



# **COMMONWEALTH GRANTS COMMISSION**

**DRAFT ASSESSMENT PAPER CGC 2003/53**

## **SUBSIDIES – ALCOHOL PRODUCTS**

Prepared for the Commission's 2003 Conferences on Draft Assessments

**AUGUST 2003**

## **NOTE**

**Included in this paper are the results of preliminary calculations based on the methods proposed throughout the paper and using the data currently available. Those results are indicative only and should be seen as work in progress. Ongoing changes are being made to standards and factor calculations as new data come to hand. Moreover, the calculations have been done using a prototype assessment system and are subject to ongoing revision as checking processes proceed.**

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## INTRODUCTION

1. This paper presents a draft assessment for the Subsidies – Alcohol Products category for the 2004 Review. This was considered a no change category and a discussion paper was not released for it.

### ***Background***

2. Prior to 5 August 1997, the States collected business franchise fees on liquor products. Some States provided subsidies, for cellar door sales and low alcohol products. A High Court decision threw doubt on the constitutional validity of business franchise fees and the States ceased collecting them. However, the Commonwealth raised its taxes on alcohol products and returned the additional revenues to the States as alcohol revenue replacement payments. In return, the States agreed to continue to provide alcohol related subsidies.

3. As part of the tax reforms associated with the introduction of the Goods and Service Tax (GST), the Australian and State Governments signed the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations (IGA)* in June 1999. Under the IGA, the Australian Government ceased paying States RRP's from 1 July 2001. States continued to provide alcohol related subsidies.

4. From 1 July 2002, the Commonwealth introduced a National Excise Scheme for low alcohol beer to replace State subsidies with a uniform rate. The Commonwealth deducts from each State's budget balancing assistance (BBA) an amount commensurate with its current subsidies, indexed for inflation, for as long as each State receives BBA. Thereafter, the Commonwealth funds the scheme. The terms of reference for the 2003 Update asked the Commission to take this new arrangement into account. Consequently, the Commission removed subsidies for low alcohol beer from the expense standard for all years and changed the assessment accordingly.

## 2003 UPDATE ASSESSMENT

### ***Scope of the category***

5. In the 2003 Update<sup>1</sup>, the scope of the category was changed to exclude subsidies on low alcohol beer. It comprised cellar door sales, low alcohol wine and other alcohol subsidies provided by the States to hoteliers, licensed clubs, wholesale and retail liquor suppliers. Other alcohol subsidies also include the reimbursement of administrative costs incurred by alcohol sellers.

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<sup>1</sup> This category was created after 1999 Review and as such the 2003 Update is used as a reference point for figures.

6. Table 1 shows the gross standard expenses used in the 2003 Update. In 2001-02, this category represented 0.03 per cent of total gross standard expenses.

**Table 1** ALCOHOL SUBSIDIES — GROSS STANDARD EXPENSES, 2003 UPDATE

	1996-97 <sup>(a)</sup>	1997-98 <sup>(a)</sup>	1998-99	1999-00	2000-01	2001-02
\$pc	3.05	2.33	3.51	3.24	1.27	1.54
% of total gross standard expenses	0.08	0.06	0.08	0.07	0.03	0.03

(a) Estimated by deflating the 1998-99 subsidies by the change in the net standard of Business Franchise fees-alcohol

### *Structure of the assessment*

7. The structure used in the 2003 Update is summarised in Table 2. Subsidies for cellar door sales and low alcohol wine products were derived by adjusting actual State subsidies to what they would have been if each State applied the standard subsidy rates. The other subsidies component was assessed on an equal per capita basis.

**Table 2** 2003 UPDATE ASSESSMENT STRUCTURE

Expenditure component	Component weight	Basis of calculation
	%	
Standard subsidies for cellar door sales and low alcohol wine products	60.0	Standardised subsidies per capita converted to factor
Other subsidies	40.0	Equal per capita

8. The component weight for cellar door sales and low alcohol wine products was derived by:

- (i) calculating the percentage that these subsidies represented of total subsidies for each year 1997-98 to 2001-02; and
- (ii) averaging those percentages to obtain a single percentage.

9. Compared to an equal per capita assessment, the 2003 Update assessment for this category redistributed \$12.9 million in grants from New South Wales, Victoria, Tasmania and the ACT to the other States. The distribution by State is summarised in Table 3.

**Table 3** EFFECT OF ASSESSMENT ON GRANTS DISTRIBUTION —  
ALCOHOL SUBSIDIES

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Contribution to 2003 Update relativities	-8.1	-3.8	3.3	5.2	4.3	-0.3	-0.5	-0.1	12.9

### ISSUES FOR THE 2004 REVIEW

#### *Calculation of the standard rate of subsidy*

10. **State views.** No comments were received directly from States. Victoria did however raise the issue of the standard rate of subsidies in relation to off-road diesel subsidies. Victoria noted that, to be consistent with other revenue assessments, the standard rate of subsidy used by the Commission to calculate the standardised subsidies should be the average of the rates used by States rather than the common rate used by most States (the modal rate).

11. **Analysis.** Although Victoria raised this issue in relation to petroleum RRP, it is also relevant to alcohol subsidies. The same rate of subsidy applies to cellar door sales in each State, so an adjustment is not required. However, differing rates of subsidy apply to low alcohol products and therefore a weighted average would be required.

12. Table 4 shows the low alcohol product subsidy rates by State, the modal rate used by the Commission in the 2003 Update, the (simple) average rate and the weighted average (standard) rate proposed by Victoria.<sup>2</sup>

13. Subsidies for cellar door sales have a subsidy rate of 15 per cent in all States and as such an adjustment for the standard rate of subsidy is not required. Nevertheless, we will calculate a weighted average rate of subsidy for these products to allow for the possibility that States could change their rates of subsidy in the future.

14. Similarly, we will calculate a standardised rate of subsidy for low alcohol wine. This is required because States have different rates of subsidy for these products. The impact of this is that each State's actual subsidy expenses will be adjusted by the ratio of the standard subsidy rate divided by the State's actual subsidy rate. This approach is consistent with the way alcohol subsidies are treated in the revenue replacement payments assessment for the FAG relativities.

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<sup>2</sup> The Ministerial Council agreed that a National Excise Scheme for low alcohol beer would replace the State subsidy scheme from 1 July 2002. This change means States will no longer operate their own subsidy schemes from 2002–03. However, the notional costs of those schemes will continue to be a cost to them through adjustments to the Guaranteed Minimum Amount calculations for the GST assessments.

15. The other subsidies component will continue to be assessed by the equal per capita method because it comprises non-standard subsidies, that is, subsidies that are provided in some but not all States.

16. **Commission decision.** The Commission accepts that calculating standardised costs of subsidies using the standard rates of subsidy is consistent with the use of internal standards. The Commission is satisfied that comparable and reasonable data are available to provide an adequate basis for calculating standard rates of subsidy. While data indicate that the impact of assessing standard rates of subsidy would be small, the change would improve equalisation by making the approach consistent with other revenue assessments. The Commission has, therefore, decided that it will calculate the standard rate of subsidy for low wine alcohol subsidies as a weighted average of each States' actual rate of subsidy.

**Table 4** LOW ALCOHOL PRODUCTS SUBSIDY RATES

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Modal rate of subsidy	Average rate of subsidy	Standard rate of subsidy
	cpl	cpl	cpl	cpl	cpl	cpl	cpl	cpl	cpl	cpl	cpl
1997–98	15.00	15.00	2.80	6.46	15.00	15.00	15.00	15.00	15.00	12.41	13.224
1998–99	15.00	15.00	2.80	6.46	15.00	15.00	15.00	15.00	15.00	12.41	13.156
1999–2000	15.00	15.00	2.80	6.46	15.00	15.00	15.00	15.00	15.00	12.41	13.259
2000–01	12.00	12.00	2.80	5.20	12.00	13.00	12.00	8.00	12.00	9.63	11.104
2001–02	12.00	12.00	2.90	5.20	12.00	13.00	12.00	8.00	12.00	9.64	10.898

cpl = cents per litre.

Source: State data returns.

Note: The standard rates of subsidy shown are different to those shown in the Revenue Replacement Payments — Alcohol Products category. This is because these are (subsidy) weighted average rates of subsidy. This category excludes subsidies for low alcohol beer, but they are included in the Revenue Replacement Payments — Alcohol Products category.

### **Updating component weights**

17. **State views.** States did not comment on this issue.

18. **Analysis.** In the 2003 Update, component weights were not updated annually. Table 5 shows expenditure on subsidies for different alcohol products. It shows that alcohol subsidies are variable both in total and by type of subsidy. Updating component weights annually using actual subsidies data would provide a more accurate assessment.

19. **Commission decision.** The Commission accepts that a conceptual case exists for updating subsidy component weights annually. The conceptual case is supported by data which the Commission is satisfied are comparable and representative, and provide an adequate basis for updating the weights. The data indicate that subsidies are variable and have a different impact on State budgets in different years which the Commission considers to be material. The Commission therefore proposes to update the subsidy component weights annually and base them on actual subsidy data.

**Table 5** EXPENSES ON SUBSIDIES FOR ALCOHOL PRODUCTS

Type/year	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Low alcohol									
1997-98	1.7	1.3	0.3	0.6	0.4	0.1	0.1	0.1	4.6
1998-99	2.3	1.6	0.4	0.7	0.5	0.1	0.1	0.1	5.9
1999-2000	2.5	1.7	0.4	0.7	0.5	0.1	0.1	0.1	6.2
2000-01	2.7	1.7	0.1	0.7	0.5	0.3	0.1	0.1	6.0
2001-02	2.3	2.0	0.2	0.7	0.5	0.5	0.1	0.1	6.4
Cellar door									
1997-98	1.8	3.9	0.0	1.4	6.8	0.2	0.0	0.0	14.2
1998-99	2.8	4.6	0.0	2.1	10.0	0.4	0.0	0.0	19.8
1999-2000	3.2	4.5	0.0	2.6	8.8	0.4	0.0	0.0	19.6
2000-01	4.0	4.4	0.7	2.3	6.3	0.4	0.0	0.0	18.2
2001-02	4.8	5.5	0.0	3.8	7.5	0.6	0.0	0.0	22.3
Other subsidies									
1997-98	0.0	0.0	22.8	0.0	0.0	1.5	0.0	0.4	24.7
1998-99	0.0	0.0	34.3	0.0	0.0	1.9	0.0	0.7	36.9
1999-2000	0.0	0.0	33.9	0.0	0.0	1.9	0.0	0.4	36.1
2000-01	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.3
2001-02	0.0	0.0	0.0	0.0	1.5	0.0	0.0	0.2	1.6

Source: State data returns, 2003 Update.

### *Scope of the category*

20. **State views.** States did not comment on this issue.

21. **Commission decision.** Given that States have not commented on this issue, the Commission has decided to retain the 2003 Update category definition.

22. The Commission's decisions are summarised in Table 6.

**Table 6** COMMISSION DECISIONS – CATEGORY DEFINITION, ASSESSMENT STRUCTURE AND COMPONENT WEIGHTS

<b>Decision</b>	<b>Reason</b>
<b>Definition:</b> Unchanged from 2003 Update.	There has been no reason to change the category's scope.
<b>Assessment Structure and Component Weights</b>	
Assess the category as three components. <sup>(a)</sup>	The three components are necessary because their needs are calculated differently.
Low alcohol wine subsidies 21.03%	
Cellar door subsidies 73.57%	
Other subsidies 5.40%	
<b>Assessment method</b>	
Adjust actual subsidies to what they would have been under standard subsidy rates.	Cellar door and low alcohol wine products sales are not affected by State policies. The subsidies required in each State can be calculated by applying a standard subsidy to sales. The subsidies per capita will then be converted to a factor.
	Other subsidies will be assessed equal per capita.

(a) The component weights shown are the component weights for 2001-02.

### **PROPOSED ASSESSMENT APPROACH**

23. The factors for low alcohol wine subsidies and cellar door subsidies factors will be calculated as follows.

- (i) Calculate standardised subsidies for each State by adjusting its actual subsidy expenses by the ratio of the standard subsidy rate divided by the State's actual subsidy rate.
- (ii) Calculate per capita standardised subsidy expenses for each State and the per capita Australian total subsidy.
- (iii) Divide each State's standardised subsidies per capita by the Australian average subsidies per capita.

24. The other subsidies component will be assessed by the equal per capita method.

25. **Reality check.** The assessment is based on actual subsidies. Low wine alcohol subsidies are adjusted for differences in rates of subsidy between States.

26. **Updatability.** Data on subsidy rates, itemised expenses and total expenses are available from the States each year. The factors and component weights will be updated annually.

## SUMMARY OF RESULTS

27. Table 7 summarises the assessment structure for the proposed assessment for the 2004 Review.

**Table 7** SUBSIDIES ALCOHOL, PROPOSED ASSESSMENT STRUCTURE FOR THE 2004 REVIEW

Expenses component	Component weight <sup>(a)</sup> %	Factors	Basis of calculation
Low alcohol wine subsidies	21.03	Low alcohol wine subsidies	Standardised subsidy per capita converted to factor
Cellar door subsidies	73.57	Cellar door subsidies	Standardised subsidies per capita converted to factor  This is the equivalent to calculating actual per capita because cellar door subsidies have a standard subsidy rate.
Other subsidies	5.40	Other subsidies	Equal per capita

(a) The component weights shown are the component weights for 2001-02.

### *Calculating the category factor*

28. Table 8 summarises the components, component weights and disability factors assessed for this category for 2001-02. It shows the calculation of the category factor.

**Table 8** ALCOHOL SUBSIDIES R2004 – DERIVATION OF CATEGORY FACTOR 2001-2002

Factors	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
<b>Subsidy Cellar Door (CDS) 0.736</b>								
Subsidy Cellar Door	0.63777	1.00004	0.00000	1.74341	4.35675	1.15787	0.00000	0.00000
Component factor	0.63777	1.00004	0.00000	1.74341	4.35675	1.15787	0.00000	0.00000
Cont. to category factor	0.46918	0.73568	0.00000	1.28254	3.20505	0.85179	0.00000	0.00000
<b>Subsidy Low Alcohol Wine (LAWS) 0.210</b>								
Subsidy Low Alcohol	0.83228	0.99196	0.59274	2.14749	0.82525	2.20826	0.51103	2.49052
Component factor	0.83228	0.99196	0.59274	2.14749	0.82525	2.20826	0.51103	2.49052
Cont. to category factor	0.17505	0.20863	0.12467	0.45167	0.17357	0.46446	0.10748	0.52382
<b>Subsidy Other (OS) 0.054</b>								
Subsidy Other	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000
Component factor	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000
Cont. to category factor	0.05402	0.05402	0.05402	0.05402	0.05402	0.05402	0.05402	0.05402
<b>CATEGORY FACTOR</b>	<b>0.6982</b>	<b>0.9983</b>	<b>0.1787</b>	<b>1.7882</b>	<b>3.4326</b>	<b>1.3703</b>	<b>0.1615</b>	<b>0.5778</b>

### *Calculation formula*

29. The following formula was used to calculate the contribution of the expenses component to the overall category factor. The contribution is calculated as the expenses component weight multiplied by the component factor (the bracketed terms in the formulas). The contribution to category factor was rescaled to ensure that the sum of standardised equals the sum of actual expenses.

$$\begin{aligned}
 \text{CDS} &= 73.57 \text{ (CDS)} \\
 \text{LAWS} &= 21.03 \text{ (LAWS)} \\
 \text{OS} &= 5.40 \text{ (OS)} \\
 \text{Category Factor} &= \text{LAWS} + \text{CDS} + \text{OS}
 \end{aligned}$$

### *Comparison of category factors*

30. Table 9 shows the category factors calculated for the 2004 Review Draft Assessment compared with the category factors assessed in the 2003 Update. The variations in the factors are due to the large actual per capita element.

**Table 9** COMPARISON OF CATEGORY FACTORS, 2003 UPDATE AND THE DRAFT ASSESSMENT FOR THE 2004 REVIEW

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
2003 Update	0.6013	0.9198	0.73130	2.3269	2.0250	1.5368	0.4000	1.6588
2004 Review Draft Assessment	0.6982	0.9983	0.1787	1.7882	3.4326	1.3703	0.1615	0.5778

***Standardised expenses***

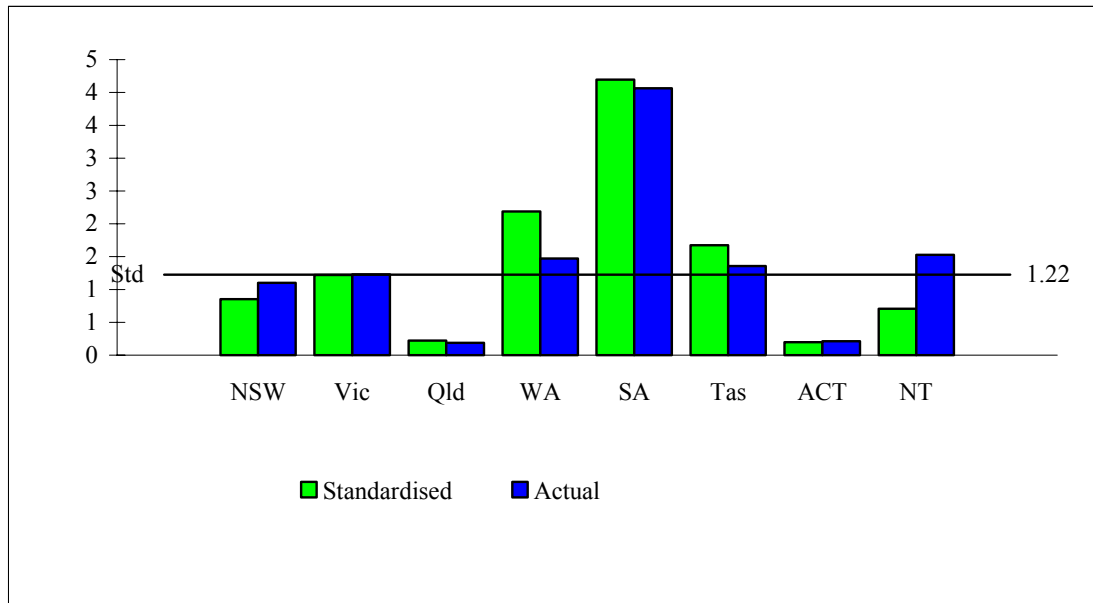
31. Table 10 shows the standardised expenses for this category for 2001-02 in the draft assessment compared with that assessed in the 2003 Update.

**Table 10** ESTIMATED, STANDARD AND STANDARDISED EXPENSES, 2001-02 SUBSIDIES ALCOHOL PRODUCTS

	Standard	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
<b>2003 Update Actual Expenses</b>									
\$ per capita	1.54	1.07	1.54	0.06	2.36	6.24	2.30	0.21	1.59
<b>2003 Update - Standardised Expenses</b>									
\$ per capita		0.92	1.40	1.11	3.54	3.08	2.34	0.61	2.53
<b>2004 Review Actual Expenses</b>									
\$ per capita	1.22	1.10	1.23	0.19	1.47	4.06	1.36	0.21	1.53
<b>2004 Review Draft Assessment - Standardised Expenses</b>									
\$ per capita		0.85	1.22	0.22	2.19	4.20	1.68	0.20	0.71

32. Figure 1 shows the gross expenses per capita, 2001-02 for the proposed assessment in terms of standardised, actual and standard expenses.

**Figure 1** ALCOHOL SUBSIDIES R2004 – GROSS EXPENSES PER CAPITA – STANDARDISED, ESTIMATED AND STANDARD, 2001-02



***Effect of assessment on grants***

33. Table 11 shows the redistribution of grants of the draft assessment and compares them with the 2003 Update. Compared to an equal per capita assessment, the Draft Assessment redistributed \$8.6 million, \$4.3 million less than in the 2003 Update.

34. The main reasons for the change in grants were changes to assessment methods and data, including:

- (i) the decision to update component weights rather than use a fixed proportion;
- (ii) the decision to use a weighted average rate of subsidy rather than a modal rate of subsidy; and
- (iii) changes in the category standard.

**Table 11** EFFECT ON GRANT DISTRIBUTION — SUBSIDIES ALCOHOL PRODUCTS

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total <sup>(a)</sup>
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Contribution to 2003 Update relativities <sup>(b)</sup>	-8.1	-3.8	3.3	5.2	4.3	-0.3	-0.5	-0.1	12.9
Contribution to 2004 Review draft assessments relativities <sup>(b)</sup>	-3.8	-0.3	-3.9	1.3	7.2	0.0	-0.4	-0.2	8.6
Total change <sup>(c)</sup>	4.2	3.6	-7.2	-3.9	2.9	0.3	0.1	0.0	11.2

(a) Total redistribution.

(b) Assuming same pool and a constant population.

(c) This figure shows the change in the amount redistributed among the States between the 2003 Update and the 2004 Review Draft Assessment. It does not necessarily equal the difference in the total contributions to the relativities between the 2003 Update and the 2004 Review.