Privatization of Retail Liquor Sales in Iowa

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I PASSAGE OF THE LEGISLATION

During the 1986 session of the Iowa legislature, a bill was passed to privatize the retail portion of the State liquor monopoly. The effective date of the bill would have been July 1, 1986. However, because the bill was passed at the eleventh hour of the session and because it had not been fully debated, the effective date was moved to March 1, 1987. This move would have allowed the legislature to fully debate the bill during the subsequent session which began in January of 1987. However, the Speaker of the House did not allow the bill to come out of committee when the legislature convened in January. Therefore, the effective date of March 1, 1987, arrived without any debate on the bill.

II CONVERSION

Language in the bill stated that when a private retailer opened a store within 15 miles of a state store, the state store must closed.

There were 195 licenses for private stores, effective March 1, 1987. Fortunately, March 1st was on a Sunday and the new licensees could not open until Monday, the 2nd, which gave the Alcoholic Beverages Division Saturday night and Sunday to close 195 state stores. These stores had to be audited, and in most cases, the existing inventory had to be repacked and shipped back to the state liquor warehouse.

While inventories, furniture and fixtures were auctioned off for each store, the bill did not allow the Alcoholic Beverages Division to sell existing store inventories at any discount. Therefore, the new licensees would rather custom-order from the warehouse at the same price, rather than take shop-worn and slow-moving product that was in the stores. As a result, the Alcoholic Beverages Division received over 100,000 cases back from the stores. The State shipped the returned cases on the basis of what the case label indicated was inside the case. Unfortunately, the contents of many of the repacked cases did not match the case label because the cases were repacked at the eleventh hour, with no supervision, by employees who knew they were losing their jobs. Licensees promptly reported errors that were not in their favor.

III OPPOSITION TO THE BILL

During the period between July 1, 1986 and March 1, 1987, the Iowa Alcoholic Beverages Division expected opposition to the bill from the churches, substance abuse and "ADD" groups. It was felt these groups would provide fuel to the debate which was supposed to occur in January of 1987. One would have expected outcries due to more outlets, longer hours, Sunday and Holiday sales, sales to minors, increased OWI's, etc., yet not one complaint was received from anyone about any of the potential problems. These "potential problems" have been used, historically, by anyone who opposes privatization, as danger signs to help prevent the erosion of the control state system. As was shown in Iowa, none of these problems materialized as a result of privatization.

Following are the statistics following privatization:

- ***The number of outlets selling liquor at retail increased from 221 state liquor stores to over 400 private liquor retailers.***

- ***Licensees may sell spirits 20 hours every day including Sundays and holidays.***

- ***It appears that alcoholic liquor sales to minors have not increased appreciably, and fatalities involving alcohol have decreased.***

- ***Overall selection of products has increased from around 900 items to nearly 1,200. (The State of Iowa has been in bailment inventory since 1985 which has resulted in a more liberal listing policy.)***

IV PRICES AND MARKUPS

Prices have increased to 7.4% above what they would have been if the State had retained its stores. A gradual price increase was predicted at the beginning of the privatization period. The prediction was an easy one due to the fact that private retailers initially did not want an instant price increase which would be apparent to the public and which could be blamed on privatization itself.

The State had a 76% markup from the laid-in cost to the consumer price. With privatization, the State markup was reduced to 50%. This meant that if private retailers wished to have comparable shelf prices, their markup could only be about 17.3%. During the initial year of privatization (1987) the public noticed little change in shelf prices and, therefore, had no complaints about the changeover. Following is the progression of average markup by the private retailers since 1987:

	MARKUP	INCREASE OVER INITIAL MARKUP
1988	20.0%	2.7%
1989	23.4%	6.1%
1990	24.0%	6.7%
1991	24.7%	7.4%

The overall average markup has leveled to 25%. Surveys that resulted in the above information also showed that markups reflect "what the market will bear" depending upon the distance to the nearest competitor and sizes and selection carried.

No complaints have been received from the public regarding prices, service, selection or convenience. Apparently, as long as the latter three have improved there is no objection to the increase in prices.

V IMPACT ON REVENUE AND PROFIT

Some would argue that privatization of any government entity is desirable, regardless of the impact on revenue and profits. In the Iowa scenario, privatization has proven to be very successful from a profit standpoint. Profits have increased by over 125 million in the first eleven years of privatization compared to what they would have been if the State still had state stores. (See Attachments B and C).

As the expense of maintaining the Iowa state store system increased each year, while sales and revenue were declining, it was necessary to make a change to maximize profit and maintain levels of customer service. (See Attachment A).

VI STATUS OF LAID OFF EMPLOYEES

The Iowa Alcoholic Beverages Division had nearly 1,200 employees just prior to privatization. Laid-off employees were given preference on state recall lists for many comparable jobs, and most who wanted to remain employed by the State were able to do so. Some laid-off employees got better jobs than they had before but most obtained lower paying jobs.

VII FURTHER PRIVATIZATION

During calendar year 1991, the Alcoholic Beverages Division went out for bids to privatize the warehousing and distribution areas of the wholesale operation. On January 1, 1992, these functions were assumed by the Jones Operation and Management Company. This project has saved the Alcoholic Beverages Division an additional $750,000 per year.

With the layoff of the warehousing and distribution people, the Alcoholic Beverages Division has 24 employees remaining, 12 of whom are in the licensing and regulation bureau.

VIII IMPACT OF PRIVATIZING THE WHOLESALE SPIRITS BUSINESS

The decision to privatize the wholesale side of the spirits business in Iowa can be reduced to two scenarios:

1. The State can give up the millions that goes to the General Fund.

2. Revenue neutrality can be maintained by placing a tax on spirits sales to replace monies going to the General Fund, which would inflate prices considerably.

Under the two scenarios listed above, the State would lose 33.5 million dollars the first year or liquor prices would be increased by 36%. As Iowa is an "island" control state, leakage across State borders would be significant.

During the second and all subsequent years, the State would lose over 26 million dollars per year or liquor prices would have to be increased by over 24%.

IX SUMMARY

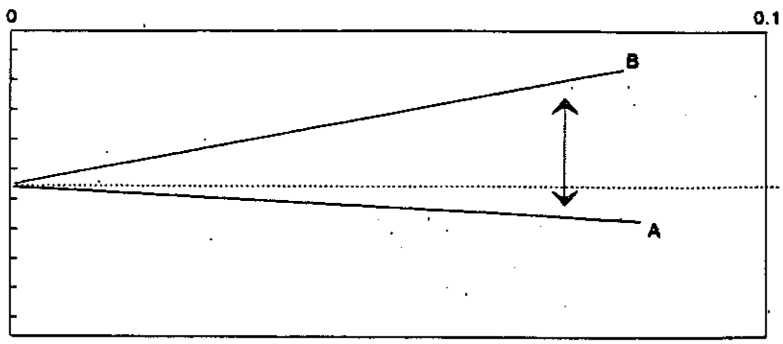
In January, 1987, when it became apparent that the Legislature did not intend to further debate the merits of retail liquor store privatization, the Iowa Alcoholic Beverages Division had only from mid-January to March 1st, to plan for the conversion from state liquor stores to private licensed liquor retailers. A longer lead time would have effected a much smoother transition, with fewer errors.

It also would have been more successful had the Alcoholic Beverages Division been able to provide input in the writing of the legislation. Many problems could have been avoided. However, any statements made by the Alcoholic Beverages Division were treated only as being self-serving and were largely ignored.

Overall, privatization was a good idea and has been a financial success as well.

ATTACHMENT A

The following graph represents the situation Iowa was experiencing with its state store system prior to privatization. As the distance between A & B increases, revenue and profits decrease. Until there is a major change of some kind, the distance will continue to increase.

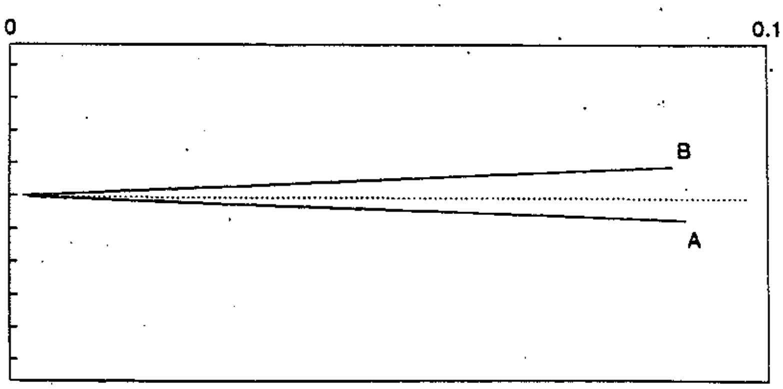


A = Steady decline in liquor sales.

B=Steady increase in cost of maintaining state stores.

When states are experiencing financial challenges, legislatures and pro-privatization groups will look at the above situation and question if a change may be necessary.

IOWA



A=Steady decline in liquor sales.

B=Steady increase in revenue and profits due to the lack of expense of maintaining state stores.

Even if "B" were a horizontal line, the state would still be in a position of maintaining revenues and profits.

ATTACHMENT B

The savings figures on the following page were determined by using actual figures each year since privatization. The figures used for the "state store" scenario are derived from the last actual budget appropriation for store operations (fiscal 1986) and adding 5% each year to reflect estimated budgetary growth.

ATTACHMENT C

REVENUE

FISCAL YEAR	NET FROM PRIVATE RETAIL SALES & RETAIL LICENCES	NET IF IOWA STILL HAD STATE STORES	DIFFERENCE
1988	23,882,723	18,153,850	$5,728,853
1989	23,468,940	16,731,382	6,737,558
1990	23,586,074	15,553,172	8,032,902
1991	24,567,118	16,027,558	8,539,560
1992	26,808,650	16,423,866	10,384,748
1993	26,448,876	13,740,583	12,708,293
1994	25,862,927	12,702,367	13,160,560
1995	25,758,902	11,200,859	14,558,043
1996	26,527,711	11,572,159	14,955,552
1997	26,998,237	12,987,956	14,010,281
1998	28,291,478	11,649,784	16,641,784
TOTAL			**$125,458,190**