Fiscal Impact Statement for Initiative 1183

The fiscal impact cannot be precisely estimated because the private market will determine bottle cost and markup for spirits. Using a range of assumptions, total State General Fund revenues increase an estimated $216 million to $253 million and total local revenues increase an estimated $186 million to $227 million, after Liquor Control Board one-time and ongoing expenses, over six fiscal years. A one-time net state revenue gain of $28.4 million is estimated from sale of the state liquor distribution center. One-time debt service costs are $5.3 million. Ongoing new state costs are estimated at $158,600 over six fiscal years.

General Assumptions

- The initiative uses the term "spirits" to describe alcoholic beverages that are distilled instead of fermented. For purposes of the fiscal impact statement, the term "liquor" is used for "spirits" to maintain consistent terminology. Beer and wine are not spirits or liquor.
- Estimates are described using the state's fiscal year (FY) of July 1 through June 30.
- New liquor distributor licenses and new liquor retailer licenses are available beginning Feb. 8, 2012. There is no limit on the number of licenses that can be issued.
- Liquor distributor licensees can begin making sales of liquor March 1, 2012. Liquor retailer licensees can begin making sales of liquor June 1, 2012.
- By June 15, 2012, the state will no longer operate the state liquor distribution center or state liquor stores.
- Estimates assume 1,428 licensed liquor retailers based on research from implementation of Substitute Senate Bill 6329 that authorized beer and wine tasting at grocery stores with a fully enclosed retail area of 9,000 square feet and the current number of state-operated and contract-operated liquor stores (328). The number of licenses is assumed to be constant for each fiscal year.
- Estimates assume 184 licensed liquor distributors, based on the number of current Washington State Liquor Control Board (LCB) licensed beer and wine distributors, wine distributors, distilleries and liquor importers. The number of licenses is assumed to be constant for each fiscal year.
- Estimates of impacts are measured against the June 2011 LCB revenue forecast (forecast).
- Retail liquor liter sales are estimated to grow 5 percent from increased access to liquor. This assumption is based on an academic study and growth experienced in Alberta, Canada, after converting from state-operated liquor stores to private liquor stores. A decrease in liquor liter sales is estimated using the forecast price elasticity assumption of 0.49 percent. Price elasticity is a method used to calculate the change in consumption of a good when price increases or decreases. For every 1 percent increase/decrease in price, liquor liter sales increase/decrease 0.49 percent. Growth from increased access and price elasticity is in addition to normal 3 percent growth in liquor liter sales assumed in the forecast.

State and Local Revenues

Actual fiscal impacts depend on liquor bottle cost in the private market and the markup applied by both private liquor distributors and retailers. Therefore, there is a wide range of potential fiscal impacts.

To estimate gains or losses to the state and local governments, the fiscal impact statement used a model developed for prior initiatives, adjusted to reflect the content of this initiative. The model measures the difference between LCB forecasted liquor revenues and the sum of the revenue gains and losses generated under the initiative using the set of assumptions set forth below.

Total Estimated State General Fund Revenues

Fiscal Year	2012	2013	2014	2015	2016	2017	TOTAL
Low Markup	$5,404,000	$51,373,000	$52,007,000	$36,083,000	$35,669,000	35,244,000	$215,780,000
High Markup	$8,777,000	$59,054,000	$58,372,000	$42,164,000	$42,204,000	$42,260,000	$252,831,000

Total Estimated Local Government Revenues

Fiscal Year	2012	2013	2014	2015	2016	2017	TOTAL
Low Markup	$6,012,000	$56,913,000	$42,500,000	$27,973,000	$26,757,000	$25,492,000	$185,647,000
High Markup	$8,361,000	$63,034,000	$50,741,000	$35,770,000	$34,949,000	$34,098,000	$226,953,000

State and Local Government Revenue Assumptions

- LCB's forecasted average bottle price for a liter of liquor (before taxes and markup) is used to estimate both state and private market bottle price.
- State's markup on liquor is 51.9 percent during FY 2012 and FY 2013, and 39.2 percent thereafter.
- Total private distributor/retailer markup for liquor sold in stores is set at a low of 52 percent and a high of 72 percent from March 1, 2012, to March 1, 2014. Thereafter, the private market markup is assumed to be a low of 47 percent and a high of 67 percent. The selected range was based on the following sources:
  - Low markup — 25 percent — is based on U.S. Internal Revenue Service data (sales revenue minus cost of goods) of retail food, beverage and liquor stores throughout the United States.
  - High markup — 45 percent — is the total liquor markup contained in the Washington State Auditor review and is based on information from the Distilled Spirits Council of the United States.
  - To these percentages, 27 percent is added through Feb. 28, 2014, and 22 percent is added thereafter. These percentages represent the total amount of new liquor distributor and retailer license fees under the initiative. While individual distributor and retailer actions will vary, academic research supports an assumption that, in the aggregate statewide, the value of the new liquor distributor and retailer license fees will be passed on to the consumer in the private market markup.

Markup Assumptions

Fiscal Year	2012	2013	July 1, 2013, to Feb. 28, 2014	March 1, 2014, to June 30, 2014	2015	2016	2017
State Markup	51.9%	51.9%	39.2%	39.2%	39.2%	39.2%	39.2%
Low Markup	52%	52%	52%	47%	47%	47%	47%
High Markup	72%	72%	72%	67%	67%	67%	67%

- The initiative imposes a new liquor distributor license fee of 10 percent of total liquor revenues from March 1, 2012, to March 1, 2014; the fee decreases to 5 percent thereafter. The initiative imposes a new liquor retailer license fee of 17 percent of total liquor revenues beginning June 1, 2012.

- Based on inventory information from the Retail Owners Institute®, private liquor stores are estimated to maintain two months of liquor inventory. In contrast, state-operated liquor stores maintain 1.2 months of liquor inventory. Therefore, an additional 0.8 month of liquor liter sales to liquor retailers is assumed during FY 2012.
- If the new liquor distributor license fee totals less than $150 million by March 31, 2013, these licensees must pay the difference between $150 million and actual receipts by May 31, 2013. The model estimates that $84 million to $91 million will be paid by licensees during FY 2013 due to this requirement.
- The initiative sets a $1,320 license fee for each liquor distribution location and a $166 license fee for each liquor retailer license. Both fees are due at the time of license renewal.
- Liquor distributor licensees are assumed to be subject to the wholesaling business and occupation (B&O) tax. Liquor retailer licensees are assumed be subject to the retailing B&O tax.
- Liquor liter taxes and liquor sales taxes are amended by the initiative, but these changes are assumed not to increase, create or eliminate any tax.
- Except for the loss of sales in state-operated liquor stores, estimates do not assume any change in pricing or volume of sales of beer and wine.
- State-operated liquor stores sell Washington State Lottery products to the public. The estimate assumes 25 percent of these sales will be lost and remaining sales will occur in other outlets selling Washington State Lottery products. This revenue loss is estimated to be $1.8 million over six years.
- Estimates of sales by current restaurant licensees who sell liquor at retail are limited to changes from price elasticity and the loss of the state's 15 percent quantity price discount to these licensees.
- Estimates do not assume any change in sales by liquor stores operated on military bases. Such sales are assumed not to be subject to liquor liter taxes, liquor sales taxes or B&O tax.
- Estimates do not assume any change in sales by liquor stores operated by tribes. Such sales are assumed to be subject to liquor liter taxes and liquor sales taxes based on current agreements between tribes and LCB, but are not subject to B&O tax.
- No additional change is assumed for tax avoidance/non-compliance by consumers or migration of sales in and out of state by consumers. These items are assumed in the forecast price elasticity assumption.
- Revenue from the state markup used to pay for the state liquor distribution center and state liquor store costs are netted to zero. The initiative eliminates both the revenue (markup) and the costs (state liquor distribution center and state liquor stores), which results in no additional revenue to the state.
- The initiative requires new liquor distributor and retailer fees to be deposited into the Liquor Revolving Fund. The Liquor Revolving Fund is distributed by statute in the following order:
    1. Payment of LCB administrative costs;
    2. Distributions to state accounts for specific purposes (such as drug and alcohol research at the University of Washington and Washington State University);
    3. Border areas (cities, towns and counties adjacent to the Canadian border); and
    4. The remainder after these distributions: a) 50 percent to the State General Fund; b) 10 percent to counties; and 3) 40 percent to cities and towns.

    Therefore, the model first reduces the Liquor Revolving Fund by LCB costs, one-time and ongoing, to determine total revenues distributed to the State General Fund and local governments. Other revenues (beer taxes, wine taxes, penalties, etc.) deposited into the Liquor Revolving Fund are assumed to be unaffected by the initiative and continue to be shared between the state and local governments.

Specific Local Government Revenue Assumptions

- New liquor distributor and retailers license fees must be used to maintain, in the aggregate, Liquor Revolving Fund distributions to counties, cities, towns, border areas and the Municipal Research Service Center in an amount no less than the amount received in comparable periods. For purposes of the model, comparable period is measured by funds forecasted for calendar year 2011. The model estimates that local distributions will exceed the maintenance level required by the initiative each fiscal year.
- An additional $10 million is also provided to counties, cities, towns and border areas.
- Approximately 38 cities and towns impose a local B&O tax. Using data from the Washington State Department of Revenue's 2008 Tax Reference Manual, total local B&O tax is approximately 10 percent of total state B&O tax. Assuming this ratio, $3 million is estimated as new local B&O taxes from liquor sales over six fiscal years.
- Total local government revenues are the sum of the increased Liquor Revolving Fund distributions, the additional $10 million and local B&O tax.

Specific State Asset Assumptions

The sale of the state liquor distribution center is estimated to generate a potential net $28.4 million in revenue. Because the sale date cannot be precisely determined, this revenue is stated separately and excluded from the total State General Fund revenue estimates in the first table above. The value of the state liquor distribution center is estimated to be $20.4 million, based on the King County Assessor's Office 2011 assessed value of the property. The sale of the equipment in the state liquor distribution center is estimated to be $8 million, based on the 2010 Washington State Auditor review, which assumed the sale of $16 million in assets would return about $8 million. Costs to sell the state liquor distribution center are estimated to total $1 million at the time of sale.

The initiative requires LCB to sell by public auction the right — at each state-owned store location — to operate a liquor store upon the premises without regard to the size of the premises if the applicant otherwise qualifies for a liquor retailer license. All state-operated liquor stores are leased and cannot be transferred or assigned. In addition, of the 166 state-operated liquor stores, 127 are located within one block of a grocery store. Because these factors (location, competition and lessor) will vary by state-operated liquor store and will affect the value of each operating right, revenue generated from the auction is indeterminate and not assumed in the model.

The initiative would repeal Engrossed Substitute Senate Bill 5942 (ESSB 5942), which directed the Office of Financial Management to conduct a competitive process for the selection of a private sector entity to lease and modernize the state's liquor warehousing and distribution facilities. Under ESSB 5942, if a proposal is determined to be in the best interests of the state by the Office of Financial Management after consultation with LCB and an advisory board created through the legislation, LCB may contract with that private entity for the lease of the state's liquor warehousing and distribution facilities. Because it is not known if LCB will enter into a contract, no revenue is assumed in the model.

State and Local Expenditure Estimate Assumptions

Revenue gains will accrue to existing accounts, the largest being the State General Fund, which may be used for any governmental purpose as appropriated by the Legislature.

Washington State Lottery proceeds in excess of expenses are deposited into the State Opportunity Pathways Account to support programs in higher education and early learning. Due to the loss of some lottery product sales in state liquor stores, it is estimated that funds to this account will decrease $1.8 million over six fiscal years.

Each county and city is required to spend 2 percent of its share of liquor revenues on alcohol and chemical dependency services, and these expenditures will increase. The additional $10 million distributed to cities, towns, counties and border areas are for enhancing public safety programs. The remaining revenue can be used for any allowable local government purpose.

State and Local Cost Estimate Assumptions

The fiscal impact statement does not estimate state costs or state savings due to social impacts from approval of the initiative. No costs are assumed for local governments.

Liquor Control Board Costs

Estimated one-time and ongoing LCB costs are assumed to be paid by the Liquor Revolving Fund. Therefore, payment of the following costs is reflected in the State General Fund revenue estimate.

LCB ongoing costs for licensing, enforcement and administration are estimated to increase by $350,000 for new fee-collection costs and implementing the "responsible vendor program." No state costs from increased enforcement activities are assumed in the estimate.

Assuming a closure date of June 15, 2012, LCB will incur one-time state costs associated with managing the closure of the state liquor distribution center and state liquor stores. There will be additional one-time costs for issuing new licenses. These state costs are estimated to total $28.7 million during FYs 2012 and 2013:

- Unemployment, sick leave and vacation buyout costs for state employees estimated at $11.8 million.
- Information technology changes and staff to issue new licenses estimated at $2.7 million.
- Staffing costs to coordinate the sale of existing inventory, termination of contract store leases, surplus of store fixtures and auction of state-operated store operating rights estimated at $11 million.
- Final audits of each state and contract liquor store estimated at $1.9 million.
- Project management and additional human resource staff estimated at $1.3 million.

Department of Revenue Costs

The Washington State Department of Revenue will administer the collection of liquor excise tax from licensed liquor distributors and retailers. Costs include additional staff, information technology changes, rule-making and policy activities, taxpayer mailings and workshops, supplies and materials. Total one-time state costs are estimated to total $120,100 during FY 2012. Ongoing costs are estimated to be $38,500 each fiscal year beginning FY 2013.

State Indebtedness

There is $5.3 million in debt service costs for a Certificate of Participation bond for the state liquor distribution center that is scheduled to be paid by Dec. 1, 2013. This one-time state cost is assumed in FY 2014.