Testimony of David M. Ozgo, Chief Economist
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Before the House Liquor Control Committee
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I would like to thank the committee for this opportunity to speak before you today. My name is David Ozgo and I am the chief economist for the Distilled Spirits Council.

Act 39 was passed with great fanfare this year. It was touted as the first major consumer friendly modernization of beverage alcohol laws in Pennsylvania, probably since the state began to allow "self-service." Unfortunately, there was a provision in Act 39 that, if implemented, will be neither consumer friendly, nor modern.

Act 39 has given the PLCB the ability to alter its pricing formula for wine and spirits on the top 150 brands – which make of over 90% of the market. Previously, the PLCB had to follow a strict pricing formula that required prices to be proportional. Under this pricing formula anytime suppliers offered discounted prices the PLCB was required to pass savings onto the consumer. This offered the consumer a level of protection.

Now that the PLCB has the flexible pricing authority that it has long sought, the PLCB is free to increase its 31% markup, thus confiscating any consumer savings and increasing the PLCB's profit margin. While it is true that retailers in Open states do vary their mark-up according to market conditions, Open state retailers also must face competition. If an Open state retailer raises his or her mark-up too high, they will lose business to competitors.

But, the PLCB is a state sponsored monopoly and is not constrained by market discipline. Without market discipline the PLCB is free to abuse its flexible pricing power to the detriment of consumers and suppliers. That is why the PLCB was traditionally required to use proportional pricing. Naturally, it is every business's dream to have a monopoly – that is why we have anti-trust laws in this country to protect consumers against potential abuses.

By allowing the PLCB carte blanche to increase its mark-up as it desires we now have a state sponsored monopoly that is neither constrained by competition nor any kind of government regulation – essentially the worst kind of economic outcome for consumers.

It is clear that the PLCB intends to increase profit margins using its new flexible pricing authority. The House Fiscal Note states:

> *"Flexible pricing is anticipated to generate an additional $35 million in revenues in 2016-17 and an additional $65 million annually thereafter."*

Obviously, the only reason that such a provision would be scored at $65 million annually would be if the PLCB increased its profit margins. Ultimately, these increased profits will come on the backs of consumers.

It is ironic that the flexible pricing provision in Act 39 is part of a market modernization bill. The increased PLCB mark-ups that flexible pricing will allow are anything but market modernization. Across the country retailer margins are declining in Open states, not going up. More and more grocery stores carry spirits and in the last 10 years there has been a proliferation of large chain package stores entering the market. In fact, the number of off-premise outlets selling spirits has increased by 50% since 2005.

Whereas we once assumed an average retail mark-up of 25%, including discounts, many of these large retailers take advantage of economies of scale and offer every day mark-ups in the 20-22% range and promotional mark-ups in the 10-15% range. This compares to the PLCB's current 31% markup.

It is ironic that the PLCB recently complained about supplier's 991 price increases over the last three years. In any given year the PLCB sells some 14,500 different products. Thus, over a three-year period suppliers raised prices on fewer 2.5% of all products offered. That is an amazing record of pricing restraint on the part of suppliers.

From the perspective of the PLCB's customers, far from modernizing the marketplace, flexible pricing that allows the PLCB to increase its mark-up is a step backward. In the interest of fairness to consumers we urge you to delay implementation of the PLCB's flexible pricing authority until the implications can be publicly vetted and consumer safe guards can be put in place.