

Questions and Answers Regarding Privatization

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Why are we talking about privatization? Governor Perdue and her Budget Reform and Accountability Commission (BRAC) have been reviewing this issue, and the ABC Commission has ordered a valuation of the ABC system for the sale and distribution of spirits from an appraiser. The valuation report from the appraiser has not yet been made public, but is expected to provide estimated values for the auction of rights to sell liquor at wholesale and at retail in the State. This examination of the system follows a legislative review of the issue. The Program Evaluation Division (PED) of the North Carolina General Assembly undertook a review of the ABC system for spirits to evaluate its effectiveness and to identify improvement options including privatization of the system. The final report from the PED (December 2008) did not recommend legislation. The issue also arose in the Spring of 2009 when the legislature formed a joint study committee to examine the ABC system, including privatization. Rather than privatize, the 2009 legislature enacted laws to reform the current control system.

What is privatization? Privatization is the change from a “control” system to a “license” or “open” state system, whereby the distribution and sale of liquor by the state, or its towns or counties, is replaced by the sale and distribution by private for-profit businesses. In a “control” system, the state or its local government units are directly involved with the distribution and sale of alcoholic beverages at the wholesale or retail level. NC is one of 18 control states, and controls spirits at the wholesale and retail level. In an “open” system, the state or local government regulates private businesses but is not directly involved with the wholesale or retail function. **What are some of the philosophical differences between a control and license state?** In a control state like NC, the system balances control over the distribution, responsible sales and marketing of spirits while generating revenue for the state and its cities and counties through sales in areas where local citizens have voted to have spirits sold through local ABC stores. In a license state, the private business is motivated by profits from the sale of spirits.

How does the sale of spirits currently work in North Carolina? Counties, and municipalities meeting certain qualifications, can hold elections to approve the establishment of an ABC Board and store. This “local option” is unique to NC. Currently, approximately 169 ABC boards operate 418 stores. Several counties have no ABC Boards or mixed beverage sales. The state does not own any liquor, but owns a warehouse/distribution center that is operated under a bailment system whereby the ownership of the product remains with the distillery until it is delivered to the ABC Board. The warehouse is operated by a private contractor under the oversight of the North Carolina ABC Commission. A levy on spirits funds the entire operation of the ABC Commission, and another levy funds the entire cost of operating the warehouse and distribution function. No state general funds are used to transport, store, or sell liquor. The ABC Commission determines which products may be sold. The price of spirits is uniform across the state.

How are the ABC Boards performing? No State funds are used to transport, store or sell spirits. Yet, the system generates substantial revenue for the State and local governments, all while engaging in responsible sales: State excise Tax - \$152 million; State sales Tax - \$45 million; other taxes \$16.7 million; distributions to counties and cities - \$46 million; boards also pay for law enforcement (\$6.8 million) and make distributions for alcohol education and rehabilitation (\$8.9 million)(FYE 2010).

How does NC compare to other control states and other license states? NC is 48th in per capita consumption and 3rd in per capita revenue per gallon (*Public Revenues from Alcohol Beverages, 2007*, DISCUS, 2009). NC's control system for the sale of spirits works, and accomplishes important public health and revenue objectives. In a privatized state, the objective of private enterprise is to increase consumption and reduce revenues returned to the government. The chart below provides a comparison of per capita consumption and revenue between NC, a control state, control states' average, and South Carolina, a license state, and license states average.

	<u>Per Capita Consumption/gal.</u>	<u>Revenue/gal.</u>
North Carolina	1.06	\$29.85
North Carolina Rank	48th	6th
Control States Average	1.23	\$30.08
License States Average	1.43	\$14.30
South Carolina	1.34	\$18.40
South Carolina Rank	30th	26 th

Source: *2006 State Data Book*, published by the Distilled Spirits Council of the United States

What about studies in other states about potential impacts of privatization? Virginia: There have been numerous studies in other states analyzing potential privatization scenarios. One of the most detailed was issued in 1993 by Price Waterhouse, an accounting firm, on the impact of privatization of Virginia's ABC system. At that time, the state of Virginia owned and operated all retail off-premise outlets for the sale of spirits, as it continues to do today. The report concluded that maintaining the current retail price would result in revenue reductions of \$24 million under privatization of the wholesale function and \$61 million under privatization of both the wholesale and retail function (full privatization). To avoid ongoing revenue losses, the report concluded that prices would have to increase by 13% under privatization of the wholesale function and 32% under full privatization. The Price Waterhouse report also estimated that privatization would result in: 5,008 off-premise liquor licenses; fewer types of products in stores, particularly in the smaller rural stores; and an increase of available hours to purchase spirits from 48-66 hours/week to 126 hours/week.

What about studies in other jurisdictions about the actual impacts of privatization?

Alberta, Canada: In 1993/1994, the Alberta government privatized the wholesale distribution and retail sale of liquor, and switched from an ad valorem tax (percentage of price) to a unit (flat) tax system of taxation. *Sobering Result: The Alberta Liquor Industry Ten Years After Privatization*, Published by The Canadian Centre for Policy Alternatives, found that: liquor consumption increased, wholesale costs rose, retail prices increased, and retail outlets tripled; tax revenues fell significantly and lost revenue over the 10 year period was estimated to be \$500 million; prior to privatization, there were 310 total retail liquor stores while in 2003 there were 983 private retail liquor outlets; Liquor Act violations increased substantially; and that government-owned retail stores had provided uniform pricing, a higher selection, and lower prices for rural consumers than market factors alone would allow.

Who Drinks? In considering any change to our control system, it is important to note who consumes alcohol. While the heavy drinker may want a liquor store on every corner, alcohol consumption is not widespread amongst most American adults. As surveyed and reported by the U.S. Department of Justice: a majority of Americans do not drink or drink infrequently (46% of adults did not drink in the prior month and an additional 26% drank once a week or less), and binge drinkers constituting 7% of the population consume 45% of the alcohol consumed by

adults. In 2006, the National Center on Addiction and Substance Abuse at Columbia University found that between 37.5%-49% of the alcohol sold in the U.S. goes to those under the legal drinking age or those with alcohol problems.

What about underage drinking? A publication by the U.S. Centers for Disease Control and Prevention released in 2007 found that in all states liquor was the most popular drink among teenagers, and that bourbon, rum, scotch, vodka and whiskey were consumed more than beer by high school students who drank. NC's ABC stores employ local citizens, many of whom are long-term employees, who engage in responsible sales, and who lose their jobs if they sell to an underage or intoxicated patron. In NC's ABC stores, there is no incentive to make irresponsible sales as there is in a private retail setting. A study entitled *Retail Alcohol Monopolies, Underage Drinking, and Youth Impaired Driving Deaths* conducted by Elsevier's Accident Analysis and Prevention noted that: in control states an average of 14.5% fewer high school students reporting drinking alcohol in the past 30 days and 16.7% fewer reported binge drinking in the past 30 days compared to high school students in license states, and that lower consumption rates in control states were associated with a 9.3% lower alcohol impaired driving death rate under age 21 compared to license states. According to NC Child Fatality Task Force (citing ALE data): just under 20% of alcohol vendors sell to minors, there are about 50,000 alcohol vendors in the state, and there is almost 100% turnover of those vendors each year. According to the North Carolina Preventing Underage Drinking Initiative: underage drinkers consumed 11.2% of alcohol sold in NC in 2005, totaling \$357 million in sales; approximately 350,000 youth drink in NC each year; for grades 9-12, 42% had at least one drink on one or more occasion in past 30 days and 23% had five or more drinks in a row in the past 30 days; in 2005, underage drinking cost NC \$1.2 billion (NC ranks 47th highest nationally). Underage drinking cost South Carolina, a license or open state, \$899 million (SC ranks 24th highest nationally).

Privatization would increase the costs of irresponsible and destructive alcohol use. Control states consume less spirits than license states. Greater consumption results in greater harms and greater costs to society. The cost of alcohol abuse in this State is estimated to be \$6.4 billion/year (using the national costs cited by the National Institutes of Health for 1998 and applying the per person costs to North Carolina's 2009 population, and without accounting for increased costs). The North Carolina Institute of Medicine reported to the General Assembly that the consequences of underage drinking alone cost the State \$1.2 billion in 2005. In 2006, the National Center on Addiction and Substance Abuse at Columbia University found that alcohol abuse and addiction cost the nation \$220 billion in 2004, more than cancer (\$196 billion) or obesity (\$133 billion). Under a government service contract, the Centre for Addiction and Mental Health in 2008 issued a very detailed report, *Avoidable Cost of Alcohol Abuse in Canada in 2002*, which concluded that substantial increases in the avoidable burden of alcohol abuse (from 8% to 16%) and avoidable cost of alcohol abuse (from 6% to 12%) would occur if Canadian provinces were to privatize alcohol sales, citing research that privatization would increase the alcohol consumption rate in Canada by 10% to 20%. The report also stated that: a monopoly system on alcohol may greatly reduce the number of outlets and limit the hours of sale; the evidence is quite strong that monopoly systems limit both alcohol consumption and alcohol-related problems; retaining state monopolies on alcohol sales is the most effective measure to avoid alcohol-attributable criminal activities and to reduce policing and court/corrections costs; and that privatization would result in significant increases in direct health care costs (e.g., a 10% increase in consumption due to privatization would result in additional costs of \$119.6 million in acute care hospital costs).

What does the World Health Organization (WHO) say? In a March 2008 report, *Strategies to reduce the harmful use of alcohol*, the WHO said that “regulating production and distribution of alcoholic beverages is an effective strategy to reduce harmful use of alcohol and in particular to protect young people and other vulnerable groups”. The report also noted that “price is an important determinant of alcohol consumption, and in many contexts, of the extent of alcohol-related problem. Considerable evidence has been accumulated to support the use of tax changes as a means of influencing price.” NC’s control system allows greater control over the retail price than under a privatized system.

What does the National Highway Traffic Safety Administration (NHTSA) say? In its 2005 Report, *The Role of Alcohol Beverage Control Agencies in the Enforcement and Adjudication of Alcohol Laws*, the NHTSA said “Research conducted over the last three decades demonstrates a connection between alcohol availability and public health outcomes. Within a given population, public health problems will increase as availability increases (through lower prices or increased physical access), and will decrease as availability decreases. Youth are particularly sensitive to these alcohol availability variables.” NHTSA also said that “Policy makers . . . need to have a clear understanding of the importance of alcohol beverage control agencies to public health efforts to prevent alcohol-related problems.”

The current system allows control over retail location, density and pricing, meeting important public health objectives. The ABC Commission approves new ABC stores and store locations and also determines the uniform price of the product, based on the wholesaler’s price and a statutory formula. NC’s control system is uniquely positioned to prevent and minimize alcohol problems, to provide customer service in a responsible way, and to maintain tax revenues. Through regulation, controlling availability, establishing minimum pricing and refusing sales to minors and intoxicated persons, NC’s control system balances public health concerns while making spirits available in jurisdictions that have voted to have such sales.

What will privatization bring to North Carolina?

* A drastic shift in public policy that has been in place since Prohibition was repealed. In 1908, NC was the first state to enact statewide prohibition of alcohol; in 1937, NC enacted the local option control system for the sale of spirits.

* The override of over 70 years of citizens’ votes under the local option system to establish ABC stores in their town or county. Not all jurisdictions want spirits sales – there are some counties that do not have ABC Boards or mixed beverage sales. In May, 2008, the town of Dobson defeated a referendum for mixed beverage sales. In September, 2008, the town of Robbins voted to allow wine sales, but not the sale of beer or mixed drinks.

* The stranding of millions of dollars of ABC Board investments in real property and store construction, leaving local governments liable for millions of dollars for long-term leases of property.

* A significant increase in the number of retail outlets for the sale of spirits. NC now has 418 ABC stores and over 6,000 outlets licensed to sell beer off-premises. Under an open license system, North Carolina would have an estimated 2,139 retail outlets for the sale of spirits, based on the national average of 30 retail outlets_for each 100,000 residents in a license state. South Carolina, a license state, in 2005 had more than twice the number of retail outlets for the sale of spirits with less than one-half of NC’s population (in 2005, NC had 394 ABC stores with a population of 8,683,000 and SC had 983 retail outlets for spirits and a population of 4,255,000). Iowa had 220 spirits stores when it privatized its retail function in 1987 and had 550 spirits stores in 2007. Convenience stores, grocery stores, big box retailers and pharmacies sell spirits in

other states and would want to sell spirits in NC. According to the U.S. Department of Justice, “restricting the density of alcohol outlets and their location is one way of decreasing consumption and related problems.”

* Greater access to spirits due to the increased number of liquor outlets, the extended hours of operation for spirits sales (current law permits spirits sales only after 9 am and before 9 pm), and the profit motive of the private businesses.

* Greater access and availability increases alcohol consumption and associated alcohol related-problems. Retail monopoly states have significantly lower rates of drinking, binge drinking and driving fatalities. When New Mexico allowed Sunday sales of alcohol, there was a 29% increase in alcohol related crashes and a 42% increase in alcohol related fatalities on Sundays.

* An increase in the gap between the cost to society from alcohol sales and the revenues generated by alcohol sales.

* A significant increase in the price of spirits, if revenues and distributions to the state and local governments remain the same, as the private retail seller would have to add its mark-up in order to make a profit under any form of privatized sales.

* Significant efforts by retail sellers to change the laws to allow greater advertising, promotion and marketing of spirits.

* Less revenue to the state, particularly if prices increase.

* Significant efforts by alcohol sellers to reduce taxes on spirits. In Iowa and in Alberta, Canada, privatization led to higher consumer prices and lower revenue after retailers successfully lobbied for lower taxes.

* An increase in underage drinking of spirits and related problems. In control states, fewer teens drink and there are lower teen deaths related to alcohol impaired driving.

* An increased need for alcohol law enforcement, alcohol education and rehabilitation and for the state and its subdivisions, but a reduction in revenues for those services.

* A reduction in the selections of spirits available to consumers. The state warehouse will ship all of the over 1800 products available to any ABC Board; under a private system, not all distributors would choose to ship all products to rural, distant or less-populated areas.

* A more difficult environment in which to implement public-health oriented policies relating to spirits. Private sellers are oriented to commercial aspects of alcohol management and not public health agendas.

* Privatization is against the trend towards more control and regulation over alcohol, and less social tolerance for alcohol, both in NC and nationally: The Nation’s Surgeon General recently sent out the first “Call to Action” for the Nation to address the underage drinking epidemic; NC’s DWI Taskforce resulted in a substantial revision and tightening of the DWI laws; NC has recently passed laws to require registrations of beer kegs, to change the appearance of drivers’ licenses for minors, and to take away drivers’ licenses for providing alcohol to a minor.

* The end to a successful era of control over the sale of spirits. **Once NC goes private, at any level, there is no going back.**