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Competition, Consumer Welfare and State Alcohol Regulation

**Written Testimony of
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Committee on the Judiciary
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Thank you for the opportunity to present this written testimony. I am an economist and research fellow at the Mercatus Center, a 501(c)(3) research, educational, and outreach organization affiliated with George Mason University in Arlington, Virginia.¹ I have been with the Mercatus Center for the past 13 years, with the exception of 2001–03 when I served as deputy director of the Office of Policy Planning at the Federal Trade Commission (FTC). Much of my academic research assesses the effects of regulation on the welfare of consumers—including wine consumers. I’ve co-authored several studies on wine retailing, including the FTC’s 2003 report on anti-competitive barriers to online wine sales that was cited heavily in the Supreme Court’s *Granholm* decision, as well as multiple peer-reviewed journal articles on regulation of direct wine shipment.²

¹ This testimony reflects only the views of its author and does not represent an official position of George Mason University. I would like to thank Mohamad Elbarasse for research assistance.

² *Granholm v. Heald*, 544 U.S. 460 (2005); *Possible Anticompetitive Barriers to E-Commerce: Wine*, Report from the Staff of the Federal Trade Commission (July 2003), available at <http://www.ftc.gov/os/2003/07/winereport2.pdf>; Alan E. Wiseman and Jerry Ellig, *Market and Nonmarket Barriers to Internet Wine Sales: The Case of Virginia*, 6 BUSINESS AND POLITICS (2004); Jerry Ellig and Alan E. Wiseman, *The Economics of Direct Wine Shipping*, 3 J. LAW, ECON. & POL’Y 255 (Spring 2007); Jerry Ellig and Alan E. Wiseman, *Interstate Trade Barriers and Potential Regulatory Competition: The Case of Virginia’s Direct Wine Shipping Ban*, 19 J. PRIVATE ENTERPRISE 26 (2004); Alan E. Wiseman and Jerry Ellig, *The Politics of Wine: Trade Barriers, Interest Groups, and the Commerce Clause*, 69 J. OF POLITICS 859 (2007).

Since the Supreme Court issued its decision in *Granholm*, several state alcoholic beverage authorities have been subject to federal litigation over the legality of certain alcohol beverage laws under the Commerce Clause, federal antitrust statutes, and other federal laws. As addressed in today's hearing and the March 2010 hearing held by the House Judiciary Subcommittee on Courts and Competition Policy, certain state officials and interest groups are concerned that recent trends in federal court decisions may result in significant changes in how states regulate the alcoholic beverage industry within their borders. In response, the House of Representatives is debating whether or not to modify the legal standards applicable to challenges of state alcoholic beverage laws under the Commerce Clause and potentially other federal laws.

Unfortunately, in the clash of in-state vs. out-of-state economic interests, the consumer often gets overlooked. The House of Representatives will no doubt hear plenty from the various interests that have a significant financial stake in this issue, including beverage alcohol producers, wholesalers, and retailers. You will hear from state officials who are concerned about the future of their states' current regulatory systems for alcohol beverages. You will likely also hear from other active players in alcohol debates who define "the public interest" in terms of a particular single issue that they feel is of primary importance, such as preventing underage access to alcohol, preventing drunk driving, or preventing other people from consuming too much.

You will hear much less from the average consumer who drinks alcohol responsibly. Public choice economics (one of the specialties of the house at George Mason University) explains why. The benefits of alcohol policies that restrict competition are concentrated on particular interest groups that either profit financially or deem it a success when their particular vision of the public interest holds sway over policy.³ Such like-minded people know who they are and have obvious incentives to organize themselves for political action. The costs of restricted competition, in terms of higher prices, reduced variety, and reduced convenience, are spread across all consumers. Many of them might not even be aware of the policies that affect competition. Average consumers have much less incentive to organize and present their views.

The social science shorthand describing this phenomenon is "concentrated benefits, dispersed costs." Anticompetitive policies concentrate benefits on well-organized industries and interest groups and spread the costs widely across the rest of society. The consumers who pay the costs rarely know what hit them.

As an economist and former federal antitrust official, I take a broad view of the public interest. We know from experience that competition tends to give consumers the blend of price, quality, service, and other good things that they most prefer. In the case of alcohol, these consumer interests must be balanced against other significant policy considerations, such as prevention of underage access and other social ills associated with alcohol abuse.

³ Bruce Yandle, *Bootleggers and Baptists: The Education of a Regulatory Economist*, 7 REGULATION 12 (1983).

But if we are concerned about the welfare of consumers, restrictions ought not be imposed on competition unless there is evidence that the restrictions accomplish some clear public purpose. Furthermore, the restrictions should be no more stringent than necessary to accomplish the public purpose. This helps ensure that the government accomplishes its policy goal at the lowest possible cost to consumers.

My testimony addresses how this type of careful analysis might be short-circuited if state alcoholic beverage laws are subject to different legal standards under the Commerce Clause. I examine four principal issues relating to the role of competition and consumer welfare:

- (1) Giving state alcohol laws that have discriminatory effects special protection from the Commerce Clause would likely encourage state protectionism.
- (2) Legitimizing state laws that have discriminatory effects would impose very real costs on consumers.
- (3) Despite the claims to the contrary, there is little credible empirical evidence that the *Granholm* decision has produced a surge in underage drinking.
- (4) Passage of legislation to create some form of a Commerce Clause exemption for state alcohol laws would likely open the door to other requests for special treatment from other industries that believe they have a special need for exemptions from the U.S. Constitution or federal laws.

1. Discriminatory restrictions on competition

I am an economist, not a lawyer. But I have followed the public policy debate about direct wine shipment and how states have responded to the *Granholm* decision. From a layman's perspective, creating special legal standards for state alcohol laws appears to open the door to state protectionism, regardless of whether that protectionism is necessary to accomplish some other important public purpose.

Some have argued that interstate commerce is sufficiently protected if states only have to justify "facially" or "intentionally" discriminatory state laws. But state laws that are facially neutral can also have unintended discriminatory effects.

The aftermath of *Granholm* provides real examples. When passing new laws on direct-to-consumer wine shipment, many states chose to level the playing field "up" by extending direct shipment privileges to out-of-state wineries, and sometimes retailers. Some states, however, chose to level "sideways" by permitting direct shipment from out of state but also imposing on-site purchase requirements or allowing direct shipment only for wines produced by wineries with production below specified limits. Legal scholars have noted that while on-site requirements qualify as facially neutral, they effectively discriminate against out-of-state wineries by forcing consumers to bear substantial travel costs to take advantage of direct shipment. In a similar fashion, production limits are often tailored to prevent direct shipment of wines produced by any out-of-state winery larger than the

largest in-state winery.⁴ Creating an exemption for state laws that are facially neutral but discriminatory in actual effect would simply encourage states to continue a trend of cleverly crafting laws that discriminate against interstate commerce and harm consumers while remaining facially nondiscriminatory.

Taking a different tack, some have argued that any state alcohol law, enacted for whatever purpose, should be upheld unless the challenger can prove that the law has no effect on the traditional goals of alcoholic beverage regulation, such as the promotion of temperance, the establishment or maintenance of orderly alcoholic beverage markets, the collection of alcoholic beverage taxes, the structure of the state alcoholic beverage distribution system, or the restriction of access to alcoholic beverages by those under the legal drinking age. But this standard does not bode well for competition or consumer welfare. For example, a discriminatory law that increases wine prices to consumers by banning direct-to-consumer wine shipment from out of state could be upheld precisely because the price increase might reduce wine consumption, arguably promoting temperance.

If such a standard were to apply to federal statutes, a state could arguably allow wholesalers or retailers to create cartels and fail to supervise them as the “state action” doctrine requires. Yet such naked restraints on competition might be immune from the federal antitrust laws because the resulting monopoly prices arguably “promote temperance” by reducing alcohol consumption.

Recent research by my George Mason University colleague Joshua Wright and James Cooper of the Federal Trade Commission provides one example.⁵ Numerous states have “post and hold” laws that facilitate price collusion by requiring alcohol distributors to notify their competitors in advance of the prices they intend to charge by “posting” them publicly. These laws also prevent price reductions because the posted prices must be “held” for a specified period of time. Cooper and Wright find that post and hold laws reduce alcohol consumption but have no effect on drunk driving accidents or teenage drinking. This suggests that the laws simply raise prices and prompt responsible drinkers to consume less, while doing nothing to control the behavior of irresponsible drinkers or social problems associated with alcohol. Several federal appeals courts have struck down state post and hold laws under the federal antitrust laws. It is difficult to see how virtually exempting state alcohol laws from antitrust would encourage state legislatures to examine whether a proposed anticompetitive restriction on competition is really necessary to achieve a defined public purpose.

⁴ Maureen P. Ohlhausen and Gregory P. Luib, *Moving Sideways: Post-Granholm Developments in Wine Direct Shipping and Their Implications for Competition*, 75 ANTITRUST LAW J. 505, 514–16 (2008); James Alexander Tanford, *E-Commerce in Wine*, 3 J. LAW, ECON & POLICY 275, 322 (2007).

⁵ James C. Cooper and Joshua D. Wright, “State Regulation of Alcohol Distribution: The Effects of Post & Hold Laws on Outputs and Social Harms,” Federal Trade Commission, Bureau of Economics, Working Paper No. 304 (original release August 2010; revised September 2010), <http://www.ftc.gov/be/workpapers/wp304.pdf>; see also George Mason Law & Economics Research Paper No. 10-32 (July 23, 2010), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1641415

2. Consumer costs

Legitimizing state laws that have discriminatory effects, regardless of their stated intent, would likely generate substantial consumer costs. A straightforward illustration of the cost comes from a series of studies on direct wine shipment Alan Wiseman and I have conducted and published during the past several years. I do not mean to imply that such a standard would impose costs on consumers only via its effects on direct wine shipment; direct shipment just happens to be the example with which I'm most familiar.

We conducted our first economic study of direct shipment in Northern Virginia when we both worked at the FTC in 2002. We conducted a follow-up study in 2004 after Virginia legalized out-of-state direct shipment. In each year, we examined the availability and prices of the "Top 50" restaurant wines in *Wine and Spirits* magazine's annual restaurant poll.⁶ We compared prices and availability online with prices and availability in Northern Virginia wine stores, which included single-location wine shops and beverage superstores. The results have been published in a series of peer-reviewed journal articles. Below, I summarize some of the key findings.

Out-of-state direct shipment increases variety

In 2002, 15 percent of wines available online could not be found in the stores; in 2004, it was 12.5 percent.⁷ We did not inquire whether some or all of these wines might be available from bricks-and-mortar retailers via special order as our goal was to find out whether a consumer could simply walk into the store and buy the wine without additional effort, just as the consumer could go search online and order without additional effort. Our result confirms what intuition suggests: it is not physically possible for a retailer to stock every wine a consumer might want to buy, even from a sample of top-selling wines. Out-of-state direct shipment thus expands the product variety readily available to consumers; barriers to out-of-state direct shipment reduce product variety available to consumers.

If anything, our results understate the extent of the variety benefit because our sample consists only of top-selling wines in restaurants. Thousands of wines produced in smaller volumes are even less likely to find their way onto store shelves due to distributors' hesitation to carry wines from smaller producers.⁸

⁶ The numbers below show more than 50 bottles per year. That is because the survey identifies the winery name, grape variety, and year, but not necessarily the bottling. Some wineries, for example, produce multiple bottlings of the same grape variety, such as a "reserve" and an "estate reserve" chardonnay. When this occurred, we included both bottles in our sample.

⁷ Wiseman and Ellig (2004), *supra* note 2 at 20; Wiseman and Ellig (2007), *supra* note 2 at 866.

⁸ See Wiseman and Ellig (2004), *supra* note 2 at 5.

Discrimination against out of state direct shipment increases consumer prices

Table 1 compares the lowest online prices with the lowest prices available in Northern Virginia wine stores in 2002, when direct shipment from out of state was illegal. These are the same figures that appeared in the FTC staff study of e-commerce in wine.

Table 1: 2002 Cost Savings (Extra Expenses) per Bottle When Shopping Online

Category	Entire Sample	Bottles ≥ \$20	Bottles ≥ \$40	Bottles < \$20
Online Savings (no transportation costs)	5.83**	9.44**	20.61**	1.66**
Online Savings (UPS Ground: 1 Bottle)	1.51	5.51**	17.88*	-3.14**
Online Savings (UPS 3 rd Day Air: 1 Bottle)	-2.44*	1.53	13.57	-7.05**
Online Savings (UPS 2 nd Day Air: 1 Bottle)	-7.26**	-3.70	6.97	-11.39**
Online Savings per Bottle (UPS Ground: 6 Bottles)	3.34**	7.03**	18.39**	-0.93**
Online Savings per Bottle (UPS 3 rd Day Ai: 6 Bottles)	0.71	4.40*	15.76*	-3.58**
Online Savings per Bottle (UPS 2 nd Day Air: 6 Bottles)	-0.77	2.91	14.28	-5.04**
Online Savings per Bottle (UPS Ground: 12 Bottles)	3.54**	7.19**	18.45**	-0.70
Online Savings per Bottle (UPS 3 rd Day Air: 12 Bottles)	1.35	5.01**	16.26*	-2.89**
Online Savings per Bottle (UPS 2 nd Day Air: 12 Bottles)	0.11	3.65	14.99*	-4.22**

Statistical significance:

*Difference significant at the 10 percent level.

**Difference significant at the 5 percent level.

Source: Alan E. Wiseman and Jerry Ellig, “How Many Bottles Make a Case Against Prohibition? Online Wine and Virginia’s Direct Shipment Ban,” Appendix A in *Possible Anticompetitive Barriers to E-Commerce: Wine*, Report from the Staff of the Federal Trade Commission (July 2003).

For the entire sample, direct shipment could save an average of more than \$3 per bottle—but only if the customer was willing to buy 6 or 12 bottles and ship via ground service. The next three columns reveal that the price savings are really concentrated in the bottles priced at \$20 or above, which accounts for a little more than half the sample. In most cases, the savings are substantial if the customer either chooses ground shipment or orders 6 or more bottles at a time.

On average, direct shipment imposes a price penalty on bottles that cost less than \$20, because shipping costs exceed the very small average price savings. This suggests that direct shipment would not be the preferred strategy for alcoholics or teenagers looking for a cheap drink.

Legalization of out of state direct shipment generates consumer savings

Virginia legalized direct shipment to consumers by out-of-state wineries and retailers in July 2003. Table 2 compares the lowest online prices with the lowest prices available in Northern Virginia wine stores in 2004.

On average, consumers could still save money in 2004 by shopping online for wines that cost \$20 per bottle or more. But the difference between online prices and prices in Virginia wine stores narrowed. Buying wines priced at less than \$20 online carried an even greater financial penalty in 2004 than in 2002.

Table 2: 2004 Cost Savings (Extra Expenses) per Bottle When Shopping Online

Category	Entire Sample	Bottles ≥ \$20	Bottles ≥ \$40	Bottles < \$20
Online Savings (no transportation costs)	3.04**	5.88**	12.87**	0.92**
Online Savings (UPS Ground: 1 Bottle)	-1.45*	2.25	10.41**	-4.23**
Online Savings (UPS 3 rd Day Air: 1 Bottle)	-5.17**	-1.48	5.61*	-7.94**
Online Savings (UPS 2 nd Day Air: 1 Bottle)	-9.59**	-5.91**	1.38	-12.35**
Online Savings per Bottle (UPS Ground: 6 Bottles)	1.45**	4.40**	11.44**	-0.76***
Online Savings per Bottle (UPS 3 rd Day Air: 6 Bottles)	-0.60	2.37*	8.81**	-2.83**
Online Savings per Bottle (UPS 2 nd Day Air: 6 Bottles)	-2.91**	0.03	6.47**	-5.12**
Online Savings per Bottle (UPS Ground: 12 Bottles)	1.60**	4.48**	11.39**	-0.56
Online Savings per Bottle (UPS 3 rd Day Air: 12 Bottles)	-0.120	2.786**	9.205**	-2.30**
Online Savings per Bottle (UPS 2 nd Day Air: 12 Bottles)	-2.17**	0.70	7.07**	-4.32**

Statistical significance:

*Difference significant at the 10 percent level.

**Difference significant at the 5 percent level.

Source : Jerry Ellig and Alan Wiseman, *The Economics of Direct Wine Shipping*, 3 J. LAW ECON & POLICY 255 (2007).

Statistical analysis revealed that the price spread between the lowest online and offline prices fell by about 6 percentage points, or 40 percent, between 2002 and 2004. The price spread between the lowest online and average offline prices fell by 5–6 percentage points, or 22 percent. Hence, the average retailer, and not just the lowest-pricing bricks-and-mortar retailer, lowered prices to meet the online competition following the repeal of the direct shipment ban. This price convergence occurred regardless of a bottle's price or popularity as measured in the *Wine and Spirits* survey.⁹

⁹ Wiseman and Ellig (2007), *supra* note 2, at 867–70.

We examined whether the percentage price differences between online sellers and Northern Virginia bricks-and-mortar stores varied systematically with direct shipment costs. We found that there was no relationship in 2002, when Virginia customers could not legally receive direct shipments from out of state sellers. In 2004, however, the price spread between online sellers and bricks-and-mortar retailers was positively correlated with direct shipment costs.¹⁰ This correlation suggests that legalization of out-of-state direct shipment increased competition between local Virginia wine stores and online retailers. Prior to the legalization of direct shipment, Virginia retail prices were completely unresponsive to interstate shipping costs, and markups were largely attributable to the average bottle price. When direct shipment was legalized, however, Virginia retailers responded to out-of-state competition by lowering their prices from where they had been in 2002 and by effectively pegging their markups to out-of-state shipping costs. Consistent with the intentions of the Commerce Clause, removal of Virginia's direct-shipment ban increased competition in local markets.

Facially neutral but discriminatory laws harm consumers

Protection of facially neutral laws that have discriminatory effects would expose consumers to potential economic harm. Consider, for example, the supposedly neutral state laws that allow direct shipment only of wines produced by wineries with annual production below a certain cap. Table 3 suggests how the caps contained in various actual or proposed state laws would affect direct shipment of most of the wines in our 2002 and 2004 sample.

I currently have production volume data for all but two of the wineries in the sample. The table shows results for 76 wines available online in 2002 and 67 wines available online in 2004. For this subset, a state law like Arizona's, which allows direct shipment from wineries producing 20,000 gallons or less annually, would have excluded all of the wines in the sample. Massachusetts' 30,000 gallon cap, struck down by federal courts, would have had about the same effect. Such caps are tantamount to banning direct shipment for our entire sample. A 150,000 gallon cap (originally enacted in Ohio) would have excluded more than 80 percent of the wines.

A 250,000 gallon cap—enacted in Ohio and proposed in Florida—would have excluded 50–60 percent of the wines from direct shipment. I do not have sales data for individual wines, but it's quite likely that excluding 50–60 percent of the wines excludes more than 50–60 percent of the potential online sales volume. The larger wineries likely produce and sell individual wines in larger quantities than the smaller wineries do.

¹⁰ *Id.* at 870.

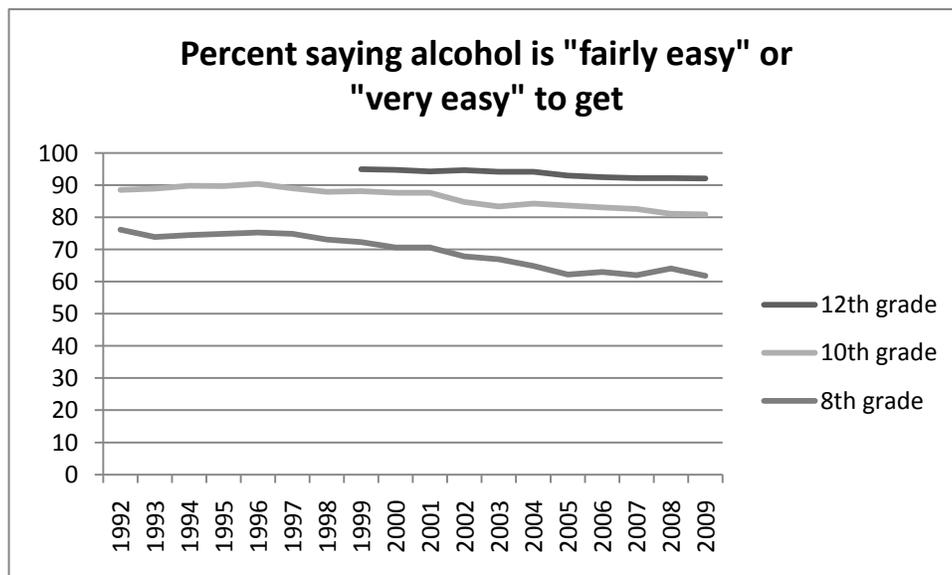
Table 3: How Many Bottles Would Production Caps Exclude from Direct Shipment?

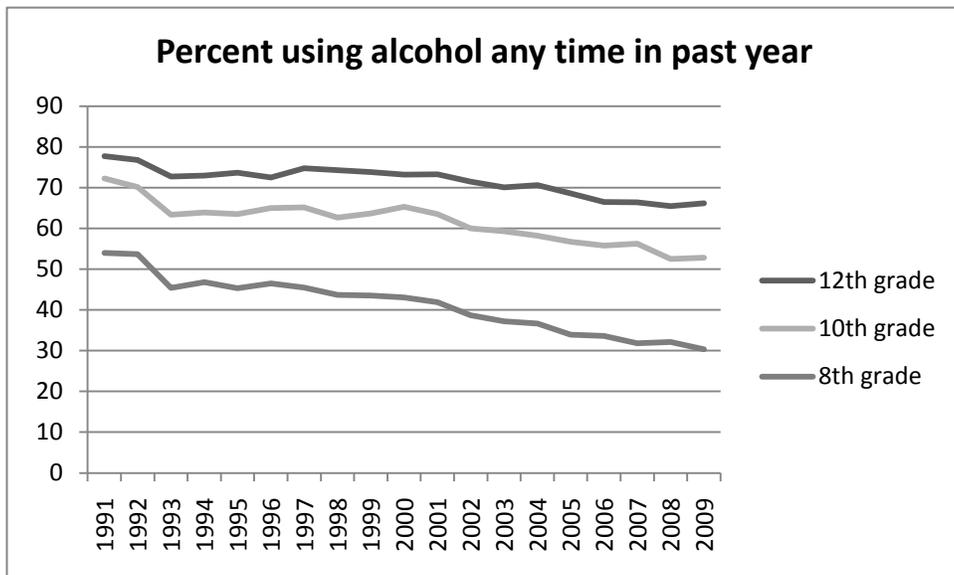
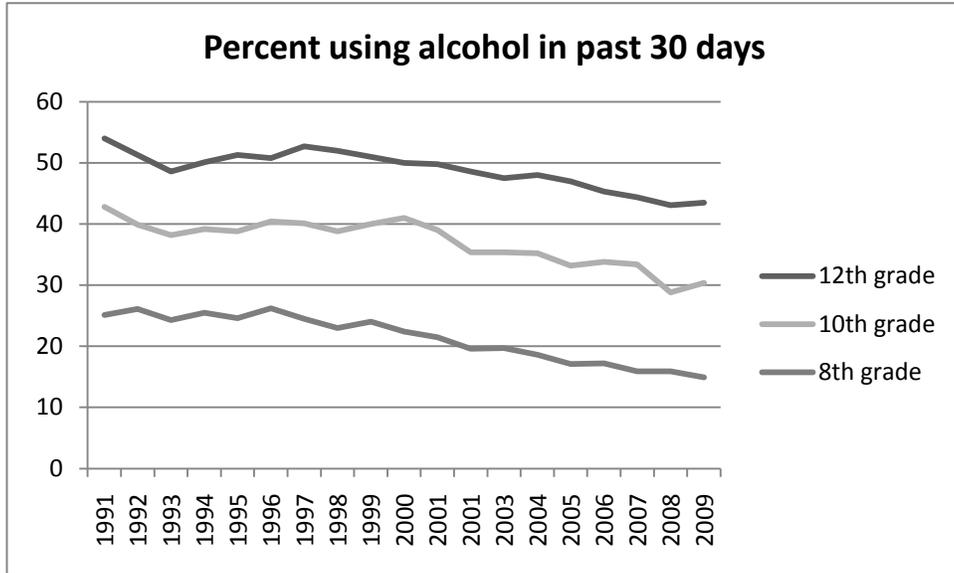
Year	Total Bottles Available Online W/Production Data	Production cap (annual gallons)			
		20,000	30,000	150,000	250,000
2002	76	76 100%	76 100%	61 80%	46 61%
2004	67	64 96%	64 96%	54 81%	37 55%

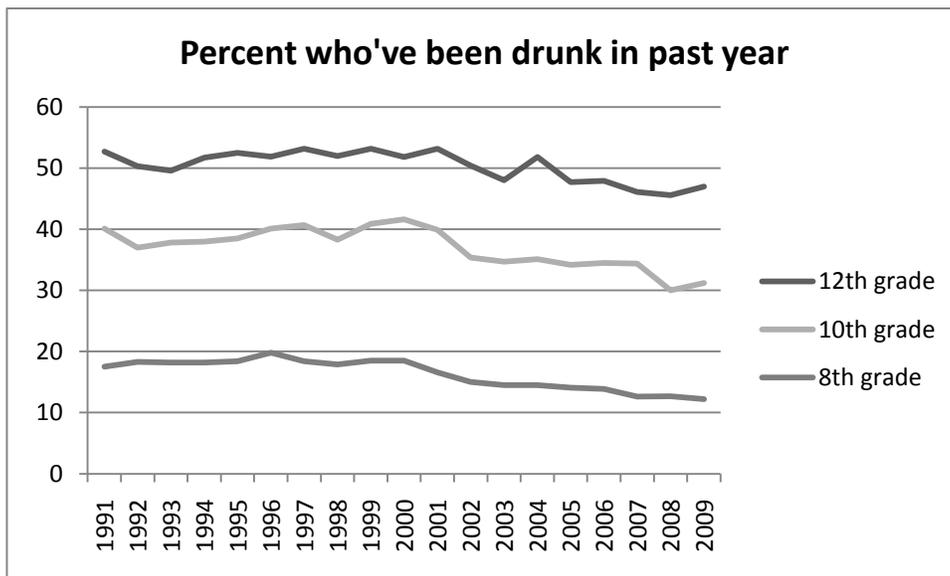
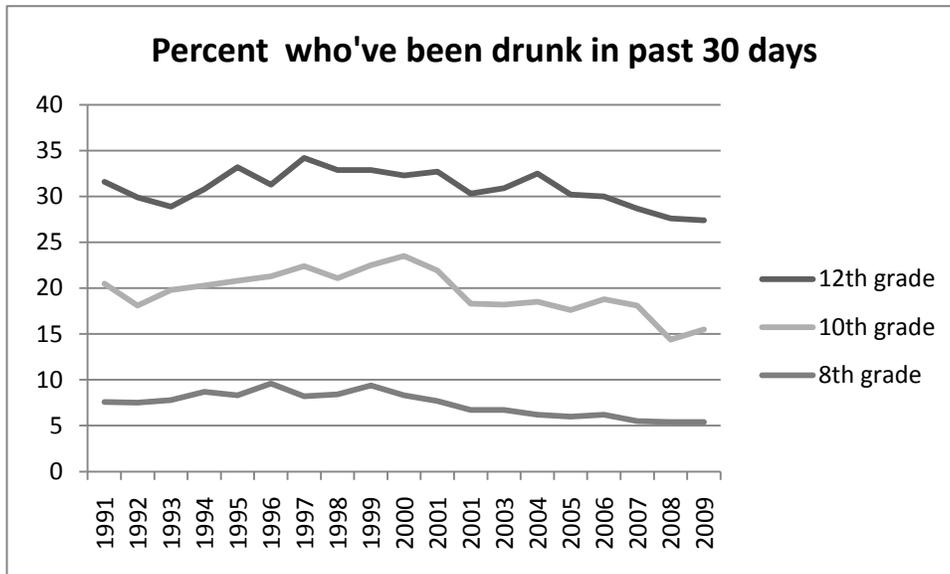
Source: Author's calculations based on data used in Wiseman and Ellig (2007) and winery production data furnished by winesandvines.com and author's survey.

3. *Granholm* and underage drinking

The University of Michigan's *Monitoring the Future* survey suggests that the *Granholm* decision unleashed no epidemic of underage access or alcohol abuse. The graphs below show typical responses on questions about 8th, 10th, and 12th graders' use of alcohol. For minors, alcohol availability, use, and drunkenness have all gradually declined over the past two decades. Similar patterns occur in response to other questions not presented in graphs, such as the percent of minors who have had five or more drinks in a row during the past two weeks, or the percent who have ever used alcohol or been drunk in their lives.







Source for data in all graphs: University of Michigan Survey Research Center, Monitoring the Future, <http://monitoringthefuture.org/data/09data.html#2009data-drugs>

While we all wish these numbers were lower, it is clear that there has been no upsurge in underage access, drinking, or alcohol abuse since the *Granholtm* decision in 2005. In fact, the percentage of affirmative responses on virtually all of the questions about alcohol use and abuse has fallen by several percentage points since 2005, as the following table shows. Clearly, the survey data show positive trends in underage drinking and alcohol abuse.

Percentage point change in alcohol availability, use, and abuse, 2005–2009

Availability		Use within past year	
8th grade	–2.4	8th grade	–3.6
10th grade	–2.8	10th grade	–3.9
12th grade	–0.8	12th grade	–2.4
Use within past 30 days		Been drunk within past year	
8th grade	–2.2	8th grade	–1.9
10th grade	–2.8	10th grade	–3.0
12th grade	–3.5	12th grade	–0.7
Been drunk within past 30 days		Lifetime use	
8th grade	–0.6	8th grade	–4.4
10th grade	–2.1	10th grade	–4.1
12th grade	–2.8	12th grade	–2.8
5+ drinks in a row, past 2 weeks		Been drunk sometime in life	
8th grade	–0.6	8th grade	–2.1
10th grade	–1.2	10th grade	–3.5
12th grade	–2.4	12th grade	–1.0

Source: Calculated from data from the University of Michigan Survey Research Center, Monitoring the Future, <http://monitoringthefuture.org/data/09data.html#2009data-drugs>

Strident assertions about underage drinking to the contrary,¹¹ I know of no controlled analysis that examines whether direct wine shipment has any effect on underage drinking or the level of alcohol-related externalities. A much-touted 2000 study of “home delivery” of alcohol, based on surveys in small communities in Wisconsin and Minnesota, actually says nothing about whether direct shipment is a significant source of alcohol for minors.¹² The study does not specifically deal with Internet sales or direct shipment; indeed, much of the home delivery in the study appears to be delivery of keg beer by local bricks-and-mortar merchants.

Proponents of a Commerce Clause exemption often point to a study by Pamela S. Erickson (former executive director of the Oregon Liquor Control Commission) as a warning that the United States is on the verge of suffering the public health evils

¹¹ See, e.g., <http://www.wswa.org/public/media/cyberbuzz/>.

¹² Linda A. Fletcher et. al., *Alcohol Home Delivery Services: A Source of Alcohol for Underage Drinkers* 61 J. STUD. ALCOHOL 81 (2000).

associated with alcohol “deregulation” in the United Kingdom.¹³ They warn that if Congress does nothing to stop litigation over state alcohol laws, “our system will continue down the dangerous path of deregulation that has already been shown in England to wreak havoc on society.”¹⁴ The argument here is not that *Granholm* has already turned the U.S. into the U.K., but rather that litigation spawned by *Granholm* will (someday) eviscerate state laws that are necessary to prevent underage drinking or control other alcohol-related social ills.

The United Kingdom has significantly higher incidence of alcohol-related health and social problems than other European countries and the U.S., including rising death rates from liver cirrhosis, higher rates of youth and childhood drinking, increasing admission of underage drinkers to hospitals for alcohol-related problems, and increased rates of drinking among girls and women.¹⁵ According to Erickson, these problems stem directly from the U.K.’s deregulated alcohol market. Key features of the U.K. system include:

- Alcohol is available 24 hours a day in bars and stores.¹⁶
- Prices have gradually fallen since 1980, in spite of high taxes.¹⁷
- There are no policies that mandate minimum prices or markups on alcohol. Large grocery store chains keep alcohol prices low so they can use it as a “loss leader.”¹⁸
- Policy does not distinctly separate production, wholesaling, and retailing.¹⁹
- The legal minimum drinking age is 5.²⁰
- The minimum age to purchase alcohol or drink in a bar is 18, but until 2003, the UK had a 20-year moratorium on “sting” operations to enforce the law.²¹

Some of the assertions in this study are less than accurate. For example, the claim that alcohol prices have declined since 1980 is based on a graph taken from the website of the Institute of Alcohol Studies in the United Kingdom. What the graph actually shows is that alcohol “affordability”—defined as households’ real disposable income divided by

¹³ Pamela S. Erickson, “The Dangers of Alcohol Deregulation: The United Kingdom Experience,” Public Action Management, PLC (2008).

¹⁴ Statement of Craig S. Wolf, President and CEO, Wine & Spirits Wholesalers of America, “Legal Issues Concerning State Alcohol Regulations,” hearing before the House Judiciary Committee, Subcommittee on Courts and Competition Policy (March 29, 2010), at 4–5.

¹⁵ Erickson, *supra* note 13, at 4–9.

¹⁶ *Id.* at 11.

¹⁷ *Id.*

¹⁸ *Id.* at 11–12.

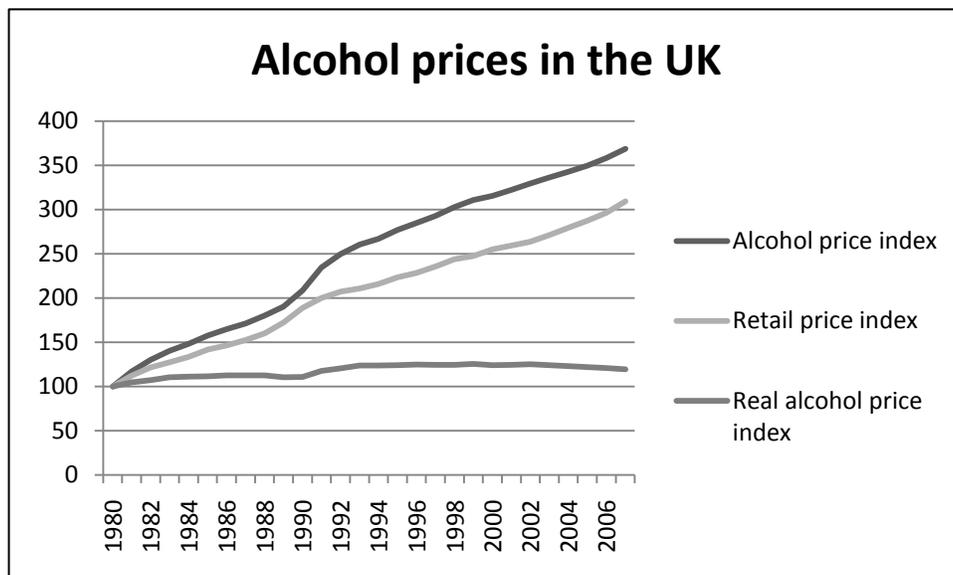
¹⁹ *Id.* at 13–14.

²⁰ *Id.* at 11.

²¹ *Id.*

the real price index for alcohol—has increased. This often occurs for consumer discretionary purchases because real incomes tend to rise over time.

If one goes to the institute’s website, one finds a table of data from the UK’s Office for National Statistics that tell a different story on prices. The graph below summarizes the price trends. Between 1980 and 2007, the price of alcohol in the UK rose by 269 percent. The retail price index rose by 209 percent; alcohol prices thus rose faster than general retail prices. Consequently, the inflation-adjusted price of alcohol was about 20 percent higher in 2007 than in 1980. Rising incomes may have made alcohol more affordable, but “falling prices” are not an appreciable part of the story. The only inflation-adjusted price decline at all occurred between 1999 and 2007, when real prices fell a mere 4.8 percent.



Data source:

<http://www.ias.org.uk/resources/papers/occasional/uk-affordability-trends.pdf>

Focusing exclusively on the social problems associated with alcohol, Erickson essentially endorses every aspect of the U.S. regulatory system that increases prices, controls promotion, or restricts access—even, by implication, for adults who drink moderately. Any measure that might increase availability, decrease price, or reduce the market power of middlemen is presented as ominous evidence that the U.S. could be headed down a slippery slope toward a UK-style disaster: “The U.S. could experience a similar alcohol epidemic if it does not maintain a fair, balanced, and strong alcohol regulatory system. The system needs to have multiple measures to control price, availability, promotional

practices, underage drinking and drunk driving.”²² The optimal price is one that is “not so high as to facilitate bootlegging, but not so low as to increase consumption.”²³ Again, the welfare of consumers who drink responsibly plays no role in Erickson’s analysis or recommendations.

The Erickson study only mentions in passing Costco’s legal challenges to some state alcohol laws.²⁴ It does not explicitly discuss the Commerce Clause, conflicts between state and federal laws, or the *Granholm* decision. Aside from implying that any change from the current system would be a mistake, it does not address the key question central to this public policy debate: Is it necessary to grant the states a virtual exemption from the Commerce Clause (and, perhaps, all federal laws) in order to implement sensible alcohol policies?

Substantial evidence suggests that governments can control underage access without adopting anticompetitive policies that harm consumers of legal drinking age. Consider again the example of direct wine shipment. In 2003, the Federal Trade Commission staff carefully examined the relevant literature and data as part of a comprehensive analysis of Internet wine sales. We faced the challenge of assessing whether online wine sales would significantly increase alcohol sales to minors. There was a lot of fear-mongering but not much hard evidence.²⁵ Since a lot of states already did permit customers to order wine online and have it shipped to their homes, we asked alcohol enforcement officials in these states whether underage access to alcohol via the Internet was a big problem. Several said they were concerned and vigilant, but none saw any evidence that it was a significant problem. A big reason was that these states already required age verification at the time of sale and at the point of delivery. The FTC staff report found that states could deal with policy concerns related to direct shipment, such as underage drinking, by requiring age verification and an adult’s signature upon delivery rather than banning direct shipment.²⁶

In 2004, a committee of the National Academy of Sciences similarly recommended that states permitting Internet sales and home delivery of alcohol should:

- Require all packages for delivery containing alcohol to be clearly labeled as such;
- Require persons who deliver alcohol to record the recipient’s age identification information from a valid government-issued document (such as a driver’s license or ID card); and

²² Id. at 24.

²³ Id. at 24.

²⁴ Id. at 21.

²⁵ There were also some sting operations conducted in states where direct-to-consumer wine shipment was prohibited, but we discounted these as atypical because they basically proved that some unscrupulous online sellers who were willing to break state laws prohibiting direct shipment were also willing to break state laws prohibiting sales to minors. These sellers would be a problem under state laws banning direct shipment as well as state laws allowing it.

²⁶ FTC Staff Report, *supra* note 2, at 31–38.

- Require recipients of home delivery of alcohol to sign a statement verifying receipt of alcohol and attesting that they are of legal age to purchase alcohol.²⁷

Underage access or alcohol-related externalities can be controlled through measures that are much less restrictive than discriminatory bans on direct shipment from out of state. The most effective measures that directly address the underage drinking problem, such as strict age-verification requirements, can surely be applied in a nondiscriminatory fashion that requires no additional protection from constitutional challenge.

Even an outright discriminatory state law can be upheld under *Granholm* if the state presents actual evidence that the discrimination is absolutely necessary to prevent underage drinking or other social ills. If the state has no empirical evidence, the underage drinking argument is likely nothing more than a smokescreen protecting private parties' profits.

4. Precedent for special treatment of other industries

Supporters of a Commerce Clause exemption correctly point out that alcohol is the only product that has its own amendment in the U.S. Constitution that gives the states authority to regulate. But the alcohol industry is hardly unique in believing that it can offer an important reason it should receive special treatment under the law. Creating such an exemption would likely open the door for many other special-interest requests for exemptions from federal laws, the Commerce Clause, and perhaps other parts of the U.S. Constitution as well.

This is more than idle rhetoric. When the FTC held a three-day public workshop on barriers to electronic commerce in 2002, virtually every industry studied as part of the workshop offered some reason justifying special regulation due to its unique characteristics:

Wine

I want to call attention to the one fact about wine that makes it different from all other commodities that will be discussed in the next three days, that difference being it is an alcoholic beverage. In addition, none of the other commodities and services being discussed here have been the subject of a constitutional amendment that acts to restrict the free flow of interstate commerce into the commodity or service.²⁸

²⁷ Richard J. Bonnie and Mary Ellen O'Connell (eds.), *REDUCING UNDERAGE DRINKING: A COLLECTIVE RESPONSIBILITY* 174–75 (2004), available at <http://fermat.nap.edu/catalog/10729.html>.

²⁸ Murphy Painter, "Public Workshop: Possible Anticompetitive Effects to Restrict Competition on the Internet," a conference held by and at the Federal Trade Commission, Washington, D.C., October 8, 2002, at transcript p. 200.

Automobiles

So, in conclusion, the Internet is an extension of the showroom that has created exciting new avenues for dealers to communicate with the consumers. It cannot replace services provided by the dealers. We are not selling books, CDs, or wine, but a very sophisticated product, a sophisticated product that has over 10,000 moving parts, electronic and mechanical, with a transaction price averaging \$25,800.²⁹

When you have a product such as a motor vehicle, which is mandated to be titled and licensed, which can be dangerous if delivered with a defect, and which can have serious safety issues if not maintained properly, then it requires a brick and mortar presence with trained employees, a dealer who is responsible to the community, and the oversight of a myriad of state and Federal agencies to protect their consumers. The consumer deserves the protection, and they can only get that from a franchise dealer.

...

If a consumer bought a vehicle online, it's a very different issue. If you buy from an unlicensed retailer, a non-franchise dealer with no physical presence in the community, when the vehicle arrives at your home or business, you would need to check the vehicle for defects and safety concerns, check all the fluid levels, check the brakes, the transmission, the electrical systems, check the fit and finish, and check all the other operating systems. If there are problems with the vehicle, I'm not sure who would fix those defects and make sure your car is safe to drive.³⁰

Caskets

It is important to place the sale of a casket in the context of the funeral service. A casket is not just a commodity like a shirt or a pair of shoes; it is a product for a special specific event at a very sensitive and specific time. Because of this unique nature of funeral service, traditional consumer protection remedies are not always applicable.³¹

²⁹ Jim Lust, "Public Workshop: Possible Anticompetitive Effects to Restrict Competition on the Internet," a conference held by and at the Federal Trade Commission, Washington, D.C., October 9, 2002, at transcript p. 403.

³⁰ Bill Wolters, "Public Workshop: Possible Anticompetitive Effects to Restrict Competition on the Internet," a conference held by and at the Federal Trade Commission, Washington, D.C., October 9, 2002, at transcript pp. 423 and 426.

³¹ Robert Vandenberg, "Public Workshop: Possible Anticompetitive Effects to Restrict Competition on the Internet," a conference held by and at the Federal Trade Commission, Washington, D.C., October 9, 2002 at transcript p. 461.

Contact lenses

Because of the health considerations that are part of contact lens wear, as well as the history of certain practices by sellers, some states, often in the context of requiring the release of contact lens prescriptions, have enacted laws seeking to regulate, in various manners, Internet sellers of contact lenses.³²

Legal services

So, I think it is essential to keep in mind that we aren't talking about contact lenses or caskets or wine bottles, that we're talking about something very different when we're talking about access to the justice system.³³

These are the kinds of comments received by a federal agency with a reputation for skepticism of such special pleading. If Congress actually demonstrates its receptivity to such special pleading by passing a law making blanket exceptions to the Commerce Clause or federal laws for alcohol, it can expect a steady stream of requests from other industries for special treatment.

Conclusion

Today's hearing addresses a number of important economic and public policy issues for American consumers. Prudent public policy seeks the right balance between the responsible consumer's interest in low prices and availability and the potential social costs associated with underage drinking and irresponsible use of alcohol by adults. The Commerce Clause and the *Granholm* decision require just such a balance. Creating some form of a Commerce Clause exemption for state alcohol laws would disturb this balance and raise the risk that anticompetitive laws would be tailored to take advantage of such a refuge.

Exempting anticompetitive and discriminatory state alcohol laws from federal scrutiny would likely create significant costs for consumers. Studies of the consumer effects of direct wine shipment laws illustrate this point. Facially discriminatory state laws reduce the variety of wines available to consumers and increase prices. Laws that are neutral on their face but discriminatory in practice, such as production caps on wineries eligible for direct shipment, create consumer costs similar to those created by facially discriminatory laws.

³² Pat Cummings, "Public Workshop: Possible Anticompetitive Effects to Restrict Competition on the Internet," a conference held by and at the Federal Trade Commission, Washington, D.C., October 9, 2002, at transcript pp. 323–324.

³³ Catherine Lanctot, "Public Workshop: Possible Anticompetitive Effects to Restrict Competition on the Internet," a conference held by and at the Federal Trade Commission, Washington, D.C., October 9, 2002, at transcript p. 590.

The argument that America faces a widespread and systemic problem that justifies a significant change in the federal legal standard applicable to state alcohol laws is nothing but an assertion. Underage drinking and alcohol abuse are declining, and they have continued to decline since the 2005 *Granholm* decision that is alleged to be the source of significant problems. Many of the social ills associated with alcohol “deregulation” in the United Kingdom seem to stem largely from its 5-year-old minimum drinking age and (until recently) nonexistent enforcement of the 18-year-old minimum purchase age. The best available evidence suggests that states can control underage access through age verification, which no reasonable person has suggested would violate *Granholm*.

The Commerce Clause allows states to discriminate against interstate commerce if they have actual evidence that such discrimination is necessary to accomplish a legitimate state goal that cannot reasonably be accomplished by less restrictive means. Creating a special exemption to Commerce Clause scrutiny for state alcohol regulation could easily encourage other industries to flood Congress with requests for special exemptions that would shield anticompetitive state or private practices from federal scrutiny.