Why tax wine consumption?

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Summary: Taxing wine consumption may be justified to the extent that wine consumers impose costs on the rest of society. Empirical evidence suggests that it is mostly non-premium wine consumers who consume excessively, while moderate consumption of wine may confer a benefit to society (lower health costs). The current ad valorem tax, by taxing non-premium wine least and fine wine most, is thus a far less inefficient way of dealing with externalities from wine consumption than would be a volumetric tax.

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Three of the most common reasons for imposing consumption taxes on individual products are to raise government revenue, to redistribute income or wealth, and to reduce negative externalities from consumption of a product.

Alcohol consumption taxation was used at the beginning of Australia's white settlement (Lewis 1992, Mill 1925) because it was one of the lowest-cost ways of raising government revenue. As recently as 1860 the New South Wales Government was deriving one-third of its revenue from customs and excise duties on alcohol, and even in the first decade of Federation those taxes supplied nearly 25% of Australian tax revenue (two-thirds from customs duties and one-third from excise taxes -- see Table 19 in Anderson 2015). However, during the past three decades these taxes on alcohol have contributed less than 3% to total Commonwealth tax revenue. With such instruments as the general Goods and Services Tax (GST) now in place, there is no longer a tax collection-cost reason to continue to impose those taxes on alcohol sales.

Similarly, with comprehensive personal and corporate income tax and capital gains tax systems in place for altering the distribution of income and wealth, there is no redistributive reason to impose taxes on alcohol consumption.

As for the externality reason, it continues to be argued that special measures are needed to alter alcoholic beverage consumption so as to reduce the social costs associated with harmful alcohol consumption. The rest of this submission focuses on this reason.

Origins of the current tax on wine consumption

Currently in Australia the taxes on beer, wine and spirits have different rates and different bases: beer and spirits are taxed relatively heavily and according to their alcohol content, while the tax on wine is a percentage of the wholesale price. This continues a long tradition of taxing wine differently and, except for super-premium wines, less heavily than other alcoholic beverages.

While beer and spirits have always attracted excise taxes in Australia, it was not until August 1970 that an excise tax (of 50 cents per gallon) was imposed on wine. So unpopular was the tax that it was halved in March 1972, and completely removed in December 1972 by the then-new Whitlam Labor Government. The Fraser Coalition Government that followed resisted re-introducing it, but the Hawke Labor Government chose to impose a 10 per cent wholesale wine sales tax in its August 1984 budget. That tax was subsequently raised to 20 per cent in the August 1986 budget, and it stayed at that level until the Keating Labor Government raised it to 31 per cent in the August 1993 budget. The outcry that followed led to its reduction to 22 per cent in October of that year and the setting up of an official study into the industry and its taxation (Industry Commission 1995). While the study was under way the wine tax was raised by two percentage points in July 1994, and again in July 1995, to 26 per cent (Anderson 2010a).

Meanwhile, State government franchise fees on wine sales had risen to close to 15 per cent at the wholesale level, but from August 1997 those fees were collected by the Federal Government on behalf of the States following a High Court ruling declaring State franchise fees unconstitutional. That made the wine tax a total of 41 per cent. Then when the Federal

Government introduced a general goods and services tax (GST) in 2000 to replace a plethora of wholesale sales taxes, it chose to add a Wine Equalization Tax (WET) of 29 percent at the wholesale level which, together with the 10 percent GST at the retail level, brought in roughly the same tax revenue from domestic wine consumers as the tax it replaced. That system has been in place for the past 15 years.

Taxes on wine and other alcohol consumption: an international comparison

A series of papers over the past two decades have provided an international comparison of the consumer tax equivalents (CTEs) of measures affecting sales of wine, beer and spirits across a wide range of countries (Berger and Anderson 1999; Anderson 2010b and 2014). They all find that low or zero taxation of wine is common among major wine-producing countries, as are differing (and usually higher) tax rates for other beverages.

More specifically, the latest of those comparative studies uses two types of comparisons of the wholesale consumer tax equivalent (both of which ignore the GST or VAT that might then also be added at the retail level). One indicator is the percentage by which the tax raises the wholesale price at particular price points. The other is the number of cents by which the tax raises the wholesale price per standard drink (=0.0125 litres of pure alcohol).

The **key messages** to emerge from the latest of these comparisons are as follows:

- For commercial premium wines (the sort that would retail in Australia at A$12 a bottle), Australia's 29% is the highest tax rate among the significant wine-exporting countries: the majority have zero taxes on such wines, France has the equivalent of 0.7%, South Africa 4%, the United States 6% and Canada 8%.
- At higher price points such as for super-premium wines, only Korea and Norway among OECD countries have a higher tax rate than Australia's 29%.
- When expressed in Australian cents per standard drink of alcohol, Australia's wholesale tax for commercial premium wines (22 cents) is the same as New Zealand's in 2012, but at any higher wine price point Australia's tax exceeds New Zealand's. That 22 cents in Australia compares with zero in Argentina, 3 cents in South Africa, 5 cents in the United States, and 6 cents in Canada – and just 1 cent in France and zero in the other Old World wine-exporting countries.
- That indicator for wines, when expressed as a percentage of those for other beverages, shows wines are taxed less than spirits in all but Japan, and are taxed at a similar or lower rate than beer in all but a handful of countries. Again, Australia is taxing wine relative to other alcoholic beverages more than most wine-exporting countries, the main exception being Chile where beer is very lightly taxed.

How to improve the current system of taxing wine consumption

In the 2009 Henry tax review, Recommendation 71 stated that "All alcoholic beverages should be taxed on a volumetric basis, which, over time, should converge to a single rate, with a low-alcohol threshold introduced for all products. The rate of alcohol tax should be based on evidence of the net marginal spill-over cost of alcohol" (Henry 2009, p. 93).

A paper by Freebairn (2010) lays out the basic economics of taxing alcohol to correct for perceived market failures. It suggests a tax on alcohol consumption is helpful in reducing consumption, given the evidence of the price sensitivity of consumers (see Fogarty 2010), but notes that the majority of consumers of alcohol impose little or no external costs on society and so are taxed excessively at present. Freebairn therefore argues the ideal market failure correction is a specific tax per litre of alcohol, with the rate given by a weighted average estimate of the marginal external cost across different categories of consumers, plus a number of other more-direct government instruments to correct the identified market failures. Examples of the latter include subsidizing information on the habit forming and longer term adverse health and employability effects of excessive drinking, and regulations on consumption by the young and on drink-driving.

Freebairn's argument that a common specific tax per litre of alcohol be applied to all beverages was based on the pragmatic ground that it would be easier to justify politically and administratively than differing rates for different beverages.

However, a more-efficient tax system would recognize that the negative externalities from drinking differ greatly between the occasion and the type of beverage consumed. Most wine drinkers impose no negative externalities on society, and moderate wine drinking with meals may even be beneficial to consumers' health (see, e.g., Estruch and Lamuela-Raventos 2014; Hodgson 2014; Stockley 2006) and therefore provide a positive externality to society.

Srivastava and Zhao (2010) use information from the Australian National Drug Strategy Household Surveys to examine the association between risky drinking behaviour, drinker characteristics, and types of alcoholic beverages consumed. Drinkers of regular-strength beer and ready-to-drink spirits in a can (RTDs) have the highest incidence of binge drinking, while drinkers of low-alcohol beer and bottled (hence mostly premium) wines are least likely to binge drink. Those are also the findings of the updated study by Yang, Zhao and Srivastava (2015). Since the former group of consumers are most likely to be linked to behaviour leading to property damage and physical abuse, this strengthens the argument for differential rates of taxation across the various types of alcoholic beverages, and in particular for a ***volumetric*** tax on wine. The current use of an ad valorem wine tax, by contrast, is an extremely inefficient way to try to reduce the societal cost of socially harmful behaviour.

Regional implications of a switch to a volumetric tax on wine

A change from the present ad valorem tax to a volumetric tax on wine consumption would encourage the local production of finer wines and discourage the growing of non-premium winegrapes. Even if a replacement volumetric wine tax were to be no higher than that needed to raise the same revenue as the present WET, Australia's hot irrigated regions (where the grapes used to produce non-premium wine are mostly grown) would suffer to the extent that their grapegrowers are unable to profitably switch to growing higher-quality winegrapes (Wittwer and Anderson 2002; Anderson, Valenzuela and Wittwer 2011). A switch to a volumetric tax on wine may therefore impose costly adjustments on such growers, although less so the lower the rate of the replacement volumetric wine tax.

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