Vermont Agency of Administration

Alcoholic Beverage Market Privatization Study

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1. Introduction and Project Background

Act 177 Directive

Vermont Act 177, enacted in 2022, requires the Vermont Agency of Administration to contract with an independent third-party consultant to study the potential privatization of Vermont's alcoholic beverage market and to submit a report to the legislature on or before January 15, 2024. The provisions of the Act direct the study to examine the impact on State revenue, the taxation and enforcement models that could be used in a private market, and recommendations for whether the State should amend regulatory structures to implement a privatized alcoholic beverage market.

On November 9, 2023, the Agency of Administration contracted with PFM Group Consulting (PFM) to conduct the study. PFM has conducted similar studies of the potential privatization of liquor systems for multiple governments, including the states of Pennsylvania and Virginia and Montgomery County, Maryland. In 2014, PFM provided subject matter expertise related to privatization to the Office of the Vermont State Auditor for a performance audit of the Department of Liquor Control.[1]

Project Approach

Over an approximately two-month period, the PFM project team undertook the following activities:

- **Reviewed prior studies on privatization, both for Vermont and other states.** Besides the 2014 Vermont State Auditor's report, that Office also released a follow-up report, on December 19, 2017, to track progress on recommendations related to the original performance audit. The project team reviewed both the 2014 and 2017 reports. The project team also reviewed studies related to the impacts of the 2012 privatization of the state of Washington liquor system. Washington is the most recent system to switch from a state control to a privatized wholesale and retail system.[2]

- **Gathered state and national industry and Vermont division of liquor control data.** For the state of Vermont, PFM provided a written request to the Department of Liquor and Lottery (DLL), Division of Liquor Control (DLC) and received data related to sales by agency store for the years 2019-2023, cost and quantity of goods sold by agency for those years, quantity of goods sold, etc. PFM also received division-specific information related to its organizational structure, headcount, salary and benefits, and budget detail.

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[1] "Liquor Control System: Fiscal Impact Projected as Neutral, but DLC Could Take Other Actions that May Increase Profits," Report of the Vermont State Auditor, November 21, 2014. Accessed online at https://legislature.vermont.gov/assets/Legislative-Reports/303321.pdf

[2] Washington changed its system as a result of a voter initiative. Reports are that Costco spent over $20 million in support of the voter initiative.

- For national comparisons, PFM relied on its own internal research as well as external industry sources, including the 2023 Liquor Handbook.[3] PFM also reviewed data gathered by the National Alcohol Beverage Control Association (NABCA), and other research related to liquor system operations in the U.S.

- **Interviewed Division leadership and subject matter experts.** The project team conducted interviews via MS Teams with the DLC Commissioner and Deputy Commissioner as well as other members of the DLC management team and subject matter experts. For the Commissioner and Deputy Commissioner, these touched on department and division organizational and staffing structure, as well as current and planned key initiatives. For other management and subject matter expert interviews, they touched on specific duties and responsibilities as well as comparisons of how their part of the DLL's operations might be impacted by a switch to a privatized system. In several cases, the initial interviews were augmented by follow-up discussions by email or phone.

- **Prepared financial models for the current system and a privatized system.** A key part of the PFM assistance to the Vermont State Auditor's Office in 2014 was to create a financial model that could forecast the revenue and expenditure impacts to the state from a switch to a privatized alcohol delivery system. For this study, PFM also built a model for that purpose. The model was built in Microsoft Excel and allows various scenarios to be tested, related primarily to staff and the costs associated with it, retail sales revenue, and state taxes and rates.

- **Researched taxation and enforcement structures in other states.** About two thirds of the states have a fully privatized approach to wholesale and retail distribution of alcohol. These state structures, and how they might apply to Vermont, were researched and analyzed.

- **Prepared the draft and final report.** The project team provided a draft report to the Agency on Administration and the DLL related to the study issues presented by Act 177. After discussion with the respective departments, the project team made a variety of edits and additions to this, the final report.

The project team thanks the Commissioner and staff of the Vermont Department of Liquor and Lottery, who were extremely generous with their time and effort by providing data and information and continued discussions related to past and current DLC operations. Of course, any errors or omissions contained within this report are the sole responsibility of the project team.

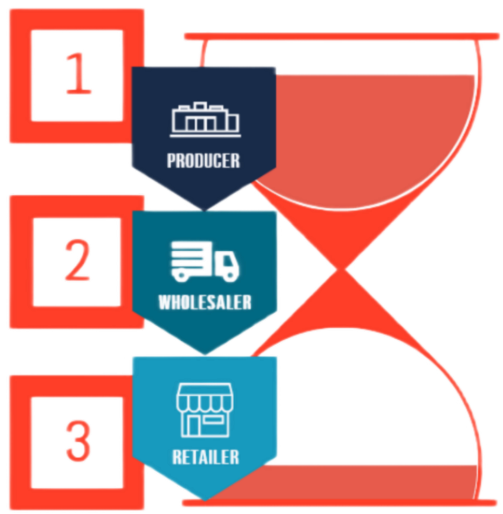
[3] "2023 Liquor Handbook," The Beverage Information Group, 2023.

2. Current System

Since the December 5, 1933, ratification of the 21st Amendment to the U.S. Constitution that ended Prohibition, states have generally relied on two models for the distribution and sale of alcohol. The models differ in their degree of reliance on private sale and distribution of alcohol.

There is what is known as a ‘three-tier’ system for the distribution of alcohol products in the U.S. The tiers are, in a purely privatized approach, meant to be insulated from each other so that no part of the process dominates the others, which was believed to be a problem with the system prior to prohibition.

Figure 1: Three-tiered System



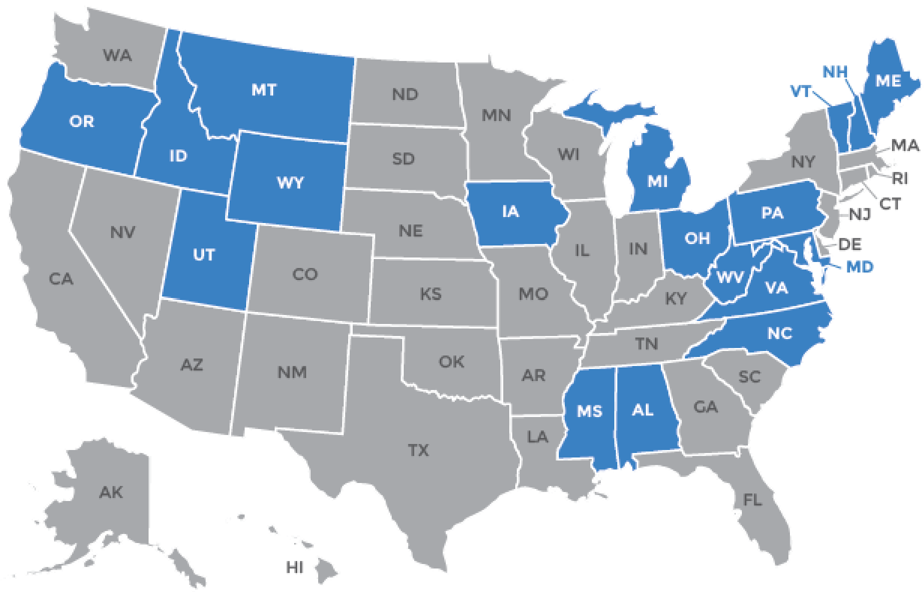
The figure to the right, from NABCA, depicts this system and its three tiers. The producers are wineries, distilleries, and others that manufacture the product for sale. The wholesale tier is responsible for paying taxes on the product sold (generally by volume), tracking its source and destination, getting the product to sellers, and providing product support. Finally, the retailers (such as liquor stores, grocery stores, and locations for on-premise consumption) make the product available to the general public. There are two primary models used in the states to operate the three-tier system.

In the **license or private model**, currently in place in 33 states, the manufacturing, wholesale and retail portions of the system are handled by private sector companies, with the state’s involvement centered on licensing and regulating private firms related to these activities, as well as enforcement of laws and regulations associated with those activities.

In the **control model**, currently in place in 17 states,[4] the state maintains some greater degree of control over either or both the wholesale and retail portions of the system. The following map identifies the current control states (in blue). It should be noted that Maryland is a privatized model state, but Montgomery County is a control county, which is why it shows up in blue.

[4] It is notable that the state of Maryland allows counties to determine whether they wish to control the wholesale and retail sales of alcohol, and Montgomery County, Maryland is a control county.

Figure 2: Control (blue) and License (gray) States



Source: NABCA.

As the map shows, there are some regional concentrations of control states, and only one of the control states (Iowa) has no neighboring control states. With the exception of Maine, every control state borders at least one license state.

Among the control states, the degree of control varies considerably. The most frequent level of control among the 17 is control of the wholesale operation for spiritous liquor (spirits), which is the case in 12 states, and the remaining 5 control the wholesale operation for both wine and spirits. No state maintains wholesale control over beer, and no control state allows for private wholesale distribution of both wine and spirits.

The retail approach in control states is more varied. There are five states that maintain a wholesale monopoly but use a private licensing system for retail. There is one state (Utah), where retail sales of wine, spirits, and beer over 5 percent alcohol by volume is controlled by the state. For the other states, some only maintain state (or in the case of North Carolina, local alcoholic beverage commission) stores. Even in this category, Pennsylvania has state stores for both wine and spirits, while Virginia has them for just spirits. As in Vermont, four states contract with agents for the sale of spirits, while four states have a hybrid approach, with both state and agency stores. The following table provides the states associated with these categories:

Table 1: Control State Characteristics of Wholesale and Retail Systems for Sale of Spirits

State	Wholesale	Retail	Notes
Alabama	Spirits	Both state and private stores	Only state with this retail approach
Idaho	Spirits	Both state and agency stores for spirits	
Iowa	Wine and spirits	Private	Contracts for shipping
Maine	Spirits	Agency stores for spirits	Contracts for state services
Michigan	Spirits	Private	
Mississippi	Wine and spirits	Private	
Montana	Spirits	Agency stores for spirits	Contracts for shipping
New Hampshire	Wine and spirits	Both state and agency stores for spirits	
North Carolina	Spirits	Local alcoholic beverage commission stores for spirits	
Ohio	Spirits	Agency stores for spirits	State sold rights to wholesale revenue to JOBS Ohio
Oregon	Spirits	Agency stores for spirits	
Pennsylvania	Wine and spirits	State stores for spirits and wine, although wine can be sold by private licensees.	There are restrictions, such as a separate entrance, for wine sold by private licensees.
Utah	Beer, wine and spirits	State and agency stores for beer*, wine, and spirits	*Over 5% alcohol by volume. Less can be sold by private licensees (grocery stores).
Vermont	Spirits	Agency stores for spirits	
Virginia	Spirits	State stores for spirits.	
West Virginia	Spirits	Private	Contracts for shipping
Wyoming	Wine and spirits	Private	

Vermont's Liquor System Approach

As with most state liquor control departments, the DLL and the DLC are responsible for programs related to licensing and regulating the sale of beer, wine, and liquor for both on-premise (such as bars and restaurants) and off-premise (agency stores) consumption. It also provides educational content and training for employees of on-premise establishments and enforces state laws and regulations. It is also responsible for typical enterprise functions, such as information technology, accounting, human resources, etc.

As noted in the prior section, Vermont controls the wholesale operation for spirits and contracts with agents to sell its product at retail. In the agent contractual relationship, the state alone determines what spirits products may be sold, sets the prices for the sale of products, and maintains ownership of the product until it is sold at retail. In return, agents receive a commission (which is a percentage of sales). Most, if not all, agency stores are not only selling distilled spirits through its contract with the state but are also second-class license holders. The second-class license allows an establishment to sell beer, wine or tobacco products.

As previously noted, every control state maintains some level of control of the wholesale operation. Wholesale in control states generally includes the following activities:

- Warehousing/storage of purchased products.
- Order fulfillment for retailers.
- Transportation of product to retailers.
- Assistance with promotion and sales.

While wholesale activities in license states must function as the method of distribution from suppliers to retailers, there is generally greater focus than in control states on building sales around specific brands and marketing activities for brands that they represent. This can create competition around marketing, pricing, and other methods to induce consumers to purchase their brands. In control states, there is certainly a focus on product selection and availability but less focus on steering consumers to a specific brand or type of distilled spirit.

Department Organization, Functions, and Staffing

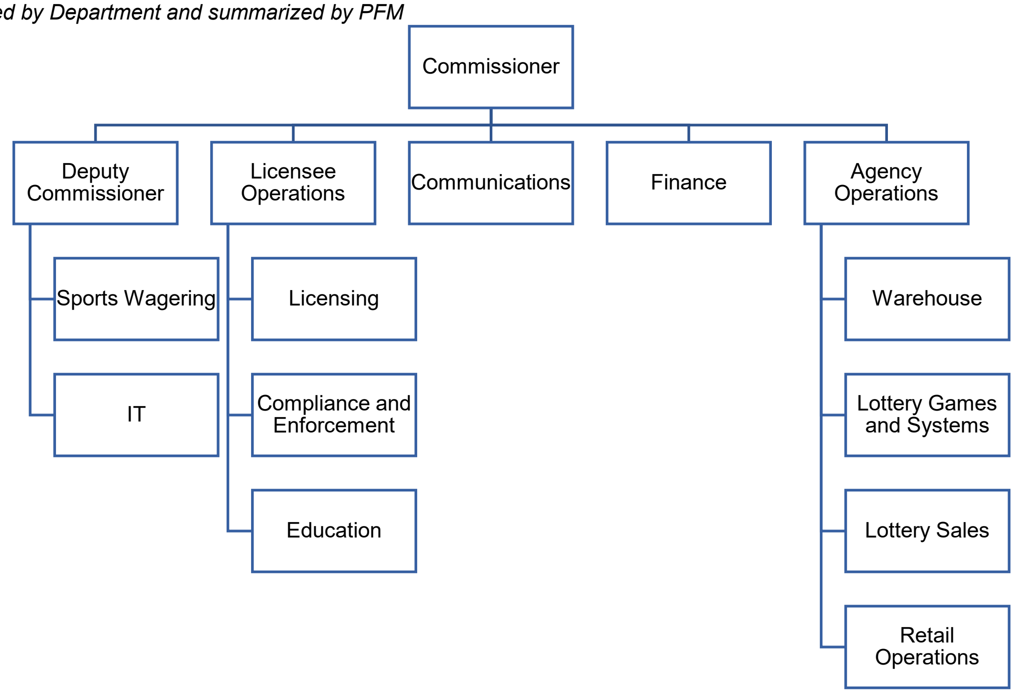
As previously noted, the DLL is responsible for regulating licensing, compliance, enforcement and education of those who sell or consume alcohol, tobacco, or gaming entertainment. The department's goal is to protect the public from harm, and all profits from the sale of these products are invested into Vermont communities through its General Fund and Education Fund.

In fiscal year 2022, the DLL was reorganized to allow for the full integration of the liquor and lottery divisions into one operational Department of Liquor and Lottery.

The DLL is headed by the Commissioner and Deputy Commissioner of Liquor and Lottery. The Commissioner oversees licensee operations, communications, the finance division, and agency operations. Starting in 2023, the Deputy Commissioner was responsible for the establishment of the sports wagering arm of the DLL. Each of the operational functions of the DLL is overseen by a (senior) director, managers, and supervisors.

Figure 3: DLL Org Chart, November 2023

Data provided by Department and summarized by PFM



The DLL is allocated a total of 74 positions, and currently 71 are filled. There are 22 employees within administrative and general functions, 23 within education, licensing and enforcement, and 26 in the purchasing, warehouse and delivery functions. Starting in FY2025, the DLL anticipates filling another 3 vacancies or new positions, 2 in the enforcement function, and 1 will be in finance to support the new Sports Wagering activities in the DLL.

Table 2: Liquor and Lottery FY2025 Budgeted Positions by Category[5]

Category	FTEs	Vacancies	Filled	Total Budgeted Salary Cost
Commissioner's Office	5	0	5	$788,534
Licensing	8	0	8	$852,227
Enforcement	13	2	11	$2,071,699
Education	4	0	4	$439,906
Communications	3	0	3	$363,316
Finance	8	1	7	$918,267
Retail Operations	7	0	7	$735,247
Liquor Operations	16	0	16	$1,365,627
Lottery Operations[6]	*10*	*0*	*10*	*$1,042,305*
Total	**74**	**3**	**71**	**$8,577,128**

Source: FY2025 Governor Recommended Position Summary, provided by Department.

[5] The position report provided to PFM was dated December 28, 2023.
[6] While lottery operations and staff members appear on the organizational chart and the staffing schedule, this report generally excludes any costs related to lottery or other non-liquor activities.

Functions
The following are the functions within the Department.

- The **Commissioner's Office** consists of the Commissioner, the Deputy Commissioner, and an Executive Assistant. The new Director of Sports Wagering, and all marketing, communications, and legislative employees are also located here. The Commissioner's Office sets the strategic vision for the DLL and works with division leadership to execute it. Some of the key strategic initiatives include growing the Vermont economy through 802Spirits store success, improving the efficiency and accessibility of government, and ensuring safe and healthy communities in the State.

- **Licensing** includes the processes of issuing and monitoring alcohol licenses. This does <u>not</u> include the approval of agency stores to sell distilled spirits (discussed later in the retail operations team). However, any other licenses, like a first-class license (beer and wine for on-premise sale), are issued by this team. Applications and renewals go through a rigorous process in the DLL online system called the Licensing and Enforcement Management System (LEMS), which is managed by the Senior Director of Licensee Operations, and they are closely monitored and handled by the Licensing Director and Program Technicians. The License Operations division also handles any customer service needs for the DLL.

- The **Office of Compliance and Enforcement** (OCE) employs sworn law enforcement officers who are charged with investigating possible violations of liquor laws and regulations, and they also carry out law enforcement activities related to these incidents. The eight (8) OCE investigators are led by four Sergeants (of which one is currently vacant), and one Lieutenant. For OCE activities, the state is divided into three zones, each of which has a Sergeant and three investigators assigned to them.[7]

- DLL provides **education and training** to about 2,000 people per year, which are mostly on-premise licensees. The Education Manager and Training Specialist organize and/or oversee online or in-person seminars provided to sellers and servers of alcohol and tobacco (which is a requirement for licensing every two years).

- The **purchasing and logistics** group is responsible for acquiring, storing, and distributing products. Since the consolidation of the Liquor and Lottery divisions, this includes lottery products, which have their own warehouse. For the purpose of this report, the project team separated liquor operations (i.e., warehouse and delivery functions) from the lottery operations.

  The Purchasing and Logistics Manager oversees the selection, pricing, storage and distribution of liquor products. The Warehouse Manager oversees two Warehouse Supervisors, one responsible for the storage function, and the other for the distribution of products to agency stores. The Purchasing and Logistics Manager spends all their time

[7] Based on the study team's conversation with Licensee Operations leadership, who also oversee the enforcement group.

on liquor-related tasks and directly oversees one Administrative Assistant.

The Purchasing and Logistics Manager also heads the Listing Committee. This consists of 10-11 individuals who make decisions about potential new products. The committee members include Department employees, two agency store representatives, and two licensees.

- **Liquor operations** include the warehouse and delivery functions of the DLC. The Warehouse Manager position oversees both functions, and there is one Warehouse Supervisor who manages warehouse specialists, and one Warehouse Supervisor who manages the Delivery Technicians.

- **Warehousing/Storage:** Vermont maintains a warehouse in Montpelier, previously connected to its administrative offices, which has since moved to a different location. As with nearly all control jurisdictions, the warehouse is operated under a bailment system – meaning that manufacturers ship sufficient quantities of product to the State warehouse but still own the product until it is ordered by a state agent and leaves the warehouse. At this point, the State takes ownership of the product and retains ownership until it is sold by the agent to either licensees or consumers.

  The DLL liquor warehouse is small compared to other control states and in interviews with DLL leadership the project team learned that they are working with the Department of Buildings and General Services to lease a new, larger warehouse. In FY2023, the DLL spent $42,000 on the lease of the current warehouse.[8]

- **Transportation:** The DLL is also responsible for the transportation of distilled spirits to Agency stores. DLL uses a fleet of trucks that it owns and maintains; it should also be noted that the warehouse staff also handles transportation duties.

  Besides the costs of employing delivery drivers, the DLL has to purchase or lease delivery trucks, maintain them, and insure them. In addition, there are costs for fuel, supplies, IT infrastructure in the trucks and for the drivers (e.g., phones, tablets, etc.), and uniform expenses.

▪ **Retail Operations:** As previously noted, the State retains ownership of all spirits products until it is purchased at the licensed agency store. All retail pricing is set by the State and must be consistent among all agency stores. While the number of licensed agents can fluctuate from year to year, in December 2023 there were 80 agent stores throughout Vermont, of which 76 were operational. Several stores had closed due to severe flooding in the 2023 summer, and a few other stores closed for other reasons (e.g., retirement). All were expected to reopen before the end of FY2024.

  The Retail Operations team noted in their interview that two so-called "kiosk" stores would

[8] Based on financial records provided by the Department. Finance staff indicated that account numbers starting with 5140 and 5150 are related to warehouse rental or lease payments.

open by the end of FY2024. These kiosk stores have a smaller footprint than the typical liquor store, with mostly best-selling items for sale and a focus on Vermont products.

Liquor stores, or 802Spirits stores, are spread across the state – while Essex County has one, Vermont's other 13 counties have at least two liquor stores. Chittenden County is the most populated county and has the highest number of 802Spirits stores (15) among the counties in the state. In FY2023, Chittenden County liquor sales made up 31 percent of total Vermont liquor sales.

The success of the state retail operations will, of course, depend on having agents with good physical locations, physical infrastructure, staffing and presentation. The DLC understands the impact that these factors can have on overall sales and state revenue. The DLC takes into consideration store locations, population, and other characteristics when determining where to locate agency stores. It is notable that, at any point in time, the State may be seeking bids for locations.[9]

Besides sales to consumers for off-premise consumption, agents also sell distilled spirits to other licensees, such as bars and restaurants. In July 2022, the DLC launched an on-premise licensee sales program, in which about half of such licensees participate. There is also a regular sales program from suppliers that is available to both walk-in and on-premise licensee customers. Licensees do not pay the 6 percent sales tax. There is, however, a 10 percent Vermont Alcoholic Beverage Tax applied to sales of alcoholic beverages (any malt, wine or spirits) that are served for immediate consumption.

Because the state acts as the wholesaler for spirits to its agency stores as well as bars and restaurants, several of the DLC's staff provide support for its agency stores. There are, for example, yearly sit-downs with agents to discuss sales performance, products and placement, staffing, etc. The DLC has a liquor merchandising specialist who can assist agency stores with a reset or refresh; these are scheduled for all stores in all districts. The DLC will also assist with product marketing – with the provision, of course, that the DLC determines the products and the prices for all spirits products sold.

A concern with the current operation relates to inventory, as previously noted, the current state liquor warehouse is small, and that is a constraint on the products that may be offered by agents (and, to a certain extent, by Class 3 licensees). While there are plans to move into new warehouse space, the point in time when that will happen is uncertain. Until that point in time, it is likely that this will continue to be a constraint on sales.

The current DLC staff support for agency retail operations is a component of its staffing that would not be necessary in a privatized system. Support for retail operations would typically be the responsibility of private wholesalers, and other aspects of the retail operation

[9] For example, in November 2023, the Division advertised bids for store locations in or near Johnson, Springfield, and Jericho, with varying requirements for square footage and storage space, along with adequate parking, signage, loading and unloading facilities.

(including products, pricing, space devoted to them, staffing, etc.) would be the primary responsibility of the private owners of the facility.

Expenditures

The Department's expenses fall into three categories:

- Cost of Goods Sold (COGS)
- Personnel Costs
- Non-personnel Costs

Each of these is described in the following.

COGS

The COGS, or cost of sales, consists of liquor purchase expenses, breakage costs, bottle redemption costs, and agent commissions. In FY2023, the total COGS was $71.5 million. Since 2018, this number has grown at an average of 6.7 percent per year.

Table 3: Cost of Goods Sold (COGS), 2018 – 2023 (in Thousands)

	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	CAGR
Liquor Purchase Expense	$44,650	$50,548	$53,636	$62,328	$56,331	$62,340	6.9%
Breakage & Over/short	$46	$34	$97	$445	$151	$93	15.1%
Bottle Redemption	$116	$100	$157	$89	$134	$146	4.7%
Agent Commissions	$6,925	$7,174	$7,622	$8,148	$8,723	$8,929	5.2%
Total COGS	**$51,737**	**$57,856**	**$61,512**	**$71,010**	**$65,339**	**$71,508**	**6.7%**

Source: FY2018 – FY2023 financial records provided by Department.

Personnel Costs

Most governmental agencies spend the bulk of their operational budget on personnel costs, and DLC is no different. In FY2023, it spent $12.1 million on its operations, with $5.3 million, or 43.7 percent, for salaries, wages, and benefits. This does not include "other personnel costs" like uniforms or travel expenses. Between FY2018 and FY2023, wages and benefits were between 44 and 51 percent of the total operational budget, growing at an average of 1.0 percent per year.

Table 4: FY2018 – FY2023 Personnel Costs

	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	CAGR
Salaries & Wages	$3,316,708	$3,073,009	$3,052,693	$3,180,344	$3,341,919	$3,358,402	0.3%
FICA	$240,325	$222,265	$225,567	$233,249	$247,660	$248,192	0.6%
Benefits	$1,488,364	$1,375,656	$1,423,165	$1,497,624	$1,568,656	$1,691,259	2.6%
Total Personnel	**$5,045,397**	**$4,670,930**	**$4,701,425**	**$4,911,216**	**$5,158,235**	**$5,297,853**	**1.0%**
Total Operations	$10,112,029	$10,474,909	$10,405,360	$10,461,563	$10,223,653	$12,131,679	3.7%
% of Operations ($)	*49.9%*	*44.6%*	*45.2%*	*46.9%*	*50.5%*	*43.7%*	

Source: FY2018 – FY2023 financial records provided by the Department.

Non-Personnel Costs
While almost half of the Department's operational budget (not including the cost of goods sold) is spent on personnel, the other half is used for standard operating expenses like rent, information technology (IT) costs, office supplies, utilities, contracted services and insurance.

Apart from personnel costs, the largest operational expenses are professional services ($2.0 million in FY23) and utilities and communications[10] ($1.6 million in FY23). The increase in the utilities category is driven by increased IT expenses (including contracts and services for the newly developed point-of-sale system) which grew from $150,000 in FY2018 to $1.2 million in FY2023. Those numbers already exclude assumed one-time capital expenses for app development. If the State chose to privatize retail operations, it would no longer need the POS system, but it may be required to honor contracts with system providers that are in place for more than one fiscal year.

Table 5: Department of Liquor[11] Operating Expenses, FY2018 – FY2023

	2018	2019	2020	2021	2022	2023	CAGR
Personnel Costs							
Salaries & Wages	3,314,408	3,070,809	3,051,493	3,178,944	3,340,069	3,353,452	0.2%
FICA	240,325	222,265	225,567	233,249	247,660	248,192	0.6%
Benefits	838,720	742,484	714,724	719,631	690,138	748,178	-2.3%
Retirement	556,415	548,384	634,338	669,480	803,643	872,561	9.4%
Other Personnel	95,909	86,989	75,302	109,913	76,725	75,471	-4.7%
Operating Expenses							
Professional Services	1,186,411	1,377,453	1,419,355	1,679,283	1,550,031	1,958,307	10.5%
Utilities	499,813	719,634	845,110	2,219,485	987,911	1,638,150	26.8%
Contracted Services	1,770,989	2,415,247	2,705,538	812,558	703,054	199,662	-35.4%
Vehicles & Equipment	162,769	803,064	348,837	295,049	201,137	354,376	16.8%
Rent	64,137	67,402	48,566	92,275	101,518	214,536	27.3%
Insurance	21,658	24,998	56,301	60,151	43,764	52,098	19.2%
Other	1,093,003	42,186	27,603	60,558	31,744	127,267	-35.0%
Supplies	267,472	353,994	252,626	243,367	319,044	419,441	9.4%
Capital Investments (IT)	0	0	0	0	1,114,500	1,859,542	N/A
Total Expenses	**10,112,029**	**10,474,909**	**10,405,360**	**10,373,943**	**10,210,939**	**12,121,231**	

Source: FY2018 – FY2023 financial records provided by the Department.

Revenues, Pricing, and Markup

The DLL's mix of revenues currently includes the sales revenue (i.e., the retail shelf price multiplied by the volume of product sold), program revenue, and taxes (sales tax and excise tax).

[10] This expenditure category includes water, sewer, trash, recycling, electricity and phone bills, gas and fuel expenses, and any other wireless, internet or app development expenses. The project team removed account numbers 516694 and 516695 from this total as the team assumes these are one-time IT investments.
[11] Given the scope of this report, the Department provided PFM with historical financial results for only liquor-related activities. In other words, these expenditure totals do not include any expenditures related to lottery, tobacco, or sports wagering activities.

The difference between the shelf price and the cost of goods sold is the markup that the State applies to liquor products. Besides this product markup, there are some other program revenues related to operating retail, for example, paper bag fee revenue (new since FY2021), and bottle deposit fees. Revenue from licenses, permits and violations are also classified as program revenue.

Overall revenues have grown at an average 3.6 percent per year between FY2018 and FY2023. The following table below breaks out the DLC's revenues. The product markup is the largest source of revenue for the DLC, followed by the excise tax and sales tax.

Table 6: Revenue from Sales, Program Revenues, and Taxes, FY2018-FY2023

	2018	2019	2020	2021	2022	2023	CAGR
Sales							
On-Premise	20,585,109	21,579,055	17,443,730	13,001,044	23,445,469	25,696,888	4.5%
Off-Premise	58,907,058	60,590,974	70,491,769	81,207,843	77,344,458	77,276,516	5.6%
Program Revenue							
Product Markup[12]	24,072,741	20,463,177	22,090,601	18,003,511	30,615,038	26,648,496	2.1%
Bottle Deposit	148,681	215,490	103,868	323,101	194,952	179,539	3.8%
Paper Bag Fee	0	0	0	11,322	12,604	10,359	N/A
Licenses, Fees, Fines, etc.	2,028,850	2,056,881	1,760,980	1,991,849	1,945,250	1,993,360	-0.4%
Operating Revenues	**26,250,271**	**22,735,549**	**23,955,450**	**20,329,783**	**32,767,844**	**28,831,753**	**1.9%**
Taxes							
Sales Tax (6%)	3,534,423	3,635,458	4,229,506	4,872,471	4,640,667	4,636,591	5.6%
Excise Tax (5%)	19,039,451	19,685,088	4,197,270	4,480,611	4,820,597	4,929,963	-23.7%
General Fund Transfer	0	1,805,000	23,000,000	22,740,000	22,750,000	20,400,000	
Total Revenues	**48,824,146**	**47,861,095**	**55,382,226**	**52,422,865**	**64,979,108**	**58,798,307**	**3.8%**

Source: FY2018 – FY2023 financial records provided by the Department; FY2018 – FY2023 Sales by Agency Stores.

Product Markup

The shelf price of a liquor product is predominantly driven by the product markup and liquor tax structure. While the tax structure is generally set by the state, regardless of whether a state is a control or licensing state, the product markup is generally determined by the wholesaler and retailer. In the case of Vermont, the DLC controls both of these aspects of price setting as well.

Markups are set by the DLC and applied as a percentage to the product cost from the liquor manufacturer and its delivery to the wholesaler (also called Freight on Board, or FOB). The

[12] The product markup is calculated by subtracting the cost of goods sold (COGS) from the total sales revenue, and backing out the 6 percent sales tax paid by off-premise customers. The sales tax is calculated separately in the Taxes section of the table. The same goes for the bottle deposit. This amount is applied to the shelf price before any markup is added, so since the bottle deposit is paid as a part of the sales price, it is not included here in the markup calculation.

following table includes the markup percentages by type of liquor product, which have remained the same for many years.

Table 7: DLC Standard Markup Percentages, 2023

Liquor Type	Markup
Tequila	85%
Vodka	80%
Brandy	70%
Rum	70%
Whiskey	65%
Cordials	65%
All others	75%
Average Markup	**73%**

The practice of rounding to the nearest whole dollar when calculating the sales price and then subtracting $0.01 also results in some revenue, though the amount is negligible.

3. Benchmarking Comparisons

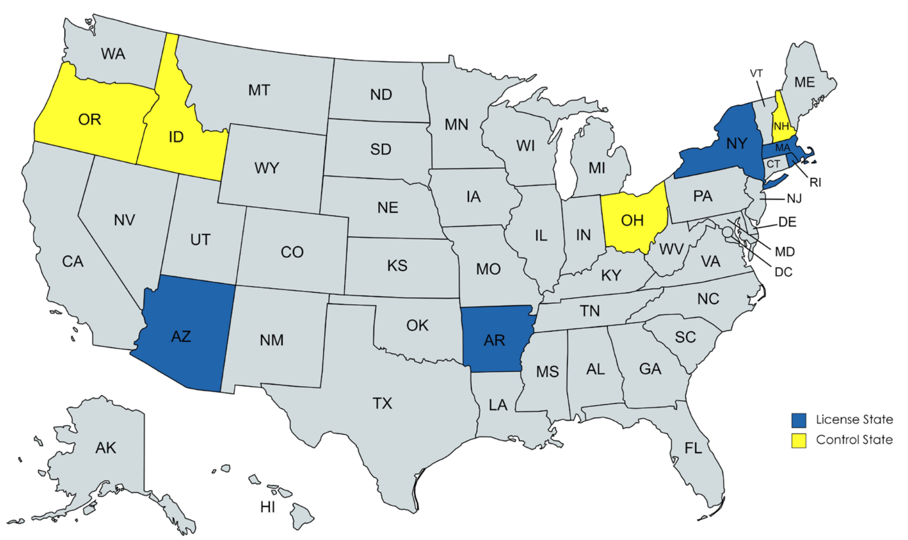
For evaluation purposes, benchmarking provides information related to how peer states regulate and administer liquor sales and distribution. At the outset, it should be understood that no two states are 'perfect peers' – there will be multiple differences in economic, demographic, and political factors that should be considered in any analysis and when making comparisons.

The process of creating a comparison group for benchmarking typically begins with bordering states, because proximity often leads states to compete for residents, businesses, visitors, and, in the case of spirits, sales. In addition, neighboring states often (but not always) have similar economic, demographic, or political structures that lend themselves to comparison. In this case, the project team also considered non-bordering states to look at both license and control states.

Comparison Group

To benchmark Vermont's liquor system, PFM examined five control and four license states, indicated on the following map.

Figure 4: Map of Benchmark States



License states were chosen based on consideration of proximity to Vermont, liquor consumption statistics, and population density; control states were selected based on system similarities. The control state group represents a spectrum of state approaches. New Hampshire retains control over both retail and wholesale of wine and spirits. Ohio and Oregon, like Vermont, use agents to operate all retail stores and control spirits only. In Ohio, the quasi-public entity JobsOhio has leased the liquor franchise since its inception in 2013. Idaho has a mix of agent- and state-run retail stores while maintaining control of the wholesale operation.

Among license states, Massachusetts, Rhode Island, and New York are similar regional states, and have similar alcohol consumption of regional license states. Arizona and Arkansas have similar population densities and are comparable to Vermont in terms of liquor consumption.

Demographic and Economic Profiles

Among benchmark states, Vermont has both the lowest total population and the lowest drinking-age population. The state's median household income ($74,014) is just below the average of all other benchmark states ($76,984); its per capita income ($41,680) is nearly equal to the benchmark average ($41,879). Compared to benchmark states, Vermont residents are well educated, with only Massachusetts ranking higher in terms of the share of the population aged 25 and up with a bachelor's degree or higher.

Table 8: Demographic and Economic Indicators, Benchmark States

State	License or Control State	Total Population	Population Aged 21+	Median Household Income	Per Capita Income	% of Pop. 25+ w/ Bachelor's or Higher
Vermont	Control	643,816	494,285	$74,014	$41,680	41.7%
Arizona	License	7,172,282	5,282,100	$72,581	$38,334	31.8%
Arkansas	License	3,018,669	2,192,687	$56,335	$31,868	24.7%
Idaho	Control	1,854,109	1,311,222	$70,214	$34,919	30.2%
Massachusetts	License	6,984,205	5,309,144	$96,505	$53,513	45.9%
New Hampshire	Control	1,379,610	1,067,193	$90,845	$48,250	39.0%
New York	License	19,994,379	15,084,936	$81,386	$47,173	38.8%
Ohio	Control	11,774,683	8,699,378	$66,990	$37,729	30.4%
Oregon	Control	4,229,374	3,216,089	$76,632	$41,805	35.5%
Rhode Island	License	1,094,250	830,563	$81,370	$43,324	36.3%
Avg. (excl. VT)		**6,389,062**	**4,777,035**	**$76,984**	**$41,879**	**34.7%**
VT Rank (of 10)		**10**	**10**	**6**	**6**	**2**

Source: U.S. Census Bureau 5-Year Estimates, 2022

Consumption

Relative to other control states, per capita consumption of distilled spirits in Vermont (1,105 bottles per 100 adults) is low, higher only than Ohio (985 bottles per 100 adults). Excluding Vermont, the control state average is 1,548 bottles, largely impacted by New Hampshire.[13] The average of Ohio, Idaho, and Oregon is 1,203 bottles. Vermont adults consume less than adults in each of the license benchmark states, which have an aggregate average of 1,469 bottles per 100 adults.

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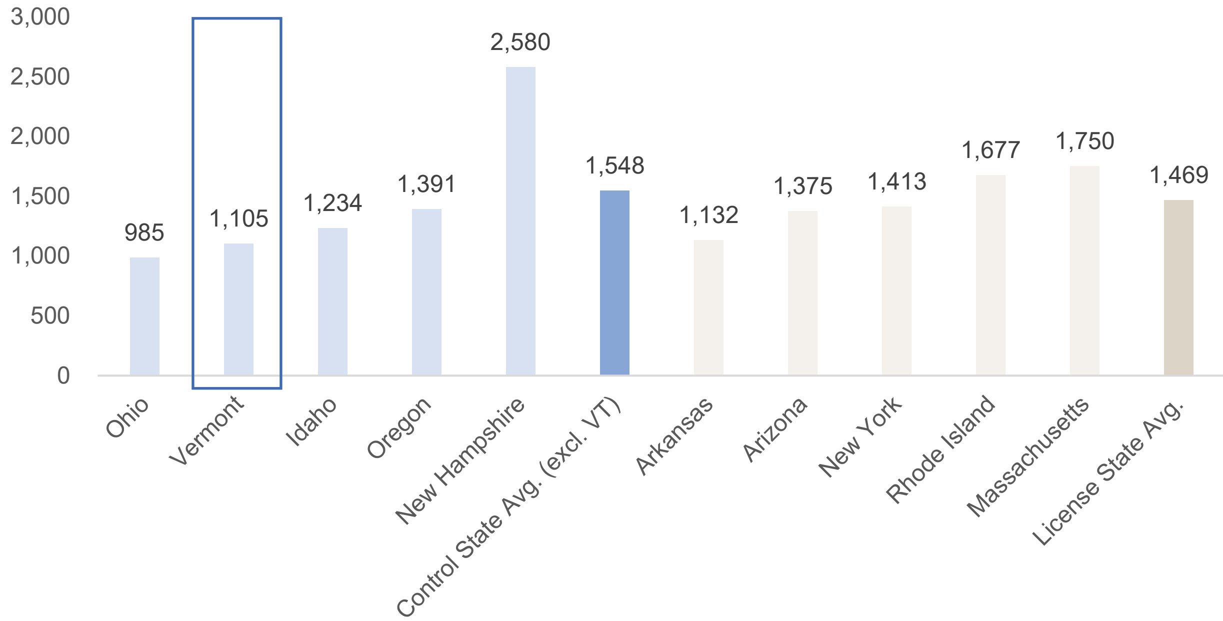
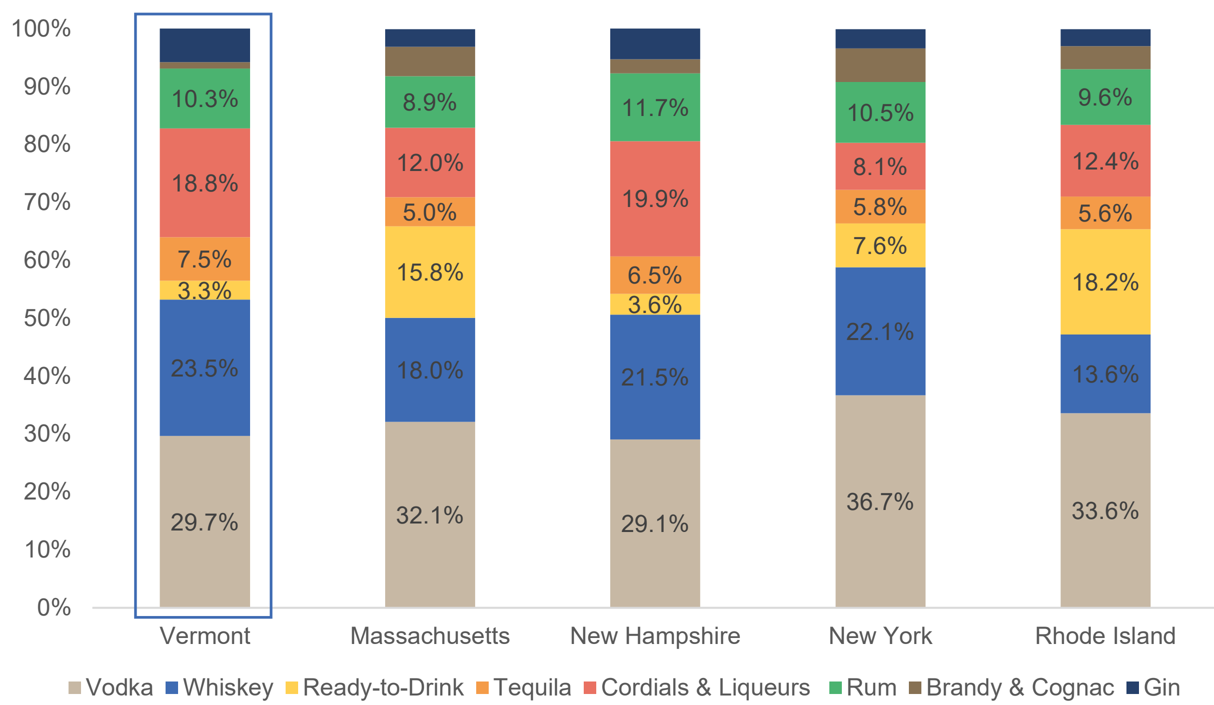
[13] New Hampshire has significantly lower prices for distilled liquor because of its mark up and tax structure. According to the 2023 Liquor Handbook, the jurisdictions with the greatest annual consumption, measured as 750 ml bottles per 100 adults, are the District of Columbia (2,620), New Hampshire (2,580), and Nevada. In the case of the District of Columbia and Nevada, the numbers are inflated by visitors, and New Hampshire by out-of-state purchasers.

Figure 5: Consumption of Total Distilled Spirits by State (750 mL Bottles per 100 Adults*)



Source: 2023 Liquor Handbook
** 2020 population 21 years and older projections*

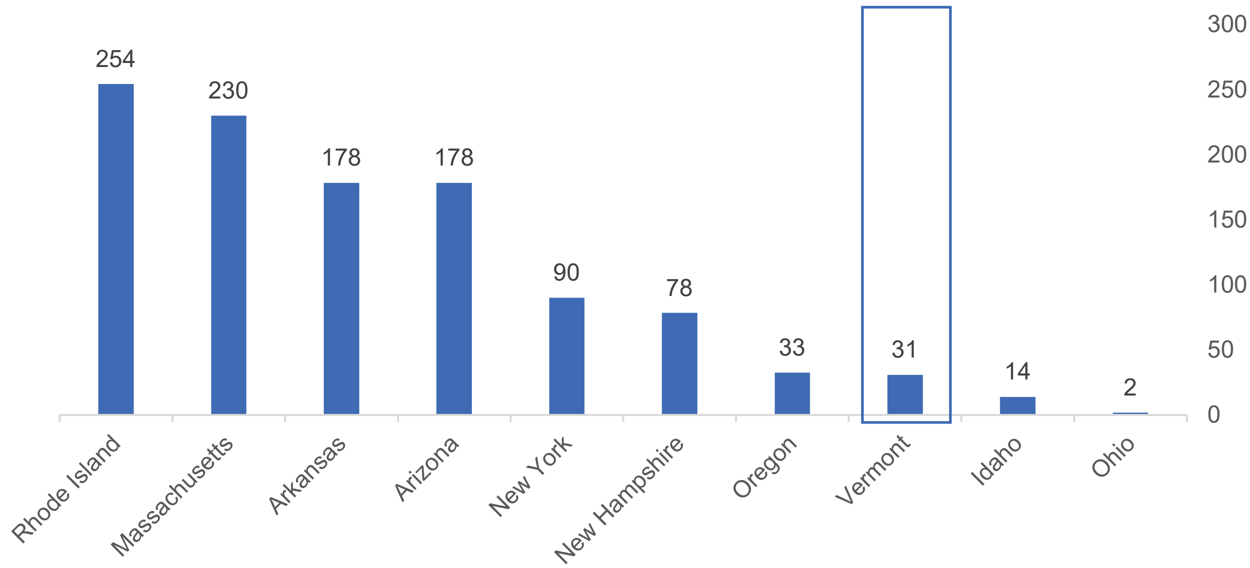
Figure 6: Distilled Spirit Consumption by Category



Source: 2023 Liquor Handbook

Nationally, the ready-to-drink (RTD) beverage category has seen strong growth and is now the second largest category of distilled spirits, after vodka. However, Vermont ranks 46th among states in per capita consumption of RTDs, suggesting that the trend is less prevalent there.

Figure 7: Per Capita Ready-to-Drink Consumption (9-Liter Cases per 1,000 Adults)



Source: 2023 Liquor Handbook

Liquor Operation: Organization

- **Idaho:** The Idaho State Liquor Division (ISLD) provides control over the importation, distribution, sale, and consumption of distilled spirits. Distilled spirits are only sold in state-operated liquor stores and contract retail stores authorized by the ISLD. The ISLD ships to all retail stores (state-run and contractors) via a third-party contract carrier. Bars and restaurants purchase distilled spirits from the State's retail stores. The ISLD does not have oversight of beer and wine. Beer and wine are handled through private distributors who generally deliver products to the retailers.[14]

- **New Hampshire:** The New Hampshire Liquor Commission (NHLC) is comprised of four divisions: (1) Enforcement and Licensing; (2) Marketing, Merchandising, and Warehousing; (3) Administrative Services; and (4) Financial Administration. The Enforcement and Licensing division is responsible for the education and enforcement of all liquor laws and rules, as well as the licensing of all private businesses that are involved with alcoholic beverages.[15]

- **Ohio:** Ohio Liquor (OHLQ) is a partnership between the Ohio Department of Commerce's Division of Liquor Control and JobsOhio Beverage System (JOBS), formed to use the profits from the sale of high-proof liquor in Ohio to fund job creation and bring new capital

[14] ISLD, "About Us." Accessed electronically at https://liquor.idaho.gov/about-us.html
[15] NHLC, "Liquor Commission." Accessed electronically at https://www.nh.gov/liquor/about_commission.shtml

investment to the state. The Division selects and prices products and manages the sale of liquor in Ohio. JOBS supplies the products to OHLQ stores and owns the profits from the sale of all high-proof liquor in the state. JOBS uses these profits – not taxes – to provide stable and dedicated funding for JobsOhio, a private nonprofit corporation dedicated to Ohio's economic development. Privately owned OHLQ stores (sometimes referred to as Contract or State Liquor Agencies) contract with OHLQ to sell high-proof liquor on consignment.[16]

- **Oregon:** The Oregon Liquor and Cannabis Commission (OLCC) is responsible for regulating the sale and service of alcoholic beverages in Oregon. OLCC has five major operational programs: (1) Distilled Spirits; (2) Public Safety; (3) Administration and Support; (4) Recreational Marijuana; and (5) Medical Marijuana. OLCC also enforces the Bottle Bill, under which most beverages sold in Oregon have a 10-cent refund value and stores and redemption centers must redeem empty containers.[17]

  The Distilled Spirits program makes distilled spirits available for sale by the bottle through liquor stores run by independent, contracted businesspeople (liquor agents), appointed by the commission members in a competitive process balancing customer service, access, and revenue generation. The program centrally purchases, warehouses, and distributes distilled spirits to Oregon's liquor stores and oversees the liquor agents. Through the oversight of retail operations, the program ensures responsible sales in liquor stores. In addition, distilled liquor is available for sale in distillery tasting room outlets. Distillery licensees distribute their products through the warehouse or make direct sales from their Distillery Retail Outlets. The commission does not own the inventory located in Distillery Retail Outlets. In 2023-25, the program will oversee the development and implementation of plans for constructing a new warehouse and replacing legacy information technology systems.[18]

  By December 2024, the OLCC is to provide the Legislative Fiscal Office with an analysis of workload and staffing in the areas of licensing, public safety, financial administration, contested cases/disciplinary proceedings, policy development, and communications. The analysis is to determine the extent to which positions devote time to matters related to liquor versus cannabis, allocating staff to appropriate funding streams, and developing a cost allocation model for shared administrative and program functions to inform future investment decisions.[19]

  The OLCC is also to perform a review of its organizational management structure, specifically evaluating the classifications, functions, division of responsibilities, and

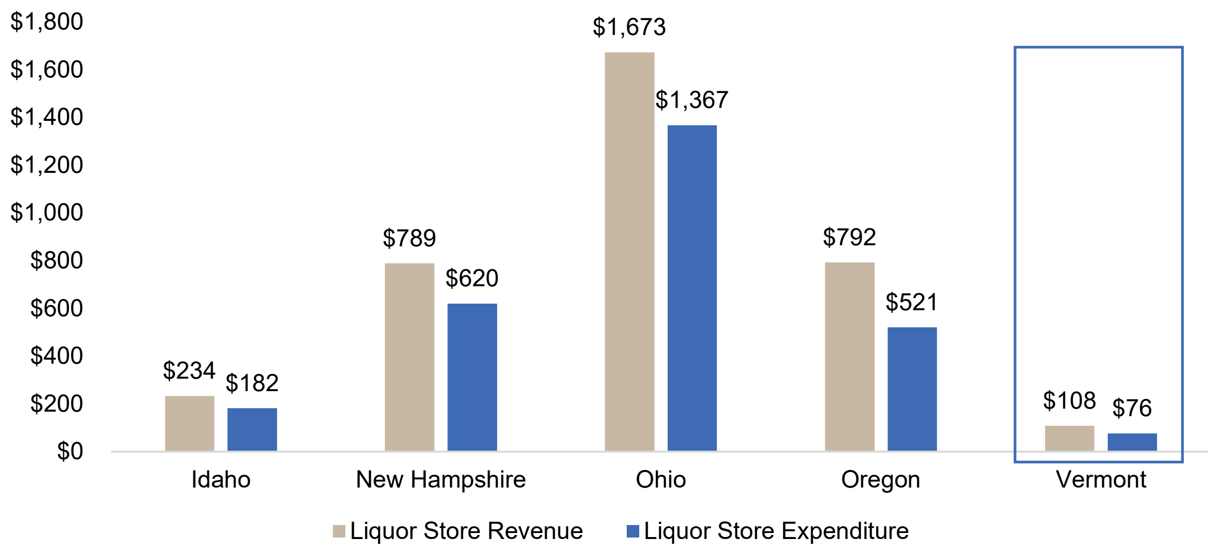
[16] Ohio Department of Commerce, "OHLQ Agency Operations." Accessed electronically at https://com.ohio.gov/divisions-and-programs/liquor-control/liquor-agency-operations/guides-and-resources/liquor-agency-operations
[17] OLCC, "Legislatively Adopted Budget, 2023-2025." Accessed electronically at https://www.oregon.gov/olcc/Docs/Budget/OLCC-Legislatively-Adopted-Budget-2023-2025.pdf
[18] OLCC, "Legislatively Adopted Budget, 2023-2025." Accessed electronically at https://www.oregon.gov/olcc/Docs/Budget/OLCC-Legislatively-Adopted-Budget-2023-2025.pdf
[19] OLCC, "Legislatively Adopted Budget, 2023-2025." Accessed electronically at https://www.oregon.gov/olcc/Docs/Budget/OLCC-Legislatively-Adopted-Budget-2023-2025.pdf

oversight authority of Division directors and Executive Team members. The agency will report on the results of this review to the Legislative Fiscal Office. [20]

Liquor Store Revenue and Expenditures

The following figure displays control state liquor revenues and expenditures, according to the U.S. Census Bureau's Annual Survey of State and Local Government Finance.[21]

Figure 8: Liquor Store Revenue and Expenditures, Benchmark Control States (in $ Millions)



Source: U.S. Census Bureau 2021 Annual Survey of State and Local Government Finance

Table 9: Liquor Store Revenue and Expenditures, Benchmark Control States (in $ Millions)

	Liquor Store Revenue	Liquor Store Expenditure	Difference	Difference as % of Expenditures
Idaho	$233.6	$182.0	$51.6	28.4%
New Hampshire	$788.6	$620.5	$168.2	27.1%
Ohio	$1,672.6	$1,367.4	$305.1	22.3%
Oregon	$792.1	$521.1	$271.0	52.0%
Vermont	$108.2	$76.3	$31.8	41.7%

Source: U.S. Census Bureau 2021 Annual Survey of State and Local Government Finance

[20] OLCC, "Legislatively Adopted Budget, 2023-2025." Accessed electronically at https://www.oregon.gov/olcc/Docs/Budget/OLCC-Legislatively-Adopted-Budget-2023-2025.pdf
[21] In the Survey, the Liquor Store sector covers "establishment and operation of alcoholic beverage distribution facilities and retail outlets owned and operated by" the state. Any associated government activities, such as licensing and enforcement of liquor laws and collection of liquor taxes, are classified in the general government category.

Pricing, Taxes, and Markup

It can be difficult to compare alcohol taxes and markups in control states because the formulas are complex and can vary by the type of product. In general, control states have used these structures to both lower consumption, which can reduce alcohol-related harms, and to raise the funds that can be used to offset the societal cost of alcohol use.[22]

The data in the following table comes from the Liquor Handbook, which is considered an authoritative source, but the project team was not able to directly validate the data as it relates to Vermont.

Table 10: Applicable State Tax Rates on 80 Proof Spirits Products, January 2022

	State Tax Rates	Notes
Control States		
Idaho	Bottle tax 64.3% wholesale markup to on-premises licensees 83.2% off-premises markup 2.0% surcharge	Has arbitrary state tax per bottle depending on size (1.75 liter-$1.00; 1.0 liter-$0.90; 750ml-$0.55, etc.). Off-premises markup includes 6% sales tax.
New Hampshire	46.5%-50% markup	Offers 10% discount on retail price of spirits to on-premises establishments purchasing at central warehouse. Markups on spirits are on FOB destination price.
Ohio	60.5% markup $3.38/gallon 5% additional markup	Discounts wholesale sales (generally to on-premises licensees) 12.5%.
Oregon	113% markup $1.40 per case upcharge	Markup of 113% applicable to items with landed case price ≤ $78.05. Items with higher price subject to markup of $14.45 per case plus 79.8% of sum of landed price plus the per case markup.
Vermont	78.6% retail markup	Markup includes 25% excise tax and varies according to type and state price.

Source: Liquor Handbook 2023

	State Tax Rates
License States	
Arizona	$3/gallon
Arkansas	$2.50/gallon $0.20/case 3 percent off-premise retail excise tax
Massachusetts	$4.05/gallon
New York	$6.44/gallon
Rhode Island	$5.40/gallon

Source: Federation of Tax Administrators as of January 1, 2023

Every state that uses a license/private structure for wholesale and retail sale of distilled spirits relies on a gallonage tax, which, as the name implies, is based on volume, while a markup is

[22] NABCA, "Tax Considerations, Public Opinion, and Policy Process – Price." Accessed electronically at https://www.nabca.org/collection/effects-alcohol-pricing-policies-tobacco-marijuana-and-other-drug-use

based on cost.[23] It can be difficult to compare the two, but several sources have sought to do so, using reported data from control states for spirits categories and translating the mark-ups into an aggregated gallonage tax rate. These are referred to as ‘implied’ or ‘imputed’ state excise tax rates.

Comparing the implied control state excise tax rates as computed by the 2023 Liquor Handbook demonstrates that New Hampshire has a very low excise tax rate. In fact, the implied excise tax rate in New Hampshire is negative. The state still generates money for its treasury, on a per-unit basis, however, revenues are significantly lower than in other control states.

The implied excise tax rate in Vermont, expressed as a gallonage tax, would be higher than all but three license states (Washington, Alaska, and Illinois). Among control states, however, it would be lower than all except for New Hampshire, Pennsylvania, West Virginia, and Wyoming. Implied rates in Ohio and Idaho are considerably higher than license state rates. Oregon has an exceptionally high excise tax rate that ultimately serves to drive up prices and reduce volumes. In fact, at $22.86 per gallon, the Oregon implied excise tax rate is about 300 percent more than typical license states.

Table 11: Estimated Benchmark Control State Excise Tax Rates (translated into a gallonage tax)

	Per Gallon Implied Excise Tax
Oregon	$22.86
Idaho	$12.15
Ohio	$11.38
Vermont	$ 8.39
New Hampshire	n/a

Source: Liquor Handbook 2023

A 2013 study compared the average price of liquor in the U.S. between retail alcohol outlets in control states versus license states. The analysis found that the overall mean price for 74 brands of liquor was $27.79 in the license states and $29.82 in the control states – approximately $2 (6.9 percent) lower in license states.[24]

By voter initiative, the state of Washington shifted from a control state to a license state, with its 333 state-run liquor stores closed and a privatized system in place on June 1, 2012. As a result, approximately 1,500 licensed stores began the sale of spirits. Substantial taxes at both the wholesale and retail levels were implemented and it was expected that prices would rise. Given that there had not been a significant change in a control state since Iowa privatized its retail operation in 1987 and West Virginia did the same in 1990,[25] this provided newer data for several

[23] A listing of state tax rates for distilled spirits, from the Federation of Tax Administrators, may be found in the Appendices.
[24] National Library of Medicine, “Differences in Liquor Prices between Control State-operated and License State retail outlets in the U.S.,” (October 2012). Accessed online at https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3529794/
[25] A key difference between the retail privatization in Iowa and West Virginia is that West Virginia imposed quotas on the number of licenses and then auctioned them for a 10-year period. Iowa did not apply quotas or auction licenses.

studies of the impact of the privatization, related to prices, consumption, and cross border competition. This topic will be discussed further in a later section on privatization.

As it relates to prices, one study, which compared price changes in Washington's private liquor stores with those in the surrounding control states of Idaho and Oregon, found that Washington's prices rose by an average of 15.5 percent for the 750 ml size and by 4.7 percent for the 1.75 l size, while only small changes were seen in the bordering states of Oregon and Idaho. Prices were found to vary greatly by store type. Liquor superstores (such as Total Wine and More) had generally the lowest prices while smaller liquor store prices were substantially higher.[26]

Public Safety and Health Comparisons

According to the Centers for Disease Control and Prevention's (CDC) Behavioral Risk Factor Surveillance System (BRFSS), more than half of U.S. adults report drinking alcohol in the past 30 days. Approximately 17 percent of adults binge drink and 7 percent report heavy drinking. Nearly all adults who drink heavily also binge drink.[27]

Excessive alcohol use is associated with an increased risk of injuries, chronic diseases such as liver disease and heart disease, several cancers, and poor pregnancy outcomes. The CDC's Alcohol-Related Disease Impact (ARDI) application indicates that, between 2015 and 2019, excessive alcohol use was responsible for more than 140,000 deaths and 3.6 million years of potential life list each year, on average.[28] More than 40 percent of these deaths and half of the years of potential life lost were due to binge drinking.

The prevalence of binge drinking, the number of drinks consumed (intensity), and how often people binge drink (frequency) affect the risk for injury, disease, and death. For these reasons, the project team used statewide binge drinking estimates as a proxy for making general health and public safety comparisons.

As shown on the following map and detailed in the following table, Vermont and the benchmark states of Ohio and Rhode Island are among states with the highest prevalence of binge drinking nationally. Arkansas and Idaho have the lowest prevalence, while the remaining benchmark states ranked in the middle.

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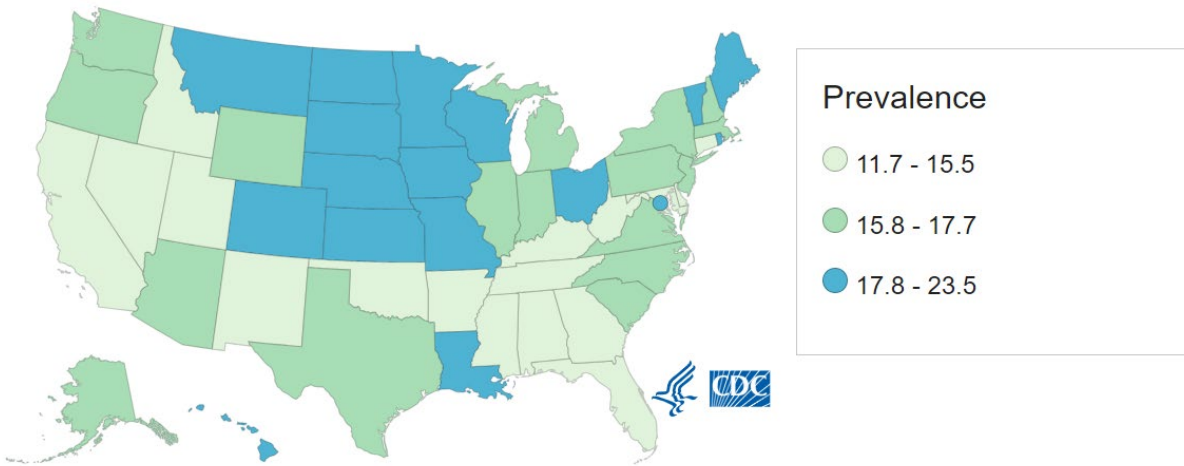
[26]Alcohol and Alcoholism, "Analysis of Price Changes in Washington Following the 2012 Liquor Privatization," William C. Kerr*, Edwina Williams, and Thomas K. Greenfield, 2015, accessed online at https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4608622/pdf/agv067.pdf

[27] The BRFSS is the nation's premier system of health-related telephone surveys that collect state data about U.S. residents regarding their health-related risk behaviors, chronic health conditions, and use of preventive services. BRFSS completed more than 400,000 adult interviews each year, making it the largest continuously conducted health survey system in the world. For more information, see https://www.cdc.gov/brfss/

[28] ARDI is an online application that provides national and state estimates of alcohol-related health impacts. These estimates are calculated for 58 acute and chronic causes using alcohol-attributable fractions. For more information, see https://nccd.cdc.gov/DPH_ARDI/default/default.aspx

Figure 9: Prevalence of Binge Drinking Among Adults Aged ≥18 Years, 2021



Source: CDC Data on Excessive Drinking

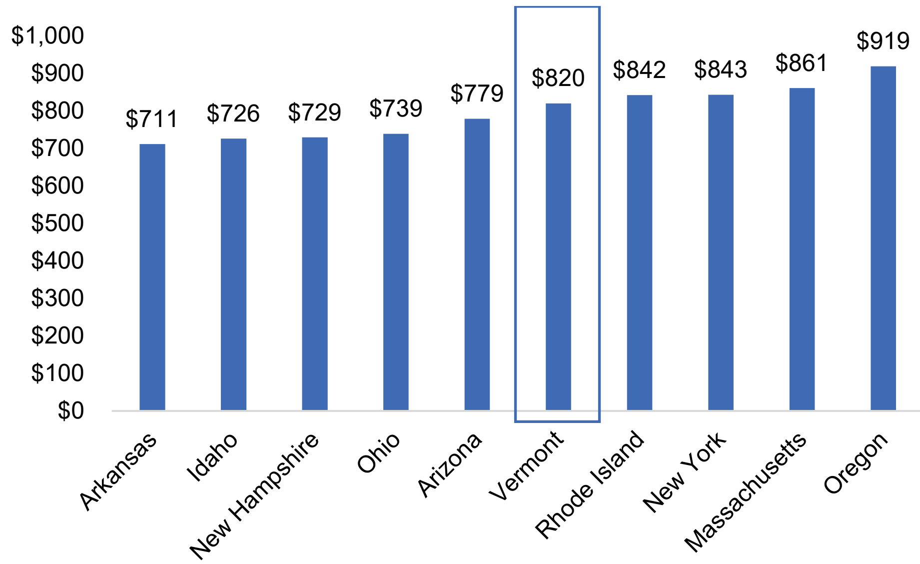
Table 2: Prevalence of Binge Drinking Among Adults Aged ≥18 Years

	Prevalence	# of Drinks	
		Median	75th Percentile
Arkansas	13.9	5.6	7.8
Idaho	15.1	5.5	7.5
New Hampshire	16.0	5.2	6.8
New York	16.0	5.3	6.8
Arizona	17.2	5.4	7.7
Oregon	17.2	5.4	6.9
Massachusetts	17.6	5.3	6.5
Ohio	18.5	5.5	7.9
Rhode Island	18.9	5.4	7.3
Vermont	19.2	5.5	7.7
Vermont Rank	1	2	3

Source: CDC

The CDC also estimates the costs of excessive alcohol consumption by state. As shown in the following figure, these costs are equal to approximately $820 per capita in Vermont, within the middle of the benchmark range of $711 per capita in Arkansas and $919 per capita in Oregon. Further, as shown in the table that follows, Vermont has nearly the lowest cost on a per-drink basis. This is due to the relatively high level of incidence and relatively low population levels.

Figure 10: Cost of Excessive Alcohol Consumption per Capita



Source: CDC Data on Excessive Drinking

Table 33: Cost of Excessive Alcohol Consumption per Capita

	Cost per Capita	Cost per Drink	Total Cost (millions)
Arkansas	$711	$2.27	$2,073.3
Idaho	$726	$1.62	$1,137.9
New Hampshire	$729	$0.92	$959.9
Ohio	$739	$2.10	$8,519.8
Arizona	$779	$2.27	$5,946.4
Vermont	$820	$1.66	$513.0
Rhode Island	$842	$1.82	$886.5
New York	$843	$2.28	$16,330.2
Massachusetts	$861	$1.93	$5,634.6
Oregon	$919	$2.08	$3,520.2
Vermont Rank	**5**	**8**	**10**

Source: CDC Data on Excessive Drinking

Of course, there are a variety of factors that have to be taken into consideration when weighing whether the current delivery system for spirits is a significant contributing factor to current rankings – and also whether changes to a private system for wholesale and retail sales of spirits would materially change those rankings.

In the case of the state of Washington, there is evidence that consumption increased following privatization of its wholesale and retail operations. One prominent study found privatization was associated with a 6.34 ounce increase in monthly liquor and a 2.01 ounce increase in monthly ethanol purchases[29] per household in a 31 month period compared to monthly purchases in

[29] Monthly liquor purchases included all products with at least 0.5 percent alcohol; Total ethanol ounces was computed using a variable based on its estimated proportion of ethanol content, 0.411 for spirts, 0.129 for wine, and 0.045 for beer, and summing across the types.

control states.[30] Interestingly, when the type of alcohol purchaser was factored into the analysis, the greatest increases in ethanol purchases were among low and moderate purchasers, while high purchasers decreased ethanol purchases.[31]

Of course, there are a variety of factors that must be considered in determining the effect of privatization. In the case of Washington, the number of private retail outlets increased considerably – by about five times as many locations as in the state store regime. The hours of operation also had the potential to increase. Both increase availability and convenience.

At the same time, taxes were substantially increased in the state to make up for the assumed lost revenue. This would tend to decrease sales within the state and increase cross border sales. It is important to distinguish between changes in in-state sales volume and changes in consumption, because many consumers are price sensitive and will cross state lines when there is a perceived material difference in prices. In the case of the state of Washington, there is substantial population on or near its borders, particularly in Vancouver, Washington (which is a suburb of Portland, Oregon), and Spokane, which is less than an hour's drive from Post Falls, Idaho.

[30] Addiction. "Washington's privatization of liquor: effects on household alcohol purchases from Initiative 1183," Sarah Beth L. Barnett, Norma B. Coe, Jeffrey R. Harris, and Anirban Basu, 2019, pp. 681-689.
[31] Ibid., p. 685.

4. Wholesale/Retail Privatization

Privatization Overview

As noted earlier, the privatization model is in place in 33 of the 50 United States. While it takes a market-based approach to serving the alcohol-consuming public, there are mechanisms in place in all of the privatized states to seek to minimize the risks associated with excess consumption of alcohol. As there are a variety of differences in how control state systems operate, there are differences within the privatized states as well. For example, some states limit the retail licenses for off-premise consumption, either by a number or as a share of population within a city or county[32] or by location (such as not within a certain number of feet from a church, school, library, hospital, etc.).[33] Other differences relate to store hours, number of licenses that may be held by a single individual or entity, and whether there may be any allowance for on-premise consumption.

Perhaps one of the more impactful decisions within states is whether grocery stores, drug stores, convenience stores, etc. may be licensed or whether a majority percentage of revenue for a retail licensee must come from the sale of alcoholic beverages. This will have a major impact on availability and customer convenience. When comparing to the existing Vermont control state system where many agents are grocery or similar stores, it may not be as material an issue here.

In every privatized state, there are licensing requirements (and generally 'privatized states' are interchangeable with 'licensed states'). The licenses will nearly always require an extensive application process that includes a detailed description of the proposed site, its ownership, its product (both related to alcohol and non-alcohol offerings), proposed hours of operation, security, and other details. While in some cases the application fees and ongoing license fees are relatively modest, they do vary considerably by state.

When looking at the state costs associated with a privatized system, the functions that currently exist to handle and process license applications for licensees for on-premise consumption will continue, as those licensees are already private sellers. The state would have to develop an application process for wholesale licenses related to the distribution of spirits (there is already a process in place for licensing wholesalers for wine and beer). It is notable that a small number of leading suppliers provide the vast majority of cases of spirits. In 2020, 15 suppliers made up 83 percent of the total case sales in the U.S.[34] In terms of a comparison with another smaller state in the eastern part of the U.S., Delaware has 23 current wholesale liquor licensees.[35]

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[32] For example, New Jersey limits retail licenses for off-premise consumption to one license for each 7,500 people in a municipality.
[33] For example, New York State cannot issue a wine store or liquor store license to any premises that is within 200 feet of and on the same street as a building exclusively used as a school or place of worship.
[34] The Beverage Information Group. 2023 Liquor Handbook. p. 221. Diageo North America, with 15.0 percent of the cases, was the largest supplier.
[35] Office of the Delaware Alcoholic Beverage Control Commissioner. Wholesalers List. Accessed online at https://oabcc.delaware.gov/wholesalers-list/

Depending on the number of wholesale licenses to be issued, it is possible that this could be accomplished with existing licensing staff. At most there would be an expectation, at least once the operation was fully implemented, that it would require no more than 1 to 2 FTEs. Currently, the Division dedicates significant resources to supporting its agents, including determining locations, store and sales standards, and the listing of products and prices. In the privatized model, the need for all these support functions would no longer exist. Licensing and enforcement would remain. It is also possible that license fees can be established to cover all or most of the cost of the licensing and enforcement functions.

Workload for enforcement staff should remain relatively stable. In the current system, officers perform compliance checks at agency stores because they are simultaneously second-class licensees (i.e., they are licensed to sell beer and wine as well). In comparison to the total compliance checks for beer and wine done by the DLC (1,086 licenses were active as of early 2024), the liquor compliance checks make up a very small portion of the workload (7.4 percent). Even if the number of retail stores selling spirits for off-premise consumption were to grow by 50 percent (to 120), these license checks would still make up less than 10 percent of the compliance locations.

Baseline

To evaluate the fiscal impact of an alternative scenario to Vermont, PFM developed a baseline forecast model. All baseline assumptions are reflective of baseline forecast factors trended from FY2018 to FY2023 (unless otherwise noted). The baseline model assumes that the DLC will retain all current operations, including liquor wholesale and the current agent retail model. The model also assumes that the State will continue to operate at the current markup and tax structure.

The baseline forecast is intended to show what DLC's financial results could be without any material changes. This means that the baseline model does not assume increases or decreases in headcount or operating levels. The model uses FY2018 through FY2023 data and applies growth rates to those amounts to project future years. The following table details the baseline assumptions.

Table 14: Baseline Model Assumptions

Baseline Model	Rate/Growth Rate[36]	Notes
Revenues		
Taxes/Transfer		
Excise Tax	5.0%	
Sales Tax	6.0%	
Transfer to the General Fund	20.0%	

[36] The revenue category details the existing tax and transfer rates. The sales category details the assumed growth rates for the years included in the model. The percent mark-up is the ongoing assumption of that percent, while program revenue is the assumption that this revenue will remain flat in the years within the model. The Expenses categories are all based on average growth rates for each year in the model.

Baseline Model	Rate/Growth Rate[36]	Notes
Sales		
COGS Growth	2.2%	Median of COGS Growth (2018-2023)
Sales Growth, On-Premise	4.5%	2018-2023 CAGR, using flat growth for FY2024
Sales Growth, Off-Premise	5.6%	2018-2023 CAGR, using flat growth for FY2024
Off-Premise Sales Share	77.2%	5-year average, excluding 2020
On-Premise Sales Share	22.8%	5-year average, excluding 2020
Program Revenue		
Average Product Markup	63.8%	2018-2023 average mark-up
License, Fees, Fines, etc.	0.0%	Zero growth; CAGR and average around zero
Expenses		
Operations		
Administration	5.9%	5-year median of YoY % change
Enforcement	0.0%	Zero growth, irregular historical rate
Warehouse	6.5%	5-year median of YoY % change
Cost of Sales		
Liquor Purchase Expense	3.0%	CPI historical growth rate, specific to distilled spirits
Breakage & Over/short	N/A	Median ($) of last six years, outlier in 2021
Bottle Redemption	4.6%	Six-year CAGR
Agent Commission	8.7%	6-year average of commission as a % of sales
General Fund Transfer	5.3%	Calculated as a % of sales. Using the median % from FY2020-23

Sales Revenue
In the status quo scenario, the State's sales revenues are expected to grow from $103.0 million in FY2024 to $126.7 million in FY2028. This is in line with the average annual growth in the previous six years for on-premise and off-premise sales, respectively. Note that while both on and off-premise sales saw fluctuations due to the pandemic, both rebounded to pre-COVID growth rates and beyond. After discussion of growth rate projections with the DLL for FY2024, the growth rates for FY2024 sales are held flat, after which the historical rates are applied.

Direct profit from sales is calculated by subtracting sales-related expenses from the gross profit amount. Therefore, the direct profit is a combination of the product markup, rounding and bottle deposit revenues.

Program Revenues
Program revenues remain unchanged, meaning that the average product markup is 63.8 percent, depending on the type of product purchased, and revenue from licenses and fees are held flat for the projection period. The historical data does not show significant changes in licenses and fees revenues, so the baseline maintains a conservative revenue estimate of about $2.0 million a year.

Cost of Sales
In the last six years, the cost of purchasing liquor increased year-over-year between 6 and 16 percent. However, this has been an unusual economic period for the national and state

economy, with a couple of years of very high inflation, as well as supply chain disruptions that have impacted prices and are unlikely to be sustained in the future. The median historic growth rate over the last five years would be 10.7 percent, but it is highly unlikely that this level could be sustained within the distilled spirits industry. As a result, the project team is using the historic level of growth as measured by the Consumer Price Index (CPI) specific to distilled spirits, which is 3.0 percent.

Operating Expenses
For all operating expenditure categories, the baseline follows historical spending trends. The administration and warehouse functions saw the largest expenditure increases year-over-year, in some years as high as 20.0 percent. However, other years, and not necessarily consistently, expenditure growth was much lower, even approaching zero. Therefore, the administration and warehouse expenses are assumed to grow at a median rate of the last six years; 5.9 percent per year for administration and 6.5 percent per year for the warehouse function.

While enforcement costs have fluctuated somewhat, they have remained relatively flat over the long term. As a result, the model assumes a 0.0 percent growth rate for the 5-year projection. The same assumption is applied to expenses in the "other" category.

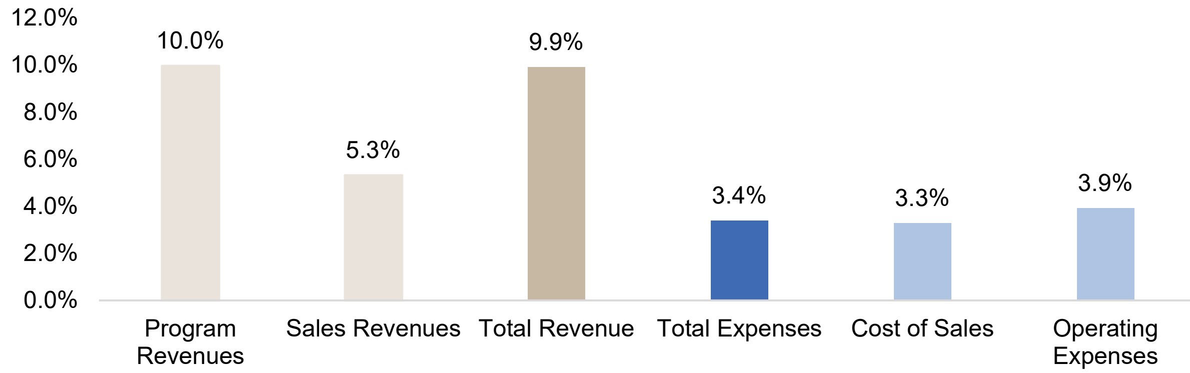
Taxes
In the baseline scenario, the State would continue to collect the 6 percent sales tax on the retail price of each off-premise liquor purchase (licensees are exempt from paying this tax at the agent stores). The State would also continue to collect the equivalent of the current 5 percent of total sales revenue dedicated to the General Fund (Excise Tax).

In addition to the Excise Tax, there is an additional transfer to the General Fund from the Liquor Control Fund to cover the decrease in the Excise Tax. Before FY2020, liquor manufacturers paid 25.0 percent in excise tax, but it has since been lowered to 5.0 percent. To make up for this loss in revenue, the DLC now transfers an additional percentage to the General Fund at the request of the Department of Finance and Management (F&M). The amount transferred ranged between $20.0 and $23.0 million from FY2020 and FY2023, which represented somewhere between 20.0 and 26.0 percent of total sales. The baseline assumes that the DLC continues to make this transfer at an amount that is 20.0 percent of total sales revenue, based on an agreement between DLC and F&M.

Projected Fiscal Impact – Baseline

From an operational perspective (not including taxes and transfers), the DLC is projected to have $43.9 million in operational profit in FY2024. This amount is expected to increase to $67.9 million by FY2028. The graph below shows that revenue from sales markup and program revenues are expected to outpace expense growth in the baseline projection.

Figure 11: Revenue and Expense Growth, FY2024 – FY2028 (Baseline)



The baseline model applies the revenue and expenditure assumptions as laid out to the most recent historical financial data provided by the Department. The table on the next page shows the resulting projected operational and overall fiscal impact in a status quo scenario.

The State's fiscal impact is more than DLC's operational surplus or deficit. It includes the sales taxes, excise taxes and transfers. When considering these additional revenues that ultimately hit the State's coffers, the fiscal impact of maintaining the current liquor administration and sales structure is expected to range between $74.1 and $105.1 million in the next five years.

Table 15: Baseline Projection

	FY2024 Proj.	FY2025 Proj.	FY2026 Proj.	FY2027 Proj.	FY2028 Proj.	FY24-28 CAGR
REVENUES						
Sales Revenues	**$102,973,404**	**$108,449,964**	**$114,219,887**	**$120,298,988**	**$126,703,938**	**5.3%**
On-Premise	$25,696,888	$26,862,474	$28,080,930	$29,354,653	$30,686,152	4.5%
Off-Premise	$77,276,516	$81,587,490	$86,138,957	$90,944,335	$96,017,786	5.6%
Cost of Sales	**($73,396,846)**	**($75,805,612)**	**($78,297,959)**	**($80,877,009)**	**($83,546,011)**	**3.3%**
Liquor Purchase Expense	($64,210,296)	($66,136,605)	($68,120,703)	($70,164,324)	($72,269,254)	3.0%
Breakage and Over/Short	($95,072)	($95,072)	($95,072)	($95,072)	($95,072)	0.0%
Bottle Redemption	($152,681)	($159,736)	($167,116)	($174,838)	($182,916)	4.6%
Agent Commissions	($8,938,796)	($9,414,199)	($9,915,068)	($10,442,775)	($10,998,769)	5.3%
Program Revenues	**$26,943,686**	**$29,752,821**	**$32,757,308**	**$35,969,036**	**$39,400,578**	**10.0%**
Product Markup	$24,760,428	$27,569,563	$30,574,051	$33,785,779	$37,217,321	10.7%
Licenses and Fees	$1,993,360	$1,993,360	$1,993,360	$1,993,360	$1,993,360	0.0%
Bottle Deposit, Paper Bags	$189,898	$189,898	$189,898	$189,898	$189,898	0.0%
Total Operating Revenue	**$56,520,244**	**$62,397,172**	**$68,679,236**	**$75,391,015**	**$82,558,505**	**9.9%**
EXPENDITURES						
Administration	$6,363,645	$6,738,353	$7,135,124	$7,555,258	$8,000,130	5.9%
Enforcement	$2,567,584	$2,567,584	$2,567,584	$2,567,584	$2,567,584	0.0%
Warehouse	$1,595,998	$1,699,197	$1,809,068	$1,926,044	$2,050,584	6.5%
Other	$2,055,253	$2,055,253	$2,055,253	$2,055,253	$2,055,253	0.0%
Total Operating Expenses	**$12,582,481**	**$13,060,387**	**$13,567,029**	**$14,104,139**	**$14,673,551**	**3.9%**
Operational Income/Loss	**$43,937,763**	**$49,336,786**	**$55,112,207**	**$61,286,876**	**$67,884,954**	**11.5%**
STATE TAXES/TRANSFERS						
Excise Tax - 5% of Sales	$5,148,670	$5,422,498	$5,710,994	$6,014,949	$6,335,197	5.3%
Sales Tax - 6% of Off-Premise	$4,636,591	$4,895,249	$5,168,337	$5,456,660	$5,761,067	5.6%
Add'l Transfer to GF/F&M - 20%	$20,400,000	$21,484,958	$22,628,034	$23,832,361	$25,101,242	5.3%

State Fiscal Impact	**$74,123,024**	**$81,139,492**	**$88,619,573**	**$96,590,846**	**$105,082,460**	**9.1%**

Privatization Scenario: Expenditure Assumptions

Personnel Savings

In a privatized system, the DLC would not need liquor warehouse managers, supervisors, specialists and delivery technicians. Additionally, the retail operations group – including the director, supervisor and district coordinators – would be fully eliminated. The purchasing team in the current system only spends time on liquor purchases, so privatization would eliminate this function as well.

Some of the DLC's functions could also be consolidated in a privatized scenario. There are currently two marketing positions, which could be consolidated without the liquor work. The finance team would be able to reduce FTEs as it would no longer be collecting revenues from agency stores, and the volume of accounting work may decrease with the elimination of the warehouse and delivery functions. However, all other general finance and accounting work remains.

Of the positions filled at the time of this report (71 FTEs), PFM anticipates that the DLC could save 22 positions if it were to privatize both the wholesale and retail functions. This would save the Department $2.6 million in FY2025 salary and benefit costs.

Table 16: Baseline and Scenario FTEs and Personnel Savings

Category	FTEs	FTEs	Total Scenario Salary Cost	Savings ($)	Savings as a % of Budgeted Salary Cost
Commissioner's Office	5	5	$788,534	$0	0%
Licensing	8	8	$852,227	$0	0%
Enforcement	13	13	$2,071,699	$0	0%
Education	4	4	$439,906	$0	0%
Communications	3	2	$126,613	$236,704	65%
Finance	8	7	$621,925	$296,343	32%
Retail Operations	7	0	$0	$735,247	100%
Liquor Operations	16	0	$0	$1,365,627	100%
Total	**74**	**49**	**$5,943,208**	**$2,633,920**	**31%**

In a privatized model, the enforcement function would be slightly different for the Department, as it would continue to monitor and perform compliance checks at all retail stores. As with privatized states, there is still a need to ensure compliance with state laws and regulations at private retail stores.

Non-personnel Savings

Between FY2018 and FY2023, rental fees for the warehouse ranged between $14,000 and $67,000 per year. In the last two years of the six, rent charges were more constant around $43,000. In the baseline, rental fees are projected to grow with other warehouse costs at 6.5 percent per year, which accounts for the Department leasing a larger warehouse at some point in the projection period. In a privatized model, the Department would not pay any liquor warehouse rental charges.

Another recurring cost that would be eliminated in a privatized model is any payments and maintenance for the delivery vehicles. While historical spending has been inconsistent, the Department can expect to save somewhere between $50,000 and $100,000 per year on vehicle costs.

IT system costs, including the point-of-sale (POS) system and portions of the procurement system, will likely decline with privatization. Since the DLC switched to a new, built-to-order system in FY2019, costs have been inconsistent because of different billing cycles (i.e., some contracts were multi-year contracts and the DLC depended on the third party's billing frequency), as well as accounting changes (i.e., while recurring charges for services were initially charged to contracted services in the ledger, they were later switched to operating expenses). Based on budgeted amounts for FY2022 and FY2023, the DLC can expect to realize $125,000 per year on POS system savings going forward, less any outstanding contracts that must be honored.

Revenue Assumptions

The most significant issue for discussion is what is likely to be the impact of a privatized system on overall sales revenue at Vermont retail locations, and what will be the tax rates applied to those sales. From a practical perspective, the ability of the state to obtain as much revenue as it did under the control model is likely, because the state has the ability to set tax rates at a level that will be revenue neutral. Of course, very high tax rates on alcohol by volume will have several potential impacts. These include:

- From a tax policy perspective, the tax structure will likely be more regressive. A tax on alcohol by volume means that as a percentage of the bottle price, a 0.750 liter bottle of spirits that sells for $10.00 will pay twice the effective tax rate (when converted to a percentage of sales price) as a $20.00 0.750 liter bottle. Research shows that higher-income households will purchase higher priced spirits. When the tax (such as with a mark-up-based system) is based on price, the higher priced items pay more in tax as a percentage of the sale price. That is not the case when it is sold based on volume. When compared to the current system, the tax (in comparison to the existing mark-up approach) is less progressive and more regressive.

- The revenue assumptions will be impacted by three considerations, which would each need to be taken into consideration as a basis for whether the privatized system is a better approach for the state and its residents and businesses. These are:

  1. **Will there be a significant increase in the number of retail sales outlets and their hours of operation?** It is not surprising that the state of Washington had significant growth in sales, as they went from 333 state retail stores to approximately 1,500 licensed locations. It is certainly hard to believe that the existing 80 Vermont locations could increase by a similar percentage (450 percent), to approximately 360 locations. Further expanded access in Washington state was not solely locations, it was also

hours of operation. The privatized locations could be open 20 hours a day, 7 days a week, which almost doubled the hours of access at the former state stores.

Vermont Assumption:

Given the more open access, the project team assumes that there will be some increase in the number of retail outlets for off-premise consumption, but that there will not be a material increase in the hours of availability. When looking at what might be considered a market-driven increase in the number of retail locations, it is highly unlikely that privatization would generate anywhere near the increase seen in the state of Washington (an increase of approximately 450 percent). First, Washington is a much higher population state (7,813,000 compared to Vermont's 647,000) with significant dense population centers. There are 26 cities in the state of Washington with a larger population than Vermont's largest city, Burlington. Seattle's population alone (721,000) is greater than the entire state of Vermont.

It is more helpful to look to the states that have moved to an open retail model from a control model. These are Iowa, Michigan, Mississippi, and West Virginia. Of these, Michigan has many of the same characteristics as Washington – very large population with several large population centers. West Virginia is not as useful, because they chose to auction licenses for a 10-year period. Given Vermont's relatively small population, lack of population density, 'border bleed' issues with New Hampshire, and relatively low levels of consumption, it is unlikely that an auction model will generate significant additional revenue for the state while also raising issues of availability for consumers.

As a result, it is worth comparing the experience of Iowa and Mississippi. The following compares the two states to Vermont, in terms of population, population density, number of currently licensed retail stores for distilled spirits for off-premises consumption and, when pro-rating to Vermont's population, the number of projected licenses.

Table 17: State Comparisons of Retail Locations

State	Population	Population Density (/sq.mile)	Retail Licenses	VT licenses pro-rated by population
Iowa	3,207,007	58	647	131
Mississippi	2,939,690	63	667	147
Vermont	647,464	70		

Iowa and Mississippi both have population centers that are significantly larger than is the case in Vermont. According to the U.S. Census Bureau, the Des Moines, Iowa metropolitan area's population in 2022 was 729,000, and Iowa has 11 cities with a population greater than Burlington. The state of Mississippi has 5 cities larger than Burlington, and the Jackson, Mississippi metropolitan area's population in 2022 was 441,000. As a result, it is likely that the actual number of licenses in Vermont would be somewhere around 120, which was the estimate made by the project team for Vermont in 2014. That will likely increase convenience for some customers. That would generally suggest an increase in consumption, and that has historically been the case both for states that switched from control to license systems and for the broader categories of consumption in license versus control states.

2. **Will changes in tax rates and shelf prices materially change sales within the state that are subject to tax?** It is a basic fact of taxation that taxes will reduce consumption, as it increases the final cost of the purchased good. How much consumption is reduced depends on the elasticity of demand, which is the flexibility that a potential buyer has in making a purchase. When a purchaser has little alternative around consumption (for example, the cost of transportation to get to and from the place of employment) the price elasticity of demand is considered relatively inelastic. When a purchaser may be able to readily reduce consumption or substitute other consumption (for example, the cost of non-essential goods, such as designer clothes or luxury cars), it is considered relatively elastic.

   As it relates to determining the price elasticity of demand for spirits purchased for off-premise consumption, many of the studies on the topic do not differentiate alcohol by beer, wine, or spirits, which makes them less useful. There have been a couple of recent studies conducted outside the U.S., which may call into question their application to the U.S.[37][38] A meta-analysis of studies of price elasticities for alcoholic beverages was conducted in 2008 covering 1,003 estimates from 112 studies. It found that elasticities are −0.46 for beer, −0.69 for wine and −0.80 for spirits. This means that for spirits, a 10 percent increase in price will lead to an 8 percent decrease in consumption, which suggests that price is an important factor in consumer decisions.[39] Of course, substitution of other alcoholic beverages is a

[37] For example, a study from Australia found that demand for nearly every subcategory of alcohol significantly responds to its own price change, except for on-premise spirits and ready-to-drink spirits. The estimated demand for off-premise beverages is more strongly affected by own price changes than the same beverages in on-premise settings. Demand for off-premise regular beer and off-premise cask wine is more price responsive than demand for other beverages. Harmful drinkers and lower income groups appear more price responsive than moderate drinkers and higher income groups. This suggests that alcohol price policies, such as increasing alcohol taxes or introducing a minimum unit price, can reduce alcohol demand. Price appears to be particularly effective for reducing consumption and as well as alcohol-related harm among harmful drinkers and lower income drinkers. "Price elasticity of on- and off-premises demand for alcoholic drinks: A Tobit analysis," Heng Jiang, Michael Livingston, Robin Room, and Sarah Callinan, Drug and Alcohol Dependence, Volume 163, June 2016, pages 222-228, accessed online at https://www.sciencedirect.com/science/article/abs/pii/S0376871616300539.

[38] Another study, using consumer expenditure data from the Czech Republic, found that off premise consumption of beer was most responsive to income as well as own price changes, while spirits were the least responsive.
The own-price elasticity of wine is –1.00 for off premise consumption, while beer is more price responsive, spirits are less price responsive, and consumption reacts weaker for off premise consumption. Own-price elasticities of demand range between –1.20 and –0.41 for off premise consumption. Between products, wine and spirits are complementary, and wine and beer are substitutes. "Estimation of alcohol demand elasticity: Consumption of wine, beer, and spirits at home and away from home," Tereza Čiderová and Milan Ščasný, Journal of Wine Economics (2022), 17, 329–337. Accessed online (paywall) at https://www.cambridge.org/core/journals/journal-of-wine-economics/article/estimation-of-alcohol-demand-elasticity-consumption-of-wine-beer-and-spirits-at-home-and-away-from-home/0B83F38607B49C755B797B65C67CA4F5

[39] "Effects of beverage alcohol price and tax levels on drinking: a meta-analysis of 1003 estimates from 112 studies," Alexander C. Wagenaar, Matthew J. Salois, and Kelli A. Komro, Addiction, 15 January 2009, accessed online (paywall) at https://onlinelibrary.wiley.com/doi/10.1111/j.1360-0443.2008.02438.x

possibility, particularly if they are taxed differently and taxes alone are driving price differentials.

Besides shifting or reducing consumption of spirits, if privatization results in significant increases in the cost of the product, consumers may cross borders and make purchases in other states. This has also been a topic of significant research and analysis, and the state of Washington has provided evidence of this, with ‘border bleed’ to both Idaho and Oregon after its wholesale and retail privatization.[40] The possible impacts for Vermont were discussed in the Vermont State Auditor’s Office 2014 performance audit. The PFM project team shares the general belief that the cross border sales in New Hampshire that already exist will mostly continue with privatization of the system in Vermont, as those consumers are probably price sensitive (and the previous discussion supports the fact that it is a consideration for many purchasers of spirits).

Cross border sales may also occur for reasons other than convenience. In some states, state stores are considered inferior in terms of the shopping experience, and customers will go to other states to frequent private stores. In the case of Vermont, the existing agents are already private retailers, and this may not be as big of a consideration. Access may also drive cross border sales, and there is a distinct possibility that a private market will result in additional retail locations, if the state does not establish a quota system around retail licenses for the sale of spirits for off-premise consumption.

The evidence from the shift from state to private retail operations is that prices will rise. One study of price changes from 2012 to 2014 in Washington found a price increase of 15 percent for 750 mL containers and 4.7 percent for 1.75 L containers, while small and nonsignificant increases were observed in neighboring control states Idaho and Oregon.[41] In a separate study, the Washington Department of Revenue estimated that the average retail price per liter of spirits rose 11.6 percent after privatization, from $21.58 in September 2011 to $24.09 in September 2012. A review of privatization for the state of Iowa determined that prices increased by 7.4 percent over what would have been expected without privatization. According to the report, Iowa private retailers resisted price increases at the start to prevent a public backlash.[42]

[40] “Estimated increases in cross-border purchases by Washington residents following liquor privatization and implications for alcohol consumption trends,” Yu Ye and William C. Kerr, Alcohol Research Group, Public Health Institute, 2016. Access online at https://www.ncbi.nlm.nih.gov/pmc/articles/PMC5056797/

[41] “Analysis of Price Changes in Washington Following the 2012 Liquor Privatization,” William C. Kerr, Edwina Williams, and Thomas K. Greenfield, Alcohol Alcohol. 2015 Nov; 50(6): 654–660. Accessed online at https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4608622/#:~:text=Results,vary%20greatly%20by%20store%20type.

[42] “Privatization of Retail Liquor Sales in Iowa,” State of Iowa Alcoholic Beverages Division, July 16, 1999, unnumbered pages 1-2. Accessed online at https://publications.iowa.gov/17022/1/privatization_of_retail.pdf

Vermont Assumption

As noted in the benchmarking, Vermont already loses sales to New Hampshire based on the current tax rate structure, and that is likely to remain in a privatized structure. It is notable that there is some elasticity of demand for distilled spirits, so price increases will generate some reduction, either in overall consumption, substitution with other forms of alcohol, or sales in other states. As noted, in general, in other states, prices rise with privatization, and where there are lower cost options across borders that are within reasonable proximity, there will be sales lost to border competition. On the other hand, the state's largest county borders the state of New York, where its gallonage tax is among the highest in the nation.

3. **Will customer convenience, satisfaction, or increased choice have a positive impact on state sales?** Consumption decisions often incorporate many factors, and how they are weighed will vary based on individual preferences. One study compared survey results for customer satisfaction with state liquor stores in Washington in 2010 to private stores in that state in 2014, after privatization. Both surveys used 10 questions on satisfaction with customer purchase experiences on an A-F (failing) grading scale. The respondents rated five purchase features more favorably after privatization (product supply, staff professionalism, location convenience, store hours, and prices; selection offered, courtesy, and checkout speed were similar, and number of staff and staff knowledge scored better with state-run stores. It is also notable that the satisfaction scores varied by the type of private store, with supply, selection, number of staff, operating hours, and checkout speed being highest for liquor superstores, while location convenience was better in grocery and drug stores, with price satisfaction being better at wholesale stores (Costco), and staff knowledge highest at liquor stores. Based on the data, the authors conclude that the results are relevant to sustained support for the policy of privatizing spirits retail monopolies.[43]

Vermont Assumption

From the project team's perspective, state-run retail stores for off-premise consumption of spirits do not generally score as highly as comparable private stores. As retail sales are not generally a core competence for governments, there can be a lag behind the greater knowledge and expertise found in private businesses that cater to consumers.

In some ways, agency stores solve part of that problem, as they are private sector entities whose existence (from a business perspective) relies on providing good customer experience, obtaining and keeping satisfied customers, and doing so in ways that will build their business. While liquor 'super stores' often provide the top

[43] "Washington state spirits privatization: How satisfied were liquor purchasers before and after, and by type of retail store in 2014?" Thomas K. Greenfield, Edwina Williams, William C. Kerr, Meenakshi S. Subbaraman, and Yu Ye, Published online November 27, 2017, accessed online at https://www.ncbi.nlm.nih.gov/pmc/articles/PMC5971128/.

level of that customer service and experience, it is unclear whether the Vermont market would provide sufficient appeal. It is notable that there is a single Costco in Vermont, to cite an example of a ‘Big Box’ retailer. As a result, it is a reasonable assumption that customer satisfaction will remain about the same.

The issue of choice is worth discussing, as, has been noted, the state warehouse does not provide what would be considered adequate space for products to be made available to the consuming public. Distilled spirits have overtaken beer in terms of sales volume, but the warehouse has not grown to keep pace with that. Much of the growth in the distilled spirits sector relates to Ready-to-Drink distilled spirits beverages, which have experienced an average growth rate of 80 percent within the last three years and are now the second largest distilled spirits category, after vodka.[44] The current space constraints likely make it difficult for the DLC to shift space to deal with this kind of consumer sentiment. As noted in the benchmarking, Vermont ranked last among the 50 states in consumption of ready-to-drink beverages in 2022, with what amounts to zero market share. It is notable that the bottom four states in this category (Maine, Idaho, Ohio, Vermont) are control states – and the twelve with the highest levels of consumption are license states.

Overall Assumption

There are several competing factors that would come into play in a license/private system. While the project team expects that prices will rise somewhat, increased access and convenience, coupled with great ability to adapt to consumer demand, would provide a gain in overall sales, even when balanced with lost border sales. A 10 percent increase, which was modeled in 2014, still appears to be reasonable, taking into consideration the state of Washington experience along with past state experience.

Privatization of revenue-producing entities can create ‘stranded costs’ - expenditures previously supported by revenues forgone in privatization. When evaluating alternative structures, the study team sought to attain Fiscal Neutrality, where revenues cover all DLC residual expenses (primarily regulatory and licensing operations), enforcement efforts and current tax revenues. The following discusses the elements of revenues and expenses that have an impact on Fiscal Neutrality.

Key Fiscal Neutrality Drivers

Revenue from Sales
Currently, the Department generates revenue by marking up the distilled spirits cost of goods. This markup (approximately 65-85 percent) generates significant State revenue and would cease to exist if Vermont implements wholesale and retail privatization. Revenues from this markup were $26.6 million in FY2023.

[44] 2023 Liquor Handbook. The Beverage Information Group. 2023.

Licenses, fees and fines
DLC issues fines for regulatory infractions and violations of the Liquor Law. Wholesale and retail privatization would expand the agency's functions as a regulatory agency. Accordingly, it will still be responsible for regulating licensee activities and operations. In a privatized scenario, the Department would have additional licensing workload as the State would start issuing retail licenses for distilled spirits, in addition to the existing second-class licenses. The State would also have to issue wholesale licenses, which would be smaller in volume, but more expensive for the licensee.

Excise Tax
The Excise Tax is currently 5 percent of retail liquor sales, which is generated through the state markup. Most license states collect alcohol taxes based on fixed rates per gallon, rather than percentage excise taxes. Accordingly, this tax could be replaced with a gallonage tax. In FY2023, the Excise Tax provided $4.9 million to the State General Fund.

Off-Premise Sales Tax
The State's 6 percent sales tax is imposed on all off-premise liquor sales. While of point of sale to licensees will change, PFM assumes this tax will remain if wholesale and retail operations are privatized. The tax could be applied at various points with a variety of implications depending on policy goals. In FY2023, the State sales tax on liquor totaled $4.6 million.

Operational Expenses
Since the Department already contracts out retail operations to private agents, operating expenses are largely driven by regulatory, licensing, enforcement and wholesale operations. In a privatized environment, DLC operating costs would be reduced by eliminating all wholesale and agent expenses, but costs associated with administrative, regulatory, licensing and enforcement functions would continue or even increase. These costs would need to be covered by program revenue and tax revenue.

The following table identifies the status of the portions of the current operation that would remain in a privatized operation and those that would no longer be needed. It also identifies the revenue streams that would remain and those (primarily the state markup) that would not be available to the state in a privatized structure.

Table 18: Privatized Scenario, 10% Additional Sales Revenue (FY2025 Start)
Scenario maintains current tax rates

	FY2024	FY2025	FY2026	FY2027	FY2028	FY24-28 CAGR
Revenue from Sales	**$0**	**$0**	**$0**	**$0**	**$0**	
Program Revenue	**$1,993,360**	**$2,266,210**	**$2,556,210**	**$2,846,210**	**$3,136,210**	**12.0%**
Product Markup	$0	$0	$0	$0	$0	
Licenses, Fees, Fines	$1,993,360	$2,266,210	$2,556,210	$2,846,210	$3,136,210	12.0%
Bottle Deposit, Paper Bag	$0	$0	$0	$0	$0	
TOTAL REVENUES	**$1,993,360**	**$2,266,210**	**$2,556,210**	**$2,846,210**	**$3,136,210**	**12.0%**
Cost of Sales	**$0**	**$0**	**$0**	**$0**	**$0**	
DLL Operating Expenses	**$9,843,390**	**$10,150,789**	**$10,476,289**	**$10,820,955**	**$11,185,915**	**3.2%**
Administration	$5,220,553	$5,527,952	$5,853,452	$6,198,117	$6,563,078	5.9%
Enforcement	$2,567,584	$2,567,584	$2,567,584	$2,567,584	$2,567,584	0.0%
Warehouse	$0	$0	$0	$0	$0	
Other	$2,055,253	$2,055,253	$2,055,253	$2,055,253	$2,055,253	0.0%
TOTAL EXPENDITURES	**$9,843,390**	**$10,150,789**	**$10,476,289**	**$10,820,955**	**$11,185,915**	**3.2%**
OPERATING SURPLUS (DEFICIT)	**($7,850,031)**	**($7,884,580)**	**($7,920,079)**	**($7,974,745)**	**($8,049,706)**	**0.6%**
Tax Revenue	**$30,185,261**	**$34,982,976**	**$36,858,102**	**$38,834,368**	**$40,917,257**	**7.9%**
Excise Tax at 5%	$5,148,670	$5,964,748	$6,282,094	$6,616,444	$6,968,717	7.9%
Sales Tax at 6%	$4,636,591	$5,384,774	$5,685,171	$6,002,326	$6,337,174	8.1%
Add'l Transfer to GF/F&M - 20%	$20,400,000	$23,633,454	$24,890,838	$26,215,597	$27,611,366	
State Fiscal Impact	**$22,335,231**	**$27,098,396**	**$28,938,023**	**$30,859,623**	**$32,867,551**	**10.1%**

In this scenario, the state would have to make up for the operating loss for the DLC. Beyond that, the DLC is currently running a surplus, and this has been a source of revenue for the State.

Tax Rate – Fiscal Neutrality

If the State wishes to match current performance, in terms of revenue available or actually transferred to the General Fund, there would be the need to replace the loss of the product markup revenue with an additional revenue source. In addition, the State would need to make up for lost revenue from the Excise Tax, which is 5 percent of sales in the baseline. In a privatized scenario, the State could apply a tax at some point to make up for the lost 5 percent, as well as the additional profit for the Department that is not directly transferred to the General Fund (the remainder of the product markup). The tax rate required to achieve the same fiscal impact in FY2025 as the State would benefit from in a baseline scenario, which is found in Table 15, ($81.1 million) is 50.3 percent.

The following table illustrates the different tax rates required in a privatization alternative from a consumer's perspective. Again, the privatization alternative yields the same fiscal impact as the baseline.

As Table 19 illustrates, the final shelf price of a product with an FOB of $10.00 would increase by 25 percent after all markups and taxes are applied. This scenario assumes that, in addition to the state tax applied at retail, the wholesaler will markup an additional 25 percent of the COGS, and the retailer will markup 20 percent of the retail COGS.

Table 19: Price Model Outputs: Baseline Pricing vs. Alternative Scenario Pricing

Item	Baseline		Privatization Alternative	
	$	**%**	**$**	**%**
COGS	$10.00	-	$10.00	-
Wholesale Markup	$0.00	0.0%	$2.50	25.0%
subtotal	**$10.00**		**$12.50**	
Wholesale Taxes	$0.00	0.0%	$0.00	0.0%
subtotal	**$10.00**		**$12.50**	
Retail COGS	$10.00		$12.50	
Bottle Deposit	$0.15			
Retail Markup	$7.41	73.0%	$2.50	20.0%
subtotal	**$17.56**		**$15.00**	
Retail Taxes	$0.00	0.0%	$7.55	50.3%
subtotal	**$17.56**		**$22.55**	
Rounding	$0.43	2.5%		
subtotal	**$17.99**		**$22.55**	
Retail Shelf Price	$17.99		$22.55	
Sales Tax	$1.08	6.0%	$1.35	6.0%
Final Shelf Price	**$19.07**		**$23.90**	

It should be noted that the actual markup by the wholesaler and the retailer will vary by product, wholesaler, retailer, location, etc. There is far more variability in each of these factors in the private market. For example, prices for the same product will vary – larger purchasers will, as can be expected, get better pricing. The type of product will also affect the markup. For example, retailers will generally increase the markup on higher end products where there is less price sensitivity and reduce them on 'bargain brands' or those that drive consumers into stores.

This 'sell at cost' approach is common for both big box liquor stores and grocery stores that are seeking to use low prices on distilled spirits to bring shoppers into stores. Those considerations cannot be factored into these pricing examples.

Taking these caveats into consideration, the primary driver that could reduce this price disparity would be increased sales, as that generates additional tax revenue. It is notable that even with a

50 percent increase in sales, the projected cost of the bottle of distilled spirits would rise by over one-third of the current cost.

Table 20: Tax Rate Required for Fiscal Neutrality, Additional Sales Scenarios

Sales Volume	FY2025 Sales Revenue	Required Tax %	Bottle Price	% of Baseline
Baseline	$108,449,964	N/A	$19.07	100%
Privatized System:				
10% Additional Sales	$119,294,960	50.3%	$23.90	125%
20% Additional Sales	$130,139,956	44.1%	$22.91	120%
30% Additional Sales	$140,984,953	38.8%	$22.07	116%
40% Additional Sales	$151,829,949	34.3%	$21.36	112%
50% Additional Sales	$162,674,946	30.4%	$20.73	109%

These are substantial price increases, and, as previously noted, they may be ameliorated by wholesalers and retailers who are interested in gaining a foothold in the market and wish to see privatization be successful from both a state and customer perspective. Still, it is difficult to construct a credible scenario where, given the current state benefit from the system, prices do not increase.

This is not dissimilar from the analysis in 2014. The primary difference is that, based on market information, the project team has increased the projected wholesale and retail markups.

5. Findings and Recommendations

The following are **key findings** that form the basis for recommendations:

1. **For a variety of reasons, Vermont is a low volume state for distilled spirits consumption and sales.** The consumption benchmarking data puts Vermont near the bottom among all states. While total volume reflects the state's small population, per capita consumption is also near the bottom for control states, and control states, on average, have lower per capita consumption rates than license states.

2. **While consumption typically increases when control states go to a retail license model, there are factors that may limit that growth for Vermont.** It is an axiom of retail that it generally chases customers, rather than the other way around. Vermont is a low population state with no major metropolitan areas, and its population density is less, (70) on a per square mile basis than other small states, such as New Hampshire (156), Delaware (522), Connecticut (747) and Rhode Island (1,100).

3. **The current liquor operation performs well among benchmarked control states on revenue versus expenditures.** Using Census Bureau data from the 2021 annual survey of state and local government finance, Vermont's difference between the liquor operation's revenue and expenditures was significantly higher than Ohio, New Hampshire, or Idaho while training Oregon.

4. **The current liquor operation has made significant advances since the 2014 performance audit by the Vermont State Auditor's Office.** At that time, there were numerous areas where the use of more and better data for decision-making was identified. It is notable that the Auditor's 2017 progress report identified numerous areas where the DLC was making progress or had implemented the recommendation. The discussions with the DLL and DLC leadership and staff for this study led the project team to conclude that progress continues to be made. There is an updated point-of-sale system in place, there is much better access to and use of web portals and other electronic access for agents. Of course, there is continued room for improvement, but it is also not possible to 'do everything at once.' In most areas, the improvement is notable.

5. **Perhaps the single area that continues to constrain the DLC and its agents is the lack of adequate warehouse space.** This was already identified as an issue of concern in 2014, and the lack of progress in resolving it is notable. Interviews with DLL leadership indicate that it is going to be rectified in the near future, and the project team believes this may hold greater promise for increased sales and customer service than any other system change.

   Of course, one of the arguments in favor of a privatized system is that private wholesalers (and major retailers, for that matter) would have solved this problem years ago. It's a valid argument.

6. **Besides the warehouse and transportation functions and support for existing agents, much of the DLL and DLC organization will remain.** The DLL is now supporting operations of the liquor, lottery, and, eventually, sports betting operations. The Department leadership and common back office functions, including HR, IT, procurement, accounting, payroll, etc. will remain. Further, many of the enforcement functions for the agency operations remain, both because there would still be enforcement of regulations for new private stores and because the same agents provide enforcement for beer, wine, and tobacco sellers. There will continue to be licensing and regulatory functions for private retailers as well. It is also possible that there would be some loss of economy of scale in a new department, as the current integration may be most cost-effective.

7. **The connections between retail distilled spirits stores and societal harms from alcohol are tenuous.** As previously noted, per capita consumption in Vermont is low. At the same time, binge drinking rates are high. Given the control state nature of the current system, it is difficult to make a connection between access and levels of binge drinking. For other considerations, the connection between the levels of possible increased sales and access do not readily connect with a material change in activities such as drunk

driving or alcohol-related crime.

8. **The State obtains significant revenue from the current system, and it would be practically impossible to maintain that level without an increase in final prices for consumers.** The State continues to benefit from revenues associated with the liquor operation. Of course, the markup that is applied is, ultimately, a tax on consumers. That tax can be justified by the societal costs associated with alcohol consumption, which is discussed in the benchmarking.

   Even with increased prices, the experience of other states is that overall consumption will increase, and that is built into the PFM model. That can be because of greater access (more locations), convenience (more locations and hours), better product selection (no warehouse constraints and more product expertise), or better marketing (wholesale operations with a profit motive). Most likely, it is a combination of these factors. That will translate into continued sales growth.

9. **Ultimate customer satisfaction is more difficult to gauge.** It is a fact that no state that has shifted to a license structure has shifted back, so there is at least some inertia in favor of a private structure. It is notable, however, that public sentiments have not been as positive related to at least the state of Washington privatization. In one report, a series of studies was conducted by ICF International from January 2014 to December 2016 to evaluate the impacts of privatizing the off-premise sales of spirits. The surveys were designed to determine whether those who supported the privatization ballot initiative still supported it, those who did not still opposed it, or whether their level of support had changed. The surveys also captured data on respondent characteristics, including individual's drinking behavior, and views on other issues related to alcohol policies, such as the number of stores (increase, stay the same, decrease) and tax rates.

   > Results showed that those who voted for the privatization initiative were 2.59 times more likely to want to change their vote to opposing privatization – a difference that was large enough to have changed the result of the election if voters had known their later opinion at the time of the vote. Those who wished to retract their vote for privatization were positively related to the indicator measuring 12-month drinking volume. Those who agreed the number of stores selling spirits should decrease were more likely to change votes from for privatization to against it.[45]

10. **System transitions are significant undertakings.** In the states that have transitioned their systems, a full cost accounting of those transitions would number in the millions of dollars. These costs are often not included in a cost-benefit analysis (because they are practically impossible to cost out), but they are significant.

The project team's **recommendations:**

[45] "Reversal of voters' position since the privatization of spirits sales in Washington State," Meenakshi S. Subbaraman, Yu Ye, William C. Kerr, Alcohol Research Group, Preventive Medicine Reports, 2020, accessed online at https://www.sciencedirect.com/science/article/pii/S2211335520300723

The State could privatize its liquor operation and achieve fiscal neutrality.
Currently, the system's benchmarks are reasonable in terms of its overall operations, and the baseline projections in future years are positive. There is evidence that the DLL and DLC are focused on data-driven decision-making. The appropriate legislative oversight bodies should continue to monitor those performance metrics against the same or similar benchmarks as exist in this study.

Should the State maintain its current wholesale and retail functions, it needs to make a concerted effort to solve its lack of warehouse space concerns. It should also make a concerted effort to ensure that product availability in growing sectors of the distilled spirits market increases in terms of accessibility and availability.

Finally, sales revenue that is also connected to the highest levels of performance, related to customer surveys and regulatory and enforcement metrics, should be rewarded, even in a control state system. The state should ensure that there are appropriate incentives in the current system to advance that standard level of performance.

6. Appendix

STATE TAX RATES ON DISTILLED SPIRITS

(January 1, 2023)

STATE	EXCISE TAX RATES ($ per gallon)	GENERAL SALES TAX APPLIES	OTHER TAXES
Alabama	see footnote (1)	Yes	
Alaska	$12.80	n.a.	under 21% - $2.50/gallon
Arizona	3.00	Yes	
Arkansas	2.50	Yes	under 5% - $0.50/gallon, under 21% -$1.00/gallon; $0.20/case; 3% off- 14% on-premise retail taxes
California	3.30	Yes	over 50% - $6.60/gallon
Colorado	2.28	Yes	
Connecticut	5.94	Yes	under 7% - $2.71/gallon
Delaware	4.50	n.a.	25% or less - $3.00/gallon
Florida	6.50	Yes	under 17.259% - $2.25/gallon, over 55.780% - $9.53/gallon
Georgia	3.79	Yes	$0.83/gallon local tax
Hawaii	5.98	Yes	
Idaho	see footnote (1)	Yes	
Illinois	8.55	Yes	under 20% - $1.39/gallon; $2.68/gallon in Chicago and $2.50/gallon in Cook County
Indiana	2.68	Yes	under 15% - $0.47/gallon
Iowa	see footnote (1)	Yes	
Kansas	2.50	--	8% off- and 10% on-premise retail tax
Kentucky	1.92	Yes	under 6% - $0.25/gallon; $0.05/case and 11% wholesale tax
Louisiana	3.03	Yes	
Maine	see footnote (1)	Yes	
Maryland	1.50	Yes	9% sales tax
Massachusetts	4.05		under 15% - $1.10/gallon, over 50% alcohol - $4.05/proof gallon; 0.57% on private club sales
Michigan	see footnote (1)	Yes	
Minnesota	5.03	--	$0.01/bottle (except miniatures) and 9% sales tax
Mississippi	see footnote (1)	Yes	
Missouri	2.00	Yes	
Montana	see footnote (1)	n.a.	
Nebraska	3.75	Yes	
Nevada	3.60	Yes	5% to 14% - $0.70/gallon, 15% to 22% - $1.30/gallon
New Hampshire	see footnote (1)	n.a.	
New Jersey	5.50	Yes	
New Mexico	6.06	Yes	
New York	6.44	Yes	under 24% - $2.54/gal.; additional $1.00/gal. in New York City
North Carolina	see footnote (1)	Yes (2)	
North Dakota	2.50	--	7% state sales tax
Ohio	see footnote (1)	Yes	
Oklahoma	5.56	Yes	13.5% on-premise
Oregon	see footnote (1)	n.a.	
Pennsylvania	see footnote (1)	Yes	
Rhode Island	5.40	Yes	under 15% - $1.10/gallon
South Carolina	2.72	Yes	$5.36/case and 9% surtax; additional 5% on-premise tax
South Dakota	3.93	Yes	under 14% - $0.93/gallon; 2% wholesale tax
Tennessee	4.40	Yes	15% on-premise; under 7% - $1.10/gallon.
Texas	2.40	Yes	6.7% on-premise
Utah	see footnote (1)	Yes	
Vermont	see footnote (1)	Yes	10% on-premise sales tax
Virginia	see footnote (1)	Yes	
Washington (3)	14.27	--	$9.24/gal. on-premise; 20.5% retail sales tax, 13.7% sales tax to on-premise
West Virginia	see footnote (1)	Yes	
Wisconsin	3.25	Yes	$0.03/gallon administrative fee
Wyoming	see footnote (1)	Yes	
Dist. of Columbia	1.50	--	9% off- and on-premise sales tax
U.S. Median	$3.77		

Source: Compiled by FTA from state sources.

Notes:
n.a. = not applicable. These 5 states do not have a general sales tax.
(1) In 17 states, the government directly controls the sales of distilled spirits. Revenue in these states is generated from various taxes, fees, price mark-ups, and net liquor profits. (see: https://www.nabca.org)
(2) General sales tax applies to on-premise sales only.
(3) Washington privatized liquor sales effective June 1, 2012.

FEDERATION OF TAX ADMINISTRATORS -- JANUARY 2023