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OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Liquor Regulation

March 2006

Removing state restrictions on competition in the liquor industry would lower prices and improve convenience, but some adverse impacts are also possible.

Major Findings:

- Minnesota restricts retail competition in the liquor business more than most states. Minnesota prohibits most grocery, convenience, drug, and general merchandise stores from selling strong beer, wine, and spirits for off-premises consumption. In addition, most of the 226 cities with city-owned liquor stores have an off-sale monopoly on these products within their city boundaries.

- Minnesota's laws for beer and wine wholesalers are similar to those in other states. A retailer is generally able to purchase a manufacturer's brands from only one wholesaler.

- In contrast, Minnesota requires manufacturers of distilled spirits to sell their brands to any licensed wholesaler, which encourages strong price competition among spirits wholesalers.

- Adjusted for differences in taxes and dram shop insurance costs, off-sale beer prices are 7 to 9 percent higher in Minnesota compared with Wisconsin, where there are few state restrictions on retail competition.

- Similarly, adjusted wine prices are 5 to 7 percent higher in Minnesota than Wisconsin.

- However, adjusted prices for distilled spirits are 8 to 10 percent lower in Minnesota despite the state's more restrictive retail environment. The state's prohibition on the use of exclusive territories for the wholesale distribution of spirits is most likely responsible for Minnesota's lower off-sale retail prices.

- Overall, adopting less restrictive retail laws like those in Wisconsin could save Minnesota consumers about $100 million annually. But such law changes would negatively impact existing private liquor stores and jeopardize the $16 million in annual profits that municipal liquor stores currently provide for city services.

- In addition, some research suggests that adopting Wisconsin's retail laws might increase problems with alcohol abuse. But allowing grocery stores to sell wine would probably have significantly smaller economic and social impacts.

- While there would probably be significant price savings for consumers, banning exclusive territories for beer and wine distribution might limit product availability and reduce other consumer benefits.

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.

Spirits manufacturers also assign exclusive territories to wholesalers in most states. However, in Minnesota and Oklahoma, spirits manufacturers are required to sell to any licensed wholesaler. The prohibition on exclusive territories encourages competition by allowing retailers a choice of wholesalers.

Restrictions on retail competition result in higher beer and wine prices.

Minnesota state law also provides protection for beer wholesalers from being terminated by brewers. Franchise protection, combined with Minnesota's requirement for exclusive territories, may make it difficult for brewers to terminate inefficient wholesalers.

Off-sale prices for beer and wine are higher in Minnesota than in Wisconsin, but prices for distilled spirits are lower.

Comprehensive information on retail liquor prices across the United States is not available from any source. As a result, we conducted an in-store survey of prices in Minnesota and Wisconsin during a 10-day period in November 2005. Wisconsin was selected as a comparison state because of its less restrictive retail laws, as well as its proximity to Minnesota. We focused on prices of liquor sold for off-premises consumption because of the difficulties of making fair comparisons of on-sale prices.

However, distilled spirits prices are lower because state law encourages competition among spirits wholesalers.

The results of our price survey suggest that beer and wine prices are higher in Minnesota than in Wisconsin. But prices of distilled spirits are lower in Minnesota despite Minnesota's more restrictive retail laws. Including sales prices, beer prices were 9 percent higher in Minnesota than Wisconsin, after adjusting for differences in taxes and the cost of mandated dram shop insurance coverage. Similarly, Minnesota wine prices were 7 percent higher than Wisconsin prices. However, prices of distilled spirits were about 8 percent lower in Minnesota than Wisconsin after tax and insurance adjustments.

Within Minnesota, municipal liquor stores tend to charge prices that are about 3 to 8 percent higher than privately owned liquor stores. Municipal liquor stores are able to charge higher prices because of the monopoly most of them have within city boundaries. However, the proximity of liquor stores licensed by a county or neighboring city keeps the price difference at a modest level.

Minnesota's more restrictive retail laws are probably responsible for the state's higher beer and wine prices, while its relatively unique law for spirits wholesaling is responsible for its lower spirits prices.

Although data on wholesale and manufacturers' prices are not available for the two states, we think the main reason for Minnesota's higher wine and beer prices is the state's more restrictive retail laws. There are few differences between Minnesota and Wisconsin in the wine market other than the differences in retail restrictions. As a result, Wisconsin has twice the number of off-sale wine outlets that operate in Minnesota. Although there are other factors that may affect the difference in beer prices between the two states, we think that Minnesota's more restrictive retail environment probably explains most of the difference.

Minnesota's lower spirits prices appear to be largely the result of the state's ban on the use of exclusive territories for spirits distribution. Even though Minnesota does not have a large number of spirits wholesalers, the ban encourages competition among them and allows retailers to choose from more than one wholesaler. Minnesota spirits wholesalers appear to operate with much lower profit and cost margins than Wisconsin wholesalers. In addition, those wholesalers who distribute both wine and spirits in Minnesota indicate that their margins on spirits are much lower than the margins on wine.

Removing all state restrictions on competition may increase alcohol abuse and could jeopardize the existence of municipal liquor stores.

Less restrictive retail laws could save Minnesota consumers about $100 million annually but could have some negative impacts.

Minnesota consumers would benefit from improved convenience and could save about $100 million per year for off-sale purchases of alcoholic beverages, if Minnesota laws on retail competition were similar to those in Wisconsin. This estimate assumes that Minnesota wine and beer prices would be similar to those in Wisconsin. In addition, we assume that Minnesota spirits prices would be about 7 percent lower than current Minnesota prices due to increased retail competition.

However, achieving such savings would probably require significant changes in Minnesota's retail environment. Wisconsin has twice the number of wine and spirits outlets per capita that currently operate in Minnesota and generally allows any type of store including convenience stores to sell alcoholic beverages.

Implementing Wisconsin-style retail laws could jeopardize the existence of Minnesota's municipal liquor stores and eliminate much of the $16 million currently transferred to city budgets annually. In addition, competition from grocery, convenience, and supercenter stores could cause significant numbers of private liquor stores to go out of business. Wisconsin has fewer than half the number of traditional liquor stores that currently operate in Minnesota.

Enacting retail laws similar to those in Wisconsin would also raise concerns about the impact of lower prices and the increased availability of alcoholic beverages on alcohol abuse. The costs of excessive alcohol consumption have been estimated to be more than $4.5 billion annually in Minnesota. While the evidence from research is not definitive, policymakers should be cautious in considering dramatic changes in Minnesota's retail laws. Even a minor increase in the costs of alcohol abuse would offset the savings consumers would receive from lower prices and improved convenience.

Allowing grocery stores to sell wine would probably have relatively modest economic and social impacts.

In recent years, the Minnesota Legislature has considered allowing wine to be sold in grocery stores of a certain size. Such sales would have relatively modest economic and social impacts, since wine accounts for only about 15 percent of off-sale purchases. In addition, wine is not generally the alcoholic beverage of choice for underage users. Selling wine in grocery stores would likely lower wine prices in Minnesota but would probably save consumers only about $15 million annually. Profits of existing stores would be affected, but most stores would probably stay in business.

Changes in state laws regulating beer and wine distribution would probably lower retail prices but could have some disadvantages for consumers as well.

Minnesota's lower spirits prices suggest that consumers might benefit significantly from additional competition in the wholesale distribution of beer and wine. Studies of beer distribution suggest that banning exclusive territories reduces retail beer prices. However, banning exclusive territories may also reduce the freshness of beer and limit product selection and availability.

The full evaluation report, *Liquor Regulation*, is available at 651-296-4708 or:

www.auditor.leg.state.mn.us/ped/2006/liqreg.htm