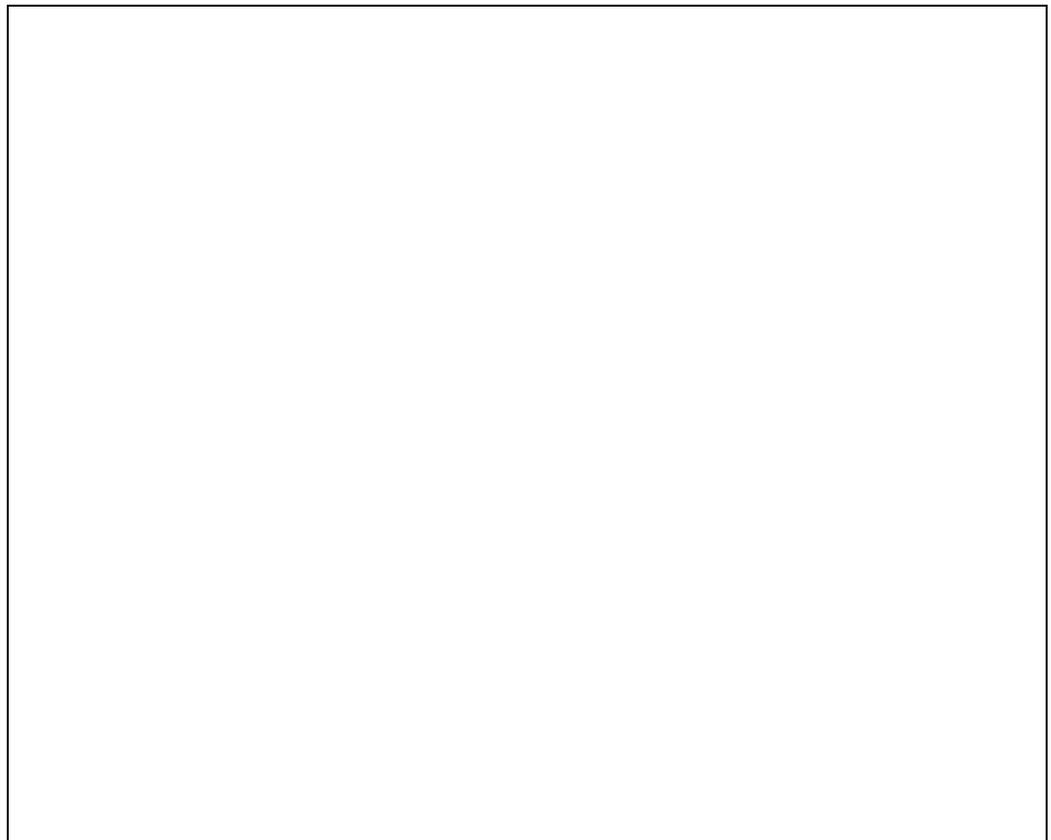




OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

EVALUATION REPORT

Liquor Regulation



MARCH 2006

PROGRAM EVALUATION DIVISION
Centennial Building – Suite 140
658 Cedar Street – St. Paul, MN 55155
Telephone: 651-296-4708 • Fax: 651-296-4712
E-mail: auditor@state.mn.us • Web site: <http://www.auditor.leg.state.mn.us>

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Evaluation Staff

James Nobles, *Legislative Auditor*

Joel Alter
Valerie Bombach
David Chein
Jody Hauer
Adrienne Howard
Daniel Jacobson
Deborah Junod
Carrie Meyerhoff
John Patterson
Judith Randall
Jan Sandberg
Jo Vos
John Yunker

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E-mail: auditor@state.mn.us

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

March 2006

Members of the Legislative Audit Commission:

Minnesota's liquor laws have been controversial in recent years. Some people have suggested that Minnesota consumers pay a significant price for the state's restrictions on retail and wholesale competition in the liquor industry. Others maintain that prices in Minnesota are competitive with other states and current state laws help control excessive consumption of alcoholic beverages.

The Legislative Audit Commission directed the Office of the Legislative Auditor to examine the competitiveness of the state's liquor industry and the impact that fewer restrictions would have on alcohol abuse and public safety.

We found that good information on liquor prices across states is not readily available, and few studies have examined the link between state regulatory provisions and liquor prices. In addition, research does not clearly answer many questions about the relationship between regulations on the liquor industry and alcohol abuse.

We surveyed off-sale liquor prices in Minnesota and Wisconsin and concluded that Minnesota consumers would benefit from fewer restrictions on retail competition. Additional consumer savings may be possible by changing state laws regulating beer and wine wholesalers. However, policymakers will want to weigh the benefits of lower prices and improved convenience against the potential for increased alcohol abuse and negative impacts on municipal liquor stores.

This report was researched and written by John Yunker (project manager) and Jan Sandberg. We appreciate the cooperation we received from the many retailers we visited in both Minnesota and Wisconsin. In addition, we thank the wholesalers and others who provided us with information during this study.

Sincerely,

A handwritten signature in black ink that reads "Jim Nobles".

James Nobles
Legislative Auditor

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Report Summary

For a number of years, legislation has been introduced in the Minnesota Legislature to allow the sale of wine in grocery stores. During the 2005 legislative session, the Minnesota Grocers Association presented a consultant's report on liquor prices. The report contended that Minnesotans pay substantially higher wine and spirits prices than residents of Wisconsin. The report blamed Minnesota laws for fostering a lack of competition in the wholesale and retail sectors of Minnesota's liquor industry. Liquor retailers and wholesalers disputed the report's findings about prices. They and others also raised concerns about increased problems with alcohol use that might result from greater retail availability of intoxicating beverages.

Minnesota laws generally restrict competition in the liquor industry.

As a result, the Legislative Audit Commission directed us to examine the competitiveness of the wholesale and retail sectors of Minnesota's liquor industry. This report examines the price differences between Minnesota and Wisconsin stores selling intoxicating beverages for off-premises consumption. The report also assesses whether Minnesota liquor laws are restricting competition and increasing consumer prices. Finally, the report considers the potential negative social impacts of encouraging alcohol use through lower prices and greater availability.

Minnesota restricts off-sale retail competition in the liquor business more than most states.

Minnesota does not allow most grocery, convenience, drug, or general merchandise stores to sell strong beer, wine, or spirits for off-premises consumption. Minnesota allows grocery and other non-liquor stores to sell only 3.2 beer and malt beverages.

State law also restricts the number of off-sale stores in Minneapolis, St. Paul, and Duluth.

In contrast, at least three-fourths of the states allow strong beer to be sold in grocery, convenience, and drug stores, and about two-thirds of the states allow wine to be sold in these types of stores. One-third of the states also allow spirits to be sold in grocery and convenience stores.

In addition, 226 Minnesota cities operated municipal liquor stores in 2004. These cities, representing close to 18 percent of the state's population, generally do not allow private off-sale liquor stores to operate within their boundaries. Overall, Minnesota ranked 9th highest among the 50 states in 2002 in revenues from government-operated retail stores and wholesale operations.

Even though Minnesotans consume about 9 percent more alcohol than the national average, state laws have restricted the number of off-sale liquor stores selling strong beer, wine, or spirits to well below the national average. Minnesota has fewer off-sale liquor outlets per adult than 40 other states and the District of Columbia. The number of off-sale outlets per adult is only about one-third of the national average.

Minnesota laws encourage competition among spirits wholesalers but restrict competition among beer and wine wholesalers.

In all states including Minnesota, each brewer assigns territories to beer wholesalers. Retailers purchasing a particular brewer's products may only obtain them from the one wholesaler who represents the brewer in that area. Similarly, in nearly all states, a vintner assigns territories to wine wholesalers, although one wholesaler will generally represent a vintner throughout most, if not all, of the state.

Introduction

In 1933, the 21st Amendment to the United States Constitution ended Prohibition and gave states broad authority to regulate the liquor industry. All 50 states adopted a three-tier system consisting of manufacturers, wholesalers, and retailers. Most states place restrictions on the involvement of manufacturers and wholesalers in the retailing tier of the industry. Some states also place restrictions on the involvement of manufacturers in the wholesale tier. The purpose of those restrictions is to prevent the encouragement of alcohol consumption that occurred prior to Prohibition when manufacturers could be involved in retail operations.

States have taken different paths in regulating the liquor industry, particularly the retail sector. In Minnesota, grocery, convenience, drug, and general merchandise stores are prohibited from selling strong beer, wine, and distilled spirits for off-premises consumption. These stores may only sell beer and other malt beverages that contain no more than 3.2 percent alcohol by weight. In contrast, about three-fourths of the states allow grocery, convenience, and drug stores to sell strong beer; and two-thirds of the states allow these stores to sell wine. About one-third of the states allow these stores to sell spirits to the public.

Minnesota also has a significant local government presence in the operation of liquor stores. In 2004, 226 cities, accounting for close to 18 percent of the state's population, owned and operated liquor stores. Most of those cities do not allow private off-sale liquor stores to operate within their city boundaries. Only five other states have liquor stores operated by local governments, although state governments in 11 states operate, or control the operations of, retail liquor stores.

Legislation to allow the sale of wine in grocery stores has been considered by the Minnesota Legislature for several years. In 2005, the Minnesota Grocers Association presented a consultant's report on liquor prices to the Legislature. The report contended that Minnesota consumers paid an additional \$444 million in 2004 due to state laws that foster a lack of competition in the wholesale and retail sectors of the liquor industry. As evidence, the report said the results of a price survey showed substantially higher prices for wine and spirits in Minnesota, compared with Wisconsin, where there are few restrictions on the type of stores that may sell alcoholic beverages.

As a result, the Legislative Audit Commission directed us to examine the competitiveness of the wholesale and retail sectors of the liquor industry in Minnesota. Legislators were specifically interested in evaluating the restrictions currently placed on the type of stores eligible to sell alcoholic beverages at the retail level. In addition, there was legislative interest in examining state laws governing the wholesale sector. Concerns were also raised about the detrimental impact that removing current restrictions could have on public safety by encouraging greater consumption of alcoholic beverages. This report addresses the following issues:

Background

SUMMARY

Minnesota restricts retail competition in the liquor business by prohibiting certain types of private businesses from selling intoxicating beverages for off-premises consumption. In addition, most of the 226 cities in Minnesota operating liquor stores do not allow any private off-sale competition within their boundaries. As a result, Minnesota has substantially fewer retail outlets per capita selling intoxicating beverages for off-premises consumption than most states.

Minnesota laws affecting the wholesale industry vary significantly for beer, wine, and distilled spirits. Minnesota laws encourage competition in the wholesaling of distilled spirits but restrict competition among beer or wine wholesalers.

All 50 states have chosen to have a three-tier system for the production, distribution, and retail sales of alcoholic beverages. But states differ in the particular ways in which they regulate the economic activities of producers, wholesalers, and retailers. This chapter examines the regulation of the liquor industry by Minnesota and other states. In particular, the chapter addresses the following questions:

- **What are the main ways in which Minnesota regulates the economic activities of businesses that produce, distribute, or sell alcoholic beverages?**
- **How does Minnesota's regulation of the liquor industry compare with that in other states?**

This chapter presents information on the key provisions of Minnesota laws and rules that impact competition in the liquor industry. Our focus is on those regulations that most affect the prices and availability of alcoholic beverages in Minnesota. We do not attempt to outline all the regulations affecting the liquor industry in Minnesota. When possible, we also provide comparative information on regulations in other states.

ALCOHOLIC BEVERAGES

Like most states, Minnesota state law defines an alcoholic beverage as any beverage containing more than one-half percent alcohol by volume.¹ There are three types of alcoholic beverages: malt liquor, wine, and distilled spirits. Malt liquor is any beer, ale, or beverage made from malt by fermentation. Wine is the product made from the alcoholic fermentation of grapes. Distilled spirits include ethyl alcohol, hydrated oxide of ethyl, and other products of distillation.

An alcoholic beverage contains more than one-half percent alcohol by volume.

¹ *Minnesota Statutes* 2005, 340A.101, subd. 2.

SUMMARY

Minnesota consumers pay higher retail beer and wine prices than Wisconsin consumers, but the difference in off-sale prices appears to be much less than previously reported. Minnesota's restrictions on retail competition are probably the main reason for its higher beer and wine prices. Despite these restrictions, retail prices for distilled spirits are generally lower in Minnesota than Wisconsin. Minnesota's prohibition on exclusive territories for spirits wholesalers is likely responsible for its lower spirits prices.

During the 2005 legislative session, questions were raised about the competitiveness of the liquor industry in Minnesota. Much of the discussion centered on a report that claimed that retail wine and spirits prices were significantly higher in Minnesota than Wisconsin. The report estimated that Minnesotans pay more than \$440 million extra each year because of Minnesota laws and other factors restricting competition in the retail and wholesaler sectors of the industry.¹ In this chapter, we examine the economic competitiveness of Minnesota's liquor industry. In particular, we address the following issues:

- **What evidence is there that retail prices in Minnesota are higher than in other states?**
- **What laws or other factors may explain any difference in prices?**

Because we found that no existing data source provides adequate data for interstate price comparisons, this chapter focuses on the results of a survey we conducted of beer, wine, and spirits prices in Minnesota and Wisconsin. We present the results of our survey and then consider the influence state laws may have on prices in Minnesota. We also present our observations about product availability in the two states and discuss the difficulties of making comparisons of product availability.

EXISTING SOURCES OF PRICE DATA

In examining the competitiveness of the liquor industry, it would be useful to have information on retail, wholesale, and manufacturers' prices of alcoholic beverages in Minnesota and other states. Retail price information would indicate how final prices to consumers vary across the nation. Information on wholesale and manufacturers' prices would help sort out the underlying sources of retail price differences. Unfortunately, price information on alcoholic beverages is generally not available or, if available, not sufficient for our purposes.

¹ American Economic Group, Inc., prepared for the Minnesota Grocers Association, *Impact of the Highly Regulated Wholesale and Retail Alcoholic Beverage Markets in Minnesota* (Washington, D.C., March 2005).

Legislators are interested in how liquor prices in Minnesota compare with those in other states.

