



*Centre for  
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## **Wine Policy Brief No. 4**

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### **MORE ON MODELING THE IMPACT OF TAX REFORM: HOW UNEQUAL IS THE PROPOSED WINE 'EQUALIZATION' TAX?**

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This note has two purposes: to respond briefly to critical comments on our earlier modeling of the effect of tax reform on the wine industry; and to present a summary of new results suggesting the wine 'equalization' tax (WET) proposed by the Commonwealth Government in March 1999 represents an even greater impost on wine consumers than previously thought.

**Response to John Gladstones' review**

In a paper elsewhere in the present issue of this *Journal*, John Gladstones (1999) reviews our early empirical studies (Wittwer and Anderson 1998a,b) of the impact of the proposed GST and possible associated changes in wine taxation on the grape and wine industry. Apart from noticing an unfortunate typo (affecting the magnitude but not the sign of four of the hundreds of numbers presented), he makes two key points: (1) that the numbers in the later paper differ slightly from those in the earlier analysis; and (2) that the latter results do not support our repeated claim that "A switch from a value-based top-up WET to a volumetric WET which raises the same government revenue would harm the industry as a whole, and especially its non-premium sector, even though it would help premium wine producers and consumers."

The first point is correct: the numbers in the later paper do indeed differ slightly from those in the earlier analysis. There are two reasons for the differences. The main one is that the first paper modeled a guess at what the government would propose, whereas the second paper came after the GST package was announced and so modeled a somewhat different tax reform proposal. These two papers are thus but a small part of an evolving policy debate where proposals are being revised from time to time. Each revision of our findings reflects the latest versions of the most likely scenarios.

The second reason for differences in results turns out to be of less importance to the debate in terms of the actual numbers produced, but is nonetheless important for

ensuring we were presenting the best possible results in the time at our disposal. It is that we are steadily revising the data and structure of our FEDSA-WINE model used in our analysis, so as to make it ever-more realistic. Further model revisions, together with further changes to the Government's proposals in March this year, have given us cause to revisit the issue once again (Wittwer and Anderson 1999), and to produce yet another set of results, one aspect of which is discussed below. This is applied policy science as it should be, providing revised empirical analyses of new proposals as soon as they can become available. Detailing all the reasons for the changes in results within the page constraints of industry journals, apart from being tedious for most readers, is a luxury typically not given to authors of modeling papers. We are, however, always happy to chat with other interested researchers about those details.

The second key point made in Gladstone's review, that we have incorrectly interpreted our own results, is itself incorrect. In our papers we compare the government's proposal of the GST plus a top-up *ad valorem* tax with an alternative scenario in which the top-up tax is volumetric (that is, based on the alcohol content instead of the price of wine). Our results, which are reproduced in the Gladstones' review in a modified form, clearly show that, compared with the government's *ad valorem* proposal, a volumetric tax that raised the same government revenue would leave the industry in aggregate output terms, and non-premium producers and consumers in particular, worse off. We do not deny the point also made by Gladstones that the non-premium sector need not be worse off with a volumetric top-up tax than at present. That is possible because the change to a GST on its own would be beneficial to the wine industry as a whole including the non-premium sector. However, the more relevant comparison in our view is between the two alternative top-up taxes.

### **Re-assessing the Government's so-called Wine 'Equalization' Tax**

Our latest paper (Wittwer and Anderson 1999) examines the likely impact on the grape and wine industry of the March 1999 proposal by the Commonwealth Government to impose a top-up wholesale sales tax on wine of 29 per cent when the GST of 10 per cent is introduced. The Government calls this a wine equalization tax, but admits it will raise wine prices slightly. The industry's initial reaction was to claim that it represented about five percentage points more than is needed to generate the same revenue from wine taxation as at present.

To test the industry's claim more formally, we recently used a further-improved version of the FEDSA-WINE model to re-do those sums. The results suggest that the Government's 29 per cent tax is not five but more like nine percentage points above a truly revenue-neutral *ad valorem* wine equalization tax. With the 10 per cent GST, it equates to a wholesale sales tax of around 50 per cent, well above the current 41 per cent rate.

The latest version of our model takes into account the different retail marketing margins for premium versus non-premium wine and for on-premise (eg restaurants) versus off-premise sales. It also accounts for the fact that the GST will apply to those retailing markups. Furthermore, we project the Australian economy to 2003 to get a new base case to compare with the alternatives, so as to take into account the rapidly

changing volumes and prices of premium versus non-premium sales that will apply a couple of years after the GST is proposed to be introduced. (We do not alter the assumed alcohol content of wine that might result if a volumetric tax is introduced though. If that were to fall for non-premium wine more than any sales volume increase, for example, a higher rate of volumetric tax would be required to raise the same wine tax revenue as currently.)

More specifically, results from our latest modeling indicate that:

- the grape and wine industry would experience little net change in the volume of output from a move to a broad-based GST in place of numerous WSTs if alcoholic products were to be left just as heavily taxed as at present with a true *ad valorem* WET;

- however, a top-up tax of 29 per cent, as proposed by the Government last March, would reduce wine output significantly;

- moreover, if instead of an *ad valorem* WET a volumetric top-up wine tax that raises the same government revenue were to be imposed, that would help premium wine producers and consumers but harm the non-premium sector compared with the *ad valorem* WET;

- furthermore, raising such a volumetric top-up wine tax to the same level as that for beer per litre of alcohol would cause all wine consumers and producers to be substantially worse off than currently; and

- lowering the add-on tax on wine so that the same total rate applies as in other wine-producing OECD countries (whose tax rates are documented in Berger and Anderson 1999) would more than halve the tax rate and thereby be very beneficial to all Australian wine producers and consumers, while still raising at least half as much tax revenue from wine as at present as consumers substituted towards higher-quality wine.

The last point is worth reflecting on. Why is it that the Australian Government believes wine consumers in this country impose so many more social costs on others from excessive drinking than is the case in other OECD countries? If the Government's 29 per cent top-up tax simply reflects revenue greed on the part of the Treasury, shouldn't this be a time for wine consumers and producers to pull together and argue for a lower overall *rate* of wine taxation, instead of dividing the industry by focusing on the *type* of tax that might be applied? If the OECD average rate was adopted, it wouldn't matter much whether an *ad valorem* or volumetric tax was used, since all segments of the market would benefit very substantially compared with what the Government is currently proposing with its 29 per cent 'non-WET'.

## References

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