Interstate Wine Shipments and E-Commerce

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I am an economist, appearing on this panel as an individual at the request of FTC staff. I own a small vineyard in Napa Valley, California, have sold grapes to large and small wineries, and am familiar with the positions taken by many of the people in the wine industry regarding the opportunities and limitations surrounding direct sales of wine to consumers. My intention, however, is to speak here as an advocate for consumers rather than as an advocate for the wine business. My work as a professional economist concentrates primarily on consumer behavior, with applications in marketing, health, and the environment. I do not have a specialty in the economics of the wine industry. I am the E. Morris Cox Professor of Economics at the University of California, Berkeley, and have served as President of the Econometrics Society and as vice-president of the American Economics Association. In 2000, I won the Nobel Prize in Economics for my work on consumer choice behavior.

In common with most economists, I believe that consumers benefit from free markets operated with the minimum government regulation required for consumer protection. The history of government regulation of markets is littered with examples of restrictions, ostensibly adopted on behalf of consumers, that instead protect concentrated economic interests at the consumers' expense. The restrictions on direct purchase of premium wines and their interstate shipment that have been adopted by a number of States are, I believe, another example of abuse of the regulatory process to protect concentrated economic interests, going far beyond the minimum regulations needed to maintain the integrity of State taxation and to protect minor consumers.

For example, consider a Florida consumer who visits one of the hundreds of small wineries in California, and finds in the tasting room a wine he would like to purchase for his own consumption, but which is not sold by retailers in Florida. Florida is one of the more extreme of the twenty-eight states that place substantial restrictions on interstate wine shipments. As a consequence, this buyer cannot purchase this wine and have it shipped to himself, even though if it were sold in Florida, it would be legal for him to purchase it there, and even through the buyer would willingly pay Florida State alcohol taxes on his purchases. The winery not only loses the immediate sale to this prospective customer, but also loses the opportunity to develop a continuing relationship with this customer through membership in its wine club and/or subsequent re-orders. For a winery producing a few thousand cases per year, with varietals produced in lots too small for national distribution, direct sales to individuals are critical to survival. The shipping restrictions of states like Florida make a felony of a market transaction that would be completely legal if it were carried out entirely within Florida or entirely within California, and provide no reasonable mechanism for the buyer or seller to meet the control and tax requirements that Florida imposes on within-State transactions. Thus, the Florida legislation is a direct attack on interstate commerce, making a transaction illegal simply because it crosses state lines.

Wine purchases through internet sellers raise additional issues of control of shipment to minors, but the principle is the same. A transaction that would be legal if conducted intra-state between a retail store and a consumer

is made illegal either because the seller is out-of-State or because the sales mode is via the internet rather than face-to-face, without providing any reasonable mechanisms to satisfy control and taxation requirements.

As a general matter, the development of e-commerce has benefitted both producers and consumers, opening markets that were previously not well served by traditional distribution and retail networks. The experience of the last decade has been that in some areas, e-commerce has had a major impact on industrial structure; e.g., changes in distribution and inventory management policy facilitated by B2B internet transactions. However, the worst fears of traditional distribution and retail networks about internet competition have not been realized. In most cases, these traditional market participants provide value added that both producers and consumers are willing to pay for, and they remain robust players in their markets. My understanding of the wine industry is that where internet or winery purchase and shipment of premium wines have been permitted, this has primarily benefitted consumers by providing them expanded choices, and has supplemented rather than replaced traditional distribution channels. For example, in California which permits intra-state internet purchases and shipments of wine, small wineries and their customers benefit without noticeable impact on traditional distributors and retailers. Another example is the State of Illinois, which permits direct sales of wine with some restrictions, and continues to support a healthy distribution and retail sales system. My guess is that in many cases, the ability of consumers to visit wineries, sample products, and arrange one-time or periodic shipments, sharpens consumer interest in premium wines, and that in the end this increased interest benefits traditional distributors and retailers.

Of course, there is an opposing view, which is that distributors and retailers of alcoholic beverages have since the passage of the 21st Amendment acquired a great deal of market power by influencing State legislation. In this view, internet sales and interstate direct shipments are a serious threat to this market power. If this is true, then clearly the interests of consumers are not being served. However, my suspicions based on the observation of many markets over many years are that there is considerably less money at stake than either the distributors and retailers, or their critics, think. Rents accrued from market power have a tendency to dissipate, through entry pressure and through the cost of maintaining the market position. I believe the evidence from States that allow direct sales indicates that distributors and retailers would not be substantially impacted. As one winery owner that I interviewed said to me: “My distributor makes me feel powerless, but he does a lot for me and I value that. I would not do anything to jeopardize the relationship.” Similarly, I see the value to consumers of direct wine shipments coming primarily from access to wines that are not available in their communities. When consumers have retail outlets with the same products, they will usually seek the convenience and value added provided by their local wine merchant. A product like premium wine, where price and service are associated with quality, is very unpromising for entry of low price or generic brands distributed by direct shipment. If direct interstate wine shipments were reopened, I would foresee some competitive pressure on distributors and retailers, primarily from direct wine sales to large retailers, but no substantial restructuring of the industry. I find it particularly sad that the anti-interstate shipping legislation that has been passed is so disproportionate in its negative impact on consumers relative to the very modest protection it provides to traditional distributors and retailers.

It is difficult to consider markets for alcoholic beverages without taking into account their history and special status. Because these products are potentially intoxicating and addictive, States have a legitimate interest in controlling their distribution, particularly to minors. Historically, "sin taxes" on alcohol have been a significant source of government revenue, in addition to discouraging consumption. These legitimate issues of control and taxation have been used as cover for legislation that is really designed to protect concentrated economic interests from the competition of interstate commerce. If these legitimate interests were the only concern, then there are many ways to satisfy them without draconian laws that infringe on consumer choice.

One way to accomplish this would be through State adoption of a standardized sales/shipment agreement, such as the model sales agreement promoted by the Wine Institute, that incorporates reasonable control and taxation mechanisms. First, consider the issue of control. It would be simple to require that shippers deliver only to recipients who can show identification proving them to be of age, and to let shippers charge for providing this service. Second, consider the issue of taxation. Either the producer or the shipper could be charged with responsibility for collecting and forwarding state tax payments on wine shipments. Problems of compliance with state control and tax requirements would not be substantially different than those currently encountered in retail stores.

Within a reasonably regulated market, an alternative might emerge that would be even more attractive for wine producers and consumers. Specialized shippers might take on the responsibility of licensing shipment to the various states and meeting state control and tax requirements, perhaps through providing wineries with special shipping labels that ensure proper delivery of the product. States that authorize such shippers might find them useful for collecting taxes on a variety of products. Because distributors are already experienced with interstate wine shipments, they are well positioned to take the lead in providing such shipping services.

If excessive State restrictions on interstate wine shipments were eliminated, and the legitimate State interests for control and taxation were met through market innovations of the form just outlined, consumer welfare would be materially improved. Consumers would have more choices. Legitimate state interests in control and taxation of alcoholic beverages would be preserved. Traditional distributors and retailers would face modest increases in competitive pressure, but they would avoid the outraged complaints of the small but influential group of premium wine consumers.

I urge the FTC to look closely at state legislation that goes beyond the minimum regulation needed to meet legitimate state concerns on control and taxation of alcoholic beverages. I urge the FTC to combat the use of the 21st Amendment as a cover for attacks on the interstate commerce clause of the Constitution by concentrated economic interests, particularly when these attacks deprive consumers of the benefits of free and competitive markets.