

## **Diageo Australia**

# **A Submission to Australia's Future Tax System Review Panel**

**1 May 2009**

## **Executive Summary**

Diageo is the world's leading premium beverage alcohol producer with high quality and historical brands spanning the spirits, beer and wine categories, including Guinness® beer, Johnnie Walker® Scotch whisky, Smirnoff® and Bundaberg rum®.

Diageo welcomes the opportunity to submit its views to the Review Panel and believes that the Review offers a landmark opportunity to reconstruct the current unwieldy, inefficient and unfair alcohol tax regime into one which will better generate the revenue, social and health outcomes demanded by the Australian Government and the Australian community. In turn, a more equitable regime will create a fairer competitive environment which supports continued investment in the production, distribution and sale of alcohol products, and improve employment security for an important sector of the national economy and create a sustainable operating environment for all sectors of the industry.

In addition to generating revenue for the Australian Government, alcohol tax is also designed to address the externalities of alcohol consumption and to support important social and health policy outcomes. While the price impact of tax will affect on overall consumption through natural price elasticity, it is a blunt instrument to address the more specific and complex issue of harmful consumption or misuse. A more balanced mix of tax, nationally-consistent licensing systems and targeted incentives and penalties to drive personal accountability for the impacts of consumption are needed.

The increasing complexity of the alcohol beverage market, driven by ever-more sophisticated consumer preferences and the increasing internationalisation of consumer markets, has outstripped the existing tax model, which is based on incremental, piecemeal reform, driven by the pursuit of short-term solutions overlaying a system which reflects the historical power of special interest groups. The existing regime fails to recognise the economic choice which consumers will make when faced with increased tax on one type of alcohol product (such as the 70% increase on the tax on spirit-based RTDs in April 2008), that is to move to lower-taxed, lower-priced products meeting the essential consumer demand. The Australian alcohol tax system needs to recognise these realities.

A new alcohol tax system which achieves the expectations of the Australian Government, of communities, and of health and social groups would be one based on the simple concept that "alcohol is alcohol", where tax is levied on the basis of the alcohol content of a beverage, not on the process used to produce that beverage, or the form of packaging or location of sale of that product. Such a volumetric approach could be applied using a graduated or progressive system which would incentivise the production and consumption of lower strength beverages.

A graduated volumetric system is supported by the overwhelming majority of stakeholders, including a broad range of health groups and academics who are not supporters of the alcohol industry. The few stakeholders who oppose the volumetric approach do so seemingly from a desire to maintain the iniquitous status quo.

Diageo Australia hopes that the Australian Government will have the appetite to take the opportunity of this review to comprehensively rebuild the alcohol tax system to the benefit of national revenue; to address the aspirations of the community and those concerned with health and social outcomes; and to provide a fair market environment which will benefit the national economy, industry as a whole and consumers.

## **Introduction**

Diageo welcomes the opportunity to provide a submission to Australia's Future Tax System Review panel. We very much welcome the Review and opportunity it represents to:

- Simplify the current unwieldy, inefficient and unfair alcohol tax system in Australia
- Establish a more equitable alcohol tax regime which addresses appropriately the revenue, social and health needs of the Government and the Australian community
- Create a fairer competitive environment which will support investment in production, distribution, sale and consumption of alcohol beverages through a sustainable operating environment.

## **Diageo**

Diageo is the world's leading premium beverage alcohol business, with a wide collection of brands spanning the spirits, beer and wine categories. These brands include Guinness® beer, Smirnoff®, Johnnie Walker® Scotch whisky, and Bundaberg rum. In Australia, Diageo is the leading spirits and ready-to-drink (RTD) producer.

Both globally and locally, Diageo has pride in its commitment to nurturing heritage brands such as Johnnie Walker® Scotch whisky and Bundaberg rum®. This year, Diageo celebrates the 250th anniversary of Guinness. The performance of the Bundaberg brand has grown to more than three times its size since it was acquired in 2000, and this has been supported through \$25 million investment in the Queensland distillery including a \$2.5 million refurbishment of the distillery's visitor's centre. In addition, Diageo focuses on driving organic growth by building brands (rather than products) through innovation and marketing in line with consumer and market demand.

Diageo Australia and the Bundaberg Distilling Company are members of the Distilled Spirits Industry Council of Australia (DSICA) and support the submission made by that organisation to the Review Panel.

## **Our commitment to the community**

Diageo recognises the Australian Government's focus on combating alcohol-related harm and we fully support its significant investment in alcohol misuse prevention and treatment services, and the programmes aimed at raising awareness of the need to consume alcohol in moderation amongst adult Australians. Diageo knows that neither we, individual Australians nor society as a whole, benefit when our products are misused, and so like Government we are committed to promoting responsible drinking and reducing the misuse of alcohol.

Diageo is positioned at the forefront of industry efforts to promote responsible drinking and wishes to be valued partner in changing Australia's drinking culture for the better. We take our corporate responsibility very seriously, both in relation to alcohol issues and more broadly as a major international company that sets the highest ethical and compliance standards.

In promoting responsible drinking and addressing alcohol misuse, we focus our resources and skills to:

- Set world class standards for responsible marketing and innovation
- Combat alcohol misuse, working with others on initiatives to reduce alcohol-related harm
- Seek to promote a shared understanding of what it means to drink responsibly. This is underpinned by our use of marketing understanding and skills, which we apply to create changes in attitudes to alcohol

## **Responsible marketing and innovation**

Producers have a responsibility to ensure that products are produced and marketed in such a way that is consistent with healthy, responsible drinking.

As a producer, we understand that we have a responsibility to ensure that the products we produce do not promote or encourage alcohol misuse. In addressing issues of alcohol misuse, Diageo believes that one area of producer responsibility is to focus on how the product is produced and marketed rather than on the source of alcohol or method of production.

We live up to this commitment through the standards set in our Diageo Marketing Code (DMC). The Diageo Marketing Code is widely recognised as global industry best practice, and is applied in addition to any existing localised regulations and industry codes. It is fully embedded within our business processes and covers all marketing activities including new product development and innovation, packaging, labelling, sponsorship, advertising (TV, print, digital & outdoor), retail promotions, and PR. We have also introduced voluntary measures to promote responsible service and consumption. These include the prominent standard drinks symbol, which we developed in 2003 and which appears on all product packaging, and our two standard drinks policy which requires that any single serve Diageo product contains two standard drinks or less.

As an example of our commitment to responsible marketing, Diageo is currently taking part in an initiative to better understand the impact of television advertising on alcohol consumption and misuse. A group of spirits producers, all members of DSICA, are participating in a trial of restricting product advertising on television to at least 9pm.

## **The role of alcohol tax**

Taxation of beverage alcohol products is accepted as being a valid way to generate revenue for national budgets. It is also conceived to address the externalities of alcohol consumption, that is the external costs which the use of the product imposes on others. Tax can also be used to support the social and health policies of governments.

However, taken alone, tax can be a very blunt instrument in driving the type of health outcomes often claimed for it, for example as the expressed basis for the large increase in the tax on spirit-based RTD products in April 2008.

The varying of tax levels will impact on overall consumption levels through natural price elasticity mechanisms, although even the least sophisticated consumer will make beneficial economic decisions in the face of tax increases on only specific products by transferring their consumption to products which have lower tax and are therefore lower priced. Tax is ineffective in making targeted impacts on risky or inappropriate consumption; rather it applies across all consumers and thus penalises the overwhelming majority of consumers who enjoy alcohol beverages responsibly. It is for this reason that Diageo does not support the idea of a minimum floor price for alcohol.

In order to achieve the social and health impacts which governments and the community seek, it is necessary to take a more comprehensive approach, deploying a range of measures which are likely to impact on risky or excessive consumption. These would include the effective implementation of licensing systems which regulate the sale of alcohol in on-trade and off-trade premises. In this regard, Diageo recognises and welcomes the consideration now being given by the governments of Australia, through the Ministerial Council for Drug Stagey process, to promote a nationally-consistent responsible service of alcohol regime. The lack of such a regime has reduced the effectiveness of licensing systems in addressing risky and inappropriate consumption. For its part, Diageo is pro-active in working with state-level licensing authorities

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and other key stakeholders such as the Australian Hotels Association to work collaboratively to deliver better responsible service of alcohol (RSA) outcomes.

At the same time, more responsible consumption will only be achieved when the behaviours of individual consumers are incentivised, and penalised when in breach of regulations. Some of the strategies applied to produce the laudable progress made over recent years to reduce the incidence and acceptability of drink-driving should, we believe, be applied to the issue of broader intoxication in the community.

### **The current alcohol tax system is broken**

The current alcohol tax system is illogical, inefficient and iniquitous. It consists of **four systems** - excise duty, customs duty, the Wine Equalisation Tax (WET), and GST. It has **two styles** of tax – ad valorem (for wine and grape wine products and cider) and volumetric tax (beer and spirits). There are at least **eight different rates** across different products. In addition, the system is administered by **two different administering authorities** – the Australian Tax Office and the Australian Customs Service.

Products containing the same amount of alcohol and of the same type are taxed very differently according to the form of packaging (e.g. bottle or draught beer) and therefore the location in which the products are sold (pub or bottle shop). Rebates and tax-free thresholds are enjoyed by some products (wine and beer) but not by others (spirits).

As a result, there are massive anomalies in terms of the tax applied to different alcohol products. Based on the Standard Drink measure (10 grams or 12.67 ml of pure alcohol) the tax burden varies from 7 cents for cask wine at 13% ABV alcohol strength, through 27 cents for a 5% ABV full strength draught beer, to 87 cents for a 5% ABV spirit-based RTD.

The system is the result of the failure of Australian Governments to make hard choices and to resist incremental short-term fixes as overlays to a system which reflects the historical power of special interest groups.

As a result, the current tax system fails to deliver on almost all of its stated intentions - revenue, social and health outcomes and a fair competitive market environment which benefits consumer choice.

Against this background the Henry Review offers a significant opportunity to move the alcohol tax regime to one which reflects the reality of the modern marketplace and the nature of consumer choice and purchase decision-making.

### **The Market has changed, forever**

The current alcohol tax system is ineffective and inappropriate even for the marketplace for which it was primarily designed. One where products fitted clearly into one of three main product 'silos' – beer, wine and spirits, and where consumption patterns flowed from the restriction of product choice. This became a self-perpetuating model, where consumption patterns drove product innovation (or the lack of it) and where consumers had to be satisfied with the conventional products on offer. As Henry Ford might have said "Any colour as long as it's white, red or amber".

With the increasing globalisation of consumer markets stemming from increased travel and the penetration of the Internet, consumer awareness has developed, resulting in demand for more diverse products which serve the occasions where they wish to enjoy alcohol products as part of their social lives. At the same time, consumers themselves have over recent years developed

different priorities, spurred by increased access to information and a significant period of relatively high and consistent economic growth and personal wealth. They demand ever higher-quality products, increased convenience and a constant supply of new, innovative offerings.

This is not unique to the alcohol beverage sector; occasions and usage rather than products themselves are driving consumer demand across all consumer good categories. For example, iPods and mp3 players have developed in response to consumer demand for portable, conveniently sized, technologically-advanced music systems, and this in turn has led to innovation in the development of both the hardware and the marketing and accessibility of music, spawning growth in the category and the participation of businesses previously not involved in the music sector, e.g. mobile phone companies.

The development of RTDs within the last 10 years has offered consumers the opportunity to enjoy products which offer traditional spirit mixes (such as rum and cola and whisky and dry ginger) in measured quantities guaranteeing serve volume and quality and allowing a better understanding of their consumption levels.

RTDs have been labelled “alcopops”, a term initially coined by the tabloid media but now used (inaccurately) by many stakeholders to describe a category of products over 75% of which are traditional spirit/mixer products such as Bundaberg Rum and Cola or Johnnie Walker whisky and Dry Ginger enjoyed predominately by mature males over the age of 25.

Over the last few years there has been an explosion of products which meet consumers’ demands for different products for different occasions and to meet different taste preferences. This led to the development of bottle and can beverages which allowed the introduction of new flavours, beyond the traditional beer/wine/spirits categories. There is now a continuum of products which include flavoured beers, flavoured ciders, wine coolers, spritzers and spirit mixed drinks, all in ready-to-drink formats. The nature of the existing tax system means that the tax on these products is as varied as the range of the products themselves.

This phenomenon is not unique to Australia; rather Australia is catching up with market and consumer trends in most other advanced-economy markets including the US, Europe and Japan.

Disappointingly, we see the Australian Government’s approach as trying to modify product definitions (e.g. of beer) to match the current antiquated tax regime rather than reforming that system to fit the realities of the changed market environment.

### **What would a better system look like?**

Looking at the intention of alcohol tax, a better system would need to produce significant and predictable revenue for the Australian Government and enable the delivery of clearer social and health outcomes. It would also need to be transparent, fair and easy to administer.

A volumetric tax system, based on the concept that “alcohol is alcohol” and which applied tax on the basis of the volume of pure alcohol in a beverage, would deliver all these. In terms of addressing the externalities of alcohol consumption, a volumetric system would more clearly reflect the impact from the pure alcohol contained in the product.

We believe that a graduated (or progressive) volumetric tax would deliver incentives to producers and consumers to prefer lower strength products while recognising the higher externalities of higher strength products. It would also make the tax more neutral in terms of reducing unnecessary impact on consumer and producer preference and remove many of the marketplace anomalies created by the current system.

The fact that a volumetric tax approach is supported by just about all health groups in Australia, many of whom do not have a natural predilection for supporting industry preferences, speaks to the value of the model in being able to deliver social and health outcomes.

Working with our partners in DSICA, we have been able to develop a graduated tax model which generates significantly more revenue than the current system; which leads to a reduction in overall consumption; and which produces a fairer and more open competitive landscape which will benefit consumer choice and underpin the industry's commitment and efforts to drive improvements in responsible consumption.

We have been able to develop the model on the basis of our global experience of the beer, wine and spirits categories in marketplaces, our market data and forecasting, and our insights through our marketing skills into the way consumer behaviour changes in response to product and price changes.

## **Conclusion**

We hope that the Henry Review will heed the advice of many stakeholders who in their submissions have voiced clear support for a graduated volumetric alcohol tax system. However, we acknowledge that the Review will be able only to make recommendations for Government's consideration.

Our hope must be, therefore, that the Australian Government will have the appetite to address the significant (but not insurmountable) political obstacles and petitions from vested interests who at present continue to gain very significant business advantage from the current iniquitous system, and as a result constrain open and informed consumer choice.

Meanwhile, Diageo remains committed to working to deliver high quality, responsibly marketed and responsibly consumed products which meet the demands of discerning consumers, in a market and tax environment where the determinant of business success is based primarily on the decisions of consumers rather than external systems. At the same time we continue to commit to the valuable relationships and collaboration we have with a broad range of stakeholders focusing on alcohol issues.

We would be happy to discuss further any of the issues raised in this submission or to provide further information if required.

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