GOVERNMENT TRANSPARENCY

SERIES

Municipal Liquor Operations in Minnesota: Drinking on the Taxpayers' Dime


FREEDOM
FOUNDATION
OF MINNESOTA

Municipal Liquor Operations in Minnesota: *Drinking on the Taxpayers' Dime*

INTRODUCTION

With the goal of encouraging greater citizen involvement in government, the Freedom Foundation of Minnesota presents its first **Government Transparency** report. By analyzing data obtained through public records, we shed light on issues that receive a surprising lack of scrutiny. First up: municipal liquor operations.

Most Minnesotans probably assume that their city tax dollars help pay for police and fire protection, road maintenance, snow plowing and public utilities. And, in most cases, local tax money does help fund these services. But in over 200 cities across Minnesota, citizens are also paying for their city government to operate liquor stores and bars. In fact, while many Minnesota cities profit from liquor sales, dozens of cities' liquor operations actually lose money year after year, forcing local taxpayers to subsidize the purchase and consumption of liquor within their communities. The following study reveals in detail the operational and financial failure of numerous municipal liquor operations, and calls into question the wisdom of allowing our government to be in the liquor business at all.

Perhaps in acknowledgement of the poor financial performance of many municipal liquor operations, some cities resort to high-minded, altruistic justifications for managing liquor stores and bars with annual losses. One city loftily claims to "promote moderation and control in the sale and use of alcohol beverages—while simultaneously generating income for the community." Of course, this begs the question of how operating a liquor store promotes "moderation." Are such cities actually suggesting that their citizens consume alcohol in greater moderation than those in cities that allow free-market competition?

We hope an honest assessment of the rationale for and financial performance of municipal liquor operations will cause Minnesota taxpayers to reconsider the wisdom of allowing government to own and operate liquor stores and bars. Free markets rely on dispassionate economic analysis and we believe city government should follow suit in directing taxpayer resources.

ISSUE BACKGROUND

Shortly after entering the White House in March 1933, President Franklin Delano Roosevelt remarked one night at dinner, "I think this would be a good time for beer."[1] Later that evening, FDR drafted a message urging Congress to end nationwide Prohibition. In short order, Congress proposed, and a majority of states ratified, the Twenty-first Amendment to the U.S. Constitution, putting an end to more than a decade of nationwide Prohibition and clearing the way for states to assume full control over the sale and distribution of alcohol. On December 5, 1933, nationwide Prohibition was officially history.

Since that time, laws and regulations relating to the sale of alcohol have varied widely from state to state. Some states have taken a "hands-off" approach to liquor regulation, allowing a free-market system to flourish, while others have chosen to maintain greater control, in many cases instituting some form of government-run monopoly for all wholesale and retail liquor sales.

Meanwhile, 75 years after the repeal of Prohibition, Minnesota is somewhere in the middle. Minnesota state law allows small cities with populations of fewer than 10,000 to own and operate their own on-sale (bars) and off-sale (liquor stores) liquor establishments[2]. These establishments—generally referred to as municipal liquor stores or municipal bars—originally were intended to help control alcohol distribution within Minnesota cities. The law allows smaller cities, which often struggle to attract private enterprise, an opportunity to offer their residents a service that they might otherwise be denied.

But government-run liquor stores and bars aren't just for small towns anymore. Statutory "grandfather" provisions have allowed cities that have grown beyond the population threshold to stay in the liquor business. As of 2006 (the most recent year in which municipal liquor data is available), 25 cities with populations over 10,000 operated at least one municipal bar or liquor store[3]. Among these cities are large suburbs including Edina, Richfield, Eden Prairie and Apple Valley. Within the seven-county Twin Cities metropolitan area, 20 cities had active municipal liquor operations at the beginning of 2008.[4]

It is clear that many cities have chosen to stay in the liquor business not to control the sale of alcohol, but to profit from it. In fact, many Minnesota cities actively promote their liquor operations as a means of "buying down" taxes and funding community programs. The City of Edina, for example, purchases magazine advertisements for its liquor stores, stating, "Without us, many Edina programs would be on the rocks." The Edina advertisements claim liquor sales benefit programs such as snowplows, "fire truck and other life-saving equipment." Of course, municipal liquor stores were not originally intended to bankroll essential city programs, but the past 75 years have seen significant "mission creep."

While it is true that many municipal liquor operations are profitable, they often profit at the expense of privately owned small business. The reason is simple: the majority of Minnesota cities that operate liquor establishments do so as a monopoly. They simply disallow private liquor sales within city limits. However, many cities cannot succeed even when they are the only game in town. A shocking number of cities lose money on their liquor operations.

Many Minnesota taxpayers are becoming increasingly concerned about their city governments' inefficiency, poor stewardship and anti-business policies. This is the first in a series of short reports in which the Freedom Foundation of Minnesota examines these problems at the local level, putting the spotlight on Minnesota's municipal governments.

DATA SUMMARY

The Minnesota Office of the State Auditor (OSA) reported in 2006 that 220 Minnesota cities operated 248 municipal liquor establishments, either bar and liquor store combinations or separate bars and liquor stores.[5] One-hundred-twenty-seven cities operated both; 93 cities operated liquor stores only. Municipal liquor stores represent a sizeable percentage of the 981 Minnesota wine and liquor outlets.[6]

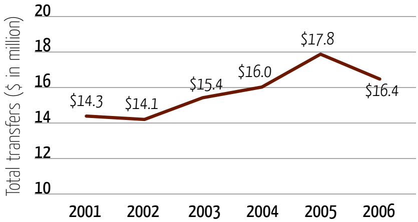
Some Minnesota cities got into the liquor business 75 years ago, ostensibly to control the sale of alcohol within city limits. To the extent that most cities with liquor operations have a monopoly on liquor stores, there is no doubt that this controls the sale of alcohol, although the merits of this type of control are certainly dubious.

According to recent findings by the Minnesota Office of the Legislative Auditor, following the release of 2005 municipal liquor data:

> *Minnesota restricts retail competition in the liquor business more than most states. Minnesota prohibits most grocery, convenience, drug and general merchandise stores from selling strong beer, wine and spirits for off-premises consumption. In addition, most of the 226 cities with city-owned liquor stores have an off-sale monopoly on these products within their city boundaries.*[7]

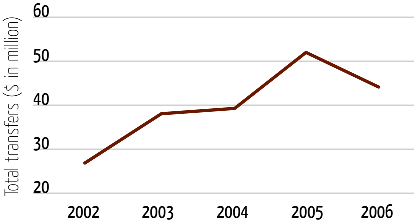
In recent years, another justification for government-run liquor establishments has emerged—profit. Liquor profits can "buy down" taxes and help pay for general fund programs. The City of North Branch, for example, says the purpose of its liquor operation is to "promote moderation and control in the sale and use of alcohol beverages—while simultaneously generating income for the community."[8] Regardless of the merits of the policy, there is no doubt that many cities transfer liquor profits to other areas of their general fund. In 2005, nearly $18 million in profits moved from municipal liquor accounts to other municipal accounts and programs. In 2006, cities transferred a total of $16.4 million to other city accounts.

FIGURE 1
Total Transfers from Liquor Operations to Other Municipal Accounts



Amazingly, dozens of cities operate their liquor programs at a net loss. In 2005, 52 cities—nearly one quarter of municipalities with liquor operations—reported negative net revenue.[9] In 2006, 44 cities lost money on their liquor operations. The unprofitable cities in 2006 combined for a total of $888,901 in losses. Effectively, these cities force taxpayers to subsidize the purchase and consumption of liquor, which most people would agree is not a prudent use of taxpayer dollars. Despite this, only seven Minnesota cities ended their liquor sales operations in 2005,[10] five of which were unprofitable the previous year. In 2006, Pine Island—which ran a consistently unprofitable operation for many years—discontinued their operations after posting more than $150,000 losses during the year. Other cities have adjusted their operations, including staff restructuring, store closings and contracting out operations. Still other cities seem to have done little to address their poor financial performance.

Figure 2
Minnesota municipalities with liquor sales operations reporting negative net income



Although 2006 is the most recent year for which official data is available, some municipal liquor operations have undergone significant change in the years since. The City of Shorewood, for example, has gotten out of liquor sales altogether.[11] The City Council voted in August 2007 to sell the city's two liquor stores, which were experiencing declining profits. On the other end of the spectrum, the City of Mound decided to "double down" on its consistently unsuccessful liquor operation, building a $1.4 million liquor store in 2003, despite years of financial losses. Since then, Mound has reported losing $65,425 in 2003, $150,528 in 2004, $118,780 in 2005 and $11,759 in 2006. Unlike private business, city governments have the luxury of being able to lose money year after year without feeling any pain. Unfortunately, taxpayers in those cities are not as lucky.

Interestingly, the Minnesota Municipal Beverage Association (MMBA) seems to suggest that some cities *intentionally* lose money. The MMBA claims that "controlling the sale of alcohol means reflecting a community attitude—often resulting in a strategic and publicly supported reduction in liquor operation revenue."[12]

Not only are many Minnesota cities running unsuccessful liquor monopolies, but they are charging Minnesotans more for the privilege of shopping at municipal establishments.

Municipal liquor stores "tend to charge prices that are about 3 to 8 percent higher than privately owned liquor stores," according to the Minnesota Office of the Legislative Auditor. "They are able to charge higher prices because of the monopoly most of them have within city boundaries." At least one study has found that municipal liquor stores located "where competition is low"—primarily in sparsely populated areas—have prices about 10 percent higher than stores in highly competitive locales.

The anti-competitive environment created by municipal liquor sales is at least partially responsible for the higher overall beer and wine prices in Minnesota liquor stores than in states with fewer government regulations. Compared to Wisconsin, off-sale beer prices are 7 to 9 percent higher in Minnesota, and wine prices are 5 to 7 percent higher.[13] Minnesota's highly restrictive wholesale liquor laws exacerbate the price differences. All liquor retailers in Minnesota must purchase from a relatively limited group of vendors—six for distilled spirits, 47 for wine and 132 for beer.

Metropolitan municipal liquor establishments consistently report much higher sales and profits than their Greater Minnesota counterparts. Population density, economies of scale and greater demand are obvious contributing factors in this disparity. It also demonstrates the desirability and potential profitability of liquor sales operations—particularly in the metro area. This, in turn, suggests that there is no longer any need for many municipalities to offer this service, which private enterprise is quite adept at offering—especially in the Twin Cities metropolitan area.

Of course, the metropolitan cities whose operations are substantially profitable are not inclined to forgo this profit, which they frequently transfer to other areas of their general fund. The City of Apple Valley designates liquor store profits to help fund Parks and Recreation Programs, for example.[15] Other densely populated suburbs—including Eden Prairie, Edina and Lakeville (which annually combine for revenues of approximately $30 million)—have no incentive to open their liquor market to private enterprise, even though doing so would minimize any potential negative impact on local taxpayers and, in many cases, offer lower prices to consumers.

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FIGURE 3
Least Profitable Municipal Liquor Operations (2006)

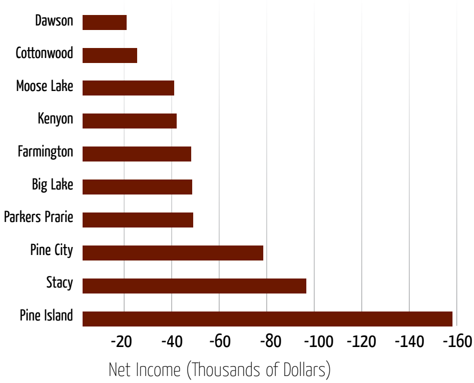


Figure 4
Least Efficient Municipal Liquor Operations (2006)

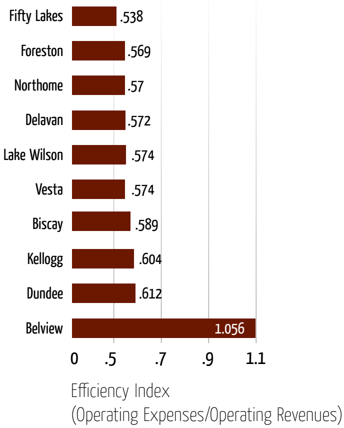
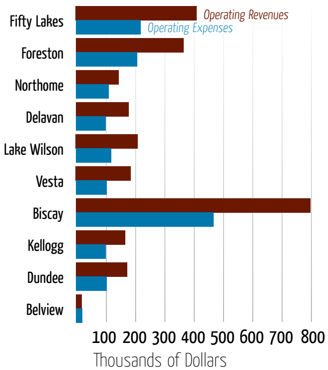


Figure 5
Least Efficient Municipal Liquor Operations in Gross Dollars (2006)



SUMMARY

In 1933, National Prohibition on alcohol sales, manufacturing and consumption ended. Yet this failed social and regulatory experiment continues to hold sway in many Minnesota communities. Because of that, Minnesota taxpayers and consumers continue to lose. They lose their freedom to choose where, when and how much to pay for beer, wine and some liquor. Residents lose income because their city leaders continue to run a failing enterprise that local taxpayers are forced to subsidize.

Former U.S. senator and 1972 Democratic presidential candidate George McGovern described this situation best in a recent *Wall Street Journal* commentary, "Freedom Means Responsibility." McGovern wrote, "I've come to realize that protecting freedom of choice in our everyday lives is essential to maintaining a healthy civil society. Why do we think we are helping adult consumers by taking away their options?"

Minnesotans, even those who choose not to purchase intoxicating beverages, have paid a significant price to have their freedom curtailed when it comes to purchasing beer, wine and alcohol. Municipalities have varied and often dubious reasons for limiting this choice. Sometimes these liquor monopolies bankroll other city functions. Some city leaders believe they are protecting citizens by controlling the sale of alcohol. Unfortunately, some cities don't achieve either of these objectives; they merely operate an obsolete business at a loss for years on end. Regardless of their reasons, this loss of freedom of choice should end.

Here's the question taxpayers should ask elected officials at all levels of state government: why? Why should cities compete with private liquor store operations?

No one will argue that cities should not continue to provide oversight and regulation of the sales and distribution of liquor in their community—whether by the bottle or by the glass. However, it has become increasingly apparent that 75 years after the repeal of Prohibition, many Minnesota taxpayers are footing the bill for the indulgences of their municipal liquor monopoly.

ENDNOTES

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2 Minnesota Statute 340A.601 Establishment of Municipal Liquor Stores. http://www.revisor.leg.state.mn.us/bin/getpub.php?pubtype=STAT_CHAP_SEC&year=2006&section=340A.601

3 Minnesota Office of the State Auditor 2006 Analysis of Municipal Liquor Operations. http://www.osa.state.mn.us/Reports/gid/2006/liquor/liquor_06_report.pdf

4 Blake, Laurie. (2008, January 3). "Municipal liquor sales: No job for a city?" Star Tribune.

http://www.startribune.com/local/west/12993201.html

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6 American Economics Group, Inc. "State Licensing of Wine Sales in Food Stores: Impact on Existing Liquor Stores." March 2004. http://www.winewithdinner.com/LiquorStoreSum030504.pdf

7 Minnesota Office of the Legislative Auditor. Liquor Regulation: Major Findings. March 2006. http://www.auditor.leg.state.mn.us/PED/2006/liqregsum.htm

8 North Branch Liquors website. http://www.northbranchliquors.com/

9 Pine City, Leroy, Biscay, Conger, St. Leo, Pine Island, Mound, Moose Lake, Watertown, Bigfork, Parkers Prairie, Twin Valley, Belview, Medford, Wolf Lake, Williams, Lake Wilson, Okabena, Houston, Dundee, Mabel, Lancaster, Ellendale, Maynard, Kenyon, Hanska, Browns Valley, Heron Lake, Hackensack, Wells, Fairfax, Vesta, Verndale, Gilman, Littlefork, Goodridge, Herman, Morton, Delavan, Lismore, Canton, West Concord, Madison,

Sacred Heart, Plainview, Erhard, Lake Park, Hanley Falls, Fifty Lakes, Darwin, Spring Grove and Ivanhoe

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15 City of Apple Valley. Department of Municipal Liquor Operations website. http://www.ci.apple-valley.mn.us/departments/Liquor_Operations/main.html

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ABOUT THE FREEDOM FOUNDATION

The Freedom Foundation of Minnesota is an independent, non-profit educational and research organization that develops and actively advocates the principles of individual freedom, personal responsibility, economic freedom, and limited government.

By focusing on some of the most difficult public policy issues facing Minnesota, we seek to foster greater understanding of the principles of a free society among leaders in government, the media, and the citizenry. Founded in 2006, we hope to create a better and more vibrant future for every Minnesotan by helping shape sound public policy. For more information about the Freedom Foundation and our projects, visit us online at www.freedomfoundationofminnesota.com.

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