



Competitive Enterprise Institute

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Advancing Liberty – From the Economy to Ecology

December 11, 2012

No. 181

Avoid a Beer Monopoly by Setting the Market Free How the Mandatory Three-Tier Distribution System Inhibits Competition

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Ask anyone who enjoys a nice brew if we are currently living under a beer monopoly and most would laugh off the question as silly. Today, most Americans have access to a wider variety of beers from a greater number of brewers than at any other time in our nation's history. The number of craft breweries continues to rise as states free up the market, making it easier for brewers to produce and sell their products. However, some distributors, in conjunction with health advocates, want to halt that progress by convincing consumers that such changes actually hurt the vibrancy of the beer market. In reality, strengthening the current distribution system will only benefit a small number of large and powerful beer distributors and make it more difficult and expensive for small and startup brewers. If we want to prevent the possibility of a beer monopoly, encourage new brewers in the market, and increase the variety of beer available to consumers, then we need to free the market more—not less.

A System Left over from Prohibition's Repeal. The current beer distribution system prevalent throughout the nation is known as the three-tier system. Its main component is the forced division, by law, between those who make alcohol, those who ship it, and those who sell it. Up until recently, breweries were strictly prohibited from dealing directly with stores or consumers and vice versa. Brewers, who make up the first tier, may only sell their products to distributors who then sell to and ship the beer to the second tier—bars restaurants, and stores—who then sell to consumers. This arcane system was the result of a series of political compromises that were needed to achieve the repeal of Prohibition.¹

Critics of brewing giants Anheuser-Busch/InBev and MillerCoors are increasingly arguing that the two companies have a monopoly in the American beer market, and that they need to be reined in to preserve a vibrant beer market and protect consumers.² This week, the [New America Foundation](#) in Washington, D.C., will host a panel on the topic, *Big Beer Blitzes America: Is Anheuser-Busch Too Powerful?* As one can glean from the title and the event description, the

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discussion will focus on the alleged problems caused by macro-brewers and how they “marginalize craft beer makers” and independent beer distributors.

While it may be tempting to blame “big beer” for market access problems small brewers might face, the real culprit is a set of outdated and restrictive laws that prevent brewers from being allowed to sell their own products. Big brewers have been fighting to change the law to cut out the middle man—to distribute their own beer. For fans of good beer who wants more variety, easier access, and better prices, breaking down the mandatory three-tier system is the right policy to support.

In recent years, many states have been allowing limited exceptions to the three-tier division. For example, in some states small brewers who may not be able to find a distributor to sell their beer are allowed to self-distribute up to a certain number of barrels.³ While these may seem like a sensible accommodation for small brewers and consumers, the National Beer Wholesalers Association (NBWA), the distributors’ lobby, has vehemently opposed any relaxation of the mandatory three-tier system. For example, while small craft brewers in Illinois have been working to gain the right to self-distribute their products, wholesalers have successfully lobbied state lawmakers to water down a bill to allow only the very tiniest of breweries—those producing less than 15,000 barrels a year—to sell up to 7,500 barrels a year without going through a wholesaler.⁴

The Wholesalers claim the system prevents the big beer companies from dominating the market and shutting out the competition. What they do not mention is that any threat to the mandatory three-tier system constitutes a threat to their business model. Currently, just about everyone in the business of buying and selling beer relies on the wholesalers—a status that has earned them a position of considerable power and near-guaranteed profits.

Three-Tier System Hinders Entrepreneurship and Consumer Choice. The argument that allowing beer companies to self-distribute would create a monopoly in the market does not hold water. For one thing, the largest beer companies already control most of the distribution system in the U.S. Large brewers make up a majority of most distributors’ portfolio of products, which gives them the power to pressure distributors into dropping their competitors’ products—including craft brews. For example in the mid-1990s just as the craft beer movement was picking up steam, Anheuser-Busch demanded that its wholesalers only distribute its products. Today, about 60 percent of Anheuser’s distributors are exclusive.⁵

Despite the large brewers’ dominance, nationwide craft beer sales are increasing at a rapid pace with no signs of slowing down. In 1978 there were only 42 breweries in the United States,⁶ but by 2011, there were almost 2,000 breweries with hundreds more in the planning stages, according to the Brewers Association.⁷ In 2007, craft beer accounted for 3.8 percent of beer sales; by 2012 that share had risen to over 5 percent. And, while nationwide overall beer remained flat, craft beer sales rose by 15 percent from 2010 to 2011.⁸ In most American cities, it is becoming increasingly easy to find bars and stores offering a wide and growing variety of craft beer. So, how is it that with the so-called beer monopoly the small beer market is more vibrant than ever and how do we maintain or improve that vibrancy? The answer is relatively simple.

From Rent Seeking to Social Engineering: The “Cheap Booze” Bogeyman. The established beer wholesalers are not the only special interest defending the three-tier system. Now some self-styled “public health” advocates are defending the mandatory three-tier system as a way to keep prices artificially high in order to prevent Americans from binge-drinking in greater numbers due to the ready availability of cheap booze.

In the current issue of *The Washington Monthly*, Tim Heffernan, a participant in the New America’s Foundation upcoming panel discussion, argues that, “By deliberately hindering economies of scale and protecting middlemen in the booze business, America’s system of regulation was designed to be willfully inefficient, thereby making the cost of producing, distributing, and retailing alcohol higher than it would otherwise be and checking the political power of the industry.”⁹ But contra Heffernan, artificially inflated prices are not a barrier keeping Americans from descending into a pit of alcohol abuse.

Many lawmakers and public health advocates maintain that raising the cost of alcohol generally results in a corresponding drop in consumption. Yet, research has repeatedly shown that the relationship between price and demand for alcohol is not so simple. Scholars at the Pacific Institute for Research and Evaluation, in a study published in the January 2006 edition of *Alcoholism: Clinical and Experimental Research*, looked at 10 years’ worth of data from Sweden and found that when the price of alcohol increases consumption does not necessarily reduce overall alcohol consumption and does not necessarily affect the behavior of problem drinkers. According to Raul Caetano, professor of epidemiology and assistant dean at the University of Texas’ School of Public Health, as alcoholic products become more expensive, “the individuals who are able to purchase expensive alcoholic beverages can just switch to less expensive ones.”¹⁰

Furthermore, Heffernan claims that allowing vertical integration—that is, allowing beer makers to also distribute their products—will lead to a system that is “rigged” to get cheap booze to consumers, which he claims has led to widespread alcohol abuse in the United Kingdom. He argues, “These vertically integrated monopolies are very ‘efficient’ in the economist’s sense, in that they do a very good job of minimizing the price and thereby maximizing the consumption of alcohol.” But this ignores the fact that many other factors apart from price influence the rate of alcohol consumption for a given culture.

For example, in the UK, beer is significantly more expensive than in the U.S. A pint in the UK will cost an average of US\$4.76, compared to US\$3.75 in the U.S.¹¹ And while the British shell out more for their lager, they also drink slightly more than their American counterparts. According to data from the World Health Organization, Britons consume an average of 4.93 liters of beer a year, while Americans drink 4.47 liters on average.¹² In Ireland, beer is far more expensive than in either America or Great Britain, at an average price of US\$6.25 per pint, yet the Irish drink considerably more than Americans or Britons, consuming 7.04 liters of beer on average a year. Clearly, price is not the only factor impacting alcohol consumption. For those concerned about problem drinking, maintaining the mandatory three-tier system as a way to inflate beer prices is not the way to address that issue.

Conclusion. Beer variety and the number of brewers depends a three major factors: consumer demand, barriers to entry, and costs. Thanks to state and federal efforts to reduce taxes on brewers, the costs for a small brewery are, in most places, coming down; the biggest concern are the artificial barriers that make it difficult for small brewers to get their product to consumers. These are the barriers that big wholesalers and a few brewers want to maintain with the mandatory three-tier system.

Under the three-tier system, if you are a new brewer, you must find a distributor willing to contract with your brewery to add the beer to their portfolio and hope that the distributor is able to convince bars, restaurants, and stores to stock your products. What if you can't find a distributor? In most cases, you are out of luck. What if you get a distributor, but they cannot, or will not, sell your beer? In some cases you would be stuck, unable to contract with a new distributor, or you could begin the costly and lengthy process of going to court to break the contract. There has got to be a better way.

Beer distributors can be helpful for small brewers. They have relationships with the owners of stores and pubs, know which products sell in which outlets, and have distribution networks already set up so that the brewer can focus on making beer instead of buying trucks and hiring drivers. Yet, if they are such a commodity then wholesalers have no need to worry about the mandatory three-tier system becoming a voluntary one. Let brewers of all sizes choose if and when they want to utilize the services of a beer distributor or sell directly to consumers. This kind of freedom and flexibility will allow beer producers to respond to market conditions. In the end more freedom not less will make it easier for small brewers to start up and stay in business, resulting in better beer choices for consumers.

Notes

¹ For background on the history of the three-tier system, see Garrett Peck, *The Prohibition Hangover: Alcohol in America from Demon Rum to Cult Cabernet*, New Brunswick, N.J.: Rutgers University Press, 2009.

² American Antitrust Institute, *Halting Beer's March to Monopoly: The Likely Anticompetitive Effects of Anheuser-Busch InBev's Proposed Acquisition of Grupo Modelo*, white paper, November 2012, <http://www.antitrustinstitute.org/~antitrust/sites/default/files/Halting%20Beer%27s%20March%20to%20Monopoly.pdf>. Jim Heffernan, "Last Call," *Washington Monthly*, November/December 2012 http://www.washingtonmonthly.com/magazine/november_december_2012/features/last_call041131.php?page=all&src=longreads&buffer_share=842dd.

³ For a list of state self-distribution laws, see the Brewers Association, <http://www.brewersassociation.org/pages/government-affairs/self-distribution-laws>.

⁴ See for example, the recent attempt by small brewers in Illinois to gain self-distribution rights, John Greenfield, "Craft brewers not satisfied with self-distribution law," *Time Out Chicago*, July 31, 2011, <http://timeoutchicago.com/things-to-do/this-week-in-chicago/14847721/craft-brewers-not-satisfied-with-self-distribution-law>.

⁵ Michael Blanding, "The Great Beer Challenge How Two Companies Control Your Options," *Consumes Digest*, May 2011, <http://www.consumersdigest.com/special-reports/the-great-beer-challenge/view-all>.

⁶ The Brewers Association Craft Beer Backgrounder, <http://www.brewersassociation.org/pages/media/Craft-Beer-Backgrounder>.

⁷ Brewers Association, "Total U.S. brewery count tops 2,000," press release, March 26, 2012, <http://www.brewersassociation.org/pages/media/press-releases/show?title=brewers-association-craft-brewing-volume-hops-13-percent>.

⁸ The Drink Nation, "U.S. Craft Brewing Sees Huge Growth; Tops 5% Market Share," March 30, 2012, <http://thedrinknation.com/articles/read/7145-U-S-Craft-Brewing-Sees-Huge-Growth-Tops-5-Market-Share>.

⁹ Heffernan.

¹⁰ Pacific Institute for Research and Evaluation, “Setting minimum prices for alcohol,” press release, January 3, 2006, <http://www.pire.org/detail2.asp?core=38135&cms=114>.

¹¹ As calculated at Pintprice.com as of December 10, 2012.

¹² World Health Organization, Global Status Report on Alcohol and Health, Geneva, 2011, http://www.who.int/substance_abuse/publications/global_alcohol_report/msbgsruprofiles.pdf.