

Let the Wine Flow

Why Congress Shouldn't Restrict Free Markets in Beer, Wine, and Spirits.

BY JEFF SIEGEL

SEPTEMBER 2010

This week, the House of Representatives will hold hearings on HR 5034, a bill designed to make it even more difficult for the federal government to get involved in liquor regulation –something that's not exactly easy now. The beer, wine, and spirits business operates under the 21st Amendment, which ended Prohibition and which left liquor regulation to the states. It's a Constitutionally-protected monopoly that has held for 80 years

To understand what's going on, and why the "Comprehensive Alcohol Regulatory Effectiveness (CARE) Act of 2010" is bad policy, one must first understand the complicated, fractured world of liquor distribution. It's a world defined by what's known as the "three-tier system." This system guarantees the country's largest distributors billions of dollars a year in revenue, limits consumer choice, maintains artificially high prices, and restricts how and where consumers can buy

beer, wine, and spirits in ways that have nothing to do with legitimate policy concerns like drunk driving and underage drinking.

Three-tier, which is law in all 50 states and the District of Columbia, requires that liquor manufacturers sell only to wholesalers. In turn, wholesalers can only sell to retailers and restaurants, and retailers and restaurants are the only ones that are allowed to sell beer, wine, and spirits to consumers. The system protects the wholesaler monopoly, since retailers and restaurants are prohibited from buying directly from the manufacturer (e.g., breweries, wineries, and distilleries). It's not a coincidence that retailer-manufacturer sales are common in other industries, and that large retailers like Wal-Mart have built cutting edge supply chains without the use of wholesalers.

About the author

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In 2005, the Supreme Court ruled in *Granholm v. Heald* that the Commerce Clause allowed wineries, under certain circumstances, to sell directly to consumers in a process called direct shipping. It was a very narrowly defined exception; today, only 34 states allow direct shipping and it remains a contentious issue even in states that allow it. Moreover, there has been no indication that Congress or the courts have any intention of loosening three-tier any time in the foreseeable future. But the decision represented a possible threat to the wholesaler monopoly and spurred them into action.

The centerpiece of the wholesalers' post-*Granholm* effort is HR 5034, which would reassert the primacy of the 21st Amendment and the role of the states in regulating liquor. This would hamper Congress' ability to pass laws to reform three-tier, such as a federal law allowing direct shipping. In addition, HR 5034 would make it more difficult for consumers to file lawsuits like *Granholm* by limiting the use of the Commerce Clause as a wedge against the 21st Amendment's state mandate. It could even allow states to pass legislation specifically barring other state's liquor imports, so that New York could protect its wine market from California, or Kentucky could protect its whiskey market from Tennessee.

The wholesalers have donated \$14.9 million to congressional campaigns through their PACs in the past decade, and they have the ear of many members of Congress. HR 5034, introduced by Bill Delahunt (D-Mass.), has 146 co-sponsors across the political spectrum, from Jesse Jackson Jr (D-Ill.) to Michele Bachmann (R-Minn.), as of this writing.

But wholesalers have even more clout with state legislators, which is why they'd prefer to keep states in charge. Liquor wholesalers are often the largest employers in key constituencies, especially in rural areas, and they're traditionally important campaign contributors. Consider what happened earlier this year in Maryland, where the wholesalers beat back an attempt to allow direct shipping even though 75 of the state's 141

legislators co-sponsored the bill. The *Baltimore Sun* reported that the state's wholesalers had donated \$3 million to legislators in the past decade. The chair of Maryland House subcommittee that deals with alcohol regulation got 12 percent of her total contributions during the previous election cycle from wholesale alcohol interests.

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HR 5034, if passed, will limit consumer choice. It would reinforce three-tier's restrictions by forcing retailers to carry only the brands that the wholesalers want to sell to them, as opposed to the brands they want to sell or that consumers want to buy (an arrangement that is unique to the alcohol industry). It would keep prices artificially high, based on the typical wholesaler markup of 30 percent. It could also end direct shipping, as compliant state legislatures rewrite their laws at the behest of wholesalers who see direct shipping as a threat to their business. This is one reason that so many family-owned wineries are so worried about HR 5034. The Wine Institute, which represents 1,000 California wineries, says the end of direct shipping could force substantial numbers of smaller wineries out of business.

Ultimately, this is an issue of choice and competitiveness. It's one thing that have an honest debate about the pros and cons of the three-tier system and whether it still makes sense, almost 80 years since the 21st Amendment put it in place. But that's not the debate we're having. Instead, the debate is whether Congress should tie its hands for no good reason, and make it harder for small businesses to compete in the alcohol distribution market. It seems like a debate that's hard to justify having.

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