Submission: Proposed offsetting of the Consumer Price Index impacts of a carbon price from automatic indexation of excise rates applying to certain alcohol beverages

1 Executive Summary

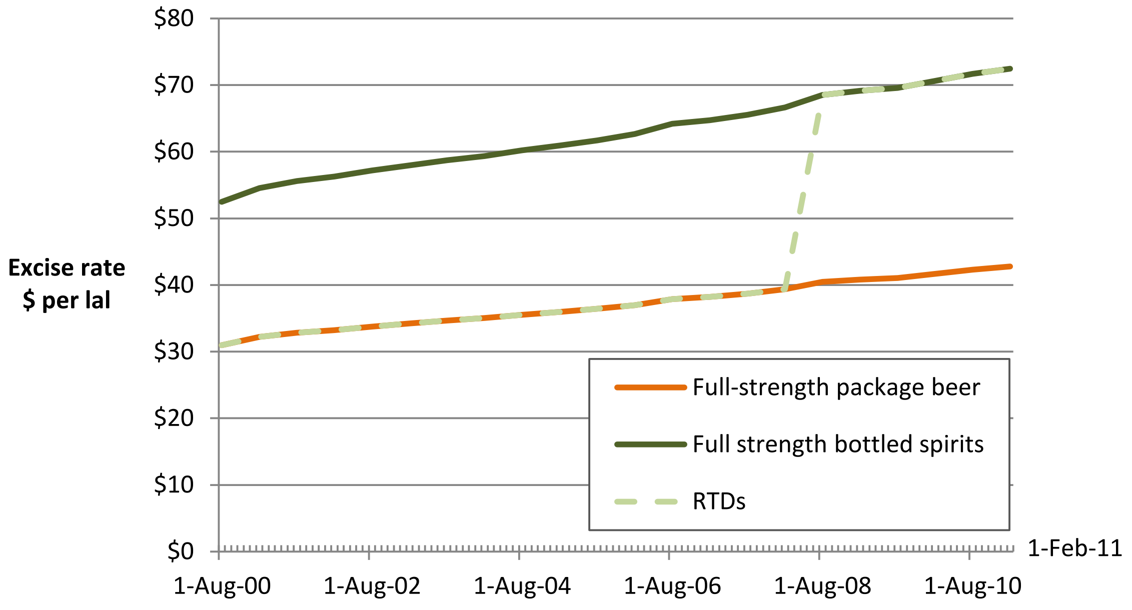
- In addition to the primary impacts of a carbon pricing mechanism common to similar consumer goods, certain goods including full-strength bottled spirits, Ready-to-Drink products (RTD) and beer will suffer unintended secondary price increases arising from the carbon price impact on the CPI-linked automatic six-monthly indexation of excise and customs tariff rates.
- **DSICA strongly recommends that automatic indexation of excise duty rates for spirits, RTDs and beer be discounted from 1 February 2013 to offset the second round effect on these products from the carbon price impact on CPI.**

2 Indexation of excise rates for spirits, RTDs and beer

- Since 1984 excise rates for certain excisable goods including spirits, RTDs and beer have been subject to automatic six-monthly indexation on 1 February and 1 August. The practice continued with the introduction of the Goods and Services Tax (GST) on 1 July 2000.
- Excise-equivalent customs duties applying to imported spirits, RTDs and beer are similarly indexed.
- The indexation factor applied is determined in accordance with the CPI change from the previous 1 January to 30 June and 1 July to 31 December (respectively). For example, the indexation rate applied on 1 February 2011 was calculated in accordance with the CPI change over the period 1 July 2010 to 31 December 2010.
- Since 1 July 2000, the excise rate applying to spirits products has increased from $51.58 per litre of pure alcohol ('lal') to $72.46 per lal – an increase of 40 per cent over some 11 years.
- It is pertinent to note that wine and wine products (e.g. cider, port) are taxed under the ad valorem Wine Equalisation Tax (WET) regime, calculated at 29 per cent of the product's wholesale sales price. Unlike spirits, RTDs and beer, the taxation rate applied to wine and wine products is not subject to indexation.

NOMINAL EXCISE RATES

Full-strength packaged beer, RTDs and Spirits; August 2000 to Present



3 Impact of a carbon price on CPI

- The Government has committed to a carbon pricing mechanism that would commence from 1 July 2012 with a fixed price (through the issuance of fixed price units within an emissions trading scheme) before converting to a cap-and-trade emissions trading scheme after three to five years.
- While the initial price has not been finalised, recent debate indicates a likely price of between $20 to $40 per tonne.
- Cabinet-in-Confidence documents prepared by the Treasury and released under Freedom of Information legislation indicate that the introduction of the carbon price will have the following impact on the CPI[1] (assuming a fixed carbon price of $30 per tonne):
  - estimated overall CPI impact with the inclusion of the fuel tax concessions of 1.04 per cent; and
  - estimated overall CPI impact excluding the fuel tax concession of 1.48 per cent.[2]
- See the detailed tables below.

Introduction of the carbon price inclusive of fuel tax concessions

Starting carbon price	**$10**	**$20**	**$30**	**$40**
Overall impact ($AUD per week)	$0.40 per week	$7.80 per week	$11.70 per week	$15.60 per week
Overall CPI impact (%)	0.35%	0.70%	1.04%	1.39%

Source: Treasury Executive Minute of 1 February 2011 'Preliminary Carbon Price Household Price Impacts'

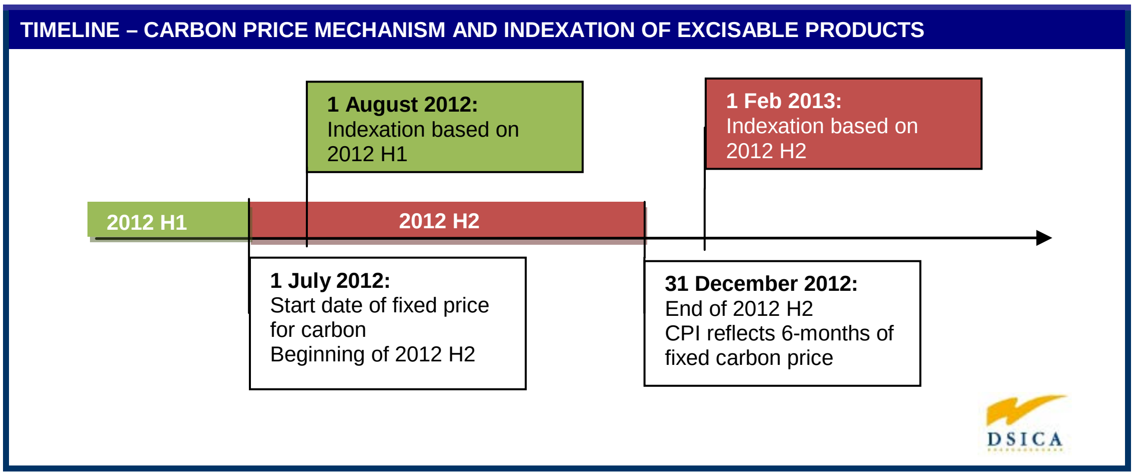
Introduction of the carbon price exclusive of fuel tax concessions

Starting carbon price	**$10**	**$20**	**$30**	**$40**
Overall impact ($AUD per week)	$5.50 per week	$11.10 per week	$16.60 per week	$22.10 per week
Overall CPI impact (%)	0.49%	0.98%	1.48%	1.97%

Source: Treasury Executive Minute of 1 February 2011 'Preliminary Carbon Price Household Price Impacts'

Secondary impacts (excise period 1 February 2013)

- The indexation factor to be applied to spirits, RTDs and beer on 1 February 2013 will include the impact of the fixed carbon price on the costs to the CPI basket of goods and services. See timeline below.



[1] DSICA understands that these figures are indicative estimates and are subject to change. DSICA further understands that the Treasury Macroeconomic Modelling Division is currently updating the Government's 2008 report *Australia's Low Pollution Future: The Economics of Climate Change Mitigation* and that modelling at a household level can only be finalised once this macroeconomic modelling is complete. DSICA will endeavour to update its estimated impacts on excise rates when this modelling has been made available for public release; or when further updated analyses are made available.

- **Under the proposed carbon pricing mechanism and existing excise and customs legislation, excise and excise-equivalent customs duty rates for spirits, RTDs and beer will be subject, on 1 February 2013, to a CPI indexation factor that will include the impacts of a fixed carbon price. This indexation increase could be up to 1.48 per cent higher than underlying inflation (i.e. resulting from a $30 per tonne carbon price).**

4 Flow-on effects of increased CPI levels on excise rates

Second round impacts of GST implementation and lessons for carbon pricing

- Under the New Tax System (NTS) that introduced the GST, the spirits excise rate increased by more than 35 per cent on 1 July 2000, and Commonwealth revenue from spirits excise duty alone increased by more than 60 per cent. This increase was designed to replace the Wholesale Sales Tax (WST) which previously applied at the rate of 37 per cent of the final wholesale selling price for spirits.
- DSICA strongly believes that the forward estimates underlying the 1998 NTS[3] documents were prepared on the basis that the Government would discount the 2000-01 automatic excise indexation increases for the second round impact of the NTS (that is, that there would be no second round effect of the NTS on excise duty rates).
- DSICA believes that the revenue estimate tables in the NTS documents clearly show that the 2000-01 and the 2001-02 excise revenue estimates were discounted for the estimated impact of the second round NTS effect. This can be seen in that the estimate for the increase in excise collections from beer and spirits between the 2000-01 and the 2001-02 years was only estimated to be $43.4 m. Given the small annual fall in spirits volumes of –0.1 per cent pa, and the likely low underlying inflation figures for these periods, this figure is only compatible with a fully discounted indexation increase on 1 February 2001.
- Consequently, DSICA believes that the indexation increase on 1 February 2001 should have incorporated the planned discount for the impact of the NTS component of CPI in the first half of the 2000-01 financial year. However, this never occurred.
- The ongoing imposition of automatic six-monthly excise indexation increases since 2001 has subsequently compounded the impact of the second round effects of GST implementation.

Australian Competition and Consumer Commission Guidelines

- DSICA notes that when implementing the GST, the Australian Competition and Consumer Commission's (ACCC) *Price Exploitation and the New Tax System Guidelines* ('the Guidelines') indicated that regulated enterprises whose prices were subject to CPI escalators had the potential for 'over recovery' if the enterprise increased prices to recover its GST liability and also increased its prices for CPI adjustments, which may include the effect of the GST. The Guidelines indicated that this practice may constitute a contravention of the prohibition on price exploitation.[4]
  - The Guidelines required that, directly or indirectly, CPI escalators used to adjust regulated prices be discounted for the contribution of the GST to the CPI (the Discount Principle).[5]
  - While these Guidelines relate to implementation of the GST, DSICA considers that the Discount Principle outlined in relation to the CPI escalators is applicable to the implementation of a carbon price. This principle may be used as a basis on which to introduce a mechanism to eliminate the second round effects that the carbon price will have on CPI levels used to calculate the indexation of excise rates applying to spirits, RTDs and beer.
- The GST increased the CPI by around 2½ per cent through the year to the June quarter 2001.[6] This is around 1.7 to 2.4 times larger than the estimated impact of a $30 per tonne carbon price.

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[2] Note that throughout this submission references will be made to the introduction of a carbon price of $30 per tonne. This rate has been selected due to the fact that the *Treasury Executive Minute of 1 February 2011 'Preliminary Carbon Price Household Price Impacts'* relies on modelling for a $30 carbon price, while other carbon prices (i.e. $10, 20 and 40 per tonne) have been scaled accordingly.

[3] The Honourable Peter Costello, M.P., *Tax reform not a new tax, a new tax system*: *The Howard Government's Plan for a New Tax System,* August 1998.

[4] Australian Competition and Consumer Commission, *Price Exploitation and the New Tax System: general principles, information and guidelines on when prices contravene section 75AU of the Trade Practices Act 1974*, March 2000, paragraph [1.45].

[5] Ibid, paragraph [2.12].

[6] *Treasury Executive Minute of 10 January 2011 'CPI Impacts- Carbon Pricing Compared to the GST and Exchange Rate Movements'.*

- **DSICA strongly urges the Government to acknowledge the Discount Principle applied by the ACCC in the introduction of the GST. DSICA urges the Government to consider what options would be available to eliminate the second round effects that the carbon price will have on CPI levels used to calculate the indexation of excise rates.**
- DSICA notes that *The Garnaut Review 2011* (‘the Review’) has acknowledged that the introduction of a carbon price will result in an increase in petrol prices. The Review further notes that this price increase could be offset through a one-off reduction in petrol excise, funded by other tax adjustments that had similar or larger positive effects on emissions.[7]
- The Review makes no reference to a similar offsetting scheme for excisable alcohol beverages. However, DSICA notes the similarities between these excisable products and considers that the application of the Discount Principle could easily be extended to include spirits, RTDs and beer.

5 Conclusion

- **DSICA strongly recommends the Government eliminate the unintended second round effects that the introduction of the carbon price will have on the automatic indexation of excise and customs duty rates applying to spirits, RTDs and beer.** CPI indexation of excise and excise-equivalent customs duty rates applying to these products on 1 February 2013 should be discounted to remove the estimated contribution of the carbon pricing package to CPI indexation in the second half of 2012.

28 June 2011

[7] Ross Garnaut, *The Garnaut Review 2011: Australia in the Global Response to Climate Change*, 2011, page 81.