LION SUBMISSION TO THE COMMISSION OF AUDIT
26 November 2013

Thank you for the opportunity to make a submission to the Commission of Audit.

About Lion

Lion is a leading beverage and food company with a portfolio that includes many of Australia and New Zealand's favourite brands. It was formed in October 2009 under the name 'Lion Nathan National Foods', when Kirin Holdings Company Limited completed its purchase of Lion Nathan and merged the business with National Foods – which it has owned since 2007. In 2011, the business became known as Lion.

We employ close to 7,000 people across Australia and New Zealand predominantly, as well as in Hong Kong, Malaysia, Singapore and the US. We take great pride in our local manufacturing footprint across the Tasman, which spans over 40 sites – including large breweries, craft breweries, wineries, distilleries, dairy farms, milk, cheese, yoghurt and juice sites as well as venues and over 40 Liquor King retail outlets in New Zealand.

We are one of the region's largest purchasers of agricultural goods and an integral component of the retail, hospitality and tourism industries. Our total direct plus indirect contribution to the Australian and New Zealand economies is estimated at more than $5 billion annually1.

Our products accompany life's sociable moments, whether it's a family meal or good times at the pub with mates. Dairy, juice, soy and the responsible enjoyment of alcohol beverages are all part of a healthy lifestyle for many people, and when enjoyed in moderation, our combined portfolio of food and drink brands can benefit wellbeing.

Executive Summary

Lion accepts absolutely the role and duty of government to regulate and tax appropriately. Appropriate regulation is a necessary and desirable component of establishing efficient markets and harmonious communities that promote substantial positive benefits for society as a whole. However, the converse can also be true for excessive or poorly designed regulation. The Commission's task is to report recommendations which:

- ensure taxpayers are receiving value-for-money from each dollar spent;
- eliminate wasteful spending;
- identify areas of unnecessary duplication between the activities of the Commonwealth and other levels of government;

[1] Deloitte Access Economics Report, January 2012

- identify areas or programs where Commonwealth involvement is inappropriate, no longer needed, or blurs lines of accountability; and
- improve the overall efficiency and effectiveness with which government services and policy advice are delivered.

These aims can be achieved by adopting reforms leading to improved processes in the areas of health policy associated with labelling, health warnings, nutrition and health claims.

In many cases, such as labelling, excellent outcomes can be achieved through co-operative self-regulation eliminating the need for Commonwealth and State/Territory Government involvement.

In addition, there is a large amount of expenditure in the health sector which is financing advocacy-based "research" which diverts significant resources from the Commonwealth to educational and remedial services and then the results, if implemented, would lead to poor policy outcomes.

We consider that there is often a bias from both government agencies (and some interest groups who have significant influence on government agencies) towards regulation without proper assessment of costs and benefits whilst ignoring the self (or co)-regulatory activities of industry. This is particularly so in the areas of taxation, alcohol labelling, advertising and sponsorship.

Accordingly, in fulfilling its terms of reference the Commission should examine closely the financing by the Commonwealth of NGOs, and key individuals, who are essentially involved in lobbying activities. Very often these groups are a significant pressure to continually introduce more and more regulation and expend more on future "research" – much of which is not soundly based.

In particular, there is relentless lobbying against marketing by food and beverage companies by groups which maintain that industry should not be involved in policy making. They constantly argue to undermine the economics of local manufacturing by seeking to restrict and/or ban various types of marketing and sponsorship of food and alcohol products. Again much of this advocacy is financed in various ways by the Commonwealth. This funding should be terminated.

The other key fiscal area the Commission is tasked with examining is the sustainability of the budget.

The Commission is asked to identify key policy areas where trends in expenses and revenue pose risks to the structural integrity of the budget.

The alcohol tax base is a clear example where the relative under-taxation of wine, given consumption patterns, is not sustainable in a revenue sense for the Commonwealth. This factor needs to be addressed in a structural sense by increasing the revenue contribution of the wine industry. The taxation of wine also needs to be changed to encourage the production of premium wine so that Australia can have a globally competitive wine industry in the future.

In addition the quality of the tax debate would be enhanced if the net social costs of alcohol could be properly quantified. We request that the Treasury be tasked to develop a correct methodology.

The question of whether all alcohol should be taxed equally is not purely an economic one, a factor not considered in the Henry Review. There is evidence to suggest that some alcohol types, like ready to drink spirits (RTDs), because of their sweet taste have inherently greater appeal to younger palates and therefore have a different 'risk' profile for this 'at risk' group and should therefore be treated differently. If the Government is to review the tax relativities between alcohol types, more research in this area is highly desirable.

Alcohol issues

Financing of pro-regulation advocates

The driving force in imposing excessive regulation on the alcohol sector is specific lobby groups and key individuals.

Invariably, the policy aim of these groups is to increase the taxation and regulation of industry on the basis that it will lead to better health outcomes. This is understandable in a democratic society, however very often these aims could be better achieved through non-regulatory means. Unfortunately, however, these NGOs consider more regulation to be a desirable end in itself and constantly assert the need. They consistently engage in media advocacy for their cause and much of their research has no merit other than to help generate publicity.

Excessive regulation is often the result of these lobby groups having a strong or even disproportionate influence on the policymaking areas of the Commonwealth bureaucracy. This can arise through the movement of personnel between these NGOs and the various departments and agencies. It can also arise due to a financial relationship between the NGOs and the Commonwealth.

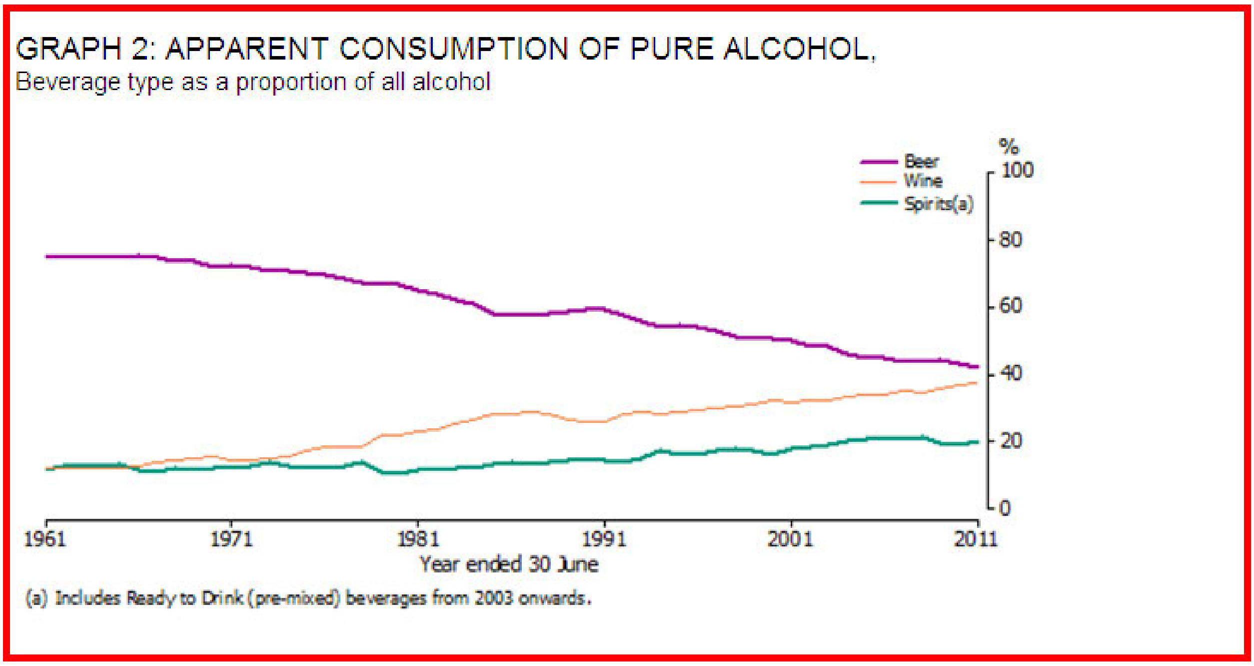
Essentially, the Commonwealth funds various groups who then lobby the Commonwealth to impose ever-increasing levels of regulation on industry. In addition, they also often advocate for increased funding for the "research" work that they undertake.

We consider this to be a structural driver of increased regulation and wasteful expenditure – and a generally undesirable structure which should be examined and reformed.

There are considerable ongoing savings to be made by eliminating wasteful funding of advocacy-based health research. We urge the Commission to recommend such an approach.

Addressing the deteriorating alcohol tax structure

During the past 50 years, there has been a significant change in the composition of alcohol consumption in Australia. The ABS[2] graph below shows the large and continuing structural trends away from beer as an alcohol source towards spirits and especially wine. By 2011 the proportion of pure alcohol available for consumption in the form of beer has decreased significantly (from 76% to 42%), while the proportions in the form of wine and spirits have increased (from 12% to 37% and 12% to 20% respectively). There is no sign that these trends will abate.



Revenue implications long-term

2 Publication at this link http://www.abs.gov.au/ausstats/abs@.nsf/mf/4307.0.55.001/

Substitution from beer to spirits increases aggregate revenue under existing policy settings. This is a good outcome for the Commonwealth (revenue goes up), consumers (they are choosing their beverage) and the community interest (higher taxes on spirits reflects higher potential harm, particularly for younger consumers).

However, whilst substitution from beer to wine clearly reflects consumer preference it decreases revenue significantly under existing policy settings.

This substitution revenue gap continues to widen as wine's market share increases. It is not a good health outcome as wine is essentially triple the alcohol by volume (ABV) of beer. Typically, wine varies in ABV from about 11 to 14.5%. Beer ABV varies from light at 2.7%, mid-strength at 3.5%(it is worth noting that XXXX Gold at 3.5% is one of Australia's best selling beers); to 4.6% - 4.8% for most full-strength beers, such as VB, Carlton Draught and Tooheys New.

Essentially wine now accounts for more than 1/3rd of the consumption of alcohol but only contributes about 1/7th of the alcohol tax revenue. This structural decline has to be addressed for longer-term budgetary sustainability reasons. The recent Henry Tax Review agreed that this is an urgent area for reform.

Lion is a substantial wine producer and has been engaging with much of the wine industry trying to forge industry agreement on addressing these taxation issues. We believe the best chance of success is through industry led reform because as well as providing deteriorating returns to the Commonwealth, the existing structure is harming the wine industry itself.

Accordingly, Lion and some other major wine producers have agreed on the following principles which should underpin reform:

- Reform will focus on creating a tax system that helps create a sustainable Australian wine industry that can compete globally i.e. the premiumisation of the wine category as a whole. We believe that this tax reform should be based on a carefully crafted volumetric tax system.

- Any change to the tax system will have a significant impact on some industry participants. We would therefore urge Government to provide assistance to the affected participants on a transition basis to help them adjust their business model or exit the industry. We also seek further Government support for industry marketing activities, particularly in new markets, as well as a continuation of the existing support for dealing with tariff and non-tariff market access barriers.

- The necessary tax reform should be achieved without resorting to a complex, costly to manage, excise-based tax system that would involve such measures as bonded warehouses, inspections, weekly settlements and other imposts which would be particularly difficult for small wine makers.

- The cost of the WET rebate has doubled to approximately $250 million since its introduction. There is a need either to remove the WET rebate or substantially reform it so that it is consistent with the original intent of the legislation i.e. to support primary producers, particularly those who can help stimulate regional tourism and remove any loopholes for “rorting".

- We don’t believe that a single uniform volumetric tax applying to all alcohol categories is justifiable. The cost of production and capital intensity of wine production is vastly different and higher than other alcohol forms, particularly spirits. A uniform rate of volumetric tax will simply drive consumers to the cheapest form of alcohol production, which will not only decimate the Australian wine industry and damage the domestic beer industry but stimulate even greater importation of cheap spirits from those overseas markets with the lowest manufacturing cost bases.

- We also believe that use of tax as a lever for health policy is ineffective and punishes the vast majority of consumers who enjoy our products responsibly.

Lion urges the Commission to recognise the deterioration of the alcohol tax base, and the primary reason being the under-taxation of wine relative to consumption; and to propose structural reform of the revenue arrangements to address this.

Properly quantifying social costs

Issue

Economic theory suggests that the optimal level of taxation on some products can be set with reference to the social impact caused by such goods. (see Appendix A)

Therefore, it may be possible to improve overall community welfare by taxing the consumption of particular commodities that cause social harm. The specific alcohol taxation system (excise and WET) explicitly does this (in contrast the GST is imposed on top of these specific imposts for general revenue purposes).

The purpose of imposing these specific taxes is to ensure the price paid by a consumer reflects the cost that consumption imposes on others. Individuals then face incentives (through higher prices) to adjust consumption to a socially optimal level.

This approach was endorsed in the recent review of the Australian Tax System (the Review). Recommendation 8.3 of the Review stated, inter alia

"*Taxes on alcohol should be set to address the spillover costs of alcohol abuse, when this delivers a net gain to the community's wellbeing and is more effective than alternative policies."*

The recommendation continued that the level of taxation should be based on "*evidence of net social cost*". Lion agrees with this assessment. The question is how should this *net social cost* be properly quantified and who should do that quantification?

The estimates being used by some stakeholders in the public debate on this issue are fundamentally flawed – the Review noted this flaw. Lion also endorses this conclusion. However, the Review did not calculate the level of social cost, nor suggest a methodology to do so.

Accordingly, what is needed is an agreed, properly based, "official" methodology for calculating the spillover costs of alcohol consumption. Lion is suggesting that the Treasury be responsible for the final calculation of this estimate, as the question is an economic one.

This official figure should then be used in the debate around appropriate levels of taxation. Using a soundly based estimate will improve the quality of the debate and will ensure that all stakeholders can address the issue knowing that an objective professional assessment has been made.

Ideal Outcome

That the Treasury agree to develop a rigorous methodology to measure the *net* social costs of alcohol harm, namely by separately estimating:

- The level of alcohol harm (gross); and
- The level of benefit from alcohol consumption.

Combining the two would provide the best estimate of the true *net* impact of alcohol related harm.

The resultant data then should be accepted as the "true measure" of both gross and net social costs.

The methodology would be public and would be updated from time to time as appropriate – perhaps every two or three years.

<u>Alcohol in Australia</u>

Though overall consumption of alcohol in Australia has declined in the last three years, Lion recognises that industry must play a role in helping to reduce misuse, particularly by at-risk groups such as young people and our indigenous communities.

Lion has pioneered the development of the mid-strength beer sector. In 1991 Lion launched XXXX Gold mid-strength category which is now the best selling beer in Australia. Lion provides consumers with a lower alcohol content beer that still boasts the taste of a full strength beer.

Lion continues to invest in the lower-than-full-strength alcohol segments of the beer market to drive consumer uptake of low alcohol alternatives.

Lion also launched the Preece Lighter in Alcohol range in 2009 for wine consumers. Lower alcohol wines now represent 4 percent of total wine sales in Australia and have experienced 50 percent growth over the last year, representing 29 percent of total bottled wine growth.

In addition, Lion also supports community partnerships, education and cultural change programs. These programs are aimed at changing community expectations around what is acceptable behaviour when drinking takes place and empowering individuals to make better choices when they drink.

The simple fact is that the only way that responsible low alcohol products can be successfully created, launched and grown over time is through the ability to responsibly market these products. Obviously advertising is a key marketing tool.

There are many groups, most of whom are somehow funded via the Commonwealth, who actively lobby to limit or ban advertising and other marketing of alcohol.

In addition, taxation policy can be used creatively to stimulate demand for responsible products. The success of mid-strength beer is partly attributable to a sensible tiered excise system. Such incentives should be retained.

<u>Issue: Alcohol advertising and sponsorship</u>

The government tasked the Australian National Preventive Health Agency (ANPHA) to monitor the compliance of the alcohol industry with voluntary codes of practice and other commitments on responsible alcohol advertising. ANPHA has been tasked with reducing alcohol misuse.

However, in December 2012 ANPHA released a discussion paper broadening this task to review alcohol related regulations on advertising and their effectiveness in addressing community concerns, and that this was to include sponsorship.

This is a concern to industry as it goes beyond the original task which the government had intended and risks recommendations being made to government that are not evidenced-based and are based on achieving a population health outcome that doesn't target that part of the population that is at risk.

Lion is a responsible marketer, complying fully with the letter and spirit of highly effective legislation and self-regulatory best practice codes. We want our products to be consumed responsibly, both because it's right and because it will ensure the sustainability of our business for many years into the future.

Banning alcohol advertising and sponsorship is a knee-jerk reaction that will not provide a solution to the complex cultural issue of misuse.

Advertising has three macro benefits – firstly, it increases consumer choice, secondly, it stimulates economic growth and thirdly it is a critical characteristic of an open and democratic society.

It should be noted that advertising and sponsorship has been critical to the successful introduction of the lower-than-full-strength segment of the beer market. Today, one in four beers consumed in Australia is lower-than-full-strength. This positive change in consumption would not have been possible if brewers were restricted from establishing these brands and categories in the market.

Issue: Alcohol health warning labels

As part of the government's review into food labelling, the government committed to providing industry with two years to adopt pregnancy health labels voluntarily before mandating. Lion led the industry in voluntarily adopting comprehensive labelling and we have honoured our commitments. Predictably lobby groups now demand a mandatory labelling regime – and one that would be inconsistent with the one already adopted by industry. This would be both pointless (as there is no evidence that alcohol labelling actually has any positive health impact) and a waste of government resources – on top of the substantial resources already committed by industry.

Currently, there is no clear indication if government proposes to mandate the current pregnancy warning labels which more than 80 percent of the industry is adopting or whether the government will mandate new warning labels which will lead to additional costs to those manufacturers who have already adopted a voluntarily label in good faith.

Food, nutrition and health

Lion believes strong brands can play a positive role in helping consumers make educated choices about the food and beverage products they consume. That is why Lion takes great pride in producing a range of products and size formats, made using high quality ingredients that have the potential to genuinely benefit the wellbeing of consumers.

Amongst the number of new products that Lion has developed to meet specific consumer wellbeing needs are low glycemic index (GI) foods, no fat yogurts and milks, dairy beverages with 1% fat and no added sugar, lower sugar juice drinks, and a specialty milk with plant sterols that can help lower cholesterol.

It is this type of innovation which is critical to better health outcomes in the longer run for the Australian community, and to the continued robust economic health of the Australian food industry.

It is critically important that regulation does not interfere or any way impede the ability of Australian industry to innovate and create sustainable domestic and food export businesses.

Unfortunately, excessive regulation in the area of marketing and labelling has the potential to achieve this highly undesirable outcome.

Issue: food labelling

The former Government undertook a review into food labelling, 'Labelling Logic' and during this process it proposed to implement a number of changes through Food Standards Australia and New Zealand (FSANZ). Whilst some of these changes are reasonable, the actual process and consultation has become complex and cumbersome.

The recommendation dealing with the 'Front of Pack' labelling (FoPL) is now being handled by The Food Regulation Standing Committee (FRSC), which is leading a process of consultation between government, industry and public health stakeholders in an attempt to develop an agreed new "voluntary" FoPL scheme. The membership of FRSC comprises senior officials of Departments for which the Ministers represented on the Forum (from Federal, State, Territory & NZ governments) have portfolio responsibility. The FRSC, in turn, has delegated the process to multiple groups including a Steering Committee, Project Committee, Technical Design Working Group and Implementation Working Group. This process is also being managed independently of other food labelling reforms such as the implementation of the new Nutrition and Health Claims Standard and proposed changes affecting the Nutritional Information Panel, which have overlapping considerations.

The risk in this complex process is that inconsistent outcomes are achieved through the various separate processes. Streamlining these processes is a desirable outcome.

It is also important to note, in relation to the FoPL example, that there remain key issues on which agreement has not yet been reached with industry – a matter of significant concern given the need for industry support of the scheme. There remain several anomalies in the nutrient criteria behind the Health-Star Rating, particularly in core food categories such as dairy. In addition, the proposed new scheme appears to be progressing in the absence of any cost/benefit analysis or adequate consumer research. This complex and incomplete process is proceeding against the backdrop of the Australian Food and Grocery Council's existing FoPL Daily Intake Guide, a comprehensive and well-understood voluntary industry scheme that has been in place since 2006, with industry investing more than $72 million to date. There does not appear to have been adequate consideration of the sufficiency of this existing scheme or other alternatives to enhance consumers' understanding of information currently on pack (e.g. nutrition information panel and the ingredients list). Further, whilst the proposed new Health Star Rating scheme has been pitched as voluntary, industry has been advised if adequate and consistent uptake is not achieved, a mandatory FoPL scheme is likely.

Taxing to control social costs

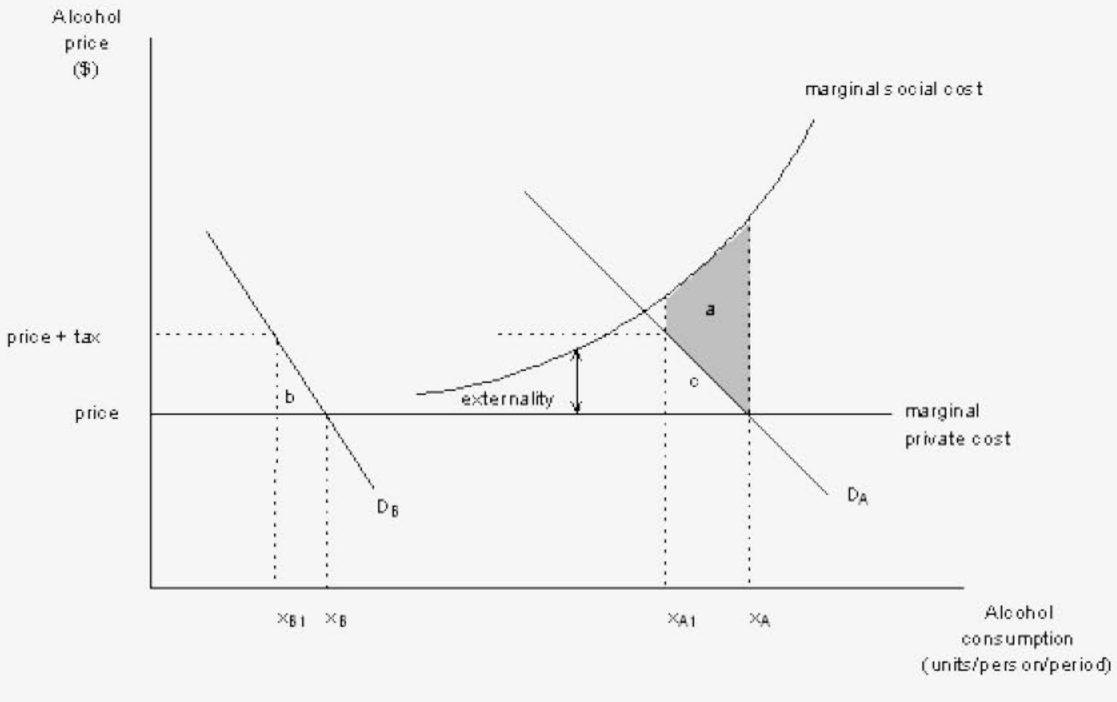
It is sometimes possible to improve overall welfare by taxing the consumption of particular commodities that cause social harm. The purpose of imposing such a tax is to ensure the price paid by a consumer reflects the cost consumption imposes on others. Individuals then face incentives (through higher prices) to reduce consumption to a socially optimal level.

However, the social cost of consuming an extra unit of alcohol varies from consumer to consumer. A person who consumes two light beers instead of one may not impose costs on others. An inebriated person in a risky environment who consumes an additional drink may impose significant additional social costs. Taxes on alcohol production do not discriminate between cases where the marginal social cost is high and where it is low.

These differences are illustrated in the chart below, in which curve D_A reflects the demand for alcohol from a high-risk drinker (who imposes increasing costs on others per unit of drink), while curve D_B reflects the demand from a low-risk drinker, where the social costs are minimal. Imposing a tax on alcohol reduces the demand in both markets (from x_A to x_{A1}, and from x_B to x_{B1}).

Although this would reduce the satisfaction of high-risk drinkers (area c), this may be less than the reduction in harm caused to others (area a + c), in which case society as a whole benefits from the reduction in high-risk consumption. However, the tax would also reduce the satisfaction of those whose consumption is low-risk (area b), reducing the benefit from the tax.

Chart: Taxing to control social costs



Source: Australia's Future Tax System Consultation Paper Section 11