2024-25 Pre-Budget Submission

Spirits & Cocktails Australia

Australian Distillers Association

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Introduction

The Australian spirits industry welcomes the opportunity to make a Pre-Budget Submission for consideration ahead of the 2024–25 Federal Budget.

This submission is lodged on behalf of Members of Spirits & Cocktails Australia and the Australian Distillers Association. Together, we represent spirits producers involved in the manufacture, marketing and sale of spirits throughout Australia. Our supply chain showcases the best of Australian industries, from farming and native botanicals harvesting, through to tourism and world class hospitality.

Our industry contributes $15.5 billion in added value to the Australian economy, supporting 5,700 spirits manufacturing jobs and a further 45,400 jobs in spirits wholesale, retail and hospitality. An additional 48,700 indirect jobs are supported throughout our supply chain.

Spirits & Cocktails Australia and Australian Distillers Association share a commitment to promoting a safe and vibrant spirits sector, which reflects Australia's mature drinking culture and creates opportunities for economic development, through the sustainable development of a distinctly Australian manufacturing industry. But this can only be achieved with the right policy settings.

Ours is one of the few industries that can offer the Albanese Government an opportunity to make progress toward achieving three of its stated priorities for 2024: easing cost of living pressure on Australians, building a future made in Australia, and defining Australia's place in the world through exports.

With modest reform, as recommended in this submission, we can take the first but important steps to achieving these goals.

Executive Summary

This is a critical time for the Australian spirits industry, where many hard-won gains can be lost, and the opportunity for a world class, distinctly Australian manufacturing industry missed.

There is clear evidence that inflation and cost-of-living pressures are impacting the Australian spirits industry. Higher costs of production, resulting from supply chain constraints and higher input costs, have been met with tighter household budgets, reduced consumption and changing consumer behaviours.

Over the last two years, spirits manufacturers have experienced surging costs for inputs such as barley, glass and cans, and freight charges that have more than doubled in some regions. These higher costs are being passed through to consumers, placing further cost-of-living pressure on hard working Australians.

In response to these pressures, and in recognition of the opportunities for future growth, this submission provides an important update for the Government on the Australian spirits industry. It identifies how the Budget can assist the industry in navigating these difficult headwinds to capitalise on our enormous potential to generate investment and employment, including in regional Australia.

A vibrant and healthy spirits industry can help showcase Australia to the world, promoting growth in domestic manufacturing, increasing trade and employment, supporting innovation and technology, and helping to grow the industry.

To support this submission, Spirits & Cocktails Australia and the Australian Distillers Association recently engaged Deloitte Access Economics to undertake an extensive survey and analysis of Australia's approximately 600+ local distillers and eight global producers with operations here in Australia. Deloitte's findings provide a comprehensive snapshot of the state of the industry, with results showing many producers under increasing financial stress.

The economic challenges faced by the Australian spirits industry are mirrored in other sectors and alcohol categories, although few – if any – face the same impediments and offer the same opportunities as spirits.

Now, more than ever, reform of Australia's outdated spirits excise regime is vital.

Alcohol taxation in Australia remains complex and increasingly discriminatory against the spirits industry. There have been numerous calls over several years to simplify the system, and make it more equitable across categories.

Modest reform and targeted support will deliver further investment, growth and job opportunities.

Our immediate recommendation to freeze bi-annual spirits excise increases for two years proposes the first small – but important – step towards reform at a time when it is needed most by the Australian spirits sector, and the wider tourism and hospitality industries it supports.

As international demand for premium spirits continues to grow, there has never been a better time to invest in the future of the Australian spirits manufacturing industry by developing a spirits industry export strategy.

With these modest reforms, the Albanese Labor Government has the potential to release the handbrake on the Australian spirits industry, unlocking opportunities to create a sustainable and scalable manufacturing industry.

Part 1
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Easing cost of living pressures on Australians

The spirits industry, like many sectors in the Australian economy, continues to feel the effects of an economy weighed down by high inflation and cumulative increases in interest rates.

The 2023–24 Mid-Year Economic and Fiscal Outlook reported a $170 million dollar reduction in revenue for spirits from the 2023–24 Budget, and a $230 million reduction in forecasted revenue for 2024–25 (a six per cent reduction). This reflects the impact of reduced consumption and price increases, driven by the excise rates putting further downward pressure on demand.

According to the Reserve Bank of Australia (RBA), consumption growth has been particularly weak this year. Many households are experiencing a painful squeeze on their finances, through higher inflation and higher interest rates. Household consumption growth has been subdued in recent quarters and per capita consumption has declined slightly, with this slowdown in growth driven by discretionary categories such as alcohol.

The Australian Financial Security Authority (AFSA) also confirms that households are feeling the impact of cost-of-living pressures. Its recent report revealed that both mortgage holders and renters are now spending more than 86 per cent of their disposable income on necessary living items.

The RBA also reports intensifying price competition among retailers over recent months, with increased promotional and discounting activity. Businesses have reported they are more constrained by customers being unwilling to accept price increases – yet spirits face another excise hike in February.

Spirits excise impacts on inflation

The Australian Bureau of Statistics (ABS) September quarter results show an annual Consumer Price Index increase of 4.9% for the alcohol category. The ABS confirms that:

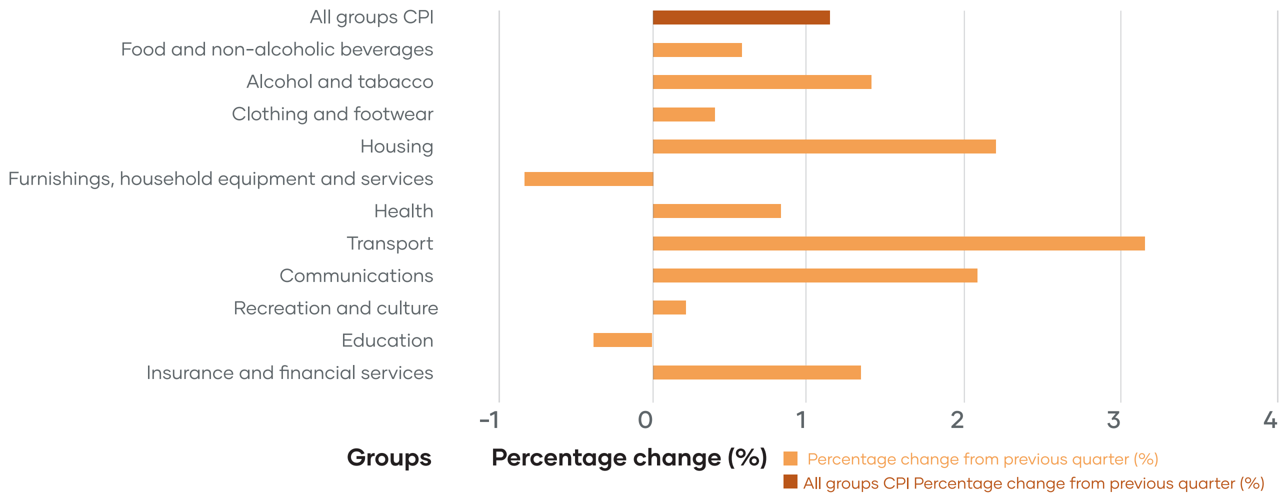
"Alcohol rose 1.3% due to the bi-annual increase in the excise tax for alcohol on 1 August."

And that the biggest excise hit has been to the spirits industry:

"Over the past twelve months, the group rose 4.9%. The main contributors were Beer (+6.8%), Tobacco (+4.9%) and Spirits (+8.4%)."

The ABS statistics confirm the negative effects of excessive and continuing excise rises on spirits and ready-to-drink spirits (RTDs) in the face of rising costs and reduced consumption.

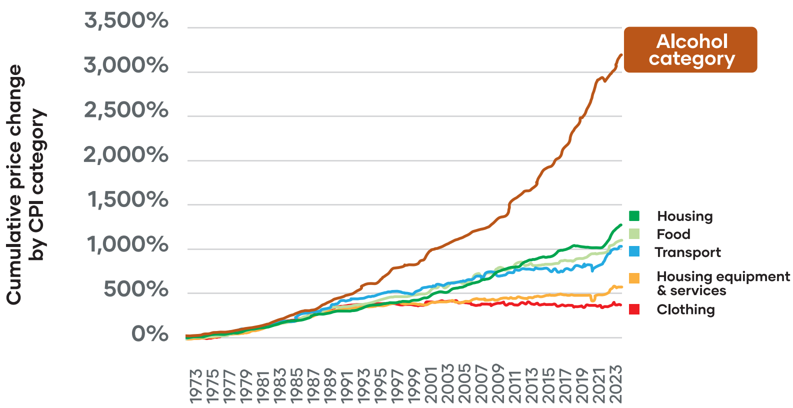
Weighted average of eight capital cities, quarterly movement (%)



Source: ABS, Consumer Price Index, Australia September Quarter 2023

The ABS data also shows that the alcohol category has had the highest cumulative Consumer Price Index increase over the past 50 years:

How these prices changed since 1973



Source: ABS, Consumer Price Index, Australia September Quarter 2023

According to the RBA, price inflation reflects primarily domestically sourced costs for labour and non-labour inputs and demand pressures.

While it may be for some businesses that non-labour costs are growing less rapidly than earlier in the year, driven by lower cost increases on imported goods, countering this potential upside is persistent upward pressure on domestic costs such as energy, logistics (including fuel) and insurance. The RBA reports that higher wage growth has also exacerbated these cost pressures.

Domestic production

These operational cost pressures have a pronounced impact on spirits manufacturers, which have limited headroom for cost recovery after absorbing the impacts of excise increases.

Deloitte's industry analysis shows that 80% of spirits sold in Australia are manufactured or bottled as finished products in Australia, from local and imported ingredients. Therefore, the spirits industry does not benefit as much as other sectors from recent improvements to global supply chains and lower shipping costs.

The flat domestic economy, combined with inflationary impacts on production and consumption, have resulted in a fragile spirits industry that is less able to absorb the impacts of regular excise increases.

The number of small and medium-sized spirits producers facing financial strain will continue to grow, with higher insolvencies, reduced hours for employees, lower employment growth and lost investment. This will ultimately lead to lower revenue for Government.

Learning from the experience of the UK spirits industry

In November 2023, the spirits industry in the United Kingdom benefited from the Chancellor of the Exchequer's intervention to pause spirits duty increases until at least August 2024, in recognition that further increases would mean less revenue for Treasury.

The reduced spirits excise revenue recorded by Treasury at MYEFO shows the same trend playing out here in Australia.

Learning from the success of the UK Government's intervention could prove pivotal to Australia's success in navigating the challenges of the current economic environment.

A future made in Australia

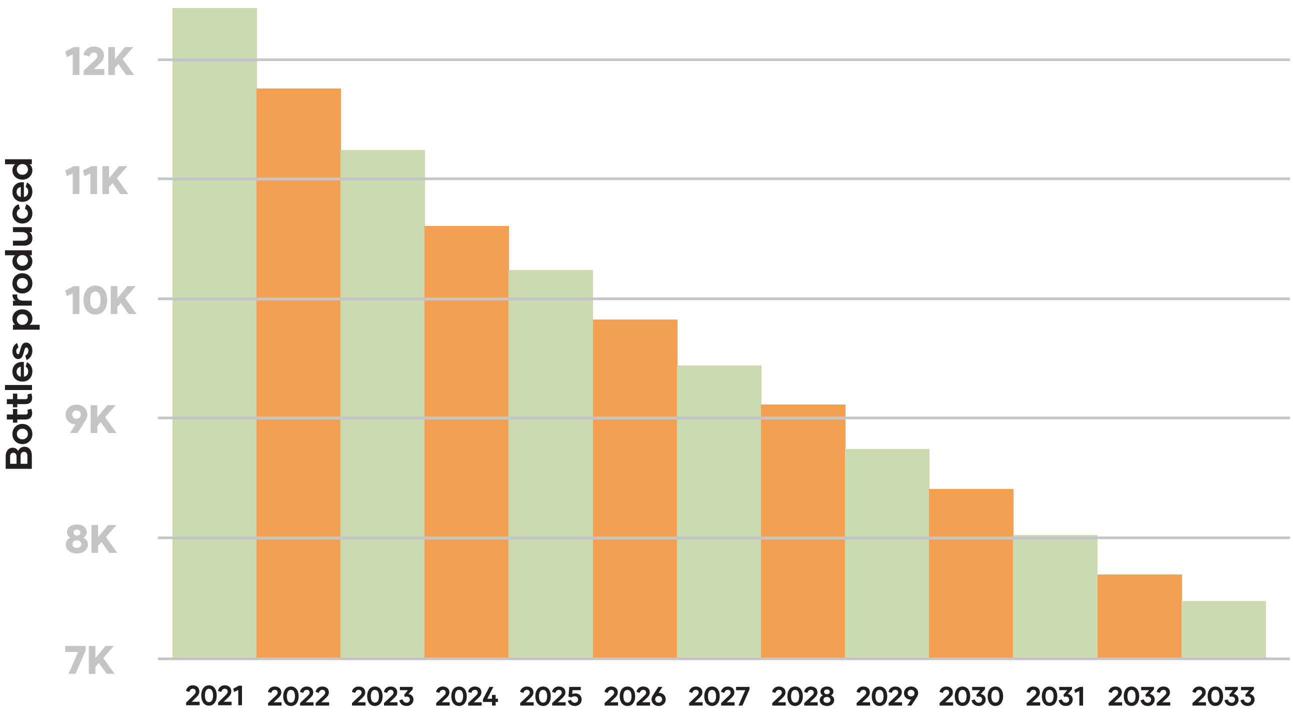
We support the Albanese Government’s goal to create a future made in Australia by fostering a productive domestic manufacturing industry that provides jobs and opportunities for future generations of Australians.

However, the current policy settings for the spirits industry do not support investment in production, nor do they encourage businesses to scale in a way that will contribute to the fulfilment of this objective.

The full remission of excise up to $350,000 is a disincentive to produce more than about 12,500 bottles of spirits (at 40% alcohol by volume in 700mL bottles) each year – which is just 250 bottles per week. This is because the cost of goods increases by $28 of excise for each bottle produced beyond 12,500 bottles. Furthermore, small producers in the wine and beer industries can produce higher volumes of product, as their lower tax rates mean that it takes them longer to surpass this $350,000 excise-free threshold.

Similarly, global manufacturers are dissuaded from investing in domestic spirits manufacturing and scaling award-winning Australian distilleries as the current spirits excise rate – which is the third highest in the world – makes such foreign direct investment unattractive. Simply put, countries with more favourable tax settings are benefitting from investment that should be being made in Australia.

Productivity frontier for excise-exempt spirits production



Source: Australian Distillers Association, 2023, internal analysis.

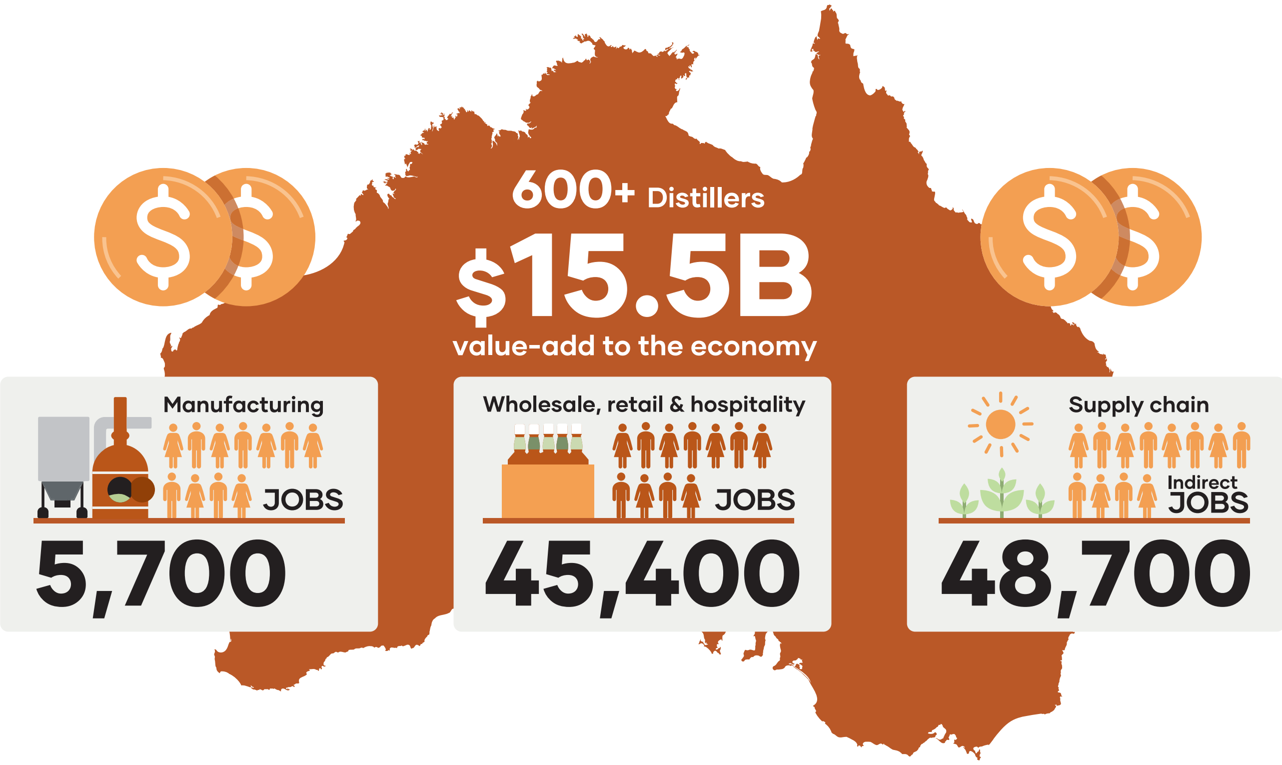
Industry economic contribution

Our industry provides $15.5 billion in added value to the Australian economy, directly supporting over 5,700 spirits manufacturing jobs and a further 45,400 jobs in spirits wholesale, retail and hospitality. An additional 48,700 indirect jobs are supported throughout our supply chain, including in agriculture and tourism. With meaningful reform, this contribution could be far greater.

The typical Australian distillery employs about a dozen people in high quality, artisanal roles including in distilling and fermenting, recipe creation, blending and maturation, and hospitality. By applying and adapting these centuries-old skills and techniques, our workforce creates unique expressions of gin, whisky, rum, brandy and agave spirits, which have deservedly won international acclaim.

Unlike geographically-constrained cultivation products, spirits can be made throughout Australia – including in the regions, where half of the industry's spirits manufacturers are located. Over two-thirds of manufacturers operate a distillery door, with over three and a half million visits made by domestic and international patrons in 2023 alone.

Economic contribution of the Australian spirits industry



Source: Deloitte Access Economics, 2023, Economic contribution of the spirits industry in Australia.

Changing conditions

Changed consumer drinking habits and preferences have also driven increased distillery visitation. Post-COVID, consumers are increasingly aware of the provenance of the products they consume, choosing to 'support local' by experiencing their favourite brands at distillery doors, while also enjoying them closer to home in world-class bars and hospitality venues.

With per capita alcohol consumption at record lows as Australians opt to drink less but more premium and moderate-strength offerings, freezing spirits excise will support further innovation and investment by domestic and global producers, including award-winning ready-to-drink (RTDs) products, like premium cocktail mixes.

Unlocking investment

Increased investment is crucial to unlock the economic potential of the Australian spirits sector.

Deloitte's analysis revealed that most Australian distillers have bootstrapped their business with personal investment, with only six per cent of manufacturers benefiting from foreign direct investment.

Improved access to foreign investment will help boost infrastructure and productivity, particularly for dark spirits manufacturing, which requires significant investment in oak barrels and warehouse capacity to accommodate the spirit while it matures for a minimum of two years. Such investment can also be used to grow brands to scale through sales and marketing, which is particularly important for new product categories and exports, which requires the education of consumers and the trade.

Global producers operating in Australia make significant investments in Australia through domestic manufacturing facilities, as well in marketing and category-wide education. This promotional activity builds an affinity for spirits among Australian consumers, benefiting producers large and small. The benefits of this investment also flow throughout the supply chain, such as to advertising firms, printers and media agencies.

While foreign investment is not currently widely used by the industry, 77% of spirits manufacturers reported that a 20% increase in this source of capital would support increased production, sales and marketing activity, exports and distillery door enhancements. The investments made by global spirits manufacturers in comparable markets like Scotland and Ireland demonstrates that freezing excise duty provides an important signal to unlock investment.

Significantly, Deloitte's comprehensive analysis of the Australian spirits industry revealed that the single biggest enabler to enhancing domestic spirits manufacturing is pausing spirits excise indexation at current levels ($100.05 per litre of alcohol). Survey participants responded that implementing this reform would enable the hiring of additional staff (51%), increased promotional and marketing activities (44%), and investment in machinery and facilities to scale-up production capacity (40%).

To unlock investment and accelerate the development of the Australian spirits industry, the regulatory and policy settings – including excise duty – need to nurture and promote a supportive commercial environment for business to take in the risk of greater investment. Businesses and investors looking to capitalise on the opportunities of the Australian spirits industry will invest where they see sustainable long-term growth potential. An enabling tax environment helps to justify making those investments, and taking the financial risk to grow and hire more people.

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Defining Australia's place in the world

One of the many ways that Australia can define its place in the world is through the export of high quality food and beverage. Simply put, nothing tastes like Australia.

Global consumer interest in distinctive, high-quality spirits presents a major export opportunity for the Australian spirits manufacturing industry.

But urgent action is needed to exploit this potential.

The craft distilling boom is a global phenomenon, with new distilleries and innovative products currently proliferating many other international markets. The longer we wait, the tougher the competition will be from other emerging producer nations – like Japan, Ireland, Canada and Mexico – eroding our natural competitive advantages.

Capitalising on the taste of Australia

Domestic spirits manufacturers benefit from Australia's existing reputation for high-quality, safe, 'clean and green' food and beverage products, and as a provider of outstanding tourism and hospitality experiences.

Distillers have unrivalled access to unique ingredients, and the creativity and freedom to push the boundaries of what is possible with innovative, high-quality spirits. The product resulting from this industrial endeavour is objectively world-class; with Australian spirits producers having won almost every major international accolade, further emphasising the industry's export opportunity.

Producers of the world's best spirits

Removing the handbrake on growth to create an export powerhouse

Australian spirits exports are currently valued at $US146 million per annum (UN Comtrade, 2022).

Exports can grow exponentially from this baseline with the correct policy settings and investment by government and industry, similar to the success enjoyed by the Australian wine industry over the last few decades.

Global spirits exports per capita (USD)

Source: Statista 2021, Leading exporters of spirits worldwide in 2021 by country (in million U.S. dollars) https://statista.com/statistics/1039949/global-spirits-export-leader-by-country/

Australian wine exports experienced stratospheric growth, from just $20 million in 1986 to surpass $3 billion in 2007, and again in 2018–19. At its peak, wine exports accounted for around 10 per cent of Australia's agricultural exports.

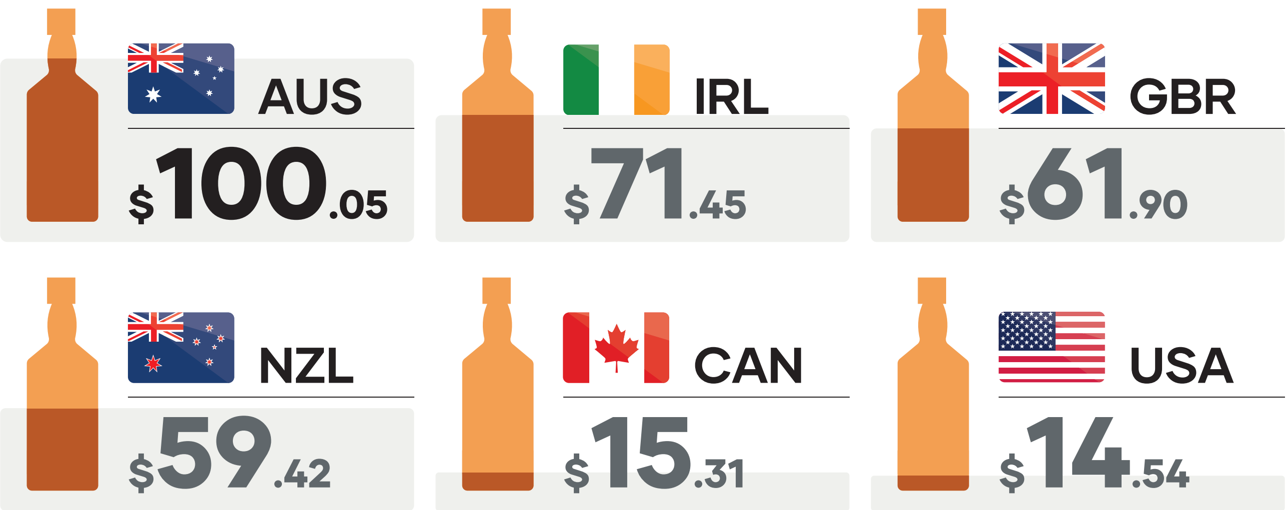
Australia grew from nothing to become the world's fourth largest wine exporter, despite our wine production accounting for only four per cent of total volumes globally.

However, spirits manufacturers face an uphill battle growing their exports in the absence of any significant government policy interventions and support. Potential assistance and opportunities for industry growth are raised further in our recommendations.

The spirits excise burden acts as a major inhibitor to export growth, continually squeezing margins and earnings that could be invested into developing new markets. A strong domestic market is the greatest enabler to global export success.

The disparity between domestic excise rates and that of comparable markets also means Australia is at a major competitive disadvantage with other spirits producing nations. For example, producers in the United States effectively have an additional $85 per litre of alcohol in revenue that they can invest in growing their export footprint.

International Comparison



A growing spirits industry, which is scaled to capitalise on export opportunities, can help to stimulate economic growth in manufacturing, hospitality, tourism and agriculture as businesses expand to meet increased international demand for quality Australian spirits.

Free trade and economic partnership agreements in the region can boost opportunities for Australian-made spirits. Regional markets are seeing excellent growth in demand for international premium spirits, particularly in economies like Vietnam, the Philippines, South Korea and Japan (all signatories to the Regional Comprehensive Economic Partnership).

With Federal Government support, funding and analysis, the Australian spirits industry can realise its potential to become an export powerhouse. We commit to working with the Government to co-design appropriate solutions to realise this potential and enhance our contribution to the Australian economy.

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Summary & Recommendations

Providing modest changes to the current regulatory framework for the Australian spirits industry will help the Albanese Government make progress on three important goals in 2024: reducing cost of living pressures for Australians, building domestic manufacturing capabilities, and unlocking opportunities to define Australia's place in the world through export.

The forthcoming Federal Budget presents a compelling opportunity to simultaneously ease inflationary pressures on hard working Australians, while unlocking opportunities for the development of a distinctly Australian manufacturing industry.

The 'game changer' for the Australian spirits industry remains temporary relief from the bi-annual ratcheting up of the excise rate, providing an opportunity for the industry to manage through the inflationary impacts of the current economic conditions.

While a pause in bi-annual excise increases will have the biggest benefit to the industry and consumers, there are also other levers that the government can use to promote the development of the industry. During a pause in the excise indexation, the industry can develop longer-term strategies, and identify structural changes and policy settings that can be utilised to support jobs and investment growth.

There is also significant opportunity to better leverage Australia's trade agreements and to better coordinate with other export industries, such as wine and tourism, by developing a spirits industry export plan. This will help to promote the provenance of Australian distilling and build the Australian brand in key overseas markets.

We look forward to working with the Government to achieve mutually beneficial solutions.

Spirits & Cocktails AUSTRALIA

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