Legislative Analysis

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ELIMINATE UNIFORM LIQUOR SELLING PRICE

House Bill 4458 as enrolled
Public Act 407 of 2004
Sponsor: Rep. Sal Rocca
House Committee: Regulatory Reform
Senate Committee: Economic Development, Small Business and Regulatory Reform

Second Analysis (12-29-04)

BRIEF SUMMARY: The bill would permit bottled liquor sold for off-premise consumption to be sold at a price higher than the minimum retail selling price established by the Liquor Control Commission. Currently, all bottled liquor must be sold at a uniform price determined by the LCC.

FISCAL IMPACT: The fiscal impact on the state and local governmental units is indeterminate.

THE APPARENT PROBLEM:

Retail prices of bottled liquor, or spirits, are established by the Liquor Control Commission. Under the Liquor Control Code, the LCC establishes the prices consumers pay for a bottle of alcoholic liquor for consumption off the premises by applying a state markup to the cost of the product to the state, and then adding a series of specific taxes. The markup, or gross profit to the LCC, is set in statute at not less than 51 percent and not greater than 65 percent. The current actual markup is 65 percent. (The product is sold to retailers at a discount of 17 percent.) Spirits sold for consumption <u>on the premises</u> (e.g., by the glass) can be sold at any price above the cost to the retailer, whereas spirits sold for <u>off-premise</u> consumption must be sold at the uniform retail price set by the LCC.

Off-premise liquor licensees - which include grocery stores, drugstores, and package liquor stores – say that in recent years they have faced increased financial pressures, largely due to increased competition and increased costs in employee compensation, business-related goods, and other expenses. Over the years, there have been a number of bills introduced designed to help licensees address their costs. Most of the proposals, including the original version of this bill, called for an increase in the discount provided to licensees when they purchase liquor from the state. However, an increase in the retailer discount, unless accompanied by a proportionate increase in the markup (and higher liquor prices) reduces state revenues. For example, the original version of House Bill 4458, which would have increased the discount from 17 percent to 20 percent, would have decreased state revenue by over $20 million. Given the state's fiscal situation, increasing the discount to retailers does not seem prudent at this time.

As a result, industry representatives have sought ways to increase their profitability without affecting state revenues. One recommended solution is to permit liquor to be sold for off-premise consumption at any price above the state minimum.

THE CONTENT OF THE BILL:

The bill would amend the Liquor Control Act (MCL 436.1229) to prohibit off-premise retailers (a licensed specially designated distributor or SDD) from selling alcoholic liquor at a price below the minimum retail selling price established by the Liquor Control Commission [but there would be no state-imposed ceiling on the price]. The bill would define "minimum retail selling price" to mean the sum of (1) the price the commission pays for the spirits, (2) the gross profit established by section 233 [that is, the state markup], and (3) the four specific taxes (totaling 13.85 percent) levied on the retail selling price.

FISCAL INFORMATION:

Currently liquor prices in Michigan are fairly tightly established. The Liquor Control Commission marks-up the cost of liquor by 65% (the gross profit), the licensees receive a 17% discount, and a 13.85% tax is collected by the commission at the time of sale by the commission. The following is an example of how liquor prices are calculated in Michigan.

		Price to On-Premise Licensee	Price to Off-Premise Licensee	Price to Retail Consumer
Calculation of base price and discount				
A	Price of bottle to LCC: includes amount to distiller and Federal Government share (1)	$6.06	$6.06	$6.06
B	Liquor mark-up: 65% of A	$3.94	$3.94	$3.94
C	Base price/bottle: A + B	$10.00	$10.00	$10.00
D	Discount to licensee: 17% of C for on-premise and off-premise licensees only	($1.70)	($1.70)	-
E	**Subtotal – price before taxes**	**$8.30**	**$8.30**	**$10.00**
Calculation of taxes				
F	Specific tax: 4% of C, convention facilities	$0.40	$0.40	$0.40
G	Specific tax: 4% of C, school aid fund	$0.40	$0.40	$0.40
H	Specific tax: 4% of C, general fund	$0.40	$0.40	$0.40
I	Substance abuse tax: 1.85% of C for off-premise licensee and retail consumers only	-	$0.18	$0.18
J	**Subtotal: price after taxes (2)**	**$9.50**	**$9.68**	**$11.38**
K	Sales tax: 6% of J for retail consumer only	-	-	$0.68
L	**Total Costs**	**$9.50**	**$9.68**	**$12.07**

(Example provided by the Department of Labor and Economic Growth)

(1) Federal excise tax = $13.50 per proof gallon. It is paid by the distillery/importer.
(2) The retail price in this row represents the shelf price consumers pay for this product in liquor and grocery stores. The difference between the retail price and the price to the off-premise licensee equals the merchant's profit. The merchant's profit matches the discount rate calculated in row D above.

The proposed bill would continue the prices charged to the licensees (line E) by the commission as well as the taxes applied and collected by the commission on the minimum pricing (lines F, G & H), but would allow licensees to charge anywhere above the minimum pricing set by the commission. The bill would place no cap on the pricing of liquor in Michigan. The fiscal impact on the state and local units of government is indeterminate. Critical in determining the fiscal effect is the price elasticity of demand for liquor. Price elasticity means the relative degree of responsiveness of the quantity of liquor sold to relatively small changes in its price. It cannot be determined how high licensees will raise prices; to what extent there will be consumption changes; or how much out-of-state purchasing by consumers may change. If liquor prices to consumers increase, and demand remains constant there would be additional revenues to the state in the form of increased sales tax revenue.

ARGUMENTS:

For:

Supporters say the bill is needed to help off-premise liquor licensees (such as package stores and grocery stores) deal with increases in their business costs. Licensees include businesses of all shapes and sizes, from small independent, neighborhood liquor stores and grocery stores to national and regional "super centers." These types of stores don't typically operate with large profit margins, and when faced with increases in costs and competition, find that limited profitability further eroded. As a result, retailers must either increase costs of other items (which make it difficult to compete with other retailers) or reduce their expenditures (including reductions in employment).

The state and spirits manufacturers can increase their prices under current law, but retailers are not afforded the same opportunity. The bill, then, provides retailers with the same opportunity to increase their profits when the need arises, within traditional market constraints. Further, current law only requires <u>off-premise</u> retailers to sell liquor at the uniform price set by the LCC. <u>On-premise</u> retailers are permitted to sell liquor by the glass at any price. The bill grants off-premise retailers the same flexibility to set their selling prices consistent with market demand and competitive pressures.

Response:

The bill represents a significant departure from longstanding state practice regarding the pricing of spirits sold for off-premises consumption. While the bill would not allow spirits to be sold below the state-established retail selling price (as a "loss leader"), it does allow for prices above that level. This could lead to price gouging in areas where there is not much competition. Moreover, some believe that if the price of liquor in the state increases, the state should receive some financial benefit, perhaps through a greater markup.

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