Insight

Privatizing the Liquor Market

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Economic theory and two century's worth of observation tell us that the government cannot run a business nearly as effectively as a private owner, yet this inefficiency is used as a selling point by politicians defending the continued existence of state-run liquor stores.

Eighteen states still maintain some form of government monopoly over the sale of alcohol, for the ostensible reason that having government in charge makes it easier to deter drinking than if it were left in the hands of the big bad private market. However, there are signs that this club may lose a few members: Residents of Washington State will vote next Tuesday whether to privatize its wholesale and retail liquor market, the Pennsylvania legislature is currently debating its own liquor privatization initiative, and Virginia's Governor Bob McDonnell may rekindle the debate in Virginia in 2012.

It is far past time we got rid of this antiquated system: a private market would give consumers better service, price competition and easier retail access while government could still deter alcohol abuse via taxes and sensible regulation.

1) Avoiding government-induced inefficiency.

The experience of states with government-operated liquor stores and distribution outlets demonstrates the myriad problems with government-operated businesses. In a competitive market, liquor retailers and distributors have an incentive to operate efficiently and keep costs low, whereas government monopolies face no such incentive. This inefficiency comes at a high price to consumers and taxpayers.

The Pennsylvania Liquor Control Board (PLCB) provides a striking example of the inefficiency of government liquor monopoly. The PLCB is the exclusive wholesaler and retailer of wine and spirits in Pennsylvania. It has trouble managing both operations (which are separate for no good reason), according to a recent audit report. In 2010, the PLCB's new $66 million Enterprise Resource Planning System led to widespread inventory

shortages and hoarding in retail stores. To compensate, the PLCB overrode the system and ordered over one million cases of excess inventory. Unable to reduce the inflow of alcohol into distribution centers, the PLCB instead ordered $500,000 worth of trailers without temperature controls to handle thousands of extra cases. Cases of wine and champagne sizzled in 100 degree heat. The Washington State Liquor Control Board has also suffered from liquor mismanagement. Miscalculations on the part of its state-run distribution center led to liquor shortages in 2009 and overpayments to trucking companies in 2010.

Pennsylvania's inventory management fiasco offers just one example of its inefficiently operated alcohol market. According to the Commonwealth Foundation, a Pennsylvania think tank, the PLCB spends $90,000 per store in advertising at the same time that it is also ostensibly "discouraging" alcohol consumption.

The contradictory nature of advertising alcohol while also trying to control alcohol consumption shows the hypocrisy of state alcohol monopolies. State legislators rail against alcohol abuse while gladly spending the proceeds from alcohol sales and setting higher and higher revenue goals. State liquor officials tout alcohol abuse programs while writing proud press releases about sales records, a special promotion, or a store opening. Nevertheless, the Commonwealth Foundation notes that 45 percent of residents in Philadelphia and surrounding counties illegally purchase alcohol outside of the state. And who can blame them? Average wine prices are lower in all six border states, while average spirit prices are lower in three of its six border states.

2) Reducing alcohol consumption.

Evidence continues to accumulate that restricting alcohol distribution through government monopoly does not decrease alcohol abuse.

Opponents of liquor privatization maintain that state-run liquor stores discourage liquor consumption by making alcohol less available while effectively restricting distribution to minors. The Centers for Disease Control and Prevention's Task Force on Community Prevention Services advises against the privatization of alcohol sales, explaining that privatization tends to increase the number of outlets, as well as days and hours of sale, and increases per capita alcohol consumption.

Apparently, the CDC does not consider beer or wine to be intoxicating; most state alcohol control board stores control only hard liquor, and where there are fewer hard alcohol stores there tend to be more stores selling beer and wine. Hard liquor, even after adjusting for alcohol content, only accounts for about 30 percent of all pure alcohol consumed. During Virginia privatization hearings, it became clear that while monopoly states have fewer hard

liquor outlets, the total number of alcohol outlets in those states is actually higher. Thus, the monopoly states seeking to control alcohol consumption don't actually control much of anything. To the extent that availability matters, states that regulate private markets do a better job of controlling alcohol availability.

Not surprisingly, recent studies and evidence from states that have privatized their liquor sales indicate no negative impact. Antony Davies and John Pulito conducted comprehensive studies in which they ranked states according to their degree of control over alcohol. They found no relationship between state control over the alcohol market and underage drinking, and actually found that the states with the most stringent controls had DUI fatality rates that significantly exceeded those in states with less stringent controls. Matthew Brouillette, president of the Commonwealth Foundation, testified that New Jersey has two-thirds the population of Pennsylvania and three times the number of liquor stores but one-third the number of alcohol related traffic fatalities.

Washington State has over 20,000 residents per liquor store, as compared to a national average of fewer than 4,500. The inconvenience and hassle factor that comes from having fewer stores does not produce any quantifiable societal benefits.

Geoffrey Segal and Geoffrey Underwood show in a study for the Reason Foundation that deregulation in Iowa and West Virginia did not lead to increased alcohol consumption, underage drinking, or drinking and driving. Privatization increased the number of outlets, but decreased the number of products sold per outlet; purchases of alcohol simply became distributed over a greater number of stores.

The reality is that discouraging alcohol consumption is a separate issue from privatizing the sale of liquor. States that want to decrease alcohol consumption should simply raise the price of alcohol by increasing taxes. Furthermore, increasing the penalties for distribution to minors or for driving under the influence provides the most effective alcohol abuse deterrent, and Washington's privatization bill does double the penalties for distribution to minors. By privatizing liquor stores, the Washington Liquor Control Board can direct resources away from management (or mismanagement) and instead concentrate on enforcement of liquor distribution laws.

3) Generating state revenue.

Defenders of the state monopoly over the liquor business argue that government markup and state alcohol taxes raise revenue for the state. Yet privatizing liquor distribution and sales would allow states to collect alcohol and sales taxes without incurring the expense of operating their own stores and paying

government employees. In addition, it would generate added funds through the auctioning of existing stores and distribution centers, the sale of liquor licenses and inventory, and the collection of additional business income tax and real estate tax revenue. Since the private sector can operate liquor stores efficiently and profitably, the government can sell retail liquor licenses at a price that reflects the profits the private sector could derive.

Washington State's Office of Financial Management estimates that the privatization initiative would increase local government revenue between $186 and $227 million and increase state revenue between $216 and $253 million over six years, without accounting for the additional revenue that the state would gain by selling its 166 existing state liquor stores.

Privatizing liquor stores doesn't prevent states intent on keeping prices high from imposing large taxes. Privatization raises money for the state, reduces government-induced waste, and makes these taxes transparent rather than swallowing them under "government markup."

Increasing government inefficiency is never the answer to any problem. If we wanted to deter smoking, for example, we could require all cigarettes to be bought from one sole shack in North Dakota. We don't because people will smoke regardless of our admonitions and the inconvenience imposed—they just won't buy cigarettes from the government. The same rationale applies to alcohol.

Prohibition ended in 1933, but the quest to mismanage alcohol sale and distribution did not. It has been 78 years. It's time for government to get out of the liquor business.

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