

## STATE ANALYSTS AND WRC AGREE: I-1183 GENERATES POSITIVE STATE/ LOCAL REVENUES

### BRIEFLY

While the Office of Financial Management's estimate of the financial impacts of Initiative 1183 differs somewhat in the details from our estimate of the impacts, the two analyses agree that the initiative will provide significant additional revenues to state and local governments

Initiative 1183, which will appear on the November ballot, would privatize liquor sales in Washington, ending the state's long-standing monopoly. Our August Special Report on the initiative presented an estimate of its fiscal impact (WRC 2011). The Office of Financial Management (OFM) has also estimated the initiative's fiscal impact (OFM 2011). This brief compares these estimates, which are summarized for the period 2012–2017 (state fiscal years) in the table below.

OFM presents high and low scenarios based on differing assumptions on the markups that distributors and retailers apply to liquor sales, while we present a single scenario. OFM calculates total fiscal impacts (the sum of revenue gains and expenditure reductions) of \$401.4 million in their low

scenario and \$479.8 million in their high markup scenario. The total impact we calculate, \$443.2 million, lies midway between these figures.

Where OFM's estimates differ significantly from ours is in

the division of the impact between state and local government: OFM shows a much smaller share of the gain going to local governments than we do.

*Markups:* In OFM's low markup case, distributors apply a markup of 35 percent to their cost of liquor in the first two years and 30 percent thereafter. Retailers add an additional markup so that the price to their customers (excluding state liquor taxes) is 52 percent greater than the distributors' cost of liquor during the first two years and 47 percent greater than the distributors' cost thereafter. The implied retailer markup as a percentage of the price the retailers pay to the distributor is 12.6 percent during the first

two years and 13.1 percent thereafter.

In OFM's high markup case, the distributors' markup is 55 percent during the first two years and 50 percent thereafter. With the retailers' markup, customer prices (excluding taxes) are 72 percent greater than distributors' costs during the first two years and 67 percent greater than costs thereafter. The implied retailer markups are 11.0 percent during the first two years and 11.3 percent thereafter.

Our calculations assume that the distributors' markup on their liquor cost is 25 percent and the retailers' markup on the prices they pay to distributors is 30 percent. Application of these successive markups results in prices to consumers that are 62.5 percent greater than the cost of liquor to distributors.

Our 62.5 percent overall markup lies midway between the overall markups of the two OFM scenarios. Under both OFM scenarios, however, distributor markups are greater than under our single scenario, while retailer markups are less than ours.

*Other key differences:* The OFM analysis assumes that privatization results in a 5 percent increase in the volume of liquor sales, citing the experience of Alberta. To be conservative we assumed no bump in sales. This difference increases OFM's impacts relative to ours.

The OFM analysis assumes that the Liquor Control Board (LCB) costs, other than the costs paid for liquor, would be constant for the years following 2013; we in contrast assumed that these costs would rise by 2 percent per year (2 percent is the Federal Reserve's long-run target for the rate of inflation). OFM assumes a smaller cut post-privatization in LCB non-liquor expenditures than we do (84.3 percent vs. 87.3 percent). Together, these two differences add \$55 million to our fiscal impact estimate compared to OFM's estimate.

### I-1183 Fiscal Impact Comparison, 2012-2017

(Millions)

	WRC	OFM	
		Low	High
State Government Impact	\$163.9	\$215.8	\$252.8
Local Government Impact	\$279.2	\$185.6	\$227.0
Total Impact	\$443.2	\$401.4	\$479.8

Our impact estimate includes \$25 million (net of associated debt) from selling the distribution center and auctioning operating rights to current liquor stores. OFM estimates that selling the distribution center might yield \$23.1 million (net of associated debt), but does not include that in the reported totals because the timing of the sale is uncertain. Citing uncertainties regarding the value of operating rights to existing stores, OFM does not include revenue from these rights in the total.

We include \$29.2 million from disposing of state liquor store inventories. OFM does not include such revenue.

### State vs. Local Impact

As we noted above, our estimates differ significantly from OFM's in the division of the impact between state and local government. Most of this difference is due to three factors:

*First*, OFM assumes that privatization will increase liquor sales volumes by 5 percent. Our own modeling shows that 73 percent of the increased revenue from an increase in sales volume goes to the state.

*Second*, we assume that in the baseline, where the state maintains its liquor monopoly, retail sales increase by 6.9 percent from 2013 to 2014. Of this, 3 percent represents the long-run annual increase for liquor sales projected by the LCB, while the additional 3.9 percent is due to the reduction in retail prices expected to occur in 2014 when the LCB is scheduled to roll back its retail markup from 51.9 percent to 39.2 percent. OFM, in contrast, assumes baseline retail sales increase 3 percent from 2013 to 2014. Our baseline thus shows greater state and local revenue from continuing the state liquor monopoly than does OFM's baseline and therefore a smaller gain from privatization. State government bears 72 percent of this reduction, and local government's share of the (reduced) gain from privatization goes up.

*Third*, excess funds from the liquor revolving account are currently distributed 50 percent to the state, 40 percent to cities and 10 percent to counties. I-1183 specifies that:

An additional distribution of ten million dollars per year from the spirits license fees must be provided to border areas, counties, cities, and towns through the liquor revolving fund for the purpose of enhancing public safety programs (pp. 59-60).

We interpreted this to mean that \$10 million would be added to the distribution local

governments would otherwise receive. Under OFM's interpretation, this \$10 million distribution reduces the excess to be distributed 50/40/10 by \$10 million. Local governments net only \$5 million from the I-1183 distribution, because half of the \$10 million comes from funds they would have otherwise received. OFM's interpretation increases the state's gain from I-1183 by \$26.7 million and reduces the local gain by the same amount, compared to our interpretation.

### Summary

It is to be expected that independent analysts will come up with somewhat different estimates of the fiscal impacts of a measure as complex as Initiative 1183, and OFM's estimates do differ somewhat from ours. We remain comfortable with the choices we made in modeling I-1183's impact. In spite of the differences, the two analyses agree that the initiative will provide significant additional revenues to state and local governments.

### References

- Office of Financial Management (OFM). 2011. Fiscal Impact Statement for Initiative 1183. Updated August 18. <http://www.ofm.wa.gov/initiatives/2011/1183.pdf>
- Washington Research Council (WRC). 2011. Initiative 1183 Would Produce Revenue Gains For State and Local Governments. Special Report. August 9. <http://www.researchcouncil.org/docs/PDF/WRCGovernance/I-1183Final080911.pdf>