



# Off the Wagon: Why ABC Privatization is a Bad Idea

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## Introduction

During his campaign for governor in 2009, Gov. Bob McDonnell vowed to reform and restructure the Commonwealth's government. Shortly after being sworn into office, Gov. McDonnell signed Executive Order Two, establishing the Governor's Commission on Reform and Restructuring. According to the administration, the purpose of reform and restructuring is "to ensure that duplicative, outdated, unnecessary and ineffective services and service delivery methods are eliminated and that state revenues are dedicated to the core functions of government."<sup>1</sup> One of the governor's reform proposals is to privatize the retail operations of the Department of Alcoholic Beverage Control (ABC).

To determine the desirability of this policy, this brief considers three questions: 1) Is Virginia ABC an inefficient government agency and a cost to state taxpayers?; 2) What are the possible economic consequences of the privatization of the sale of spirits?; and 3) What are the possible social consequences of the privatization of the sale of spirits?

This brief will show that far from being ineffective and a cost to taxpayers, Virginia ABC is a well-run agency that is a consistent source of government revenue. Further, based on previous studies, opening the sale of spirits to the private market most likely will not benefit the consumer in terms of competitive pricing and product variety. In addition, it is likely that substantially reducing the control of spirit sales will disproportionately affect lower-income and minority communities in terms of the social costs associated with the increased availability of distilled spirits.

## Overview

Candidate McDonnell campaigned on the pledge to eliminate waste, fraud, and abuse within state bureaucracy. To achieve this goal, candidate McDonnell envisioned creating a commission that would "review all major state agencies and boards on an eight-year cycle and advise the General Assembly on the elimination of waste, duplication, and inefficiency on the part of such agencies."<sup>2</sup> The Governor's Commission on Reform and Restructuring was established on January 16, 2010 by the signing of Executive Order Two by Governor McDonnell. One of the proposals the Governor has tasked the Commission to consider is the privatization of the sale of spirits within the Commonwealth.

There are three privatization models being considered by the Commission. Currently, it appears a limited privatization of the sale of spirits through an auction of a limited number of licenses to large and small retailers has garnered the most support. This model could increase the number of retail outlets to about 1000, more than triple the current ABC retail locations.<sup>3</sup> The Governor's senior policy advisors estimate that this option could immediately generate between \$300 to \$500 million in revenue. Most, if not all, of the revenue generated

would be used to fund transportation projects, according to the administration.

Concerns have been raised by both Democratic and Republican lawmakers about the potential for substantial increases in the number of distilled spirit retail outlets statewide. Under the most popular model, local governments would have the ability to regulate where spirits are sold through zoning ordinances. The state ABC agency would maintain the authority to enforce liquor laws. Additionally, according to a recent news account in the Roanoke Times "McDonnell wants to maintain the state's ability to regulate signage, marketing and advertising 'so we can do this in a very conservative Virginia way.'"<sup>4</sup>

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## Is the Virginia ABC an Inefficient State Agency?

Some politicians tend to assume that government agencies are managed less efficiently than privately owned entities. By contrast, however, Virginia ABC stands as a model of a well-managed public enterprise, and a reliable source of revenue for the Commonwealth.

The Virginia Department of Alcoholic Beverage Control achieved 75 years of "control, service, and revenue" in 2009. In

addition to achieving this milestone, Virginia ABC also experienced a year of record revenue with \$665.6 million in gross sales.<sup>5</sup> ABC's record annual gross sales resulted in \$111.8 million in net profits before transfers in 2009. From net profits, \$67.6 million was transferred to other government agencies, \$65.4 million was transferred to the Department of Mental Health, Mental Retardation and Substance Abuse Services, and the remaining \$46.4 million was transferred to the General Fund.<sup>6</sup> As a mark of consistency, Virginia ABC has contributed more than \$1.5 billion to the General Fund over the past five years, and more than \$6 billion since 1934.<sup>7</sup> Furthermore, according to the Alcohol Research Group, in 2006 Virginia had the third highest revenue return to the state for every gallon of spirit sold at \$64.83 per gallon (the average control state returned \$53.07 per gallon and the average license state returned \$15.42 per gallon).<sup>8</sup>

### Possible Economic Consequences of Privatization

Proponents of privatization will argue that opening the sale and purchase of a good or service to the private market will inevitably result in lower prices and greater variety for the consumer. In theory, the private market mechanisms that result in these outcomes work best when the market for the good or service is a perfectly competitive market (no barriers to entry or exit, i.e. minimal or no government regulation). Not all markets function in such a way, however. Therefore, these assumptions do not always hold.

Previous research on the economic effects of privatization of liquor sales consistently demonstrate that privatization will lead to higher prices, and in some incidences, reduced product variety. Iowa privatized the sale of alcohol in March 1987. By December 1988, liquor prices had increased by 6.1 percent.<sup>9</sup> In 1981, three years after voting to privatize the sale of table wine, voters in Alabama returned the sale of these beverages to state stores because privatization resulted in higher prices and limited selection.<sup>10</sup> The Canadian province of Alberta privatized the sale of liquor in 1993. Three years after privatization, nominal retail liquor prices increased from between 8.5 percent to 10 percent. Adjusting for inflation, the real price increase was about half of the nominal increase (this is strikingly similar to Iowa's experience).<sup>11</sup> The late Julian Simon, a former professor of business administration at the University of Maryland, "observed many years ago that in the United States prices were on average more than 11 percent higher in 27 'private-license states' compared with 16 'monopoly states,' and that the treasuries of the monopoly states collected more per capita revenue from alcohol sale than the private-license states."<sup>12</sup>

York University (Canada) professor of economics, Nuri Jazairi, offers the following explanation for these outcomes:

*"There are some general possible explanations, essentially based on economies of scale arguments, why, under liquor control, revenues are greater and prices are lower than under privatization, other things being equal. The liquor control boards can as single buyers (monopsonists) bargain for lower prices and greater special discounts from suppliers and carriers. The liquor control boards are also likely to have lower operating costs. The privately-owned outlets are fragmented and multiply rapidly, while the control stores are open for fewer hours, and are integrated and centralized in their operations and distribution network. Finally, privately-owned retail outlets require higher rates of return on their capital costs than control boards, and these higher costs, among others, lead to higher alcohol prices under privatization."*<sup>13</sup>

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### Possible Social Consequences of Privatization

If not consumed responsibly, alcohol is a dangerous, and sometimes fatal, substance. According to the Virginia Department of Health, from 2004 to 2006, in 25.8 percent of all deaths in Virginia resulting from injury, one of the parties involved had a blood alcohol concentration (BAC) of 0.01 percent or greater. In over 30 percent of homicide deaths, one of the parties involved had a BAC of 0.01 percent or greater. During the same period, 27 percent of all motor vehicle crash deaths were alcohol related (BAC  $\geq$  0.01 percent).<sup>14</sup> The Code of Virginia establishes 0.08 percent as the legal BAC limit for motor vehicle operation. Clearly, public safety and social costs related to alcohol consumption must be evaluated when considering a policy that deregulates the sale of liquor.

It is inconclusive as to whether privatization of liquor sales increases alcohol consumption, and thus the risks associated with increased consumption, generally. Both proponents and opponents of privatization of liquor sales can cite studies that support their particular arguments on how privatization of liquor retailing affects society. At a macro level, Duquesne University economists John Paulito and Antony Davies, find that although alcohol consumption is slightly higher in private sale states, there is no difference in the rates of underage drinking, underage binge drinking, and alcohol-related traffic deaths between license states and control states.<sup>15</sup> However, at a micro level, research demonstrates that low income and minority communities are at greater risk of being impacted by the negative social consequences of increased alcohol availability due to privatization.

Thomas LaVeist, of the Department of Sociology and Health Policy at John Hopkins University, and John Wallace, of

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the School of Social Work at University of Michigan, analyzed 194 census tracts in Baltimore, Maryland (a license state) to determine “whether the physical availability of alcohol is greater in predominantly African American communities compared to predominantly white communities as indicated by the presence of off-premise liquor stores.”<sup>16</sup> Their study found that off-premise liquor stores are disproportionately located in both low income and predominately African American census tracts. Their data also reveals “significant associations between the presence of liquor stores and the risk of health-related social problems in low income neighborhoods.”<sup>17</sup>

In a national survey, researcher John Romley of the RAND Corporation, and colleagues, found the same tendencies in liquor store locations as found in the Baltimore study.<sup>18</sup> The authors conclude, “Mismatches between alcohol demand and the supply of liquor stores within urban neighborhoods constitute an environmental injustice for minorities and lower-income persons, with potential adverse consequences for drinking behavior and other social ills.”

## Conclusion

It is the position of the Virginia Interfaith Center for Public Policy that service providers and communities of faith should actively work to limit the expansion of alcohol retailers to the present state-run system of Virginia ABC stores.

To determine the desirability of privatizing liquor retailing in Virginia, this brief considered three questions: Is Virginia ABC an inefficient government agency and a cost to state taxpayers? What are the possible economic consequences of the privatization of the sale of spirits? and What are the possible social consequences of the privatization of the sale of spirits? The Center has concluded

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that: Virginia ABC is a well-run agency that is a consistent source of government revenue; based off of previous studies, opening the sale of spirits to the private market will most likely not benefit the consumer in terms of prices and product variety; and it is likely that substantially reducing the control of spirit sales will disproportionately affect lower-income and minority communities in terms of the social costs associated with the increased availability of distilled spirits.

The need for additional state revenue, particularly to address transportation needs, is driving the privatization of Virginia ABC debate. It is the position of the Virginia Interfaith Center that dismantling the existing system neither addresses the longer term revenue needs of the state nor promotes safer communities across the Commonwealth.

## About the Interfaith Center

The Virginia Interfaith Center for Public Policy is Virginia’s oldest faith-based advocacy group. We are a nonpartisan coalition of faith communities working to create progressive public policy by engaging people of faith, educating the public about social issues, the legislative process, and the call to advocacy.

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## Footnotes

1 “Governor McDonnell’s Commission on Government Reform and Restructuring,” Virginia.gov, <http://www.reform.virginia.gov>, (accessed July 29, 2010).

2 “Government Reform,” Governor Bob McDonnell: Opportunity Virginia, [http://www.bobmcdonnell.com/index.php/issues/government\\_reform/#Eliminating%20Waste,%20Fraud](http://www.bobmcdonnell.com/index.php/issues/government_reform/#Eliminating%20Waste,%20Fraud), (accessed July 29, 2010).

3 A different privatization model could increase the number of retail outlets from anywhere between 2,000 to 3,000.

4 Michael Sluss, “Privatized liquor plan starts to take shape,” The Roanoke Times, 21 July 2010, <http://www.roanoke.com/news/roanoke/wb/254297> (accessed July 29, 2010).

5 “Annual Report 2009,” Virginia Department of Alcoholic Beverage Control, <http://www.abc.virginia.gov/admin/annual/docs/2009ar.pdf> (accessed July 29, 2010).

6 Ibid.

7 “About ABC,” Virginia Department of Alcoholic Beverage Control, <http://www.abc.virginia.gov/admin/aboutabc.html> (accessed July 29, 2010).

8 2006 figures. Data from powerpoint titled “Short Overview, Privatization” provided by Judy Gurley with the Virginia Wine Wholesalers Association.

9 M.A. Fitzgerald and H.A. Mulford, “Privatization, Price and Cross-border Liquor Purchases,” Journal of the Study of Alcohol, 54 (1993), 462-464.

10 Nuri Jazairi, “The Impact of Privatizing the Liquor Control Board of Ontario,” September 1994, <http://www.yorku.ca/nuri/lcbo.htm>.

11 Douglas West, “The Privatization of Liquor Retailing in Alberta,” Public Policy Sources, 5 (1997), <http://www.fraserinstitute.org/research-news/display.aspx?id=13529>.

12 Jazairi, “The Impact of Privatizing the Liquor Control Board of Ontario.”

13 Ibid.

14 Virginia Department of Health, “Alcohol and Injury,” Division of Injury and Violence Prevention, <http://www.vahealth.org/injury/data/reports/documents/2008/pdf/Alcohol%20and%20Injury%20Report.pdf> (accessed July 30, 2010).

15 John Paulito and Antony Davies, “Government-Run Liquor Stores: The Social Impact of Privatization,” The Commonwealth Foundation, 21, no. 3 (2009).

16 Thomas LaVeist and John Wallace, Jr., “Health risk and inequitable distribution of liquor stores in African American neighborhood,” Social Science and Medicine, 51 (2000), 613-617.

17 Ibid.

18 John Romley, Deborah Cohen, Jeanne Ringel, and Roland Sturm, “Alcohol and Environmental Justice: The Density of Liquor Stores and Bars in Urban Neighborhoods in the United States,” The RAND Corporation, May 2006.





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