Local Business Taxes (BPOL and Merchant's Capital Taxes)	$550,000

* A reduction in ABC's mark-up indirectly reduces the amount of revenue generated from the 20% state tax. Code changes would be necessary to maintain revenues to both the General Fund and localities.