

To: Dr. John Yinger
From: Amanda Burd and Allison Wyman
Date: May 10, 2010
RE: Selling Wine in Grocery Stores: A Win(e)-Win(e) Situation for New York

In 2011 New York State will face a \$7.4 billion deficit.ⁱ To meet the requirement for a balanced budget New York State must find additional revenue sources. In order to raise revenues, we recommend the New York State Legislature adopt the proposal to sell wine in grocery stores and increase the tax on wine. This proposal allows New York State to collect additional revenues with few administrative costs; thus the amount gained from additional revenues would more than offset any loss as a result of this proposal.

Current New York Liquor Laws and the Proposal

Governor Paterson's 2010 proposal to sell wine in grocery stores (the proposal) calls for a change in the antiquated New York State liquor laws, which make New York one of only fifteen states that do not allow the sale of wine in grocery stores. Under New York State Chapter 478, the Alcoholic Beverage Control board, a subset of the State Liquor Authority, determines who can hold liquor licenses.ⁱⁱ Beer is sold in grocery stores and beer distribution outlets, while wine and hard liquor are sold in approximately 2,500 liquor stores.ⁱⁱⁱ Wineries can sell their wine on location, but liquor stores cannot sell merchandise other than alcohol. Further, New York's liquor laws, which are considered strict when compared to other states, currently allow only one liquor license per person, limiting franchising opportunities. However, under the proposal, a single person (or company) would be allowed to hold multiple licenses thus licensing fees would be collected from the 19,000 grocery stores across the state and any additional stores that open in the future. To mitigate the loss of the monopoly on wine sales, liquor stores would have the ability to recoup lost wine sales by expanding their market and selling food items and merchandise related to wine. Lastly, the proposal calls for an increase in the wine tax rate from

30¢ per gallon to 51¢ per gallon. On May 1, 2009 the tax on wine was raised from 189¢ per gallon.^{iv}

Whenever a tax rate changes it is important to perform a tax analysis. The legal incidence of this tax is paid by the firms who sell the wine, but the tax is passed onto consumers through an increased purchase price, which results in a decrease in consumer income. Since the same tax rate is charged to everyone regardless of their ability to pay, this tax, like all alcohol taxes, is regressive. Because this revenue is earmarked for the general fund it is also difficult to determine the benefit principal. The concern of excess burden reducing consumer surplus is somewhat lessened since this tax brings New York State in line with its neighboring states as illustrated below in Table 1. The elasticity of demand for wine is estimated to be -.4 which means that demand is relatively inelastic and less responsive to price changes.^v Thus, even with the equity concerns that plague all alcohol taxes, this tax should be implemented since New York will increase revenues with minimal market effects due to the relative inelasticity of demand.

The following table represents wine taxes per gallon for the states bordering New York. The table also includes Washington State, which Applied Economics and Management Professor Bradley Rickard contends is similar to New York State in consumption patterns. As the table shows, the tax is not meant to reduce demand for wine, but instead will bring the tax in line with neighboring states. Pennsylvania is not included in the table because all wine sales occur at state-run liquor stores, leading to a different revenue structure.

Table 1

New York	\$.30
New Jersey	\$.875
Connecticut	\$.60
Massachusetts	\$.55
Vermont	\$.55
Washington State	\$.87

History

New York State first considered selling wine in grocery stores in 1964 as other states adopted the proposal. Then, under the leadership of Governor Mario Cuomo in 1984, the proposal rose again as a way to create larger markets for local wines. The proposal gained publicity and momentum, but was ultimately defeated.^{vi} In 2009 the proposal was defeated after much lobbying from liquor stores. As New York State now debates the 2010 proposal, a Sienna College poll shows 58% of New Yorkers support selling wine in grocery stores.^{vii}

Generated Revenue

If passed, the current proposal is expected to raise \$300 million in the first two years from fees.^{viii} The 2009 proposal was only expected to raise \$160 million.^{ix} This is accomplished in three ways: license fees, increased wine consumption, and an increased wine tax.

License Fee

Legalizing multiple liquor licenses per holder and allowing an increase in licensed sale locations would raise \$300 million over two years.^x Further, allowing grocery stores to sell wine would expand the number of liquor-selling outlets from 2,500 to 21,500, thereby increasing the amount of revenue generated from liquor license fees.^{xi} The State would not charge a flat dollar rate for the license but instead would charge a percentage of the previous year's gross sales. This fee for grocery stores is proportional based on store sales. Currently it is believed that the smallest grocery stores would pay \$1,000 while the largest stores would pay \$680,000, with the rest of the stores falling somewhere in between.^{xii} Further, chains would need to purchase a license for each store based on that store's gross sales.^{xiii}

Additional Revenue

Opening the wine market to grocery stores is expected to increase wine sales. Other states that have allowed grocery stores to sell wine have seen a 300% increase in demand; however this is only when accompanied with other very large changes to blue light laws.^{xiv} More realistically, an expert in cool climate wines at Cornell University, Bradley Rickard, suggests that Washington State's consumption pattern, which saw a 26% increase in demand that was sustained over time, could be similar to New York because both are major wine-producing states.^{xv} Although the authors recognize Washington State changed its wine laws in 1969 without an associated tax increase, which makes it different from New York today, Washington provides the best comparison for New York because it is a major cold-climate wine producing state with other similar characteristics. Thus, while we will use Washington State as a yardstick for future effects of the proposal in New York, we also recognize the comparison is not perfect. It is also noteworthy that all other states that have made this change have seen an increase in wine consumption, and with the relative inelasticity of demand for wine the tax should have little impact on increased consumption. Lastly, the long-term \$22 million per year the proposal is expected to generate does not take into account the wine tax increase.^{xvi}

Under the proposal the tax on wine would increase from 30¢ per gallon to 51¢ per gallon, bringing it more in line with neighboring states as evidenced by Table 1. This is expected to increase revenues since the tax does not vary with the price of the wine and the elasticity of demand is $-.4$ ^{xvii}. However this tax may slightly lower the demand for higher priced wine as people use lower priced wine as a substitute, which affects the amount of sales tax the state is able to collect. For instance, despite the 2009 recession the country saw a 2.1% increase in the amount of wine sold, yet it was associated with a retail estimated value drop of 4% as people

purchased less expensive wine.^{xviii xix} This increase in wine consumption could also be a substitution for people patronizing bars and restaurant, which would be associated with a decrease in sales tax revenue from other sources.

Effects on stakeholders

In addition to the increased revenues for the State, the proposal to sell wine in grocery stores affects five main groups: farmers, wineries, liquor stores, grocery stores, and consumers. Only liquor stores do not favor the proposal.

Farmers and Wineries

Under the current New York law only liquor stores can sell wine. As a major wine-producing state, New York has 1,000 grape farms and over 270 wineries.^{xx} However, with only 2,500 wine outlets across the state, which is approximately .595 wine distribution sites per local municipality, New York ranks 46th in the nation for wine outlets per 100,000 people.^{xxi} This provides a host of problems for wineries and grape farmers. Although New York wineries can only sell in-state through liquor stores and mail order, New York liquor stores have complete discretion about the wine to sell in their stores.^{xxii} Thus, in order to sell wine in-state wineries must compete for a limited amount of retail shelf space with the large variety of wine made around the world.

Grape growers claim the limited wine market has caused a wine surplus for many wineries, which has caused wineries to cancel their contracts with grape farmers.^{xxiii} Now, even though the wine grape market is thriving in other states, grape growers in New York are in a crisis because “thousands of tons of quality, wine grapes have been left on the vine for lack of a home at a winery.”^{xxiv} With a similar line of reasoning, local wineries claim the current liquor policy leads to an excess demand for New York wines, because it is hard for the New Yorkers

who travel upstate to wineries in the summer to find their favorite New York wine downstate. However, both of these arguments confuse excess demand with lack of demand, where growers and wineries are claiming the former while the latter actually reflects the truth. For instance, if New York citizens were demanding New York wine and were not willing to settle for other substitutes, liquor stores would stock New York wines. However, liquor stores have struck a balance between selling New York wines and other wines, and still continue to turn a profit. There are two explanations for this. One explanation is that New Yorkers are not demanding New York wine; the second explanation is that New Yorkers would prefer New York wine but are willing to settle for a similarly priced substitute. The truth probably lies somewhere between these two explanations.

However, New York should adopt the proposal because other states have found that allowing local wineries to sell their product in a new market has led to an increase in wine sales. This creates positive externalities for the local labor market and improves the state reputation. Although every state is different, Washington State saw a 26% increase in wine sales that sustained over time.^{xxv} Further, this type of increase in consumption would benefit other local markets that depend on the sale of wine, like the stainless steel wine tank industry in upstate New York.^{xxvi} Thus, an even less dramatic sales increase in New York would allow wineries to grow their business through retail and increased opportunities for wine tasting and help external markets dependant on the wine industry, creating economic development in New York State.

New York Liquor Stores

New York liquor stores, who currently hold a monopoly over wine sales, do not favor the proposal. Critics claim the change would close more than 1,000 small businesses, resulting in 4,500 lost jobs.^{xxvii} However, Appleseed, the economic consulting firm, found the proposal

would actually create a net 2,000 new jobs for the state.^{xxviii} The American Economics Group also finds, on a whole, the proposal would create more jobs.^{xxix} Further, provisions of the bill would offset the wine sales liquor stores would lose to supermarkets. According to Appleseed, liquor stores would lose about 15% of their wine sales to supermarkets, which represents a 6%-8% average reduction in total sales per store.^{xxx} However, allowing liquor stores to sell other products could offset this small decrease in average sales. Under the current bill liquor stores could sell snacks and gift baskets, and could sell liquor directly to bars, restaurants and small convenience stores.^{xxxi} Thus, the bill provides an avenue for liquor stores to offset the lost revenue they would face if the proposal became law.

Grocery Stores and Consumers

Grocery stores favor the proposal, as they believe it promises an increase in sales. Wegmans, a national upscale supermarket, has already pledged to match wine with different food products, a method used by the chain in other states.^{xxxii} Further, grocers claim the proposal would help stimulate the economy and create jobs, since the increase in product offering may lead national food retailers to invest in New York through increasing investments in existing stores, opening new stores, and expanding employment opportunities.^{xxxiii} However, it is unlikely the proposal will stimulate the economy in this way, because the proposal does not give New Yorkers more income to spend, only more choice. That means that on average, if people shopping at a grocery store choose to buy wine, they will forego or buy less of another product. On the state level, some grocery stores may see an increase in profit due to wine sales, while other stores may see a decrease in profit due to consumers buying food compliments for wine at a liquor store. Thus, it is not likely that national chains will invest more in New York when grocery stores are netting, on average, about the same revenue. However, regardless of the

faulty logic of grocers, New York State should adopt the proposal because it would benefit the consumer seeking convenience, offer a greater variety of wines for all, and the competition between grocery and liquor stores would drive down the price of wine, creating a consumer surplus.

Negative Externalities

The Last Shop on Main Street, the advocacy group leading the charge against the proposal, claims increasing the number of vendors that sell wine would make it easier for underage-drinkers to obtain alcohol.^{xxxiv} However, Appleseed debunks this myth; state-by-state data shows no correlation between selling wine in food stores and underage drinking.^{xxxv} Further, the proposal does not increase the number of alcohol-selling outlets, just changes the types of alcohol the outlets can sell.^{xxxvi}

Others fear opening the wine market to supermarkets would erase the niche of the specialty wine store. This is a reasonable fear. However, with the large variety of wines available and the provisions in the bill that would allow liquor stores to sell other products, liquor stores would still be important. Although the proposal allows grocery stores to enter the wine market, grocery stores would probably not sell exotic, expensive wine. Thus, liquor stores would still be the only place for the wine connoisseur to find a rare bottle, or the wine novice to seek the perfect match for a meal.^{xxxvii} Through unparalleled selection and customer service, wine and liquor stores would continue to play a vital role in the wine industry.

Conclusion

In conclusion, we recommend the New York State Legislature adopt the proposal to sell wine in grocery stores and increase the tax on wine. Since most of the infrastructure and tax collection mechanisms used in the proposal already exist, the proposal would generate \$300

million in the short-term and \$22 million per year in revenue in the long-term at a relatively low cost to the State. In addition, it would net 2,000 new jobs for the state, help the local industry dependant on wine manufacturing, and provide lower prices and convenience to the consumer. Further, the proposal allows liquor stores to sell other products to offset the loss in revenue from the end of their monopoly on wine. Therefore, to help close the budget gap New York should adopt the proposal to sell wine in grocery stores.

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