



*Who should sell hard liquor in the Fifth District — state-run monopolies or private companies?*

# Liquid Assets

BY KARL RHODES

When George Griffin was named acting director of the Department of Liquor Control in Montgomery County, Md., he received some advice from a long-time veteran of county government.

“Our director of management and budget told me ... that this is not a difficult job if you stay focused,” Griffin recalls. “Just remember that you only have two primary goals: One is to promote temperance and the other is to increase revenue.”

When it comes to the sale of alcohol, Montgomery County is a control jurisdiction — a state or local government that exercises monopoly ownership of distilled spirits either at the wholesale or retail level, and quite often both. Montgomery County, for example, has a complete monopoly over the sale of liquor, and it is the only locality in the nation that also controls the wholesale distribution of beer and wine. All other control jurisdictions leave beer and wine

sales to private companies that they license and regulate.

A control jurisdiction is “sort of a schizophrenic system,” Griffin says. “The government, in an effort to control, is actually selling alcoholic beverages to the public for a profit. On the other hand, it shows the balance that we try to reach ... offering a legal product to the public and at the same time ensuring that it’s done so in a way that doesn’t encourage risky consumption or unlawful behavior.”

The entire spectrum of alcohol regulation and control is represented in the Fifth District. Virginia and North Carolina are strict control states, while South Carolina and Washington, D.C., are among the most open jurisdictions in the nation. West Virginia franchises its retail operations to private companies, but it maintains control at the wholesale level. Maryland varies by locality.

Each of these systems traces its roots back to Prohibition. In 1933, after

Prohibition was repealed, the federal government turned the regulation of alcohol sales over to the states. Most people were glad that Prohibition was over, but they did not want to return to the proliferation of saloons they had witnessed before Prohibition.

“It was not uncommon to find one saloon for every 150 to 200 Americans, including those who did not drink,” writes K. Austin Kerr, a historian at Ohio State University. “Hard pressed to earn profits, saloonkeepers sometimes introduced vices such as gambling and prostitution into their establishments.”

To prevent that from happening again, the states devised various ways to regulate the sale of liquor. Eighteen “control states” established government-run monopolies to distribute liquor at the wholesale level, and the vast majority of these states also controlled retail liquor sales. Meanwhile, “open states” allowed private vendors to own and operate liquor stores and wholesale

## Public Spirited

### State and local revenues from liquor sales

State	Revenue (000)	Population (000)	Revenue Per Capita	Regulatory Status
District of Columbia	\$25,293	572	\$44.22	Open
Maryland	37,104	5,296	7.01	Mixed <sup>a</sup>
North Carolina	168,676	8,049	20.96	Control
South Carolina	82,164	4,012	20.48	Open
Virginia	139,449	7,079	19.70	Control
West Virginia	15,716	1,808	8.69	Control <sup>b</sup>
Control States Total*	\$1,821,345	78,958	\$23.07	Control
Open States Total*	\$2,794,769	202,464	\$13.80	Open
United States Total	\$4,616,115	281,422	\$16.40	Mixed

<sup>a</sup>Maryland has both open and control jurisdictions.

<sup>b</sup>West Virginia privatized its stores in 1991, but continues to control wholesale distribution.

\*Numbers adjusted for Montgomery County, a large control county in a mostly open state.

SOURCES: Distilled Spirits Council of the United States (2000) and the U.S. Census Bureau (2000)

operations as long as they obtained licenses and followed the rules.

No state has ever fully converted from a control state to an open state, but in 1991 West Virginia took a step in that direction by privatizing its retail liquor stores. Similar retail conversions have been considered recently in Virginia and North Carolina.

"It's an issue that comes up periodically," Griffin says. "It particularly comes up when there are difficult fiscal times. ... People are looking for revenue sources, even if it may be just a one-time infusion. ... If you can sell something off and bring in some money, somebody will put it on the table."

That's what happened during the recession of the early 1990s, when most control states switched to bailment warehouse systems that require distillers to maintain ownership of liquor inventories until the spirits leave state-owned warehouses. In essence, states generated one-time infusions of cash by selling off their wholesale inventories. They also created new revenue streams by forcing distillers to pay bailment fees to store required inventories in state warehouses. This was a bitter pill for distillers to swallow, and it significantly increased the control states' financial incentive to maintain their monopolies at the wholesale level. But maintaining control at the wholesale level is not as controversial as maintaining control at the retail level, where states sell liquor directly to consumers.

A proposal to sell Virginia's liquor stores to private operators died in last year's General Assembly, but the bill's patron, Delegate Allen L. Louderback, plans to reintroduce the legislation in next year's session.

"I don't really think we should be in the business of selling alcohol, and we're turning around and having to figure out ways to help people break their alcohol addiction," says Louderback, a Republican from Luray. "We're sending a mixed message to the public. ... I don't believe that the government needs to be in the business of running retail operations of *any* type."

Members of the General Assembly were reluctant to privatize Virginia's state-run stores last year because they "were convinced that they were going to lose all this profit," Louderback says.

"I don't think they fully understood that the profit could still be there regardless of whether we were running the stores or not."

The Virginia Department of Alcoholic Beverage Control (ABC) turned a profit of \$46.2 million last year — not counting the state's excise and sales taxes on alcohol, which generated three times again that amount.

Louderback wants to franchise the state's 271 ABC stores to the private sector in phases over five years, and he wants to limit franchise ownership to five stores for any one person or corporation. "I don't want a private monopoly any more than I want a government monopoly," he explains.

Vernon M. Danielsen, chairman of the Virginia ABC, bristles at the suggestion that small private retailers would be more efficient than his state-run monopoly. "I have 271 stores," he says. "My overhead ... to control those ... is a substantial economy of scale. And I come from the private sector. ... I think I can run ABC with the staff that we have ... as profitably as it can be run. ... And that means that all of that [profit] goes to the state."

Monopoly profit is one of two primary advantages of a control system, Danielsen says. "The other side of it is that, in a state-owned store, our employees are a whole lot more careful about who they sell to."

Virginia's underage enforcement program employs kids in their late teens who attempt to purchase alcohol at ABC stores and at licensed establishments that

## Public Consumption

### Gallons of liquor purchased in the Fifth District

State	Gallons (000)	Population (000)	Gallons Per Capita	Regulatory Status
District of Columbia	1,687	572	2.95	Open
Maryland	7,670	5,296	1.45	Mixed <sup>a</sup>
North Carolina	8,145	8,049	1.01	Control
South Carolina	5,707	4,012	1.42	Open
Virginia	6,831	7,079	0.96	Control
West Virginia	1,367	1,808	0.76	Control <sup>b</sup>
Fifth District Total	31,407	26,816	1.17	Mixed
United States Total	352,983	281,422	1.25	Mixed

<sup>a</sup>Maryland has both open and control jurisdictions.

<sup>b</sup>West Virginia privatized its stores in 1991, but continues to control wholesale distribution.

SOURCES: Distilled Spirits Council of the United States (2000) and the U.S. Census Bureau (2000)

sell or serve beer, wine, or liquor by the drink. "At a [state-owned] ABC store, we are at least three times better than in the other stores," Danielsen says. "In an ABC store, we're between 5 and 10 percent noncompliance. At the [licensed establishments] we are at 25 to 26 percent noncompliance." Licensed establishments include restaurants, bars, and clubs that sell alcohol by the drink and stores that sell beer and wine for off-premise consumption.

Louderback counters that privatizing the liquor stores would allow Virginia ABC to focus on enforcement. "It might be better that we're not watching our own operation," he suggests. "It might even be tighter than the existing situation because ... if someone messes up and loses their franchise, they could lose a lot of money."

The market value of the proposed franchises is another point of disagreement. Louderback predicts that Virginia's existing stores would bring in about \$500 million. But Danielsen says that estimate is on the high side

— even if Virginia ABC eased restrictions on advertising, product mix, hours of operation, and store appearance. And Louderback doesn't want to relax those rules.

"As with McDonald's or Burger King or any other franchise, you can set the guidelines... whether it's employee dress or the appearance of the store or the cleanliness of the store," Louderback says. "If they don't meet those guidelines, they could lose their franchise. I think that's a pretty big incentive to maintain a quality operation."

Maybe so, says Danielsen, but "the more restrictions you put on it — and the restrictions bring it closer to the way it's operated now — the less valuable it is."

**W**est Virginia can shine some light on the hypothetical debate in Virginia. The Mountain State franchised its 155 liquor stores to private retailers in 1991 on 10-year contracts that generated \$22 million.

The market for store-bought spirits is about five times larger in Virginia than



it is in West Virginia, so a valuation based solely on sales would put the price of Virginia's stores at about \$110 million. But Virginia's population is growing while West Virginia's population is shrinking, and Virginia's stores are highly profitable, while several of West Virginia's stores were struggling in 1991.

"West Virginia had some problems with its retail operation," Danielsen says. "It was not very efficient, and it was not making much money."

Keith Wagner, deputy commissioner of the West Virginia Alcoholic Beverage Control Administration, also acknowledges that West Virginia underpriced some of its franchises in 1991. "In the original bidding, there was no [minimum] price attached," he says. "We sold franchises for \$100, if that was the highest bid. ... One of our biggest franchises — in Parkersburg — was originally sold, I think, for \$500."

When West Virginia re-bid the franchises in 2000, the state put a minimum price on each territory based on its average sales during the previous 10 years. Franchisees had to win new competitive bids to retain their 10-year contracts to operate liquor stores in their territories. "We gave preferential treatment to those who had already held franchises," Wagner says, but franchisees like the one in Parkersburg had to pony up. Those gains, however, were offset by lower prices for franchises in regions where the population had declined, and West Virginia again netted \$22 million for the 10-year contracts.

"Since then, we've had two or three bidding periods because we didn't sell

## What About Beer and Wine?

While the regulation of liquor varies dramatically throughout the Fifth District, the regulation of beer and wine is very similar.

In control states and open states alike, beer and wine are widely available for off-premise consumption at private retailers that maintain alcohol licenses. States also license restaurants, bars, clubs, and other establishments that sell beer, wine, and liquor by the drink.

"As a general rule, there is a great disparity between what beer and wine [retailers] are allowed to do...and what distilled spirits [retailers] are allowed to do," says Dave Holliday, vice president for state government relations at the Distilled Spirits Council of the United States (DISCUS). "There is a great gap between what distilled spirits taxes are and what beer and wine taxes are."

Holliday also notes a huge difference in availability—particularly in control states, where there are only a few hundred off-premise outlets for distilled spirits, compared to thousands of off-premise stores for beer and wine. "What we work on a lot is trying to level the playing field so that beer and wine don't have such a pronounced market advantage against spirits," he says.

Control state officials argue that tighter liquor restrictions are necessary because spirits are far more potent than beer and wine. "That's the reasoning, but it's wrong," Holliday says. He notes that the standard servings of beer (12 ounces), wine (5 ounces), and liquor (1.5 ounces) contain the same amount of alcohol. And according to DISCUS numbers for 2000, residents of the Fifth District consumed nearly 20 times more beer and wine than liquor.

Per capita consumption of beer and wine are somewhat higher in Washington, D.C., and South Carolina, where alcohol-related traffic deaths are higher, but the correlation is not as dramatic with beer and wine as it is with distilled spirits.

Two bartenders interviewed for this story contend that distilled spirits *do* tend to be more dangerous than beer and wine. They note that a standard serving of beer fills up drinkers more than a typical mixed drink or glass of wine. They also note that beer and wine are more often consumed with food.

They agree with the immortal words of Redd Foxx: "Wine is fine, but liquor is quicker."

—KARL RHODES

all the stores, and we're getting ready to have another one for the remaining 14 franchises," Wagner says. That bidding period probably will dispose of five or six more stores, he predicts.

Wal-Mart has expressed an interest in bidding this time. Unlike many states, chain stores are allowed to sell liquor in West Virginia. In fact, Rite Aid is by far the largest franchisee in the state with 45 stores, the most allowed by law. Other major franchisees include Pharmor and Big Bear Super Markets.

West Virginia has not increased its enforcement efforts, and Wagner says it hasn't been necessary. "In the past 12 years that they've been out there, you can count on one hand the number of violations for underage sales," he insists. "Most of our retail operators have invested a lot of money in this business ... and they realize that they could lose their license."

Overall, Wagner believes West Virginia has come out slightly ahead by privatizing its stores. Generating \$22 million every 10 years has more than made up for agency profits that are about \$1 million less per year than they were in 1989.

Also, by selling the stores, the state was able to eliminate 500 government jobs, Wagner says. "Of course, the politicians would like to have those jobs back — those patronage jobs at the liquor stores — but I think they realize that this has been good for the private sector."

**A**dozen years after privatization, West Virginia doesn't seem to have a drinking problem. In fact, its residents consume less liquor (0.76 gallons per capita in 2000) than any other state population in the Fifth District, according to the Distilled Spirits Council of the United States Inc. (DISCUS).

ABC officials in other states suggest that moonshine keeps that number down, but the black market for white lightning doesn't seem to have a major impact on the state's highway safety statistics. In 2001, West Virginia had 0.68 alcohol-related traffic fatalities for every 100 million miles traveled, according to the National Highway Traffic Safety Administration. That's not quite as good as Virginia (0.46),

Maryland (0.56), or North Carolina (0.58), but it's significantly better than the open jurisdictions of Washington, D.C. (1.01) and South Carolina (1.27).

South Carolina's fatality rate is the worst in the nation. Consumption of distilled spirits in the Palmetto State was 1.42 gallons per capita in 2000, which was significantly above the national average of 1.25 gallons, according to DISCUS. South Carolina has three times as many liquor stores per capita than the Fifth District average, and there are relatively few restrictions on how these stores advertise spirits.

through the legislature, and signs are that it will," Brazell says. "Then it would go back to the legislature for ratification in 2005."

Although South Carolina has the most alcohol-related traffic fatalities in the nation, on a per capita basis, that statistic is improving. In fact, the fatality rate has declined significantly in all 50 states since 1982, improvements that corresponded with laws that raised the legal drinking age to 21. But while the national fatality rate fell 62 percent, Washington, D.C.'s rate jumped 63 percent.

Maria Delaney, director of the Dis-

## Yo, Ho, Ho, and a Revenue Flow!

Who gets what from a bottle of rum?

State	Retail Price <sup>a</sup>	State & Local Revenue <sup>b</sup>	Federal Revenue	Private Sector Revenue <sup>c</sup>	Regulatory Status
District of Columbia	\$10.79	\$1.23	\$2.15	\$7.40	Open
Maryland	10.49	1.00	2.15	7.33	Mixed <sup>d</sup>
North Carolina	10.95	3.39	2.15	5.41	Control
South Carolina	11.55	1.70	2.15	7.70	Open
Virginia	11.44	4.25	2.15	5.04	Control
West Virginia	11.09	2.64	2.15	6.29	Control <sup>e</sup>
Control States Average	\$11.25	\$4.08	\$2.15	\$5.02	Control
Open States Average	\$11.57	\$1.58	\$2.15	\$7.83	Open
National Average	\$11.49	\$2.19	\$2.15	\$7.15	Mixed

<sup>a</sup>Price and tax rates are for a 750-milliliter bottle of 80-proof rum.

<sup>b</sup>Includes state and local taxes in each state plus wholesale and retail markups in control states.

<sup>c</sup>Includes indirect taxes paid by the private retailers and wholesalers.

<sup>d</sup>Maryland has both open and control jurisdictions.

<sup>e</sup>West Virginia privatized its stores in 1991, but continues to control wholesale distribution.

SOURCE: Distilled Spirits Council of the United States, Bottle Tax Burdens (2001)

Another possible factor is the state's use of mini-bottles to serve liquor by the drink. South Carolina is the only state in the nation that requires bars and restaurants to pour distilled spirits from mini-bottles, says Danny Brazell, public affairs director for the South Carolina Department of Revenue.

"One of the reasons why some groups are looking to change the law is because they think that when [liquor] is served this way, the consumer is more apt to drink too much," Brazell says. A mini-bottle holds 1.7 ounces of spirits, while a standard shot contains 1.5 ounces.

Changing the law would require an amendment to the state constitution, which must be approved by voters. The earliest possible referendum date "would be November 2004, if this gets

the Alcoholic Beverage Regulation Administration, declined to speculate on why D.C.'s fatality rate has gone from the best in the nation in 1982 to one of the worst in 2001.

Delaney has been on the job just a few months, but she is bringing enforcement ideas to D.C. from her previous experience in Connecticut. Starting a program of routine compliance checks such as those employed in other Fifth District states is high on her list of priorities.

The first step, Delaney says, is to educate and train the people who serve and sell alcohol in the District. In a series of seminars, Delaney plans to put the private operators on notice by saying: "Hey! We're going to be starting these [compliance checks]. This is what

## On Every Corner?

### Liquor stores in the Fifth District

State	Stores <sup>a</sup>	Population <sup>b</sup>	Population Per Store	Regulatory Status
District of Columbia	266	570,898	2,146	Open
Maryland	1,057*	5,458,137	5,164	Mixed <sup>c</sup>
North Carolina	389	8,320,146	21,389	Control
South Carolina	872	4,107,183	4,710	Open
Virginia	271	7,293,542	26,913	Control
West Virginia	155	1,801,873	11,625	Control <sup>d</sup>
Fifth District	1,953	27,551,779	14,107	Mixed

<sup>a</sup>Total number of liquor stores, including stores that sell other things, as of March 2003

<sup>b</sup>U.S. Census Bureau estimate for July 1, 2002

<sup>c</sup>Maryland has both open and control jurisdictions.

<sup>d</sup>West Virginia privatized its stores in 1991, but continues to control wholesale distribution.

\*In addition to this 2001 number, some localities in Maryland allow an undetermined number of beer and wine licensees to sell liquor for off-premise consumption.

SOURCE: Alcohol regulation agencies in each state

you need to do. You need to *card* people. You can't rely on your scanning devices. You can't rely on a young kid who you pay \$2 an hour."

Stopping underage drinking will be a new priority for Delaney and her 11 investigators, but "eminent danger" investigations will continue to be critically important, she says. "If there's a shooting at a location, and the board deems that there is an eminent danger to the public ... they will do a summary suspension and actually close the place down until the next hearing date," Delaney explains. At the hearing, the board will weigh evidence and testimony and decide on whether or not to revoke the establishment's liquor license.

**I**n the eyes of many control-state officials, Washington, D.C., is the poster child for the ills of open jurisdictions. The District has one liquor store for every 2,146 residents. In sharp contrast, Virginia has one liquor store for every 26,913 residents.

"There are a lot of stores in the District, and I think they've been very liberal with their zoning laws and their licensing laws on the size of the stores," says Griffin, the liquor control director in Montgomery County, Md. "You get a lot of pint stores and that type of thing."

The high number of liquor stores, coupled with extensive newspaper advertising, contributed to the District's consumption of 2.95 gallons of distilled spirits per capita in 2000.

That's three times the average consumption for the control states of Virginia and North Carolina, according to DISCUS numbers.

"I don't think 'consumption' is the right word," says Delaney, who notes that many commuters who work in D.C. buy liquor there and drink it at home in Virginia or in Maryland. The District also attracts many tourists who purchase alcohol but do not show up in population numbers.

All of those factors combined to produce \$44 of revenue per capita from the sale of distilled spirits in D.C. in 2000. That's more than twice the per capita revenue generated by any other state in the Fifth District, according to DISCUS. But the money comes with ominous strings attached.

"For every percent increase in average consumption, there are corresponding increases in alcoholism, sclerosis of the liver, DUI, and fetal alcohol syndrome," warns Danielsen at the Virginia ABC.

D.C.'s high revenue per capita is not the norm in other open jurisdictions. Nationally, revenue in open states averages \$13.80 per capita, compared to \$23.07 per capita in control states, according to DISCUS. In the Fifth District, Maryland's revenue is just \$7.01 per capita, and it would be even lower if it weren't for the profits generated by Montgomery County, a control jurisdiction.

Montgomery County produces far

more revenue from alcohol sales than any other locality in Maryland, but Griffin hasn't forgotten the temperance side of his control conundrum. He notes that the county also has lower per capita consumption of distilled spirits (0.80 gallons) than any other locality in Maryland. As for underage drinking, he says the compliance rate at the county-owned liquor stores is 98 percent, and the compliance rate at the licensed establishments is about 85 percent.

Griffin is proud of Montgomery County's overall performance, but he believes there is room for improvement, both in his county and across the country.

"I don't think we've ever fully arrived at a comfortable public policy approach to alcohol," he says. "At different times we've had virtually no rules, when anyone could buy whatever they wanted whenever they wanted. And then, at other times, we've gone so far as to actually have national prohibition. ... Both approaches were abject failures."

Seventy years after the repeal of Prohibition, the solution lies somewhere between, he says. "We're trying to strike that balance for the public." **RF**

#### READINGS

Distilled Spirits Council of the United States. "Summary of State Laws and Regulations Relating to Distilled Spirits," January 2002.

Pacific Institute for Research & Evaluation. "The Effects of Privatization of Alcohol Control Systems: A Summary of Research on the Impact of Privatization on Alcohol Consumption and Problems," 2000.

Wagenaar, A. C., and H. D. Holder. "Changes in Alcohol Consumption Resulting From the Elimination of Retail Wine Monopolies." *Journal of Studies on Alcohol*, 1995, vol. 56, no. 5, pp. 566-572.

West, Douglas S. "The Privatization of Liquor Retailing in Alberta." Report to the Centre for the Study of State and Market, University of Toronto, June 21, 1996.

Visit [www.rich.frb.org/pubs/regionfocus](http://www.rich.frb.org/pubs/regionfocus) for links to relevant sites.