

THE IMPACT OF PRIVATIZATION ON ALCOHOL CONSUMPTION AND STATE REVENUES

WHAT WE BELIEVE

- Alcohol is a unique product whose position in global society requires careful management, well thought out and executed regulatory regimes. Or, Captain Morgan is not Captain Crunch.
- The 21st amendment has succeeded in its purpose to reintegrate alcohol into American society in the least impactful way and, while not perfect, its resulting system of state-based government controls, regulations, three tier and control state systems continues to this day to protect American society while providing a competitive marketplace for alcohol with low barriers to entry.
- By contrast, poor alcohol management policies in many other parts of the world underscore the potential adverse consequences for any given society. Intelligent management of alcohol in society is paramount to minimizing potential costs and consequences to society.
- Access to alcohol needs to be limited.
- Deregulation has consistently led to an increase in underage drinking, binge drinking among adults/the underaged, crime, serious health consequences.

"Those who cannot remember the past are
condemned to repeat it."

George Santayana, Reason in Common Sense

- THE GREAT BRITAIN EXPERIENCE
- There is currently an epidemic of alcohol abuse in Great Britain.
- They should know better because it has happened numerous times before and all as a result of deregulation.
- The Gin Craze: In the 1700s, laws were changed to help the gin industry and increase gin consumption. The tax was decreased, which made it an attractive product versus beer. Consumption quickly rose and huge problems ensued. For almost a decade, Brits tried to get the problem under control, mostly via major tax hikes. The high taxes were initially ignored, but eventually a balanced tax and campaign against spirits took hold. But it took over 100 years.
- World Wars: When the First World War commenced, drinking was again very heavy and England realized it could lose more people to alcohol than to the war. At that point, the government instituted tight controls over drinking hours and places, and encouraged people to drink a weak beer product. These strategies worked well - so well that they were retained and loosened somewhat. During the Second World War, tight control was again instituted and mostly retained after the war.

GREAT BRITAIN, CONT.

- The slippery slope of deregulation: Alcohol was allowed to be sold in grocery stores in the 1960s; bar and pub closing hours were extended, as were Sunday sales. After 2003, 24-hour sales were allowed. Drinking laws for youth were very weak and there was little enforcement. Large increases in alcohol disease and hospitalization occurred.
- The UK has been engaged in numerous attempts to quell the problems. Some of these attempts may eventually work, but a mere review of their history could have told them that when you loosen regulations, problems ensue.

"If you build it, they will come." --Field of Dreams

- Research has consistently shown that is the case with facilities that sell alcoholic beverages. The more stores there are, the more alcohol that is sold - with its attendant increase in drunken driving, underage consumption, addiction and crime.
- In England today, alcohol is available in bars, clubs and grocery stores 24 hours a day, seven days a week.
- Supermarkets, in particular, profited from the new regime. They were free to stock wine, beer, and liquor alongside other consumables, making alcohol as convenient to purchase as marmalade. They were free, also, to offer discounts on bulk sales, and to use alcoholic beverages as so-called loss leaders, selling them below cost to lure customers into their stores and recouping the losses through increased overall sales. Very quickly, cheap booze became little more than a force multiplier for groceries.
- Four large grocery chains control 75 percent of the market. Again, most use alcohol as a loss leader, as they engage in price wars.
- Relative to disposable income, alcohol today costs 40 percent less than it did in 1980.

RESULTS

- Since the 1970s rates of cirrhosis and other liver diseases among the middle-aged have increased by eightfold for men and sevenfold for women.
- Since 1990, teenage alcohol consumption has doubled. Since World War II, alcohol intake for the population as a whole has doubled, with a third of that increase occurring since just 1995. The United Kingdom has very high rates of binge and heavy drinking, with the average Brit consuming the equivalent of nearly 10 liters of pure ethanol per year.

HOW DOES THE US COMPARE?

- The United States, although no stranger to alcohol abuse problems, is in comparatively better shape. A third of the country does not drink, and teenage drinking is at a historic low. The rate of alcohol use among seniors in high school has fallen 25 percentage points since 1980.
- However, we still have problems. According to the Centers for Disease Control and Prevention, excessive alcohol use was attributed in:
 - approximately 80,000 deaths each year in the United States.
 - Each year, approximately 5,000 people under the age of 21 die as a result of drinking
 - more than 1.2 million emergency room visits and 2.7 million physician office visits in 2006.
 - 2.3 million years of potential life lost (YPLL) annually, or an average of about 30 years of potential life lost for each death.
 - economic costs of excessive alcohol in 2006 estimated at \$223.5 billion.

US...continued

- Why has the United States, so similar to Great Britain in everything from language to pop culture trends, managed to avoid the huge spike of alcohol abuse that has gripped the UK? The reasons are many, but one stands out above all: the market in Great Britain is rigged to foster excessive alcohol consumption in ways it is not in the United States-at least not yet.
- Monopolistic enterprises control the flow of drink in England at every step-starting with the breweries and distilleries where it's produced and down the channels through which it reaches consumers in pubs and supermarkets. These vertically integrated monopolies are very "efficient" in the economist's sense, in that they do a very good job of minimizing the price and thereby maximizing the consumption of alcohol.
- What prevents the US from becoming Great Britain?

THE 21st AMENDMENT

- The 21st Amendment grants state and local governments express power to regulate liquor sales within their own borders. Thus, the existence of dry counties and blue laws; of states where liquor is only retailed in government-run stores, as in New Hampshire; and of states like Arkansas where you can buy booze in drive-through liquor marts.
- More significantly, state and local regulation also extends to the wholesale distribution of liquor, creating a further barrier to the kind of vertical monopolies that dominated the United States before Prohibition and are now wreaking havoc in Britain.
- Since the repeal of Prohibition, such constraints on vertical integration in the liquor business have also been backed by federal law, which, as it's interpreted by most states, requires that the alcohol industry be organized according to the so-called three-tier system. The idea is that brewers and distillers, the first tier, have to distribute their product through independent wholesalers, the second tier. And wholesalers, in turn, have to sell only to retailers, the third tier, and not directly to the public. By deliberately hindering economies of scale and protecting middlemen in the booze business, America's system of regulation was designed to be **willfully inefficient**, thereby making the cost of producing, distributing, and retailing alcohol higher than it would otherwise be and checking the political power of the industry.

CHANGE IS COMING

- For eighty years, the kind of vertical integration seen in pre-Prohibition America has not existed in the U.S. But now, that's beginning to change. The careful balance that has governed liquor laws in the U.S. since the repeal of Prohibition is under assault in ways few Americans are remotely aware of.
- Over the last few years, two giant companies-Anheuser-Busch InBev and MillerCoors, which together control 80 percent of beer sales in the United States-have been working, along with giant retailers, led by Costco, to undermine the existing system in the name of efficiency and low prices. If they succeed, America's alcohol market will begin to look a lot more like England's.

MICHIGAN

- One state currently considering deregulation, Michigan, has good control of the industry. Michigan's system of regulations has succeeded in helping reduce problems related to alcohol use.
- Since 1997, underage drinking has declined significantly as measured by the Michigan Youth Risk Behavior Survey.
- The number of Michigan teens who had used alcohol was 68.8 percent in 2009, down from 81.9 percent in 1997 and below the national average of 72.5 percent.
- Alcohol use before the age of 13 was 18.8 percent in 2009, down from 34.9 percent in 1997, and lower than the national average of 21.1 percent.
- Binge drinking among teens affected 23.2 percent of them in 2009, down from 32.4 percent in 1997 and below the national average of 24.2 percent.
- With statistics like these, why would Michigan want to change its approach with legislation that would diminish verification requirements for alcohol license applicants, increase the number of resort liquor licenses and allow beer to be shipped directly to consumers? Why would any state?

WASHINGTON STATE

- Privatized in 2012 as a result of a statewide referendum led by Costco who contributed roughly \$25 million to the winning campaign.
- Legislation greatly favored volume sellers. This means small retailers are driven out of the market place over time.
- Prices rose 11 to 25%.
- Border sales increased 35 to 60%.
- Outlets went from 329 to 1500. Hardware stores can sell alcohol.

Washington...continued.

- Not surprisingly volume went up as consumers traded to the cheaper brands and larger bottles.
- This becomes a race to the bottom by small outlets in order to compete.
- Grocery stores will sell alcohol at cost in order to bring in customers to buy bread.
- This was the Great Britain model now being copied by Wal-mart.
- 9/16/13 WSJ article--"We have been continuing to move prices lower," on alcohol, the company's U.S. chief William Simon told an investor conference last week, "and seeing returns in the form of market share gains."
- While beer was being sold almost at cost, products like bottles of Coca-Cola or Quaker Quick Oats were being marked up by 30% or more, Bloomberg reports.
- Wal-Mart's push into beer is part of a plan to double alcohol sales by 2016 and seize a larger slice of a U.S. beer market worth about \$45 billion. While founder Sam Walton frowned on drinking to excess, selling cheap suds is a way to lure shoppers who typically buy other products at the same time.

Washington...continued

- The average of 17 independent studies on the impact of privatization on consumption showed an increase of more than 40 percent in sales of privatized alcoholic beverages.
- Teen drinking and shoplifting have increased significantly. Why?
- High school students interviewed for The Olympian investigation said it's easy to steal bottles of hard liquor from grocery stores, because "you're not an automatic suspect when you walk in a grocery store."
- Individual stores reported losing as much as \$30,000 to \$50,000 in the first 3 months of privatization.

It Just Doesn't Add Up

- Privatization is bad for state coffers.
- You get less tax revenue and more problems associated with increased drinking.
- Increased prices means you will lose sales to border states but those problems you get to keep.
- You trade a government monopoly for a private one where the government and its citizens have less influence when problems arise (and they will).

It Just Doesn't Add Up...continued

- A Washington Post study showed that every state that has tried this experiment immediately lost money.
- Iowa---In fiscal year 1986, the last full year before privatization, \$71.6 million was sent to the state after expenses, according to , a spokeswoman for the Iowa Alcoholic Beverages Division relying on prior year's records. In fiscal year 1988, the first full year after privatization, \$46.3 million was sent to the state. It took Iowa until 2004 to reach pre-privatization levels.
- In West Virginia, during fiscal year 1990, the last full year before privatization, \$9.7 million was sent to the state after expenses, according to a spokeswoman for West Virginia Department of Revenue relying on prior year's records. In fiscal year 1992, the first full year after privatization, \$6.6 million was sent to the state.

It Just Doesn't Add Up...continued

- Maine, which leased out its wholesale operation to help close a \$1 billion shortfall in the \$5 billion budget, received \$125 million upfront, but continues to collect less money each year than it would have had it stayed in the business.
- The state receives about \$6 million a year, officials said. It was receiving \$28 million to \$30 million each year before privatization
- Auctions? Iowa and West Virginia, the only two states that have fully privatized their retail stores in the last two decades, each made less than \$20 million upfront when they privatized.

Suggestions?

- Focus on modernizing control states when/if necessary.
- Give the customer a better experience with more choice, convenience, knowledgeable staff, and attractive stores.
- Beware of allowing private label spirits as this tends to undermine market prices and impact state revenues.
- Beware of the big box stores.
- If grocery stores are to sell beer, wine and spirits, mandate a separate entrance or a store within a store.
- Never allow retailers to sell at or below cost.
- Remember that auctions do not work.
- Never sell off the wholesale operation.