

# Alcohol Taxation

Issued *March 2010*

## ***A Caveat***

This background paper has been developed to accompany VAADA's Alcohol Taxation Position Paper (issued February 2010). It contains a more detailed discussion of the complexities of alcohol taxation than was possible or desirable in VAADA's position paper.

VAADA awaits the Commonwealth Government's response to the review of Australia's taxation system (*Australia's Future Tax System*). It is likely the findings and recommendations of this significant review will impact on VAADA's position with respect to taxation and, it is hoped, address the issues outlined in this paper.

While acknowledging that an optimal tax policy is difficult to achieve, the taxation and pricing of alcohol as part of a suite of policy measures is considered an effective means of positively influencing public awareness and attitudes, consumption and longer term public health outcomes.

The price elasticity of demand for alcohol, particularly for wine, is an important determinant in shaping consumption patterns and trends. With this in mind, the use of taxation to influence the price of alcohol can prove highly effective in bringing about sustained shifts in consumption toward products with lower average alcohol by volume.

VAADA believes a comprehensive suite of measures is required to reduce alcohol-related harm across the Victorian community, of which alcohol taxation should be one component.

## Specific recommendations

In relation to alcohol taxation and associated matters, VAADA recommends that:

1. The *ad valorem* Wine Equalisation Tax (WET) be replaced with a consistent volumetric taxation regime.
2. Twice-yearly indexation of excise duty be continued as a means of maintaining the real economic cost to the consumer of alcohol and to avoid substitution effects caused by changes in the price of alcohol.
3. Hypothecation of alcohol tax revenue should be instigated by the Commonwealth Government as an efficient means of allocating resources to alcohol-related treatment and education services and programs.
4. In relation to minimum (floor) pricing, its adoption and implementation warrants further, more comprehensive exploration and consideration. Notably, an across-the-board excise model that includes regulating the minimum (floor) price for alcohol in combination with the volumetric tax as proposed by the National Health Preventative Taskforce, is worthy of further consideration and modelling.
5. Use of volumetric taxation be continued and strengthened.
6. Research and strengthening of data collection methods and evidence bases for the purposes of:
  - good policy formulation;
  - effective program development;
  - sound and informed program evaluation; and
  - assisting ongoing policy development and reform.
7. Improved access to, and quality of, comprehensive, publicly available wholesale and retail alcohol sales data to assist modelling and enhanced policy development and advice.

## Introduction

Alcohol and its consumption are an accepted and enjoyable part of Australian culture, with a long history and deep sociocultural roots. However, attitudes toward alcohol are also complex and ambivalent, and evidence of significant alcohol-related harm to individuals and communities demands a concerted and effective response. Harmful and excessive consumption of alcohol is influenced by a complex set of social, cultural, environmental and economic factors, one of which is the way alcohol is taxed.

Policies addressing alcohol taxation must be viewed and developed in concert with policy reform in a number of areas, specifically alcohol advertising and marketing as well as liquor licensing systems. Harm reduction strategies, public and school-based education and awareness programs, alcohol and other drug treatment services, and State and Territory policing must be resourced to support and carry reform.

This paper focuses on consumption of alcohol by the general population that does not consume alcohol significantly outside recommended safe drinking guidelines. It is VAADA's continued view that '[t]here be a greater national and local focus on the harms arising from alcohol misuse. However, this focus needs to go beyond youth and teenage drinking, to consider broader cultural questions of alcohol consumption across Australian society and its impact in social, economic and health terms' (VAADA 2008, p.3).

Specific issue areas covered here include:

- Alcohol Pricing and Taxation
- Volumetric Tax
- Wine Equalisation Tax
- Excise Tax
- Ready to Drink 'Alcopops' Tax
- Minimum pricing
- Substitution Effects
- Hypothecation
- Evidence-Based Approaches

## Alcohol - Consumption Guidelines and Consumption Patterns

The Australian Alcohol Guidelines were reviewed and revised in 2009 by the National Health and Medical Research Council. The updated *Australian Guidelines to Reduce Health Risks from Drinking Alcohol* (NHMRC 2009) takes a new approach to public health guidance. By estimating the risk of alcohol-related harm over a lifetime and providing advice on how to lower that risk, the six new guidelines encourage people to make informed choices about how much and how regularly they drink. The Guidelines state that:

- For healthy men and women, drinking no more than two standard drinks on any day reduces the lifetime risk of harm from alcohol-related disease or injury.
- For healthy men and women, drinking no more than four standard drinks on a single occasion reduces the risk of alcohol-related injury arising from that occasion.
- Parents and carers should be advised that children under 15 years of age are at the greatest risk of harm from drinking and that for this age group, not drinking alcohol is especially important.
- For young people aged 15–17yrs, the safest option is to delay the initiation of drinking for as long as possible.
- For women who are pregnant or planning a pregnancy, not drinking is the safest option.
- For women who are breastfeeding, not drinking is the safest option.

## Consumption Patterns

Estimates based on the *2007 National Drug Strategy Household Survey* (Victoria) show that in terms of alcohol use:

10.1% of Australians aged 14 years or older had never consumed a full serve of alcohol; a further 7.0% had not consumed alcohol in the previous 12 months. The average age at which males first consumed a full glass of alcohol was 16.3 years, whereas for females it was 17.1 years.

The Survey found:

[t]hree in five (60.8%) Australians drank at levels considered at low risk of harm in the short- or long-term. Almost one in ten (8.6%) drank at levels considered risky or high risk for both short-term and long-term harm. Females aged 14 years or older (20.1%) were more likely to be abstainers than males (14.0%). (Australian Institute of Health and Welfare 2008, p.30).

In relation to risk factors and the burden of disease, Australian Bureau of Statistics (ABS) data indicate that, of those males and females who drank alcohol in the previous week of the survey (59% of the total population):<sup>1</sup>

- 21% did so at a level which would pose a risk to their health.
- Males 25-34 years reported the highest proportion of drinking at risky/high risk levels (17%).
- For females the proportion drinking at risky and high risk levels were highest in the middle age groups. 13% of females aged 45-64 years reporting consumption which would place them in the risky or high risk groups. (2009, p.7, Cat No. 4364.0).

## Costs of Alcohol Consumption

The estimated cost to Australian society of alcohol-related harm including crime and violence, illness, injury and disease and lost productivity is in excess of \$15billion per year (Collins and Lapsley 2008, p.65). Further, the total estimated federal and state budgetary impact of alcohol abuse has been estimated at \$1,415.6 million (Collins and Lapsley 2008, p.70).

## Setting an Optimal Alcohol Taxation Policy

The heterogeneous nature of the demand for alcohol and its supply, and its cultural and social roles in Australia, make the formulation and application of an optimal alcohol taxation regime 'no easy task.'<sup>2</sup> Alcohol policy-setting is complex and shaped by a multitude of influences, including:

- community attitudes and social norms;
- the imperative to enhance and maintain the public health of the general populace;
- taxation and pricing structures to influence demand and users' consumption profiles;
- age groupings, life stages, disposable income, behavioural patterns, and responsiveness to price changes; and

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<sup>1</sup> Persons were classified to a health risk level (low risk, risky, or high risk) based on their estimated average daily consumption of alcohol during the previous week.

<sup>2</sup> See Drugs and Crime Prevention Committee, Parliament of Victoria *'Inquiry Into Strategies to Reduce Harmful Alcohol Consumption, 'Inquiry Into Strategies to Reduce Harmful Alcohol Consumption, Final Report Vol 2, Ch 14.1.*

- vast product availability and a proliferation of independent and franchise wholesale and retail liquor outlets, and discount incentives such as ‘happy hours’.

Overlaying the liquor taxation and pricing debate is a prominent public health campaign which centres on reducing and minimising the harms associated with episodic and excessive alcohol consumption.

Key determinants of alcohol consumption and levels of consumer desire (‘demand’) include age and life stage. Demand is also influenced by a combination of factors, namely the consumer’s disposable income, consumer product preferences, and the responsiveness of demand for a product to changes in price.

On the ‘supply side’ (and in light of the liberalisation of liquor licensing laws nationwide from the early-1980s), consumers can choose from a vast array of available products that range from beer (low- through to high-strength alcohol per volume of content), to wine, cask wine, and straight and pre-mixed spirits. This is coupled with a proliferation of independent and franchise wholesale and retail liquor outlets, and discount incentives such as ‘happy hours’.

One study has rightly highlighted the inconsistencies in the current alcohol taxation regime when viewed against the principles of efficiency, equity and enforceability of taxation policy, pointing out that ‘...the tax on cask wine is only a fraction of that on mid-strength beer even though wine has higher alcohol content. The amount of wine equalisation tax (WET) is unrelated to alcohol content. These differences seem unrelated to policy objectives’ (Webb 2009, p.6).

## Key Issues

### Alcohol Pricing and Price Elasticity of Demand

The extent to which changes in price influence demand for a particular product must be considered when examining consumer spending patterns and behaviour. This is referred to as the ‘price elasticity of demand’.

Although increasing the price of alcohol is one means of attempting to influence alcohol consumption patterns, the exact influence and efficacy of taxation and price increases, as well as associated positive and negative impacts, are contested.

Nonetheless, the literature relating to the price of alcohol overwhelmingly points to the inverse impact of price changes on consumption, otherwise known as the price elasticity of demand (see above). The Alcohol and Other Drugs Council of Australia (ADCA) note that

...[a] major review of international evidence on the price sensitivity of alcohol consumption was conducted under the auspices of the World Health Organisation as part of a wider review of alcohol control policies ... [it] identified 53 adequate studies spanning 17 countries which examined data spanning the years 1870 to 1991. All of these studies found a negative correlation between price for wine and consumption. [t]his trend was noted in all but one study in respect of spirits and in all but three for beer (ADCA 2003, p.8).

Further, the Ministerial Council on Drug Strategy (MCDS) stated in 2001 that

[i]ncreasing the price of alcohol (or using price as a means of diverting consumer preferences to low alcohol varieties) has been shown repeatedly to be one of the most effective prevention strategies to minimise consumption of alcohol, which in turn, can be associated with a reduction in alcohol-related harm (MCDS 2001, p.35).

For example, Chaloupka (2002) points to an extensive review of the economic literature on alcohol demand which showed that the price elasticities of demand for beer, wine, and distilled spirits are -0.3, -1.0, and -1.5, respectively. That is, a one percent increase in the price for beer would reduce consumption by 0.3 per cent (Chaloupka 2002).

However, a 2008 study in the United Kingdom found a mean elasticity of demand, whereby a 1 per cent increase in price would reduce consumption by -0.51 for all drinkers. It also found that heavy drinkers are much less price elastic than moderate drinkers, and one ‘...cannot reject the hypothesis that the very heaviest drinkers have perfectly price inelastic demands’ (Oxford Economics 2009, p.15). That is, the ‘heavy’ drinkers<sup>3</sup> are unaffected by large price increases.

Importantly, this may indicate a need for a complementary variety of initiatives to influence drinking levels among those drinking at riskier levels. These could range from advertising campaigns, labelling and self-identification of heavy or harmful drinking patterns.

## The Taxation of Alcohol

A significant portion of the retail price of alcohol comprises taxation components: Goods and Services Tax (GST), volumetric tax and a Wine Equalisation Tax (WET). Given tax is inevitably passed on to the consumer as a price increase, one of the most effective and efficient ways to influence sales (and, by extension, consumption and related harms) is through the structure and level of tax imposed on a product. Crosbie and Stockwell point out that ‘...[g]iven the extent of alcohol and related harm in the Australian community there is an overwhelming scientific and ethical case for examining the likely impact of pricing and taxation policy on the many public health and safety problems associated with alcohol misuse’ (Crosbie 2000, p.5). This view is supported by findings from an Alcohol Education Rehabilitation Foundation (AERF) study in April, 2009 into community attitudes towards alcohol.

## Volumetric Taxation

Volumetric taxation is a tax levied on the alcohol content per volume of the product, rather than on other considerations such as the manufacturing cost. For example, low, medium and full strength beers (≤4.9% alcohol content per volume) attract lower taxation levels than spirits (up to 40% alcohol content per volume). While on the other hand, wine is not taxed on alcohol content, but on the wholesale price of the product.

The Australian Medical Association and the National Drug Research Institute both support the use of volumetric alcohol taxation as good health policy, where alcohol is taxed according to the amount of alcohol contained in the product, thereby encouraging the consumption of lower alcohol products (DCPC 2006, p.357-358). Further, in terms of the cost-effectiveness of a range of interventions, it was found that ‘...volumetric taxation of alcohol had the lowest intervention costs and provided the greatest benefits in terms of disability adjusted life years’ (Skov 2009, p.3).

## Wine Equalisation Tax

The Wine Equalisation Tax (WET) is a value-based tax applied to wine consumed in Australia. It is paid on the value of the goods at the last wholesale sale.

Following the removal of certain taxes in 2000 and the co-inciding introduction of the Goods and Services Tax (GST), the WET was introduced with the aim to equalise tax rates and maintain wine prices. The WET rate for 2009-2010 is 29 per cent of the wholesale sale value. A rebate of up to \$500,000 *per annum* is available for small, cellar door wine producers with annual turnover of up to \$1.73 million.

With respect to cask wine and costs per standard drink, the Alcohol and Other Drugs Council of Australia (ADCA) points out that:

...[t]he WET does not reflect the external costs imposed on the community arising from the misuse of wine and related products and in fact favours cheaper beverages such as cask wine irrespective of their alcohol content (ADCA 2003, p.5).

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<sup>3</sup> Those who consumer above recommended NHMRC guidelines or at risk of short- and long-term harm to themselves or others.

Importantly, it highlights:

[t]he current alcohol taxation system enables a male drinker to consume a daily intake that is considered by the National Health and Medical Research Council (NHMRC) to be high risk for long-term harm for only \$2.28 (7 or more standard drinks) and a female drinker to do so for just \$1.63 (5 or more standard drinks) based on the cost of a four-litre cask of wine that contains 40 standard drinks (ADCA 2003, p.5).

A full exploration of these issues are beyond the scope of this paper as a great deal of complexity surrounds the WET, with implications within the wine industry between small- and large-scale producers of wine, and gaming among suppliers in relation to available subsidies.

Given the anomalies of the WET and the price of cask wine relative to Australian drinking guidelines, there is an obvious need for a revamping of this tax. Substituting the WET with a consistent volumetric tax regime is worthy of consideration.

### Excise Tax

The excise tax on alcohol is levied twice a year as a means of maintaining the real cost of alcohol, and thereby avoiding the income and substitution effects caused by changes in the relative prices of alcoholic beverages. In order to ensure a precise maintenance of real price, it would be recommended to examine differences in rates of change of Consumer Price Index and alcohol prices.

If rates of change of the two are significantly different, a composite price index of alcohol could be developed to ensure accurate real adjustment and maintenance of price relativities between categories and types of alcohol.

### Ready to Drink 'Alcopops' Tax

Following the reduction on the excise duty on ready-to-drink (RTD) alcoholic beverages after the introduction of *A New Tax System* on 1 July 2000, there was a significant growth in the sales of RTDs of 254% from 1999 to 2007 (or a 3.54 growth factor off a low base). In the 2008-09 Commonwealth Budget, the Government expressed its concern about the growth in the consumption of RTDs, particularly among teenagers. As a policy response, it closed a loophole where spirits in pre-mixed drinks were taxed at a lower rate than bottled spirits.

By restoring the alignment between the rates of excise on RTDs and full-strength spirits, the Government has attempted to send a price signal to reduce binge drinking consistent with other initiatives. A proportion of this revenue will be redirected to preventative health through the National Health Prevention Strategy with the States (Australian Government 2008). The general intent of this approach is welcomed as one response to a public health issue, while also directing public attention to the issue of excessive alcohol consumption outside of NHMRC guidelines.

In its submission to the Senate Standing Committee on Community Affairs, the Public Health Association of Australia points to the 'gateway effect' of RTDs and highlights the appeal of such beverages to young people – particularly young women – in terms of taste and appearance. The 'gateway effect' denotes the way in which this appeal may lead to people acquiring a taste for alcohol at a younger age and to consuming more alcohol at a younger age, with the attendant financial, health and other risks this implies (Senate Standing Committee on Community Affairs 2009, p.13).

However, as put forward to the same Inquiry, VAADA maintains that '...we need to be cautious of "scapegoating" young people for behaviour that may be relatively common among adults. Efforts to reduce alcohol misuse should not be focussed solely on young people but should acknowledge that harmful and excessive alcohol consumption is a problem across all age groups.' (Victorian Alcohol And Drug Association 2008, p.4-5).

## Minimum Pricing

A key rationale of minimum alcohol pricing (or floor price) – whereby alcohol is priced per unit of 10 millilitres of alcohol – is that it would target heavy drinkers and young people, as consumers of this type tend to consume stronger and cheaper products.

In Australia, the National Preventative Health Taskforce maintains that minimum pricing would aim for a real shift in per capita consumption rather than merely product preference. Importantly, the Taskforce has recently recommended that a public interest case for minimum (floor) price for alcohol be developed to discourage harmful consumption. This approach is supported by VAADA.

More specifically, the Taskforce has put forward an across-the-board excise model that includes regulating the minimum (floor) price, especially with regard to small containers (300ml). In combination with the volumetric tax structure, all products could have a floor price based on their alcohol content in a 300ml container.

It should be noted that issues of political will and commitment – as evidenced in Scotland and Great Britain in 2009 – are central determinants in the adoption of minimum alcohol pricing and the extent of its implementation.

## Substitution Effects

A key aspect in assessing consumer behaviour and consumption patterns is to consider substitution effects. This is the rate at which consumers switch spending to or from a commodity relative to price changes, but where the total utility or satisfaction derived by consumers is left unchanged (Bannock, 2003, p 371).

As a result of changes in the relative prices of alcoholic drinks, substitution effects would deliver highly efficacious policy outcomes. Longer term, this may lead to reductions in alcohol-related violence, lower levels of community harm as well as reduced economic and social costs as outlined earlier.

Specifically, the Inquiry undertaken by the Senate Standing Committee on Community Affairs notes that – although based on only nine months of data from May 2008 to February 2009 - substitution of spirits for RTDs following implementation of the alcopops measures in May 2008 has not been so complete as to cancel out the intent of the measures. As evidence, the Committee pointed to a 7.9 per cent decrease in combined spirits sales, as well as reductions in total consumption of alcohol (Senate Standing Committee on Community Affairs 2009, p.12).

However, it is important to be cognisant of possible adverse substitution effects across different consumer types such as low-income or Indigenous populations. While an increase in the tax and price of cask wine might lead to a fall in demand for that product, policy makers and service providers must query what, if any, product is being consumed in its place.

Importantly, addressing health-related harms associated with the substitution of different types of alcohol must take other matters into account. For instance, the removal from sale in a Northern Territory community of two-litre cask wine over twelve months to April 2003 found that they were replaced by two-litre casks of fortified wine or port. With the ten-fold increase in the sale of port came an associated increase in incidents of alcohol-related illness in the community, including diabetes. The community was also faced with the problem of harmful consumption of cask wine and fortified wine (Drugs and Crime Prevention Committee (DCPC), 2006a), illustrating the complexities and unintended consequences of setting an optimal tax regime for alcohol.

## Hypothecation

Hypothecation is the process whereby a portion of the taxation revenue raised directly from the sale of alcohol is allocated for the express purpose of addressing (through research, education, rehabilitation or other means) the costs, harms or misuse of the commodity in question (DCPC, 2006b).

The use of hypothecation has considerable merit as it helps to ensure funding for programs that may have significant public benefit. Thus, revenue sourced from tax, excise and alcohol sales duties are allocated toward programs and education aimed at awareness and harm minimisation, and can be independent of government policy of the day. Further, it has wide support from public, service provider and government representative bodies, including the Australian Drug Foundation (ADF), VicHealth and VAADA (DCPC 2006, Vol 1).

More specifically, a comprehensive population-based alcohol harm reduction program was introduced in the Northern Territory in 1992 funded by a levy of 5 cents per standard drink. Under the Living With Alcohol (LWA) Program, the proceeds of the levy supported increased treatment, public education and other prevention activities. An evaluation of LWA found there were reductions in estimated alcohol-caused deaths from acute conditions (road deaths 34.5%, other 23.4%) and in road accident injuries requiring hospital treatment (28.3%). In addition, there were substantial reductions in per capita alcohol consumption and self-reported hazardous and harmful consumption via surveys.

These reductions were evident from the outset of the introduction of LWA, and were largely sustained throughout the four years studied. The data indicated significant health and safety benefits accrued to the people of the Northern Territory during the first four years of the LWA program, although the authors point out this benefit is likely to be due to a combination of several factors: namely, the effect of the levy on alcohol consumption, and the effect of the LWA (Stockwell *et al* 2001).

## Non-Price Methods

As a complementary policy approach, methods of influencing demand by measures other than price (i.e. non-price methods) can also be used to reduce alcohol-related harm. Based on submissions to the review into Australia's tax system, *Australia's Future Tax System* (2008), the Commonwealth Department of Treasury points out that the use of taxation and pricing are not the only methods available to effectively reduce harm from alcohol use. Other policies with the same aim include regulating the physical availability of alcohol (licensing restrictions), restricting advertising (see VAADA's Position paper on this topic (2010)), providing information (through labelling requirements and education) and policing (random breath testing) (Skov 2009).

## Evidence-Based Approaches

Ongoing data collection and analysis are necessary to monitor and accurately evaluate the impact of policy and programs. Importantly, the need for evidence-based policy and interventions has been widely recognised and accepted by the alcohol and other drugs sector (DCPC 2006). An often-repeated claim throughout much of the literature in Australia and overseas is the need for good, reliable and robust data and information on which policy and programs can be based.

Sound, comprehensive data is not only required to understand changes in taxation and the relationship between taxation and patterns of consumption and associated costs and harms, but also to understanding the full range of issues impacting on alcohol consumption. In its submission to the Inquiry into the Impact of Changes to the Tax on Ready-to-Drink Alcoholic Beverages, the Public Health Association of Australia stated that it seeks 'a systematic approach to the collection of data on alcohol use so that information and evidence is available to decision makers and to researchers to ensure better analysis and decision making.' (The Senate Standing Committee on Community Affairs 2009, p 39).

In a joint submission to the review of Australia's tax system, fifteen of Australia's prominent alcohol and drug research, policy and peak bodies, affirmed that in order to:

...[o]ptimise tax settings designed to influence price points as a contribution to safer and healthier consumption of alcohol, continual empirical scientific study is needed on price elasticities, cross-elasticities and substitution effects in the Australian context (ADF 2009, p.20).

Further, the Alcohol and Other Drugs Council of Australia has spoken in support of mandating of the collection of alcohol sales data, '...considered essential in the evaluation of community initiatives to reduce alcohol-related harm and the effects of liquor licensing changes' (ADCA Media Release 2008). Internationally, similar calls for a stronger evidence base have been made in the European Union (Centre for Public Health, 2009).

Hence, there is a clear need for improved access to, and quality of, comprehensive, publicly available wholesale and retail alcohol sales data to assist modelling and enhanced policy development in relation to alcohol consumption patterns.

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## Disclaimer

While efforts have been made to incorporate and represent the views of our member agencies, the position and recommendations presented in this Paper are those of VAADA.