FARE submission to the Inquiry into the Australian grape and wine industry

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About the Foundation for Alcohol Research and Education

The Foundation for Alcohol Research and Education (FARE) is an independent, not-for-profit organisation working to stop the harm caused by alcohol.

Alcohol harm in Australia is significant. More than 5,500 lives are lost every year and more than 157,000 people are hospitalised making alcohol one of our nation's greatest preventative health challenges.

For over a decade, FARE has been working with communities, governments, health professionals and police across the country to stop alcohol harms by supporting world-leading research, raising public awareness and advocating for changes to alcohol policy.

In that time FARE has helped more than 750 communities and organisations, and backed over 1,400 projects around Australia.

FARE is guided by the World Health Organization's *Global Strategy to Reduce the Harmful Use of Alcohol*[i] for stopping alcohol harms through population-based strategies, problem directed policies, and direct interventions.

If you would like to contribute to FARE's important work, call us on (02) 6122 8600 or email info@fare.org.au.

[i] World Health Organization (2010). *Global strategy to reduce the harmful use of alcohol.* Geneva: World Health Organization.

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Summary

The Foundation for Alcohol Research and Education (FARE) welcomes the opportunity to provide a submission to the *Inquiry into the Australian Grape and Wine Industry*. FARE has prepared a submission to this Inquiry because the recommendations made about the production and sale of wine by this Inquiry have the potential to impact on the health and safety of Australians.

FARE's submission outlines actions that need to be taken to address issues within the wine industry that encourage the production of cheap and low quality wines. The preferential taxation treatment of wine adds to alcohol-related harms in the community as well as acting as a barrier to the necessary structural adjustment of parts of the wine and grape growing industries.

In Australia wine is the cheapest alcohol product available for sale, with some wine sold for as little as 24 cents per standard drink. The majority of bottled wine (65 per cent) is sold for under $8.00[1]. The Winemakers' Federation of Australia (WFA) acknowledges this, with Chief Executive Officer Paul Evans recently saying: "We believe that wine, at the retail point of sale, is too cheap."[2]

The availability of cheap wine is concerning as low alcohol prices contribute to increased consumption and harms. There is strong evidence to show that the lower the price of alcohol, the higher the levels of consumption.[3] Young people and heavy drinkers are particularly sensitive to alcohol price, with the heaviest drinkers more likely to seek out cheaper drinks than moderate drinkers.[4] In 2009, a meta-analysis was conducted of 112 peer reviewed studies on the effects of alcohol price and taxation levels on alcohol consumption which found that there was "overwhelming evidence of the effects of alcohol pricing on drinking".[5] Even small increases in the price of alcohol can have a significant impact on consumption and harm.[6]

The low price of alcohol is partially the result of the convoluted, inequitable and harmful alcohol taxation arrangements in Australia, where wine is the only alcohol product taxed based upon its wholesale price, rather than alcohol content. Beer and spirits are taxed on a volumetric basis, albeit at different rates, with the amount of tax paid determined by the volume of alcohol within the product and the category of alcohol (for instance, full strength packaged beer is taxed differently to spirits).

The Allen Consulting Group report *Alcohol taxation reform: Starting with the Wine Equalisation Tax (WET)* highlights the inequities in the current taxation arrangements:

> *The current alcohol taxation regime reflects competing policy pressures and compromises. The result is that different amounts of tax are payable on any standard drink depending on the classification of beverage, the alcohol concentration, container size, size of producer and the pre-tax price of the produce.*[7]

This is why nine separate government reviews have recommended overhauling the wine taxation system, including the Henry Review which determined that reforming the WET was a matter of urgency for the Australian Government.[8]

Reforming the WET is supported by the public health sector, leading Australian economists and two of the biggest producers in the wine industry. Despite this, the alcohol taxation system has remained largely unchanged, with the exception of the introduction of the alcopop tax in 2009.

This submission concentrates on the Wine Equalisation Tax (WET) and its accompanying policy, the WET rebate. Any Inquiry that looks into the grape and wine industries and does not consider the WET and WET rebate in concert will have failed to recognise a fundamental influence on the industry and the way it operates. The health and safety of all Australians should be paramount and the level of taxpayer-funded welfare of the wine industry must be brought to an end.

Recommendations

FARE makes the following recommendations to the *Rural and Regional Affairs and Transport References Committee* regarding the *Inquiry into the Australian grape and wine industry:*

1. That the Inquiry recommends that clear objectives be developed for wine taxation that addresses the economic externalities created by the current tax arrangements.
2. That the Inquiry recommends that the ad valorem Wine Equalisation Tax be abolished and replaced with a volumetric tax rate.
3. That the Inquiry acknowledges that the Wine Equalisation Tax rebate is not meeting its original policy intent of supporting small producers in regional and rural Australia.
4. That the Inquiry recommends that the Wine Equalisation Tax rebate be abolished.
5. That the Inquiry recommends than an industry adjustment package is only necessary to facilitate the need for structural change in the wine industry. This should be independent of the tax system.

1. The current alcohol taxation system

In order to understand the inequities in the current wine taxation arrangements, it is important to understand the context in which it operates. The broader alcohol taxation system in Australia is a complex arrangement with different levels of tax being applied depending on the type of product, their volume of alcohol, the way in which alcohol is packaged, the value of the product and, in the case of wine, the size of the producer.

Beer and spirits are subject to excise duty which is a volumetric tax based on the alcohol content of the product. The rate is also adjusted twice a year in line with changes to the Consumer Price Index (CPI).

The excise for beer is imposed at eight different rates according to the volume of alcohol (light, mid strength or full strength), the type of packaging (draught or brewed) and whether the product was brewed for commercial or non-commercial purposes. These rates currently range from $2.84 to $47.09 per litre of alcohol with the first 1.15 per cent of alcohol in beer tax-free.[9]

Spirits attract a higher rate of tax in light of their lower costs of production and alcohol content, which can be up to 40 per cent alcohol content per volume. The current tax rate for spirits is $79.77 per litre of alcohol.[10]

Brandy and '*Other excisable beverages'* (which does not include beer, brandy or wine) are also subject to excise duty. The rate for Brandy (a spirit distilled from grape wine) is $74.50 per litre of alcohol and the rate for *Other excisable beverages* (which exceed ten per cent by volume of alcohol) is the same as for spirits, at $79.77 per litre of alcohol.[11]

Unlike all other alcohol products, wine is taxed under a different regime to beer and spirits. It is subject to the Wine Equalisation Tax (WET) which is a tax based on the value of the wine.

The WET was introduced on 1 July 2000 with the Goods and Services Tax (GST) as part of *A New Tax System* in order to maintain wine prices and revenue collection from wine sales, following the abolition of the 41 per cent wholesale sales tax that had previously operated. The WET therefore 'equalised' the price of wine to prices at prevailing levels.[12]

The WET applies not only to wine, but also to any other alcohol products made from fruit and vegetables, with greater than 1.15 per cent alcohol by volume (ABV). These include cider and mead.[ii] The tax is paid by wine producers, wholesalers and importers at 29 per cent of the last wholesale price.[13]

In addition to the favourable tax arrangements for wine, a tax rebate was introduced in 2004 to allegedly support small rural and regional wineries in Australia. The WET rebate applies to all products subject to the WET.

It is payable to eligible wine producers in Australia and New Zealand based on 29 per cent of the wholesale value of eligible domestic sales, up to a maximum of $500,000 each financial year.[14]

Eligible producers are those that either manufacture the wine or provide the grapes to a winemaker to make the wine on their behalf.

[ii] Note that flavoured and coloured ciders are usually subject to excise rather than the WET, and attract the same excise rate that applies to ready-to-drink products (RTDs).

2. The case for reforming the wine tax

The following sections outline why the current wine tax arrangements need to be reformed as a matter of urgency. The case for reforming the current wine tax arrangements is clear, with five reasons why this action must occur as a matter of urgency:

1. The current wine taxation arrangements are bad for Australia's health.
2. The current wine tax arrangements are bad for the wine industry.
3. The current wine tax arrangements result in non-drinkers and moderate drinkers paying a disproportionate amount of alcohol taxation.
4. The wine industry are significant recipients of corporate welfare.
5. Nine government reviews have recommended reforming the wine tax.

2.1 The current wine taxation arrangements are bad for Australia's health

Alcohol harms in Australia are significant

Alcohol is responsible for significant harms in Australia, contributing to 3.2 per cent of the total burden of disease and injury in Australia each year.[15] In 2010 there were 5,554 deaths and 157,132 hospitalisations attributable to alcohol, equivalent to 15 deaths and 430 hospitalisations each day.

Alcohol is associated with over 200 health conditions including strokes, ischaemic heart disease, cancers, liver cirrhosis, respiratory diseases and sexually transmitted infections[16] and if consumed during pregnancy, can lead to Fetal Alcohol Spectrum Disorders (FASD) in the developing fetus.[iii]

Alcohol is also responsible for short term harms and is associated with road traffic accidents, suicide, homicide, alcohol poisoning, injury and violence.[17]

Alcohol also contributes to significant harm to people other than the drinker. These harms include acts of violence on our streets and in our homes, road traffic accidents, child maltreatment and neglect and lost productivity. As a result of other people's drinking, there are more than 360 deaths, 14,000 hospitalisations and over 70,000 victims of alcohol-related assault each year.[18]

The combined cost of both the harms from alcohol to individuals and those incurred on people around the drinker is estimated at $36 billion annually.[19]

Some Australian communities and populations are also more affected by alcohol than others. Residents from the Northern Territory for example are three times more likely to die from alcohol use than other Australians. Aboriginal and Torres Strait Islander peoples are 7.5 times more likely to die from alcohol-related causes than other Australians.[20] Young people also experience a higher proportion of alcohol-related harms as a result of risky consumption, with one Australian teenager dying and more than 60 being hospitalised each week from alcohol-related causes.[21]

[iii] FASD is a lifelong condition characterised by brain damage, cognitive, social, emotional and behavioural deficits.

The current alcohol taxation arrangements contribute to excessive consumption and harms

The WET contributes to wine being the cheapest alcohol product available for sale in Australia.[22] This is a concern because of the strong relationship between price, consumption and harms. A meta-analysis of 112 international studies showed that the price of alcohol is inversely related to overall consumption of alcohol including at harmful levels.[23] Young people have been shown to be especially responsive to price.[24,25] A recent study from the United States of America (USA) found that raising the price of alcohol through taxes was effective in reducing binge drinking.[26]

The WET is a value-based tax which means that the cheaper the product, the less tax is paid for that product. This encourages the production of low quality, low cost wine and has contributed to an oversupply of wine in Australia. The WET rebate has prevented market forces from operating to remove uneconomic producers which has led to a continuation of grape production at artificially high levels and discouraged a reduction in vineyard plantings. The oversupply of wine in Australia has been compounded by changing market conditions and has led to heavy price discounting as producers try to sell excess stock.

The inconsistencies in taxes and the resulting distortions violate the principles of efficiency and simplicity which the 2008 Australian Future Tax System Review (the Henry Review) has outlined as principles of an effective tax system.[27] These price inconsistencies also send confusing signals to consumers that certain alcoholic products should be preferentially consumed over others.

Tax and price should be used as a mechanism to signal to the consumer the volume of alcohol in the product and, from a public health perspective, provide an indication of its potential for harm.

Wine is the cheapest form of alcohol available for sale in Australia

Heavy discounting reduces the price of wine to the point where it has become the most affordable alcohol product in Australia.

The price of wine has fallen by 25 per cent relative to the consumer price index (CPI) since 1980.[28] Wine can now be purchased for just 29 cents per standard drink.[29] An increase in the affordability of wine leads to increased levels of consumption, which in turn leads to increased harms for individuals and the community at large.

Unsurprisingly, the increased affordability of wine has coincided with an increase in the consumption of wine in Australia over the past 50 years. The apparent consumption of wine increased from 12 per cent of all alcohol in 1962-63, to 38 per cent in 2013-14. This is in contrast to beer which has almost halved, from 75 per cent to 41 per cent over the same period, and spirits (including ready-to-drink beverages) which has increased from 13 per cent to 19 per cent.[30]

2.2 The current wine tax arrangements are bad for the wine industry

The history of the WET and WET rebate

The WET and WET rebate reflect competing policy pressures and compromises.

The WET was introduced in conjunction with the GST, to maintain a tax treatment for wine roughly consistent with the previous wholesale sales tax regime and preserve the concessional taxation treatment of cask wine.[31] The WET favours large producers as a value-based tax. It also encourages the production of cheaper wines, and larger producers are generally best placed to operate on the lower profit margins that are associated with cheap wines.[32]

In contrast, the WET rebate was introduced to support smaller producers because of the large producer bias associated with the WET. It was also introduced to replace the previous accelerated depreciation arrangements for grapevine plantings.[33] In 2013-14, the total WET revenue was estimated at $760 million[34] and the WET rebate is estimated to have cost taxpayers $333 million.[35] In 2015-16, The Treasury estimates that the WET rebate will cost $350 million.[36]

The original intention of the WET rebate was to support small Australian producers in rural and regional communities and to replace the previous depreciation arrangements for grapevine plantings.[37] It also recognised that the WET benefited large producers because it favours the production of cheaper wines which tend to have lower profit margins. As a result, producers need to produce large volumes to be economically viable.[38]

In 2005, the WET rebate was extended to New Zealand producers to satisfy bilateral trade obligations associated with the *Australia and New Zealand Closer Economic Relations Trade Agreement of 1983*.

The WET and WET rebate are contributing to distortion within the wine market

It is well recognised that the WET has a significant impact on the wine industry and the type of products that are produced.[39] A value-based tax results in wines with the same alcohol content being subject to different levels of taxation based on the price of the product. Cheaper wines are taxed at a lower rate than more expensive wines, even though the alcohol content is the same.[40] This creates an incentive to produce large volumes of low quality wine, encouraging an oversupply of wine.

In addition, the production of cheap wine affects not only the wine produced for domestic markets but also those destined for export.[41] This is a risky strategy since this market segment is price sensitive, fiercely competitive on a global scale and operates on low profit margins.[42]

Because of its bias towards large producers, the WET has contributed to wine being the cheapest alcohol product available for sale in Australia with 65 per cent of sales for bottled wines being sold for under $8.00.[43] Despite the high proportion of sales, the revenue achieved from the sale of these wines represents just 37 per cent of total revenue.[44] This is reflected in the average price per litre of Australian wine in 2012-13 which was $4.86.[45]

The WET and WET rebate provide an incentive for producers of premium wine to stay small and for large producers to focus on the production of bulk wine[46] and discourage the production of quality wines for domestic consumption because they are more expensive to produce and therefore attract a higher rate of tax. In addition, they act as a disincentive to respond appropriately to economic conditions and as the Henry Review suggests, they likely increase the costs of inputs to wineries that would otherwise be more successful by supporting uneconomic wineries.[47]

The extension of the WET rebate to New Zealand producers has coincided with wine imports from New Zealand growing by 139 per cent.[48] The impact of this influx is evident in the list of the top 20 wines in Australia, where 30 per cent of wines are New Zealand brands.[49]

The WET and WET rebate are resulting in the production of wine based imitation products

The alcohol industry has been quick to innovate and take advantage of the perverse incentives offered by the current taxation arrangements. For example, some companies are producing wine based products that imitate other alcoholic products such as spirits. The advantage for the producers is that they are able to pay tax under the WET scheme rather than as a spirit, therefore substantially reducing the amount of tax charged and reducing the cost of the imitation product.

TriVoski or Divas Vodkat are examples of such products that are produced to imitate traditional white spirits. Despite being wine based, they are clearly marketed as spirits, with advertising on the Old Richmond cellar website stating that Divas Vodkat "…TASTES AND SMELLS EXACTLY LIKE TOP QUALITY VODKA!".[50]

The WET allows these imitation products to pay a much lower rate of tax. For example, a 750ml bottle of TriVoski containing 13 standard drinks can be purchased for $9.95. This equates to 77 cents per standard drink. Similarly, two 700ml bottles of Divas Vodkat can be purchased for $19.98, equating to 59 cents per standard drink.[51]

These wine based imitation products do not fit with the image that the wine industry tries to project. The wine industry promotes the image of rural and regional wineries that attract tourism to different regions through cellar door sales. Wine is portrayed as a premium beverage that is consumed 'in moderation' and usually with meals. However the above are produced and sold cheaply due to the favourable treatment of wine under the WET.

2.3 The current wine tax arrangements result in non-drinkers and moderate drinkers paying a disproportionate amount of alcohol taxation

The costs and benefits of alcohol taxation

The total costs and benefits of alcohol to society comprise both those to the individual (that is, the private costs and benefits to the drinker as a result of their decision to drink) as well as those to the public (the costs and benefits to others due to that person's drinking).[52]

The significant costs associated with harmful alcohol consumption are spread across the Australian community through the taxation and welfare systems and via the cross-subsidies in Australia's medical and other insurance systems.[53]

Preferences on whether to consume alcohol, and if so how much and how frequently, determine the extent to which they pay for the consumption of others or benefit from the current arrangements. This represents a real opportunity cost for non-drinkers and moderate drinkers who subsidise the cost of alcohol-related harms caused by the drinking of others. For many, these preferences are influenced by the cost of alcohol.

As discussed, the WET favours the production of low quality low value wine. This makes wine attractive to consumers as it is more affordable than other alcohol products. The recent oversupply of wine has resulted in wine being very cheap and, as a result, we have seen a steady increase in the consumption of wine in Australia over the past 50 years. This is a concern not just due to the increasing levels of harm associated with alcohol consumption, but also because of the disproportionate cost of the harm that is imposed on non-drinkers and moderate drinkers.

The Henry Review's recommendation to reform the WET recognised that a volumetric tax rate applied to wine would remove production and consumption biases from the alcohol taxation system, reduce compliance and administration costs, and better target the health and social costs of alcohol consumption.

Moving the wine tax to a volumetric taxation rate is cost beneficial

A benefit cost analysis undertaken in 2012 found that the majority of Australians (85 per cent) would be better off from changes to the alcohol taxation system.[54] The benefit cost analysis extended the preliminary analysis by the Henry Review and examined the impacts of relevant reform scenarios on alcohol related harms, consumer satisfaction and welfare, and government tax and revenues.

The analysis looked at the reduction in direct harm to others, the reduction in harm to the drinker, the change in people's consumption decisions, changes in tax efficiency and changes in the efficiency of the resource allocation. It also examined different scenarios in relation to how the funds generated by increased tax revenue might be used. These proposals included a lump sum to each taxpayer each year, an equivalent increase in post-tax incomes by reducing Australian Government income tax, and an equivalent reduction in state and territory taxes through the Australian Government granting the jurisdictions the equivalent of the increase revenue from alcohol excise.

When the WET and WET rebate were removed and replaced with a $29.05 excise (based on the excise amount for full strength draught beer at the time), the analysis found a cost benefit resulting in:

- an increase in revenue of approximately $849 million per annum
- a reduction in total alcohol consumption of 12.3 million litres of pure alcohol per annum
- a net public benefit of $230 million per annum ($330 million per annum reduction in harms to others caused by alcohol and a net loss of consumer surplus of $100 million per annum) with benefits estimated to flow to 85 per cent of Australians.[55]

The benefit cost analysis found that reforming the WET would result in a clear benefit to the community and moderate drinkers in light of the collateral damage they incur from others' harmful alcohol use.[56] These benefits are derived from significant savings as a result of a reduced level of harm from others and increased disposable income through a rebate of increased alcohol excise back to taxpayers.

2.4 The current wine tax arrangements are corporate welfare at its worse

In 2013 the Prime Minister, the Hon Tony Abbott MP, announced an end to corporate welfare, saying that his government was loth to give any more handouts to business:

> *We don't want to see corporate welfare… we don't believe in corporate welfare… This government will be very loth to consider requests for subsidies, we will be very loth to do for businesses in trouble the sorts of things they should be doing for themselves…. we are not here to sort of build a field of dreams.*[57]

In 2013-14 the Government paid out a third of a billion dollars ($333 million) to Australian and New Zealand wine producers through the WET rebate. This is a form of corporate welfare that supports otherwise unprofitable business to continue operating.

While the WET rebate was originally introduced to support small producers in rural and remote areas in Australia, it is no longer achieving its objectives. Larger producers and producers from New Zealand are now eligible for the rebate and it does not appear to have helped smaller producers develop a greater presence in the market, since 90 per cent of production is sourced from 24 wine companies. Ongoing reports of 'rorting of the system' further undermines the intent of the rebate.

By supporting members of the wine industry that would not be economically viable without government assistance, the government is directing skills and investments away from more productive activities which has implications for the economy.[58]

If the Government identifies that there is a need for an industry assistance package for the wine industry, this should be based on clear policy principles associated with the identified need. Assistance may be needed to support adjustment of the industry but this should be focused on supporting the transition of workers to other parts of the workforce and should be phased out over time. Any industry assistance package should be developed independently of the alcohol taxation system.

2.5 Nine separate government reviews have recommended reforming the wine tax

Nine separate government reviews have concluded that the alcohol taxation system should be overhauled.[iv] In 2009, the Henry Review determined that reforming the WET was a matter of urgency for the Australian Government and should be based on the principle that alcohol tax should be levied on a common volumetric basis across all forms of alcohol, regardless of place, method or scale of production.[59]

The issue was also explored by the (former) Australian National Preventive Health Agency (ANPHA) in 2011-12 which concluded that the WET required reappraisal.[60]

The Henry Review described the current alcohol taxation system as “incoherent” and stated that the “current alcohol taxes reflect contradictory policies… As a consequence, consumers tend to be worse off to the extent that these types of decisions to purchase and consume, which may have no spillover cost implications, are partly determined by tax”.[61]

The Henry Review recommended that alcohol taxes should be set to address the health and social costs imposed on the community of alcohol abuse.

[iv] Reviews that have recommended a volumetric tax be applied to wine include:

- the 1995 Committee of inquiry into the wine grape and wine industry
- the 2003 House of Representatives Standing Committee on Family and Community Affairs inquiry into substance abuse
- the 2006 Victorian inquiry into strategies to reduce harmful alcohol consumption
- the 2009 Australia's future tax system (Henry Review)
- the 2009 National Preventative Health Taskforce report on *Preventing alcohol related harms*
- the 2010 Victorian inquiry into strategies to reduce assaults in public places
- the 2011 WA Education and Health Standing Committee inquiry into alcohol
- the 2012 Australian National Preventive Health Agency *Exploring the public interest case for a minimum (floor) price for alcohol, draft report*
- the 2012 Australian National Preventive Health Agency *Exploring the public interest case for a minimum (floor) price for alcohol, final report*.

3. Wine tax: Separating fact from fiction

The following sections outline the facts about the current WET and possible impacts of changes to the WET. The purpose of these sections is to dispel the myths and clearly articulate the facts on wine tax in Australia. The facts elaborated upon in the following sections are:

1. The tax applied to wine is not the highest or among the highest in the world.
2. Wine tax reform will not result in the mass loss of jobs.
3. The wine glut is not an excuse to delay reforming the WET.
4. Changes in the price of alcohol do impact on young people and binge drinkers.
5. Large segments of the wine industry are supportive of alcohol tax reform.

3.1 The tax applied to wine is not the highest or among the highest in the world

The alcohol industry has portrayed Australia as one of the highest taxing countries in the world in relation to the tax on wine. In its *Pre-budget submission 2010-11*, the WFA said that "Australia, when measured as consumer tax equivalents, is high compared with other Organisation for Economic Co-Operation and Development (OECD) countries and the OECD average".[62]

This message was reiterated at a recent public hearing of the *Inquiry into the harmful use of alcohol in Aboriginal and Torres Strait Islander communities* when Andrew Wilsmore, Manager of Public Affairs at Woolworths Liquor Group and former WFA employee said "Australia is already one of the highest taxed countries in the world when it comes to alcohol taxation."[63]

Other industry members have said:

> "Australia's wine industry is already subject to one of the highest tax regimes in the wine-producing world" – Supporting Australian Wine.[64]
>
> "Wine is taxed significantly more heavily in Australia than in any other wine-producing country globally" – Treasury Wine Estates.[65]
>
> "Even with the WET rebate, Australia is one of the most heavily taxed wine producing countries in the world, raising approximately $650 million annually in wine taxes (not including GST)" – WFA.[66]

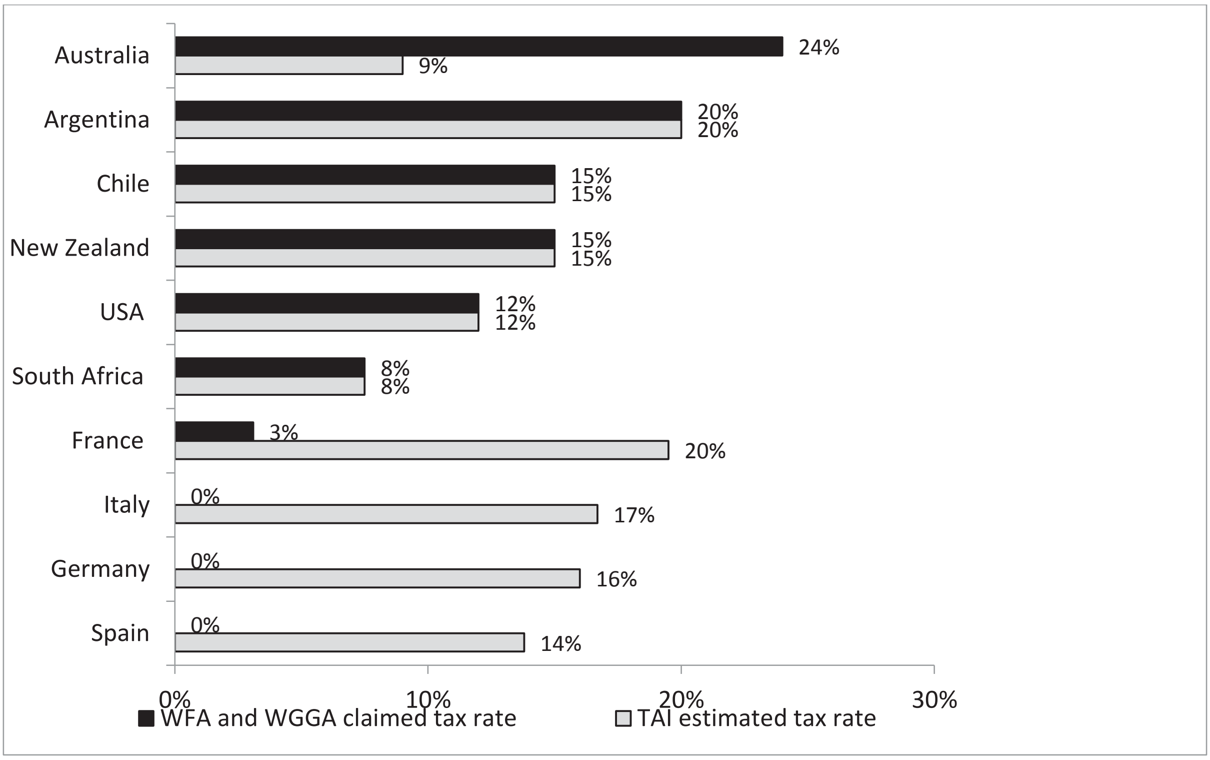
The WFA and Wine Grape Growers Australia (WGGA) have argued that taxes in Australia make up 24 per cent of the retail price of a bottle of wine compared to 3.1 per cent in France and zero per cent in Italy and Spain.[67]

The Australia Institute (TAI) analysed the claims made by the WFA and WGGA and found that the WFA and WGGA were comparing the WET and GST applied to wine, with only the wine tax applied in European countries and not the GST equivalent Value Added Tax (VAT). This is a significant omission since the VAT rate on wine was 19.6 per cent in France, 20 per cent in Italy and 16 per cent in Spain in 2011.

The misleading figures presented by the WFA and the WGGA also do not take into account the WET rebate which offsets the WET liability so that many producers do not pay any or very little tax.

The graph below illustrates the discrepancy between the tax rates reported by the WFA and WGGA. The figures for Australia are based on the WFA and WGGA's claims and TAI's estimates for low-volume producers. By including the VAT on wine in European countries the impression is much different to the one portrayed by the WFA and WGGA as demonstrated by the graph below.

Graph 1. International tax rates on wine as reported by WFA and WGGA and TAI calculations (%)[68]



3.2 Wine tax reform will not result in the mass loss of jobs

The wine industry claims that reform of the wine taxation system would result in a large number of job losses within the wine industry.

WFA Chief Executive Paul Evans has said that any move to a volumetric tax "would have a devastating impact" on the industry, particularly in South Australia.[69] *Supporting Australian Wine* made similar comments in its submission to the Australian Government's Tax Forum in October 2011 including that "A volumetric tax has the potential to devastate regional communities".[70]

In 2010, the WFA claimed that 12,000 jobs will be lost, including small producers forced out of business, due to the loss of the WET rebate:

> *Our modelling shows that taxing wine in the same way as packaged beer, and removing the WET rebate, would see 95% of wine increase in price, sales volumes fall by 34%, 29,000 hectares of vineyard become redundant and about 12,000 jobs lost.*[71]

These claims about job losses within the wine industry as a result of changes to a volumetric tax are greatly exaggerated. TAI undertook an assessment of a number of industry claims about the Australian wine tax regime. They found that the underlying assumptions by which the WFA calculated the extent to which consumption will be reduced in response to expected higher prices were floored.

TAI determined that the actual fall in sales volumes would be 5.2 per cent and a possible loss of 599 jobs.[72] The job loss estimates are 95 per cent fewer than those claimed by the WFA.

3.3 The wine glut is not an excuse to delay reforming the WET

Action by industry to increase production and demand for Australian wine, as well as government incentives, led to an overproduction of wine in the 2000s which outstripped demand. The WET contributed to this oversupply since it encourages the production of large quantities of low quality low priced wine. This oversupply of wine was compounded by multi-year set-price contracts for grapes and the WET rebate, which have acted as barriers to leaving the industry and allowed otherwise unprofitable producers to continue to operate.[73] A high Australian dollar, increased competition from overseas and economic slump in the late 2000s have also contributed to the problem.[74]

In late 2009, key industry bodies declared that this situation had created a wine glut of such a scale that it was causing serious damage to the industry and consequently announced the *Wine Restructuring Action Agenda* (the Agenda). The Agenda acknowledged an urgent need to reduce wine inventories and production capacity in order to rebalance supply and demand. A surplus of 20 per cent of bearing vines and 100 million cases of wine surplus was identified.[75]

Evidence suggests that the oversupply of wine in Australia has now come to an end. In June 2013, Ferrier Hodgson reported that the glut was shrinking and there were strong signs that the industry was now recovering.[76] In 2012, Merrill Lynch said that in their view the grape glut had ended, pointing to the reduction in the number of vines in Australia, new markets opening up, poor harvests in European countries and an increase in the price of wine in the USA after declines over the previous year.[77]

FARE undertook an analysis of the Australian wine industry, assessing the extent of the wine glut against six key indicators. These indicators were:

- forward stock to sales ratio
- projected forward stock to sales ratio
- stakeholder commentary
- changes in wine inventory levels against the wine industry's restructure targets
- changes in vineyard area against restructure targets
- proportion of bulk wine.

The analysis found that, on balance, the wine glut in Australia had come to an end. The key indicator examined was the stock forward sales ratios which are calculated by the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES). This represents the actual stock available in one year against sales made in the following year.

In 2006, ABARES suggested that the preferred stock to forward sales ratio was "between 1.5 and 1.6 years of sales for red wines and between 1.2 and 1.3 years of sales for white wines".[78]

For 2010-11 the stock to forward sales ratio was 1.4, the lowest since 1994-95. This equates to 1.53 for red table wines and 1.23 for white table wines.[79]

The decline in stock to forward sales ratios was attributed to production declines, as well as increases in domestic sales and export volumes with the latter being largely due to growth in the lower value bulk wines.

Australian wine grape production projections to 2013-14 modelled by ABARES indicated that the stock to forward sales ratio is likely to further decline. By 2013-14, the stocks-to-forward sales ratio for white and red table wine were projected to be 1.08 and 1.36 respectively. This is below the ideal ratios of between 1.2 and 1.3 years of sales for white wines and between 1.5 and 1.6 years of sales for red wines.[80]

Stakeholder commentary supports the claim that the wine glut is over. In 2012, the Chief Executive of Treasury Wine Estates David Dearie said that “it certainly appears that way” when asked whether the wine glut was over.[81] A Rabobank report supported Dearie’s view, reporting that global supply was at the lowest point in over a decade, and stronger pricing suggesting that the industry was recovering.[82] Others question whether indeed there ever was a wine glut. In early 2010, the Margaret River Wine Industry Association president, Leah Clearwater, indicated that she was sceptical about the accuracy of estimates of the oversupply and the Western Australian Wine Industry Association was reported as saying that there was only a very small oversupply in Western Australia, and that the key problem was, perhaps, a failure to adequately promote Australian wine products both domestically and abroad.[83]

There is still some dispute on whether the wine glut continues or whether it has subsided. If the glut has now ended then the existence of a glut is no longer a reason to delay reform. Alternatively if the glut is still in existence, this is partially a result of the WET which is keeping unsustainable wine producers in the market and encouraging the production of mass produced, bulk cheap wine. Both of these scenarios support the need to immediately reform the WET.

3.4 Changes in the price of alcohol do impact on young people and binge drinkers

Economic theory suggests that increasing the price of alcohol will lead to lower levels of alcohol consumption, however the alcohol industry argues that this is not the case, particularly for heavy and binge drinking.

There is evidence to show that people who consume alcohol respond to changes in the price of alcohol in a similar way to price changes for other consumer products.[84] An increase in price will lead to reduced overall alcohol consumption. Heavy drinkers in particular are likely to buy cheaper products within their preferred beverage range but will also seek lower alcohol products.

The WFA argues that “there is no clear evidence that such a measure (increasing wine taxes) would reduce potential harm from excessive drinking”[85] and that “drinkers suffering addiction or those who consume at risky levels will simply transfer their poor drinking behaviours to other substitutes.”[86] It also says that young people will continue to engage in binge drinking behaviour despite a price increase:

> *Australian and New Zealand students were happy to pay higher prices for the same number of drinks, and would simply buy more if the strength of the alcohol was reduced. In fact, even when the cost was increased by up to 25 per cent, there was still no significant change in buying behaviour.*[87]

Contrary to the WFA's assertions, policies that increase the price of alcohol lead to a reduction in the proportion of young people who are heavy drinkers, reduction in underage drinking, and reduction in per occasion 'binge drinking'.[88]

Recent research in the USA looked at the impact of increasing alcohol taxes on risky consumption levels and found that raising the price of alcohol through taxes was effective in reducing binge drinking. Specifically, the research found that a one per cent increase in price due to taxation resulted in a 1.4 per cent reduction in binge drinking (defined as drinking at or above levels associated with intoxication) by adults.[89] This research builds on the evidence for the effectiveness of increasing the price of alcohol through taxes in reducing not just overall consumption, but high risk consumption.[90,91]

The *WHO Expert Committee on Problems Related to Alcohol Consumption* concluded that the evidence does support the negative relationship between alcohol price and consumption by heavy drinkers. This relationship is particularly evident when looking at measures of harmful outcomes associated with heavy alcohol consumption such as alcohol related liver disease. Studies of cirrhosis of the liver have found that an increase in tax leads to a reduction in mortality.[92,93] Most people who die of cirrhosis have a long history of heavy drinking and so the death rate from cirrhosis is a reasonably good indicator of the incidence of heavy drinking.[94]

3.5 Large segments of the wine industry are supportive of alcohol tax reform

There is a common misconception that the wine industry is not supportive of alcohol taxation reform. However the wine industry is very diverse with large, medium and small producers and large segments of the industry are now supportive of reform.

Treasury Wine Estates has stated that "the phenomenon of very cheap wines seen in Australia in recent years is a further unintended consequence of the WET rebate, and adds weight to calls to remove or fundamentally reform the scheme".[95]

Former Chief Executive David Dearie used stronger language in another forum, calling for the scrapping of the WET and WET rebate and saying that it is "widely rorted, underpins the excess supply that has blighted Australian wine".[96]

Pernod Ricard Winemakers (previously Premium Wine Brands) said that:

> *PWB believes that existing wine tax arrangements are distorting market forces by sustaining the 20 per cent of vineyards which the industry Wine Restructuring Action Agenda found to be surplus to market requirements and incentivising the production and sale of cheaper wines, contrary to the industry endorsed strategy of value building through premium, branded products. We believe that tax reform would end these distortions and allow normal market forces to address the structural oversupply issues….. PWB supports the reform of the wine tax system in Australia so that wine is taxed by alcohol content (i.e. a volumetric tax).*[97]

Treasury Wine Estates and Pernod Ricard Winemakers are two of the largest wine producers in Australia, making up 20.5 per cent of Australian wine production. They are so committed to taxation reform that they have joined forces and engaged Newgate Communications to lobby for changes to the tax system.

Commentary from within the wine industry suggests that there are several other small and medium sized producers who acknowledge that the industry would benefit from reforming the WET.

Jeremy Oliver, an Australian wine writer and presenter has written: “Is there any sense in any aspect of the current taxation environment? If so, I can’t see it. Surely it’s time to fix this thing before the collateral damage it directly causes gets even worse.”[98]

Westend Estate Wines (now Calabria Family Wines) says that “the Wine Equalisation Tax is having a negative impact throughout the domestic market, and virtual wineries with no long-term vision are abusing the system which was put in place to benefit the smaller wineries”.[99]

4. Policy proposals for the development of a better wine tax system

The following sections outline the policy proposals for the development of a wine tax system that addresses the current flaws in the WET and WET rebate. The sections cover the following:

1. Develop clear policy principles for a new wine tax system.
2. Move the WET to a volumetric tax rate.
3. Abolish the WET rebate and independently determine the need for an industry support package with a clear policy intent.

4.1 Develop clear policy principles for a new wine tax system

Taxation of wine and alcohol more generally should be based on public policy principles that acknowledge the harmful nature of alcohol and address the administrative burden that exists with the current taxation arrangements.

The current approach to alcohol taxation in Australia has become increasingly complex and inconsistent with products with the same alcohol content paying different levels of tax and some producers paying no net tax at all. It distorts production and consumption decisions and does not reflect the health and social costs of consumption, leaving consumers worse off. This is most evident with the WET and WET rebate. A new wine tax system should modify health behaviours and maximise the benefits to the community.

General principles for good tax system design include equity, efficiency, simplicity, sustainability and policy consistency.[100] FARE has identified the following principles for a more equitable alcohol taxation system:

1. Alcohol taxation must be applied according to the category and volume of alcohol within products and their potential to cause harm.
2. The economic externalities of alcohol consumption must be used to inform alcohol taxation rates.
3. Alcohol taxation must minimise distortion that may encourage harmful consumption of alcohol.
4. Alcohol taxation must ensure the cost of alcohol increases with the cost of living.
5. Alcohol taxation must minimise loopholes.
6. Revenue collected from alcohol taxation should be used to pay for the costs incurred by Government to address alcohol harms.

Clear public policy principles are needed for a revised wine tax arrangement in Australia. These objectives should articulate the policy intent of any tax and subsidy arrangements and ensure that the system developed considers this intent. This will ensure that the current situation does not continue where the WET and WET rebate are not meeting their intentions, for example the WET rebate not meetings its intention to support small producers.

Recommendation

1. That the Inquiry recommends that clear objectives be developed for wine taxation that addresses the economic externalities created by the current tax arrangements.

4.2 Move the WET to a volumetric tax rate

In contrast to beer and spirits, which are taxed on the basis of the volume of alcohol within the product, wine is taxed under the WET: an ad valorem tax that is based on the value of the product. The WET encourages the production of large quantities of cheap wine and in doing so, encourages consumption of excessive levels of low quality, cheap wine. Large producers are favoured under this system because cheap wine has low profit margins and therefore producers need to produce large quantities of cheap wine to be profitable and simply remain economically viable. Because the WET favours large producers, the government introduced the WET rebate in 2004. The WET rebate is aimed at supporting small producers in regional communities.

The WFA claims that the WET should be retained because the wine industry operates in a fundamentally different way to the production of spirits and beer. However Treasury Wine Estates[101] and Premium Wine Brands (Pernod Ricard), two of the largest wine producers in Australia, both support the introduction of a volumetric tax for wine. In its submission to the Tax Forum in 2011, Premium Wine Brands said that:

> *To support sustainable value growth of the industry and to incentivise the production of premium products, the existing wine tax system should be reformed so that wine is taxed on a volumetric basis, with the rate set to reflect a revenue neutral approach.*[102]

The submission went on to say that the WET rebate is "inhibiting industry restructuring as it subsidises producers who would otherwise not be able to compete in the market and restricts consolidation in the industry (as a result of how the rebate is structured)".[103]

Alcohol taxation in Australia needs to be reformed to address the structural problems within the industry that are encouraging the over production of low quality, cheap wine and damaging the reputation of Australian wine in international markets. The current alcohol taxation system has been described as incoherent and inconsistent[104] and does not recognise the extent and costs of alcohol harms to the Australian community.

The WET is the most inequitable part of the alcohol taxation system as it distorts production and consumption decisions and results in non-drinkers and moderate drinkers paying a disproportionate amount of taxation. It includes non-wine products in the taxation regime and does not take into consideration the social costs associated with alcohol harm. The current system acts against efforts to address the overproduction of wine, is not sustainable, provides no incentive to change and become profitable and as such is damaging to the industry.

Nine government reviews have recommended that a volumetric taxation system should be introduced across all alcohol beverage types. The Henry Review reported that a common alcohol tax base would better address social harm, better satisfy consumer preferences and effectively introduce a floor price through a common alcohol tax base.[105]

The WET must move to a volumetric tax rate as a matter of urgency. A graduated or stepped alcohol taxation arrangement where alcohol products are taxed based on their alcohol content within their product categories is needed. [106]

Recommendation

2. That the Inquiry recommends that the ad valorem Wine Equalisation Tax be abolished and replaced with a volumetric tax rate.

4.3 Abolish the WET rebate and independently determine the need for an industry support package with a clear policy intent

The WET rebate provides a tax rebate of up to $500,000 to all wine producers in Australia, regardless of their size. In 2005 the rebate was extended to New Zealand wine producers and since this time New Zealand wine imports into Australia are estimated to have grown by 139 per cent.[107]

The WET rebate represents corporate welfare at its worse. It is no longer achieving its policy objectives and needs to be abolished. It was originally designed to support small business in rural and regional areas in Australia however the intent of the policy has been undermined by its availability to all producers and by the extension of the rebate to New Zealand producers. It also supports producers who would otherwise not be able to compete in the market and discourages consolidation because of the way in which the rebate is structured.[108]

Together with the WET, the rebate perpetuates the circumstances that are damaging the reputation of the wine industry as a whole and grape growers in particular.

Members of the alcohol industry agree that the WET rebate needs reform. The WFA has stated that the WET rebate being paid to foreign entities is “completely at odds with the original intent of the rebate which was introduced to support small and medium sized Australian producers and the regional communities they operate in”.[109]

In its 2014 Pre-budget Submission, the WFA said that:

> *…there is a need to urgently reform eligibility to the WET rebate to ensure it is not accessed by unintended recipients. In particular, the extension of rebate entitlements to New Zealand and other foreign producers at a time when imports are directly damaging branded Australian wine businesses that support local communities should cease immediately.*[110]

WFA also believes that “the WET rebate should also be removed from bulk, unbranded and retailer ‘own brand’ wine as the long-term future of the industry lies in strong branded product that can command loyalty and profitable margins from consumers and the highly consolidated domestic wine retail sector.”[111]

Treasury Wine Estates says that:

> *The Wine Equalisation tax (WET) rebate is a damaging subsidy that has negatively impacted the profitability and productivity of the industry. It is preventing consolidation and sustaining uneconomic production, at a time when the industry urgently needs to retire excess supply and rebuild value in the Australian wine category… The WET rebate should be abolished or, at a*

minimum, fundamentally reoriented to become a cellar door style rebate available only to the retail sales of genuine wine producers.[112]

Premium Wine Brands agrees, saying that "despite the fact that PWB currently benefits from the WET rebate we believe that its abolition would be in the best interests of the wine industry".[113]

Transitional assistance may be needed to support the industry through this change. In particular, smaller producers who are potentially successful but need temporary assistance, regional areas in which these growers and producers are located and may need some form of assistance as the industry adjusts to the new arrangements.

The Productivity Commission has identified reasons why a structural adjustment package might be warranted. The Allen Consulting Group has summarised these as follows:

1. Problem	The structural change needed is substantial.
2. Timeframe	The barriers to adjustment are long-term.
3. Safety nets	The existing safety nets such as welfare payments, alternative employment or retraining opportunities are insufficient.
4. Unfair disadvantage	The change burdens a group already disadvantaged in the community.
5. Unfair advantage	The change assists a group already at an unfair advantage in the community.
6. Unexpected change	The change will be unanticipated by market participants.
7. Facilitation	There will be significant opposition to the necessary changes to warrant pacifying opponents through assistance measures.
8. Transition	The assistance reducing the transition costs attributable to market impediments.

If an industry assistance package is required to support the wine industry, the policy objectives that underpins the support package should be clearly defined, based on identified policy principles associated with identified need and developed independently of the alcohol taxation system.

The Productivity Commission has developed a set of general principles to guide selection of specific structural adjustment measures. Measures should:

- be targeted to those groups where adjustment pressures are most acutely felt and operate proactively as well as retrospectively
- facilitate, rather than hinder, the necessary change
- be transparent, simple to administer and of limited duration
- be compatible with general 'safety net' arrangements.[114]

The WET rebate should be abolished. This will result in significant savings to the federal budget which should then be used to invest in prevention, early intervention and treatment for alcohol and other drugs. Investment in these areas will ameliorate the need for later stage treatment for alcohol related harm which are more intensive and costly.

Recommendation

3. That the Inquiry acknowledges that the Wine Equalisation Tax rebate is not meeting its original policy intent of supporting small producers in regional and rural Australia.

4. That the Inquiry recommends that the Wine Equalisation Tax rebate be abolished.

5. That the Inquiry recommends than an industry adjustment package is only necessary to facilitate the need for structural change in the wine industry. This should be independent of the tax system.

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