Fiscal TOPICS

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LSA LEGISLATIVE SERVICES AGENCY

Alcoholic Beverage Control

Background

At the turn of the 20th century, the beer and liquor industry was booming. Local brewers and distillers often had ownership ties to saloons, selling to them on extended credit terms, furnishing equipment and supplies, charging low or no interest on credit, and paying rebates for pushing their brand or carrying it exclusively. This relationship became known as "tied houses." Competition for control of the retail outlets was fierce and tremendous pressure was exerted on retailers to maximize sales without regard to the well-being of customers or the general public. Saloons were places of illicit activity, such as gambling, prostitution, crime, and corruption. These abusive practices led to a campaign for laws prohibiting all drinking of alcohol. Prohibition was established in 1919 by the 18th Amendment to the United States Constitution leading to a 14-year dry spell that fostered more crime and corruption based in illegal alcohol.[1]

In 1933, the 21st Amendment to the United States Constitution repealed Prohibition and gave states the authority to regulate the production, importation, distribution, sale, and consumption of alcoholic beverages within their borders. A three-tier system was created to control the corruption and social problems from prior to Prohibition by eliminating tied-house abuses that prevented retailers from making their own business decisions and encouraged corruption. With "tied houses" gone, beer, wine, and liquor were sold through independent distributors.

The three tiers are: (1) manufacturers/producers (i.e., distillers, brewers, wineries, and importers), (2) wholesalers/distributors, and (3) retailers. Persons and companies are typically legally licensed and permitted to do business in only one tier. Manufacturers/producers are permitted to sell alcoholic products only to wholesaler/distributors, and they in turn are permitted to sell only to retailers. Retailers are the only entities licensed to sell to consumers. The three-tier system has four primary goals:

- To avoid the overly aggressive marketing and sales practices of the pre-Prohibition era that threatened retailer independence;
- To generate tax revenues that can be collected efficiently from the alcoholic beverages industry;
- To facilitate state and local control of alcoholic beverages; and
- To encourage moderate consumption (temperance).

The alcoholic beverages industry is regulated at the federal, state, and local levels. The federal government licenses and regulates all manufacturers to ensure the beverages they produce are safe and to reduce counterfeit products. Each state has its own set of laws and regulations that separate each tier by prohibiting suppliers and distributors from having any financial interest or influence with retailers. For example, contracts for a retailer to exclusively sell one manufacturer's products are not permitted; rebates and extension of credit are not allowed; consignment sales may be banned; and producers may not be allowed to give promotional items, electric signs, refrigeration equipment, or services to a retailer.

At the end of Prohibition, beer and wine were viewed differently and as less problematic than liquor. Typically, liquor is more stringently regulated than the less intoxicating beverages. This difference is reflected in the exceptions various states have to the three-tier restriction. A common exception is the brewpub that functions simultaneously as a producer and as a retailer with no requirement to sell to a distributor. Some states allow an entity to have a part in two of the tiers, such as letting small breweries act as their own distributor. Many states permit wineries to sell bottles of wine on-site to customers, and some states, such as Oregon, permit intrastate shipments of wine directly from the producer to the customer. Also, it is common for producers to give a distributor the exclusive right to market their product within a geographical area, so there will not be two distributors of the same product competing against each other, i.e., a franchise-type arrangement.[2]

More Information

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[1] References: Associated Beer Distributors of Illinois (ABDI): http://www.abdi.org/public/history.htm and Fosdick, Raymond B. and Albert L. Scott, Toward Liquor Control. (The Center for Alcohol Policy, 2011. Originally published by Harper and Brothers, 1933)

[2] Reference: Arizona Department of Liquor Licenses and Control (ADLLC): http://www.azliquor.gov/assets/documents/3_tier.pdf

Beverage Control Models

The two approaches states have taken are generally referred to as the "control" model and the "open" model and are described as follows:

- Control State Model: These states regulate the three-tier distribution system by direct involvement in the wholesale and/or retail tiers. States with the control model include: Maine, Vermont, New Hampshire, Pennsylvania, Maryland (Montgomery County), Ohio, Virginia, West Virginia, North Carolina, Georgia, Mississippi, Michigan, Iowa, Montana, Wyoming, Idaho, Utah, and Oregon. Most of these state governments maintain a monopoly on the distribution tier of the system and sometimes only for distilled beverages. The three-tier system still operates in these states. Producers sell to the distributor. In the control state model, the state is the distributor rather than a private entity and the state distributor sells to private retail outlets. Some states (for example, Utah and Pennsylvania) monopolize both the distribution and retail tiers. In Iowa, beer has been distributed by private licensed wholesalers and sold by private licensed retailers. Prior to 1985, Iowa monopolized both the distribution and retail sale of package liquor and wine through state-owned stores. In 1985, wine was privatized, and in 1987, the state-owned liquor stores were closed. At that point, the State of Iowa became the sole wholesaler for spirits with wine and beer handled by the licensed private wholesalers.
- Open State Model: The remaining states regulate the three-tier distribution system by licensing and without direct involvement in any of the distribution tiers.

In November 2011, voters in the State of Washington approved an initiative that essentially dismantled the three-tier distribution system and the state-operated retailing system for the sale of liquor and wine. Under the new law, the state-operated liquor retailing system was eliminated in favor of heavily taxed private retailing. By a substantial margin, Washington has the highest liquor tax rate in the nation. With a liquor tax rate around $35 per gallon, its liquor tax is about 50.0% higher than in Oregon, which has the next highest rate. In Washington, retailers may bypass distributors by purchasing directly from producers, may negotiate volume discounts, and may warehouse their inventory themselves. Private retailing began on June 1, 2012. Although private retailing should increase competition in principle, in many cases producers have entered into exclusive marketing agreements with distributors for the market region.

Iowa Beverage Control

Iowa adheres to the three-tier system and has strict regulations regarding how alcoholic beverages are bought and sold.

- Off-premises licensees (liquor stores, grocery stores, convenience stores, etc.) must purchase the liquor, wine, and beer for resale in their licensed establishments as follows:
  - Liquor is purchased from the Iowa Alcoholic Beverages Division only.
  - Wine is purchased only from a licensed wine wholesaler.
  - Beer and wine coolers are purchased only from beer wholesalers.
- On-premises licensees (bars, restaurants, hotels, motels, etc.) must purchase the liquor, wine, and beer for resale in their licensed establishments as follows:
  - Liquor is purchased from Class E liquor licensees (liquor stores, grocery stores, etc.) that hold federal wholesale permits.
  - Wine is purchased only from a licensed wine wholesaler. On-premises licensees may also purchase limited quantities of wine (less than one case per brand, per day) from off-premises Class E liquor licensees (liquor stores, grocery stores, etc.) that are also licensed to sell bottles of wine.
  - Beer and wine coolers are purchased only from beer wholesalers.
- Some other restrictions facilitating adherence to the three-tier system are:
  - Liquor, wine, and beer inventory may not be transferred from one retail premise to another even if both premises are owned by the same owner.
  - All liquor bottles must have Iowa markers displayed, i.e., the "Iowa Refund 5 cents" or the Iowa Alcoholic Beverages Division sticker.
  - Licensees must store all liquor, wine, and beer inventory on the licensed premises, except for special authorized circumstances.
  - When going out of business, there are specific regulations for the return of unopened product to wholesalers or sale of the inventory to a specific liquor control licensee.
  - The amount of liquor, wine, and beer that an individual over age 21 may bring into the state for personal consumption is limited by volume.
  - Bootlegging is a criminal offense.

Fiscal Impact

In FY 2012, the Iowa Alcoholic Beverages Division had revenues totaling $283.9 million, including: a $1.2 million General Fund appropriation, $242.2 million from liquor sales, $14.3 million from sale of licenses, $14.8 million in beer tax, $7.3 million in wine tax, and $4.0 million in miscellaneous revenue. These revenues were used as follows: $159.5 million for liquor payments, $96.4 million was transferred to the State General Fund, $17.9 million was transferred to the Department of Public Health for substance abuse programs, $3.6 million was remitted to cities and counties for issuing licenses, $280,000 was transferred to the Economic Development Authority to promote the native wine and native beer industries, and the balance was carried forward.