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Wine Economics Research Centre

Wine Policy Brief No. 2

Making the most of wine tax reform

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September 2010

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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.

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- 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

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This Brief draws on points made in a mini-symposium of papers that were revised following a workshop on *The World's Wine Markets by 2030*, convened by the University of Adelaide's Wine Economics Research Centre in collaboration with the American Association of Wine Economists and the Australian Agricultural and Resource Economics Society, Adelaide Convention Centre, 8-9 February 2010.Thanks are due to the GWRDC (Project Number UA08/04) and the University of Adelaide's Wine 2030 Research Network for financial support. Views expressed are the author's alone and not necessarily those of the funders. Forthcoming in the *Australian and New Zealand Wine industry Journal* 25(5): 7-8, September/October 2010.

Making the most of wine tax reform

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In the May/June issue of this Journal, Stephen Strachan and Tony Keys each contributed thoughtful articles on the wine tax debate. Both stressed that demands for wine tax reform are not expected to go away. So how should wine producer groups respond?

Reform was not included in the Federal Government's response to the Henry Review of Australia's Future Tax System. The reason given by the Government for not biting the bullet this time, despite the report's clear recommendation to do so, was that it recognised the wine industry was "in the middle of a wine glut" and making major adjustments to changed market circumstances (Swan and Rudd 2010). That is, there was no explicit rejection by the government of the arguments from health lobbyists, beer and spirits producers and the Finance Department for reform. Those arguments thus still need to be addressed by those opposed to reform, bearing in mind the Henry Review's terms of reference which were to evaluate mechanisms for raising revenue in an economically efficient and equitable way that would simplify the tax system and reduce its compliance costs.

Beer and spirits producers argue that wine should be taxed at least at the same rate as beer per unit of alcohol. The Henry Review goes further and recommends the phasing in of a single volumetric tax rate for all forms of alcohol. That could make sense from a government revenue-raising viewpoint if consumers of all forms of alcohol responded to a tax of $x per litre of alcohol with the same reduction in alcohol expenditure. A single volumetric tax rate could make sense also from a social cost viewpoint if all types of alcohol consumption led to the same degree of costly anti-social behaviour. However, neither of those conditions prevails. In terms of consumer responsiveness to price (hence tax) changes, Selvanathan and Selvanathan (2010) suggest there are considerable differences between wine, beer and spirits consumers in Australia. And in terms of social costs from such things as binge drinking, Srivastava and Zhao (2010), using information from the Australian National Drug Strategy Household Surveys, find major differences between the key groups: 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) wine are least likely to binge drink. Since the former group 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 types of alcoholic beverages, and, more specifically, for a lower rate of tax on wine, other things equal.

In addition to taxes, a case can be made for using, in addition to taxes, other more-direct government instruments to correct identified market failures. Examples 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 2010).

What about the issue of switching from an ad valorem tax regime to a volumetric one? The industry argues that this would be inequitable, since it would hit most the producers in hot irrigated areas who are already suffering more from higher water costs and climate change than producers in cooler areas. That claim is strongly supported by modelling results that distinguish all the key winegrowing regions of Australia (Anderson, Valenzuela and Wittwer 2010). The counter argument from an efficiency viewpoint, though, is that such a switch is justified if drinkers of bottled fine wine impose fewer social costs on the community than drinkers of cheaper non-premium wine. Such a switch is also likely to encourage more Australian vignerons to produce, and more Australians to consume, finer wines instead of larger quantities of cheaper wines. That may well improve overall health and make the industry more competitive internationally through moving up the quality ladder.

Stephen Strachan stresses a further point about agreeing to switch to a volumetric tax, which is that the wine industry would be seen to be accepting the argument that wine is worthy of a ‘sin tax’ just like other alcoholic beverages. He believes that would then make it highly likely the government would remove the Wine Equalization Tax (WET) rebate. That rebate currently applies to the first $1.72 million of each winery’s annual sales. Its removal would therefore more or less than offset any benefit a small fine wine producer may gain from a switch to volumetric taxation. Often forgotten, though, is that as from 2005 New Zealand wineries also have been eligible for the WET rebate on their sales in Australia. Thus competition in the Australian market from across the Tasman would diminish if the rebate were to be removed.

Finally, how do alcohol tax rates in Australia compare with those abroad? A new international comparison of the consumer tax equivalents (CTEs) of measures affecting sales of wine, beer and spirits across a wide range of countries (Anderson 2010) finds that low or zero taxation of wine is common among major wine-producing countries, as are differing tax rates for other beverages. The comparison shows that Australia has a relatively high tax for fine wines because it is far more common for volumetric tax measures to be used abroad. Specifically, on a volume of alcohol basis, Australia's super-premium wine consumers face a CTE more than three times greater than the average for high-income countries, while its non-premium consumers face a CTE of only half the high-income country average. Australia's beer and spirits CTEs are about seven times and more than twice the high-income country averages, however. Hence relative to other beverage consumption, non-premium wine in Australia is taxed at below the high-income average and super-premium wine faces a tax that is well above average for comparable countries. If excessive (especially binge) wine drinkers consume mostly non-premium wine, and if fine wine drinkers impose no externalities on society, then the use of an ad valorem tax is an especially inefficient way to try to reduce society's cost of socially harmful behaviour – and at the same time it also discourages the local consumption and hence production of finer wines. But what is clear from the above is that there are very many other factors that will also be part of the political calculus.

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