



WHO COLLABORATING CENTRE FOR  
RESEARCH AND TRAINING IN ALCOHOL AND DRUG ABUSE

# Alcohol Taxation in the Western Pacific Region

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## **Disclaimer**

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## **1. Introduction**

The price of alcohol is a key factor influencing levels of consumption and alcohol related harm. Alcohol taxes – that is, specific taxation of alcohol products in addition to any general sales or company taxes – is an important means by which policymakers can influence price.

Alcohol tax is one of the most effective public health strategies for reducing alcohol related harm.<sup>1</sup> It is particularly cost effective for the many governments that already have an alcohol tariff or excise tax system in place.<sup>2</sup>

A second important function alcohol specific taxes serve is a ‘user pays’ approach in that the revenue governments receive goes some way to compensate for the costs borne by health services, policing and justice systems as a result of alcohol related crime, injury and ill health.<sup>3</sup> Few countries currently set their alcohol tax rates at levels that compensate for the fiscal costs of alcohol related harm to their community.

This paper provides many examples of the impact that changes in alcohol tax rates can have on alcohol consumption and on alcohol related harm. Alcohol taxation is an effective part of a package of alcohol control policies. In an analysis of the cost effectiveness of different interventions in different regions of the world a combination of increased taxation, an advertising ban and brief advice to heavier drinkers was found to have the potential to reduce alcohol related disability adjusted life years (DALYs) by more than 900 per 1 million population per annum.<sup>4</sup>

## **2. The effects of price on consumption and harm**

### **2.1 Alcohol price and consumption**

In general, the way drinkers respond to changes in the price of alcohol is similar to their response to other consumer products. There is an inverse relationship between price and demand. Research studies confirm that the price of alcohol affects both individual and population levels of consumption, and also levels of alcohol-related harm.<sup>1,5</sup> When other factors are held constant, a rise in alcohol prices leads to a drop in consumption.<sup>6</sup>

The effect of price changes on alcohol consumption is described as the price elasticity of demand. Demand for alcohol has been found in many high income countries to be inelastic to price – that is, a change in its price results in a drop in consumption, but one that is relatively smaller than the increase in price.<sup>7</sup> This means that while tax can be used as a strategy to reduce consumption and harm it will still serve the purpose of raising government revenue in most countries.<sup>1</sup>

Most of the studies on the effects of the price of alcohol on levels of consumption and of alcohol-related problems have been conducted in high income countries. The limited data available from low-middle income countries has shown a similar pattern in the relationship between price and total consumption as in developed countries,<sup>8,9</sup> particularly as their economies grow<sup>1</sup> and as personal incomes increase.<sup>10</sup> In Korea the relatively high price of beer, due to the taxation structure, is likely to explain the relatively low levels of risky consumption (as compared with the cheaper, traditional beverage *soju*).<sup>11</sup>

The price elasticity for different beverages and for different countries and over time is not uniform. Comparisons of beer, spirits and wine price elasticity have found it to be lower for the beverage generally preferred in a particular culture or market, than for less preferred alcoholic beverage types.<sup>5</sup> The way drinkers respond to and compensate for price changes is complex, because of the possibilities for substitution. Consumers tend to shift to more expensive beverages if relative prices decrease, either within the same beverage category or across beverage categories. If prices are raised, they both reduce overall consumption but also shift to cheaper beverages.<sup>12</sup> Heavy drinkers tend to buy the cheaper products within their preferred beverage category.<sup>13</sup> This and any general shift toward cheaper alcohol has significant implications and requires policy makers to also monitor the minimum priced beverages available and the availability of illegal alcohol – that is, untaxed alcohol which is therefore cheaper.

Studies of price elasticity also show a variation over time in consumer responses to a price change. The impact of an increase in alcohol price is stronger in the longer term than it is in its immediate effects.<sup>14,15</sup> From a public policy perspective, it is the long term effects, taking into account alcohol's dependence producing properties, that are more important.<sup>1</sup>

### **2.3 Effects of alcohol tax on consumption by subgroups and by harms**

There is a body of research evidence about the impact of tax on consumption and harm which has demonstrated the effects on different sub groups in the population and on different kinds of alcohol related harm.

Young people are particularly sensitive to price. Grossman et al.<sup>16</sup> showed that beer taxes in the United States reduced drinking by young people. Other studies have shown reduction of both the frequency of drinking by young people and the likelihood of heavy drinking.<sup>17</sup> Under age drinking and heavy drinking by young women college students has also been shown to be affected by price.<sup>18</sup> Other studies have shown the sensitivity of young people to taxation strategy.<sup>3,13,19</sup> Policies that increase alcohol prices have been shown to reduce the proportion of young people who are heavy drinkers, to reduce underage drinking, and to reduce per occasion binge drinking.<sup>20,21</sup> Higher prices delay intentions among younger teenagers to start drinking and slow progression towards drinking larger amounts. Research has also shown that young people who faced higher alcohol prices are less likely to make the transition from abstainer to moderate drinker and from moderate drinker to heavy drinker.<sup>22</sup>

Heavy drinkers are sometimes thought to be likely to be less affected by price. The research, however, has shown the opposite effect. Heavy drinkers responding to price in carefully controlled laboratory conditions have been found to be as price responsive as more moderate drinkers.<sup>23,24</sup> Higher prices impact on the amounts consumed by frequent and heavy drinkers, and reduce the consequences of heavy drinking.<sup>13,19,25</sup>

This research is supported by a large body of evidence which has shown an impact of prices on harms caused by alcohol, also indicating therefore that heavier drinking has been reduced. Research that compares differing alcohol taxes or prices with data on harm, for example in different states in the USA, shows that they can be effective in reducing consumption and liver cirrhosis.<sup>26,27</sup> Several studies show alcohol tax increases can reduce fatality rates from traffic crashes.<sup>19,27,28</sup> Several studies have shown that the price of alcohol and alcohol tax increases can impact on rates of crime, including, assault,<sup>29</sup> violence related injury,<sup>30</sup> homicide and family violence.<sup>15,31-34</sup> There is also a relationship between alcohol prices and child abuse and other violence towards children.<sup>13,34</sup>

Natural experiments have occurred recently in Scandinavia and Europe as part of required changes due to economic treaties. In Finland, alcohol excise taxes were lowered on 1 March 2004, as a result of EU membership and because neighbouring Estonia, with much lower

alcohol taxes and prices, would be joining from 1 May. Finland's tax rate on spirits was reduced by 44 per cent, on intermediate products by 40 per cent, on beer by 32% and on wine by 10%. This led to a 36% drop in vodka prices and 28% on other spirits. The price of strong beer went down by 13 per cent and medium strength beer prices sold in grocery stores by 15 per cent. In the weeks following the decreases sales were increased by more than 15%. The rate of increase has stabilised somewhat but continued higher than previously. The growth in spirits sales was disproportionately high. It appears that, at these lower prices, some wine consumers are now buying vodka.<sup>35</sup>

As part of the European Free Trade Area, Norway lowered its alcohol excise tax on spirits by 15% in 2002 and 10% in 2003, and on wine and beer by 5% in 2002. Official sales figures for 2002 showed a 7.2% increase in pure alcohol per person aged 15 years. This 2002 consumption rate is the highest since 1877 other than the 1980 year.<sup>36</sup>

On 1 July 1999, Switzerland removed its higher excise taxes on imported spirits, under a WTO free trade agreement. Between 1998 and 2000, imported spirits increased their share of total spirits sales from 53% to 58%. The tax reduction and increased competition resulted in a 30-50% fall in retail prices of imported spirits. A longitudinal study measured the effects of this sharp price change on drinking with large surveys three months before and 28 months after the policy change. Total consumption increased significantly, from 7.68 g/day to 8.26 g/day, through increased consumption of spirits. All sub-groups (age, gender, linguistic, smokers/non-smokers; heavier/lighter month or daily drinkers) except those over 60 increased their spirits consumption, with the 15-29 age group responding most strongly to the price reduction. The follow-up survey showed an increase in alcohol related problems, with 68% of the increased linked to increase consumption of spirits.<sup>37,38</sup>

There are also recent natural experiments on the effect of price and taxation on consumption in the Western Pacific Regions. In Australia's Northern Territory, increases in alcohol tax rates and increased coverage in 1992 resulted in a 22% reduction in adult per capita consumption in the next four years. There were also reductions in hazardous drinking patterns and significant reductions in alcohol related illnesses and deaths.<sup>39</sup> In addition, an increase in 1995 in the tax on cask wine, which was linked to problem drinking and which raised the retail price by over A\$2 a cask<sup>40</sup> led to a significant drop in its consumption.<sup>41</sup> Increase in alcohol excise tax rates in Malaysia in 2005 halted the growth in total consumption<sup>42</sup> and decreased consumption in some product areas, such as a 5% drop in sales of branded beers.<sup>43</sup> An increase in excise tax rates in the Philippines had similar results.<sup>42</sup>



## **2.4 Alcohol taxation as a public health tool**

A New Zealand report on rates of alcohol taxes in New Zealand argued that their primary purpose should be as part of the government's alcohol strategy, to reduce harmful alcohol use and its consequences. Enabling government to recover some or all expenditure and revenue losses caused by alcohol harm should be its secondary purpose. Setting rates requires attention to fiscal impacts, but the philosophy behind excise taxes and the way they are implemented is altered if a harm reduction perspective and purpose is adopted.<sup>3</sup>

Alcohol import tariffs and domestic excise taxes have historically been a source of revenue but in there have also been concerns about public disorder and violence, and effects on productivity and the labour supply. The interest of modern governments in alcohol's contribution to accidents and ill-health has paralleled the growth of responsibility for health and social services.<sup>44</sup> Alcohol is now the third largest contributing factor to injury and disease in high income countries, such as New Zealand and Australia. In low-middle income countries with overall low mortality – such as many Asian and Pacific Islands countries – alcohol is now the leading factor.

## **2.5 Using taxation to recoup economic costs of alcohol related harm**

Alcohol taxation can be justified on the grounds of recouping the costs associated with alcohol related harm. Alcohol can have negative consequences and costs for the drinkers themselves and for third parties and for communities (negative 'externalities'). A tax on alcohol that goes to government to help meet the fiscal costs of alcohol related harm (health care, policing and family support, for example) is a way of 'internalising' these costs to the sellers and drinkers in proportion to the alcohol consumed, instead of being met by all taxpayers.<sup>3,45</sup>

Economic costings have been carried out in high income countries in the region. For example, the most comprehensive estimate for New Zealand suggests that harmful use of alcohol misuse reduces effective GDP by 4%, and has also reduced the welfare of New Zealanders via additional mortality and morbidity by 2% and the population of New Zealand by 0.8%.<sup>3</sup> An Australian estimate based on 1998-1999 data put the net tangible costs of alcohol – from net health costs, loss of productivity, road crashes and crime but excluding loss of life – at 1.98% of GDP, compared with 1.71% for tobacco and 1.76% for illicit drugs. It was estimated that 48% of these health, road and productivity costs could be avoided if effective policies and programmes were introduced.<sup>46</sup>

From one perspective, the rate at which alcohol taxes should be set is the rate at which costs of alcohol externalities to government and to the community is recovered.<sup>47</sup> This is seldom the case at present. For instance, revenue from alcohol taxation is estimated to cover only around a fifth of the fiscal costs of harm in New Zealand and a third of fiscal costs in the USA.<sup>3,48-50</sup>

It is further acknowledged that much alcohol-related harm such as impacts on the children of heavy drinking parents is neither well recorded nor readily costed.<sup>51</sup>

### **3. Setting alcohol taxation rates**

#### **3.1 Types of tax on alcohol**

Alcohol is currently taxed in a number of ways. Imported alcohol products have often subject to tariffs, as a means of reducing importation, to protect domestic production or traditional beverages, and as a source of revenue for governments. Under trade treaties, barriers to international trade must be removed and import tariffs must be progressively reduced. However, they may be replaced by excise taxes which treat imported and domestic products equally. Some countries within the region have been challenged under trade treaties for setting alcohol excise tax rates considered to discriminate against imported products or against one type of beverage compared to another. In general, when tariffs are replaced with alcohol excise rates, these have been set so as to maintain the level of revenue to government, or to be consistent with rates (and alcohol prices) in neighbouring countries – usually at a lower rate. In replacing tariffs with excise taxes, few countries have as yet taken the opportunity to revise alcohol excise rates upward to help address the likely public health impacts of the change.

Alcohol products are often also subject to indirect taxes in the form of sales taxes (VAT, GST etc.), the level of which varies between countries. This is added on to the retail price. Sales taxes increase the total price to the drinker, but equally affect all other products purchased (with the occasional exception of food) so that they do not affect the price of alcohol relative to other commodities. The company taxes paid by alcohol producers and sellers are similar in purpose and level to company taxes for other sectors. Other special taxes or tax changes may affect alcohol prices and consumption in some cases. For example, a new entertainment tax

in South Korea in 2004 affected sales of alcoholic drinks, particularly on-licensed premises' sales of European style spirits.<sup>52</sup>

### **3.2 Setting the rate**

When reducing consumption and harm are not the primary purpose of alcohol taxes, governments juggle other priorities. These are usually the level of revenue generated, effects on consumption of illegal untaxed alcohol, the effect of taxation on cross-border trading and consumption and any regressive distribution effect across socio-economic groups.<sup>53</sup>

Governments often try to apply the Laffer curve concept, which suggests that increases in tax rates will drive up the revenue collected until an optimum rate. Rates higher than that point will be counter productive in that the resulting high prices will begin to reduce alcohol purchase and therefore tax revenue to government. Governments often aim for an alcohol taxation rate that will theoretically produce the maximum revenue. However, the final balance between price and consumption reflects social and cultural factors, as well as market ones, and is not easy to predict.<sup>13</sup>

There are four main methods by which alcohol excise tax rates are set.<sup>45</sup>

- A levy on the volume of pure alcohol in the product ('specific rate')
- A levy on the volume of each beverage type ('unitary rate')
- A levy on price of the alcohol product ('ad valorem', by value)
- A combination of the three methods above ('combination rate').

Each method has advantages and drawbacks. For example, a percentage ad valorem rate keeps pace with inflation but it is complicated to administer, as prices vary between beverage types, brands, sales outlets and other market conditions. Excise taxes based on the volume of beverage or the volume of pure alcohol are sometimes argued to be regressive, compared to a tax that is a percentage of the price. That is, the tax weighs more heavily on poor drinkers than it does on rich drinkers. However, an analysis in New Zealand showed that alcohol taxes (based on a combination of a unitary and specific rate) were distributed proportionately across the lower income brackets (but declined towards the upper end of the income scale).<sup>54</sup>

Analysis shows that the 'user pays' approach of a tax on pure alcohol may benefit the majority of population who drink less or no alcohol. In New Zealand it is estimated that 70% of the adult population would gain from an increase in the alcohol tax rate, as the current rate does not currently cover the direct fiscal costs of alcohol related harm. Only heavy and chronic drinkers would be worse off.<sup>3</sup>

A 'specific rate' reflects the level of pure alcohol consumed in drinking the beverage. The pure alcohol content is an appropriate indicator for risk of intoxication, health impacts and other alcohol-related problems, and also reflects the risk of social costs that may be transferred to communities.<sup>3</sup> Taxes that reflect pure alcohol content will have a proportional effect on beer, wine and spirits. However, many countries currently tax distilled spirits at a relatively high rate.

### **3.2 Maintaining alcohol tax rates against inflation**

It is the retail 'real' price of alcohol relative to other prices that affects consumption levels. In many countries the real price of alcoholic beverage has declined over recent years. Reasons include cheaper industrialised production methods and economies of scale from industry consolidation, but also failure to adjust alcohol taxation rates to keep pace with inflation.<sup>1,19</sup> Industrialisation and economic growth in China have decreased the price of alcoholic beverages relative to disposable income, contributing to a sharp increase in total consumption.<sup>55</sup> The real price of alcoholic beverages needs to keep pace with or be raised against the rate of inflation if price is to be a strategy for constraining alcohol consumption and minimising harm.<sup>56</sup>

However, alcohol excise taxes are only part of the retail price. High tax rates do not necessarily mean high retail prices, In international comparisons, there is no significant correlation between average prices of alcoholic beverage types and taxation rates<sup>57</sup> and the way tax changes affect the average and range of prices also varies.<sup>58</sup> Alcohol tax increases may or may not be incorporated into prices in a uniform way across all alcohol beverage types and brands. In a complex market, the effect of alcohol tax increases on price may be reduced by other market considerations of the producers, distributors, or sellers in setting prices.<sup>59</sup> For example, in 2004 Malaysian alcohol producers in a highly competitive situation decided to partially absorb a tax rise.<sup>42</sup> However, generally and in the longer term such strategies would be unlikely to be viable and the research evidence cited above does show a significant relationship between taxation levels and consumption and harm over time suggesting that price is affected.

## **4. Alcohol tax policies in the region**

Alcohol taxation policies in most Western Pacific countries, as in other regions, have multiple purposes: to generate government revenue, to constrain consumption and alcohol-related harm, to prevent non-essential spending, or to address specific economic purposes such as balancing trade deficits or protecting a particular business sector. Differences of purpose can cause conflicts in alcohol policy development processes, from fundamental concept to implementation.

### **4.1 Continuing importance for government revenue**

The relative importance of alcohol excise taxes as a source of government revenue declined in the industrialised countries during the 20th century, with increased revenue from company taxes, the introduction of personal income taxes and indirect taxes such as ‘value added or general sales taxes.’<sup>1</sup> In many developing countries, however, alcohol and tobacco tariffs or taxes contribute a substantial portion of total revenue for government. From an economic perspective, alcohol’s price inelasticity makes it a fairly stable source of income. Tariffs on alcohol are an important income stream for Pacific Islands governments, for example. For this reason it has been recommended that any reduction of tariffs on alcohol imports should be at least offset by increases in the level of alcohol excise taxes on both imported and domestic alcohol.<sup>60</sup>

### **4.2 Methods used to set rates**

In many Western Pacific countries, alcohol taxes, both import tariffs and excise taxes, are differentiated by beverage type and level of pure alcohol content (abv – alcohol by volume). In Singapore, for example, beer is charged at a unitary rate of S\$3.1-3.7 per litre of beverage and distilled spirits at S\$30 per litre under 46% abv and S\$70 over 46% abv.<sup>45</sup> There are two rationales for these rate differences. First, production costs are higher for wine and beer than for distilled spirits, so the price per litre of pure alcohol in distilled spirits would be far lower, if an equal rate were applied to both. Secondly, it is official policy in some countries, such as China, to encourage consumption of low-strength beverages such as beer or wine, to reduce risk of problems. China increased its tax rate on distilled spirits in 1998 for this reason.<sup>61</sup> In countries with traditions of heavy spirits consumption, this can be an effective strategy for reducing the level of pure alcohol consumed and associated harm.<sup>1</sup>

Relatively low tax rates are sometimes applied to traditional local beverage types or beverages produced from local ingredients. For example, in Republic of Korea the excise tax rate for *takju*, a traditional wine, is lower than for other wines.<sup>62</sup> *Soju* is Korea's most popular traditional drink, a spirits distilled from potatoes with 25% abv and is also relatively low in tax. *Soju* is cheap, heavily consumed and associated with most risk of harm.<sup>11</sup> In 1996 a WTO ruling required Japan to allow imported spirits the same market access as its traditional spirits drink, *shochu*, and the tax on imported spirit was greatly reduced over the next five years.

Differences in alcohol tax rates or tariffs for different types or strengths of alcoholic beverage sometimes have unintended consequences by providing incentive for alcohol producers to introduce and promote comparatively cheap beverages. This occurred in New Zealand in response to a 'specific rate' tax scale with only a few wide steps. 'Lite' spirits products, at a strength of around 18% abv, were developed to slip under the bar of the 14-23% abv band for products such as sherries and fortified wines. This meant they were taxed at NZ\$18.6 per litre of pure alcohol, rather than at NZ\$23.7, therefore a low rate of tax for the beverage relative to its alcohol content. This enabled cheap pricing that put the products in the market niche of ready-to-drinks (spirit mixes).<sup>3</sup> They had names like Vodka 62, to indicate 62% of the standard strength. The tax scale was amended in 2003 to remove this anomaly, and the alcohol available for consumption in this category dropped by 90%.<sup>63</sup> Tax scales with finely graduated steps for different strengths of alcohol can help avoid this problem.

In February 2006, Australia revised its alcohol taxes mechanisms for beer and spirits. Imported spirits and ready-to-drinks (but not beer) are subject to a 5% ad valorem tariff. Excise taxes on beer and spirits are now set on a volumetric basis reflecting pure alcohol content. Rates are reviewed twice a year to take account of consumer price index movements. Tax on wine is based on wholesale value, however and there is no mechanism for inflation.

There is a variety of alcohol taxation approaches among Asian countries. Alcohol tariffs vary from none in Hong Kong to 150% in Vietnam for imported beer and wine. Excise taxes are more sophisticated. Among these countries, alcohol excise taxes in Philippines and Malaysia are distinctive. Alcoholic beverages in Malaysia are now taxed by a combination system; 15% of the invoiced value is added to a unitary rate. In the Philippines, excise tax is based on the net retail price. This means the price in some major supermarkets in metropolitan Manila, excluding excise tax and sales tax. For example, any alcohol product, regardless of beverage type, which has a net retail price less than 250 pesos will be charged at 75 pesos per litre of

pure alcohol, compared with 300 pesos per litre of pure alcohol for products with a net retail price over 675 pesos.<sup>45</sup>

### **4.3 Protecting against inflation**

There are a number of recent practices within the region in regard to protecting alcohol taxation against erosion from inflation. For example, in New Zealand alcohol tax rates are adjusted by inflation rate twice a year and recently Australia adopted the same system for beer and spirits taxes. The Philippines uses 'net retail price' as the basis for taxing some beverages, which tends to ensure that tax rates rise to reflect price rises due to inflation or other factors. Malaysia's combination system adds 15% of the price of alcoholic beverage types to unitary tax, so price rises due to inflation will also be partly reflected in the tax rate.

### **4.4 Earmarked revenue from alcohol taxes**

In some Western Pacific countries (and some countries in other regions), revenue from alcohol taxation is earmarked for particular purposes, rather than absorbed into general revenue. The WHO WPRO has prepared a document outlining the possible mechanisms and advantages of establishing health promotion foundations funded by earmarked taxes on alcohol and tobacco.<sup>64</sup>

### **4.5 Duty free alcohol**

Duty-free alcohol sales for travellers and residents means a loss of tax revenue and is increasingly a source of cheap alcohol that contributes to consumption and heavy drinking. Since it is duty free, the amounts involved are generally unreported. This issue has been raised by small Pacific Islands nations, which have high proportions of local people, overseas residents and relatives living overseas who fly in and out of the country.

### **4.6 Targeted tax on ready-to-drinks**

Special taxes on alcopops – sweet premixed drinks, usually based on spirits, have been introduced in France, Switzerland, Germany, and Sweden in response to increases in young people's drinking.

In July 2004 Germany's tax change added an extra €0.83 per 275ml bottle. Consumption of ready-to-drinks by German young people almost halved over the following years. A 2005

report by the German Drug Commission showed the proportion of 12 to 17 year olds who drank ready-to-drinks once a month had dropped from 28% to 16%, and a third of those who drank ready-to-drinks the previous year no longer did so. The teenagers cited the tax as the main reason for these changes. No substitution to other drinks was reported. The most recent sales figures for these drinks show a 75% drop since the tax change.<sup>65</sup>

In February 2004 the tax on ready-to-drinks in Switzerland was increased to triple that of spirits, leading to a sharp drop in imports. This tax change was initiated by the Council of States (representing the regions) and confirmed by the National Council, with both houses voting strongly in support. The tax on a 0.275 litre bottle increase from SFr.0.45 up to SFr.1.80 and for a 0.3 litre bottle from SFr.0.50 up to SFr.2. This was estimated to generate around Fr.50 million, 10% of which would be used for prevention work. However, a ready-to-drink was partly defined by the sugar level – over 50g per litre – and this led to low-sugar versions being produced to avoid the tax.<sup>65,66</sup>

From April 2002, ready-to-drinks based on spirits in the UK were taxed at the rate for spirits, rather than at the same level as wine. Wine-based flavoured drinks remained the same. From 2000 to 2002 sales of flavoured alcohol beverages had increased by 70% in value increase. One in ten adults (11% of women and 5% of men) drank ready-to-drinks and one in five of 18-24 year olds (22%). Following the tax rate change one distiller's brands dropped 12% in sales the following year. By November 2005, sales had dropped 22% from £1.6 billion to £1.2 billion as a result of the tax change. A quarter to a third of 20-24 year olds said ready-to-drinks were now 'too expensive for what they are'. The 18-24 year old market is switching to alternatives, such as cocktails. The market expected to fall a further 18% to around £1 billion.<sup>65</sup>

In January 2007, Sweden will implement a special tax on ready-to-drinks with the aim of reducing their consumption by young people. The tax rate will be the current rate plus six Swedish krona per litre of drink. The revenue from the special increase only – predicted to generate around 100 million SEK (US\$1.6m) – will be directed to funding preventive measures to reduce alcohol related harm.<sup>67</sup>



## 5. Issues specific to the region

### 5.1 Cultural variations

Evidence from high-income Western countries is relevant to this region, provided some substantial differences in policy contexts are taken into account, particularly in low-middle income countries. For example, not all have adequate systems in place for monitoring and taxing domestic alcohol production particularly that produced in the informal sector.

Despite growing sales of imported or locally produced European-style beers, wines and spirits, traditional alcohol beverages remain popular and are sometimes taxed at a different rate. Examples are *takju* and *yakju* in the Republic of Korea, and *sake* and *sochu* in Japan. Some countries set a separate rate of alcohol tax for traditional beverage if they are produced from local ingredients. Alcohol beverages produced from certain agricultural products, such as coconut and Buri palm, are taxed at lower rate in Philippines.<sup>45</sup> Under trade treaties, tariffs on imported alcohol products can be reduced more slowly to protect local production that meets certain ‘rules of origin’.

### 5.2 Unrecorded and untaxed alcohol sales

As well as traditional beverages that are legally produced and taxed, drinkers can often access illegal alcoholic beverage, including home brewing, alcohol production in the informal sector, cross-border smuggling and by means of counterfeiting excise stamps. In New Zealand home brewed beer, wine and, since 1996, spirits is not taxed if it is for personal consumption and not for sale. This is estimated at a fairly steady 3% of all alcohol consumed.<sup>68,69</sup> Bush beers or toddies and other home produced or ‘cottage industry’ alcohol beverages are common in many countries of the region. These are typically produced at lower cost than commercially produced beverages.<sup>57</sup>

In some countries, high availability of illegal alcohol products for sale significantly affects the effectiveness of alcohol taxation as a public health intervention to reduce consumption and alcohol related harm. An increase in alcohol tax affecting prices may theoretically meet a rapid response from increased informal production and smuggling.<sup>1</sup> Low-middle income countries often have limited capacity to take enforcement action against illegal production.

In the Western Pacific region, estimates of adult per capita consumption of unrecorded alcohol beverages range from very low in Australia to around 7 litres in the Republic of

Korea. Other countries with high estimates of unrecorded consumption are the Philippines at 3 litres and Malaysia at 3.4 litres. In some Pacific Islands, 'bush beer' or toddy is a source of cheap unregulated alcohol. In most of the countries in the region it is estimated at 0.5-2 litres per head of population aged 15 plus.<sup>70</sup> Vietnam has faced particular problems from illegal beverages, with official estimates that around 30-40% of all spirits sold are smuggled products.<sup>42</sup> Vietnam is attempting to address this with stronger border controls, tax stamps on alcohol containers and monitoring retail sales outlets.<sup>71</sup> However, excise stamps are now available very cheaply on the black market and vendors also have other methods of evading the tax.<sup>45</sup>

## **6. Industry responses to alcohol taxation**

Alcohol tax increases create uncertainty for the industry,<sup>50,72</sup> in that such indirect taxes are designed to be carried by the customer. Increases in alcohol tax rates can lead to higher prices which change alcohol purchase decisions or, alternatively a narrow profit margin for the industry if they absorb part of the tax burden rather than transfer it to customers through prices. The industry is also concerned that drinkers may shift to cheaper alcohol products. This may include non-commercial or illegal beverages in countries in which the availability of home-brew or other non-commercial beverages is relatively high.<sup>73</sup>

The alcohol industry funded social aspects organisation, the International Centre for Alcohol Policy, has described alcohol taxes as a limitation of commercial freedoms and consumer rights, particularly those of non-abusive drinkers.<sup>73</sup> Contrary to the research evidence, industry representatives suggest that alcohol-related problems result entirely from the abuse of alcohol by a minority of drinkers. They describe alcohol taxation as a 'blunt instrument' that penalises the majority of drinkers for whom alcohol is harmless. They also claim that alcohol taxation will be ineffective in influencing the drinking behaviour of alcohol abusers, because heavy and chronic drinkers are comparatively less sensitive to price.<sup>73</sup>

In consultations on the European Commission's recent Alcohol in Europe report,<sup>65</sup> alcohol industry representatives viewed tax and price measures as of low impact and low policy importance, despite the weight of research evidence on their effectiveness, and favoured educational measures, for which there is little evidence of effectiveness.<sup>1</sup> In the UK, the Portman Group similarly opposed the 2002 tax increase rate on ready-to-drinks, saying:

Whilst the Chancellor may well be right to go for fiscal fairness, the best way to tackle alcohol misuse is to be encouraging responsible consumption, whatever the type of drink, rather than expecting a tax hike to do the trick.<sup>74</sup>

Industry responses to alcohol taxation increases may vary. Some alcohol producers have found profit-maximizing responses to alcohol tax increases in the way they market products. To compensate for an alcohol tax rise, the alcohol industry in Philippines intensified its promotions and specifically targeted previously under-explored sections of the population.<sup>72</sup>

Other producers have developed products to exploit anomalies in alcohol tax scales. A problem in New Zealand with under-taxed 'lite' spirits was described in section 4.2. After the scale was flattened to remove the tax advantage for lower strength spirits, some producers responded by introducing a 'very light spirits' which at 13.9% absolute alcohol slips under the bar of the tax grade for wines.<sup>75</sup> Until recently Japan's tax system had disparities between beverage types. Traditional and European style beer was taxed on its malt content, so a 'third generation' of beers from other ingredients was developed so as to incur lower tax despite similar alcohol content. A new tax scale from May 2006 introduced parity between alcohol types, and further tax increases are expected.<sup>76</sup>

## **7. Policy options**

Alcohol taxes provide a useful public health tool that raise the real cost of alcoholic beverages to drinkers in a way that reflects their potential for alcohol related harm.

That purpose supports a scale of tax rates that reflects the pure alcohol content of the various beverage categories. It often also suggests an increase in the level of the tax scale, so as to prompt a sufficient increase in current alcohol prices to influence harmful drinking and alcohol-related harm. Mechanisms are necessary to ensure that rates do not slide against inflation or falling costs of import and production and also to review the alcohol tax rates regularly, to consider whether additional increases may be necessary.

Rates set higher than the pure alcohol content scale may be considered for some beverage types. This can be a way of addressing particular problems, such as traditional heavy per occasion drinking of spirits, or of protecting vulnerable groups such as young people from products such as sweet ready-to-drinks which are particularly appealing to them. In setting any special tax rates of this kind, governments will take into consideration any trade treaties

they belong to. Special taxes can be consistent with trade principles provided they are even handed in the treatment of foreign and local producers, and are based on evidence and explanations for different treatment of the beverage category. The public health purposes and evidence for the special tax must be clearly stated to ensure that it is not seen as merely a barrier to trade and competition.

To establish a public health-oriented alcohol taxation system, the follow key points should be considered:

1. It is recommended that alcohol taxation policy be based on an explicit statement by government that its purpose is to influence levels of alcohol consumption and to reduce alcohol related harm.
2. Alcohol taxation policy should focus on raising the minimum prices at which alcohol is available to drinkers. This will require regular monitoring and collection of data on prices.
3. The level of alcohol tax rates should reflect the pure alcohol content of the beverage, rather than simply the value of the alcohol product. It is the volume of alcohol consumed, on a particular occasion or cumulatively, that increases the risks.
4. Spirits have lower production costs per litre of pure alcohol than wine and beer for spirits, so traditionally higher tax rates for spirits may be justified under alcohol tax policy that aims to maintain or increase alcohol prices paid by drinkers.
5. The scale of tax rates based on alcohol content should be sufficiently finely graded to avoid anomalies that may make pure alcohol cheaper in one beverage type rather than another. This is because for many people alcohol products are substitutable if the price is right. Experience indicates that the alcohol industry will tailor its products and its marketing to take advantage of tax and price differences.
6. A higher tax on a particular beverage type may be considered where this has a particular impact on public health or on vulnerable groups, but care should be taken the policy is designed to treat alcohol producers or sellers as even-handedly as possible while achieving its goal.

7. The policy should include a mechanism to ensure that the amount of tax as a proportion of the drink price is not eroded. Although alcohol tax is only one factor in the price to consumers, it should be regularly adjusted to keep pace with purchasing power, rising incomes and inflation – and the overall rate increased if necessary to help achieve public health goals.
8. In many countries, effective alcohol taxation policy will require resources and monitoring systems to ensure enforcement of the alcohol excise law on *all* imported and locally produced alcohol. Policies that allow alcohol to be sold duty free to travellers and residents could also be reviewed.
9. The evidence suggests that this alcohol taxation system will be a key part of a package of effective policies to reduce alcohol related harm in each country, and in the region as a whole.

## **8. Benefits**

Alcohol tax systems directed to public health purposes, with higher tax rates, can benefit governments in that a ‘user pay’s’ approach to drinking recoups more of the current fiscal expenditure on policing, health care and social services. Reduced consumption, or even slowing the current growth in consumption in many Western Pacific Region countries, will mean savings for governments by reducing future alcohol related harm. Most countries already have systems in place for tariff or excise tax collection. Improved enforcement systems may be partially self-funding.

Taxes and tariffs on alcohol are very long standing policy tools world wide, and are accepted by many alcohol producers. In terms of the harm that arises from alcohol, a tax that reflects pure alcohol content of their products has an unarguable logic. Fair, non-discriminatory and predictable policies are important to industry. The adoption of similar policies across the region can be helpful. As the Beer Wine & Spirits Council of New Zealand say, the pursuit of fairness in taxation is important to the industry. In some countries it will be particularly important that all imports and production of alcohol are covered by the taxation system.

Communities will benefit from reduced alcohol related harm to drinkers and to their families. A higher tax shifts more of alcohol’s true costs onto the drinker in proportion to the amount

drunk, rather than leaving it as a burden on other taxpayers. As even small tax increases can be effective, the resulting effect on prices will make little difference to low and moderate drinkers but can be expected to reduce drinking among teenagers and discourage heavier drinkers.

From a public health perspective, a reduction in consumption that reduces harm, particularly among young people and heavy per occasion drinkers, will have net benefits for governments. This is because current country alcohol tax rates are well below the direct fiscal costs of policing, health care and health promotion and very much below the full social and economic impacts on society. In nearly all countries in the region, alcohol consumption is rising.

Greater consistency between the countries of the Region in public health approach, methods and tax rates will also help reduce the opportunities for illegal importation or alcohol production.

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