Wine Economics Research Centre

Wine Briefs

Wine Brief No. 33 2022-02 ISSN 1837-9397

THE UNIVERSITY of ADELAIDE

Proposed alcohol tax reform in the UK: How much will it erode wine exporter gains from FTAs with the UK?

Kym Anderson and Glyn Wittwer

February 2022

make history.

Wine Economics Research Centre

The Wine Economics Research Centre was established in 2010 by the School of Economics and the Wine 2030 Research Network of the University of Adelaide, having been previously a program in the University's Centre for International Economic Studies.

The Centre's purpose is to promote and foster its growing research strength in the area of wine economics research, and to complement the University's long-established strength in viticulture and oenology.

The key objectives for the Wine Economics Research Centre are to:

- publish wine economics research outputs and disseminate them to academia, industry and government
- contribute to economics journals, wine industry journals and related publications
- promote collaboration and sharing of information, statistics and analyses between industry, government agencies and research institutions
- sponsor wine economics seminars, workshops and conferences and contribute to other grape and wine events

Contact details:
Wine Economics Research Centre
School of Economics
University of Adelaide
SA 5005 AUSTRALIA
Email: wine-econ@adelaide.edu.au

Centre publications can be downloaded at: https://economics.adelaide.edu.au/wine-economics/

Proposed alcohol tax reform in the UK: How much will it erode wine exporter gains from FTAs with the UK?

Kym Anderson
Wine Economics Research Centre, University of Adelaide, Adelaide and
Arndt-Cordon Department of Economics, Australian National University, Canberra
kym.anderson@adelaide.edu.au

and

Glyn Wittwer
Centre of Policy Studies, Victoria University, Melbourne, Australia
glyn.wittwer@vu.edu.au

February 2022

Corresponding author:
Professor Kym Anderson, Executive Director,
Wine Economics Research Centre
School of Economics and Public Policy
University of Adelaide
Adelaide SA 5005, Australia
Phone +61 (0)414 254 121
kym.anderson@adelaide.edu.au

Acknowledgement:
The authors are grateful for financial support from Wine Australia, under Research Project UA1803-3-1, and from the University of Adelaide's Faculty of the Professions and School of Agriculture, Food and Wine. Forthcoming in the *Australian and New Zealand Grapegrower and Winemaker,* Issue 698, March 2022.

Proposed alcohol tax reform in the UK: How much will it erode wine exporter gains from FTAs with the UK?

Kym Anderson and Glyn Wittwer

The Australian wine industry warmly welcomed the Free Trade Agreement between the United Kingdom and Australia (UK-Au FTA) when it was signed in late 2021, as it will allow Australian wine to be imported into the UK tariff-free as soon as the Agreement is ratified by both governments (hopefully later this year). This comes after a year in which punitive tariffs were imposed by China on Australian wine imports, causing those imports to shrink by 97% or A$1 billion in 2021. With that huge loss of the China market, the UK became Australia's top-ranked market for our wine exports in 2021 in value ($453 million) and volume (243 million litres, see Wine Australia 2022).

It was therefore with some dismay that the industry learnt of a proposal to reform the UK's excise duty on alcohol. The proposal – currently open for consultations and expected to take effect from February 2023 – would switch the tax base from product volume to volume of alcohol. It would involve a fall in the tax on sparkling wine (by one-sixth if it averages 12% alcohol by volume or ABV), but still wines with more than 11.5% ABV would become dearer (HM Treasury 2021).

Specifically, all wines with an ABV between 8.5% and 22% would be taxed at £25.88 per litre of pure alcohol. That would raise the duty on a wine with 14.5% ABV, for example, by £0.77 per litre (from £2.98 to £3.75 or 26%). Since virtually all wine imported from Australia is at least 11.5% ABV, and on average has a higher ABV than that of almost any other supplier of wine to the UK, Australian Grape and Wine (AGW 2022) believes Australian producers would be hit especially hard by such a change in excise duty.

Some media reports have claimed it would wipe out the recently won gain expected from the UK-Au FTA. That seems to be based on the estimate by Wine Australia that the proposal would raise the duty on Australian still wine by 11% on average. If there were no changes in volumes consumed as of 2021, wholesalers in the UK would thereby pay an additional £80 million (about A$150 million) per year in excise duty on Australian wines.

But it is wrong to assume that extra tax payment would be borne entirely by Australian vignerons. As with all wholesale taxes, the burden is shared along a value chain that includes also importers, wholesalers, retailers, pubs, bars, restaurants and final consumers.

Insofar as final consumers are asked to bear some of that burden by paying more, either in the bottle shop (off-premise) or in a restaurant or bar (on-premise), they will adjust downwards the volume they consume. For example, if the UK consumer price of Australian still wine were to rise as much as 10%, and if the price elasticity of demand for that wine is -0.6 (the upper end of the range of available estimates), that would reduce the quantity consumed in the UK by 6%. If Australia's share of that was proportional, our exports would fall by (6% of 243 ML =) 15 ML. The average export price also would fall a bit (depending on how the loss is shared along the value chain and how that trade's share of bulk to bottled wine alters), but that would still lead us to expect the loss to be only around A$30 million – before we take into account the diversion of some Australian exports to other countries and interactions with other suppliers to the UK market.

A more careful calculus, including for comparing with the positive impact of the UK-Au FTA on Australia's wine industry, requires a global model of alcoholic beverage markets. This is because each of these two policy changes affects all suppliers to the UK, not just Australians. It does so through trade diversion in the case of an FTA: Australians gain along with UK consumers, other suppliers lose. In the case of a rise in wine excise duty, all suppliers lose along with UK consumers (and others along the value chain), while HM Treasury would gain tax revenue.

In this article we draw on such a model, and find that the proposed reform to UK excise duties is likely to reduce Australian wine exports disproportionately, but by considerably less than the gain to Australian wine exporters that is projected to come from the UK-Au FTA.

Modelling UK beverage markets in an interconnected world

The UK is currently the world's largest importer of wine, as well as a major market for beer and spirits. Its policies that affect consumption of any of those three beverages therefore have spillover effects on UK markets for the other two beverages, as well as on the rest of the world's alcohol markets.

To analyse changes to UK policies empirically therefore requires a global model of national beverage markets connected through international trade, in which the interactions between each nation's producers and consumers of these three beverages, and among various types of wine, are explicitly recognized. Wittwer and Anderson (2020) recently generated such a model, the GLOBAL-BEV model. It identifies three red still wine qualities, three white still wine qualities, and sparkling wine, in addition to having a beer sector and a spirits sector in each country. We use that model here to address three questions:

1. What is the likely impact of the proposed reform of the UK's alcohol excise duty regime on Australia's wine exports?
2. How does that impact compare with the gain to Australian wine exporters from the recently agreed UK-Au FTA (and the expected UK-NZ FTA)?
3. How do these impacts on Australia's wine exporters compare with those for New Zealand?

Results

The answers to those three questions according to our model simulation results, in millions of Australian dollars per year, are summarized in Tables 1 and 2. (Those results ignore the proposed small changes to the beer excise rates and a small reduction in the spirits excise rate.) From row 1 of Table 1, our results suggest revenue from Australian wine exports would fall if the UK's proposed wine excise duty changes were implemented, and by much more than the fall in exports from the rest of the world. But row 2 of that table suggests that loss of A$8 million would be small compared with the direct gain of A$55 million from the UK-Au

FTA that will allow Australian wine tariff-free entry into the UK. Those two effects are illustrated in Figure 1. Even if/when a UK-NZ FTA is ratified with the same tariff-free access to the UK wine market, Australian exports are still projected to be up by almost A$50 million. So the direct effect of those 3 policy changes would be an annual boost of A$41 million in Australian wine exports to the UK.

However, to get the net effect, one needs to look also at the reduction in Australian exports to non-UK markets due to the FTA, which is projected to be A$25 million.[1] So our answer to the first question is that the proposed excise duty reform would offset only about one-third of the net benefit from the UK-Au FTA – even if New Zealand is able to sign a similar FTA with the UK (see the final column of Table 1).

Table 2 provides comparable projections for the impact of these 3 possible policy changes on New Zealand's wine exports. The UK's wine imports from New Zealand in 2020 were almost as valuable as Australia's (£270 million, compared with £290 million of Australian wine), but they are mostly whites with lower alcohol content than Australia's wine on average. Hence the estimated loss to NZ from the proposed excise duty reform is less than half that for Australia. New Zealand will lose more from the UK-Au FTA, but, if it is able to secure tariff-free access to the UK market through its own bilateral FTA, its direct gain will be very similar to Australia's (A$44 million compared with Australia's A$50 million). Like Australia, though, New Zealand would have to reduce sales to other markets in order to divert product to the UK, especially as it currently has much less surplus stock than Australia.

Turing this around, how are UK's wine imports likely to be affected by these proposed changes to its excise duty and import tariff policies? These are shown in Table 3. Australia and New Zealand each accounted for around 9% of the value of UK wine imports in 2020, but Australia would account for twice that share (18%) of the world's loss of wine exports to the UK if its proposed excise duty reform were to be implemented (row 1 of Table 3). On the other hand, both Australia and New Zealand would gain handsomely from their respective FTAs. If/when both FTAs are ratified, their combined imports by the UK would be boosted by an estimated A$94 million per year. However, that would be at the expense of the rest of the world's wine exporters, to the tune of A$98 million. So world wine exports to the UK would shrink slightly (by A$4 million) as a consequence of the two bilateral FTAs (row 2 of Table 3). That is, rather than these agreements expanding world trade, their trade-diverting effects completely offset their trade-creating effects. Drilling down, bulk wine imports from ANZ are projected to expand at the expense of bottled wine imports from the rest of the world, such that UK consumption of locally bottled ANZ wines expands in response to a slight fall in their local prices both absolutely and relative to prices of wines imported from the rest of the world.

Conclusion

---

[1] In our modelling we assume no change in stocks. However, in the current surplus situation because of the punitive tariffs on China's wine imports from Australia, the reduction in Australian exports to non-UK markets may be closer to zero in the first year or so as surplus stocks are drawn down.

AGW (2022) is thus vindicated in its belief that the UK's excise reform proposal would be more harmful to Australia's wine industry than to that of other wine exporters (including New Zealand), because Australian wines have higher ABVs than those of most other countries. According to the above simulation results, however, that damage would be relatively small, both in absolute terms and compared with the gain projected to flow from the UK-Au FTA – even if New Zealand manages to reach a similarly favourable FTA with the UK. Moreover, the annual damage to Australian exports from the excise reform would diminish over time as Australian producers responded by exporting lower ABV wines to the UK.

The reason the trade impact of the excise change is small compared with the potential boost to HM Treasury's tax revenue is because the burden of the tax is spread along the entire value chain and thus shared with the UK's wine importers, wholesalers, retailers, pubs, restaurants, bars and final consumers.

To ease the relatively heavy burden of the excise proposal on Australian exports, AGW (2022) has requested that the proposed very broad bracket (from 8.5% to 22% ABV) for taxing wine at a uniform rate per litre of pure alcohol be split into two brackets at 15% ABV, with the requested lower ABV range attracting a lower excise rate than for the upper range. That would ensure Australia is not an outlier in terms of that reform's adverse impact on its exports. AGW (2022) also has some constructive suggestions for making the proposed excise reform more workable from a practical viewpoint, perhaps the most important of which is to base the excise to be paid on increments of 1% ABV rather than 0.5%.

References

AGW (2022), "Submission Responding to 'The New Alcohol Duty System' Consultation Paper", Adelaide: Australian Grape and Wine, January.

HM Treasury (2021), *The New Alcohol Duty System: Consultation*, London: HM Treasury and HM Revenue and Customs, October.

Wine Australia (2022), *Export Report December 2021*, Adelaide: Wine Australia, 3 February.

Wittwer, G. and K. Anderson (2020), "A Model of Global Beverage Markets", *Journal of Wine Economics* 15(3): 330-54, August.

Table 1: Estimated impacts on Australian wine exports to the UK and rest of world (ROW) of proposed UK alcohol excise duty reform and UK bilateral FTAs (A$ million per year)

	To UK	To ROW	Total
Due to proposed UK excise duty change	-8.3	-0.2	-8.5
Due to UK-Au FTA	55.2	-28.0	27.2
Due to UK-Au FTA plus UK-NZ FTA	49.5	-24.8	24.7
Net effect of excise changes and 2 FTAs	41.2	-25.0	16.2

Source: Authors' model simulation results.

Table 2: Estimated impacts on New Zealand's wine exports to the UK and rest of world (ROW) of proposed UK alcohol excise duty reform and UK bilateral FTAs (A$ million per year)

	To UK	To ROW	Total
Due to proposed UK excise duty change	-3.5	1.4	-2.1
Due to UK-Au FTA	-8.5	3.3	-5.2
Due to UK-Au FTA plus UK-NZ FTA	43.9	-19.3	24.6
Net effect of excise changes and 2 FTAs	40.4	-17.9	22.5

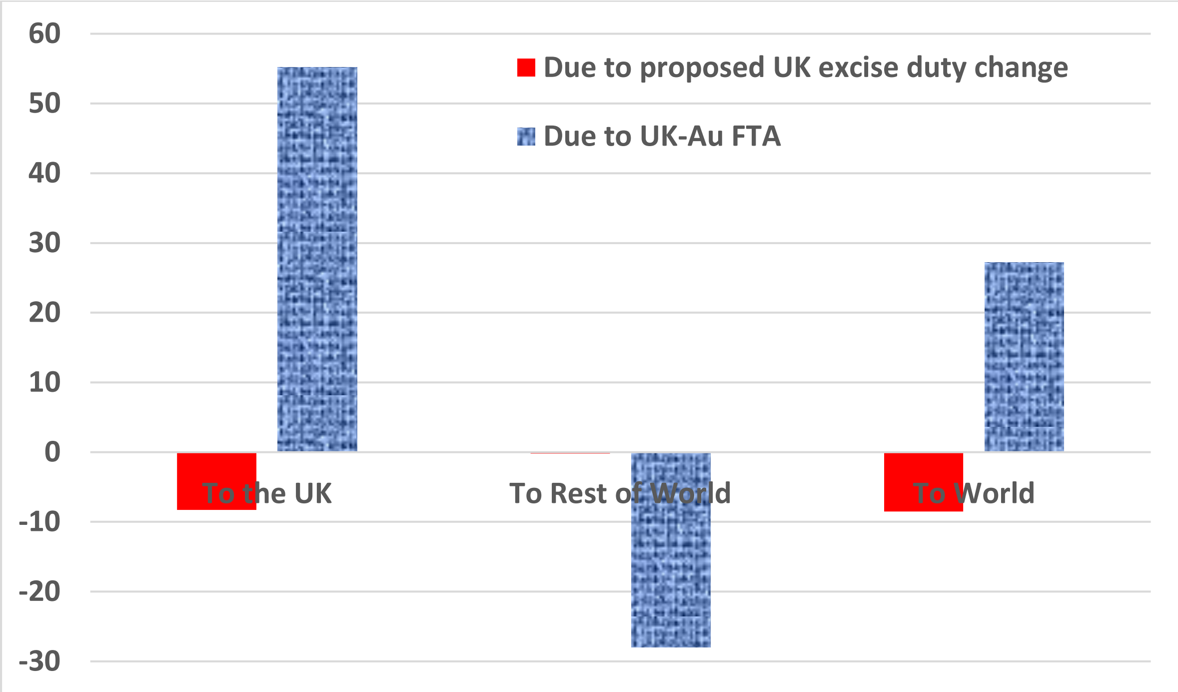
Source: Authors' model simulation results.

Table 3: Estimated impacts on UK wine imports from ANZ and the rest of the world of proposed UK alcohol excise duty reform and UK bilateral FTAs (A$ million per year)

	From Aust	From NZ	From ROW	Total
Due to proposed UK excise change	-8.3	-3.5	-33.6	-45.4
Due to UK-Au plus UK-NZ FTAs	49.5	43.9	-97.5	-4.1
Due to Δ excise and 2 FTAs	41.2	40.4	-131.1	-49.5

Source: Authors' model simulation results.

Figure 1: Impacts on Australian wine exports to the UK and rest of world (ROW) of proposed UK alcohol excise duty reform and UKAu FTA (A$ million per year)



Source: Authors' model simulation results (see first 2 rows of Table 1).