

**Testimony of David M. Ozgo, Chief Economist, Distilled Spirits Council of the United States
Before the Competitive Alcohol Liquor Pricing Task Force
Hartford Connecticut, September 12, 2012**

My name is David Ozgo and I am the chief economist for the Distilled Spirits Council of the U.S. We represent the major distillers and importers of distilled spirits. Our members account for around 65% of everything sold in the U.S. I would like to thank you for this opportunity to speak before the committee.

Beverage alcohol is by far the most regulated product in the U.S., if not the world. There are over 4,000 laws, rules and regulation that govern the sale of spirits, wine and beer across the 50 states. While the states and Federal government are certainly well within their legal right to regulate beverage alcohol sales, they impose a heavy burden on suppliers, wholesalers, retailers and consumers nonetheless. For the most part, however, we applaud the efforts of legislators and regulators. But, regulations should serve the interest of the public and not just the vested interest of a few private commercial operators.

What is the public interest rationale behind Connecticut's minimum retail pricing laws and restrictions on wholesale quantity discounts? The only possible legitimate rationale would be to reduce alcohol abuse. Drinking patterns tend to be very regional. So, if Connecticut's minimum pricing laws have had any impact on alcohol abuse we would expect Connecticut to have better outcomes than surrounding states. We reviewed several key measures of alcohol abuse having to do with underage drinking, binge drinking, drunk driving and alcohol related deaths. In no instance could we find any evidence that the minimum pricing laws reduce alcohol related abuse in Connecticut.

This should come as no surprise. Pricing is a very ineffective public policy tool when it comes to reducing alcohol abuse. In fact, a 2009 study sponsored by the National Institute on Alcoholism and Alcohol Abuse and conducted by researchers at the Yale School of Public Health showed that the heaviest drinkers – those who are most likely to abuse alcohol, were the least likely to alter their drinking habits in response to higher prices. The authors concluded that neither the externality nor 'internality' justification for higher alcohol prices was supported by their results. In short, high prices do not protect society from abusive drinkers, nor do they protect abusive drinkers from themselves. Other studies have drawn similar conclusions.

The public is in no way served by Connecticut's minimum pricing requirement nor the ban imposed on wholesalers against quantity discounts. The only benefits to this system accrue to the state's retailers who are able to enjoy state protection against competition. At the Federal level these kinds of price controls were done away with years ago in other industries when the Civil Aeronautics Board was put out of businesses and airlines were allowed to offer flights and prices that passengers wanted, the Motor Carrier Act freed truckers to price as they saw fit and the Staggers Act allowed railroads to price more freely. The result? Airline travel became affordable for the average person, the trucking industry became more efficient and offered new services that saved consumers billions of dollars and the environment millions of gallons of gas, and railroads were brought back to life along with new services that made the U.S. more competitive internationally.

Yes, businesses were forced to become more efficient or go out of business after losing their government protection. But, that's the way economies are supposed to work. Public policy should not be used to grant favors to a protected few.

It is interesting to note that Connecticut's minimum bottle prices have nothing to do with actual cost of acquisition. In fact, "Min bottle" is based on the bottle price as posted in the monthly Connecticut Beverage Journal. Currently, wholesalers post two separate prices for all of the products that they sell to retailers in the state. The first price is a single bottle price, the other a case prices. The state currently requires retailers to price products a minimum of 8-cents per bottle more than the single bottle wholesale price. However, since what wholesalers sell to retailers is generally at the case price level, the actual markup is significantly greater than the statutory 8-cents per bottle.

This system of separate bottle and case pricing makes sense in a less regulated market. In this case, a retailer that wants to stock a small amount of a certain product – say a very expensive cognac – can purchase fewer than 12 bottles from a wholesaler in the anticipation that they may only sell a bottle or two a month. Since the wholesaler's cost for selling at less than a case are higher, they are passed on to the retailer via a higher bottle price. However, for most products, retailers purchase from wholesalers in case increments. In Connecticut, where retailers must sell at the bottle price plus a minimum 8-cent markup, this can lead to substantially higher retail prices than would be found in a free market.

As a result of the wholesale and retail pricing restrictions Connecticut consumers are forced to pay higher prices. My research shows that these pricing restrictions have had two affects. First, many Connecticut residents flee across the border for lower prices in surrounding states. In a recent survey of package stores in nearby Massachusetts and Rhode Island the minimum price that Connecticut retailers could legally sell at was higher than prices being offered on 85% of the 1.75 liter bottles of spirits analyzed. 1.75 liter bottles account for 42% of all volumes shipped into Connecticut and around 55% of volumes sold through package stores. They are easily the most important bottle size for consumers concerned about price. When leading wine brands were reviewed it was found that 71% of prices were below the Connecticut minimum price.

Comparing Connecticut sales volumes to surrounding states, shows that Connecticut conservatively loses an estimated 12% of spirits, 15% wine and 16% of beer volumes, valued at over \$200 million in retail revenue. These sales would have generated over \$20 million in excise and sales taxes.

Secondly, there is some evidence that the high prices force more in-state shoppers into what are known as Value brands – the least expensive products available. While Value brands offer the consumer good value for their money, state policy should not be dictating their beverage choices.

Clearly, the pricing restrictions that Connecticut puts on beverage alcohol serve no legitimate public policy purpose. According to the various measures of alcohol abuse Connecticut preforms no better than the surrounding states. The pricing restrictions merely impose higher prices on Connecticut consumers forcing many of them to shop in surrounding states and others to purchase brands that they otherwise would not and some to simply forgo purchases. Connecticut is the only state in the country with these kinds of pricing laws. It is time modernize Connecticut pricing practices.

Notes

- 1) ... if Connecticut's minimum pricing laws have had any impact on alcohol abuse we would expect Connecticut to have better outcomes than surrounding states. We reviewed several key measures of alcohol abuse having to do with underage drinking, binge drinking, drunk driving and alcohol related deaths. In no instance could we find any evidence that the minimum pricing laws reduce alcohol related abuse in Connecticut.

As the table below shows, in the key five measures analyzed Connecticut does not consistently outperform the surrounding states. For 12-17 year old past month drinking and 12-17 year old binge use Connecticut's average is higher than the average of surrounding states. Also, alcohol related traffic fatalities as a percentage of total traffic fatalities were higher in Connecticut than in the surrounding states whether the driver had any alcohol in his or her system (.01+) or was legally impaired (.08+).

While the alcohol induced adjusted death rate per 100,000 is lower in Connecticut than the surrounding state average, Maryland, New Jersey, and Pennsylvania all have rates lower than Connecticut and both Massachusetts and New York have rates that are similar (5.7% in Massachusetts and New York versus 5.6% in Connecticut). Thus, again, there is no pattern of Connecticut consistently achieving better results than surrounding states.

Connecticut and Surrounding States - Social Indicators					
State	12-17 Year Olds Reporting Any Monthly Use	12-17 Year Olds Reporting Binge Use	Alcohol Related Traffic Fatalities as a % of Total Traffic Fatalities .01+	Alcohol Related Traffic Fatalities as a % of Total Traffic Fatalities .08+	Alcohol Induced Adjusted Death Rate
CT	18.6%	13.3%	43.0%	38.0%	5.6%
DE	16.3%	9.4%	42.0%	36.0%	7.1%
MA	16.7%	10.3%	45.0%	36.0%	5.7%
MD	13.3%	8.2%	38.0%	31.0%	4.8%
ME	14.4%	7.8%	30.0%	23.0%	8.4%
NH	17.6%	11.2%	42.0%	35.0%	8.4%
NJ	15.1%	9.2%	34.0%	27.0%	4.0%
NY	16.8%	10.1%	36.0%	30.0%	5.7%
PA	15.0%	8.7%	38.0%	33.0%	4.9%
RI	18.2%	9.6%	45.0%	38.0%	7.3%
VT	18.3%	10.8%	35.0%	25.0%	8.4%
Average	16.4%	9.9%	38.9%	32.0%	6.4%

- 2) Pricing is a very ineffective public policy tool when it comes to reducing alcohol abuse. In fact, a 2009 study sponsored by the National Institute on Alcoholism and Alcohol Abuse and conducted by researchers at the Yale School of Public Health showed that the heaviest drinkers – those who are most likely to abuse alcohol, were the least likely to alter their

drinking habits in response to higher prices. The authors concluded that neither the externality nor 'internality' justification for higher alcohol prices was supported by their results. In short, high prices do not protect society from abusive drinkers, nor do they protect abusive drinkers from themselves. Other studies have drawn similar conclusions.

In "Sin Taxes: Do Heterogeneous Responses Undercut Their Value" (National Bureau of Economic Research, NBER Working Paper Series Paper 15124, July 2009) the authors summarize their research by noting:

"The standard welfare approach would suggest (considering only efficiency conditions and ignoring distributional issues) that for most goods, higher taxes should be levied, ceteris paribus, on goods that have an inelastic demand. However, in the case of potentially harmful goods, sin taxes are levied in part to reduce the potential harms, external and internal, of consumption. For these drinkers, under several behavioral economic theories of addiction, taxes could increase welfare by serving as a precommitment device that serves to bolster weak self-control. However our results suggest that the heavier drinkers are least likely to respond to higher taxes, thus, neither the externality nor "internality" justification for higher alcohol taxes is supported by our results." (p. 25).

While the authors are referring to beverage alcohol tax rates, taxation in most states is the vehicle through which the state affects pricing.

Also, in "Can harms associated with high-intensity drinking be reduced by increasing the price of alcohol?" (Drug and Alcohol Review, 2012) the authors found that high intensity drinking (more than 10 drinks per day) was not impacted by higher prices. Similar results were found in "The demand for alcohol: The differential response to price," (Journal of Health Economics 14(2):123-148, 1995) where the researchers noted that the heaviest drinking 5% did not respond to higher prices.

3) In a recent survey of package stores in nearby Massachusetts and Rhode Island the minimum price that Connecticut retailers could legally sell at was higher than prices being offered on 85% of the 1.75 liter bottles of spirits analyzed.

As the tables below show, the 1.75 liter prices of six bellwether brands were surveyed in 11 Massachusetts and Rhode Island stores. Of the 66 bottle prices collected 56 (85%) of them were lower than the minimum Connecticut bottle price as published in the Connecticut Beverage Journal. Wine saw similar results of the 14 popular brands/sizes analyzed. Of the 154 prices collected 110 (71%) had a lower price than the Connecticut minimum price.

It is important to note, that the Connecticut minimum prices are just that – the minimum price that a product can be sold for in Connecticut. Some prices will be higher than the minimum.

Spirits Pricing Data

Massachusetts Bottle Price Comparison to Connecticut Minimum Prices 1.75 Liter Bottles						
	Smirnoff Red Label	Captain Morgan Original	Bacardi Superior	Skyy Vodka	Svedka	Jack Daniels Black
CT Minimum	\$21.99	\$28.99	\$22.99	\$23.99	\$22.99	\$41.99
Store 1	\$19.99	\$26.99	\$25.99	\$19.99	\$17.99	\$37.99
Store 2	\$19.99	\$26.99	\$21.99	\$19.99	\$19.99	\$38.99
Store 3	\$20.99	\$26.99	\$21.99	\$22.99	\$18.99	\$37.89
Store 4	\$19.99	\$25.99	\$24.99	\$18.99	\$18.99	\$37.99
Store 5	\$19.99	\$27.99	\$24.99	\$19.99	\$19.99	\$39.99
Store 6	\$19.99	\$26.99	\$21.39	\$17.59	\$17.99	\$37.99
Store 7	\$21.95	\$25.99	\$21.99	\$21.99	\$16.99	\$33.99
Store 8	\$23.99	\$29.99	\$25.99	\$19.99	\$20.99	\$38.99

Rhode Island Bottle Price Comparison to Connecticut Minimum Prices 1.75 Liter Bottles						
	Smirnoff Red Label	Captain Morgan Original	Bacardi Superior	Skyy Vodka	Svedka	Jack Daniels Black
CT Minimum	\$21.99	\$28.99	\$22.99	\$23.99	\$22.99	\$41.99
Store 1	\$20.98	\$26.49	\$21.99	\$21.99	\$19.89	\$36.88
Store 2	\$22.99	\$29.99	\$22.99	\$22.99	\$21.99	\$39.99
Store 3	\$20.99	\$27.99	\$23.99	\$21.99	\$19.99	\$39.99

Wine Pricing Data

Massachusetts Bottle Price Comparison to Connecticut Minimum Prices Wine							
	Kendall Jackson 750 MI	Woodbridge Mondovi 1.5L	Menage a Trios Red 750 MI	Clos Du Bois Chardonay 750 MI	Barefoot Pinogrigio 1.5 L	Franzia Chard Box 5 L	Apothic Red Blend 750 MI
CT Minimum	\$12.99	\$12.99	\$10.99	\$9.99	\$11.99	\$16.99	\$9.99
Store 1	\$9.98	\$9.98	\$7.98	\$9.98	\$8.98	\$15.99	\$7.78
Store 2	\$10.99	\$9.99	\$7.98	\$10.99	\$9.99	\$11.99	\$7.99
Store 3	\$9.99	\$9.97	\$8.99	\$11.99	\$9.98	\$13.98	\$10.99
Store 4	\$9.99	\$12.99	\$8.99	\$12.99	\$10.99	\$13.99	\$8.99
Store 5	\$10.98	\$9.98	\$9.99	\$16.99	\$10.99	\$17.99	\$9.99
Store 6	\$9.99	\$9.97	\$9.99	\$10.98	\$9.99	\$12.99	\$7.99
Store 7	\$9.99	\$9.99	\$12.99	\$12.99	\$9.99	\$12.99	\$9.99
Store 8	\$11.99	\$9.99	\$8.99	\$13.99	\$11.99	\$14.59	\$11.99

Massachusetts Bottle Price Comparison to Connecticut Minimum Prices Wine							
	Chat St. Michelle Riesling 750 MI	Chat St. Michelle Chardonay 750 MI	Barefoot Pinogrigio 750 MI	Barefoot White Muscato 750 MI	Franzia Blush 5 L	Barefoot White Muscato 1.5 L	Cupcake Chardonay 750 MI
CT Minimum	\$9.99	\$9.99	\$6.99	\$6.99	\$13.99	\$11.99	\$9.99
Store 1	\$7.78	\$7.78	\$5.99	\$5.99	\$12.99	\$8.98	\$7.98
Store 2	\$8.99	\$8.99	\$6.99	\$6.99	\$13.99	\$9.99	\$8.99
Store 3	\$7.99	\$8.99	\$5.99	\$5.98	\$12.98	\$9.99	\$7.99
Store 4	\$7.99	\$7.99	\$5.99	\$5.99	\$12.99	\$10.99	\$7.99
Store 5	\$8.98	\$8.99	\$6.00	\$6.00	\$14.99	\$10.99	\$7.98
Store 6	\$7.49	\$7.49	\$7.49	\$5.99	\$12.99	\$9.99	\$8.99
Store 7	\$7.99	\$8.98	\$6.99	\$6.99	\$12.99	\$9.99	\$8.99
Store 8	\$11.99	\$11.99	\$7.59	\$7.59	\$12.59	\$11.99	\$12.99

Rhode Island Bottle Price Comparison to Connecticut Minimum Prices Wine							
	Kendall Jackson 750 MI	Woodbridg e Mondovi 1.5L	Menage a Trios Red 750 MI	Clos Du Bois Chardonnay 750 MI	Barefoot Pinogrigio 1.5 L	Franzia Chard Box 5 L	Apothic Red Blend 750 MI
CT Minimum	\$12.99	\$12.99	\$10.99	\$9.99	\$11.99	\$16.99	\$9.99
Store 1	\$11.89	\$10.89	\$8.89	\$9.98	\$8.89	\$14.49	\$8.39
Store 2	\$11.99	\$12.99	\$8.89	\$13.99	\$8.99	\$15.59	\$8.99
Store 3	\$12.59	\$12.99	\$9.99	\$11.99	\$10.99	\$15.59	\$9.99

Rhode Island Bottle Price Comparison to Connecticut Minimum Prices Wine							
	Chat St. Michelle Riesling 750 MI	Chat St. Michelle Chardonnay 750 MI	Barefoot Pinogrigio 750 MI	Barefoot White Muscato 750 MI	Franzia Blush 5 L	Barefoot White Muscato 1.5 L	Cupcake Chardonnay 750 MI
CT Minimum	\$9.99	\$9.99	\$6.99	\$6.99	\$13.99	\$11.99	\$9.99
Store 1	\$8.89	\$9.89	\$5.99	\$5.99	\$11.89	\$8.89	\$9.99
Store 2	\$11.99	\$11.99	\$7.59	\$7.99	\$14.99	\$9.99	\$8.49
Store 3	\$9.29	\$9.99	\$6.99	\$5.99	\$14.99	\$10.99	\$8.99

Stores

Massachusetts Stores	
Store 1	Yankee Spirits - 376 Main Street, Sturbridge, MA 01566 (508) 347-2231
Store 2	Kappy's - 10 Revere Beach Parkway, Medford, MA 02155 (781) 395-8888
Store 3	Luke's - 167 Market Street, Rockland, MA 02370 (781) 878-0226
Store 4	Atlas - 156 Mystic Ave. Medford, MA 02155 781.395.4400
Store 5	Austin - 117 Gold Star Boulevard, Worcester, MA 01606 (508) 853-8953
Store 6	Wegmans - 9102 Shops Way, Northborough, MA 01532 (508) 936-1900
Store 7	Gasbarro's - 98 Highland Avenue, Seekonk, MA 02771 (508) 336-6869
Store 8	Wines and More - 280 School Street, Mansfield, MA 02048 (508) 339-6900

Rhode Island Stores						
Store 1	Haxton Tollgate - 1123 Bald Hill Road, Warwick, RI 02886(401) 828-3000					
Store 2	Douglas - 1661 Mineral Spring Avenue North Providence, RI 02904 (401) 353-6400					
Store 3	Townline - 5782 Post Road, East Greenwich, RI 02818 (401) 884-7517					

- 4) Comparing Connecticut sales volumes to surrounding states, shows that Connecticut conservatively loses an estimated 12% of spirits, 15% of wine and 16% of beer volumes, valued at over \$200 million in retail revenue. These sales would have generated over \$20 million in excise and sales taxes.**

Beverage alcohol consumption levels tend to be driven by local cultural norms. Thus, barring any dramatic demographic differences, nearby states will generally have similar levels of per capita consumption. The table below shows average per capita gallons across the Connecticut area. Since New Hampshire is known to attract out-of-state shoppers with state mandated low prices, New Hampshire volumes were included as well.

Calculation of Regional Volume Averages							
State	Adult Per Capita Gallons			Adult Population	2010 Gallons		
	Spirits	Wine	Beer		Spirits	Wine	Beer
Connecticut	2.41	4.88	21.97	2,615,000	6,309,780	12,755,849	57,459,661
Massachusetts	2.32	5.70	26.32	4,855,000	11,255,036	27,674,601	127,800,183
Rhode Island	2.48	4.74	27.49	770,000	1,908,276	3,647,711	21,166,295
New York (Metro)	2.47	5.17	22.48	7,612,921	18,795,071	39,358,367	171,173,082
New Hampshire	5.24	6.61	44.17	954,000	4,998,960	6,308,318	42,140,591
Population				16,806,921	43,267,123	89,744,847	419,739,812
Avg. Gal./Adult					2.57	5.34	24.97

Subtracting the regional average volume levels for spirits, wine and beer reveals per capita “deficits” of 0.16 gallons of spirits, 0.46 gallons of wine and 3.00 gallons of beer. Multiplying these figures by the Connecticut adult population shows that Connecticut has a sales deficit of 422 thousand gallons of spirits, 1.2 million gallons of wine and 7.8 million gallons of spirits.

However, this estimate will understate lost cross border volumes. While cultural norms tend to be regional and are one important factor in whether or not someone chooses to drink, income is another driving factor. Median household income in Connecticut is almost \$68,000 annually, higher than Massachusetts, Rhode Island and New York. Thus, we would not only expect Connecticut per capita volumes to be equivalent to the regional average, we would expect Connecticut volumes to be somewhat higher.

It is likely that high prices drive more shoppers across the border than our calculated deficit figures above would indicate. Additionally, other shoppers are simply driven out of the market. To account for these secondary effects we estimated how much volume is lost from shoppers simply being priced out of the market. The table below uses the Massachusetts pricing data from section 3 above to estimate the pricing impacts on spirits and wine. The spirits prices in

Massachusetts were an average of 8.5% below the Connecticut minimum price and the wine prices were 9.1% below. We conservatively assumed beer prices to be 5% below. Using price elasticity measures of -0.80 for spirits, -0.55 for wine and -0.40 for beer we calculated the percent of additional off-premise retail volume that is likely lost.

Estimate of Connecticut Volume Deficit and Lost Sales Due to High Prices				
Measure	Spirits	Wine	Beer	Totals
Connecticut Deficit (Gal./Adult)	-0.16	-0.46	-3.00	
Lost Cross Border Volume (Gal.)	422,180	1,207,611	7,847,935	
Cases (000)	177,570	507,923	3,487,971	
Pricing Impact (Percent of Volume)	6.7%	5.0%	2.0%	
Pricing Impact (Cases)	134,598	268,386	499,200	
Total Lost Volumes (Cases)	312,167	776,309	3,987,171	
Percent of Current Taxed Volume	12.4%	14.5%	16.0%	
Retail Value	\$ 65,503,289	\$ 50,834,424	\$ 95,128,621	\$ 211,466,335
Excise Tax Value	\$ 4,007,840	\$ 1,328,912	\$ 2,063,361	\$ 7,400,113
Sales Tax Value	\$ 3,930,197	\$ 3,050,065	\$ 5,707,717	\$ 12,687,980
Total Tax Revenue	\$ 7,938,037	\$ 4,378,978	\$ 7,771,078	\$ 20,088,093

Total lost volumes (in cases) amount to 312 thousand for spirits, 776 thousand for wine and nearly 4 million for beer. At retail these lost sales would be worth an estimated \$211 million and would generate over \$20 million in sales and excise taxes.

- 5) **“... there is some evidence that the high prices force more in-state shoppers into what are known as Value brands – the least expensive products available.**

A comparison of brands shipped into Connecticut and Rhode Island by DISCUS member companies showed that 14.7% of all volumes shipped into Connecticut were Value brands. However, Value brand made up only 10.7% of Rhode Island volumes. Given the much higher level of household income enjoyed by Connecticut residents these results are opposite of what one would expect.