

BUNDABERG DISTILLING COMPANY

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Customs Amendment (Fuel Tax Reform and Other Measures) Bill 2006 and three related bills

Submission by

Bundaberg Distilling Company Ltd

to

Senate Economics Legislation Committee

May 2006



1. Executive Summary

Bundaberg Distilling Company (Bundaberg) produces Australia's leading spirit and also the highest selling mid-strength Ready to Drink (RTD) product in Australia.

Bundaberg urges the Government to use the opportunity presented by the Amendment Bills currently before the Parliament to make changes that would encourage the production and consumption of lower strength RTDs. Implementing these changes would be consistent with the Governments' own National Alcohol Strategy (MCDS, p.29).

Bundaberg, supported by the Distilled Spirits Industry Council of Australia (DSICA), calls on the Government to amend the customs and excise legislation to provide the following for packaged mid and low-strength RTDs:

- ❖ **Excise-free threshold:** An excise free threshold of 1.15% abv for low and mid-strength packaged RTD products (as is allowed for all beer products).
- ❖ **Tiered rates:** Low-strength packaged RTDs be granted the same lower excise rate (currently \$31.73 per litre of alcohol) that applies to low-strength packaged beer.

Bundaberg uses the opportunity of this submission to correct the popularly held perceptions that there is an increasing trend of alcohol harm amongst young and underage people, and that the increasing popularity of RTDs is causing this. The best available evidence does not support these conclusions, despite commonly held beliefs and media coverage. Accordingly, Bundaberg submits that there is no reason on health policy grounds to reject a policy change that would reduce excise on lower strength RTDs.

2. Introduction

2.1 Background to Bundaberg Distilling Company

History

- The Bundaberg Distilling Company Ltd was established in 1888 by a group of sugar millers who saw the potential of the molasses produced as a by-product of sugar refining. The distillery has been in continuous operation in Bundaberg Queensland since 1939.
- During this time, Bundaberg Rum has become a part of the national identity. The company worked closely with the Commonwealth government to ensure the supply of rum rations to Australians serving in the Boer War of 1899, and both World War I and World War II. It continues to contribute to national sporting and environmental initiatives (see below).
- In 2006, the company remains committed to producing Aussie rum of the highest quality.

Recent investment in Distillery upgrade

- In 2004, Bundaberg Rum announced a major distillery expansion plan. The \$24 million investment builds on the \$20 million maturation and capacity expansion over 2001-03.
- The expansion includes the installation of new maturation tanks, new timber storage vats and the opening of Bond 15, a \$4.6 million facility that will ultimately hold 90 vats of rum worth approximately \$450 million.
- In recognition of the distillery's status as a national icon, and a significant tourism destination, the expansion also includes a new \$2.7 million Visitors Centre. The centre will offer an interactive guide to the rum making process.

Key Products

- Bundaberg has historically been at the forefront of developments in the alcohol market, producing new beverages to satisfy changing consumer tastes.
- The Bundaberg distillery has been producing RTDs beverages since 1942, with the release of the popular Rum and Cola to supply the needs of Australian troops serving abroad.
- Bundaberg also pioneered the development of mid-strength alcoholic beverages. In 1999, the distillery released the first mid-strength pre-mix mid-strength beverage in the Australian market. The product was a Bundaberg Rum and Cola beverage with an alcohol content of 3.5% alcohol by volume (abv). The product was referred to in 1999 as "Bundy Gold" and was introduced to compete with the increasingly popular mid-strength beer products such as XXXX Gold.

- Bundaberg now offers five different ready-to drink beverages:
 - ❖ *Rum and Cola*
 - ❖ *OP Rum and Cola*
 - ❖ *'Dark and Stormy' (blend of rum and ginger beer)*
 - ❖ *Rum Dry and Lime*
 - ❖ *Mid 3.5% and Cola*

Bundaberg in the Community

- On a local scale, Bundaberg plays an important role in the community.
 - ❖ The distillery employs 56 locals and is the primary tourist destination in the region attracting 75,000 tourists to the town each year.
- Bundaberg has been a strong supporter of Australian sport.
 - ❖ In 2003, the company entered a \$5 million sponsorship arrangement for the Rugby World Cup.
 - ❖ Bundaberg is currently sponsoring the 2006 Bundaberg Rum Rugby Series, in addition to acting as the official spirit of the National Rugby League.
 - ❖ Bundaberg was the primary sponsor of a recent football charity match that raised \$400,000 for those affected by Cyclone Larry.
- Bundaberg has also entered a partnership arrangement with LandCare to preserve Australia's rivers and waterways by the establishment of the Bundaberg Rum Bush Fund.
 - ❖ An initial \$300,000 was committed to establish a Bush Fund and to date almost \$1 million have been distributed to 99 LandCare groups from the Fund.
 - ❖ In 2003-2004, the Fund supported key projects in Dubbo (NSW), Omeo (Victoria) and the Mary River in Queensland.
 - ❖ In 2004-2005, the Fund staged the *Murray River Revival Tour* — a ten day concert tour to highlight the issues affecting the river which provided \$150,000 in grants for local LandCare groups to help restore it.
 - ❖ In 2005-2006, Bundaberg sold Bear Fresheners (for cars) at more than 700 liquor outlets across regional Australia. All donations will be matched dollar for dollar by

Bundaberg. Bundaberg also initiated the Legends of League charity appeal which raised \$400,000 to help communities affected by Cyclone Larry.

- Other community initiatives include sponsorship for research into turtles by the Queensland Parks and Wildlife Service and funding for the Royal Flying Doctor Service of Australia.

Bundaberg in the Spirits Industry

- In 2004, Bundaberg Rum was named the number one spirits trademark in Australia.
- Bundaberg is a member of the Distilled Spirits Industry Council of Australia (DSICA). This submission will draw extensively on market research and revenue estimates prepared by DSICA.

2.2 The Mid-Strength and Low-Strength Alcohol Market

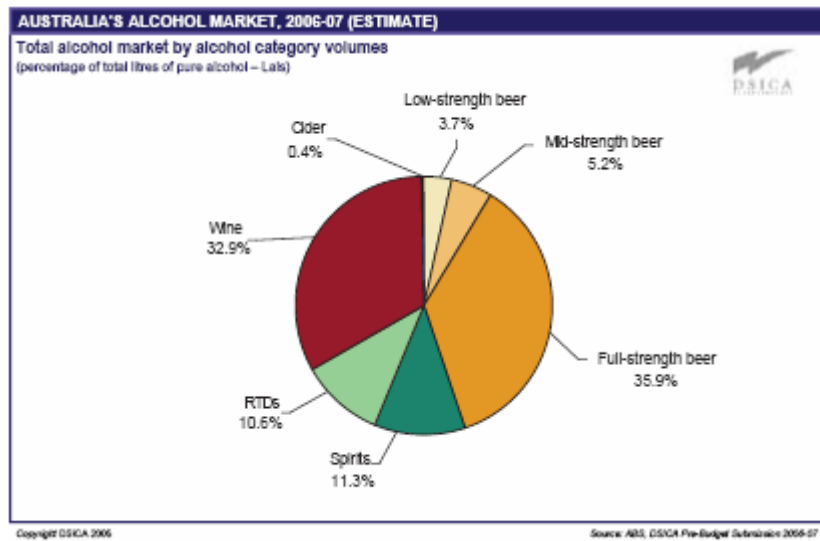
The Australian alcohol market

Key statistics about the respective shares of the alcohol market in Australia are as follows (2005-06 year, estimates, measured in litres of alcohol - lals) (DSICA 2006b).

- **Beer** represents about **46%** of the total market.
 - ❖ **Full strength beer** (> 3.5% abv) represents **37%** of the market;
 - ❖ **Mid strength beer** (>3% abv, but ≤ 3.5% abv) represents **5%** of the market;
 - ❖ **Low strength beer** (≤ 3.0% abv) represents **4%** of the market.
- **Spirits** represents about 22% of the total market.
 - ❖ **Full strength bottled spirits** (FSBS > 10% abv) represents **12%** of the total market;
 - ❖ **RTDs** (< 10% abv) represent **10%** of the total market.
- **Wine** (including cider) represents about **32%** of the total market.

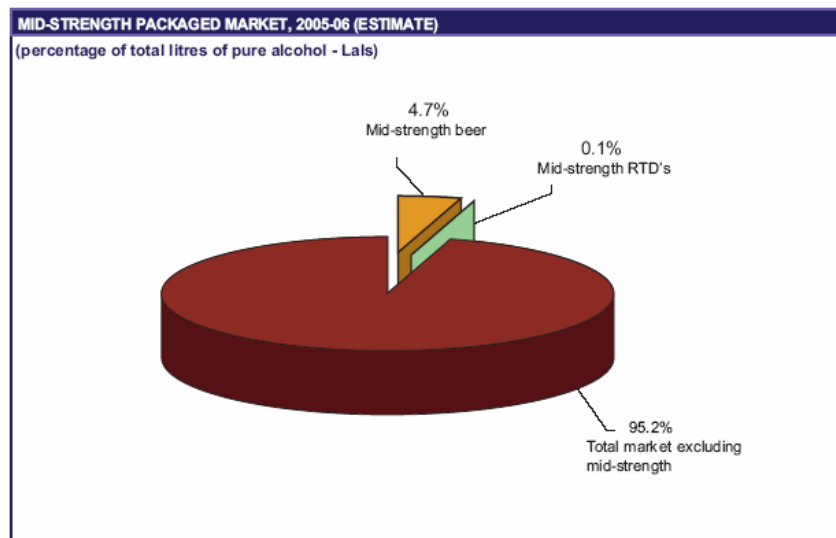
Figure 1 below provides a graphical representation of the estimated alcohol market break down by category in 2006-07 (DSICA 2006a, p. 7).

Figure 1: Australia's alcohol market, 2006-07 (estimate)



The Mid-Strength packaged market in Australia

- Of total alcohol sales (2005-06), the mid-strength packaged market comprises 4.8% of the total Australia market (DSICA 2006b).
- This is comprised as follows:
 - ❖ Mid-Strength packaged beer = **4.7%** (or 98% of the mid-strength market)
 - ❖ Mid-Strength packaged RTDs = **0.1%** (or 2% of the mid-strength market).

Figure 2: Market share of mid-strength packaged alcohol products 2005-06

- Mid-strength beer has shown a trend to increase its market share within the total beer and the packaged beer market in the last five years.
- The Australian Bureau of Statistics (ABS) publication, Apparent Consumption of Alcohol in Australia 2003-04 (3 November 2005), shows that the mid-strength beer increased its share of the total beer market from 11.1% in 2000-01 to 14.1% in 2003-04 (ABS 2005, p.1).
- DSICA figures indicate that in the packaged beer market, mid-strength packaged beer increased its share from 12.4% in 2000-01 to 15.8% in 2003-04 (DSICA 2006b). This increasing trend to drink lower strength beer is encouraging.
- In the RTD market, mid-strength RTDs have held a fairly static but low share of the total RTD market at about 0.8% of the total RTD market (DSICA 2006b).
 - ❖ This low market penetration reflects that there are very few mid-strength RTDs on the market. This is predominantly due to producers being unable to competitively price a mid-strength RTD product against its prime competitor – mid-strength beer.
- RTDs have on the other hand increased their market penetration over the years. This has been due to the introduction of new products and the general growth in the popularity of RTDs.

The Low-Strength market in Australia

- The low-strength market in Australia is comprised almost exclusively of low-strength beer. As outlined above, this comprises 3.8% of the total alcohol market in Australia.

- Bundaberg is not aware of any low-strength RTDs on the Australian market.
- DSICA estimates (DSICA 2006b) that the low-strength packaged beer market has been showing a decline in recent years (from 9.9% in 2000-01 to a forecast 8.4% in 2006-07).

2.3 Current taxation anomalies

Beer vs RTDs

- Beer and RTDs compete with one another in the marketplace as substitute beverages and share similar product characteristics.
 - ❖ They have similar alcohol content;
 - ❖ They are sold to consumers in similar ways as ‘six-packs’ or in cases;
 - ❖ They are generally packaged in either cans or bottles.
- Indeed, consumer research reveals that beer and RTDs are generally regarded as interchangeable products.
- However, despite their comparable features the current excise taxation system unfairly discriminates against RTDs in favour of beer.
- Bundaberg submits that several anomalies exist that result in the higher taxation per litre of alcohol for RTD beverages. This not only prices low and mid-strength packaged RTD products out of the overall lower strength alcohol market but also fails to provide an incentive to drinkers to choose lower strength products less associated with harm.
- In the context of low and mid-strength products, the anomalies are as follows:
 - ❖ **Excise free threshold:** All RTDs, including low and mid-strength products, do not have access to the 1.15% alcohol excise free threshold that applies to all beer products (both packaged and draught); and
 - ❖ **Lower excise rate for low-strength beer:** Low-strength packaged RTDs do not have access to the lower rate of taxation available for packaged low-strength packaged beer.
- Figure 3 below, produced by DSICA (DSICA 2006a, p. 33) shows the typical excise effect of these anomalies as between beer and RTDs in terms of the price impact on an individual can of product.
- In relation to the low and mid-strength markets, this diagram illustrates the following anomalous effects:

- ❖ Mid-strength RTDs pay **16 cents (or 49%) more excise** per can of product than mid-strength beer of the same alcohol strength.
- ❖ Low-strength RTDs would pay **19 cents (or 106%) more excise** per can of product than low-strength beer of the same alcohol strength.
- ❖ **The lower the strength of the RTD, the greater the excise differential with a beer of the same alcohol strength, and therefore a competitive disincentive to produce lower strength RTDs.**

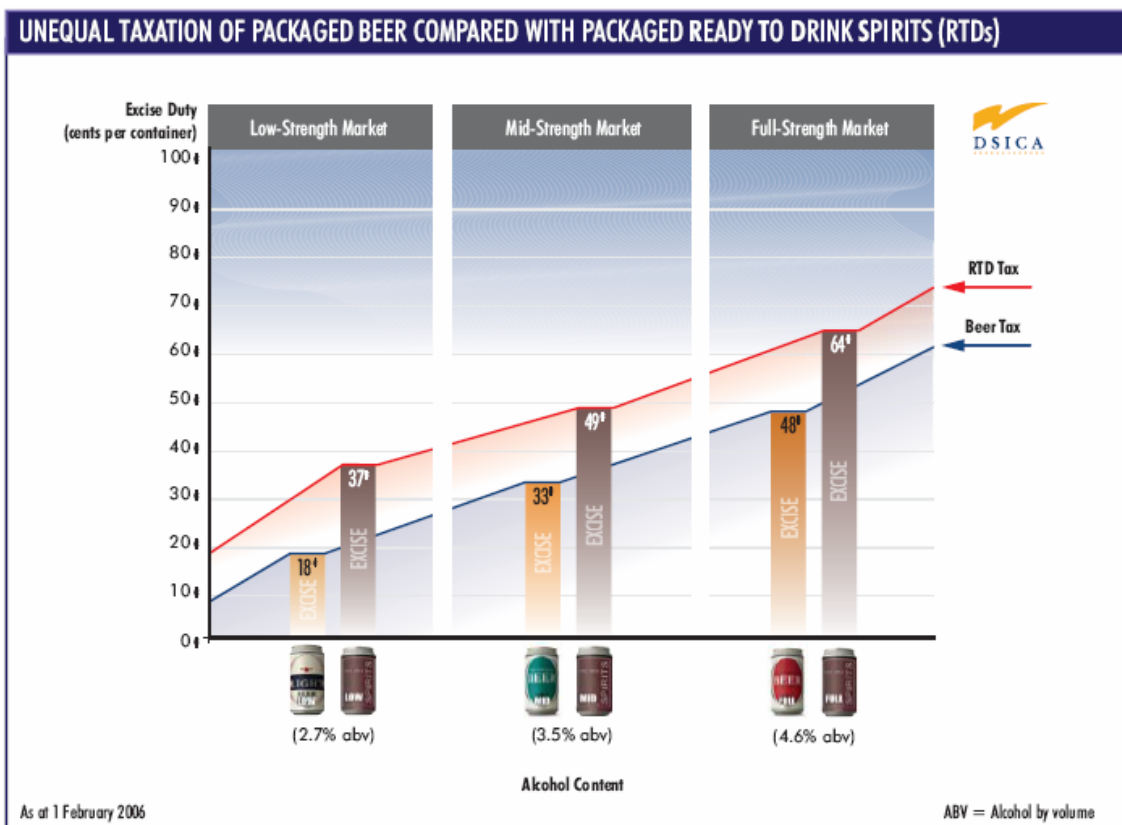


Figure 3: Excise on representative products < 10% abv

Draught Beer and RTDs

- The unequal taxation treatment between packaged beer and packaged RTDs also extend to draught beer and draught RTD products (beverages packaged in greater than 48 litre containers).
- Draught beer enjoys the 1.15% excise-free exemption and a three-tier system of taxation rates. Furthermore, since *A New Tax System*, draught beer has significantly lower rates of excise compared with packaged beer.
- In contrast, draught RTDs are subject to the same excise rate as that of packaged RTDs and do not have the 1.15% excise-free threshold.
- This anomaly results in the following observations between draught beer and draught RTDs:
 - ❖ All RTDs are subject to an effective taxation rate per litre of alcohol of \$36.98;
 - ❖ Full-strength draught beer has an effective excise rate¹ of \$19.52 (nominal rate of \$26.03) per litre of alcohol;
 - ❖ Mid-strength draught beer pays an effective excise rate of \$13.35 (nominal rate of \$19.89) per litre of alcohol; and
 - ❖ Low-strength draught beer has an effective excise rate of \$3.63 (nominal rate of \$6.33) per litre of alcohol.
- The draught RTD market in Australia is growing but the current tax structure does not encourage manufacturers to produce draught RTDs.
- Bundaberg submits that in the medium to long term, draught RTDs should attain complete taxation equivalence with draught beer where the same tiered excise rates would apply and the 1.15% excise-free threshold currently applicable to beer.

Price effects

- The excise differential between beer and RTDs illustrated above magnifies the price differential between the two competing products.
- Differences in production costs and economies of scale will mean that it is always cheaper to produce beer (of whatever strength) than RTDs.
- The excise differential emphasises this price differential even more as the impact flows through the sales chain with margins and GST levied on top of the excise inclusive prices.

¹ 'Effective excise rate' takes into account the 1.15% excise-free threshold that applies to all beer products.

- Comparative prices for Bundaberg’s mid-strength product and its main competitor (XXXX Gold) are detailed below:

Table 1: Comparative prices for mid-strength alcohol products

Product	6 pack price	Case Price (24 cans)
Bundaberg Rum Mid 3.5 & Cola	13.00	45.00
XXXX Gold (3.5%)	10.00	35.00

2.4 Bundaberg’s presence in the Mid-Strength market - Bundaberg Gold

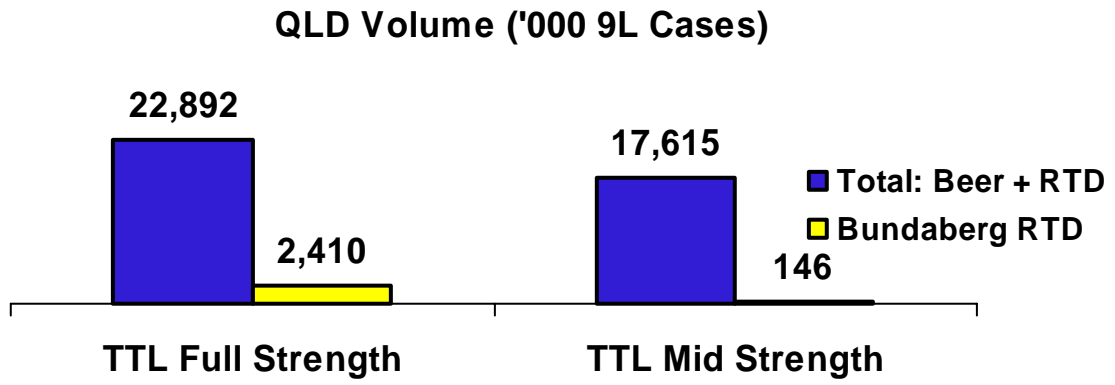
Bundaberg Rum Mid 3.5 & Cola

- As outlined above, Bundaberg introduced this mid-strength product in 1999 as “Bundy Gold”.
- Bundy Gold was the first mid-strength premix spirit product in Australia.
- The product has the flavour of Bundaberg Rum at mid-strength and blended with Cola. It is available in 345ml “stubbies” and 375ml cans.
- The main competitor product for Bundaberg Mid-Strength is mid-strength beer, with the most popular in Queensland being “XXXX Gold” (3.5% abv).

Market penetration by Bundaberg Mid-Strength – Queensland case study

- Queensland is the largest market for Bundaberg rum in Australia and is the largest mid-strength market.
- The market (off-premise) for all mid-strength products (beer and RTDs) in Queensland is estimated at 17.6 million cases.
 - ❖ Of this, Bundaberg Mid-Strength represents 146,000 cases, or 0.8% of the market. This can be compared to the full strength market in Queensland where Bundaberg full strength RTD products have a 10.5% share of the market.
 - ❖ See Figure 4 below.

Figure 4: Queensland mid strength alcohol market



3 *Health and Social Aspects*

3.1 *The National Alcohol Strategy 2006-2009*

- On 15 May 2006, the peak national policy making body on licit and illicit drugs, the Ministerial Council on Drug Strategy (MCDS) endorsed the National Alcohol Strategy 2006-2009 (the Strategy).
- The aim of the Strategy is to develop safer drinking cultures in Australia to produce healthier outcomes for all Australians.
- The recommendations from the Strategy will guide the development and implementation of a policy framework to respond to alcohol-related harm in Australia.
- As a member of DSICA, Bundaberg supports the development of the strategy as a framework for action over the next 3 years.

Cultural place and availability

- One of the priority areas of the strategy is “Cultural Place and Availability” (MCDS, p. 5).
- The aim of this priority area of the Strategy is to facilitate safer and healthier drinking cultures by developing community understanding about the special properties of alcohol and through regulation of its availability (MCDS, p. 27).

“Economic Availability”

- In this priority area, the Strategy identifies using price-related levers such as taxation to prevent and limit alcohol related harm. It concludes that the strategy should (MCDS 2006, p. 30):

“Focus ongoing dialogue on price-related levers to reduce consumption of alcohol at harmful levels.”

- In its discussion of this aspect of the Strategy, it notes that “a tax structure that increases the affordability of low-strength alcoholic beverages is one potential way of achieving both public health and economic benefits.” (MCDS 2006, p. 29)
- Accordingly, it is apparent from the Strategy, which has been endorsed by the Federal Government as a participant in the MCDS, that it acknowledges and is a supporter of a taxation structure that provides a price/taxation incentive for the consumption of lower strength beverages. The Bills currently before Parliament provides the Government with an ideal opportunity to implement its endorsed policy on this.

3.2 Underage drinking issues and RTDs

Perception of alcohol abuse by young people

- Bundaberg and the spirits industry acknowledge that there is a perception in the community that there is an increasing level of alcohol abuse by young (and underage) drinkers.
- Furthermore, there is a perception that the increasing popularity of RTDs is contributing and/or causing the perceived increased levels of alcohol abuse.
- Accordingly, stakeholders and policy makers often argue that there should be no changes to the taxation regime for RTDs that would see a reduction in their price.
- DSICA research, assisted by Professor Ian McAllister, a leading research academic from the Australian National University (ANU), indicates that these commonly held perceptions are unfounded.
- Bundaberg and the industry acknowledge that alcohol is capable of causing harm and that some sectors in the community are more prone to be at higher risk than others.
- The industry is committed to assisting with the development and implementation of a range of harm reduction strategies to address these issues – based on a sound evidence base of the demographics in need.
- The spirits industry is however concerned to correct incorrectly held perceptions that there is an increasing trend towards greater levels of alcohol abuse by young people and the perception that RTDs are a cause of this incorrectly held belief.

DSICA Indicators of alcohol consumption amongst young people

- For a number of years, DSICA has, with the assistance of Professor Ian McAllister, produced a reference tool that summarises alcohol consumption patterns amongst young people. DSICA refers to this as its Indicators of alcohol consumption amongst young people (the Indicators) (DSICA 2006c).
- Data for the Indicators is drawn from the best available survey evidence as identified by Professor McAllister.
- A detailed explanation of the current state of the Indicators is provided in the DSICA publication *Indicators of Alcohol Consumption Amongst Young People, Third Release April 2006*.
- Key insights identified by the Indicators – all of which run contrary to the popular held beliefs that there is an increasing trend of harmful alcohol consumption amongst young people – are as follows:

- ❖ **Prevalence:** The proportion of underage drinkers is *NOT increasing*.
- ❖ **High Risk Drinkers:** The proportion of underage drinkers engaging in high risk drinking is *NOT increasing*.
- ❖ **Quantity consumed:** The alcohol amongst of alcohol consumed by underage drinkers is *NOT increasing*.
- Furthermore, in the particular context of the sales growth in RTDs, the Indicators evidence the following:
 - ❖ **There is *no correlation* between the growth in the market for RTDs and the number of current underage drinkers.**
 - ❖ **There is *no correlation* between the growth in the market for RTDs and the number of underage drinkers consuming alcohol at high risk levels.**
- Accordingly, Bundaberg submits that based on the best available survey evidence, there is no reason to believe that there are worsening trends of underage alcohol consumption nor is there reason to believe that the growing market for RTDs is causing such a situation.
- Furthermore, given that the best available survey evidence disputes these commonly held perceptions, Bundaberg submits that there is no sound policy reason to refuse a reduction in excise taxation for low and mid-strength RTDs (or even full strength RTDs).

4. ~~Proposals~~ **Proposals for excise changes for low and mid-strength RTDs**

4.1 Summary

- To promote an incentive for the production and consumption of low and mid-strength RTDs, Bundaberg recommends that the Australian Government amend the customs and excise legislation to provide the following:
 - ❖ **Excise-free threshold:** An excise free threshold of 1.15% abv for low and mid-strength packaged RTD products (as is allowed for all beer products).
 - ❖ **Tiered rates:** That low-strength packaged RTDs be granted the same lower excise rate (currently \$31.73 per litre of alcohol) that applies to low-strength packaged beer.

4.2 Excise comparison

- The tables below summarise the impact of the above recommendations on the amount of excise collected on representative can/6 pack/case of mid and low-strength RTDs compared to low mid and low-strength RTDs of the same alcohol content.

Table 2: Excise payable on *mid-strength* RTDs compared to mid-strength beer as at 1 February 2006

	abv	Excise per can	Excise per 6 pack	Excise per case
Mid-strength beer	3.5%	\$0.33	\$1.98	\$7.92
Mid-strength RTD	3.5%	\$0.49	\$2.94	\$11.76
Differential		\$0.16	\$0.96	\$3.84

Table 3: Excise payable on *low-strength RTDs* compared to mid-strength beer as at 1 February 2006

	abv	Excise per can	Excise per 6 pack	Excise per case
Low-strength beer	2.7%	\$0.18	\$0.72	\$4.32
Low-strength RTD	2.7%	\$0.37	\$2.22	\$8.88
Differential		\$0.19	\$1.50	\$4.56

- As can be observed from Tables 2 and 3 above, the lower the strength of the comparative product, the more the excise differential increases.
 - ❖ This occurs due to the greater impact of the 1.15% excise free threshold for lower strength products.
 - ❖ Such an effect magnifies the disincentive to produce products with a lower alcohol content.

4.3 Price effects of the proposed change

- Table 4 below demonstrate the impact of the proposed changes on the comparative prices for mid-strength products, using Bundy Mid and XXXX Gold as representative products.

Table 4: Estimated price impacts on mid-strength RTDs compared to mid-strength beer

Representative Product	Price – 6 pack		Price – Case	
	Current	Future	Current	Future
XXXX Gold (3.5% abv))	10.00	10.00	35.00	35.00
Bundy Mid (3.5% abv)	13.00	11.60	45.00	40.20
Differential	3.00	1.60	10.00	5.20

Observations

- The following observations can be made from Table 4:
 - ❖ The price of mid-strength RTDs would fall by approximately 11%.
 - ❖ Mid-strength RTDs would remain more expensive than mid-strength beers of the same alcohol content.
 - ❖ The price differential between mid-strength RTDs and mid-strength beer would reduce in the order of 45% to 50%.
- Bundaberg firmly believes that a reduction in price in the order of 11% would provide significant encouragement for consumers to demand more mid-strength RTDs. This is entirely consistent with the MCDS National Alcohol Strategy.

4.4 Revenue estimates

- DSICA has performed detailed estimates of the cost to Commonwealth Government excise revenue of implementing these measures. These estimates have been calculated as part of DSICA’s annual detailed Pre-Budget Submission for 2006-07.
- DSICA’s estimate of the cost of this measure for the 2006-07 year is \$1.7 million (DSICA 2006a, p. 33). This figure stands in stark contrast to the loss to excise revenue of \$730 million when the 1.15% excise free threshold was introduced for beer in 1988-89.
- Bundaberg believes that \$1.7 million is a very small price to pay to encourage consumption of lower alcohol products.

5. Conclusion

- Bundaberg recommends that the Government amend the relevant Amendment Bills currently before the Parliament to implement excise taxation equivalence for low and mid-strength packaged RTDs in accordance with the excise regime that currently applies to low and mid-strength packaged beer.
- Such an amendment would be consistent with the Government's own National Alcohol Strategy and would come at minimal cost to Government revenue.
- These changes are also supported by other leading health bodies including the Alcohol and Other Drugs Council of Australia, the Australian Medical Association, the Royal Australasian College of Physicians and the National Drug Research Institute (see submission by DSICA for detailed consideration of the views of these and other health organisations).

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¹ AC Nielsen Liquor Digest/Liquor Scan data collected for Bundaberg, moving annual total (MAT) to July 2005.