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When "Help" is Harmful

By Pamela Erickson

You've heard the admonition: "First, do no harm." It originally applied to doctors via the Hippocratic Oath. But, today it's a fairly standard warning about a lot of things. It is especially applicable to dramatic changes to alcohol regulations in an effort to "help small suppliers." But such changes could end up hurting them and costing society in the long run. I remember working at the state level and listening to small suppliers call for "no rules" without understanding that some rules protect them. If they got some of the things they wanted, they could be out of business in short order.

In order to "do no harm", we should pause, remember the goals of alcohol regulation, and learn more about the nature of the alcohol industry before making further changes. With greater knowledge and understanding, we may be able to help businesses flourish without sacrificing public health or incurring additional state costs.

Let's start by listing what we know.

First, we know that the number of suppliers in all segments of alcohol have seen tremendous growth. The federal Alcohol and Tobacco Tax Trade Bureau (TTB) annual report for FY 2021 shows that there are 16,783 wineries, 13,368 breweries and 4,126 distilleries and more being added every day "driven by the craft beverage boom…"

Second, the growth of suppliers creates a mixed impact on public health. Given the huge growth, more regulatory resources must be devoted to the basics of licensing including educating these new licensees on selling and serving from a tap or tasting room. The likely impact is less enforcement of concerns like underage and binge drinking. Public health is very concerned about reports of increased drinking and impaired driving during the pandemic. But we don't know much about how craft products contribute to consumption. Has the drinking public substituted craft for other products? Given that craft products often have a higher prices and greater alcohol content, are drinkers just drinking less or has their consumption of alcohol just gotten higher? And, with a brewery or other alcohol supplier seemingly on every corner, research shows that too much availability of alcohol is a public health concern. The temptation to treat alcohol as any other commodity rather than a product which is estimated to cause 95,000 deaths in American every year should be highlighted.

Third, most of these suppliers are very small. In January of this year, 48% of wineries produced less than 1,000 cases, and 33% produced between 1,000 and 4,999 cases. That means that 81%, the vast majority, are exceptionally small. Again, breweries demonstrated a similar pattern: 77% of breweries produced 1000 barrels of beer or less**.**

Fourth, it appears that changing consumer preferences are driving this growth.

> "At the end of the day, the craft-beer movement was driven by consumer demand. We've seen three main markers in the rise of craft beer—fuller flavor, greater variety, and more intense support for local businesses."
> ***Bart Watson, the chief economist at the Brewers Association, a trade group.***

We have seen this happen for other commodities such as coffee. People seem to have refined their tastes and are willing to pay more for their products. This has impacted the alcohol market share. According to the National Beer Wholesalers Association website, "Since 2010, about 5% of the market volume has shifted from large brewers and importers to smaller brewers and importers." Looking at the top three breweries (Anheuser-Busch, Molson-Coors, and Constellation Brands) they still constituted the lion's share of the business. In 2010, they had 82% market share and in 2020, they dropped to 71%.

Back to the coffee example, I can no longer go to my favorite coffee shop for my favorite type of coffee (Celebes) as most of the small, independent coffee roasters have been bought out by large national chain coffee companies; and, they only offer their blends. This has generally not happened to small alcohol suppliers because of regulations that require three independent tiers. Each tier must be independent of the other. While suppliers worry about their product, wholesalers worry about scale, e.g. filling a truck, so they are looking to add products and get very concerned by supplier's efforts to take products off their trucks.

Fifth, the small supplier seems to be populated with a lot of scrappers! Although there were many closures of small businesses during COVID, the alcohol industry suppliers actually grew. Small retailers suffered the most, but many suppliers were able to quickly develop new ways of operating and stayed alive.

Sixth, we know we have a major disconnect between suppliers and wholesalers. Despite the huge growth in suppliers, the wholesale tier did not follow the same pattern because they are different businesses. With ever increasing transportation, labor and energy costs ($5.00 diesel), distributors are always looking to find the right scale to efficiently service the retailers in their markets. They consolidated and formed larger organizations. In part, this was due to the fact that the wholesale business got a lot more complicated. While the market share shifted somewhat between large and small brewers, wineries and distilleries, the large companies still had most of the business. But even they were impacted by changing consumer preferences as SKUs increased. SKU, or "stock keeping unit", represents discreet products the wholesaler must account for. For the beer industry, those more than doubled in just 8 years. In 2010 they averaged 536 and by 2018 it hit 1,174. The upshot is that wholesalers simply could not take on all suppliers. So, that left a lot of suppliers out in the cold as distribution originally was the exclusive purview of the distributor tier.

Seventh, we know that legislatures reacted by giving small suppliers special privileges to "self-distribute", to sell from tap or tasting rooms, to sell at festivals, and to get licensed to "direct ship" to consumers in other states. However, these "special privileges" came with problems as they put small suppliers in the wholesale *and* retail tier without any real experience in those types of businesses.

Here is an example:

When I was a regulator in Oregon, every small town and community had one or more festivals. And, they often wanted to sell local craft alcohol products. Small suppliers used their own employees to staff festivals and initially they had no training to check ID and spot intoxication. There were a lot of sales to minors and people got drunk tasting a myriad of products. It also cost a lot of staff time to police these events. Eventually, servers got training and things got under control.

Many small suppliers relied on Direct-to-Consumer sales to remain in business. Today almost all states allow small wineries to direct ship. Most require a license, special markings on the package, and ID checking. But other, larger businesses want the same privileges and there is a great deal of non-compliance. Recently, Michigan announced an improvement in compliance, as a recent check revealed that only 71,529 bottles were shipped illegally. That is an improvement over a year ago when 160,000 bottles were shipped illegally.

In some states, tasting rooms and tap rooms are eligible for special, less expensive licenses. Some of these evolve over time and become more like bars and restaurants, who pay more for their licenses.

Finally, we now know that there are costs to these special privileges. Without training and enforcement, there will continue to be a lot of non-compliance, disadvantaging honest businesses. The non-compliance also leads to tax loss and the potential for unsafe products. Less full distribution trucks create inefficiencies and higher costs for the entire system. So, how can policy-makers be truly helpful?

1. At what point is too much local alcohol a bad thing from a public health perspective?
2. We need to know more about the business challenges in the supply, wholesale and retail tiers. Many may be content with their current status as a small supplier. How many seek to grow to the next level?…whatever that is.
3. What is required for a small alcohol supplier to grow? At what level of production should a supplier need a distributor? How much capital is needed to bring products to a regional and/or national level?

4. What are the state's resources for capital grants or loans to grow a business? When I was a regulator, most banks would not loan money to a business in the alcohol industry. While those guidelines may be gone, there may still be some reluctance. How can the state help with this issue? Does the state employ professionals that can help develop a reasonable business plan and introduce the business to sources of capital?
5. How can the wholesalers and suppliers work together to fashion creative solutions? As a first step, these entities need to understand each other's businesses. If we want a state, investor, or wholesaler to help grow a supplier's business, we need suppliers that are market-savvy.
6. How can states deal with the non-compliance problems and pay for the costs of two systems of distribution (wholesale and direct sales)? Is there regulatory parity? A state cannot get a TTB permit revoked for a brewer or retailer since the TTB has no role in licensing them.
7. How has the small supplier phenomenon and the special privileges affected the balance of business needs and public health/safety concerns? Are consumers substituting for better quality products or are they just drinking more? What is the impact of regulation changes on public health? Has consumption increased, are there more deaths due to alcohol, and what about traffic crashes due to DUI?

All of these things should be monitored closely.

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