THE WINE AND SPIRIT TRADE ASSOCIATION

Budget Submission 2011

Rebalancing the duty burden on the wine and spirit industry

International Wine & Spirit Centre / 39-45 Bermondsey Street / LONDON SE1 3XF
t +44 (0)20 7089 3877 / f +44 (0)20 7089 3870 / e info@wsta.co.uk
Registered Number: 410660 England Limited by Guarantee VAT Number: GB 243 8280 60

Introduction

This year's Budget offers the Chancellor an opportunity to support the recovery of the alcohol industry from the recession. Scrapping the duty escalator imposed by the previous administration would provide a vital boost to the sector's confidence and competitiveness, encouraging investment, growth and enabling it to play its part in the UK's economic recovery.

The alcohol industry makes a significant contribution to the UK economy, supporting close to two million jobs[1] and generating £14.7 billion in duty and VAT in 2009-10[2]. Jobs in the industry range from the service to the manufacturing sectors and are spread across the UK, from local rural economies to the regional centres of the big brewing, distilling, wine and bottling companies, which are a vital source of private sector-based employment. The industry can help to deliver the Government's growth agenda if encouraged to do so.

We very much welcome the intention set out in the Coalition's programme for government for an alcohol taxation system which does not unfairly penalise responsible drinkers and responsible businesses. This is the system we need for a sustainable, competitive alcohol industry.

However in recent years, the duty on alcohol has placed a disproportionate burden on the sector. This, coupled with the growing weight of new legislation and the wider economic climate, has put the industry under sustained pressure. Many companies no longer see the UK as a market for investment and are re-locating to other markets, with the resulting loss of jobs and support for the local economy.

- **The duty escalator should be scrapped to support the industry's recovery.**
- **CPI should be used for the indexation of alcohol duty increases.**
- **The proposed 2011 duty increase will represent cumulative tax increases of 35% on wine and 30% on spirits since 2008.**
- **UK tax now accounts for 74% of the average price of a bottle of spirits.**
- **In 2010, total wine sales fell by 2% in volume.**
- **Consumer expenditure on alcohol has fallen by £2.5bn since 2007/08.**
- **Overall alcohol consumption has dropped by an estimated 11% since 2004 and people drinking over the recommended guidelines continues to fall.**

Sales data points to continuing challenges for the industry. To support the industry's recovery, the taxation burden must be rebalanced by scrapping the duty escalator. If the 2011 duty increases go ahead, taxes on wine and spirits will have increased by 35 per cent and 30 per cent respectively since 2008. The WSTA would support a switch from the Retail Prices Index (RPI) to the Consumer Prices Index (CPI) for the measure against which alcohol duty increases are indexed - a move which the Government announced it was considering in the last budget. Use of CPI would be consistent with the Government's own measure of inflation.

It is essential that taxation remains a revenue-raising measure and is not used as a blunt tool for tackling alcohol misuse. We must reach problem drinkers through other means. This is best achieved through a genuine partnership between industry and Government, such as what is being achieved in the ongoing work on the Public Health Responsibility Deal.

1 *Oxford Economics, The economic outlook for the UK drinks sector and the impact of the changes to excise duty and VAT announced in the 2008 Budget and Pre-Budget Report, February 2009*

2 *Based on: ONS, Consumer Trends Reports; HMRC, Alcohol Bulletins, November 2010*

1. Rebalancing the duty burden

The alcohol industry understands the challenge the Government faces in putting the public finances back on a sustainable footing. However it already bears a significant share of the tax burden.

Given the Chancellor's commitment to spending reductions rather than tax rises to make up the bulk of the consolidation, scrapping the duty escalator introduced by the previous Government, which increases duty by 2 per cent above inflation every year, would be consistent with this.

If the proposed duty increase goes ahead as planned in the 2011 Budget, this could represent a 35 per cent cumulative increase in wine duty since the escalator was introduced in the 2008 Budget and a 30 per cent increase in spirit duty[3].

35%: the three year increase in wine duty if the 2011 tax rise goes ahead

The WSTA believes that, if the Government decides to retain the duty escalator, then there should be a switch from RPI to CPI for the indexation of alcohol duty increases. This would ensure consistency with the Government's own measure of inflation. CPI provides a more accurate reflection of consumer spending patterns in the UK.

Table 1. UK Excise duty rates for wines and spirits since 2007

Year	Wine duty (per hl)	Wine duty per bottle (75cl)	Spirits Duty (litres of pure alcohol)	Spirits duty per bottle (70cl @37.5%)
2007	£177.99	£1.33	£19.56	£5.13
2008 (Budget)	£194.28	£1.46	£21.35	£5.60
2008 (PBR)	£209.82	£1.57	£22.20	£5.83
2009	£214.02	£1.61	£22.64	£5.94
2010	£225.00	£1.69	£23.80	£6.25
Increase 2007/2010	26.4%		21.7%	
2011 (projected)*	£240.30	£1.80	£25.42	£6.67
Increase 2007/2011	35.0%		30.0%	

**Assuming the escalator goes ahead as planned, calculated using RPI at 4.8% for the year to December 2010[4] + 2%*

Year-on-year duty increases. Between 2008 and 2010, the cumulative duty increase on wine was especially severe, increasing by 26 per cent. Duty on spirits has increased by 22 per cent in this period.

74%: the amount of tax on a bottle of spirits as a proportion of average retail price

These increases have inevitably driven up prices, with prices rising above the level of inflation[5].

3 Assuming the escalator goes ahead as planned, calculated using RPI at 4.8% for the year to December 2010 + 2% (ONS, Consumer Price Indices for December 2010, 18 January 2011).

4 ONS, Consumer Price Indices for December 2010, 18 January 2011

5 For example, in 2009 RPI on alcohol increased by 4 per cent, whereas RPI on all items decreased by 0.5 per cent (ONS, Statistics on Alcohol, England 2010, May 2010).

- In terms of how the duty increases already imposed translate into tax on a single product, the duty per 75cl bottle of wine has increased from £1.33 prior to the 2008 budget to £1.69 in 2010. Duty on a standard 70cl bottle of spirits has increased from £5.13 to £6.25 (See Table 1).

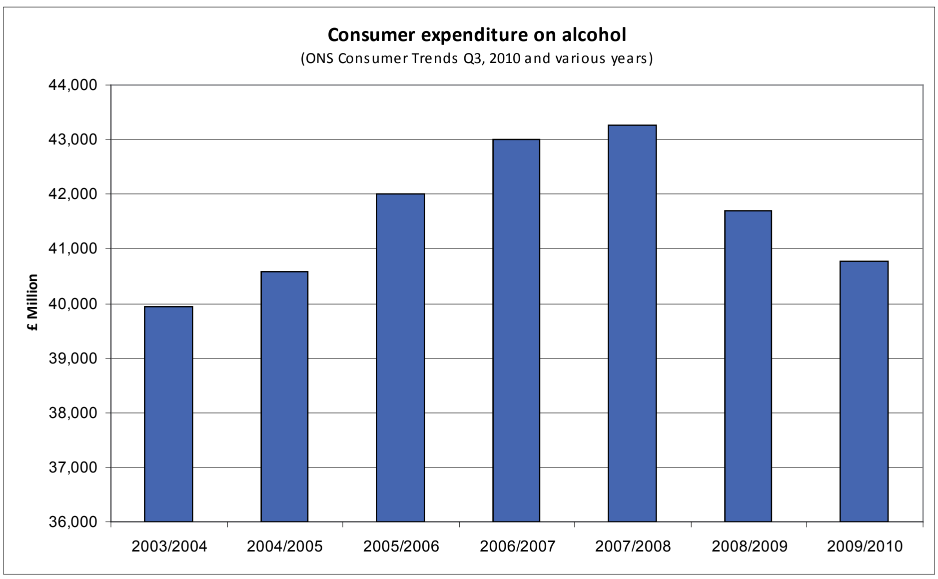
- UK tax (duty plus VAT) now accounts for 54 per cent of the average retail price of a bottle of wine in the UK market and 74 per cent of a bottle of spirits.

- The average retail price for a bottle of wine in the UK off-trade has increased from £4.01 in early 2008 to £4.47 in 2010, up 11 per cent[6].

- The average retail price for a 70cl bottle of spirits has increased from £9.66 in early 2008 to £11.01 in 2010, up 14 per cent.

£2.5bn: the drop in consumer expenditure on alcohol since 2007/08

Consumer expenditure on alcohol reduced. Government revenue from alcohol has been boosted by year-on-year duty increases, rather than increased consumer expenditure. Since 2007-08, consumer expenditure on alcohol has dropped from £43.3bn to £40.8bn, a decrease of 6 per cent[7]. Further duty increases therefore risk damaging the industry and diminish returns to the Treasury.

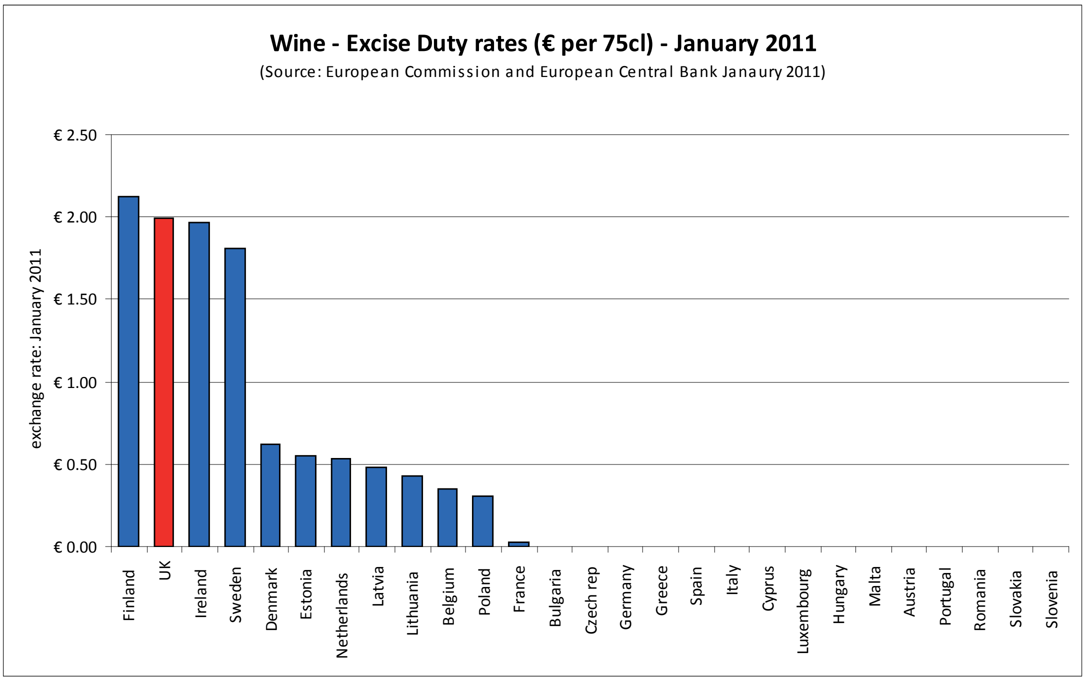


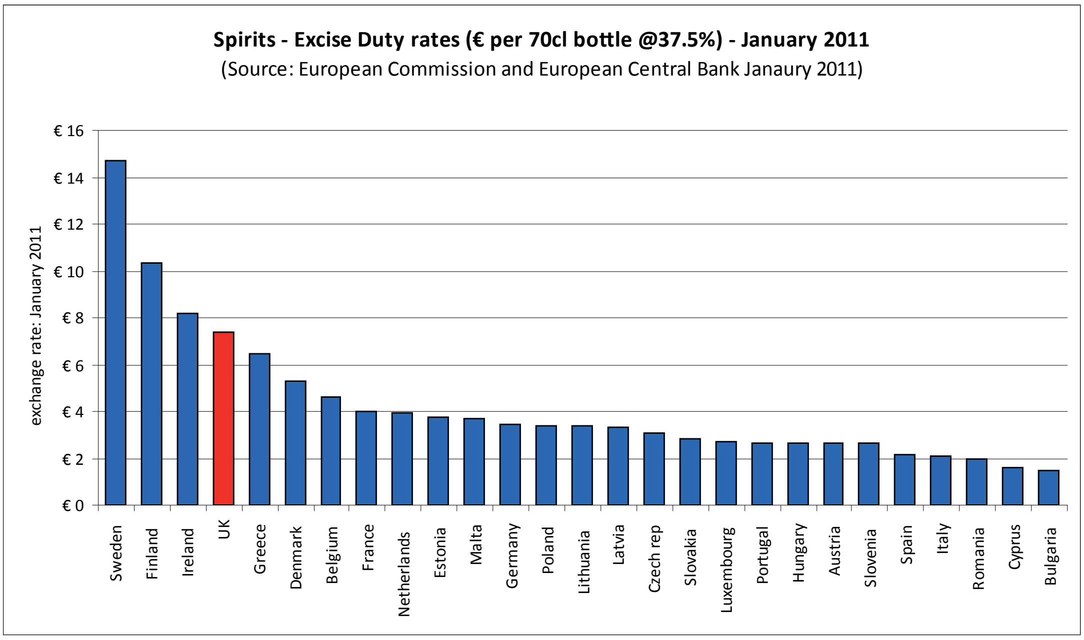
6 *Nielsen data, 2008 & 2011*
7 *ONS, Consumer Trends Q3, Various Years*

The nature of the market means it is difficult to persuade consumers to pay even slightly more for products and higher taxes cannot be passed on in their entirety. Consumers do not consider duty rates when making product choices, they merely compare prices. This is why, even though average prices have risen, they have clearly not increased in line with duty and VAT increases. This means that businesses are making less margin - even before increased costs and exchange rates are accounted for - and is likely to reduce employment in the sector.

Small businesses in particular are less able to absorb such extra costs and are disproportionately disadvantaged in comparison with larger competitors.

The UK already has some of highest duty rates in Europe. Analysis of duty rates shows that the UK has the second highest rate of excise duty on still wine in the EU behind Finland. We have the fourth highest rate of duty on spirits.[8] This makes the UK alcohol industry among the most heavily taxed in Europe.





8 *European Commission and WSTA analysis.*

2. Supporting the industry's recovery

By scrapping the duty escalator in this year's Budget, the Chancellor has an opportunity to support the industry's recovery from a difficult few years. A period free of duty rises would allow it to grow in both confidence and value. Such a boost to an industry which contributes 2 per cent of the UK's total output and supports an estimated 1.8 million jobs in the economy,[9] would allow it to play its part in the UK's economic recovery.

It is important that alcohol duty rates are not considered in isolation, ignoring the wider pressures on the industry. For example, rises in fuel duty are also of serious concern to businesses. As in other sectors, fuel represents a high proportion of haulage costs and any further increase in fuel duty would contribute significantly to inflationary pressures and have a substantial impact on costs passed on to consumers.

As well as year-on-year duty increases, the January rise in VAT and the economic climate, the industry has also had to work with a growing body of regulation aimed at curbing alcohol misuse. This includes wide ranging reform of the licensing system and different legislative requirements imposed in constituent parts of the UK. The lack of a consistent, UK-wide approach to new legislation imposes additional operating costs on businesses. Unsurprisingly, these pressures have combined to have a significant impact on the industry.

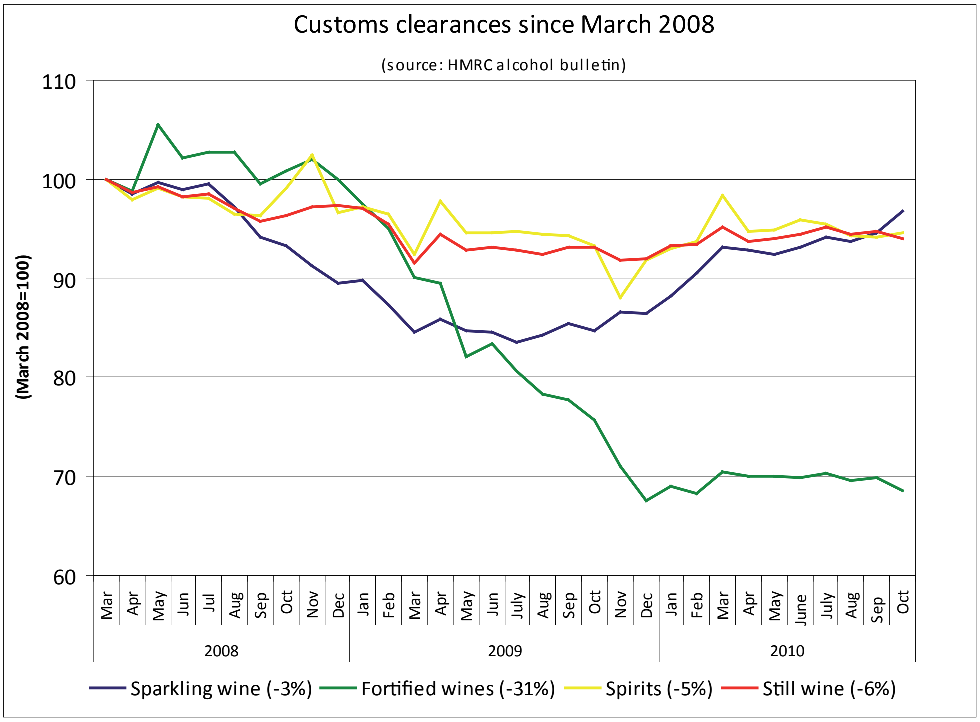
Evidence of the impact on the industry:

-2%: total volume decline in wine sales in 2010

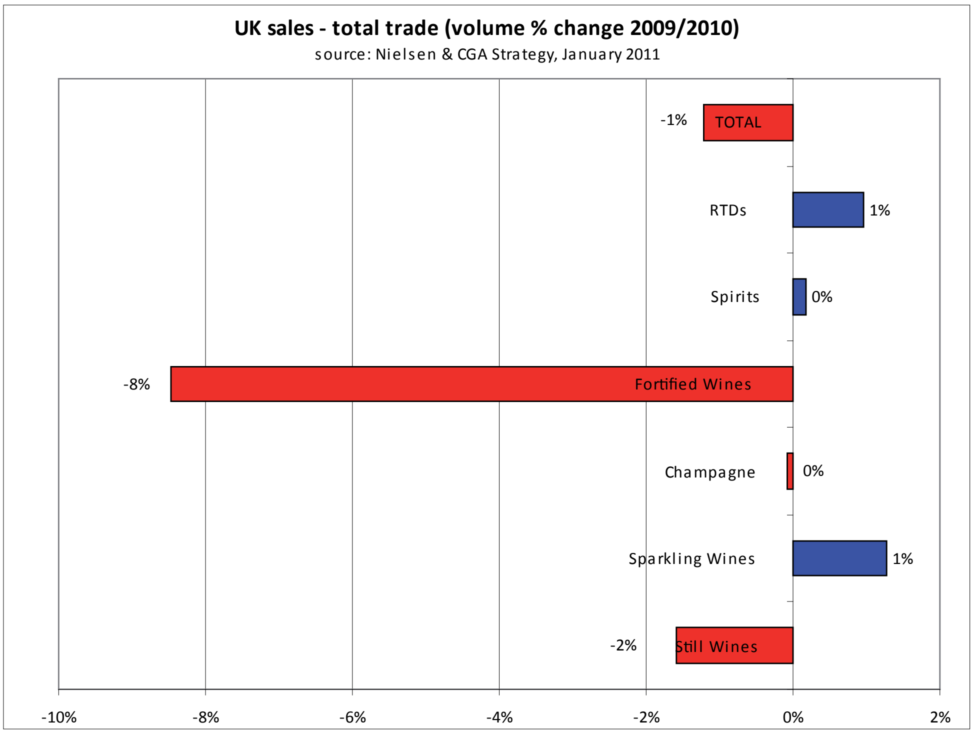
- The introduction of the duty escalator in 2008 and the subsequent duty increases were projected to reduce employment in the industry by up to 80,000 jobs[10].
- Many companies no longer see the UK as a market for investment and are re-locating to other markets, with the resulting loss of jobs and support for the local economy. Global wine businesses such as Constellation, Gallo and Treasury Wine Estates have been restructuring and moving jobs and investment out of the UK.
- Major retailers such as First Quench Drinks with Threshers, Bottoms Up and Wine Rack have failed.
- Many smaller businesses, who are less able to cope with higher taxes and the recession, have failed throughout the supply chain.
- 4,000 pubs have closed in two years[11].

A decline in HMRC customs clearances. HMRC customs clearances continue to show evidence of challenging conditions for the wine and spirit market. Whilst sparkling wine showed some recovery last year, the latest data from October 2010 indicated that clearances remained 3 per cent lower compared to March 2008, prior to the introduction of the duty escalator. Still wine remains 6 per cent lower than 2008 and spirits 5 per cent lower. Fortified wines have suffered the sharpest decline and October clearances were 31 per cent down on March 2008.

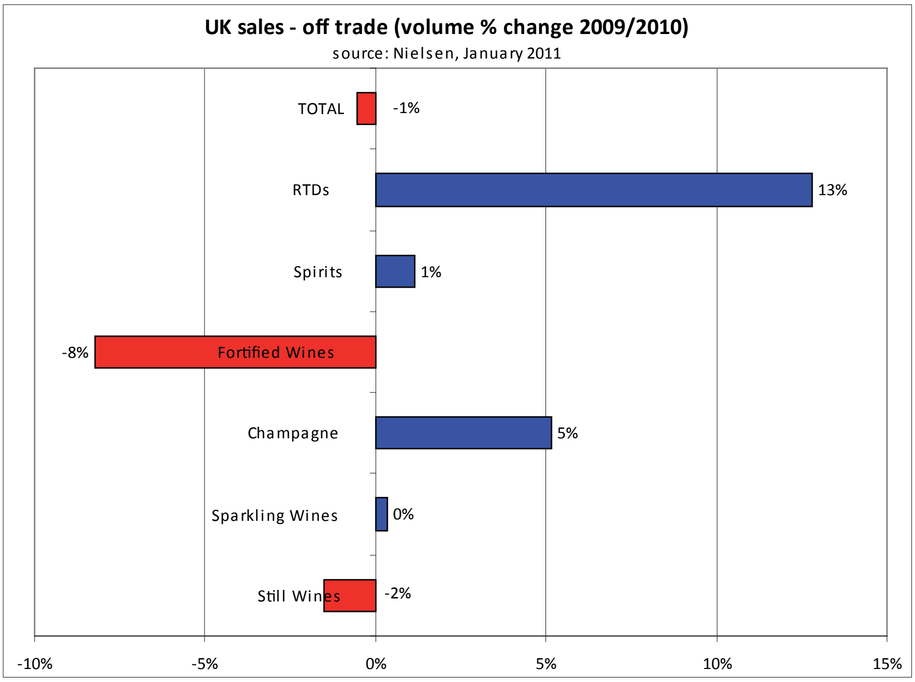
9 *Oxford Economics, The economic outlook for the UK drinks sector and the impact of the changes to excise duty and VAT announced in the 2008 Budget and Pre-Budget Report, February 2009*
10 *Ibid.*
11 *British Beer and Pub Association, Response to Alcohol Taxation Review, August 2010*



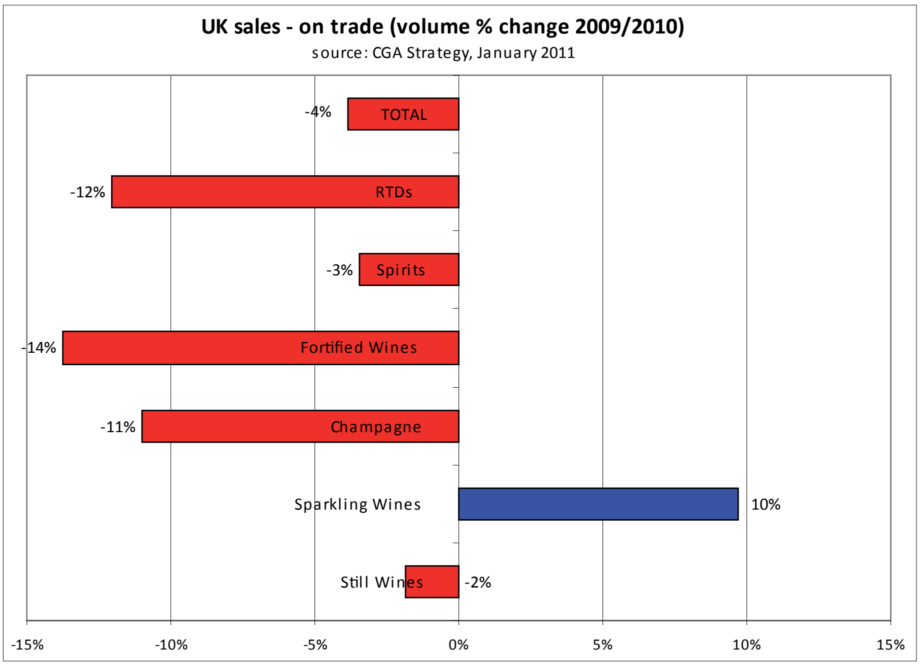
Declining wine and spirit sales. The latest sales data which takes into account both the on-and-off trades, reveals that total wine and spirit sales fell by 1 per cent in volume terms in 2010. Wine sales dropped 2 per cent last year and spirits and champagne witnessed zero growth. There was a slight increase in total sales of 2 per cent in value, from £18.1bn in 2009 to £18.5bn in 2010. However, viewed in the context of declining consumer expenditure and volume sales, this increase can be more than accounted for by rises in alcohol duty and VAT.



Sales in the off-trade. Looking at wine and spirit performance in the off-trade, overall volumes declined by 1 per cent in 2010. Still wines saw volumes decline by 2 per cent and fortified wines suffered a slump of 8 per cent. Ready to Drink beverages (RTDs) were the best performing category, with the increase of 13 per cent driven by sales of new pre-mixed cocktail products and some significant new product launches. Spirits struggled to a growth of 1 per cent. The value of total wine and spirit sales in the off-trade increased by 4 per cent in 2010, up £387m, but again this can be attributed to the impact of duty increases.



Challenging conditions in the on-trade. 2010 was again a tough year for the on-trade, with all categories - with the exception of sparkling wines - suffering declining volume sales. A decline of 4 per cent in total wine and spirit sales disguises even greater falls for champagne (11 per cent), RTDs (12 per cent) and fortified wines (14 per cent). Of serious concern to the wine industry in light of the off-trade sales decline last year, was a fall in the on-trade of 2 per cent in still wine volume sales. Spirit sales suffered a decrease of 3 per cent. In the face of such poor volume sales, it is unsurprising that even with duty increases, the value of total on-trade sales decreased by a percentage point from £8.7bn to £8.6bn.



3. A socially responsible industry

The industry takes its role in fostering a culture of responsible drinking very seriously. We want to work in partnership with Government to tackle irresponsible alcohol consumption and the associated harms.

We want to support the Government's aim of forging a new approach, by encouraging individuals to make their own choices about sensible alcohol consumption, rather than through top-down interventions.

Forging a new partnership with Government.
For this partnership between industry and Government to flourish, the burden of taxation and regulation must be proportionate.

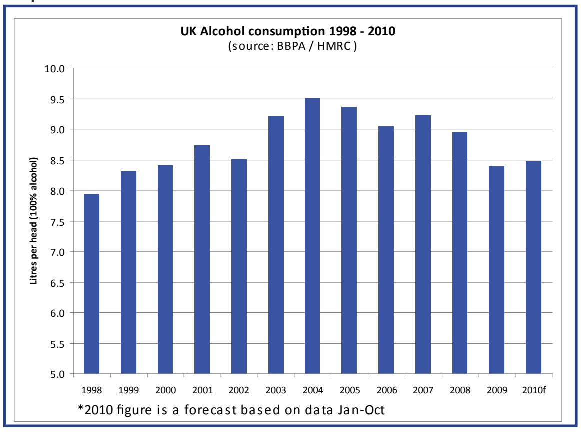
Taxation should be a revenue-raising measure and not used as a tool for tackling alcohol misuse. To do so is both ineffective and unfair, as it penalises the majority of moderate drinkers and responsible businesses.

Measures to tackle alcohol misuse must be targeted at problem drinking. There is little evidence of a direct correlation between the level of taxation in a country, overall consumption and alcohol harm.

Contrary to popular perception, alcohol consumption in the UK has been falling since 2004, the proportion of people drinking over the recommended weekly guidelines has dropped and levels of binge drinking have reduced.

Facts about alcohol consumption

- Average alcohol consumption has been falling since2004. An analysis of HMRC clearance data shows that total alcohol consumption has fallen by an estimated 11 per cent from 2004 to 2010*.



- The majority of people drink responsibly. People in Great Britain drinking over the recommended weekly guidelines continues to fall. The proportion of men drinking more than 21 units a week has fallen from 31 per cent in 2006 to 26 per cent in 2009. The number of women drinking more than 14 units a week has dropped from 20 per cent to 18 per cent *(ONS, Smoking and drinking among adults 2009, 27 January 2011, Table 2.2)*.

- Consumption in the UK is lower than in many of our European neighbours. The UK ranks 14th highest out of 31 countries in terms of adult alcohol consumption, behind France and 15th highest out of 28 countries in terms of deaths from chronic liver disease, behind Germany *(European Commission & OECD, Health at a Glance: Europe 2010, December 2010, p.71)*.

Yet whilst overall consumption has reduced, evidence suggests that harms remain high. This is why specific, targeted measures to tackle these harms are the most appropriate ways of addressing the problem, rather than through a whole-population approach such as taxation.

The alcohol industry is already working to encourage responsible consumption in a number of ways and wants to continue to be in a position to invest resources in this vital area.

- **A new partnership through the Responsibility Deal.** The WSTA is leading the industry's work with the Department of Health on a Responsibility Deal for Public Health. This is looking at a number of areas in which the industry can make commitments to encourage responsible alcohol consumption. These include improving the coverage of health information on drinks labels, providing consistent information to consumers about unit content and supporting local initiatives.

- **Community Alcohol Partnerships.** Community Alcohol Partnerships, developed by the WSTA-coordinated Retail of Alcohol Standards Group, aim to tackle the problems caused by underage access to alcohol. This is achieved through co-operation between alcohol retailers and local stakeholders, such as trading standards, police, local authority licensing teams, schools and health networks. What began as a pilot project in St. Neots, Cambridgeshire has developed into a tried and trusted method of local partnership working which delivers results. In 2009, Kent University evaluated CAPs in three areas of Kent. It found that from March to September 2009, Kent CAP pilot areas saw a decline in offences of criminal damage greater than in non-pilot areas. A total of 29 schemes are now in operation.

29: The number of Community Alcohol Partnerships in the UK

- **Sensible drinking campaigns.** The Drinkaware Trust is a UK-wide charity supported by the alcohol industry, which aims to reduce alcohol related harm by challenging the national drinking culture. In 2009, Drinkaware received a boost in annual funding to more than £5 million for three years, marking a major commitment from more than 50 alcohol-related companies to tackling alcohol misuse. The Campaign for Smarter Drinking, a £100 million social marketing campaign and launched in partnership with both Drinkaware and Government, aims to encourage responsible enjoyment of alcohol among 18 to 34 year olds. The campaign deploys mainstream advertising, on-pack messaging and communications materials in bars, clubs and shops throughout the UK. It is pleasing to note the positive trend revealed in the latest statistics, showing that in the 16-24 age group, the proportion of males drinking above recommended weekly guidelines has dropped sharply, down from 30 per cent in 2006 to 21 per cent in 2009[12].

74%: The proportion of adult males drinking within recommended weekly guidelines

- **Challenge 25 scheme.** Challenge 25 is a retailing strategy developed by the industry that encourages anyone who is over 18 but looks under 25 to carry acceptable ID (a card bearing the PASS hologram, a photographic driving license or a passport) if they wish to buy alcohol. It has proved to be an effective tool to tackle underage purchases.

12 *ONS, Smoking and drinking among adults 2009, 27 January 2011, Table 2.2*