Spirits & Cocktails Australia

Australian Distillers Association

2023 PRE-BUDGET SUBMISSION

Creating the Conditions for Sustainable Growth

TABLE OF CONTENTS

Cover image: EARP Distilling Co. (NSW, Newcastle)

1. INTRODUCTION

The Australian spirits industry welcomes the opportunity to make a Pre-Budget Submission for consideration ahead of the 2023–24 Federal Budget.

This submission is lodged on behalf of Members of Spirits & Cocktails Australia and the Australian Distillers Association. Together, we represent spirits producers involved in the manufacture, marketing and sale of spirits throughout Australia, from global importers to local distributors. Our supply chain stretches from 'farm to glass', incorporating farmers and primary producers, production and logistics, manufacturing, and the hospitality and tourism sectors.

Our industry directly supports over 52,900 jobs in spirits manufacturing, retail, wholesale and hospitality, contributing $11.6 billion in added value to the Australian economy.

We share a commitment to promoting a safe and vibrant spirits sector, which reflects Australia's mature drinking culture and creates opportunities for sustainable growth and economic development.

Wild Flower (QLD, McPherson)

AN INDUSTRY RIPE FOR GROWTH

Reducing the spirits excise rate to align it with the brandy rate and freezing CPI indexation for three years will facilitate sustainable growth for Australian spirits manufacturing and boost investment in an industry ripe for growth.

The Australian spirits industry has fast become one of the most exciting markets for innovative spirits – from Bloody Shiraz Gin and Tasmanian Whisky to the uniquely Australian invention of the RTD (ready-to-drink spirits) – our ability to embrace the best of this great southern land's natural environment and Australian ingenuity has set us apart on the world stage.

Our industry comprises both global manufacturers behind iconic spirits brand names, as well as local distillers whose products celebrate the best of Australian provenance. Our story is steeped in the legacy of centuries-old traditions and techniques, which have been replicated and reimagined to create distinctly Australian expressions of whisky, rum, gin, vodka and mezcal that have deservedly won international acclaim.

Over the last decade, more than 400 new distilleries have entered the Australian market, joining the likes of Johnnie Walker, Jack Daniels, Jim Beam and Absolut on retail shelves to meet growing consumer demand for premium spirits and ready-to-drink products.

Our success delivers over $11.6 billion in total value add to the Australian economy each year, and over 52,900 direct jobs, with 5,000 of these jobs in spirits manufacturing. Significantly, two-thirds of manufacturing operations are located in regional and rural Australia, bringing important economic benefits to these communities.

However, we are still only seeing a fraction of the potential that the Australian spirits industry represents.

We understand the challenges facing the Federal Budget and note the focus on budget repair and policy levers that put downward pressure on inflation. We join many others in hoping that this includes a conversation about Australia's tax system and opportunities to ensure a more sustainable stream of revenue for the Government.

With modest changes to current tax settings for spirits and the promise of a more holistic review, our industry can contribute to:

- growth in domestic manufacturing
- increased trade and employment
- support of innovation and technology, and
- the growth of regional industry.

We acknowledge the full remission of the first $350,000 in excise benefits a large number of craft distillers. However, the headline excise rate has a severe impact on Australian manufacturers of all sizes who are producing commercial volumes of spirits. Aspirational domestic distillers with plans to grow beyond craft-sized operations are limited in their ability to reinvest in their businesses. Similarly, global manufacturers are dissuaded to invest in Australian distilleries to create a scalable domestic manufacturing industry, as high levels of excise ultimately makes such investment prohibitive.

Amplifying these issues is the burden of high inflation. Over the past twelve months, spirits manufacturers have reported surging costs for inputs such as barley, glass and cans, and freight charges that have more than doubled in some regions, which in some cases may have resulted in costs being passed through to consumers.

All Australian businesses and consumers are grappling with the challenges of rising inflation and cost of living pressures. However, very few sectors are subject to a 'double whammy' of inflationary pressures on the cost of goods and twice-yearly indexation of excise.

With modest reform, the Albanese Labor Government has the potential to lift the handbrake on the Australian spirits industry to unlock opportunities to create a sustainable and scalable manufacturing industry. As international demand for premium spirits continues to grow, there has never been a better time to invest in the future of the Australian spirits industry.

2. EXECUTIVE SUMMARY

Recommendation

Modest tax reform will facilitate sustainable growth for spirits manufacturing in Australia and boost investment in an industry ripe for growth.

We recommend that the following tax policy measures should be considered ahead of the 2023–24 Federal Budget:

- Reduce the spirits excise rate to align it with the brandy excise rate; and
- Freeze CPI indexation on the spirits and brandy excise rates for three years.

Economic modelling that supports our recommendation

A PwC analysis commissioned by Spirits & Cocktails Australia (Appendix) revealed that the rate of **spirits excise in Australia is now so high that the Government collects less revenue than it would if the rate was lower**.

PwC's modelling utilises the best and most recent evidence and price elasticities on how alcohol tax changes impact consumption, as detailed in Monash University's, 'Disaggregated econometric estimation of consumer demand response by alcohol beverage types (2015)'. PwC's model uses these elasticities and applies them to granular information on Australian alcohol sales from IRI Worldwide.

Three policy scenarios were modelled: reducing the spirits excise rate to align it with the brandy excise rate; freezing the spirits excise indexation for three years; and combining both these proposals.

In all three policy scenarios, PwC's modelling shows that freezing or decreasing the spirits excise rate increases Government revenue as it accelerates an established market trend that sees consumers shift from lower taxed beer and wine to higher taxed spirits and RTDs. If the spirits rate was reduced to the brandy rate, taxation on spirits would remain 125% higher than full strength draught beer and 58% higher than full strength packaged beer. Critically, the model also shows that total alcohol consumption would remain relatively flat.

Diageo manufacturing plant (NSW, McMahon)

UNLEASH THE **POTENTIAL**

Australia is home to over 400 distilleries and manufacturing plants, located in every State and Territory.

While the domestic spirits industry has grown significantly in recent years to complement global brands manufactured in Australia, the punitive nature of our spirits tax system threatens to thwart the continued growth of the sector.

Savvy governments know that higher taxes never deliver stronger growth. But spirits manufacturers in Australia currently bear the burden of the third highest spirits tax in the world; with indexation, this load grows twice a year.

Such a harsh and disproportionate tax, contrasted to other countries and categories, is holding the Australian spirits industry back, stifling job creation, manufacturing, tourism, agriculture and export opportunities.

The potential for an Australian spirits boom is there, waiting to be tapped.

There is a strong consensus among those familiar with the alcohol industry that Australian-made spirits are on the threshold of a boom similar to that of the wine industry in the 1980s. When governments back then recognised the potential and quality of Australian wine, they championed the industry's expansion through tax breaks and financial incentives for investment. Exponential growth and domestic activity followed, benefiting Australia's agriculture, tourism and export industries.

It is worth remembering that thirty years ago, Australians socialising or dining out rarely had a choice of wine beyond "white or red". But thanks in part to the vision of policymakers at the time, Australia's varietals are known and celebrated around the world.

Today, a similar decision by the Albanese Government has the potential to build a legacy that rewards Australian ingenuity and showcases Australian produce internationally yet again.

Fair and sustainable tax reform will unleash the potential of a fast-growing, domestic manufacturing industry. It will create jobs, especially in the regions, stimulate investment to increase exports, support value-added agriculture and contribute to the growth of regional communities.

3.1. Manufacturing

We support the Albanese Government's goal to foster a productive domestic manufacturing industry that provides jobs and opportunities for future generations of Australians.

However, the current policy settings for the spirits industry do not support efficiency, nor do they encourage businesses to scale in a way that will contribute to the fulfilment of this objective.

For instance, the full remission of excise up to $350,000 disincentivises smaller distilleries from producing more than about 12,500 bottles of gin each year (or other products produced at 40% alcohol by volume) – which is just 250 bottles per week. This is because the cost of goods increases by $27 worth of excise beyond every product produced after the 12,500th bottle of spirits. What's more, small producers in the wine and beer industry can produce higher volumes of product as their lower tax rates mean that it takes them longer to surpass this $350,000 excise-free threshold.

Similarly, global manufacturers are dissuaded from investing in scaling award-winning Australian distilleries as the current spirits excise rate – which is the third highest in the world – makes such foreign direct investment unattractive.

Simply put, countries with more favourable tax settings are benefitting from investment that should be being made in Australia.

Why global manufacturers look elsewhere when considering investing in distilleries

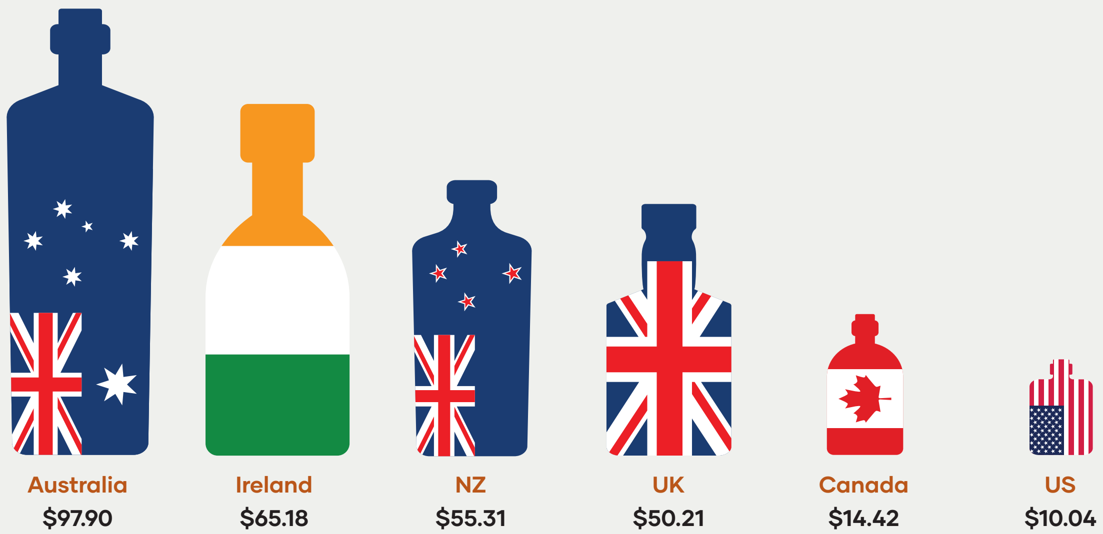


Figure 1: Australia's spirits excise per litre of alcohol vs. comparable markets (in AUD) from 1 February 2023.

CASE STUDY

How tax relief in the UK enabled Brown-Forman to invest in Scottish distilleries

Brown-Forman, the largest American-owned spirits and wine company, is always looking for opportunities to grow within its international markets. Headquartered in Louisville (Kentucky) in the United States, Brown-Forman employs more than 5,200 people globally and sells its quality spirit brands like Jack Daniel's Tennessee Whiskey, Woodford Reserve and Herradura Tequila in more than 170 countries.

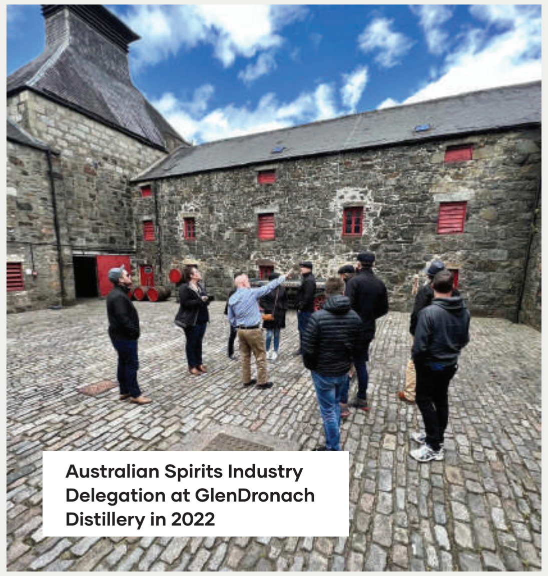
Following consecutive cuts in spirits duty announced by the United Kingdom's Chancellor of the Exchequer in 2014 and 2015, Brown-Forman had the confidence to invest in the UK market, with a £285 million ($495m AUD) purchase of three Scotch whisky distilleries – The BenRiach, GlenDronach, and Glenglassaugh.

Since Brown-Forman's investment in 2016, the global volume of scotch whisky sold and exported from the three distilleries has tripled. Brown-Forman has helped develop the brand offerings, including making changes to packaging, extending the core scotch whisky range, releasing new expressions and creating new whiskies (such as the GlenDronach Aged 50 Years, the oldest and most prestigious Single Malt to be released from the distillery).

In the last five years, Brown-Forman has invested approximately £10m ($19m AUD) for the development of new assets to support and improve production from these facilities and improve all three distillery visitor experiences to enhance the tourism offering. In 2022, the company announced an additional US $50m ($70.4m AUD) investment in the GlenDronach Distillery to significantly increase production at its home in the Valley of Forgue, Aberdeenshire, as global demand for the GlenDronach has tripled since 2016. This represents a significant investment in the long-term future of the distillery.

Australia is the second largest international market for Brown-Forman, with sales of over five million nine litre cases of full and premixed spirits, and 150 employees located across all Australian States and Territories. The company creates jobs throughout its supply chain and in marketing and hospitality, and in 2022, contributed more than $436m in excise paid on its products sold in Australia.

With the right business conditions and tax incentives in Australia, global companies like Brown-Forman can play a greater role in fostering and developing the Australian spirits industry, providing their craftsmanship, know-how and experience to stimulate economic development, innovation and competition.



Australian Spirits Industry Delegation at GlenDronach Distillery in 2022

3.2 Global Trade and Exports

Modest tax relief could provide incentives for local and global distillers to expand operations, employ more people, support more local businesses throughout the supply chain, and consider potential for export to new markets.

However, as it stands Australian distillers are disincentivised to grow their businesses to the necessary level to market and export to lucrative growth markets in Asia and around the world. Australia has a growing international reputation as a producer of high-quality spirits, as evidenced by global awards, but this reputation is not being capitalised on.

The twice-annual indexation tied to the CPI also affects the ability of Australian spirit manufacturers to expand into new markets, both domestically and internationally, as the high cost of production can make it difficult for distillers to price their products competitively, which can make it difficult for them to gain a foothold in new markets.

There is an enormous potential for Australian distilled spirits to be a future export star of premium value-added food and beverage products, similar to the success enjoyed by the Australian wine industry. Free trade and economic partnership agreements in the region can boost opportunities for Australian distillers, as regional markets are seeing excellent growth in demand for international premium spirits, particularly in economies like Vietnam, the Philippines, South Korea and Japan (all signatories to the recently signed Regional Comprehensive Economic Partnership).

Figure 2: Global spirits exports per capita (USD)

Source: Statista 2021, Leading exporters of spirits worldwide in 2021 by country (in million U.S. dollars) https://statista.com/statistics/1039949/global-spirits-export-leader-by-country/

3. GROW OUR INDUSTRY TO GROW THE ECONOMY

CASE STUDY

Australia missing the boat on spirits exports

Granddad Jack's Craft Distillery was the first craft distillery to open in the Gold Coast, Queensland. This family owned and operated distillery creates award-winning craft spirits and liqueurs that celebrate the life and stories of their late granddad. Their products are now exported to North America, Norway, Fiji, Singapore and New Zealand.

Founder and CEO, David Ridden, says that for Australian artisanal spirits producers to access international markets, they need to be able to make money and profit from their sales here in Australia.

"To access export markets, distillers need to invest heavily. The amount of money we can access from Federal, State and Local Governments is simply not enough to realise our export potential.

"Spirits excise is single-handedly the biggest obstacle standing in our way.

"Our excise rate is nearly $100 per litre of alcohol and twice-yearly indexation takes the profitability out of our business. We can't put our prices up with retailers every time the tax goes up, so our margins are squeezed by excise and GST bills that increase every six months.

"What this means for distillers, is that it's one less person we can employ to free us up to research new markets, speak to AusTrade or State Development teams, and apply for grants. Instead, businesses just stagnate.

"When you get to a point when all you're doing is surviving – because our excise increases twice a year, taking so much out of everything you do – and the tax office makes more money than you do, then there's a big problem.

"Australian spirits exports can be bigger than wine has ever been.

"We tick all the right boxes – international markets are looking for niche, premium and super premium products. We can export less volume and generate more revenue.

"The Government wants to manufacture more in Australia – and we can do just that – but excise is killing us before we even get a chance to start.

"Imagine what we could achieve with more fair and sustainable settings for spirits excise."

Granddad Jack's (QLD, McPherson)

3.3 Employment

The spirits industry is a significant supporter of diverse employment throughout Australia. While jobs in the industry are predominantly in hospitality and spirits manufacturing, the industry creates significant indirect jobs in related industries such as bottle, can, label and cap manufacturing, tourism, transportation and event planning.

Significantly, two-thirds of the operations creating these jobs are located in regional and rural Australia, bringing important economic benefits to these communities.

The excise remission of $350,000 provided to distillers in Australia was intended to provide relief for small businesses and encourage growth in the industry. While doing this, it has simultaneously disincentivised businesses from innovating and growing beyond the $350,000 threshold.

The excise remission has effectively created a ceiling for our developing industry, encouraging manufacturers to stay small and not to grow beyond this threshold. In turn, the cost of investment beyond the $350,000 cap to expand or to purchase new equipment is too great to facilitate the efficient scaling of our industry.

A growing spirits industry, which is scaled to promote export, can also help to stimulate economic growth in manufacturing, hospitality, tourism and agriculture as businesses expand to meet increased demand for their services.


Backwoods Distilling Co. (VIC, Indi)

"Whatever we save on tax, we can spend on people."

Bree Attwood,
Backwoods Distiling Co.,
Yackandandah (VIC, Indi)

3. GROW OUR INDUSTRY TO GROW THE ECONOMY

EMPLOYMENT

52,900 DIRECT JOBS

51,600 INDIRECT JOBS

47% SPIRITS WORKFORCE AGED UNDER 30

Spirits wholesaling
1,500 JOBS

Hospitality
36,000 JOBS

Spirits manufacturing
4,900 JOBS

Spirits retailing
9,800 JOBS

ECONOMIC CONTRIBUTION

Every **$1** of direct value add from the Australian spirits industry supports another **$2** throughout the wider economy

SUPPORTING JOBS

Every person employed in the Australian spirits industry supports another employed person elsewhere in the economy.

Source: Deloitte Access Economics 2021, 'Economic contribution of the Australian spirits industry report'

3.4 Small business

While domestic Australian spirit manufacturers are producing some of the best spirits in the world, they are receiving some of the lowest rates of foreign and domestic investment.

Investors are looking for businesses that have the potential to grow and generate a return on investment. The current excise rate makes it difficult for spirit manufacturers to compete with international producers on price, which can limit their potential for growth and profitability. This makes them less attractive to investors, who are preferring to invest in businesses that are operating in more favorable and certain market conditions.

Twice-annual indexation of excise compounds this problem as the cost of operating in the Australian market becomes even more expensive, providing another reason for investors to look elsewhere.

Husk Distillers (NSW, Richmond)

> "Any further rise in CPI will have far reaching consequences for the entire Australian spirits industry. Indexation is a burden on our industry that must be urgently addressed."
>
> Paul Messenger, Founder & CEO
>
> Husk Distillers (NSW, Richmond)

CASE STUDY

Diageo acquires award-winning Australian coffee liqueur producer Mr Black

Mr Black is a domestic distilling industry success story. Established in 2015 on the Central Coast of New South Wales, this small but mighty brand fast won international acclaim for reimagining Australia's love of coffee to produce an incredible coffee liqueur – an essential ingredient of the popular Espresso Martini cocktail.

Such was this brand's success at global awards that it caught the attention of the world's largest spirits producer, Diageo.

Through its investment arm Distilled Ventures, Diageo made an initial investment in Mr Black to scale its operations in readiness for export into key markets. In just seven short years, this enabled Mr Black to become the most popular coffee liqueur in the United States and the fastest growing coffee liqueur in the world.

In 2022, Diageo completed a final purchase of the business to continue developing the brand and exporting this fantastic Australian product to the world.

Mr Black is an important story that demonstrates the maturing of the Australian distilling industry and the transformative role that foreign investment can play. However, Australia's current spirits excise regime means that countries with more favourable tax settings continue to benefit from investment that might otherwise be made here to elevate award-winning Australian spirits on the world stage.


Stephen Colbert mixing a Mr Black Espresso Martini with Hugh Jackman on The Late Show

3.5 Regional growth

The spirits industry makes an important contribution to regional Australia, with a significant proportion of operations occurring outside metropolitan areas. About 32% of the spirits industry workforce is located outside capital cities – and approximately 65% of spirits manufacturers are in regional and rural Australia.

A thriving spirits industry in Australia can have a significant impact on regional communities. Growing the industry not only provides more opportunities for people working in distilleries in regional areas, but also helps create jobs in tourism as visitors embrace tastings and tours. It also creates further opportunities throughout the supply chain, through the manufacturing of glass and bottle caps, and in logistics as product is moved around the country.

The growth of the Australian spirits industry supports such regional growth, but our current tax settings are putting a 'handbrake' on this opportunity.

REGIONAL FOOTPRINT

TOURISM

Source: Deloitte Access Economics 2021, 'Economic contribution of the Australian spirits industry report'

3. GROW OUR INDUSTRY TO GROW THE ECONOMY

CASE STUDY

Value-adding to regional communities

Bass & Flinders Distillery on Victoria's Mornington Peninsula started as a passion-project in the back of a tin shed, at the bottom of the hill of a winery in 2009. The 100% family-owned distillery drew inspiration from the surroundings of the Mornington Peninsula and its wineries, "where the sea meets the wine-growing hinterland", value-adding to the region by using locally produced wine to create fine brandy, gins and liqueurs.

Bass & Flinders Distillery released its first gin in 2014, when the gin craze first took off. At the time, it had three gins on the market that they could serve at new consumer-focused gin events and festivals. The distillery fast outgrew its humble beginnings in the tin shed, expanding its operations to Dromana to better service the growing tourist trade, who were excited to see something other than a winery on the Peninsula.

Holly Klintworth, the distillery's Head Distiller and President of the Australian Distillers Association, learned the craft of making brandy and gin from her father Wayne.

"Dad was onto something special and exciting. In many ways, he was ahead of the curve for the Mornington Peninsula," she reflects.

"We went from being the only distillery on the Peninsula to now being one of eight.

"We were one of the first to offer Gin Masterclasses and now we have more space to run them. We offer a world-class visitor experience with outdoor space to accommodate food, live music and cocktails, attracting over 20,000 visitors per year.

"But we have had to rely on our own profits for reinvestment, which has slowed our ability to achieve scale. We could have invested in our growth a lot sooner, if the conditions were ripe for investment.

"At the moment, most distillers are playing in the premium spirits space as the conditions do not support further growth. Our customers are amazed that $30 of the retail price of our spirits goes straight to paying excise and GST.

"No matter how big or small, excise is the number one issue facing Australian distillers. The sustainability of our industry and future growth is hamstrung by this tax.

"Australian spirits continue to take out the top international awards – we've already proved to the world what we are capable of achieving.

"The quality is there, but we need the support of Government to foster the economic conditions to support our sustainable growth and scale."

Bass & Flinders Distillery (VIC, Flinders)

3.6 Agriculture

Australian spirits producers are some of the most efficient and innovative in the world. The production of spirits in Australia does not just involve grains, sugar and wheat, but involves a wide range of ingredients, ranging from Davidson Plum and lemon myrtle, to native pepperberry and finger limes.

The Australian industry utilises significant agriculture product from across the country and value-adds to it.

Our contribution to value-adding to the agricultural sector has the potential to be scaled up if modest changes are made to Australia's spirits tax settings.

Porongurup Distillery (WA, O'Connor)

3. GROW OUR INDUSTRY TO GROW THE ECONOMY

CASE STUDY

Case study: Turning $300 into $33,000 through the production of award-winning Australian whisky

Starward Distillery, awarded the 2022 best whisky distillery in the world, produces a range of single malt and blended whiskies in Port Melbourne, Victoria.

As Australia's largest whisky exporter, Starward sources 100% of its malted barley from Australian farmers.

As a raw commodity, one tonne of barley costs approximately $300 and produces 1,300 bottles of award-winning whisky which are exported around the world for around $33,000.

"We often think of value-added manufacturing as a high-tech industry not an agricultural industry," says Starward's Founder, David Vitale.

"We're really proud to do our world renowned barley justice by turning it into amazing whisky, which puts Australia firmly on the map as a great whisky-making nation."

Since 2015, Diageo has been investing in Starward through its Distilled Ventures Program which has allowed the Victorian distillery to produce up to 1.3 million litres of whisky per year.

By 2025, it is anticipated 65% of Starward's revenue will come from whisky exported overseas.

> "We're really proud to do our world renowned barley justice by turning it into amazing whisky, which puts Australia firmly on the map as a great whisky-making nation."
>
> David Vitale , Founder
>
> Starward (VIC, Macnamara)

3.7 The Handbrake

Industry experts are confident that the spirits industry is on the cusp of a boom similar to that of the wine industry in the 1980s. Recognising the promise and quality of Australian wine, governments during that period provided tax breaks and financial incentives for investment. The result was exponential export growth and domestic activity, establishing Australian wine as an important and enduring contributor to our agricultural, tourism and export industries. The Government established Wine Australia to champion the industry's expansion of exports and to advocate for them on the world stage.

Our industry enjoys a unique position where global spirits manufacturers want to invest further in Australia in a way that grows the domestic spirits industry and creates jobs. But Australia's oppressively high spirits tax – which is the highest alcohol tax in Australia and the third highest in the world – acts as a disincentive to such investment.

Similarly, successful domestic producers seeking to expand and explore the export market are stymied by taxes which thwart their ability to reinvest in their businesses to facilitate such growth.

Every six months, the tax increases - and so does the inequity. The most recent spirits tax increase of 3.7% (effective from 1 February 2023) is levied against an industry facing inflationary pressure, extensive supply chain issues and depressed consumer confidence.

While we welcomed the minor change to the excise remission scheme in July 2021, we also know it holds us back. In the first year of the change, the remission scheme was a cost to the Budget of approximately $20 million for the spirits category. Yet in August 2021, the Government increased the amount of excise received from the spirits industry by more than $100 million – five times as much as was allocated to the industry less than a month earlier.

The new cap of $350,000 also acts as an artificial cap to growth because the marginal cost of production once a producer exceeds the remission cap consumes the profits that would otherwise be made. When the excise rate is increased twice per year, this reduces the production capacity at the same inverse rate. The production frontier has already reduced by nearly 10% since the introduction of the scheme in July 2021.

Furthermore, distillers face a comparative disadvantage to winemakers and brewers, because the significantly higher tax rate for spirits means they reach the $350,000 cap producing significantly less product than other categories. The production ceiling kicks in much earlier for spirits than beer and wine.

3. GROW OUR INDUSTRY TO GROW THE ECONOMY

With no end in sight to these automatic six-monthly tax increases, the sustainable growth of the Australian spirits industry is increasingly under threat. As the tax gap between spirits and other categories continues to grow (because our tax increases from a significantly higher base) so too does our competitive disadvantage. While we're staring down the barrel of paying $100 in excise per litre of alcohol, our colleagues in beer pay just half that, hovering around the $50 mark, when the 1.15% concession is applied.. When translated to the tax paid per standard drink, the disparity between alcohol categories is clear.

There is no public policy rationale for this discrimination.

Figure 3: Comparison of tax per standard drink as at 1 February 2023

Four Pillars Distillery (VIC, Casey)

IT'S THE RIGHT TAX **POLICY**

Providing modest changes to the current taxation framework will help to lift productivity – a key priority of the Albanese Government. This Budget presents a compelling opportunity to create much needed stimulus by reconsidering its tax settings for spirits. By pausing the automatic biannual tax increase for three years and reducing the spirits tax rate to the brandy rate, it would give a powerful kickstart to the domestic industry's attempt to grow into a premium agricultural-based export industry.

Modelling undertaken by PwC demonstrates that re-setting spirits excise rates can increase Government revenue, while helping the spirits industry, as well as the tourism and hospitality industries – all without significantly increasing the volume of alcohol consumed.

These revenue gains and flow-on benefits are made possible by the spirits industry working together; sales of traditional spirits brands, which account for up to 80% of the Australian market, provide the revenue gains to Government to reinvest in our industry, while leaving a substantial balance to aid in the country's economic recovery.

Our proposed changes to spirits excise will support further innovation and investment by local and international producers in the local manufacturing of ready-to-drink spirits (RTDs), particularly low calorie and low alcohol options; as Australians' drinking habits have become more responsible, these product lines have emerged as one of the fastest growing segments of the Australian spirits market.

With such change comes further growth and job opportunities. Recently the Economic Society of Australia published an article about the Australian alcohol tax system and the modelling of harm for various types of beverages. It notes that regular and mid strength beer is under-taxed, and pre-mixed spirits in a bottle may be over-taxed. The paper concludes that the current Australian alcohol tax system is "complex, anomalous and incoherent". (Srivastava et. al, 2022).

Now, more than ever, reform of the spirits tax regime is vital. Alcohol taxation in Australia remains complex and increasingly discriminatory toward the spirits sector, and there have been numerous calls over the years to simplify the taxation system and make it more equitable across categories.

Our recommendation in this submission proposes the first small, but important, step towards tax reform at a time when it is most needed by the Australian spirits sector and the wider hospitality and tourism industries it supports.

4.1 Changing drinking trends

Drinking trends across Australia are changing dramatically, and for the better.

The most comprehensive independent data on Australian drinking trends, the National Drug Strategy Household Survey conducted by the Australian Institute of Health and Welfare, found that over the last 10–15 years there have been significant declines in people drinking at risky levels. Most Australians are drinking less frequently on a daily and weekly basis, and more are deciding not to drink at all.

Australians are choosing to consume more premium drinks, less frequently, than drinking in greater quantities, and their choices increasingly blur the traditional categories of 'beer', 'wine' and 'spirits'.

Spirits consumers play the biggest role of any alcohol drinkers in supporting more premium, higher value revenue growth. This is consistent across consumption in venues and at home consumption, across socio-economic and age demographics, and in regional and metropolitan locations.

With Australians drinking less, but consuming more premium products, there is a strong economic policy rationale for the Government not to discourage spirits drinkers from consuming products that sustain this 'premiumisation' of Government revenue.

There has been some media speculation that in response to the COVID pandemic and long periods of lockdown, Australia's consumption of alcohol has increased. The Australian Institute of Health and Welfare (AIHW) reported in December 2021 that "to date, no clear patterns of the effects of COVID-19 restrictions on alcohol and other drug consumption have emerged, with many people reporting unchanged levels of consumption. Longitudinal data now available suggest that participants in these surveys may have initially increased or decreased consumption, but then reversed that pattern of consumption at the next data collection point."

The AIHW noted a spike in alcohol sales in March 2020, driven by speculation that liquor stores would shut as part of the restrictions for the first lockdown. This spike dropped in April 2020 and by the second half of 2021, sales data had returned to pre-COVID trends. The forecast is a return to longer term consumption trends, which for total alcohol consumption have remained relatively unchanged or slightly reduced over the last ten years.

There is no evidence to suggest that spirits consumption comes at a greater social cost than the consumption of beer, wine or other alcohol beverages. The breathalyser does not discriminate on the type of alcohol consumed, but instead focuses on the volume consumed; the same principle should apply to the alcohol tax system.

Sources:
DrinkWise 2018, Australian Drinking Habits: 2007 vs 2017, <https://drinkwise.org.au/ourwork/australiandrinking-habits-2007-vs-2017/#>.
Australian Institute of Health and Welfare 2017, National Drug Strategy Household Survey 2016: detailed findings. Drug Statistics series no. 31/Cat. no.PHE 214, Australian Government, <https://www.aihw.gov.au/reports/illicit-use-of-drugs/ndshs-2016-keyfindings/contents/summary>.
Australian Bureau of Statistics 2018, 4364.0.55.001- National Health Survey: First Results, 2017-18 <https://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20 Subject/4364.0.55.001~201718~Media%20Release~How%20healthy%20is%20the%20typical%20Australian%3F%20(Media%20Release)~1>.
Australian Institute of Health and Welfare, 2019, <https://www.aihw.gov.au/reports/alcohol/alcohol-tobacco-other-drugs-australia/contents/impact-of-covid-19-on-alcoholand-other-drug-use>.¬

60%
OF DRINKERS HAVE NO MORE THAN 2 STANDARD DRINKS IN ONE SESSION
(up from 48% in 2007)

AUSTRALIA'S PER CAPITA ALCOHOL CONSUMPTION IS ITS LOWEST IN
50 YEARS

20%
OF AUSTRALIANS ABSTAIN FROM DRINKING
With the sharpest declines among people aged 18-24

Sunshine & Sons (QLD, Fairfax)

4.2 Multiple inquiries have recommended reform

Multiple inquiries, including the 2009 Australia's Future Tax System Review (the Henry Tax Review), have been critical of inconsistencies in Australia's alcohol tax system. All have pressed for alcohol tax reform.

The Treasury identified in 2015 that the system had come to reflect multiple priorities—raising revenue, reducing social costs of excessive alcohol consumption, and providing support to certain producers.

Several other anomalies compound the complexity. Spirits are taxed at one level if they are fermented from grapes (specifically brandy), and at a higher rate if fermented from grain (such as whisky). Cheap wine is taxed lightly, while premium wine is taxed heavily. Additionally, beer is taxed at one rate at the local pub and another when purchased to consume at home.

Tax on beer and spirits is covered by 19 separate excise categories and 10 different excise rates, from nil to $97.90 per litre of pure alcohol (/LAL). The Wine Equalisation Tax (WET), which covers wine, mead, sake and some forms of perry and cider, is levied at 29% of the product's wholesale value.

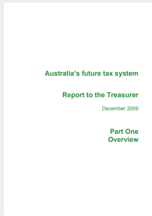
To address the inconsistencies, the Henry Tax Review had recommended that alcohol taxation be set to a single objective—to address the spill over costs of alcohol consumption to society.

Over a decade later, the same contradictions remain, and the discrimination of spirits taxation is continually widened by twice-yearly CPI increases on excise.

A series of excerpts from these reports are included on the next page, which characterise the issues inherent in Australia's complicated alcohol tax regime. The first of these reports was tabled 14 years ago.

The industry is still waiting for action.

4. IT'S THE RIGHT TAX POLICY



Henry Tax Review (2009)

Taken together, current alcohol taxes reflect contradictory policies. They encourage people to drink cheap wine over expensive wine, wine from small rather than large producers, beer in pubs rather than at home, and brandy rather than spirits, and to purchase alcohol at airport duty-free stores. As a consequence, consumers tend to be worse off to the extent that these types of decisions to purchase and consume, which may have no spill over cost implications, are partly determined by tax.

Rethink: Tax Discussion Paper (2015)

The taxation of alcohol is complex, with rates varying considerably for different types of alcoholic beverages. This reflects policy changes over time to meet multiple objectives that include raising revenue, reducing the social costs of excessive alcohol consumption, and supporting wine producers and independent beer producers.

Senate Red Tape Inquiry (2017)

The committee recommends that the Australian Government progress the reform of alcohol taxation, including the introduction of a single volumetric tax rate across all alcohol products, to be phased in to allow reasonable adjustment.

ShiftingThe Dial: 5-Year Productivity Review (2017)

The Australian Government should move towards an alcohol tax system that removes the current concessional treatment of high-alcohol, low-value products, primarily cheap cask and fortified wines. Ideally, this would be achieved through a uniform volumetric tax rate for alcoholic beverages, calibrated to reflect the health impacts of alcohol consumption.

CHANGE TO DELIVER SUSTAINABLE GROWTH

Reduce the spirits excise rate to align it with the brandy rate and freeze CPI indexation for three years.

Spirits & Cocktails Australia and the Australian Distillers Association believe that reform of Australia's complex alcohol excise and taxation structure is an important long-term goal to address the harmful consumption of alcohol. We are also confident it will optimise the investment environment for both global and local spirits producers.

SRD (SA, Barker)

5.1 Recommendation

Our recommendation (Option 1) is to reduce the spirits excise rate to align it with the brandy excise rate, and freeze the Consumer Price Indexation (CPI) increases for spirits for three years. This will enable the Government to deliver tax relief for consumers, and provides time to develop a longer-term alcohol tax reform plan that balances the many competing interests of the industry. Option 1 would deliver greater revenue gains to the Government than Option 2 or 3 alone, while also having stronger benefits for consumers.

	Policy summary	Increased revenue in financial year post-implementation (1 July '22 – 30 June '23)	Impact over forward estimates (2022 – 2026)	Pure alcohol consumption change (2022 – 2026)
1.	**Reduce the spirits excise rate to align it with the brandy excise rate and freeze spirits and brandy CPI increases for three years**	**+ $143 million**	**+ $766 million**	**- 0.22%**
2.	Reduce the spirits excise rate to align it with the brandy excise rate	+ $121 million	+ $530 million	- 0.19%
3.	Freeze spirits and brandy CPI increases for three years	+ $36 million	+ $408 million	- 0.16%

Alternatively, the Government could consider doing either component of this option (aligning the spirits excise rate with the brandy rate or freezing CPI increases for three years). PwC's analysis of all options shows that each will deliver a net increase to Federal Government revenue, with a small decrease in the total consumption of alcohol by Australian consumers.

In all three policy scenarios, PwC's modelling shows that decreasing the spirits excise increases Government revenue as it accelerates an established market trend that sees consumers shift from lower taxed beer and wine to higher taxed spirits and RTDs. Our preferred option provides the greatest gain to government revenue, both in the first year and over the forward estimates.

Importantly, all three options do not seek to increase tax on any other alcohol category and none results in any significant change to overall alcohol consumption (in all cases, overall alcohol consumption decreases by less than one per cent). As the policy options are primarily designed to benefit consumers, the model assumes that the full benefit of the excise increase is passed through to consumers, with producer and retailer margins remaining constant.

For more detailed information on the assumptions, data and elasticities used by PwC in formulating revenue gain estimates, please refer to the PwC analysis (Appendix).

www.pwc.com.au

Spirits excise option modelling

Update report

November 2021

pwc

6. APPENDIX: PWC MODELLING OF SPIRITS EXCISE OPTIONS

Disclaimer

This report is not intended to be read or used by anyone other than Spirits and Cocktails Australia.

We prepared this report solely for Spirits and Cocktails Australia's use and benefit in accordance with and for the purpose set out in our engagement letter dated 28 October 2021. In doing so, we acted exclusively for Spirits and Cocktails Australia considered no-one else's interests.

We accept no responsibility, duty or liability:

- to anyone other than Spirits and Cocktails Australia in connection with this report
- to Spirits and Cocktails Australia for the consequences of using or relying on it for a purpose other than that referred to above.

We make no representation concerning the appropriateness of this report for anyone other than Spirits and Cocktails Australia. If anyone other than Spirits and Cocktails Australia chooses to use or rely on it they do so at their own risk.

This disclaimer applies:

- to the maximum extent permitted by law and, without limitation, to liability arising in negligence or under statute; and
- even if we consent to anyone other than Spirits and Cocktails Australia a receiving or using this report.

Liability limited by a scheme approved under Professional Standards legislation

Overall results

These results examines the revenue to government from three options of changes to taxation of spirits, as follows:

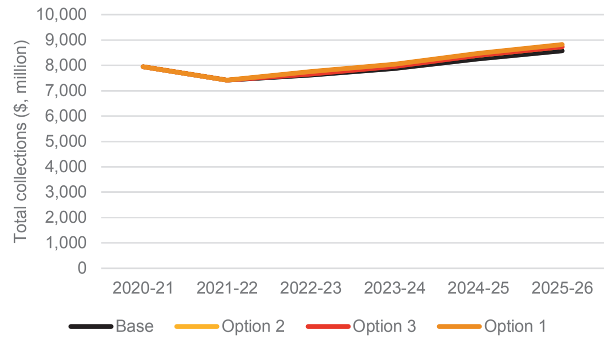
- **Option 1** - A combination of freezing Consumer Price Index (CPI) of the brandy excise and extending it to all spirits and ready-to-drink beverages (RTDs) (i.e. a combination of Options 2 and 3 below).
- **Option 2** - Applying the current brandy excise rate to all spirits and RTDs. Currently, brandy is taxed at $83.04 per litre of pure alcohol (LAL) and spirits at $88.91 per LAL. This option would, in effect, abolish the existing spirits excise category and tax all spirits and RTDs, including brandy, at the existing brandy rate.
- **Option 3** - Freezing CPI increase of brandy and spirits excise at current rates for a period of three years. Currently rates are indexed with CPI twice a year in February and August.

All changes are assumed to start at the beginning of the 2022-23 tax year. The graphs to the right show the impact of Options 1-3 on total government revenue from alcohol excises, as well as collections just from excise of spirits and RTDs (i.e. excluding wine equalisation tax (WET) and excise on beer and cider). This shows that government collections from alcohol excise changes only marginally.

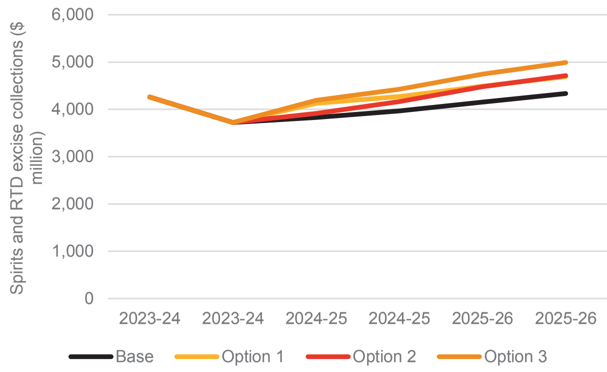
Each option is examined in detail in the following pages and key assumptions are explained in the appendices.

Throughout this report the term 'excise' is taken to mean both excise and excise equivalent customs duty as no distinction is drawn between domestically produced goods and excise equivalent goods in the analysis. Total revenue also includes changes to Goods and Services Tax (GST) collections.

Total alcohol excise revenue (2020-21 to 2025-26)



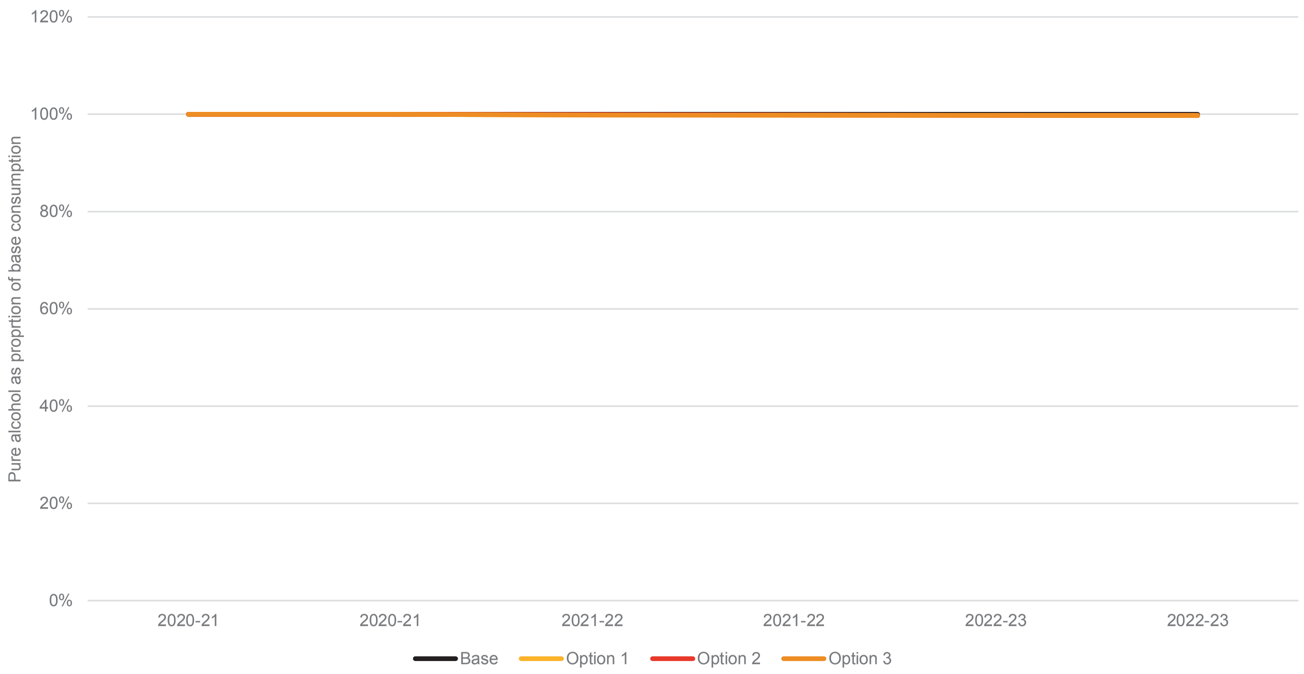
Spirits and RTD excise revenue (2020-21 to 2025-26)



Overall results

The graph below shows proportional changes in total alcohol consumption associated with the three options. This show minor decreases in the volume of pure alcohol.

Total pure alcohol consumption, as a proportion of the base forecast (2020-21 to 2025-26)



Option 1 detailed revenue results

The table below shows detailed revenue impacts from the combined option. Because indexation is frozen at the brandy rate, rather than the existing spirits rate in Option 2, the revenue impact of this option is less than the sum of the parts (Options 2 and 3).

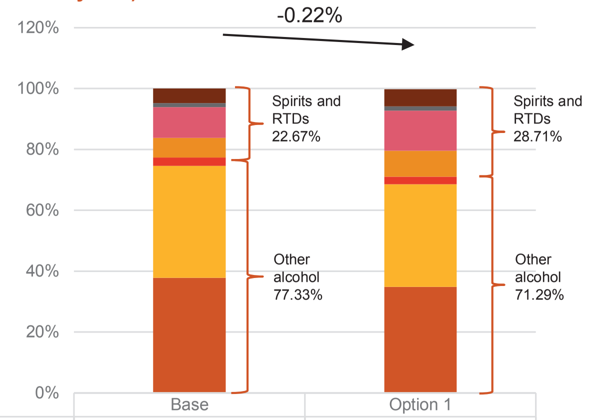
Total government revenue related to alcohol (2020-21 to 2025-26, $ millions)

	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	Four year total
Option 1							
Spirits and RTDs excise	4,261	3,721	4,191	4,427	4,744	4,992	18,353
Other alcohol excise and WET	3,689	3,699	3,572	3,622	3,728	3,830	14,752
All excise and WET sub-total	*7,950*	*7,420*	*7,763*	*8,049*	*8,471*	*8,822*	*33,105*
GST on spirits and RTDs	907	921	1,049	1,097	1,148	1,178	4,472
GST on other alcohol	2,549	2,560	2,428	2,400	2,400	2,433	9,660
All GST sub-total	*3,457*	*3,481*	*3,477*	*3,497*	*3,547*	*3,611*	*14,132*
Total revenue	**11,407**	**10,901**	**11,239**	**11,546**	**12,019**	**12,433**	**47,237**
Base							
Spirits and RTDs excise	4,261	3,721	3,829	3,967	4,153	4,334	16,283
Other alcohol excise and WET	3,689	3,699	3,791	3,913	4,107	4,245	16,056
All excise and WET sub-total	*7,950*	*7,420*	*7,620*	*7,880*	*8,260*	*8,579*	*32,339*
GST on spirits and RTDs	907	921	941	959	976	993	3,868
GST on other alcohol	2549	2560	2576	2591	2642	2695	10,505
All GST sub-total	*3,457*	*3,481*	*3,516*	*3,550*	*3,618*	*3,688*	*14,373*
Total revenue	**11,407**	**10,901**	**11,136**	**11,430**	**11,878**	**12,268**	**46,712**
Difference							
Spirits and RTDs excise	0	0	362	460	590	658	2,070
Other alcohol excise and WET	0	0	-219	-291	-379	-415	-1,304
All excise and WET sub-total	*0*	*0*	*143*	*169*	*211*	*243*	*766*
GST on spirits and RTDs	0	0	108	138	172	185	604
GST on other alcohol	0	0	-148	-192	-243	-262	-845
All GST sub-total	*0*	*0*	*-40*	*-54*	*-70*	*-77*	*-241*
Total revenue	**0**	**0**	**103**	**115**	**141**	**166**	**525**
% change (excise)	0.00%	0.00%	1.87%	2.15%	2.56%	2.83%	2.37%
% change (all revenue)	0.00%	0.00%	0.93%	1.01%	1.19%	1.35%	1.12%

Option 1 detailed consumption results

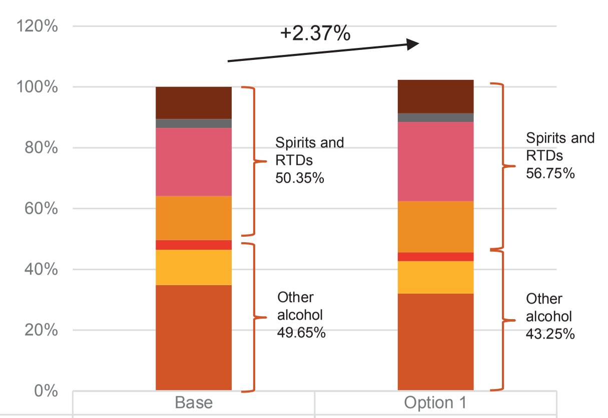
Under Option 1, pure alcohol consumption decreases by 0.22 per cent. Alcohol volumes within the spirits and RTD categories increase, but this is offset by decreases in other categories. As a result of these changes, the proportion of excise revenue generated by spirits and RTD categories increases from 50.35 per cent to 56.75 per cent (as a percentage of excise revenue in the base case).

Pure alcohol consumption by category, proportion of base total (sum of four years)



	Base	Option 1
Dark RTD	4.77%	5.59%
Light RTD	1.29%	1.41%
Dark spirits	10.11%	13.21%
Light spirits	6.50%	8.50%
Cider	2.69%	2.48%
Wine	36.78%	33.77%
Beer	37.86%	34.81%

Excise revenue by category, proportion of base total (sum of four years)



	Base	Option 1
Dark RTD	10.58%	11.04%
Light RTD	2.86%	2.79%
Dark spirits	22.43%	26.10%
Light spirits	14.47%	16.81%
Cider	3.18%	2.92%
Wine	11.61%	10.66%
Beer	34.86%	32.03%

Option 2 detailed revenue results

The table below shows detailed revenue impacts from applying the brandy excise rate to all spirits and RTDs from 1 July 2022.

Total government revenue related to alcohol (2020-21 to 2025-26, $ millions)

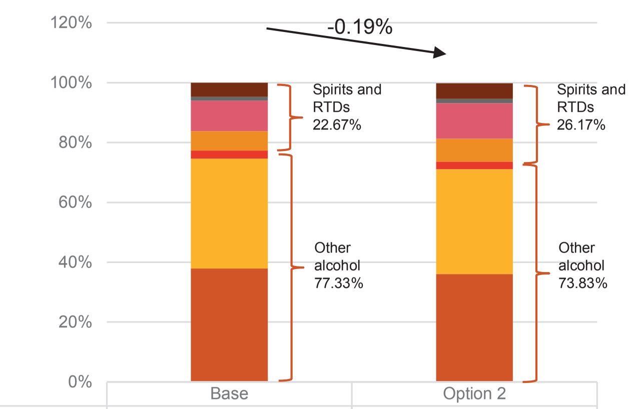
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	Four year total
Option 2							
Spirits and RTDs excise	4,261	3,721	4,125	4,273	4,487	4,694	17,579
Other alcohol excise and WET	3,689	3,699	3,615	3,729	3,909	4,037	15,290
All excise and WET sub-total	7,950	7,420	7,741	8,002	8,396	8,731	32,869
GST on spirits and RTDs	907	921	1,028	1,048	1,068	1,089	4,233
GST on other alcohol	2,549	2,560	2,457	2,470	2,516	2,564	10,006
All GST sub-total	3,457	3,481	3,485	3,518	3,584	3,653	14,239
Total revenue	**11,407**	**10,901**	**11,226**	**11,520**	**11,980**	**12,383**	**47,108**
Base							
Spirits and RTDs excise	4,261	3,721	3,829	3,967	4,153	4,334	16,283
Other alcohol excise and WET	3,689	3,699	3,791	3,913	4,107	4,245	16,056
All excise and WET sub-total	*7,950*	*7,420*	*7,620*	*7,880*	*8,260*	*8,579*	*32,339*
GST on spirits and RTDs	907	921	941	959	976	993	3,868
GST on other alcohol	2549	2560	2576	2591	2642	2695	10,505
All GST sub-total	*3,457*	*3,481*	*3,516*	*3,550*	*3,618*	*3,688*	*14,373*
Total revenue	**11,407**	**10,901**	**11,136**	**11,430**	**11,878**	**12,268**	**46,712**
Difference							
Spirits and RTDs excise	0	0	296	306	333	360	1,296
Other alcohol excise and WET	0	0	-176	-184	-198	-208	-766
All excise and WET sub-total	0	0	121	122	136	151	530
GST on spirits and RTDs	0	0	88	89	92	96	365
GST on other alcohol	0	0	-119	-121	-126	-132	-498
All GST sub-total	0	0	-31	-33	-34	-36	-134
Total revenue	**0**	**0**	**89**	**89**	**102**	**116**	**396**
% change (excise)	0.00%	0.00%	1.58%	1.55%	1.65%	1.77%	1.64%
% change (all revenue)	0.00%	0.00%	0.80%	0.78%	0.86%	0.94%	0.85%

PwC November 2021 7

Option 2 detailed consumption results

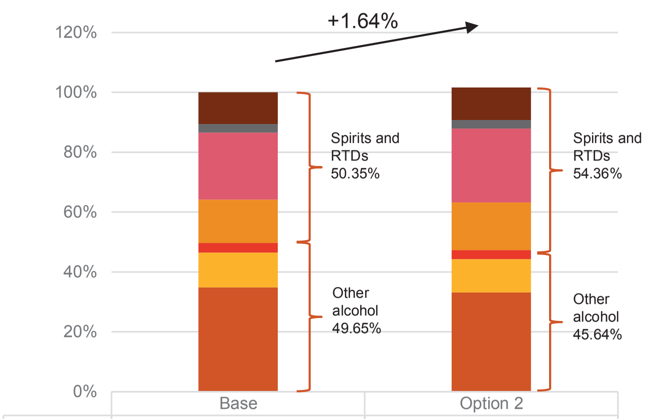
Under Option 2, pure alcohol consumption decreases by 0.19 per cent. Alcohol volumes within the spirits and RTD categories increase, but this is offset by decreases in other categories. As a result of these changes, the proportion of excise revenue generated by spirits and RTD categories increases from 50.35 per cent to 54.36 per cent (as a percentage of excise revenue in the base case).

Pure alcohol consumption by category, proportion of base total (sum of four years)



	Base	Option 2
Dark RTD	4.77%	5.26%
Light RTD	1.29%	1.37%
Dark spirits	10.11%	11.89%
Light spirits	6.50%	7.65%
Cider	2.69%	2.57%
Wine	36.78%	35.01%
Beer	37.86%	36.06%

Excise revenue by category, proportion of base total (sum of four years)



	Base	Option 2
Dark RTD	10.58%	10.91%
Light RTD	2.86%	2.83%
Dark spirits	22.43%	24.70%
Light spirits	14.47%	15.92%
Cider	3.18%	3.03%
Wine	11.61%	11.06%
Beer	34.86%	33.20%

PwC November 2021 8

Option 3 detailed revenue results

The table below shows detailed revenue impacts from freezing CPI on brandy, other spirits and RTDs from 1 July 2022 for three years.

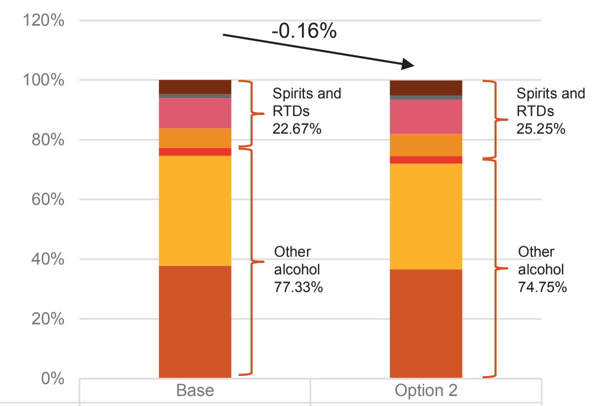
Total government revenue related to alcohol (2020-21 to 2025-26, $ millions)

	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	Four year total
Option 3							
Spirits and RTDs excise	4,261	3,721	3,911	4,162	4,480	4,713	17,266
Other alcohol excise and WET	3,689	3,699	3,745	3,799	3,913	4,024	15,480
All excise and WET sub-total	*7,950*	*7,420*	*7,656*	*7,961*	*8,393*	*8,737*	*32,747*
GST on spirits and RTDs	907	921	964	1,014	1,066	1,094	4,138
GST on other alcohol	2,549	2,560	2,545	2,516	2,518	2,555	10,134
All GST sub-total	*3,457*	*3,481*	*3,508*	*3,530*	*3,584*	*3,650*	*14,272*
Total revenue	**11,407**	**10,901**	**11,164**	**11,491**	**11,977**	**12,387**	**47,019**
Base							
Spirits and RTDs excise	4,261	3,721	3,829	3,967	4,153	4,334	16,283
Other alcohol excise and WET	3,689	3,699	3,791	3,913	4,107	4,245	16,056
All excise and WET sub-total	*7,950*	*7,420*	*7,620*	*7,880*	*8,260*	*8,579*	*32,339*
GST on spirits and RTDs	907	921	941	959	976	993	3,868
GST on other alcohol	2549	2560	2576	2591	2642	2695	10,505
All GST sub-total	*3,457*	*3,481*	*3,516*	*3,550*	*3,618*	*3,688*	*14,373*
Total revenue	**11,407**	**10,901**	**11,136**	**11,430**	**11,878**	**12,268**	**46,712**
Difference							
Spirits and RTDs excise	0	0	82	196	327	379	983
Other alcohol excise and WET	0	0	-46	-114	-194	-221	-576
All excise and WET sub-total	*0*	*0*	*36*	*81*	*133*	*158*	*408*
GST on spirits and RTDs	0	0	23	55	90	101	270
GST on other alcohol	0	0	-31	-75	-124	-140	-370
All GST sub-total	*0*	*0*	*-8*	*-20*	*-34*	*-39*	*-100*
Total revenue	**0**	**0**	**28**	**61**	**99**	**119**	**307**
% change (excise)	0.00%	0.00%	0.47%	1.03%	1.61%	1.84%	1.26%
% change (all revenue)	0.00%	0.00%	0.25%	0.53%	0.83%	0.97%	0.66%

Option 3 detailed consumption results

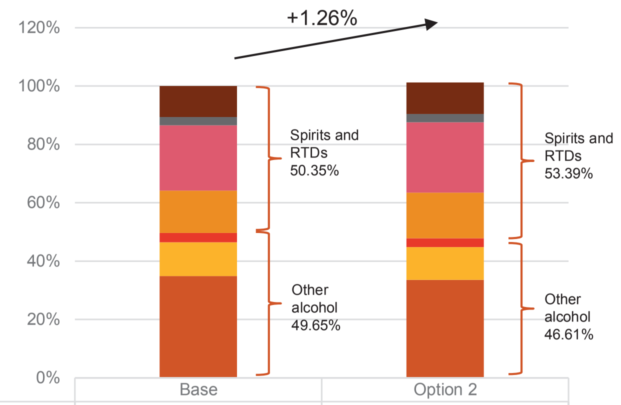
Under Option 3, pure alcohol consumption decreases by 0.16 per cent. Alcohol volumes within the spirits and RTD categories increase, but this is offset by decreases in other categories. As a result of these changes, the proportion of excise revenue generated by spirits and RTD categories increases from 50.35 per cent to 53.39 per cent (as a percentage of excise revenue in the base case).

Pure alcohol consumption by category, proportion of base total (sum of four years)



	Base	Option 2
Dark RTD	4.77%	5.12%
Light RTD	1.29%	1.34%
Dark spirits	10.11%	11.44%
Light spirits	6.50%	7.35%
Cider	2.69%	2.60%
Wine	36.78%	35.46%
Beer	37.86%	36.53%

Excise revenue by category, proportion of base total (sum of four years)



	Base	Option 2
Dark RTD	10.58%	10.82%
Light RTD	2.86%	2.84%
Dark spirits	22.43%	24.16%
Light spirits	14.47%	15.57%
Cider	3.18%	3.06%
Wine	11.61%	11.19%
Beer	34.86%	33.61%

A

General approach

General approach

Key assumptions and sources are set out below.

- Baseline and forecast total volume consumption and retail value are taken from industry IWSR data provided by Spirits and Cocktails Australia. These forecasts were taken as given and not tested.
- Government revenue current and forecast were based on this consumption data provided, but has been adjusted to ensure that excise (and the level of pure alcohol implied by that excise) aligns with the latest federal budget forward estimates.
- However, the specifics of the headline budget figures have been disaggregated to divorce brandy from other spirits and cider from RTD and WET. It has been assumed that 18.9 per cent of cider is included in other alcohol excise with RTDs (proportion of market that is flavoured cider from IBIS World *Cider Production in Australia*).
- Implied volume of pure alcohol is also sense checked against ABS *Apparent Consumption of Alcohol*, and typical alcohol by volume (ABV) percentages of various products on a desktop exercise.
- GST cannot be adjusted to specific budget forecasts, so is based on retail values in IWSR.
- The categorisation of baseline data is important to the results, especially in terms of assigning elasticities (as more categories can mean more responsiveness across categories, rather than own price adjustments within a category). Our modelling is built on the categories shown to the right, discussed and agreed with Spirits and Cocktails Australia.
- Price points for the full bottled spirits (FBS) have been aligned to IWSR data, where our budget category means IWSR low-price, value and standard (i.e. under $47.49), our mid means ISWR premium ($47.50 to $65) and our high means all other categories. It should be noted that the vast majority of IWSR data is in their Value and Standard categories for FBS, which is why they are in different categories for our modelling.

Description	Product	Sub-product	Price point
Low strength beer	Beer	Low	All
Mid strength beer	Beer	Mid	All
Full strength beer	Beer	Full	All
Red wine	Wine	Red	All
White wine	Wine	White	All
Other wine	Wine	Other	All
Cider	Cider	All	All
Brandy	FBS	All	All
Budget light spirits	FBS	Light	Budget
Mid light spirits	FBS	Light	Mid
High light spirits	FBS	Light	High
Budget dark spirits	FBS	Dark	Budget
Mid dark spirits	FBS	Dark	Mid
High dark spirits	FBS	Dark	High
Light RTD	RTD	Light	All
Dark RTD	RTD	Dark	All

- Our model is built on half years (as indexing happens twice a year). We have assumed seasonality based on IRI data provided by Spirits and Cocktails Australia which shows that approximately 46 per cent of consumption occurs in the January to June half year.

B Elasticities

Elasticities

Elasticities are the assumption our modelling is the most sensitive to.

Our key source, discussed and agreed with Spirits and Cocktails Australia, has been Srivastava, P. et al (2014) *Econometric Modelling of Price Response by Alcohol Types to Inform Alcohol Tax Policies*, Monash University.

This has been reviewed against international examples and meta analysis and found to be the most appropriate for the Australian context. We note that the own price elasticities are higher than other analysis (i.e. Fogarty, J. (2004) *The Own-Price Elasticity of Alcohol: A Meta-Analysis,* University of Western Australia and Fogerty (2010) *The demand for Beer, Wine and Spirits),* but this can be due to the level of product detail in the Monash paper (compared to a single own price elasticity for spirits).

We have taken the Morishma elasticities of substitution from the Monash paper for cross product, and taken own price elasticity as given, with disaggregation across price points as below.

For disaggregating the Monash elasticities across price points, we have used one standard deviation of Australian estimates as shown in Fogerty (2010) *The demand for Beer, Wine and Spirits.* We have assumed lower own price elasticity for lower price points, to avoid a crowding to the bottom of the price points as price reduce, but have also allowed for a 0.3 price reaction to move up a price point (although as all are within the same taxation rate, this will not impact excise revenues).

For pass through of option price changes for the market to respond to with these elasticities, we have assumed that all costs except excise and profit are fixed, and profit margin stays consistent as a percentage on top of fixed costs and revised excise. In essence, the full excise cut is passed through to prices for consumers, with mark up proportions staying consistent.

Description	Own price	Substitution of products	Within category
Low strength beer	-0.974	1.529	
Mid strength beer	-3.374	1.666	
Full strength beer	-1.215	1.483	
Red wine		1.490	
White wine		1.546	
Other wine		1.621	
Cider		1.494	
Brandy	-1.519	1.728	
Budget light spirits	-1.51	1.577	0.3
Mid light spirits	-1.26	1.577	0.3
High light spirits	-1.01	1.577	0.3
Budget dark spirits	-1.769	1.728	0.3
Mid dark spirits	-1.519	1.728	0.3
High dark spirits	-1.269	1.728	0.3
Light RTD	-1.164	1.534	
Dark RTD	-1.831	1.277	

Note – simplified structure for options where all spirits and RTD have a price movement.

C

Sensitivities

Sensitivities

Alcohol excise modelling is most dependent on the choice of elasticities.

To test these sensitivities, we have modelled six sensitivity scenarios for each option, as follows:

- **A** – assume zero own price elasticity (i.e. current consumers of a product will have no volume reaction to a price change) and zero cross price elasticity (i.e. consumers will not move their expenditure between products, regardless of price movements)
- **B** – assume low own price elasticity (i.e. current consumers of a product will have a low volume reaction to a price change – we have used average elasticities for all spirits, rather than detailed product own price) and zero cross price elasticity (i.e. consumers will not move their expenditure between products, regardless of price movements)
- **C** – assume detailed own price elasticity (i.e. current consumers of a product have nuanced reactions to a price change dependent of the particular product that has a price change) and zero cross price elasticity (i.e. consumers will not move their expenditure between products, regardless of price movements)
- **D** – assume zero own price elasticity (i.e. current consumers of a product will have no volume reaction to a price change) and detailed cross price elasticity (i.e. consumers will move their expenditure between products in reaction to price change)
- **E** – assume low own price elasticity (i.e. current consumers of a product will have a low volume reaction to a price change – we have used average elasticities for all spirits, rather than detailed product own price) and detailed cross price elasticity (i.e. consumers will move their expenditure between products in reaction to price change)
- **F** – assume detailed own price elasticity (i.e. current consumers of a product have nuanced reactions to a price change dependentof the particular product that has a price change) and detailed cross price elasticity (i.e. consumers will move their expenditure between products in reaction to price change)

Our recommended set of assumptions is F, for the following reasons:

- Although A is the most conservative, is shows no consumer response which is unrealistic, given several decades of Australian literature that at a minimum shows an own price reaction for all categories of alcohol. Similarly, D is not recommend as it does not leverage the strong evidence base of own price reactions.
- B and E are also not recommended because although they do show an own price response, they have a single spirits own price reaction (which is most prevalent in the literature) which understates individual category movements that are relevant for the options presented (i.e. options modelled above separate movements for brandy, bottled spirits and RTDs, for example option 1 has no movement for brandy). This is because estimates of own price elasticity that only have a single spirits category are lower as they treat cross substitutions between products as own price, instead of the substitution reaction they actually are.

Sensitivity tests for each of the three options are presented on the follow pages. These show that without any cross product substitution, the net excise is always net negative, as without consumers moving into the now more attractively priced product, a discount applies only to current consumers, even if they increase consumption of that product. Change in pure alcohol consumption is generally higher with no cross price as there is no substitution out of non-spirits products which are both lower excise per litre alcohol and generally (though dependent on other factors) also higher all inclusive retail price higher per litre of pure alcohol. With lower own price elasticity, revenue responses are generally negative as there is not the increase in consumption to offset the discount effect.

PwC

November 2021
16

Sensitivities

Sensitivity tests for option 1 – sums across four budget years

			No own price elasticity		Low own price elasticity (general spirits from Fogerty 2010)		Detailed own price elasticity (detailed categories from Monash)
No cross price elasticity	Spirits and RTD excise change ($ million)	A	-1,799	B	-1,159	C	-421
	Other alcohol excise and WET change ($ million)		0		0		0
	Total taxation revenue – excise and GST ($ million)		**-2,021**		**-1,238**		**-338**
	Pure alcohol % change		0.00%		1.00%		2.15%
Monash substitution elasticities	Spirits and RTD excise change ($ million)	D	703	E	1,469	F	2,070
	Other alcohol excise and WET change ($ million)		-1,304		-1,304		-1,304
	Total taxation revenue – excise and GST ($ million)		**-1,122**		**-188**		**525**
	Pure alcohol % change		-2.36%		-1.16%		-0.22%

Sensitivity tests for option 2 – sums across four budget years

			No own price elasticity		Low own price elasticity (general spirits from Fogerty 2010)		Detailed own price elasticity (detailed categories from Monash)
No cross price elasticity	Spirits and RTD excise change ($ million)	A	-1,060	B	-664	C	-207
	Other alcohol excise and WET change ($ million)		0		0		0
	Total taxation revenue – excise and GST ($ million)		**-1,191**		**-708**		**-153**
	Pure alcohol % change		0.00%		0.59%		1.27%
Monash substitution elasticities	Spirits and RTD excise change ($ million)	D	498	E	940	F	1,296
	Other alcohol excise and WET change ($ million)		-766		-766		-766
	Total taxation revenue – excise and GST ($ million)		**-563**		**-26**		**396**
	Pure alcohol % change		-1.38%		-0.72%		-0.19%

PwC

November 2021
17

6. APPENDIX: PWC MODELLING OF SPIRITS EXCISE OPTIONS

Sensitivities

Sensitivity tests for option 3 – sums across four budget years

			No own price elasticity		Low own price elasticity (general spirits from Fogerty 2010)		Detailed own price elasticity (detailed categories from Monash)
No cross price elasticity	Spirits and RTD excise change ($ million)	A	-790	B	-490	C	-145
	Other alcohol excise and WET change ($ million)		0		0		0
	Total taxation revenue – excise and GST ($ million)		**-888**		**-523**		**-105**
	Pure alcohol % change		0.00%		0.44%		0.94%
Monash substitution elasticities	Spirits and RTD excise change ($ million)	D	389	E	719	F	983
	Other alcohol excise and WET change ($ million)		-576		-576		-576
	Total taxation revenue – excise and GST ($ million)		**-407**		**-6**		**307**
	Pure alcohol % change		-1.03%		-0.55%		-0.16%

PwC

November 2021
18

www.pwc.com.au

© 2021 PricewaterhouseCoopers. All rights reserved. PwC refers to the Australia member firm, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details. Liability limited by a scheme approved under Professional Standards Legislation.

North of Edan (NSW, Eden-Monaro)

Let's work together to unleash our potential

We welcome the opportunity to discuss our proposal to create the conditions for sustainable growth of the Australian spirits industry.

We would be pleased to meet with you at your convenience.

Greg Holland, Chief Executive
Spirits & Cocktails Australia
0414 888 855
gholland@spiritsandcocktails.au

Paul McLeay, Chief Executive Officer
Australian Distillers Association
0418 610 489
paul@australiandistillers.org.au