Victorian Alcohol and Drug Association (VAADA)

Position Paper: *Alcohol Taxation*

# Alcohol Taxation

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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 drug treatment services, and State and Territory policing must be resourced to support and carry reform.

## 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.'[1] Webb, for instance, highlights the inconsistencies in the current alcohol taxation regime when viewed against the principles of efficiency, equity and enforceability of taxation policy. '[T]he 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).

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

## Key issues

A significant component of the retail price of alcohol comprises various taxation components: Goods and Services Tax (GST), volumetric tax and a Wine Equalisation Tax (WET). This means that 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 (as tax is inevitably passed onto the consumer as a price increase). 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'

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[1] 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.

(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.

## Alcohol Pricing and Price Elasticity of Demand

Increasing the price of alcohol is one means of attempting to influence alcohol consumption patterns. While the exact efficacy of taxation and price increases is contested, the literature overwhelmingly points to an inverse impact of price changes on consumption, otherwise known as the price elasticity of demand.

## 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 cost of the manufacture of the product. For example, low, medium and full strength beers (≤4.9% average alcohol per volume) attract lower taxation levels than spirits (up to 40% average alcohol per volume). Wine is not taxed on the content of alcohol, but on the on the wholesale price of the product. 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).

The Australian Medical Association and the National Drug Research Institute both support the use of volumetric alcohol taxation as good health policy, thereby encouraging the consumption of lower alcohol products (Drugs & Crime Prevention Committee 2006, pp.357-358). The National Health Preventative Taskforce also supports a 'tiered' volumetric system that '…provide(s) economic incentives for the production and consumption of lower strength alcohol products and disincentives…for the highest risk products' (National Health Preventative Taskforce 2009, p.255). The Alcohol and other Drugs Council of Australia (ADCA) supports a similar model of alcohol taxation (ADCA 2009, p.5).

## 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[2] caused by changes in the relative prices of alcohol. 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 (i.e. Consumer Price Index and alcohol prices) are significantly different, a composite price index of alcohol should be developed to ensure accurate real adjustment and maintenance of price relativities between categories and types of alcohol.

## Wine Equalisation Tax

Following the removal in 2000 of certain taxes and the introduction of the Goods and Services Tax, the Wine Equalisation Tax (WET) was introduced with the aim to equalise tax rates and maintain wine prices. 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. The WET rate for 2009-2010 is 29 per cent

[2] Income effect - The change in demand for a product caused by the impact of a change in its price on the (real) spending power of consumers.
Substitution effect – The rate at which consumers switch spending to or from a commodity when its relative price changes but the total satisfaction of consumers is left constant (Bannock *et al*, 2003).

of the wholesale sale value. A rebate of up to $500,000 *per annum* is available for small, cellar door wine producers with turnover of up to $1.73 million.

With respect to cask wine and costs per standard drink, 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).

More specifically, when considered in light of the revised Australian Guidelines to Reduce Health Risks from Drinking Alcohol, the anomalous implications of the WET in relation to the price of cask wine, point to the need for a revamping of the WET to substitute with a volumetric tax.

## Ready to Drink 'Alcopops' Tax

Following the reduction of 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%, or a 3.54 growth factor from 1999 to 2007 (from a low base). In the 2008-09 Commonwealth Budget, the Government expressed its concern about the growth in the consumption of RTDs alcoholic beverages, 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.

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 health and other risks that this may bring about (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' (Victorian Alcohol And Drug Association 2008, pp.4-5).

## Minimum Pricing of Alcohol

A key rationale of minimum alcohol pricing (or floor price) - whereby alcohol is priced per unit of 10 millilitres per alcohol - is that it would target heavy drinkers and young people, as drinkers 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 just 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 and promote safer 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 the 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. As noted previously, this is the '...rate at which consumers switch spending to or from a commodity relative to price changes but the total utility or satisfaction derived by consumers is left constant' (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, reduced community harm as well as reduced economic and social costs outlined earlier.

However, it is important to be cognisant of possible adverse substitution effects for low-income and Indigenous groups. While an increase in the tax and price of cask wine might lead to a fall in demand for cask wine, policy makers and service providers must query what, if any, product is being used in its place.

## 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 (Drugs and Crime Prevention Committee 2006). 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 treatment programs and education aimed at awareness and harm minimisation.

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. Hypothecation is widely supported by public health bodies and policy bodies including the Alcohol and Other Drugs Council of Australia, the Australian Drug Foundation (ADF), VicHealth, and VAADA (Drugs and Crime Prevention Committee 2006, p.362).

## 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 (Drugs and Crime Prevention Committee 2006, p.1227). 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 arguments and policy could be more soundly based.

In a joint submission to the 2009 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' (AERF et al 2009, p.20). ). Equally, in facilitating this, there is an important need for improved access to, and quality of, wholesale and retail alcohol sales data to assist in modelling and policy development.

## Australia's Future Tax System (The Henry Review)

In 2009, a major review of the Australian taxation system was undertaken by the federal Department of Treasury. The principal aim of the review was to consider the best structure of the tax system to meet the needs of the twenty-first century.

VAADA supports many of the findings of the Review including that the current alcohol taxation system is ineffective in reducing the social harms from alcohol and the recommendation for the introduction of volumetric taxation of alcohol.

Specifically, the Review notes the need for the urgent introduction of a volumetric tax on wine products in order to raise the tax paid on cheap wine given the anomalous nature of the wine equalisation tax. VAADA strongly supports this view. Other findings include the need for reform of alcohol taxation in order to reduce inefficiencies in the current alcohol taxation system by restructuring taxes for certain forms of alcoholic beverages most open to excessive consumption, most notably cheap wine.

Importantly, the Review claims that the final rate of volumetric tax '...would be intended solely to optimise price signals facing consumers. It should be set without regard to the government's fiscal position, and irrespective of any specific spending commitments related to alcohol abuse' (Australia's Future Tax System, Chapter E5-3, 2010). This is strongly endorsed by VAADA for ensuring and maintaining the integrity of volumetric alcohol taxation in order to bring about sustained reductions in marginal social costs[3] and spillover effects.

VAADA is disappointed the Federal Government has rejected the Henry Review's recommendations with regard to alcohol taxation. The common volumetric alcohol tax recommended by the Review would not discriminate between beverage types, and it would better target the spillover costs of alcohol consumption (Australia's Future Tax System, Chapter E5-3, 2010). As the Review points out, this is particularly important given that some forms of alcohol are subject to excessive consumption (Australia's Future Tax System, Chapter E5-3, 2010). The recommendations made by the Henry Review are in line with the evidence that increasing the price of alcohol through taxation does reduce consumption.

[3] The change in total costs of an activity. This includes the private costs to the producer and the consumer as well as the adverse or external costs imposed on people who are not directly involved in the activity. In relation to alcohol, a common example among others is anti-social behaviour and damage to public property and physical harm to others caused by public drunkenness.

## VAADA's Recommendations

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 cost 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.

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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.