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ARE AUSTRALIA'S WINE CONSUMERS OVER-TAXED?

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With the Senate inquiry on reforming Australia's tax system in full swing, the wine industry is debating whether the current ad valorem wine tax should continue or be replaced by a volumetric tax. Premium wine producers prefer the latter, because it would lower the tax on their wine as a percentage of the bottle price. Non-premium wine producers, on the other hand, fear moving to a volumetric tax would force their customers to pay more.

That debate might be more productive and less contentious if instead it focused on the question: how large should be the tax on wine consumption? This is because an international comparison shows Australian wine consumers are very highly taxed. Specifically, if we were to adopt the OECD average wine tax, then even non-premium wine would be taxed less than now, in which case all industry participants would be better off.

There was no tax on Australian wine consumption prior to the mid-1980s (apart from a very brief period in the early 1970s). Since the August 1984 budget, however, it has gradually risen from zero to 41 per cent at the wholesale level. Since retail mark-ups tend to be proportional, that means what would have been a \$10 bottle of wine has to retail at more than \$14.

Consumers of wine could be forgiven for thinking the promised replacement of all wholesale sales taxes (WSTs) with a uniform, across-the-board 10 per cent goods-and-services tax (GST) would bring that retail price back to about \$11 a bottle. After all, the government wants almost nothing to be exempt from the GST (to minimize tax administration and lobbying costs). By the same logic, nothing should be taxed at *more* than 10 per cent, except where an activity imposes negative 'externalities' on others (such as with cigarette smoking, fuel burning, or excessive public health costs). Our excise taxes on fuel, tobacco, beer and spirits are there for that reason, and the government plans to lower them only to the extent that they would also be subject to the GST.

But there is no excise tax on wine currently, only the WST. Why, then, is the government talking about imposing a 'Wine Equalization Tax' (WET) so as to maintain the current rate of tax on wine consumers if/when the GST is introduced?

There are two obvious possibilities: either to boost government coffers, and/or because the government believes wine too is worthy of a 'sin' tax. But there are also some obvious problems with these so-called justifications. Consider each in turn.

True, the wine tax was introduced largely as a revenue-raising device, by State as well as Federal governments. When the High Court ruled the States' so-called 'franchise fees' unconstitutional in 1997, the Federal Government began collecting that revenue (about 15 per cent of wholesale sales) on behalf of the States. Hence the hike in the Federal WST that year from 26 to 41 per cent when those state taxes were abolished. Together these ad valorem wine taxes have provided a tidy growth dividend for governments, only part of which has come from the gradual rise in the rate of taxation. The other part is due to the trebling in the pre-tax wholesale price of wine since the mid-1980s – thanks to wine quality improvements, a shift in preferences toward premium wines, and rapid growth in export demand. Together these changes have caused wine tax revenue to rise sevenfold in nominal value terms since 1986, or threefold as a percentage of total government revenue (from 0.15 to 0.45 per cent – see Figure 1).

A key purpose of introducing the GST is to simplify the tax structure by being able to do away with such piecemeal means of raising revenue at the State and Federal levels, and to fund State governments with GST revenue. This suggests that former motivation for the wine tax would no longer be relevant. Since wine tax provides less than 0.5 per cent of government revenue, its loss would hardly be noticed when doing the sums for the proposed new tax regime.

And what of the second possible justification for continuing to tax wine consumers, namely, that they impose net negative externalities on society? Are they so large as to warrant a 41 per cent tax, bearing in mind the increasing evidence suggesting that moderate wine consumption with meals is beneficial to health and thus provides an external *benefit* in the form of savings on government health expenditure? One way to address that question is to compare the wine consumption tax in Australia with those in other countries.

A new study by the authors has done just that. It turns out to be rather difficult to compare taxes across countries because they come in several forms and are a mixture of volume- and value-based (ie, cents per litre or percentage) taxes. Consumers can be taxed via tariff or non-tariff barriers to imports, by excise taxes, by wholesale sales taxes, and by value-added taxes or goods-and-services taxes; and those taxes can be levied at State/Provincial as well as national levels. For those taxes that are volume based, the percentage equivalent depends on the price of wine.

With all this in mind, we calculated the consumer tax equivalent (CTE) at the average pre-tax retail price of wine in Australia in 1995-97, namely, \$5.50 per litre in aggregate, or \$2.70 per litre for non-premium wine and \$9 per 750ml bottle for

premium wine. In making this calculation, the domestic price of all wine is assumed to be raised by the full amount of any import tariff inflated by the excise or wholesale sales tax. Hence Australia's 5 per cent tariff causes the estimated CTE to be 48 per cent rather than 41 per cent, the extra two points coming from the wholesale sales tax on the tariff itself.

Table 1 summarizes the results excluding VAT/GST (since that is a general tax applying to all products and so does not bear on the issue of externalities from alcohol abuse), for all the countries for which we could get data. Those countries account for 85 per cent of world wine consumption. Their average CTE amounts to 16 per cent, one-third Australia's CTE. When the CTE is disaggregated into premium and non-premium wine, the CTE is the same in Australia because of our use of an ad valorem tax measure, but those CTEs are vastly different in other countries. On average, the non-premium CTE when converted to percentage terms is three times larger than that for premium wine in other countries. Hence Australia's premium wine consumers face a CTE five times greater than the OECD average, while its non-premium consumers face a CTE just twice the OECD average.

The estimates in Table 1 suggest a negative correlation between wine production per capita and the wine CTE. This is illustrated in Figure 2. Evidently the more important is wine production in a country, the less inclined are governments to tax their wine consumers. One possible reason is simply relative lobbying strengths: the more significant is national wine production, the stronger the wine industry's lobby against wine taxes; whereas in countries with little or no wine production, the local brewing and spirits industries would lobby for high taxes on that competing provider of alcohol.

What is also clear from Figure 2 is that Australia is well above the 1996 line summarizing that negative relationship. That was not the case for Australia prior to the most recent wine tax hike: in 1991 when the WST was only about 32 per cent and production per capita was less, Australia was much closer to the regression line. And in 1986 it was slightly below that line. If a 10 per cent GST is introduced in Australia by 2001 and the wine WST is commensurately reduced from 41 per cent back to around 32 per cent (as currently proposed by the Treasury), Australia will move closer to the regression line in Figure 2 as shown – but only slightly closer, and it will not be as close as in the early 1990s, because production per capita is expanding so rapidly.

How does Australia compare when beer taxation rates also are considered? It turns out that in the OECD on average, when CTEs are expressed in percentage terms, premium wine is taxed only about one-third as much as beer while non-premium wine is taxed two-thirds as much as beer. Australia falls half way between those two, that is, it taxes non-premium wine relative to beer less and premium wine relative to beer more than other OECD countries.

When CTEs are expressed on a per litre of beverage basis, however, in the OECD on average non-premium wine is taxed slightly more heavily than beer and premium wine is taxed three times as much as beer. Even for Australia the non-premium wine tax almost matches that of beer by this measure, and the premium wine CTE is more than four times that for beer. These higher ratios result from the fact that even non-premium wine is more expensive per litre than beer.

When the comparison is made on a per-litre-of-alcohol basis, only the premium wine CTE exceeds that for beer. For Australia that final comparison is especially stark: non-premium wine is taxed at only one-third the rate of beer per unit of alcohol, while premium wine is taxed at 50 per cent above that beer rate – more than twice the non-premium/premium gap for the average OECD country. Only in Sweden and Mexico is the CTE for premium wine relative to beer, on a per-litre-of-alcohol basis, significantly above that ratio for Australia and New Zealand.

These comparisons suggest that if Australia were to copy the European wine-producing countries' relative tax structure, or even that of the OECD average, it would switch to a volumetric wine tax at about the same level as currently for non-premium wine, which would make it at least one-third lower than the current tax for premium wine.

Had Australia's wine tax been specific rather than ad valorem even as recently as 1991 (when at 32 per cent it would have been equivalent to 72 cents per litre of wine or about \$5.70 per litre of alcohol), and had the specific rate not changed from that level since then, Australia's wine CTE in ad valorem terms would have halved in aggregate and fallen by more than four-fifths for premium wine by now. In terms of Figure 2, that would have put Australia almost exactly on the regression line in 1998 – still well above the average for all the large wine-producing countries, but much closer than currently. And being in proportion to the amount of alcohol, that form of wine taxation also would have provided a much more efficient form of taxing the negative externality perceived to be associated with excessive drinking.

This difference in outcomes raises the question as to why Australia continues with an ad valorem measure. The main Australian wine industry bodies still lobby for the retention of ad valorem taxation rather than a switch to a specific (volumetric) tax. This is partly out of fear that such a switch might be accompanied by a rise in the tax rate to match that of beer, and partly because they do not acknowledge that wine deserves a 'sin' tax.

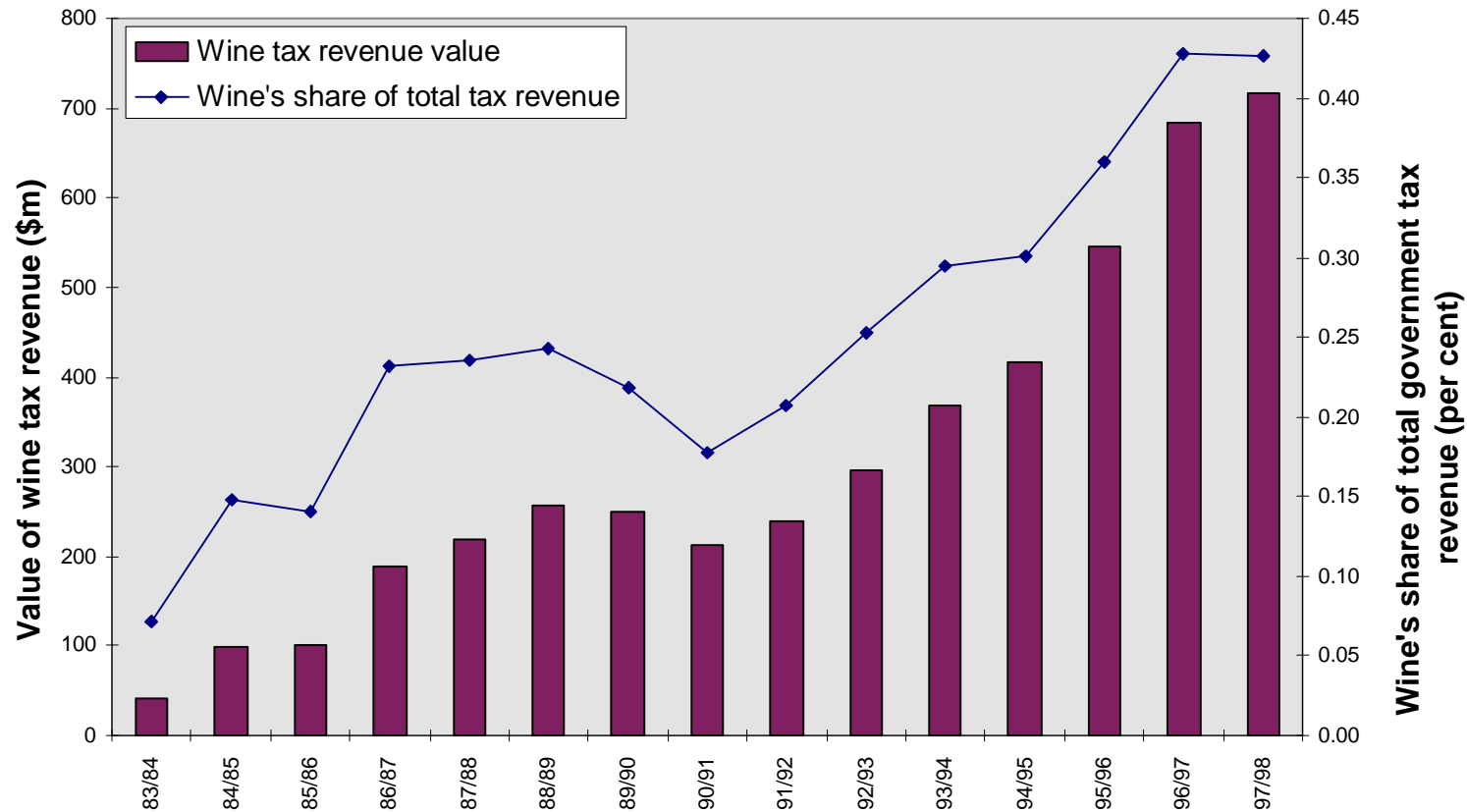
The evidence suggests that while the wine rate is no more than half that of beer in ad valorem CTE terms or per litre of alcohol, it is already more than the beer rate when expressed per litre of beverage. Even so industry bodies expect the Government would argue that, notwithstanding the possible positive health benefits of moderate wine consumption with meals, at least non-premium wine has net negative externalities associated with its consumption that warrant a CTE higher than at present. Even if a change in tax instrument lowered the CTE on premium wine, large producers (as well as consumers) of non-premium wine could be taxed more. Their share of all wine firms and grapegrowers (and consumers) is continuing to fall over time, however, and already about 5 per cent of non-premium wine is imported to make up for shortfalls as Australian grapegrowers convert more land to premium varieties.

Should these trends continue, there may come a time early next century when the balance of interest group preferences will swing towards a volumetric tax in place of an ad valorem WST or (if the GST is introduced) WET. That is less likely the more the price of wine falls as global supplies expand, however – and the more people continue

to believe the government would not peg a volumetric tax but rather raise it over time to bring in more revenue.

The authors are, respectively, a Masters student and the Director of the Centre for International Economic Studies. This article is based on the authors' longer paper entitled 'Consumer and Import Taxes in the World Wine Market: Australia in International Perspective', CIES Policy Discussion Paper 99-03, February 1999. Details of it and other wine economics papers are available on the Centre's website (www.adelaide.edu.au/cies), or contact the CIES Executive Assistant, Zoe Ratcliffe, by phone (08) 8303 5672, fax (08) 8223 1460, or email cies@economics.adelaide.edu.au

Figure 1: Value of wine tax revenue and wine's share of total government revenue, 1983/84 to 1997/98



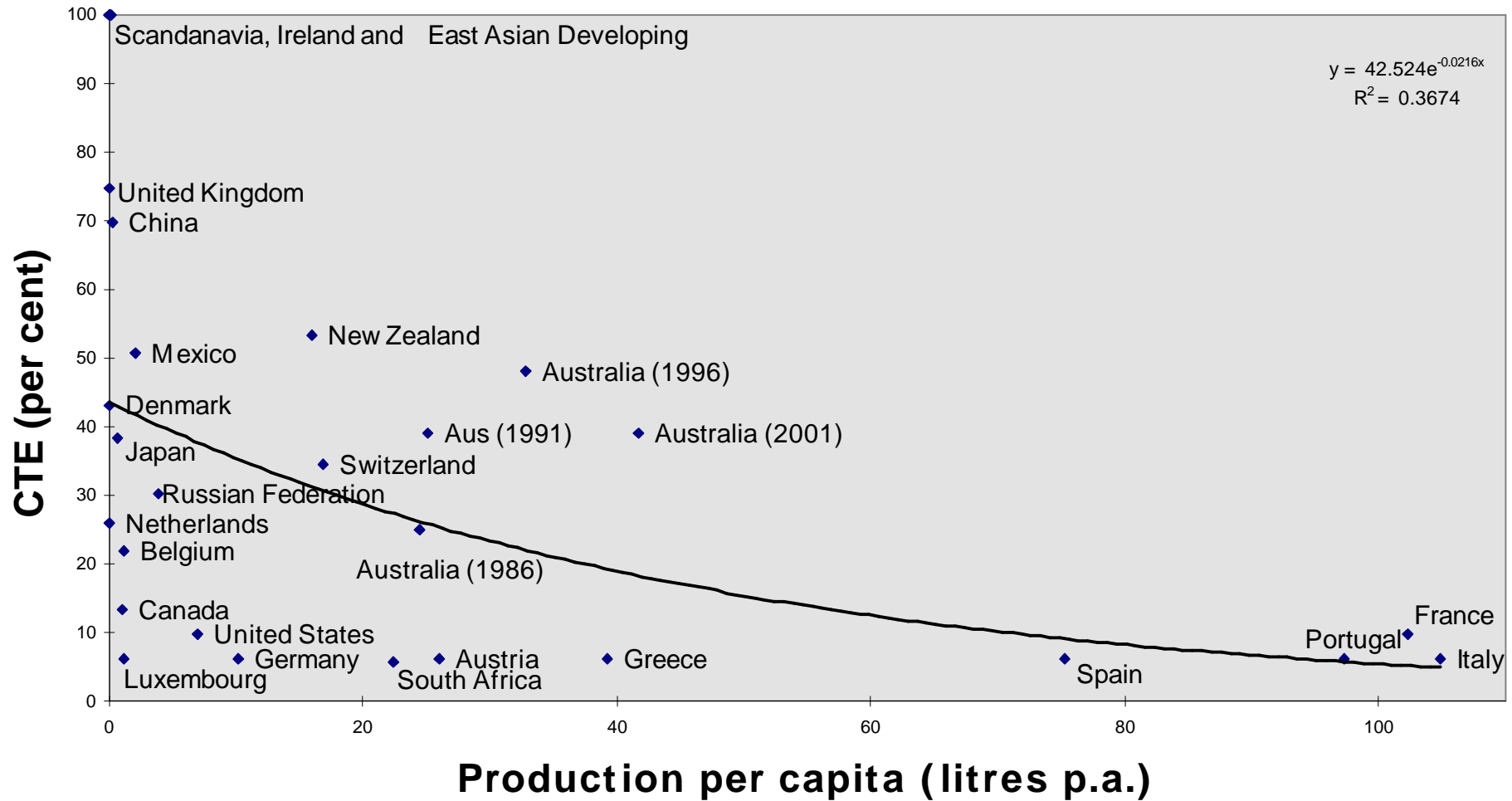
Source: The value of Australian wine sold domestically is from Osmond and Anderson (1998 pp 74-75), except revised figures for 1996/97 and 1997/98 which are from the 1998 ABS publication Australian Wine and Grape Industry (cat. 1329.0). Wholesale sales tax rates including State license fees were obtained from WFA (1998b, p.21). The value of wine tax revenue is calculated simply as the product of the State franchise inclusive WST rate and the value of Australian wine sold domestically. Total government revenue data (Commonwealth and State) is from the ABS publication Taxation Revenue, Australia (cat. 5506.0).

Table 1: CTE on wine (excluding VAT/GST)*, wine production and consumption per capita and shares of world wine consumption volume, various countries and country groups, January 1996.

	% CTE on wine that without taxes would retail at the following prices:			Production per capita litres	Consump. per capita litres	Share of world consump. volume per cent
	\$5.50/litre (average)	\$2.70/litre (non premium)	\$12/litre (premium)			
Australia	48	48	48	32.8	18.2	1.7
New Zealand	53	94	32	15.9	9.9	0.3
European wine producers	8	14	4	92.9	53.7	50.4
France	10	19	5	102.3	59.7	19.4
Italy	6	12	4	104.8	62.3	17.5
Greece	6	12	4	39.2	30.5	1.4
Portugal	6	12	4	97.2	59.2	3.0
Spain	6	12	4	75.3	37.2	9.1
Scandinavians	107	212	52	0.0	13.5	1.2
Denmark	43	85	21	0.0	27.2	0.5
Finland	121	240	58	0.0	5.2	0.1
Iceland	273	546	131	0.0	5.1	0.0
Norway	213	425	103	0.0	8.8	0.2
Sweden	129	257	62	0.0	12.7	0.4
Other Western Europe	26	51	13	6.3	19.5	11.8
Austria	6	12	4	26.0	32.6	0.8
Belgium	22	43	11	1.2	21.1	0.8
Germany	6	12	4	10.1	22.8	6.2
Ireland	114	227	55	0.0	7.3	0.1
Luxembourg	6	12	4	1.2	50.4	0.0
Netherlands	26	51	13	0.0	13.2	0.7
Switzerland	35	69	17	16.9	41.2	0.6
United Kingdom	75	149	36	0.0	12.4	2.6
NAFTA	13	23	8	5.4	5.8	9.2
United States	10	20	5	7.0	7.6	7.8
Canada	13	27	6	1.0	6.7	0.7
Mexico	51	51	51	2.0	0.2	0.7
Asia and Pacific	73	86	66	0.3	0.4	2.4
Japan	38	55	30	0.7	1.2	0.7
China	70	70	70	0.3	0.3	1.5
Malaysia	205	395	106	0.0	0.1	0.0
Korea	216	216	216	0.1	na	0.1
Thailand	124	124	124	0.0	0.1	0.0
Singapore	209	418	100	0.1	0.8	0.1
Other						
South Africa	6	11	3	22.4	20.0	3.2
Russian Federation	30	51	20	3.9	4.3	4.6
OECD Average	14	26	8	28.1	26.0	75.3

*Calculated assuming non premium wine accounts for 70 per cent of total domestic wine consumption. World consumption shares are used to calculate the bold weighted averages for country groups.

Figure 2: Comparing per capita wine production and the average CTE on wine (excluding VAT/GST), Australia, 1986, 1991, 1996 and 2001, and various countries, 1996



Source: As for Table 1