



# Karnataka State Excise Reforms 2026

Draft Report

April 2026

Resource Mobilization Committee



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- 2 **Health and Family Welfare Department**, Government of Karnataka
- 3 **Home Department**, Government of Karnataka
- 4 **Director General and Inspector General of Police**, Government of Karnataka
- 5 **Karnataka State Temperance Board**, Government of Karnataka
- 6 **National Institute of Mental Health and Neuro Sciences (NIMHANS)**, Bengaluru

### Associations, Companies

- 7 **Brewers Association of India, (BAI)**
- 8 **Confederation of Indian Alcoholic Beverage Companies, (CIABC)**
- 9 **Federation of Wine Merchants Association, (FWMA)**
- 10 **International Spirits & Wines Association of India, (ISWAI)**
- 11 **Karnataka Brewers and Distillers Association, (KBDA)**
- 12 **Karnataka Wine Merchants Association, (KWMA)**
- 13 **Karnataka State Wine Producers Association, (KSWPA)**
- 14 **Madhya Nisheda Andolana**, Karnataka
- 15 **Giest Brewing Company**
- 16 **Sula Vineyards**
- 17 **Woodpecker Distilleries & Breweries Private Limited**

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## PREFACE

The Committee was constituted by the Government of Karnataka to examine the structure of alcohol excise taxation in the State and to recommend reforms. In the course of its work, the Committee held extensive discussions with the Finance Department and the Excise Department, examined the existing legislative and regulatory framework, reviewed the empirical literature on the social costs of alcohol consumption, and analyzed Karnataka's excise revenue data, consumption patterns, and institutional arrangements.

We were asked to recommend reforms to the excise system. We concluded that the system needed to be redesigned from its foundations.

Karnataka's excise framework has served the State for six decades. It has generated substantial and stable revenue. But it was designed when social and cultural attitudes to alcohol were very different and in an era of physical controls, manual supervision, and administratively determined prices — and it reflects the priorities of that era. The framework taxes alcohol based on price and product category rather than on alcohol content. It under-taxes the cheapest, highest-strength products — where the social harm is greatest — and over-taxes premium products where the harm per unit of alcohol is no different. It relies on a multi-layered approval architecture that creates compliance burdens for businesses without proportionately improving regulatory outcomes. And it operates, implicitly, as a revenue-maximization system rather than a corrective instrument.

This report proposes a different approach. It begins not with revenue but with harm. It asks: what does alcohol cost Karnataka — in lives lost on the roads, in violence inside homes, in the burden on hospitals and households? It estimates that cost, translates it into a per-litre benchmark, and designs a tax system around it. The benchmark — approximately ₹2,000 per litre of pure alcohol by FY 2028–29 — is derived from publicly verifiable data, tested across a range of assumptions, and deliberately conservative.

We recognize that this proposal asks the State to do something difficult. Raising the effective tax on the cheapest alcohol — which is also the most widely consumed — is politically challenging. It will be opposed by those who benefit from the current system's complexity. And it carries real risks: higher prices can drive consumption into illicit channels if enforcement is inadequate. The report addresses these risks directly and proposes specific countermeasures - a phased glide path, digital track-and-trace systems, and distribution reforms that strengthen legal supply.

We also recognize that this report does not have all the answers. The deemed input tax credit for domestic supplies requires a detailed empirical study. The tension between economic and public health perspectives on retail outlet regulation remains genuinely unresolved. The appropriate pace of distribution reform will depend on implementation experience. We have tried to be honest about what we know and what we do not.

The Committee's recommendations are informed by extensive consultations conducted over the course of its work. The Committee held formal hearings with written submissions, working meetings, and informal consultations with a wide range of stakeholders. These included, as already noted, the Finance Department and the Excise Department of the Government of Karnataka, which provided the fiscal and administrative

data that underpin the analysis in this report. The Committee engaged with industry associations - including representatives of distillers, brewers, and the Indian spirits and wines industry - to understand the operational realities of manufacturing, pricing, and compliance under the current system. Public health experts, including researchers from NIMHANS, contributed perspectives on the epidemiology of alcohol use disorders, the treatment gap, and the relationship between pricing policy and consumption behaviour. Stakeholders from the distribution and retailing side of the business - including those involved in wholesale logistics, depot operations, and retail licensing - provided insights into the practical challenges and costs of the current distribution architecture. The Committee also consulted with technology companies working on digital track-and-trace, supply chain automation, and compliance platforms, whose experience informed the recommendations on technology-enabled regulation.

These consultations shaped the report in important ways. The Committee's understanding of the price-slab arbitrage problem, the compliance burden, the operational strengths and limitations of KSBCL, and the practical feasibility of QR-code-based track-and-trace systems all drew substantially on stakeholder inputs. Where stakeholder views diverged — as they did on the pace of transition, the future role of KSBCL, and the regulation of retail outlet density — the report has tried to present the competing perspectives fairly rather than suppress the disagreement.

This report is now being placed in the public domain for wider consultation. All interested parties — manufacturers, retailers, distributors, public health organizations, citizen and consumer groups, academic institutions, and members of the public — are invited to submit their views on the Committee's findings and recommendations. The Committee believes that the analytical framework presented in this report provides a sound basis for deliberation, and that the reform it proposes will be strengthened by the scrutiny and input of those it affects.

The Committee was encouraged by the Government's prompt and constructive engagement with its preliminary recommendations. The Budget for FY 2026–27 announced the introduction of an Alcohol-in-Beverage-based excise duty structure from April 2026 and the rationalization of pricing slabs from sixteen to eight — reflecting the acceptance of the reform direction recommended in this report. These announcements mark the beginning of the transition. The recommendations in this report provide the analytical foundation, the calibrated benchmark, and the implementation roadmap for its completion by FY 2028–29.

We place on record our appreciation of the Government's engagement and our hope that this report contributes to a more coherent, transparent, and socially responsible excise system for Karnataka.

**Dr K P Krishnan, IAS (Retired)**  
*Chairman, Resource Mobilization Committee*

## AT A GLANCE

**The problem:** Alcohol consumption in Karnataka imposes social costs estimated at 2.0% of GSDP (central estimate) — approximately ₹51,000 crore annually. The current excise system does not reflect these costs. Economy IML — the largest-volume, highest-harm segment — pays an effective excise of ₹600–800 per litre of pure alcohol, well below the estimated social cost of ₹1,077/Litre of alcohol in beverage (LAIB) (FY 2022–23).

The proposed ideal solution: A strength-based excise levied per litre of alcohol in beverage (LAIB), calibrated to the social cost benchmark.

How to calculate the tax on any product: Three inputs. Three steps. One formula. (Target rate: ₹2,000 per LAIB by FY 2028–29)

**Step 1:** Pure alcohol = Bottle size (litres) × % of Alcohol in beverage (AIB)

**Step 2:** Excise = LAIB × ₹2,000

**Step 3:** VAT = (Price + Excise) × VAT rate

### Example:

A 750 ml bottle at 42.8% AIB contains 0.321 litres of pure alcohol → Excise = ₹642

**Table 1: The Ideal tax architecture**

| Component                     | Purpose  | Rate  |
|-------------------------------|--|---|
| Specific excise<br>(per LAIB) | <b>Corrective:</b><br>To internalize social cost             | ₹2,000/LAIB<br>by FY 2028–29                |
| State-level VAT               | <b>Consumption tax:</b><br>To bring parity with normal goods | 18% ad valorem<br>(illustrative)            |
| Deemed input tax<br>credit    | <b>Mitigates cascading:</b><br>GST-alcohol boundary          | 6% for domestic supplies<br>(illustrative)  |
| Import treatment              | Prevents unearned tax advantage                              | Full VAT,<br>no deemed credit               |
| Indexation                    | Maintains real value over time                               | Linked to<br>nominal GSDP growth, quarterly |

### The intermediate glide path tax architecture

- The intermediate glide path reflects a pragmatic compromise between the ideal design and implementation constraints. While a strength-based excise is optimal, an immediate shift risks revenue disruption and illicit consumption.
- The intermediate framework therefore adopts a hybrid approach: a uniform ED linked to alcohol content with a simplified slab-based AED, enabling gradual alignment while ensuring stability.

To calculate the tax structure at the target rate of approximately 1,542/LAIB by FY 2026–27, Ex-factory price slabs are reduced for IMFL to 8 and Beer to 3.

How to calculate the tax on any product: Three inputs. Three steps. One formula (Target rate of approximately 1,542/LAIB by FY 2026–27).

**Step 1:** Pure alcohol = Bottle size (litres) × % of Alcohol in beverage (AIB)

**Step 2:** Excise Duty = LAIB × ₹1000

**Step 3:** AED: Excise Duty + Differential AED as per Ex-factory price slabs

### Example:

A 750 ml IMFL bottle at 42.8% AIB contains 0.321 litres of pure alcohol and falls within the ₹471–520 ex-factory price slab, attracting an AED of ₹220 → Excise = **541**

**Table 2: Components and Design of the Proposed Alcohol Excise System**

| Component   | Purpose   | Rate   |
|---|---|--|
| Specific excise (per LAIB)                                  | <b>Corrective:</b><br>To internalize social cost  | ₹1,542/LAIB by FY 2026–27                                |
| Uniform Excise Duty (ED) linked directly to alcohol content | To establish the core harm-based taxation principle addressing negative externality of alcohol consumption        | ₹1,542/LAIB by FY 2026–27<br>₹1000 across all price slab |
| Slab-based differential AED                                 | Transitional instrument to smoothen price adjustments across segments   | IMFL: ₹ 50 to ₹3700<br>BEER: ₹ 800- ₹2700                |
| Import treatment  | Prevents unearned tax advantage by maintaining prices broadly within the range observed in the neighboring states | Similar ED and AED as mentioned above.                   |
| Indexation  | Maintains real value over time  | Linked to nominal GSDP growth, quarterly                 |

**Table 3: Key numbers**

| Component                                 | Purpose                                   | Rate  |
|---|---|---|
| Social cost of alcohol (% of GSDP)        | Social cost of alcohol (% of GSDP)        | 1.45% – 2.6%<br>(central: 2.0%)             |
| Social cost benchmark, FY 2028–29         | Social cost benchmark, FY 2028–29         | ₹2,000 per LAIB<br>(range: ₹1,243 – ₹2,972) |
| Current effective excise on economy IML   | Current effective excise on economy IML   | ₹600 – 800 per LAIB                         |
| Projected consumption reduction (6 years) | Projected consumption reduction (6 years) | 8 – 9%                                      |

## What this report recommends and what it does not:

**Recommends:** Final desired destination is strength-based excise calibrated to social cost. State-level VAT at 18%. Digital track-and-trace compliance. Registration-based market entry. Phased transition over three years starting with an intermediate system of taxation based on excise duty based on LAIB and additional excise duty (AED) calibrated to smoothen the transition with retention of reduced but rationalized price slabs determined by producers and not government.

**Does not recommend:** Prohibition. Deregulation. Revenue-driven rate-setting. Any measure that increases illicit trade risk without countermeasures.

## EXECUTIVE SUMMARY

Alcohol consumption in Karnataka imposes annual social costs estimated at 1.45 to 2.6% of Gross State Domestic Product. These costs fall on families through domestic violence, on road users through drunk driving fatalities, on the health system through liver disease and alcohol use disorders, and on the poorest households through the diversion of scarce income from food, health, and education. The evidence, drawn from nationally representative surveys, peer-reviewed research, and official statistics, is documented in detail in Section 1 of this report.

The question for policy is not whether these costs exist - they are well established - but whether the state's tax system is designed to address them. This report concludes that it is not.

**Background:** Nationally, alcohol taxes contribute 1.2% of GDP, 7.7% of total tax collections, and 13.7% of states' own tax revenues, with employment at ~1.5% of the workforce. Alcohol taxation is a significant source of revenue. In Karnataka, it accounts for 1.4% of GSDP, 11.1% of total tax revenue, and 20.3% of own tax revenue (2024–25), while contributing only ~0.4% of employment, largely concentrated at the retail level (~70%).

**The problem:** Karnataka's current excise framework taxes alcohol based on price and product category rather than on alcohol content. This creates a fundamental misalignment: economy Indian Made Liquor- the highest-strength, highest-volume, highest-harm segment of the market - bears an effective excise of approximately ₹600-800 per litre of pure alcohol, while the estimated social cost of that alcohol is approximately ₹1,077 per litre (FY 2022-23). Premium and imported products, by contrast, are taxed at or above the social cost benchmark. The system under-taxes the products causing the most harm and over-taxes those causing the least. A sixteen-slab price classification structure (recently rationalized to eight) compounds this by creating opportunities. The result is an excise regime that is complex, opaque, and poorly aligned with its own corrective purpose.

**The principle:** This report argues that excise taxation should be calibrated to the social cost of alcohol consumption, not to revenue targets, product categories, or administrative convenience. The harm arises from the alcohol in beverage. The tax should therefore be levied on this - per litre of pure alcohol - at a rate that reflects the external cost that consumption imposes on society. This is the Pigouvian principle, and it leads to a simple proposition: every alcoholic beverage should ideally be taxed in exact proportion to its alcohol content.

**The behavioral shift:** A strength-based excise does more than correct the current system's distortions. It actively nudges consumption toward lower-strength beverages-products that contain less alcohol per serving and therefore cause less harm. International evidence from the UK's 2023 duty reform, Australia's 2008 RTD tax, and the WHO's 2022 Global Alcohol Action Plan confirms that this substitution effect is a significant and intended consequence of strength-based taxation. For Karnataka, where the market is dominated by spirits at 42.8% ABV and strong beer at 6–8%, the potential for this compositional shift is substantial.

**The number:** The social cost benchmark, derived transparently from publicly verifiable data and tested for robustness, reaches approximately ₹ 2,000 per litre of pure alcohol in beverage by FY 2028-29 under a central scenario of 10 per cent nominal GSDP growth. This figure is conservative - it excludes intangible costs, intergenerational effects, and many alcohol-attributable conditions. Even under the most cautious combination of assumptions (1.45 per cent of GSDP, 60 per cent external cost share), the benchmark for FY 2028–29 is ₹1,243 per LAIB - still substantially above what economy IML currently pays.

**The tax architecture:** The reformed system comprises two levies with distinct purposes. A strength-based specific excise - levied per litre of pure alcohol in beverage and converging toward ₹2,000/LAIB by FY 2028-29 - performs the corrective function. A state-level ad valorem VAT at 18 per cent on excise-inclusive transactional value performs the general consumption tax function, with a deemed input tax credit for domestic supplies (to mitigate cascading at the GST-alcohol boundary) and no deemed credit for imports (which bear no prior domestic tax). Industrial alcohol is excluded from the corrective excise but remains within the VAT framework.

**Production externalities** - water use, effluent discharge - are addressed through separate input pricing and environmental instruments, not through excise. The design ensures that each type of cost is addressed by the instrument best suited to it.

**The institutional reform:** The tax reform requires modernization of the regulatory framework. The report recommends a shift from ex ante controls to technology-enabled ex post compliance - including digital track-and-trace (based on Andhra Pradesh and Punjab models), mandatory registration, standardized returns, and risk-based enforcement. Distribution should transition over 3-5 years from quota-based licensing to registration-based entry with spatial regulation. The role of KSBCL as sole wholesaler should be reviewed, with a phased move toward competitive wholesale under digital oversight. Fixed percentage retail margins should also be reformed

**What this report does not recommend:** This report does not recommend prohibition, which would eliminate legal supply while driving consumption into illicit channels. It does not recommend deregulation, which would remove safeguards against harmful consumption. It does not recommend any measure designed to reduce the state's fiscal capacity. And it does not recommend a reform that ignores the risk of illicit trade - the phased glide path, digital track-and-trace infrastructure, and distribution reforms are designed specifically to mitigate that risk.

**The implementation path:** The transition should proceed in three phases, aligned with the Budget announcement for FY 2026-27: a preparatory and legislative phase (FY 2026-27), a transition phase (FY 2027-28), and a consolidation phase (FY 2028-29) in which the reformed system is fully operational. From FY 2028-29 onward, the excise rate should be indexed to nominal GSDP growth on a quarterly basis, eliminating ad hoc rate revisions and ensuring that the tax automatically tracks the evolving social cost.

**The opportunity:** Karnataka has the chance to become the first Indian state to design its excise system from first principles - starting with the harm, deriving the tax, and building the institutions to support it. The Budget announcement for FY 2026-27 has already set the reform in motion. This report provides the analytical foundation, the calibrated benchmark, the tax architecture, and the implementation roadmap. What remains is the legislative and administrative commitment to see it through.

## CHAPTER 1

### THE SOCIAL HARM OF ALCOHOL CONSUMPTION

Alcohol is not a normal consumer good. When a person buys a shirt or a meal, the consequences of that purchase are confined largely to the buyer. When a person drinks, the consequences radiate outward - to the spouse who is beaten, the pedestrian who is struck, the child whose school fees are diverted, the employer whose worker does not show up, and the public hospital that absorbs the cost of treatment. This distinction - between goods whose costs are private and goods whose costs spill over onto others - is the starting point of this report. Before examining what Karnataka's tax system should look like, it is necessary to understand what alcohol does.

#### Who drinks, how much, and what

India has approximately 160 million alcohol consumers. The National Family Health Survey (NFHS-5, 2019–21) reports that 18.3 per cent of men and 4.8 per cent of women aged 15-49 consume alcohol; among men aged 15 and above, about 19 per cent currently drink, with prevalence higher in rural areas (20 per cent) than in urban areas (17 per cent).<sup>1</sup> A separate national survey places the overall prevalence at 14.6 per cent, with 5.2 per cent of the population - over 7 crore individuals - classified as harmful or dependent users who need intervention or treatment.<sup>2</sup>

Karnataka's position within this national picture is instructive. About 11 per cent of the state's population consumes alcohol - below the national average.<sup>3</sup> Yet Karnataka is one of five southern states that together account for roughly 45 per cent of all alcohol sold in the country.<sup>4</sup> Fewer people drink, but those who do drink more. This pattern of high-intensity consumption among a smaller base of drinkers is precisely the configuration that generates the most harm, because the relationship between alcohol intake and damage is not linear: the risk of accidents, violence, liver disease, and dependence rises steeply with the quantity consumed per occasion.

The composition of what people drink compounds the problem. India's alcohol market is overwhelmingly spirits-based. Within spirits, lower-priced Indian Made Liquor (IML) accounts for the dominant share of sales - high in alcohol content, sold at low price points, and therefore delivering more pure alcohol per rupee than beer or wine. In a market structured this way, the potential for harm per unit of consumer expenditure is substantially higher than in countries where lower-strength beverages predominate

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3 NFHS-5 state-level data for Karnataka; CRISIL Research (2020).

4 CRISIL Research (2020). Five southern states — Andhra Pradesh, Telangana, Tamil Nadu, Karnataka, and Kerala — account for approximately 45 per cent of all alcohol sold in India.

## What the harm looks like?

The damage from alcohol consumption shows up across every domain of public life. It shows up on the roads, inside homes, in hospital wards, and in the household budgets of the poorest families. The evidence is extensive and, in many cases, comes from India itself.

**On the roads:** Drunk driving caused 10,080 reported accidents in 2022, killing 4,201 people and injuring 8,8095; over 3,000 deaths were recorded in 2023<sup>6</sup>. Between 2008 and 2017, 76,446 people died in more than 211,000 alcohol-related crashes<sup>7</sup>. These are likely underestimates due to inconsistent reporting and misclassification. Clinical evidence suggests a higher prevalence: one emergency room study found 45.9 per cent of injured drivers tested positive for alcohol, rising to 79.2 per cent among those with life-threatening injuries<sup>8</sup>, while a systematic review estimates that 6-48 per cent of fatally injured road users had alcohol in their systems<sup>9</sup>.

What makes drunk driving a particularly important category of harm is that its victims are overwhelmingly innocent third parties - pedestrians, cyclists, passengers, and occupants of other vehicles. The cost falls on people who had no part in the decision to drink. A randomized evaluation of sobriety checkpoints in Rajasthan confirmed that enforcement significantly reduced traffic deaths, providing experimental evidence of the causal link between alcohol and road fatalities. But the same study documented an important limitation: drivers learned the patrol patterns and rerouted, illustrating why enforcement alone cannot solve the problem<sup>10</sup>.

**Inside homes:** The connection between alcohol and domestic violence is among the most extensively documented relationships in Indian public health data. Among women whose husbands drink frequently, 73.4 per cent report experiencing domestic violence, compared with 24.6 per cent of women whose husbands do not drink.<sup>11</sup> A partner's alcohol consumption is associated with a more than threefold increase in the odds of sexual violence against women, even after controlling for indicators of women's empowerment.<sup>12</sup> Alcohol explains roughly a quarter of the gap in intimate partner violence between Scheduled Caste and General category women.<sup>13</sup>

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10 Banerjee, A., Duflo, E., Keniston, D., & Singh, N. (2019). Deterring drunk driving in India. J-PAL. <https://www.povertyactionlab.org/evaluation/deterring-drunk-driving-india>

11 Panda, S., et al. (2024). Trends and correlates of intimate partner violence experienced by ever-married women of India: Results from NFHS Rounds III and IV. *BMC Public Health*, 21, 2088

12 Kumari, S., et al. (2024). Prevalence of intimate partner violence among Indian women and their determinants: A cross-sectional study from NFHS-5. *BMC Women's Health*, 24, 353. <https://doi.org/10.1186/s12905-024-03195-x>

13 Das, P., Tripathy, A., & Nanda, S. (2022). Decomposing the gap in intimate partner violence between Scheduled Caste and General category women in India. *SSM – Population Health*, 19, 101177. <https://doi.org/10.1016/j.ssmph.2022.101177>

These are correlations, but stronger evidence points to causation. When Bihar imposed alcohol prohibition in 2016, researchers used a difference-in-differences design comparing Bihar to neighboring Jharkhand and found that the ban led to measurable reductions in both husband's alcohol consumption and domestic violence against women.<sup>14</sup> International research has documented similar effects: higher alcohol taxes are consistently associated with reductions in violence, crime, and risky sexual behavior across multiple countries.<sup>15</sup>

**In the body:** The World Health Organization classifies alcohol as causally linked to more than 200 diseases and injury conditions - liver cirrhosis, several cancers, cardiovascular diseases, and neuropsychiatric disorders among them.<sup>16</sup> In India, alcohol-attributable deaths between 2011 and 2050 are projected to cause a loss of 258 million life years. The direct health system cost of treating just three categories of alcohol-related conditions - liver disease, cancers, and road injuries - is estimated at INR 3,127 billion (approximately US\$ 48 billion) over this period.<sup>17</sup> The National Mental Health Survey (2016) found an alcohol use disorder prevalence of 4.6 per cent nationally; Karnataka falls within the 2.5-4.9 per cent prevalence band.<sup>18</sup>

A particularly concerning dimension is adolescent initiation. The prefrontal cortex — responsible for impulse control, planning, and assessment of long-term consequences — continues developing until approximately age 25.<sup>19</sup> Yet systematic reviews find that the mean age of drinking initiation in India ranges from 14.4 to 18.3 years.<sup>20</sup> Among male adolescents aged 15–19, 8.1 per cent already consume alcohol, a figure that more than doubles to 21.8 per cent by age 20–24.<sup>21</sup> In Kerala, the average initiation age has dropped from 19 to 13 years over two decades.<sup>22</sup> Those who start earlier drink more heavily as adults and face a higher risk of dependence.<sup>23</sup>

**In the household budget:** The total societal burden of alcohol in India - health system costs, out-of-pocket expenditure, and productivity losses-is estimated at INR 121,364 billion (US\$ 1,867 billion) between 2011 and 2050, equivalent to an average annual loss of 1.45 per cent of GDP even after adjusting for tax receipts from alcohol sales.<sup>24</sup> A more recent estimate using the Global Burden of Disease 2019 framework places the economic burden at INR 6.2 trillion for 2019 alone.<sup>25</sup>

These aggregate figures conceal a sharply regressive pattern. Alcohol expenditure as a share of total household spending is significantly higher among poorer families. Studies from rural India show that when alcohol prices rise, the poorest households do not reduce consumption proportionately - instead, their alcohol expenditure share increases, crowding out spending on food, health, and education.<sup>26</sup> The damage is therefore concentrated where families can least afford it.

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14 Chaudhuri, K., Jha, N., Nilayamgode, M., & Suryanarayana, R. (2024). Impact of Bihar's alcohol ban on intimate partner violence. *Ideas for India*. <https://www.ideasforindia.in/topics/social-identity/impact-of-bihar-s-alcohol-ban-on-intimate-partner-violence.html>. See also: Dixit, A., et al. (2023). *The Lancet Regional Health – Southeast Asia*, 18, 100295. <https://doi.org/10.1016/j.lansea.2023.100295>

15 Markowitz, S., & Grossman, M. (1999). *Journal of Health Economics*, 19(2), 271–282. [https://doi.org/10.1016/S0167-6296\(99\)00025-9](https://doi.org/10.1016/S0167-6296(99)00025-9). See also: Markowitz, S., Kaestner, R., & Grossman, M. (2005). *American Economic Review*, 95(2), 263–266. <https://doi.org/10.1257/000282805774670284>

16 World Health Organization (2024). *Global Status Report on Alcohol and Health 2024*. Geneva: WHO. <https://www.who.int/publications/i/item/9789240096745>

17 Jyani, G., Prinja, S., Ambekar, A., Bahuguna, P., & Kumar, R. (2019). Health impact and economic burden of alcohol consumption in India. *International Journal of Drug Policy*, 69, 34–42. <https://doi.org/10.1016/j.drugpo.2019.04.005>

18 National Mental Health Survey of India (2016). Cited in Basu, A., et al. (2024). *Indian Journal of Psychiatry*, 66(7). <https://journals.sagepub.com/doi/10.1177/02537176241265079>

19 Squeglia, L.M., Jacobus, J., & Tapert, S.F. (2014). *Handbook of Clinical Neurology*, 125, 501–510. <https://doi.org/10.1016/B978-0-444-62619-6.00029-5>

20 Nadkarni, A., et al. (2022). Alcohol use among adolescents in India: A systematic review. *Cambridge Prisms: Global Mental Health*, 9, e1. <https://doi.org/10.1017/gmh.2021.32>

21 Pradhan, S., et al. (2024). *Pan African Medical Journal*, 51, 17. <https://doi.org/10.11604/pamj.2024.51.17.42611>

22 The Lancet (2009). *The Lancet*, 373(9657), 17. [https://doi.org/10.1016/S0140-6736\(08\)61939-X](https://doi.org/10.1016/S0140-6736(08)61939-X)

23 Reddy, M.P., et al. (2015). *Indian Journal of Medical Research*, 141(6), 844–849. <https://doi.org/10.4103/0971-5916.160711>

A field experiment with cycle-rickshaw drivers in Chennai provides a revealing window into how this works at the individual level. When randomly assigned financial incentives to stay sober during working hours, drivers did not work more or earn more - but they saved 50 per cent more. The primary economic cost of drinking, in other words, was not lost labour but impaired financial decision-making while intoxicated. Money that would have been saved was instead spent - a form of damage that is invisible in standard economic statistics but devastating for households living close to the margin.<sup>27</sup>

## How large is the cost?

Two complementary strands of research allow us to estimate the aggregate social cost of alcohol consumption as a share of economic output. The first is the India-specific study by Jyani et al. (2019), which estimates the net economic burden at 1.45 per cent of GDP annually - a figure that is conservative because it models health effects only for liver disease, cancers, and road traffic injuries, excluding many other alcohol-attributable conditions as well as the costs of violence, crime, and household disruption.<sup>28</sup> The second is a systematic review by Manthey et al. (2021), covering 29 countries, which finds that total alcohol-attributable costs average approximately 2.6 per cent of GDP when all components-healthcare, productivity, criminal justice, property damage -are included.<sup>29</sup>

These two estimates define a plausible range of 1.45 to 2.6 per cent of GDP. Taking the midpoint as a central estimate yields an annual social cost of approximately 2.0 per cent of GSDP for Karnataka.

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- 24 Jyani, G., Prinja, S., Ambekar, A., Bahuguna, P., & Kumar, R. (2019). Health impact and economic burden of alcohol consumption in India. *International Journal of Drug Policy*, 69, 34–42. <https://doi.org/10.1016/j.drugpo.2019.04.005>
- 25 Gupta, S., et al. (2024). Assessing the societal value of health lost to alcohol use in India compared to excise taxes on alcohol sales. *BMC Public Health*. <https://pubmed.ncbi.nlm.nih.gov/39192681/>
- 26 Chari, A.V., Liu, E.M., Wang, S.Y., & Wang, Y. (2017). *Social Science & Medicine*, 191, 236–246. <https://doi.org/10.1016/j.socscimed.2017.09.024>
- 27 Schilbach, F. (2019). Alcohol and self-control: A field experiment in India. *American Economic Review*, 109(4), 1290–1322. <https://doi.org/10.1257/aer.20170458>
- 28 Jyani, G., Prinja, S., Ambekar, A., Bahuguna, P., & Kumar, R. (2019). Health impact and economic burden of alcohol consumption in India. *International Journal of Drug Policy*, 69, 34–42.
- 29 Manthey, J., et al. (2021). What are the economic costs to society attributable to alcohol use? *PharmacoEconomics*, 39, 809–822. <https://pubmed.ncbi.nlm.nih.gov/articles/PMC8200347/>

## CHAPTER 2

### THE ECONOMIC CASE FOR STATE INTERVENTION

The previous section established that alcohol consumption generates large and pervasive harm - on the roads, inside homes, in the health system, and in household budgets. But documenting harm, by itself, does not tell us what the government should do about it. Many activities cause harm. The question for policy is whether the harm justifies intervention, and if so, what form that intervention should take.

This section develops the economic case for state intervention in alcohol markets. It argues that two distinct types of market failure - externalities and internalities - prevent the price of alcohol from reflecting its true cost to society. It then examines the available policy instruments and explains why excise taxation, designed around alcohol content, is the most effective response.

#### Why the market gets it wrong

In a well-functioning market, the price a consumer pays for a good reflects its full cost. When someone buys rice or clothing, the transaction is largely self-contained: the buyer bears the cost, the seller receives the payment, and third parties are mostly unaffected. Economists call this a situation where private costs equal social costs, and there is no particular reason for the government to interfere with the price.

Alcohol is different in two fundamental ways.

**First, alcohol consumption creates externalities - costs imposed on people who are not part of the transaction.** The pedestrian killed by a drunk driver did not choose to drink. The woman beaten by an intoxicated husband did not choose his consumption. The taxpayer who funds a public hospital treating alcohol-related liver disease did not consent to the expenditure. The employer who loses a day's work to an absent employee did not share in the drinking. In each case, a significant portion of the cost falls on someone other than the consumer. When this happens, the price the consumer pays - even if it includes tax - is lower than the true cost the consumption imposes on society. Consumers therefore drink more than they would if they had to bear the full consequences of their decisions. This gap between private cost and social cost is the classic economic justification for corrective taxation.<sup>30</sup>

In a theoretical world with perfect insurance markets, some of these costs might be internalized. Health insurers could charge higher premiums to heavy drinkers; employers could adjust wages for workers who drink. In practice, this does not happen. Group insurance pools risks without differentiating by drinking behavior. Government-funded health schemes cannot charge differentiated premiums. Wages do not adjust on an individual basis, particularly in settings with collective bargaining, minimum wages, or informal employment. The result is that a large share of alcohol-related costs remains external — borne by families, employers, insurers, taxpayers, and the public at large.<sup>31</sup>

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30 The theoretical framework for corrective taxation of goods with negative externalities originates with Pigou, A.C. (1920). *The Economics of Welfare*. London: Macmillan. For the application to alcohol and health externalities, see Gruber, J. (2016). *Public Finance and Public Policy* (5th ed.), Chapter 6. Worth Publishers. <https://www.macmillanlearning.com/college/us/product/Public-Finance-and-Public-Policy/p/1319105254>

31 On the conditions under which health care costs and productivity losses constitute true externalities rather than internalised costs, see Manning, W.G., Blumberg, L., & Moulton, L.H. (1995). The demand for alcohol: The differential response to price. *Journal of Health Economics*, 14(2), 123–148. [https://doi.org/10.1016/0167-6296\(94\)00042-3](https://doi.org/10.1016/0167-6296(94)00042-3). Manning et al. estimated externalities from drinking at \$1.22 per ounce of ethanol — substantially higher than prevailing alcohol taxes.

**Second, alcohol consumption involves internalities - costs that individuals impose on their own future selves through imperfect decision-making.** Standard economics assumes that when a person decides to drink, they are making a rational trade-off: the pleasure of drinking today is weighed against the health consequences tomorrow, and the decision reflects the consumer's informed preference. If this were true, the private costs of drinking - the drinker's own health damage, lost income, reduced life expectancy - would not justify intervention, because the consumer has already accounted for them.

Two bodies of evidence challenge this assumption. The first concerns adolescent initiation. As documented in Section 1, a substantial proportion of adult drinkers begin during adolescence, before the brain regions responsible for impulse control and long-term planning have fully matured. The decision to start drinking is made at an age when the individual is neurologically unable to properly assess long-term consequences. Surveys of young smokers - the closest available parallel - illustrate the point starkly: among high school seniors who smoked a pack a day and said they would not be smoking in five years, 74 per cent were still smoking five years later, nearly identical to the 72 per cent who predicted they would be. Young people systematically underestimate the addictive power of the substances they consume.<sup>32</sup>

The second body of evidence concerns self-control problems among adults. Even people who understand that drinking is harmful and who want to drink less often find themselves unable to execute their own plans when temptation is immediate. This is not a matter of ignorance - it is a failure of implementation. The most compelling evidence from India comes from Schilbach's (2019) experiment with cycle-rickshaw drivers in Chennai. When offered a choice between unconditional cash payments and sobriety incentives of equivalent expected value, the majority chose the sobriety incentives - voluntarily giving up guaranteed money to create a mechanism that would help them resist the temptation to drink. This revealed preference for commitment demonstrates that these individuals knew they had a self-control problem and were willing to pay to overcome it.<sup>33</sup>

When adolescents make poorly informed decisions about initiation, or when adults cannot execute their own long-term plans, the resulting harm is an externality - damage the consumer inflicts on their future self without fully accounting for it. This is conceptually analogous to an externality: in both cases, the consumption decision does not reflect the full cost, and intervention can improve welfare.<sup>34</sup>

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32 Gruber, J. (2016), citing longitudinal survey evidence on prediction errors among adolescent smokers. The rational addiction model — Becker, G.S., & Murphy, K.M. (1988). A theory of rational addiction. *Journal of Political Economy*, 96(4), 675–700. <https://www.jstor.org/stable/1830469> — assumes this kind of systematic prediction error does not occur.

33 Schilbach, F. (2019). Alcohol and self-control: A field experiment in India. *American Economic Review*, 109(4), 1290–1322. <https://doi.org/10.1257/aer.20170458>. On the theory of time-inconsistent preferences that explains demand for commitment, see O'Donoghue, T., & Rabin, M. (1999). Doing it now or later. *American Economic Review*, 89(1), 103–124. <https://doi.org/10.1257/aer.89.1.103>

34 Gruber, J. (2016), Chapter 6. The conceptual equivalence between externalities and internalities as justifications for corrective taxation is developed formally in Gruber, J., & Köszegi, B. (2001). Is addiction “rational”? Theory and evidence. *Quarterly Journal of Economics*, 116(4), 1261–1303.

### **Box 2.1: The Chennai Rickshaw Drivers - Evidence of Self-Control Problems from India**

In 2019, the economist Frank Schilbach conducted a field experiment with 229 cycle- rickshaw drivers in Chennai to test whether alcohol consumption involves self-control problems - a question with direct implications for tax policy.

Randomly selected groups of drivers were offered either financial incentives for remaining sober during daytime working hours (verified by breathalyzer) or unconditional cash payments of equivalent expected value. A third group was given the choice between the two.

The majority of those given the choice selected the sobriety incentives - voluntarily giving up guaranteed money to create a mechanism that would help them resist the temptation to drink. This is a revealed preference for commitment: these men understood they would be tempted, knew they would find it difficult to resist, and were willing to pay for external help.

The effects were striking. Sobriety incentives increased sober visits by 33 per cent and reduced breathalyzer scores. But the most revealing finding was economic: increased sobriety had no measurable effect on labour supply, productivity, or earnings- yet it increased savings by 50 per cent. The primary cost of daytime drinking was not lost work but impaired financial decision-making while intoxicated.

**Why this matters for excise policy.** If drinkers were making fully rational choices, there would be no case for government intervention beyond correcting externalities. The Chennai experiment demonstrates that many drinkers are not - they want to drink less, cannot execute their own plans, and are willing to pay for help. A higher excise tax functions as precisely this kind of help: it raises the cost of giving in to temptation, acting as a commitment device that assists individuals in doing what they themselves want to do. This is the internalities argument for corrective taxation, and it justifies a tax rate above what externalities alone would require.

*Source: Schilbach, F. (2019). Alcohol and self-control: A field experiment in India. American Economic Review, 109(4), 1290–1322.  
<https://doi.org/10.1257/aer.20170458>*

## What the State can do - and what does not work

Given that alcohol markets are characterized by both externalities and internalities; the state has a legitimate basis for intervention. The question is which instrument to use. Four broad options are available: prohibition, information campaigns, direct regulation and enforcement, and taxation. Each has different strengths and limitations.

**Prohibition** is the most extreme intervention. By banning production, sale, or consumption, it seeks to eliminate harm at its source. In practice, prohibition rarely eliminates demand. It displaces consumption into illicit markets, increases the circulation of spurious and adulterated alcohol - with severe health risks for the poorest consumers - and imposes large enforcement costs. India's own experience confirms this: states that have imposed prohibition have contended with persistent illicit production, smuggling across state borders, and periodic mass poisoning events from methanol-laced country liquor. Prohibition amounts to overcorrection - a policy response that exceeds what the underlying market failure requires and generates new harms of its own.

**Information campaigns** can help when the problem is ignorance. If people underestimate the health risks of drinking, providing accurate information may lead to better decisions. For smoking, public health information has contributed to large declines in consumption over several decades.<sup>35</sup> However, information is of limited value when the problem is not ignorance but self-control. People who already know they should drink less but cannot resist when the bottle is in front of them are not helped by another pamphlet. Nor does information address the neurological immaturity that leads adolescents to discount long-term consequences.

**Direct regulation and enforcement** - drink-driving checkpoints, age verification at point of sale, penalties for serving intoxicated persons - can target specific harmful behaviours. As the Rajasthan checkpoint experiment showed, enforcement works when it is in place. But it faces a fundamental limitation: the harm from alcohol is concentrated among a subset of heavy drinkers, and detection is costly and imperfect. Drunk driving frequently goes undetected. Domestic violence is chronically underreported. Penalties imposed after the fact may be insufficient to deter behaviour driven by impaired judgment and present bias. Moreover, enforcement capacity in India is stretched thin, and behavioural adaptation - as the Rajasthan study documented — erodes effectiveness over time. Enforcement is a necessary complement to policy, but it cannot bear the primary weight of reducing alcohol-related harm.

**Taxation** offers a fundamentally different mechanism. Rather than trying to detect and punish harmful behaviour after it occurs, taxation raises the price of alcohol for everyone, reducing consumption at the margin. It works through two channels simultaneously. For externalities, it forces consumers to internalize costs they would otherwise impose on others - the Pigouvian principle. For internalities, it acts as a commitment device: by making alcohol more expensive, it increases the cost of giving in to temptation, helping individuals with self-control problems stick closer to their own long-term plans. Gruber and Köszegi (2004) formalized this argument for smoking, showing that the optimal tax on an addictive good consumed by individuals with self-control problems is substantially higher than what externalities alone would justify.<sup>36</sup>

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<sup>35</sup> Gruber, J. (2016) notes that much of the large decline in smoking in the United States over the past thirty years has been traced to information releases about health risks.

<sup>36</sup> Gruber, J., & Köszegi, B. (2004). Tax incidence when individuals are time-inconsistent: The case of cigarette excise taxes. *Journal of Public Economics*, 88(9–10), 1959–1987. <https://doi.org/10.1016/j.jpubeco.2003.06.001>. They calculate that the optimal tax for self-control problems alone would be \$5–\$10 per pack, above and beyond any externality-correcting tax.

Taxation has another practical advantage: it does not require the state to identify which specific individuals are drinking harmfully. It operates on the price signal, affecting all consumption, with the largest behavioural impact on the most price-sensitive consumers - who tend to be younger, poorer, and heavier drinkers. Indian evidence confirms that alcohol demand responds to price. Meta-analyses estimate a central price elasticity of approximately -0.5: a 10 per cent increase in price reduces consumption by about 5 per cent.<sup>37</sup> India-specific estimates range from -0.14 for spirits to -0.46 for country liquor, with youth generally more price-responsive than adults.<sup>38</sup> A multi-state analysis found that a 1 per cent increase in tax reduces alcohol consumption by 0.14 per cent.<sup>39</sup>

The distributional concern - that alcohol taxes are regressive because poorer households spend a larger share of income on alcohol - is real but must be weighed against the distribution of harm. The health damage, household disruption, and economic vulnerability caused by alcohol consumption are also concentrated among poorer households. A tax that reduces heavy consumption in these households may be regressive in expenditure terms but progressive in welfare terms.<sup>40</sup>

## Two conclusions for Karnataka

The analysis above leads to two conclusions that anchor the rest of this report.

**First, excise taxation is the most effective policy instrument available to Karnataka for reducing alcohol-related harm.** Prohibition overcorrects and generates illicit markets. Information campaigns cannot address self-control failures. Enforcement is necessary but insufficient as a primary instrument. Taxation works through the price mechanism, addressing both externalities and internalities without requiring individualized detection. It is administratively feasible, scalable, and - as the evidence on price elasticities confirms - effective at changing behaviour.

**Second, the tax must be based on alcohol content - not on price, brand, or product category.** The harm documented in Section 1 arises from alcohol. A person's liver, brain, and reflexes respond to the quantity of alcohol consumed, not to the price paid for it. A litre of cheap whisky at 42.8 per cent alcohol-by-volume inflicts the same physiological damage as a litre of expensive whisky at the same strength. A tax system that charges different rates based on price or category - as Karnataka's current system does - creates a perverse outcome: it under-taxes high-strength, low-price products (where harm per rupee is highest) and over-taxes premium products (where harm per rupee is lower). This is the opposite of what corrective taxation should do. It also creates an incentive for consumers to substitute toward cheaper, higher-strength products - precisely the pattern most associated with harmful drinking.

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37 Wagenaar, A.C., Salois, M.J., & Komro, K.A. (2009). Effects of beverage alcohol price and tax levels on drinking: A meta-analysis of 1,003 estimates from 112 studies. *Addiction*, 104(2), 179–190. <https://pubmed.ncbi.nlm.nih.gov/19149811/>. See also: Gallet, C.A. (2007). The demand for alcohol: A meta-analysis of elasticities. *Australian Journal of Agricultural and Resource Economics*, 51(2), 121–135.

38 Kumar, S. (2017). Price elasticity of alcohol demand in India. *Alcohol and Alcoholism*, 52(3), 390–396. <https://pubmed.ncbi.nlm.nih.gov/28430934/>. See also: Jadhav, V., & Mukherjee, S. (2025). Price elasticity of demand for alcoholic beverages in India. NIPFP Working Paper 431. [https://www.nipfp.org.in/media/documents/WP-431\\_2025.pdf](https://www.nipfp.org.in/media/documents/WP-431_2025.pdf)

39 Gupta, S., Suryanarayana, R., & Nilayamgode, M. (2022). Price and tax elasticity of alcohol consumption: Evidence from seven Indian states. *medRxiv*. <https://doi.org/10.1101/2022.11.28.22282831>

40 Chari, A.V., Liu, E.M., Wang, S.Y., & Wang, Y. (2017). The impact of price policy on demand for alcohol in rural India. *Social Science & Medicine*, 191, 236–246. <https://doi.org/10.1016/j.socscimed.2017.09.024>. On the welfare-progressive nature of sin taxes despite expenditure-regressivity, see Gruber, J. (2016), Chapter 6.

A strength-based excise does more than eliminate the distortions created by price-based taxation. It actively nudges consumption toward lower-strength beverages - a behavioural shift that directly reduces harm.

The mechanism is straightforward. When tax is levied per litre of pure alcohol, a bottle of strong beer at 8% ABV pays nearly twice the excise of a regular beer at 4.5% ABV, even if the two are sold at similar retail prices. A consumer choosing between a 42.8% ABV spirit and a 13% ABV wine faces a threefold difference in excise per bottle. These price signals create incentives - for both consumers and producers - to shift toward lower-alcohol alternatives. Consumers who are price-sensitive (and the evidence reviewed earlier confirms that many are, particularly in lower-income segments) will gravitate toward products that deliver the social experience of drinking at a lower alcohol cost.

International evidence supports both channels. The United Kingdom's 2023 alcohol duty reform — which moved to a fully volumetric (strength-based) system - was explicitly designed to incentivize this shift. Modelling by the University of Sheffield using the Tobacco and Alcohol Policy Model estimated that the reform would reduce consumption by encouraging substitution toward lower-strength products, with the largest health gains coming from reduced consumption of high-strength ciders and wines that had previously been undertaxed relative to their alcohol content.<sup>41</sup> Early evidence from the UK confirms that brewers began lowering the ABV of their products within weeks of the new duty rates taking effect.<sup>42</sup>

In Australia, the 2008 “alcopops tax” - a 70% excise increase on spirit-based ready-to-drink beverages - produced a more than 30% reduction in RTD sales and a 1.5% reduction in total pure alcohol sold nationally. While some substitution toward spirits and wine was observed, aggregate ethanol consumption fell, and emergency department presentations for acute alcohol problems among young adults declined in the years following the tax.<sup>43</sup> Australia's Henry Tax Review (2010) subsequently recommended a comprehensive volumetric tax across all beverages, concluding that a uniform rate per standard drink would create the strongest incentive for substitution toward lower-alcohol products.<sup>44</sup>

The WHO's 2022 Global Strategy to Reduce the Harmful Use of Alcohol explicitly identifies the substitution toward lower-strength beverages as a policy objective and recommends excise structures that set tax rates in proportion to alcohol content as the primary mechanism to achieve it.<sup>45</sup> Rehm et al. (2016), in a review commissioned as part of this strategy, conclude that if consumers replace standard beverages with lower-strength alternatives without fully compensating by increasing the volume consumed, the net effect is a reduction in total ethanol intake - and therefore in harm.<sup>46</sup>

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41 Brennan, A., et al. (2024). Estimating the effect of transitioning to a strength-based alcohol tax system on alcohol consumption and health outcomes: a modelling study of tax reform in England. *The Lancet Public Health*, 9(10). [https://www.thelancet.com/journals/lanpub/article/PIIS2468-2667\(24\)00191-9/fulltext](https://www.thelancet.com/journals/lanpub/article/PIIS2468-2667(24)00191-9/fulltext)

42 Anderson, P., and Kokole, D. (2025). Nudging alcohol moderation via excise tax reform: The case of beer in Australia. *Australian Economic Review*, 58(1). <https://onlinelibrary.wiley.com/doi/10.1111/1467-8462.70006>. The authors cite Burton et al. (2024) for UK evidence on rapid brewer reformulation in response to duty changes.

43 Chikritzhs, T., et al. (2009). Is the “alcopops” tax working? Probably yes but there is a bigger picture. *Medical Journal of Australia*, 195(2), 84–86. <https://pubmed.ncbi.nlm.nih.gov/21770879/>. See also: Gale, M., et al. (2015). Alcopops, taxation and harm: a segmented time series analysis of emergency department presentations. *BMC Public Health*, 15, 468. <https://pmc.ncbi.nlm.nih.gov/articles/PMC4430875/>

44 Australia's Future Tax System Review (Henry Tax Review), 2010, Chapter E5-3 (Alcohol taxation).

45 World Health Organization (2022). *Global Alcohol Action Plan 2022–2030*. Geneva: WHO. See also: WHO (2017). *Tackling NCDs: 'Best Buys' and Other Recommended Interventions*. Geneva: WHO.

46 Rehm, J., Lachenmeier, D.W., Llopis, E.J., Imtiaz, S., and Anderson, P. (2016). Evidence of reducing ethanol content in beverages to reduce harmful use of alcohol. *The Lancet Gastroenterology & Hepatology*, 1(1), 78–83. [https://doi.org/10.1016/S2468-1253\(16\)30013-9](https://doi.org/10.1016/S2468-1253(16)30013-9)

For Karnataka, where the market is dominated by spirits at 42.8% alcohol in beverage (AIB) and strong beer at 6-8% AIB, the potential for this behavioural shift is substantial. A strength-based excise makes lower-ABV products - regular-strength beer, wine, lower-proof spirits - relatively more affordable per unit of beverage purchased, even as it raises the price of ethanol across the board. Over time, this price signal can reshape both consumer preferences and producer strategies, shifting the market's center of gravity toward a less harmful composition of drinking. This is not a side effect of the reform - it is one of its central purposes.

Producers, facing a tax structure that penalizes alcohol content rather than product value, have an incentive to reformulate products at lower ABVs or to market lower-strength alternatives more aggressively.

A strength-based excise - levied per litre of pure alcohol - eliminates these distortions. It ensures that every product is taxed in proportion to the element that causes harm. It is transparent, simple, and directly aligned with the Pigouvian principle. The next section develops the methodology for calibrating this tax to the social cost of alcohol consumption in Karnataka.

The constitutional basis for Karnataka's authority to levy such a tax - including the relevant entries in the State List, the GST exclusion under Article 366(12A), and the Supreme Court's jurisprudence on state powers over alcohol - is discussed later.

## CHAPTER 3

### CALIBRATING THE EXCISE TAX

Section 1 established that the social cost of alcohol consumption in Karnataka lies in the range of 1.45 to 2.6 per cent of GSDP. Section 2 established that a strength-based excise tax — levied per litre of pure alcohol - is the right instrument. This section answers the operational question: how much should that tax be?

The answer requires converting a macro-level cost estimate - expressed as a percentage of the state's economy - into a per-litre figure that can be applied at the point of production or import. The methodology is deliberately transparent, the data sources are publicly verifiable, and the assumptions are conservative at every step. The objective is not to arrive at a precise number that captures every dimension of alcohol-related harm - no methodology can do that - but to establish a credible and defensible benchmark around which excise policy can be designed.

#### From social cost to a per-litre benchmark

The estimation proceeds in four steps.

First, the total economic cost of alcohol consumption is estimated as a percentage of Karnataka's GSDP, using the range established in Section 1: 1.45 per cent (lower bound, from Jyani et al. 2019), 2.0 per cent (central estimate, midpoint), and 2.6 per cent (upper bound, from the Manthey et al. 2021 systematic review).<sup>47</sup>

Second, this total cost is adjusted to isolate the portion that is external - costs borne by third parties rather than by the consumer. As discussed in Section 2, private costs borne and internalized by the drinker should not be included in a corrective tax benchmark. Similarly, production-related externalities - water use, effluent discharge, environmental impact - require separate policy instruments and should not be loaded onto the excise duty. A combined deduction of 30 per cent is applied: approximately 25 per cent for private costs (consistent with the WHO International Guidelines for Estimating the Costs of Substance Abuse and empirical decompositions that find private costs constitute 20-30 per cent of total costs) and 5 per cent for production externalities.<sup>48</sup> The resulting external cost share is 70 per cent of total economic cost

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47 Jyani, G. et al. (2019). *International Journal of Drug Policy*, 69, 34–42. <https://doi.org/10.1016/j.drugpo.2019.04.005>. Manthey, J., et al. (2021). *Pharmaco Economics*, 39, 809–822. <https://pmc.ncbi.nlm.nih.gov/articles/PMC8200347/>

48 Single, E., et al. (2003). *International Guidelines for Estimating the Costs of Substance Abuse*. WHO, Geneva. <https://apps.who.int/iris/handle/10665/42744>. The Manthey et al. (2021) decomposition finds productivity losses account for ~61%, healthcare for ~18%, criminal justice for ~11%, and other costs for ~10%. Of these, healthcare and criminal justice are almost entirely external. The 25% private cost deduction is at the upper end of empirical estimates (Manning et al. 1989; Canadian Substance Use Costs and Harms project), ensuring the benchmark is conservative

Third, the external cost is converted to per capita terms using official population projections for Karnataka from the Report of the Technical Group on Population Projections, 2011-2036.<sup>49</sup>

Fourth, the per capita external cost is divided by per capita pure alcohol consumption - 4.19 litres, derived from WHO data on India's total alcohol per capita consumption adjusted for total population - to yield a benchmark in rupees per litre of pure alcohol (LPA).<sup>50</sup> This consumption figure is held constant across the time series, a conservative assumption since rising incomes and urbanization could increase it over time.

The formula is:

$$\text{Social cost per LAIB} = \frac{(\text{GSDP} \times \text{cost ratio} \times \text{external share})}{(\text{population} \times \text{per capita pure alcohol consumption})}$$

### What the numbers show?

#### Worked example for FY 2022–23 (central estimate):

Karnataka's GSDP at current prices: ₹21.83 lakh crore. Total economic cost at 2.0 per cent: ₹43,660 crore. External cost at 70 per cent: ₹30,562 crore. Population: 6.77 crore. Total pure alcohol consumed: 6.77 crore × 4.19 litres = 28.37 crore litres. Social cost per LPA: ₹30,562 crore ÷ 28.37 crore litres = ₹1,077 per litre. Applying this methodology across FY 2018–19 to FY 2024–25 produces the following time series:

**Table 3.1: Estimated Social Cost per Litre of Pure Alcohol, FY 2018–19 to FY 2024–25**

| Year    | GSDP<br>(₹ lakh crore) | Popln.<br>(crore) | Low<br>(1.45%) | Central<br>(2.0%) | High<br>(2.6%) | Actual Excise / LAIB |
|---------|------------------------|-------------------|----------------|-------------------|----------------|----------------------|
| 2018–19 | 15.00                  | 6.62              | 549            | 757               | 984            | 712                  |
| 2019–20 | 15.88                  | 6.65              | 578            | 798               | 1,037          | 761                  |
| 2020–21 | 15.35                  | 6.68              | 557            | 768               | 998            | 811                  |
| 2021–22 | 17.21                  | 6.73              | 619            | 854               | 1,111          | 923                  |
| 2022–23 | 21.83                  | 6.77              | 781            | 1,077             | 1,401          | 1,054                |
| 2023–24 | 25.67                  | 6.82              | 912            | 1,258             | 1,635          | 1,212                |
| 2024–25 | 28.62                  | 6.86              | 1,011          | 1,394             | 1,812          | 1,270                |

49 National Commission on Population, Ministry of Health and Family Welfare (2020). Report of the Technical Group on Population Projections for India and States, 2011–2036. [https://nhm.gov.in/New\\_Updates\\_2018/Report\\_Population\\_Projection\\_2019.pdf](https://nhm.gov.in/New_Updates_2018/Report_Population_Projection_2019.pdf). Karnataka benchmarks: 6.52 crore (2016), 6.68 crore (2021), 6.91 crore (2026), 7.07 crore (2031); intervening years linearly interpolated.

50 WHO Global Health Observatory. Alcohol, total per capita (15+) consumption. [https://www.who.int/data/gho/data/indicators/indicator-details/GHO/total-\(recorded-unrecorded\)-alcohol-per-capita-\(15-\)-consumption](https://www.who.int/data/gho/data/indicators/indicator-details/GHO/total-(recorded-unrecorded)-alcohol-per-capita-(15-)-consumption). India's total APC for population aged 15+ is 4.92 litres (2019 data); adjusted for total population (~85% aged 15+) yields approximately 4.19 litres.

Sources: GSDP — PRS India / Karnataka Budget Documents; Population — MOSPI Technical Group (2020); Social cost ratios — Jyani et al. (2019) and Manthey et al. (2021); Per capita APC = 4.19 litres (WHO); External cost share = 70%; Excise revenue — PRS India / Karnataka Budget Documents.<sup>51</sup>

51 GSDP and excise revenue: PRS Legislative Research, Karnataka Budget Analysis 2025–26. <https://prsindia.org/budgets/states/karnataka-budget-analysis-2025-26>

Two findings stand out. The central social cost benchmark has nearly doubled over this period - from ₹757 per LPA in FY 2018-19 to ₹1,394 in FY 2024-25 - driven by nominal GSDP growth. And actual excise incidence per LAIB, while rising, has consistently tracked below the central benchmark. The gap indicates that Karnataka's excise system has not kept pace with the growing social cost of alcohol consumption.

### Where the current system fails

The gap between the benchmark and actual excise incidence is not uniform across products. It is sharpest where it matters most.

Economy IML - high in alcohol content, sold at low prices, and accounting for a large share of total consumption - faces an effective excise burden of approximately ₹600–800 per litre of pure alcohol. This is 40–60 per cent of the central social cost benchmark for FY 2022–23. The tax system under-corrects precisely in the segment where consumption is heaviest and harm is greatest.

Mid-range products show closer alignment, though with dispersion. Premium and imported spirits, by contrast, face effective excise burdens of ₹1,200 - 2,000 or more per LAIB - at or above the benchmark. This reflects the current system's reliance on price-based and category- based taxation, which charges more for expensive products regardless of their alcohol content.

The result is a system that taxes the wrong thing. Two bottles with identical alcohol content face widely different tax burdens depending on their price. This creates an incentive for consumers to substitute toward cheaper, higher-strength products - the precise pattern of consumption associated with the most severe harm. A strength-based excise eliminates this dispersion by applying a uniform rate per litre of pure alcohol, ensuring that every product is taxed in proportion to the element that causes harm.

### The forward-looking benchmark: ₹2,000 per LAIB by FY 2028–29

**Table 3.2: Projected Social Cost per LAIB under Alternative GSDP Growth Scenarios (₹/LPA, Central Cost Estimate, 2.0% of GSDP)**

| Year    | Low Growth<br>(8%) | Central<br>(10%) | High Growth<br>(12%) |
|---------|--------------------|------------------|----------------------|
| 2025–26 | 1,495              | 1,522            | 1,550                |
| 2026–27 | 1,607              | 1,667            | 1,728                |
| 2027–28 | 1,728              | 1,826            | 1,928                |
| 2028–29 | 1,859              | 2,000            | 2,150                |
| 2029-30 | 1,996              | 2,188            | 2,394                |
| 203031  | 2,146              | 2,396            | 2,670                |

Notes: Base year FY 2024–25 GSDP = ₹28.62 lakh crore. Population from MOSPI (2020). Per capita APC = 4.19 litres. External cost share = 70%.<sup>52</sup>

52 GSDP and excise revenue: PRS Legislative Research, Karnataka Budget Analysis 2025–26. <https://prsindia.org/budgets/states/karnataka-budget-analysis-2025-26>

Under the central scenario, the social cost benchmark reaches **₹2,000 per litre of pure alcohol by FY 2028–29**. Even under conservative 8 per cent GSDP growth, it exceeds ₹1,850. This figure - ₹2,000 per LAIB - serves as the policy anchor for the reformed excise system recommended in this report.

### Box 3.1: How to Calculate the Tax on Any Bottle - The Three-Step Formula

Under the reformed system, the tax on any alcoholic beverage can be calculated using three inputs and three steps.

**Inputs needed:** Bottle size (*in litres*) - Alcohol in beverage (*AIB, as a decimal* - e.g., 42.8% = 0.428) - Transactional value (*ex-factory price for domestic; landed cost for imports*)

**Step 1: Pure alcohol content** - Pure alcohol (litres) = Bottle size × AIB

**Step 2: Specific excise duty** - Excise (₹) = Pure alcohol × ₹2,000 per LAIB

**Step 3: State-level VAT** - VAT (₹) = (Transactional value + Excise) × Applicable VAT rate > (12% net for domestic supplies with deemed credit; 18% for imports)

#### Quick examples:

| Product                  | Size   | AIB   | Pure alcohol | Excise |
|--------------------------|--------|-------|--------------|--------|
| Economy IML<br>(quarter) | 180 ml | 42.8% | 0.077 L      | ₹ 154  |
| Premium whisky           | 750 ml | 42.8% | 0.321 L      | ₹ 642  |
| Strong beer              | 650 ml | 6.5%  | 0.042 L      | ₹ 85   |
| Wine                     | 750 ml | 13.0% | 0.098 L      | ₹ 195  |

The excise is determined entirely by alcohol content. A beer pays less than a whisky because it contains less ethanol — not because it is cheaper or because it falls in a different product category. This is the corrective principle made operational.

Under the current system, computing the tax requires identifying the applicable price slab, looking up category-specific rates, and navigating administrative classifications. Under the reformed system, the calculation requires a multiplication.

*Note: The excise rate of ₹2,000/LAIB is the FY 2028–29 benchmark. The deemed credit of 6% is illustrative, pending an empirical study (see Section 4).*

## The intermediate glide path

While a fully strength-based excise is the economically optimal solution, an immediate shift to the full social cost benchmark risks revenue volatility, price shocks, and potential diversion toward illicit consumption. A phased approach is therefore necessary to ensure both fiscal stability and behavioral adjustment. Thus, the intermediate glide path reflects a pragmatic balance between the ideal design and implementation constraints.

The proposed intermediate framework adopts a hybrid structure. It combines a uniform Excise Duty (ED) linked directly to alcohol content with a simplified slab-based Additional Excise Duty (AED). This allows the system to begin aligning taxation with alcohol strength- while retaining a transitional instrument to smooth price changes across products.

Under this framework, the effective tax rate converges toward approximately ₹1,542/LAIB by FY 2026–27, corresponding to the lower-bound social cost estimate (1.45% of GSDP, ~₹43,500 crore) and implying a ~25% increase over the current average excise levels. Further to support simplification and reduce classification arbitrage, ex-factory price slabs are rationalized to 8 slabs for IMFL and 3 slabs for beer.

Thus, the tax on any product can be computed using a simple three-step method:

- **Step 1:** Pure alcohol (litres) = Bottle size × Alcohol in Beverage (AIB)
- **Step 2:** Excise Duty (ED) = Pure alcohol × ₹1,000 per LAIB
- **Step 3:** Total excise = ED + applicable AED based on ex-factory price slab.

Each component of the structure serves a distinct purpose. The uniform ED establishes the core harm-based taxation principle by linking tax liability directly to alcohol content. The slab-based AED functions as a transitional tool, moderating price shifts across categories (ranging from ₹50 to ₹3,700 for IMFL and ₹800 to ₹2,700 for beer). The combined structure ensures gradual movement toward the full corrective benchmark without abrupt market disruption.

Imports are subject to the same ED and AED structure to prevent unintended price advantages and maintain parity with domestic products. To preserve the real value of taxation over time, rates are indexed to nominal GSDP growth on a quarterly basis, ensuring that the tax continues to track the evolving social cost of alcohol consumption.

## What happens to consumption

If excise duty is raised from the current ₹1,270 per LAIB (FY 2024–25) to the social cost benchmark, demand will contract as prices rise, while income growth will partially offset this through increased purchasing power. The net effect depends on two parameters: the price elasticity and income elasticity of alcohol demand

Using a central price elasticity of - 0.5 (consistent with major meta-analyses and within the range of Indian estimates) and an income elasticity of 0.6 (consistent with recent NIPFP estimates), the projection shows that pure alcohol consumption declines from approximately 0.287 billion litres in FY 2024-25 to 0.262 billion litres by FY 2030-31 - a reduction of approximately 8-9 per cent over six years.<sup>53</sup> This is not a trivial number. Applied to the categories of harm documented in Section 1 - road accidents, domestic violence, alcohol use disorders, household economic damage - even a single-digit percentage reduction in aggregate consumption translates into measurable reductions in human suffering.

Moreover, the consumption reduction is likely to be accompanied by a compositional shift - consumers and producers substituting toward lower-strength beverages in response to the alcohol-content-based price signal. International evidence from the UK's 2023 duty reform and Australia's 2008 RTD tax suggests that this substitution effect is a significant and intended consequence of strength-based taxation, amplifying the health benefits beyond what aggregate volume reductions alone would suggest.

## Robustness

The benchmark rests on assumptions, and those assumptions should be tested. Two dimensions of sensitivity are examined: the underlying social cost parameters and the price elasticity of demand

**Table 3.3: Sensitivity of the Social Cost Benchmark for FY 2028–29 (₹/LAIB)**

| Cost/GSDP | Ext. share = 60% | Ext. share = 70% | Ext. share = 80% |
|-----------|------------------|------------------|------------------|
| 1.45%     | 1,243            | 1,450            | 1,657            |
| 2.00%     | 1,714            | 2,000            | 2,286            |
| 2.60%     | 2,229            | 2,600            | 2,972            |

Under the most conservative combination of assumptions - 1.45 per cent of GSDP and a 60 per cent external cost share - the benchmark for FY 2028-29 is ₹1,243 per LAIB. This is still substantially above the effective excise incidence in economy IML segments (₹600-800 per LAIB), confirming that the current system under-taxes the highest-harm products even under the most cautious estimates. Under the most aggressive combination (2.6 per cent, 80 per cent), the benchmark reaches ₹2,972 per LAIB. The central estimate of ₹2,000 sits comfortably in the middle of this range and does not depend on any extreme assumption.

The robustness of the benchmark can also be tested by applying the same methodology to neighboring states. If the formula - social cost per LAIB = (GSDP × cost ratio × external share) / (total population × per capita consumption) - produces broadly comparable results across states with different economic structures and consumption patterns, it suggests that the Karnataka estimate is not an artefact of state-specific assumptions.

53 Price elasticity: Wagenaar, A.C., et al. (2009). *Addiction*, 104(2), 179–190. <https://pubmed.ncbi.nlm.nih.gov/19149811/>. India-specific estimates: Kumar, S. (2017). *Alcohol and Alcoholism*, 52(3), 390–396. <https://pubmed.ncbi.nlm.nih.gov/28430934/>. Jadhav, V., & Mukherjee, S. (2025). NIPFP Working Paper 431. [https://www.nipfp.org.in/media/documents/WP-431\\_2025.pdf](https://www.nipfp.org.in/media/documents/WP-431_2025.pdf). Income elasticity of 0.6 consistent with NIPFP WP 431 estimates of 0.42–0.80.

The following table applies the central scenario parameters (2.0 per cent cost ratio, 70 per cent external share, 10 per cent GSDP growth projected to FY 2028-29) to five neighboring states, using each state's own GSDP, population, and the WHO's national per capita consumption estimate of 4.19 litres (total population adjusted). In practice, per capita consumption varies across states - higher in Telangana, lower in Kerala - but in the absence of reliable state-level estimates of litres of pure alcohol consumed per capita (as distinct from prevalence rates), the national average is applied uniformly to maintain methodological consistency. The three-yearly review mechanism recommended in Section 6 should commission state-specific consumption estimates that would allow this table to be refined.

**Table 3.4: Indicative social cost benchmarks for selected states, FY 2028–29**  
(₹/LAIB, central scenario)

| State                 | GSDP<br>FY 2023–24<br>(₹ lakh crore) | Population<br>(crore, approx.) | Projected GSDP FY<br>2028–29<br>(₹ lakh crore, 10% growth) | Social cost<br>benchmark<br>(₹/LAIB) |
|-----------------------|--------------------------------------|--------------------------------|--|--------------------------------------|
| <b>Karnataka</b>      | 25.67                                | 6.80                           | 41.33  | 2,000                                |
| <b>Tamil Nadu</b>     | 27.21                                | 7.70                           | 43.82  | 1,882                                |
| <b>Andhra Pradesh</b> | 14.49                                | 4.90                           | 23.33  | 1,573                                |
| <b>Telangana</b>      | 14.00                                | 3.80                           | 22.55  | 1,961                                |
| <b>Maharashtra</b>    | 40.56                                | 12.50                          | 65.31  | 1,726                                |
| <b>Kerala</b>         | 10.22                                | 3.40                           | 16.46  | 1,599                                |

Notes: GSDP at current prices from Ministry of Statistics and Programme Implementation (FY 2023–24). Population estimates from Census projections (mid-2024). Per capita consumption: 4.19 litres of pure alcohol (WHO national estimate, total population adjusted). Central scenario: cost/GSDP = 2.0%, external share = 70%, GSDP growth = 10% nominal per annum. The formula applied is: Benchmark = (Projected GSDP × 0.02 × 0.70) / (Population × 4.19).

Sources: Ministry of Statistics and Programme Implementation; Reserve Bank of India, Handbook of Statistics on Indian States; WHO (2018), Global Status Report on Alcohol and Health.

**What the table shows.** The benchmarks cluster in a range of approximately ₹1,550 to ₹2,000 per LAIB across all six states. Karnataka's ₹2,000 sits at the upper end - reflecting its combination of relatively high per capita GSDP and moderate population - but it is not an outlier. Telangana, with a smaller population and comparable per capita GSDP, produces a benchmark of ₹1,961. Tamil Nadu, the largest southern economy, produces ₹1,882. Maharashtra, despite having the largest absolute GSDP, produces a lower benchmark (₹1,726) because its much larger population dilutes the per capita figure.

Three observations are important. First, the inter-state variation is driven primarily by differences in per capita GSDP - states with higher per capita output generate higher benchmarks because the economic value of the harm (measured as a share of GSDP) is larger in absolute terms per person. This is economically coherent: the opportunity cost of alcohol-related harm is higher in a richer economy.

Second, if state-specific consumption data were available, the benchmarks would diverge more. Telangana, where the prevalence of current drinking among men is approximately 50 per cent (NFHS-5), likely has higher per capita consumption than the national average - which would lower its benchmark. Kerala, where prevalence among men is approximately 26 per cent, likely has lower per capita consumption - which would raise its benchmark

Third, the table has a practical implication for inter-state coordination. If neighboring states were to adopt comparable benchmarks using the same methodology, the price differentials that drive cross-border leakage would narrow significantly. A reform in Karnataka that is broadly consistent with what the evidence would support in Tamil Nadu and Telangana is less vulnerable to cross-border arbitrage than a reform that pushes Karnataka's rates far above its neighbors.

On the elasticity side, if demand is less responsive to price than assumed (elasticity of - 0.3), the consumption reduction is smaller but still meaningful. If demand is more responsive (-0.7), the consumption reduction is larger - a 25 per cent decline in volume by FY 2028–29 - which achieves a greater reduction in harm.<sup>54</sup>

### How Karnataka's benchmark compares internationally

The ₹2,000/LPA benchmark can also be placed in an international context. Several jurisdictions now levy excise on the basis of alcohol content, and their rates - converted to a common currency - provide a frame of reference for assessing whether the proposed Karnataka rate is within a defensible range.

**Table 3.5: Excise duty per litre of pure alcohol — selected jurisdictions (2025–26)**

| Jurisdiction                               | Excise rate per LAIB | Approximate INR equivalent | Structure                      | Indexation             |
|--|----------------------|----------------------------|--------------------------------|------------------------|
| Karnataka<br>(proposed, FY 2028–29)        | ₹ 2,000              | ₹2,000                     | Uniform specific (LAIB)        | GSDP growth, quarterly |
| United Kingdom (spirits, >22% ABV)         | £ 33.99              | ₹3,640                     | Volumetric, tiered by AIB band | RPI, annual            |
| United Kingdom (beer, 3.5–8.5% ABV)        | £ 22.58              | ₹2,420                     | Volumetric, tiered by AIB band | RPI, annual            |
| Australia (spirits, >10% ABV)              | A\$ 108.00           | ₹6,050                     | Volumetric, by category        | CPI, biannual          |
| Australia (full-strength beer)             | A\$ 57.79            | ₹3,240                     | Volumetric, by category        | CPI, biannual          |
| South Africa (spirits)                     | ZAR 258.78           | ₹1,220                     | Specific, by category          | Annual budget          |
| Thailand (spirits)                         | ~THB 300–400         | ₹750–1,000                 | Mixed (specific + ad valorem)  | Periodic               |
| India — national weighted average current  | —                    | ₹1,228                     | Price-slab, by category        | Ad hoc                 |
| Karnataka (current effective, economy IML) | —                    | ₹600–800                   | Price-slab, by category        | Ad hoc                 |

*Notes* Exchange rates approximate as of March 2026 (£1 ≈ ₹107; A\$1 ≈ ₹56; ZAR 1 ≈ ₹4.7; THB 1 ≈ ₹2.5). UK rates from HMRC, effective February 2026. Australian rates from ATO, effective February 2026. South Africa rates from SARS, 2025-26 budget. Thailand rates estimated from excise schedules. Indian national average from NIPFP estimates. Karnataka current from Committee analysis. PPP adjustments not applied - rates are compared at market exchange rates, which understates India's purchasing-power-adjusted tax burden.

<sup>54</sup> Detailed revenue projections under alternative elasticity assumptions, and worked examples for volume and revenue calculations, are available in the supporting tables to this section.

**What the table shows.** Karnataka's proposed ₹2,000/LAIB sits at the lower end of the range for high-income jurisdictions that have adopted strength-based taxation. The UK charges approximately ₹2,400-3,600 per LAIB depending on product category and AIB band. Australia charges ₹3,200–6,000 - among the highest in the world, with biannual CPI indexation that has compounded rates over four decades. South Africa, a middle-income economy with per capita income closer to India's, charges approximately ₹1,220 per LAIB on spirits.

In purchasing power parity (PPP) terms, the comparison would look different. India's PPP conversion factor is roughly 3.5-4 times the market exchange rate, meaning that ₹2,000 in India has the purchasing power equivalent of approximately US\$85–95 - well above the UK's

£34 (US\$43) or Australia's A\$108 (US\$70) in nominal terms. This suggests that ₹2,000/LAIB, while conservative at market exchange rates, represents a meaningful tax burden in terms of domestic purchasing power - particularly for lower-income consumers, for whom alcohol constitutes a larger share of expenditure.

Two design features are worth noting. First, both the UK and Australia index their excise rates to inflation automatically - the UK annually to RPI, Australia biannually to CPI. This is precisely the mechanism recommended in this report for Karnataka (quarterly indexation to GSDP growth), and it ensures that the real value of the tax does not erode over time. Second, neither the UK nor Australia applies a fully uniform rate across all products — both retain some category-based differentiation (lower rates for beer and cider in the UK; no volumetric excise on wine in Australia). Karnataka's proposed uniform LPA rate is, in this respect, more theoretically pure than either the UK or Australian system.<sup>55</sup>

## Indexation

A specific excise duty - expressed as a fixed rupee amount per litre - does not automatically adjust for inflation or income growth. If left unchanged, its real value erodes over time, and alcohol becomes progressively more affordable relative to incomes. This is precisely what has happened in many jurisdictions: excise rates are set and then left in place for years, with periodic ad hoc revisions driven by budgetary pressures rather than by any connection to social cost.

The reformed system should avoid this. Once the benchmark of ₹ 2,000 per LAIB is reached in FY 2028–29, the excise rate should be indexed to nominal GSDP growth, with adjustments carried out quarterly. This ensures that the tax automatically tracks the social cost - which itself grows with the economy - without requiring annual political decisions about rate changes. Rules-based indexation replaces ad hoc revision, reducing policy uncertainty for both the government and the industry.

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<sup>55</sup> UK rates: HMRC, Alcohol Duty rates, updated 1 February 2026. <https://www.gov.uk/guidance/alcohol-duty-rates>. Australian rates: ATO, Excise duty rates for alcohol, updated 2 February 2026. <https://www.ato.gov.au/businesses-and-organisations/gst-excise-and-indirect-taxes/excise-on-alcohol/excise-duty-rates-for-alcohol>. South Africa: SARS, Rates of excise duty, 2025–26. For a comparative discussion of international alcohol tax design, see Cnossen, S. (2011). The economics of excise taxation. In M. Keen (ed.), *Changing Customs*. IMF.

## CHAPTER 4

### THE BROADER TAX ARCHITECTURE

The strength-based excise duty developed in Section 3 addresses the corrective objective - it internalizes the social cost of alcohol consumption by taxing the element that causes harm. But excise duty is not the only tax that alcohol bears, nor the only policy instrument that interacts with alcohol markets. Alcohol sits within a broader ecosystem of taxes, input costs, and environmental regulations, and the design of each component affects the coherence of the whole.

This section sets out the complete tax architecture within which the reformed excise should operate. It addresses four questions: how should alcohol be taxed beyond the corrective excise? How should input taxes and credits be handled given that alcohol sits outside GST? How should imports be treated to avoid creating unintended advantages? And how should production-related externalities — which are distinct from consumption harms - be addressed through instruments other than excise?

#### The Ideal dual tax structure

Alcohol requires two distinct taxes, serving two distinct purposes. The first - the strength-based specific excise - has been developed in the preceding sections. Its function is corrective: it makes the consumer pay for the social harm caused by ethanol. The second is a general consumption tax - an ad valorem levy that treats alcohol as a normal good in the state's consumption tax base.

The need for this second levy arises from a structural feature of India's tax system. When GST was introduced in 2017, alcoholic liquor for human consumption was kept outside its scope under Article 366(12A). This means that alcohol transactions are not subject to the value-added tax that applies to virtually every other consumer good. Without a separate state-level levy, alcohol would escape general consumption taxation altogether - an outcome that is neither fiscally sensible nor economically defensible.

The appropriate instrument is a state-level VAT, levied ad valorem on transactional value. The rate should be determined through a careful calibration that reflects two considerations. On one hand, the standard GST rate for most goods and services is 18 per cent, which provides a natural benchmark for treating alcohol as a normal consumption good once the corrective excise has already been applied. On the other hand, sin goods under GST - tobacco, aerated beverages - attract substantially higher rates: 28 per cent plus compensation cess (effectively 40 per cent or more) under the pre-2025 structure, and a consolidated 40 per cent under the reformed GST slabs. However, the analogy with tobacco and aerated drinks must be applied carefully. In the framework proposed here, the corrective function is already performed by the specific excise on alcohol content. The VAT is not intended to perform a further corrective role - it is a general consumption tax. Layering a sin-goods-level VAT on top of an already calibrated corrective excise would amount to double-counting the harm. For this reason, the standard 18 per cent rate is the more appropriate starting point for the VAT component, though the final rate is a policy decision for the state government and should be informed by a detailed fiscal impact assessment.

**However, this structure reflects the end-state of full implementation. During the transition, the price slab-base AED operates as a temporary adjustment mechanism to smooth price shifts across segments and preserve revenue stability. It does not adhere to the core principles of VAT or GST design and is not intended as a permanent feature of the tax system. Rather, it is a pragmatic transitional tool, to be phased out as the system converges to a fully strength-based excise with a standard VAT framework.**

The two levies perform complementary roles. The specific excise ensures that a ₹200 bottle and a ₹5,000 bottle with the same alcohol content bear the same corrective tax burden - because they cause the same harm. The ad valorem levy ensures that the ₹5,000 bottle contributes more to the general fiscal base - because its higher value reflects greater ability to pay. Neither levy can do both jobs. Conflating them - as many existing systems do - muddles the corrective and fiscal objectives and makes it impossible to tell whether the tax on any given product is adequate relative to the harm it causes.

As noted above, the intermediate glide path structure introduced as slab-base AED departs from standard VAT principles. The AED is a pragmatic, transitional construct designed to meet specific objectives - namely, preserving revenue stability and smoothing large price disruptions during the shift to a strength-based excise system

### **The GST interface and input tax treatment**

Because alcohol remains outside GST, a structural problem arises at the boundary between the two systems. Manufacturers and distributors of alcohol pay GST on their inputs - raw materials, packaging, transport, utilities - but cannot claim credit for these payments against the state-level VAT on alcohol. This creates cascading: taxes paid at earlier stages are embedded in the cost base and taxed again when the VAT is applied to the final product.

A full invoice-based input tax credit mechanism - the standard approach under GST - would eliminate this cascading but would be impractical in a sector that operates entirely outside the GST credit chain. The alternative is a deemed input tax credit, applied as a flat deduction against the VAT liability for domestic production and distribution.

The appropriate level of this deemed credit must be determined through a detailed empirical study of the actual GST burden embedded in the alcohol supply chain - covering raw materials (grain, molasses, malt), packaging (glass, caps, labels, cartons), energy, transport, and services. The study should estimate the weighted average GST incidence across product categories and supply chain stages, so that the deemed credit approximates the actual cascading burden rather than being set arbitrarily. For illustrative purposes, this report uses a deemed credit of 6 per cent — which, when applied against an 18 per cent VAT, yields an effective rate of 12 per cent on domestic supplies. This figure should be treated as a working assumption pending the results of such a study.

Within the alcohol supply chain, VAT paid at earlier stages - by manufacturers on sales to wholesalers, by wholesalers on sales to retailers - would be creditable at subsequent stages, ensuring that the state-level levy retains the essential character of a value-added tax rather than a turnover tax.

The constitutional basis for the state's power to levy both excise duty and the ad valorem VAT on alcohol - including Entry 51 (excise duties), Entry 54 (sales tax), and the implications of alcohol's exclusion from GST - is discussed later.

## Treatment of imports

Imported alcohol requires different treatment. Products entering Karnataka from other states or countries are typically zero-rated or lightly taxed in the exporting jurisdiction. They do not embody the prior domestic taxes - GST on inputs, state-level levies at earlier supply chain stages - that are built into the cost structure of domestically produced alcohol. If imports were given the same deemed credit as domestic supplies, they would receive a tax advantage they have not earned - a credit against taxes that were never paid

Accordingly, **imports should bear the full VAT without the benefit of any deemed input tax credit.** This is not protectionism. It is the application of a straightforward principle: the deemed credit compensates for embedded domestic taxes, and imports do not bear those taxes.

This distinction becomes increasingly important as India's trade environment evolves. If tariff protection on alcohol is reduced under future trade agreements - particularly with the European Union - Karnataka cannot rely on customs duties to offset distortions created by its internal tax design. The combined excise and VAT structure must be neutral between domestic and imported products on its own terms. The differential deemed credit treatment achieves this neutrality.

**However, we do appreciate the challenges in moving to the ideal tax structure immediately and recommend a transition whereby to reiterate AED operates as a temporary adjustment mechanism to smooth price shifts across segments and preserve revenue stability. It is a pragmatic transitional tool, to be phased out as the system converges to a fully strength-based excise with a standard VAT framework.**

## The VAT base and industrial alcohol

Two further design points complete the tax architecture.

First, the ad valorem VAT should be levied on the full transactional value of the product, inclusive of excise duty. This is standard VAT practice - the consumption tax is applied to the total price the consumer pays, which already includes the corrective excise. Excluding excise from the VAT base would create an artificial reduction in the consumption tax base and deviate from established tax design principles.

Second, the corrective excise developed in this report applies only to alcoholic liquor intended for human consumption. Industrial alcohol - used in manufacturing, chemicals, pharmaceuticals, and related sectors - does not generate the consumption externalities that justify the Pigouvian levy. Extending the social-cost-based excise to industrial alcohol would be conceptually wrong and would risk distorting legitimate industrial activity. However, industrial alcohol should not fall outside the state's fiscal framework altogether. It should remain subject to the VAT on the same terms as potable alcohol. The anti-diversion controls needed to prevent industrial alcohol from entering illicit beverage channels are addressed in Section 5.

The Supreme Court's recent confirmation of state powers to tax and regulate industrial alcohol - in *State of Uttar Pradesh v. Lalta Prasad Vaish* (2024) - is discussed in later.

### Where and when to collect

The excise duty and VAT are conceptually taxes on consumption - the harm occurs and the value is realized when the product is consumed within Karnataka. But administratively, it makes no sense to try to collect tax at the point of consumption. The tax should be collected upstream, where the number of collection points is small, record-keeping is formal, and evasion is more difficult to conceal.

For alcohol produced within Karnataka, both the specific excise and the VAT should be collected at the **manufacturing stage**. For alcohol entering from other states or countries, they should be collected at the **point of entry into the state**. The tax accrues to the jurisdiction of consumption - this is the destination principle - but it is collected where administrative efficiency is highest.

### Production externalities: a different problem, a different instrument

The excise duty developed in this report is calibrated to the social cost of *consuming* alcohol. But producing alcohol also generates externalities - primarily through water use, effluent discharge, and energy consumption. These production-related harms are real, but they are conceptually distinct from consumption harms, and loading them onto the excise duty would distort its corrective purpose.

Distillation and brewing are water-intensive processes. In many parts of Karnataka, groundwater extraction for industrial use imposes costs on competing users - agriculture, households, ecosystems - that are not reflected in the price producers pay for water. Where water is underpriced or allocated administratively, producers use more than they would if they faced the true resource cost. Similarly, distillery effluents, if inadequately treated, contaminate water bodies and degrade soil.

These problems call for instruments that target the resource or pollutant directly:

**Water pricing.** Where water is supplied through public systems, tariffs should reflect not only the cost of supply but the scarcity value of the resource. Where groundwater is extracted, appropriate charges or licensing mechanisms should ensure that the extraction cost reflects environmental damage. Rational water pricing would incentivize investment in water-saving technologies and recycling.

**Environmental regulations.** Effluent treatment requirements, discharge monitoring, and penalties for non-compliance should be enforced with the same seriousness as tax compliance. Where feasible, market-based instruments - pollution charges, tradable permits - can complement command-and-control regulation.

The principle is simple: one externality, one instrument. The excise duty addresses consumption harm through the price of the final product. Water pricing and environmental regulation address production harm through the cost of inputs. Conflating the two within a single instrument would make neither objective achievable with precision.

## CHAPTER 5

### CONSTITUTIONAL AND REGULATORY FRAMEWORK

Alcohol consumption raises regulatory concerns because its impacts extend beyond the individual consumer to the broader community. Governments therefore treat alcohol as a commodity requiring regulatory oversight rather than leaving its production and sale entirely to market forces. Excessive alcohol consumption is associated with a range of social harms, including public health burdens, road accidents, crime, and reduced economic productivity. These impacts impose costs not only on consumers but also on families, communities, and public institutions such as healthcare systems and law enforcement agencies.

Public policy intervention in alcohol markets is therefore generally justified on the grounds that unregulated markets may not adequately account for the wider social consequences of consumption. While moderate consumption for leisure or cultural purposes may not produce comparable harms, excessive consumption can generate outcomes that require regulatory attention. Governments therefore seek to balance consumer choice with mechanisms that encourage responsible consumption and mitigate harmful outcomes.

In addition to consumption-related concerns, regulatory oversight may also be necessary in relation to production and distribution activities within alcohol supply chains. Industrial processes associated with large-scale manufacturing may raise environmental concerns such as water usage, pollution, or waste management. Although these issues are not unique to alcohol production, they illustrate the broader role of regulation in ensuring that commercial activities do not impose disproportionate costs on communities or natural resources. State intervention in alcohol markets must therefore be viewed as a combination of public health policy, economic regulation, and fiscal governance rather than as a purely revenue-driven exercise

#### Constitutional Basis for State Regulation

The authority of state governments to regulate alcohol flows directly from the constitutional distribution of legislative powers in India. The Constitution assigns powers to regulate, impose taxes and fees across different levels of government through the Seventh Schedule. With reference to alcohol, state governments are empowered to exercise various complementary powers such as to -

- (i) regulate public health (entry 6, List II),
- (ii) regulate intoxicating liquors, that is to say, the production, manufacture, possession, transport, purchase and sale of intoxicating liquors (entry 8, List II), and
- (iii) impose fiscal levies on various taxable events along the production, sale and consumption of alcohol (entry 51 - excise duties on alcohol, entry 54 - sales taxes on intra-state alcohol sales, entry 66 - fees on related matters).

Once the state government has the power to levy the underlying tax or fee, it also has the competence to impose a surcharge (tax on tax) or a cess (earmarked tax or fee) on these taxes.

When the goods and services tax (GST) was introduced in 2017, several indirect taxes on goods and services were subsumed under it. Significantly, alcoholic liquor for human consumption was kept outside the purview of GST under Article 366(12A). Inclusion of alcohol would require a constitutional amendment.

Together, these provisions provide the constitutional foundation for state excise laws. In Karnataka, these powers are exercised through the Karnataka Excise Act, 1965, which governs the regulation, taxation, and administration of alcohol within the state. The constitutional scheme therefore recognizes alcohol as a sector where regulatory authority and fiscal powers are primarily vested in state governments, reflecting the localized nature of alcohol consumption patterns and public health impacts.

## **Powers of the State to Levy Taxes**

The Constitution of India establishes a structured framework for taxation powers through Article 246, which allocates legislative competence between the Union and the States. The constitutional definition of taxation is intentionally broad. Article 366(28) describes taxation as including any “impost, whether general, local, or special.” This formulation allows governments to design fiscal instruments tailored to specific policy objectives. Indian courts have consistently interpreted taxes as compulsory exactions of money imposed by public authority for public purposes, without the expectation of a direct benefit to the taxpayer. In this sense, taxation represents part of the common fiscal burden necessary for financing public services and governance. Within the alcohol sector, excise duties imposed by states constitute a major fiscal instrument.

## **Distinguishing Between “Tax” and “Fee”**

A related issue concerns the distinction between taxes and fees. While taxes are imposed for general public purposes, fees are generally associated with the provision of a specific service or regulatory privilege. Judicial interpretation has broadly classified fees into two categories:

- Compensatory fees, which are intended to recover the cost of providing a specific service; and
- Regulatory fees, which are charged for granting permission to undertake a regulated activity, such as obtaining a license. Here, the costs involved in administering the machinery to grant a license may be small and there is no need for a strict quid pro quo. However, the fee cannot be excessive.

The Supreme Court clarified this distinction in *Commissioner, Hindu Religious Endowments vs. Sri Lakshmindra Tirtha Swamiar of Shirur Mutt*, observing that taxes are imposed as part of a general public burden, whereas fees are associated with a specific benefit or privilege. In the context of alcohol regulation, governments frequently impose license fees on manufacturers, distributors, and retailers as part of the regulatory framework. However, where license fees become excessively high or disconnected from regulatory purposes, they may effectively operate as taxes. From a policy standpoint, transparent taxation mechanisms may provide a clearer and more accountable fiscal framework than reliance on disproportionately high regulatory fees.

## Coordination with National Food Safety Regulation

There may be a jurisdictional overlap between the Karnataka Excise Act, 1965 and the Food Safety and Standards (Alcoholic Beverages) Regulations, 2018 issued by the Food Safety and Standards Authority of India (FSSAI) under the Food Safety and Standards Act, 2006 (FSS Act).<sup>56</sup> While both laws largely operate in a complementary fashion, potential conflicts may arise - especially in the regulation of alcohol content/strength and labelling. For the excise department, based on statistics available in the annual report, the share of license fee is 2% of the total excise revenue as of 2021-2022 to 2023-2024. The FSS Act specifies that the Union government should control the food industry in public interest (Section 2). The definition of food under the FSS Act states that it “*means any substance, whether processed, partially processed or unprocessed which is intended for human consumption*” and particularly includes alcoholic drinks (Section 2(j)). As per Section 23, packaging and labelling of all foods should be based on prescribed regulations in this regard. Every person in the food business must obtain a license from the FSSAI prior to commencing the business (Section 31).

Under Section 89 of the FSS Act, 2006, FSSAI regulations override any conflicting state laws on food safety and standards, which includes alcoholic beverages. This is because FSSAI acts on the basis of the Union’s powers under Entry 18 of the Concurrent List (List III), which allows both the Union and the States to frame laws on “adulteration of foodstuffs and other goods”.

Section 94 recognizes the power of state governments to make rules and regulations but clarifies that this is subject to the powers of the union government and the FSSAI. At the same time, states retain power to levy excise duties and sales tax on alcoholic liquors (entries 51 and 54, List II) and to more generally, regulate the production, manufacture, possession, transport, purchase and sale of intoxicating liquors (entry 8, List II). While businesses need to follow both state excise rules and FSSAI standards, if a conflict arises, especially on safety, quality, or labelling, FSSAI regulations will prevail.

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<sup>56</sup> See Food Safety and Standards (Alcoholic Beverages) Regulations, 2018.

FSSAI and state excise department officers have overlapping duties. In a bid to address this, the FSSAI has mandated that state governments can notify excise department officers to act as Food Safety Officers (FSOs). FSOs are required to collect liquor samples for testing against food standards. If excise officers are notified to act as FSOs they can collect the said samples.<sup>57</sup> FSSAI and state excise department officers have overlapping duties. In a bid to address this, the FSSAI has mandated that state governments can notify excise department officers to act as Food Safety Officers (FSOs). FSOs are required to collect liquor samples for testing against food standards. If excise officers are notified to act as FSOs they can collect the said samples.<sup>58</sup> Two potential areas of overlap have been identified below: Labelling and Packaging.

**General Regulations:** The Food Safety and Standards (Packaging and Labelling) Regulations, 2011 contain the general packaging and labelling regulations. These Regulations prescribe certain standards for packaging and labelling to all products including alcoholic beverages. Certain exceptions are made for alcoholic beverages such as no need for declaring the best before date for consumption. In addition to these general regulations, alcoholic beverages are subject to specific requirements stemming from the Food Safety and Standards (Alcoholic Beverages) Regulations, 2018. Manufacturers are required to comply with strict labelling requirements such as displaying statutory warnings, disclosing alcohol content, allergen information and providing other alcohol-specific information. On the other hand, in Karnataka, labelling and packaging of alcoholic beverages is governed by the state government through Karnataka Excise (Bottling of Liquor) Rules, 1967 (as amended). Under the Karnataka Excise (Bottling of Liquor) Rules, 1967 (as amended) the Excise Commissioner must give approval of labels for every brand of liquor or wine. The labels approved remain in force only until June 30th every year. Accordingly, applications must be made for renewal of the approvals. Manufacturers must also pay fees for approval and renewal to the Excise Commissioner.

Excise Adhesive Labels (EALs) which are monitored by the Karnataka State Beverages Corporation (KSBCL) must be prefixed for authenticity; and other content-related rules (such as MRP and warnings) must be adhered to. Further, there are specific requirements that mandate listing of the batch number, date of manufacture, “For Sale in [State] only,” and other such details. A conflict might arise if FSSAI changes its requirements such as the size of the warning font/ its placement. In such a situation, manufacturers will have to redesign labels that are already approved by the Excise Commissioner, causing a “double approval” bottleneck.

FSSAI sets permissible national scientific limits for additives, enzymes, and contaminants (like methanol or heavy metals). The Food Safety and Standards (Alcoholic Beverages) Regulations, 2018 also clearly define what constitutes “Whisky”, “Vodka,” or “Craft Beer”. In Karnataka, when prosecuting cases against adulterated or spurious alcohol, the Excise Department works alongside the Directorate of Forensic Science Laboratories (DFSL), Karnataka, to conduct chemical examinations related to excise cases. If Karnataka’s traditional definition of a local liquor (like Toddy or Mahua) conflicts with FSSAI’s standardized definition, the manufacturer faces a legal gray area regarding which standard to follow for “adulteration” charges. As per Article 246 of the Constitution of India, if there is a conflict in an “occupied field” of legislation between the union and the states, the state will

<sup>57</sup> Source: <https://www.fbnnews.com/Top-News/states-can-notify-excise-officials-to-act-as-food-safety-officers- fssai-38885>

<sup>58</sup> Source: <https://www.fbnnews.com/Top-News/states-can-notify-excise-officials-to-act-as-food-safety-officers- fssai-38885>

have to prove that its encroachment into the field is “incidental” and not “consequential”<sup>59</sup>. Our suggestion therefore is that the Government of Karnataka only prescribe functions relating to the state lists. The FSSAI, as an agency under the Union government, may continue to operate in fields specified in the union list.

## **Taxation of alcohol meant for industrial use**

The Supreme Court of India, in its decision in *State of Uttar Pradesh v Lalta Prasad Vaish*<sup>60</sup> has ruled that state governments have the power to levy taxes on denatured spirits and alcohol not intended for “human consumption. This includes items like “denatured spirits” (alcohol that has been chemically treated to make it unfit for human consumption) and “industrial alcohol” (any alcohol used for industrial consumption). The main reason for this decision is to prevent the misuse of alcohol meant for industrial use. According to the Supreme Court, the states have the power, not only to tax, but also to “regulate” the production of industrial alcohol. In our view, this judgement explicitly allows the state to use its policing powers to prevent misuse of alcohol meant for industrial use. At the same time, we submit that care should be taken to avoid excessive policing. This can be done through minimally-invasive control mechanisms relying on technologies such as QR codes, tamper-proof electronic locks, etc.

When it comes to licensing, we note that industrial alcohol is an industrial/commercial product and an important raw material/input for many industrial processes. Therefore, the decision to produce alcohol for any purpose should remain a commercial decision of the manufacturer, with the state’s intervention coming in only in terms of mandatory registration and monitoring of the manufacturing facility. In earlier times, denatured spirits would be “cut” or “tampered” with by adding methanol or other chemicals. It is not advisable to “tamper” the rectified spirit with methanol or other chemicals which may endanger a potential drinker’s life - even if their consumption is illicit.

Alcohol regulation in Karnataka operates within a complex framework that combines constitutional authority, fiscal policy, and regulatory oversight. State governments possess clear powers to regulate and tax alcohol under the constitutional scheme. At the same time, effective alcohol policy requires the integration of taxation, licensing systems, and institutional governance mechanisms.

As Karnataka considers potential reforms to its excise framework within a regulatory structure that has evolved over more than six decades it is important that policy discussions remain grounded in constitutional principles, administrative efficiency, and contemporary regulatory practices.

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<sup>59</sup> M. Karunanidhi vs Union Of India AIR 1979 SC 898.

<sup>60</sup> 2024 SCC Online SC 3029

## CHAPTER 6

### STRUCTURE OF THE ALCOHOL INDUSTRY IN INDIA AND KARNATAKA

Understanding the structure of the alcohol industry is essential for evaluating the fiscal and regulatory role of excise taxation. As discussed in the previous chapters, alcohol taxation operates not only as a revenue instrument but also as a regulatory tool aimed at addressing social externalities associated with alcohol consumption. The effectiveness of such policy interventions depends significantly on the underlying characteristics of the alcohol market, including patterns of production, distribution, consumption, and employment.

In India, the alcohol industry represents a large and complex economic sector with strong linkages to agriculture, manufacturing, logistics, hospitality, and retail trade. State governments exercise primary regulatory authority over the sector, including the power to levy excise duties on alcoholic beverages for human consumption. Consequently, the structure of the alcohol market has important implications for state fiscal systems, employment generation, and rural value chains.

This chapter examines the structure of the alcohol industry at both the national level and within Karnataka. It analyses the sector's economic significance, production and distribution networks, employment footprint, and linkages with agriculture and tourism. Understanding these structural features is essential for interpreting the fiscal dynamics of excise taxation discussed in subsequent chapters.

#### National Overview of the Alcohol Industry

The alcohol industry in India constitutes a major economic sector with extensive linkages across agriculture, manufacturing, services, and public finance. In recent years, the alcoholic beverages market in India has been estimated at approximately USD 148.3 billion in 2025, and is projected to reach around USD 176.2 billion by 2034, reflecting a compound annual growth rate (CAGR) of about 1.84 percent during the period 2026–2034 (IMARC Group, 2025). This growth is driven by structural factors including demographic expansion, rising incomes, urbanization, and changing consumer preferences.

India is predominantly a spirits-based alcohol market, with distilled spirits accounting for the majority of total alcohol consumption. According to the World Health Organization (2018), spirits constitute the dominant share of alcohol consumed in India, in contrast to many developed economies where beer and wine dominate consumption patterns. From a macroeconomic perspective, the alcohol sector contributes significantly to public finances. Alcohol taxation generates revenue equivalent to around 1.2 percent of India's GDP and roughly 7–8 percent of total tax collections, with excise duties on alcoholic beverages representing one of the most important sources of fiscal autonomy for state governments (NIPFP, 2023; RBI, 2023).

The industry also generates substantial employment across multiple sectors. Manufacturing activities such as distilling, brewing, blending, and bottling create direct employment in factories and processing units. At the same time, a large number of jobs are generated through distribution networks, retail outlets, hospitality establishments, logistics providers, and packaging industries. Taken together, industry estimates suggest that the alcohol sector supports approximately 7.9 million direct and indirect jobs in India, representing around 1.5 percent of the national workforce (ISWAI, 2023). The sector's economic footprint extends beyond beverage production itself. Alcohol manufacturing maintains strong backward linkages with agriculture, particularly the sugar industry, which supplies molasses used in spirit production. Grain-based distilleries also create demand for maize, rice, and other cereals, providing additional market opportunities for farmers.

At the same time, the alcohol industry is undergoing structural transformation. Although total consumption volumes fluctuate across economic cycles, value growth in recent years has increasingly been driven by premiumization, with consumers shifting toward higher-quality products and branded alcoholic beverages. This trend is reshaping the competitive landscape of the industry and influencing revenue outcomes for state governments.

## **Structure of the Alcohol Industry in Karnataka**

Within the national context, Karnataka occupies a prominent position in both the production and consumption of alcoholic beverages. The state represents one of the largest markets for Indian Made Foreign Liquor (IMFL) in India and consistently ranks among the leading states in alcohol sales volumes. According to data from the Karnataka State Excise Department, annual excise revenue from alcoholic beverages exceeded ₹34,600 crore in 2023–24, reflecting both strong demand and an extensive distribution network within the state (Government of Karnataka, Excise Department, 2024).

Several structural factors explain Karnataka's importance in the alcohol industry. First, the state has a large and diversified consumer base, supported by rapid urbanization and income growth in metropolitan centres such as Bengaluru, which has emerged as one of India's largest urban consumption markets. According to the Reserve Bank of India's Handbook of Statistics on Indian States, Karnataka is among the largest state economies in India with a Gross State Domestic Product exceeding ₹28 lakh crore, supporting strong consumer demand across sectors (RBI, 2024).

Second, Karnataka hosts a significant manufacturing base comprising distilleries, breweries, wineries, and bottling units. Industry data indicate that the state currently houses over 30 distilleries, around 14 breweries, and more than 25 wineries, along with numerous bottling plants and blending units operating under excise licences (Government of Karnataka, Excise Department, 2024).

Third, Karnataka operates a centralized wholesale distribution system through the Karnataka State Beverages Corporation Limited (KSBCL). Established in 2003, KSBCL functions as the sole wholesale distributor of alcoholic beverages in the state, procuring products from manufacturers and supplying them to licensed retailers. This system enables tighter monitoring of inventory flows, excise duty collection, and regulatory compliance within the distribution chain (KSBCL Annual Report, 2023).

The manufacturing ecosystem supporting the alcohol industry in Karnataka spans several districts and industrial clusters. Distilleries, breweries, and bottling units are distributed across both southern and northern regions of the state, with notable concentrations in Bengaluru, Belagavi, Bagalkot, Mandya, Vijayapura, and Kalaburagi districts. These regions also host a significant share of the state's sugar and agro-processing industries, creating strong industrial linkages between agriculture and alcohol manufacturing.

## **Agricultural Linkages**

The alcohol industry in Karnataka also maintains strong backward linkages with agriculture, particularly through the sugarcane and grain sectors. Molasses derived from sugarcane processing represents a key raw material for distilleries producing ethanol and potable spirits. Karnataka has a well-developed sugar industry with over 60 working sugar factories and a daily crushing capacity of about 3.29 lakh tonnes of cane, making it one of the major sugar-producing states in India (Asha and Ramanjini, 2021).

These sugar mills generate large quantities of molasses as a by-product, which serves as a primary feedstock for distilleries. By providing a stable downstream market for molasses, distilleries enhance the financial viability of sugar mills and indirectly support sugarcane farmers. The integration of sugar mills with distilleries has expanded significantly in recent years due to the national Ethanol Blending Programme (EBP). Karnataka has emerged as a major ethanol-producing state, with an estimated ethanol production capacity of about 270 crore litres annually, placing it among the leading ethanol-producing states in the country (Bio Energy Times, 2025).

The diversion of molasses and other sugarcane derivatives toward ethanol production plays an important stabilizing role in the sugar market. During years of surplus sugar production, sugar mills can convert molasses and sugarcane juice into ethanol, thereby reducing excess sugar supply and helping maintain stable sugar prices. This integration between the sugar and alcohol industries also improves the cash flow of sugar mills, enabling more timely payments to sugarcane farmers.

In addition to molasses-based production, grain-based distilleries are becoming increasingly important in Karnataka's alcohol and biofuel ecosystem. Grain distilleries utilise feedstocks such as maize and broken rice, creating additional demand for agricultural produce. Expansion of ethanol production has led to rising demand for maize in particular, which has increased significantly in recent years as a feedstock for ethanol manufacturing.

These linkages illustrate that the alcohol industry in Karnataka functions not merely as a consumer goods sector but as an important agro-processing industry. By generating demand for agricultural by-products such as molasses and surplus grains, distilleries contribute to agricultural value addition, support the financial sustainability of sugar mills, and enhance income opportunities for farmers across major sugarcane- and grain-producing districts of the state.

## Emerging Opportunities: Alcohol Tourism

Alcohol-related tourism has emerged as a niche but expanding segment within India's tourism economy, particularly in regions where alcoholic beverage production is closely linked with agricultural landscapes. Among the different forms of alcohol-related tourism, wine tourism has developed most visibly, combining vineyard visits, wine tasting experiences, food culture, and rural tourism activities. Such tourism models integrate agriculture, agro-processing, hospitality, and cultural experiences, thereby generating employment and stimulating local economic activity.

The most developed example of wine tourism in India is found in Nashik, Maharashtra, which has evolved into the country's principal wine tourism destination. Nashik accounts for more than 50 percent of India's wine production and hosts several large wineries, including Sula Vineyards, Grover Zampa, and York Winery (APEDA, 2023). Industry estimates suggest that over 250,000 visitors annually participate in vineyard tours, wine festivals, and tasting events in the Nashik region, contributing significantly to local tourism revenues and supporting employment in hospitality, transport, and allied services.

Karnataka also possesses favorable agro-climatic conditions for viticulture and wine production. Regions around Nandi Hills in Chikkaballapur district, the Bengaluru rural belt, and parts of northern Karnataka provide suitable soil and climatic conditions for grape cultivation. According to data from the Karnataka Wine Board, the state hosts over 25 licensed wineries and more than 3,000 hectares of vineyards, making it the second-largest wine-producing state in India after Maharashtra (Karnataka Wine Board, 2023).

Despite this production base, the development of wine tourism in Karnataka remains relatively limited when compared with Maharashtra. While several wineries in the Nandi Hills region offer vineyard visits and tasting experiences, the scale of tourism infrastructure including organized vineyard trails, wine festivals, and integrated hospitality facilities remains modest. Expanding wine tourism in Karnataka could generate significant economic opportunities by linking agricultural production with tourism and hospitality services. International experience shows that wine tourism can create high-value rural economic clusters, where agricultural landscapes, food culture, and local heritage are combined to attract domestic and international visitors. Developing structured wine tourism circuits in Karnataka particularly around Nandi Hills, Bengaluru rural districts, and northern grape-growing regions could therefore enhance value addition in the viticulture sector while supporting rural employment and regional tourism growth.

## Revenue Composition and Market Orientation

Excise revenue generated from the alcohol industry in Karnataka is overwhelmingly driven by domestic consumption within the state. The distribution of revenue sources (**Table 6.1**) indicates that approximately 98–99 percent of excise revenue arises from sales within Karnataka, while interstate exports account for only a small share and exports outside India remain negligible.

**Table 6.1: Segment and location wise excise revenue (2024-25) (%)**

|              | Within<br>Karnataka<br>(%) | Outside<br>Karnataka<br>(%) | Outside<br>India<br>(%) |
|--------------|----------------------------|-----------------------------|-------------------------|
| Breweries    | 99.73                      | 0.26                        | 0.0002                  |
| Distilleries | 99.94                      | 0.05                        | 0.0004                  |
| Wineries     | 97.11                      | 2.88                        | 0.0038                  |

Source: Excise Department, GoK

This revenue structure indicates that Karnataka’s excise system is fundamentally consumption- driven rather than export-driven. Unlike some industries where export performance plays a major role in revenue generation, the fiscal performance of the alcohol sector in Karnataka is closely tied to domestic demand conditions and retail market dynamics. Nevertheless, interstate price differentials can influence cross-border flows of alcohol. When retail prices vary significantly across neighbouring states, consumers may have incentives to purchase alcohol outside Karnataka, particularly in border districts

## **Employment and Economic Linkages**

The alcohol industry also represents an important source of employment within Karnataka’s economy. Based on licensing data, the sector supports more than 1,00,000 direct jobs across retail, hospitality, manufacturing, and institutional channels (**Table 6.2**). Retail establishments such as liquor shops, bars, and restaurants account for a large share of employment, reflecting the labour-intensive nature of hospitality services. Manufacturing facilities including breweries, distilleries, and wineries also generate employment in production, logistics, and quality control. Beyond direct employment, the sector also supports a large number of indirect jobs in packaging, transportation, warehousing, security services, and marketing. The industry is also a major consumer of glass packaging, accounting for a significant share of demand for glass bottles and related manufacturing inputs.

**Table 6.2: Employment Generated by the Alcohol Industry in Karnataka**

| Sl. No.            | Type of Licences                                      | No of Licences | Total No. of Employment |
|--------------------|---|----------------|-------------------------|
| 1                  | CL-2 ( <i>Retail Shops</i> )                          | 4,005          | 12,015                  |
| 2                  | CL-4 ( <i>Clubs</i> )                                 | 326            | 3,260                   |
| 3                  | CL-6A ( <i>Star Hotels</i> )                          | 95             | 9,500                   |
| 4                  | CL-7 ( <i>Hotels &amp; Boarding Houses</i> )          | 3,430          | 27,440                  |
| 5                  | CL-14, 15 & 7C ( <i>TDC IMFL &amp; Beer</i> )         | 24             | 120                     |
| 6                  | CL-8, 8A & 8B ( <i>Military Canteen Stores</i> )      | 71             | 142                     |
| 7                  | CL-9 ( <i>Bar &amp; Restaurant</i> )                  | 3,654          | 29,232                  |
| 8                  | CL-11C ( <i>MSIL</i> )                                | 1,076          | 2,152                   |
| 9                  | CL-16, 17 & 18 <i>Airport Licences</i>                | 30             | 240                     |
| 10                 | Retail Vend of Beer ( <i>RVB</i> ) <i>Independent</i> | 64             | 512                     |
| 11                 | Retail Vend of Beer ( <i>RVB</i> ) <i>Attached</i>    | 915            | 1,830                   |
| 12                 | Wine Tavern   | 196            | 980                     |
| 13                 | Wine Boutique   | 78             | 156                     |
| 14                 | Microbreweries ( <i>86 Units</i> )                    | 86             | 3,104                   |
| 15                 | Breweries ( <i>14 Units</i> )                         |                | 2,722                   |
| 16                 | Winery ( <i>25 Units</i> )                            |                | 600                     |
| 17                 | Distillery ( <i>31 Units</i> )                        |                | 6,533                   |
| <b>GRAND TOTAL</b> |   | <b>14,050</b>  | <b>1,00,538</b>         |

Source: Excise Department, GoK

The analysis presented in this chapter highlights several structural characteristics of the alcohol industry in Karnataka. The sector generates significant fiscal revenue, supports employment across multiple sectors, and maintains strong linkages with agriculture and manufacturing. At the same time, the industry's heavy reliance on domestic consumption implies that excise revenue remains closely tied to consumption patterns within the state. This dependence introduces fiscal risks, particularly when policy changes, economic conditions, or public health considerations influence alcohol consumption. Understanding these structural features is therefore essential for interpreting the fiscal dynamics of excise taxation examined in the next chapter.

## CHAPTER 7

### STRUCTURAL CHALLENGES IN KARNATAKA'S EXCISE SYSTEM

Karnataka's alcohol regulatory framework operates within a complex policy environment shaped by evolving consumption patterns, institutional arrangements, and administrative practices. While the excise system has historically been designed to ensure revenue generation and regulatory control over the manufacture and sale of alcoholic beverages, changes in market conditions and consumption behaviour have introduced new policy challenges. Evidence suggests that alcohol consumption in the State exhibits a distinctive pattern characterized by relatively low prevalence of drinkers but higher levels of consumption among those who do consume alcohol. At the same time, consumption remains concentrated in lower-priced product segments, creating a market structure driven largely by volume rather than value. These features have important implications for both the social costs associated with alcohol use and the design of effective taxation and regulatory policies.

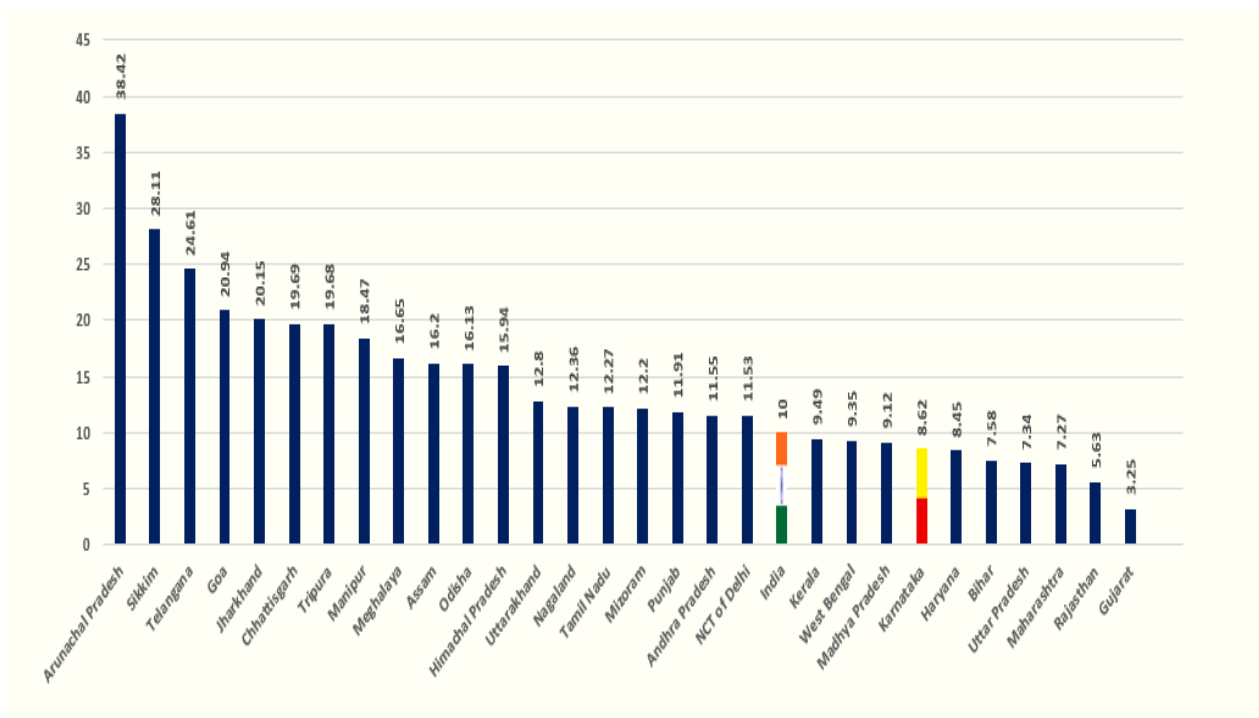
Alongside these consumption dynamics, the governance of the alcohol sector in Karnataka is shaped by a multi-layered institutional and regulatory framework. Responsibilities related to taxation, licensing, public health considerations, and local regulatory oversight are distributed across several administrative authorities, while operational approvals within the excise system often involve multiple levels of permission. Over time, the accumulation of regulatory provisions has created a system characterized by procedural complexity and overlapping controls. Understanding how these structural features interact with consumption patterns and policy objectives is essential for assessing the effectiveness of the current excise framework.

**This chapter therefore examines three interrelated dimensions of the system: the relationship between consumption patterns and policy design, the legal and institutional context of alcohol regulation, and the regulatory complexity arising from the existing web of permissions governing the sector.**

#### Consumption Patterns and the Structural Paradox

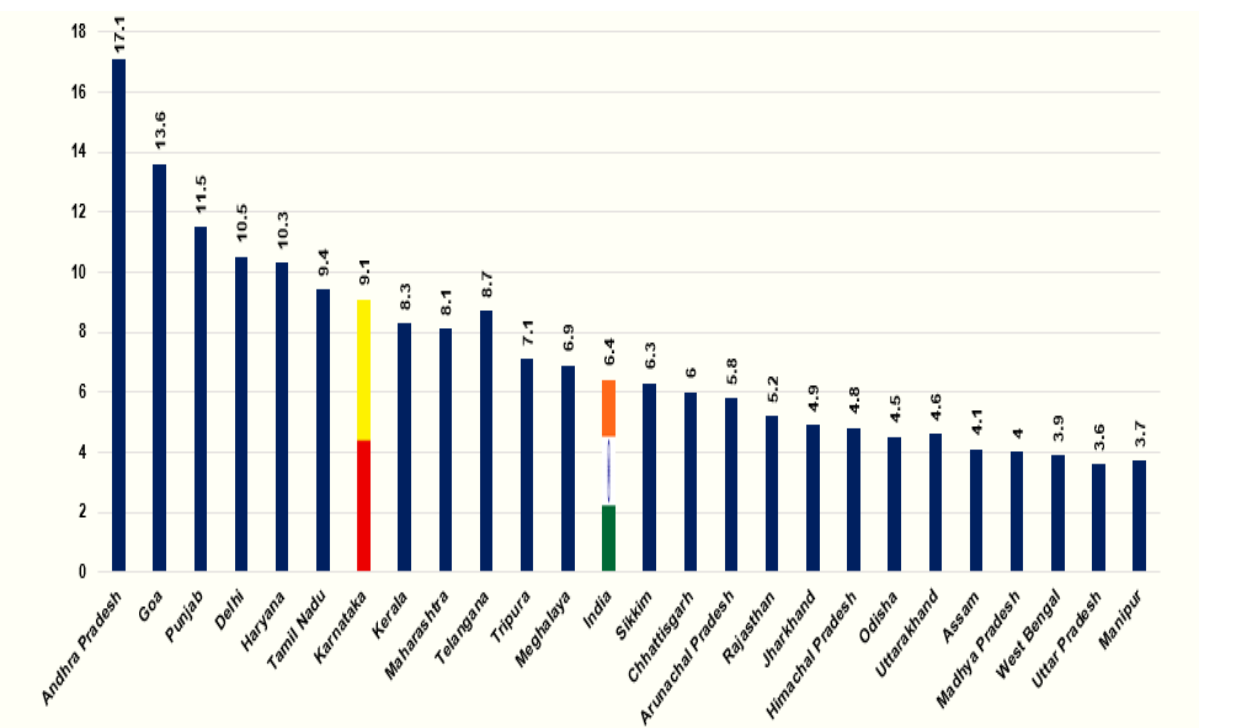
An important starting point for understanding the policy challenges facing Karnataka's alcohol regulatory system lies in the State's distinctive consumption pattern. Evidence from the National Family Health Survey (NFHS-5) reveals a paradoxical structure: lower prevalence of alcohol use combined with higher intensity of consumption among users. The proportion of individuals aged fifteen years and above who consume alcohol in Karnataka is approximately 8.62 percent, which is lower than the national average of around 10 percent (**Figure 7.1**). However, per-capita alcohol consumption in the State is significantly higher, estimated at approximately 9.1 litres per person per year, compared with the national average of 6.4 litres (**Figure 7.2**).

**Figure 7.1: Population aged 15+ currently consuming alcohol (%)**



Source: NFHS5, 2021

**Figure 7.2: Per-capita alcohol consumption (litres per person per year)**



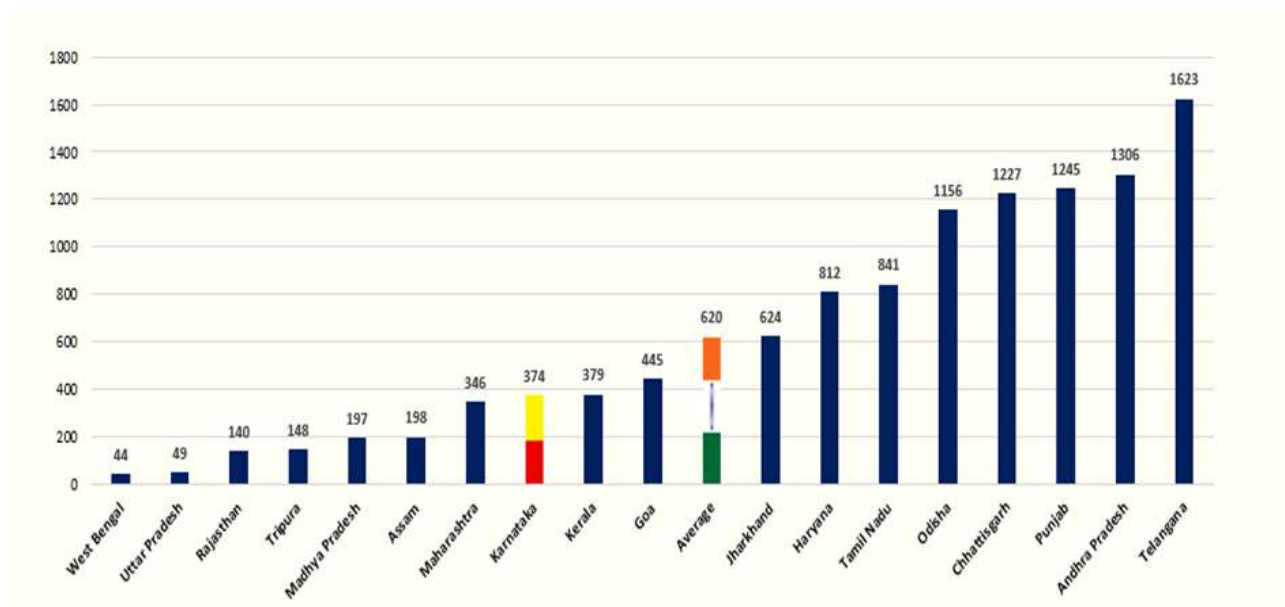
Source: NFHS5, 2021

This combination indicates that alcohol consumption in Karnataka is concentrated among a relatively smaller segment of the population, but that this group consumes substantially larger quantities. In other words, the State exhibits a pattern of intensity-driven consumption rather than prevalence-driven consumption. From a public policy perspective, such a structure carries significant implications. When alcohol consumption is concentrated within a smaller group of high-intensity users, the probability of alcohol misuse and related harms increases substantially. Higher intensity of consumption is closely associated with:

- alcohol dependence and health disorders
- road traffic accidents
- domestic violence and family distress
- workplace productivity losses
- increased healthcare and policing costs.

Thus, even though fewer individuals consume alcohol overall, the external social cost per consumer and per household tends to be higher. Another important feature of Karnataka's consumption structure is revealed by expenditure data. Despite higher per-capita consumption volumes, per-capita expenditure on alcohol remains below the national average (**Figure 7.3**).

**Figure 7.3: Average annual alcohol expenditure per person (2022–23)**



Source: NIPFP, 2024

\* Average of only the above -mentioned states

This combination suggests that alcohol consumption in the State is concentrated in lower- priced product segments. In effect, Karnataka exhibits a volume-heavy but low-value consumption pattern. From a fiscal perspective, such a structure results in the State relying heavily on large consumption volumes in lower price segments to sustain excise revenue collections. From a social perspective, however, the affordability of lower-priced alcoholic beverages may contribute to persistent high-intensity consumption among economically vulnerable groups, thereby increasing the likelihood of alcohol-related harm. The coexistence of low prevalence, high intensity, and low expenditure represents a structural paradox that has important implications for excise policy design. It suggests that the current policy environment may be inadvertently sustaining a consumption pattern characterized by high volumes of lower- priced alcohol, rather than encouraging moderation or shifts toward safer consumption patterns.

This pattern underscores the need to re-examine the underlying policy framework governing alcohol taxation and regulation in the State.

## **Legal and Institutional Context**

Within the current governance framework, alcohol regulation in Karnataka is distributed across several institutional domains. The Excise Department's primary mandate has historically focused on taxation, licensing, and enforcement of regulatory compliance in the manufacture and sale of alcoholic beverages. This includes the monitoring of Extra Neutral Alcohol (ENA) production and movement, licensing of manufacturing facilities and retail outlets, and administration of excise duties that form an important component of the State's own-tax revenue.

However, broader public health aspects of alcohol consumption fall largely outside the operational mandate of the excise administration. Issues such as alcohol-related disease prevention, behavioural health interventions, treatment services for alcohol dependence, and epidemiological monitoring are more closely aligned with the responsibilities of the Department of Health and Family Welfare (DHFV). While certain regulatory provisions exist within excise laws relating to licensing conditions and operating restrictions, the State does not currently operate a fully integrated public health-oriented alcohol policy comparable to those implemented in areas such as tobacco control.

From an institutional design perspective, this division of responsibilities suggests the potential value of a clearer allocation of policy roles. Revenue administration and licensing functions may continue to remain with the Excise Department, while the design and implementation of harm-reduction strategies could be anchored more directly within the public health system. Such an approach would enable alcohol policy to incorporate both fiscal and health objectives more effectively.

In addition, regulatory oversight of the physical location and operation of retail establishments often intersects with the jurisdiction of municipal and local body laws. Matters relating to zoning, land-use approvals, and neighbourhood-level compliance fall naturally within the scope of local governance. Greater clarity in the allocation of responsibilities across taxation, health policy, and spatial regulation could therefore improve institutional coherence and reduce overlapping administrative controls.

## Regulatory Complexity and the Web of Permissions

**One of the most visible features of the current excise system is the extensive network of approvals required for both manufacturers and retailers operating within the alcohol sector.** Over time, regulatory provisions have accumulated through successive amendments and administrative procedures, resulting in a multi-layered system in which several authorities exercise overlapping responsibilities.

For manufacturing units, approvals are required at multiple administrative levels. Certain permissions such as the grant of brewery or distillery licences and policy decisions relating to molasses allocation are issued by the State Government. Operational approvals relating to licensing, structural alterations, branding, and pricing fall within the jurisdiction of the Excise Commissioner. Additional approvals concerning warehousing arrangements, transport permits, or export permissions are often handled by district-level authorities such as Deputy Commissioners or supervisory officers within the excise administration. Operational oversight of spirit movement, procurement, and dispatch is further coordinated through agencies such as the Karnataka State Beverages Corporation Limited (KSBCL).

The role of KSBCL illustrates both the strengths and limitations of Karnataka's current institutional model. As the centralized wholesale intermediary, KSBCL has helped create a system in which inventory flows are more visible and excise collection is more secure than in fragmented wholesale models. It provides a single channel through which supplies move from producers to retailers, thereby supporting revenue assurance and facilitating distribution control. At the same time, the centralization of wholesale functions within one entity also adds another institutional layer to an already complex system. Manufacturers and retailers do not interact solely with the Excise Department; they must also operate within the procedural and logistical requirements of KSBCL. This arrangement can enhance control, but it can also lengthen supply chains, reduce flexibility, and create operational bottlenecks if not supported by efficient digital systems and clearly delineated responsibilities.

Retail operations similarly involve multiple layers of administrative oversight. Licensing decisions, renewal procedures, premises shifting approvals, and distance-rule relaxations are generally processed at the level of the Excise Commissioner or Deputy Commissioners. Local inspection and operational compliance are supervised by field-level officers such as range inspectors, while supply logistics and retail liquor movement are coordinated through KSBCL systems.

**Table 7.1: Web of permissions required for manufacturers**

| SI No | Permissions   | Authority  |
|-------|---|--|
| 1     | <ul style="list-style-type: none"> <li>• Prior sanction for grant of Brewery and Distillery licenses.</li> <li>• Molasses policy &amp; quota.</li> </ul>  | State Government   |
| 2     | <ul style="list-style-type: none"> <li>• Licensing (grant/renewal/transfer/shifting of all manufacturing licenses).</li> <li>• Major alterations, installation of tanks and structural modifications.</li> <li>• Bottling- strength variation, quantity variation, rebottling, aseptic packing.</li> <li>• Pricing (DP/MRP) &amp; branding.</li> <li>• Exports/imports of ENA/NS, molasses-related permissions.</li> <li>• Re-distillation &amp; destruction.</li> <li>• Concurrence for export outside India.</li> </ul> | Excise Commissioner  |
| 3     | <ul style="list-style-type: none"> <li>• Minor alterations &amp; warehouses.</li> <li>• Inter-State export concurrence.</li> <li>• Transit permits &amp; NOCs relating to lifting of molasses within the State.</li> <li>• Bottling on authorised holdings.</li> </ul>  | Deputy Commissioner  |
| 4     | <ul style="list-style-type: none"> <li>• Transport permits.</li> <li>• Spirit movement supervision.</li> <li>• Naukaranama &amp; bottling oversight.</li> </ul>   | Superintendent/<br>Range Officer/<br>Distillery/<br>Brewery/<br>Winery Officer |
| 5     | <ul style="list-style-type: none"> <li>• Spirit procurement &amp; sale.</li> <li>• OTL &amp; escort arrangements.</li> </ul>  | KSBCL/<br>Warehouse Officer  |

Source: Excise Department, GoK

**Table 7.2: Web of permissions required for retailers**

| SI No | Permissions   | Authority                            |
|-------|---|--------------------------------------|
| 1     | <ul style="list-style-type: none"> <li>• Grant / renewal of major retail licences*</li> <li>• Concurrence for shifting of premises.</li> <li>• Relaxation from objectionable distance norms.</li> <li>• Renewal of discontinued licences.</li> <li>• Approval for attached beer licences (RVB).</li> <li>• Policy-level oversight across all retail formats.</li> </ul> | Excise Commissioner                  |
| 2     | <ul style="list-style-type: none"> <li>• Grant &amp; renewal of retail licences*</li> <li>• Shifting of premises.</li> <li>• Blueprint / layout alterations.</li> <li>• Transfer of licence (death / other cases).</li> <li>• Grant of occasional licences (CL-5)</li> <li>• Distance relaxation (with EC concurrence).</li> </ul>                                      | Deputy Commissioner (Excise/Revenue) |
| 3     | <ul style="list-style-type: none"> <li>• Naukaranama (staff approval).</li> <li>• Local inspection &amp; compliance verification.</li> <li>• Supervision of retail operations.</li> </ul>   | Range Excise Inspector               |
| 4     | <ul style="list-style-type: none"> <li>• Issue of liquor permits to retail licensees.</li> <li>• Supply of liquor to shops, bars, clubs &amp; hotels.</li> <li>• Operational control over retail liquor movement.</li> </ul>  | KSBCL Excise Inspector               |

Source: Excise Department, GoK

**While such oversight mechanisms were historically intended to ensure regulatory compliance, the cumulative effect of these overlapping permissions is a system that is administratively complex and often fragmented. Businesses operating within the legal market must navigate a range of procedural approvals that may involve multiple authorities and sequential documentation requirements. This structure can increase transaction costs, create delays in routine operational decisions, and diffuse accountability across institutions.** In contemporary regulatory environments, many jurisdictions have moved toward simplified approval systems supported by digital platforms and risk-based compliance monitoring. In this context, rationalizing the existing web of permissions in Karnataka could reduce procedural duplication while maintaining effective oversight of the alcohol sector.

### **Illustration of Regulatory Complexity: The Beer Sector**

The beer manufacturing and distribution ecosystem provides a useful example of how regulatory complexity operates in practice. Breweries are subject to a number of operational conditions relating to production processes, packaging systems, and yield norms. These provisions were originally designed to ensure compliance with excise rules and prevent diversion of alcohol into unregulated channels. However, in practice many of these requirements have evolved into compliance-heavy administrative procedures. Routine operational decisions including shift operations, weekend working schedules, packaging processes, or dispatch approvals may require separate administrative clearances. On the distribution side, logistical processes involving depot operations, indent placement, and product dispatch frequently involve overlapping documentation requirements.

Even where online systems have been introduced, manufacturers often remain required to maintain parallel manual registers and physical documentation for inspection purposes. The coexistence of digital and manual procedures leads to duplication of effort and increases administrative workload without necessarily strengthening regulatory outcomes. This example illustrates how the cumulative effect of procedural controls can generate a regulatory environment in which compliance requirements become disproportionately burdensome relative to the risks they are intended to address. Moving toward a system that relies more heavily on digital monitoring and risk-based supervision could significantly improve administrative efficiency while preserving regulatory integrity.

The broader consumption patterns discussed earlier in this chapter reinforce the need to reassess the existing excise framework. Karnataka's alcohol economy is characterized by a relatively small share of consumers who drink, but with higher levels of consumption among those who do. At the same time, much of this consumption is concentrated in lower-priced product categories, resulting in a market that is driven more by volume than by value.

From a fiscal standpoint, this structure generates substantial excise revenue because high volumes of sales produce large tax collections even when individual consumer spending remains relatively modest. However, the same structure may also generate significant social costs. High-intensity consumption is more closely associated with alcohol use disorders, road accidents, domestic violence, and productivity losses. Consequently, a fiscal model that relies heavily on volume-driven consumption may be efficient in revenue terms but less desirable from a public welfare perspective.

## The Case for Reform

The preceding discussion highlights a number of structural features within Karnataka's alcohol regulatory system that together point to the need for policy reform. Changes in consumption patterns, the evolution of the alcohol market, and the growing complexity of the regulatory framework have created a policy environment that differs significantly from the conditions under which the current excise system was originally designed. As a result, certain aspects of the existing framework may no longer align fully with contemporary public policy objectives. A central concern arises from the interaction between market structure and policy design. Karnataka's alcohol economy is characterized by consumption that is concentrated in relatively lower-priced segments and driven largely by high volumes. While this structure generates substantial excise revenues, it also raises broader policy considerations relating to the social costs associated with high-intensity consumption. Ensuring that the regulatory framework addresses these concerns requires careful attention to how taxation structures, pricing incentives, and regulatory controls shape market behaviour.

Institutional arrangements also influence how effectively alcohol policy objectives can be pursued. The governance of the alcohol sector currently involves several administrative domains with responsibilities that span revenue administration, licensing, public health concerns, and local regulatory oversight. Strengthening coordination across these domains and clarifying institutional roles could help improve the overall coherence of alcohol policy while ensuring that fiscal, regulatory, and public health considerations are addressed in a complementary manner. Administrative processes within the excise system present another area where reform may improve efficiency. Over time, regulatory provisions governing licensing, production, and distribution have accumulated into a multi-layered system of approvals. Although these mechanisms were introduced to maintain regulatory oversight, the resulting procedural complexity can increase administrative burdens for both regulators and industry participants. Simplifying approval structures, reducing procedural duplication, and expanding the use of digital compliance systems could help streamline regulatory administration while maintaining effective monitoring.

**In this context, the case for reform is not based on a single deficiency but on the cumulative effect of structural features that have developed over time. A modernized excise framework would aim to improve policy coherence, enhance administrative efficiency, and ensure that the regulatory system remains responsive to evolving economic conditions and public welfare considerations. Periodic reassessment of regulatory systems is a normal feature of effective governance, and the evolving dynamics of Karnataka's alcohol market make such a review both timely and necessary.**

## CHAPTER 8

### FISCAL ROLE AND REVENUE DYNAMICS

Excise taxation on alcoholic beverages occupies a distinctive position in the fiscal architecture of Karnataka. Unlike most commodities that fall within the Goods and Services Tax (GST) framework, alcoholic liquor for human consumption remains constitutionally excluded from GST and is therefore subject to the exclusive taxation authority of state governments. This constitutional arrangement provides Karnataka with significant policy autonomy in designing and administering its excise regime. Consequently, excise taxation has evolved into one of the most important sources of own-tax revenue for the state. Over time, excise collections have grown steadily and now contribute around ₹40,000 crore annually to the state's revenue. This makes excise duty one of the significant tax streams available to the state government. In an era where many traditional state taxation powers have been subsumed under GST, excise remains one of the few major tax instruments that state governments can independently adjust to meet fiscal requirements.

Over the past decade, excise duties on alcoholic beverages have consistently contributed a substantial share of the State's own tax revenue, typically around 20 percent, and around 1.2-1.5 percent of GSDP. This places alcohol excise among the top revenue sources for the State, alongside GST/VAT and stamp duties. Importantly, the data also indicate that excise revenue has exhibited lower volatility compared to other major taxes, reinforcing its role as a stable fiscal anchor.

**Table 8.1: Excise as % of own tax revenue**

| Year      | Excise Duty as % to total tax revenue |
|-----------|---------------------------------------|
| 2013      | 20.5                                  |
| 2014      | 19.7                                  |
| 2015      | 20.3                                  |
| 2016      | 19.9                                  |
| 2017      | 20.6                                  |
| 2018      | 20.6                                  |
| 2019      | 21.1                                  |
| 2020      | 24.0                                  |
| 2021      | 21.8                                  |
| 2022      | 20.8                                  |
| 2023      | 21.2                                  |
| 2024(RE)  | 20.2                                  |
| 2025 (BE) | 19.2                                  |

Source: RBI

The buoyancy of excise revenue reflects both structural demand characteristics and administrative features of the tax system. Time-series evidence suggests that excise collections have grown broadly in line with nominal GSDP, with periods of above-trend growth corresponding to rate revisions and improved enforcement. The relatively inelastic nature of alcohol demand, combined with centralized wholesale distribution through KSBCL, has contributed to high collection efficiency and steady revenue growth even during economic slowdowns.

However, the strength of revenue performance is closely tied to a volume-driven consumption model that raises important policy concerns. Disaggregated data show that a significant share of excise revenue is derived from high-volume sales in lower and mid-price segments, particularly within Indian Made Liquor (IML) (Table 8.2). This indicates that revenue growth is not primarily driven by premiumization or value addition, but by sustained consumption volumes. Such a structure implies that the fiscal system may be indirectly dependent on consumption patterns that are associated with higher social costs.

**Table 8.2: Slab wise market share -IML (in %)**

| Sl.no. | Range         | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 | 2023-24 |
|--------|---------------|---------|---------|---------|---------|---------|---------|---------|
| 1      | 000-449       | 9.0     | 9.6     | 9.8     | 6.8     | 5.6     | 6.8     | 6.9     |
| 2      | 450 - 499     | 47.6    | 48.1    | 47.4    | 52.6    | 56.7    | 55.0    | 56.2    |
| 3      | 500 - 549     | 16.4    | 15.2    | 14.1    | 14.2    | 11.9    | 11.5    | 9.3     |
| 4      | 550 - 599     | 14.1    | 14.2    | 15.3    | 15.2    | 15.5    | 15.1    | 11.8    |
| 5      | 600 - 699     | 1.1     | 1.6     | 1.8     | 1.3     | 1.2     | 2.3     | 5.3     |
| 6      | 700 - 799     | 0.7     | 0.6     | 1.0     | 0.8     | 0.4     | 0.4     | 0.6     |
| 7      | 800 - 899     | 3.3     | 3.1     | 3.0     | 2.5     | 2.2     | 2.5     | 3.0     |
| 8      | 900 - 999     | 0.5     | 0.5     | 0.3     | 0.2     | 0.4     | 0.4     | 0.3     |
| 9      | 1000 - 1099   | 3.4     | 3.2     | 3.5     | 3.2     | 2.9     | 1.8     | 0.8     |
| 10     | 1100 - 1199   | 1.6     | 1.6     | 1.5     | 1.4     | 1.4     | 2.5     | 3.7     |
| 11     | 1200 - 1299   | 0.2     | 0.2     | 0.2     | 0.2     | 0.2     | 0.2     | 0.3     |
| 12     | 1300 - 1399   | 0.5     | 0.6     | 0.6     | 0.1     | 0.0     | 0.0     | 0.1     |
| 13     | 1400 - 1799   | 0.3     | 0.2     | 0.2     | 0.5     | 0.4     | 0.3     | 0.4     |
| 14     | 1800 - 2199   | 0.1     | 0.1     | 0.0     | 0.0     | 0.0     | 0.0     | 0.0     |
| 15     | 2200 - 4924   | 0.7     | 0.7     | 0.7     | 0.5     | 0.5     | 0.4     | 0.5     |
| 16     | 4925 - 7650   | 0.4     | 0.4     | 0.4     | 0.4     | 0.4     | 0.6     | 0.5     |
| 17     | 7651 - 15000  | 0.1     | 0.1     | 0.1     | 0.1     | 0.1     | 0.1     | 0.1     |
| 18     | 15001 - Above | 0.0     | 0.0     | 0.0     | 0.0     | 0.0     | 0.0     | 0.1     |

Source: Excise Department, GoK

The relationship between tax rates, prices, and revenue is therefore more nuanced than a simple positive correlation. Evidence from past rate changes suggests that while moderate increases in excise duties have yielded higher revenues, the response is not linear. In some cases, higher rates have been associated with shifts in consumption toward lower-priced products or temporary slowdowns in volume growth. This highlights the importance of tax design particularly the alignment of rates with alcohol content in ensuring that revenue objectives are met without inducing undesirable substitution effects.

Inter-state price differentials further complicate revenue dynamics in a federal setting (Table 8.3 and 8.4). Comparative data indicate that alcohol prices and effective tax rates vary significantly across neighboring states. These differences create incentives for cross-border purchases and informal trade, particularly in border districts. Such leakages can erode the tax base and weaken the effectiveness of state-level excise policy, especially when price differentials are large and enforcement capacity is uneven.

**Table 8.3: Price Comparison of Indian Made Liquor (180 ml) Across States**

| Sl. No | DP Slab From | DP Slab To | Karnataka | Andra Pradesh | Telangana | Maharashtra | Tamil Nadu | Kerala |
|--------|--------------|------------|-----------|---------------|-----------|-------------|------------|--------|
| 1      | 0            | 470        | 80        | 99            | 110       | 175         | 140        | 160    |
| 2      | 471          | 520        | 95        | 130           | 160       | 210         | 170        | 180    |
| 3      | 521          | 570        | 115       | 140           | 160       | 220         | 170        | 190    |
| 4      | 571          | 650        | 135       | 160           | 190       | 205         | 170        | 200    |
| 5      | 651          | 750        | 155       | 230           | 190       | 220         | 200        | 280    |
| 6      | 751          | 900        | 185       | 180           | 190       | 215         | 200        | -      |
| 7      | 901          | 1,050      | 210       | 190           | 190       | 225         | 170        | -      |
| 8      | 1,051        | 1,300      | 235       | 190           | 190       | 220         | 220        | 190    |
| 9      | 1,301        | 1,800      | 295       | 220           | 220       | 280         | 260        | 325    |
| 10     | 1,801        | 2,500      | 350       | 220           | 300       | 300         | 260        | -      |
| 11     | 2,501        | 5,000      | 445       | 350           | 340       | 375         | 350        | 385    |
| 12     | 5,001        | 8,000      | 595       | 620           | 520       | 700         | 520        | 615    |
| 13     | 8,001        | 12,500     | 780       | 660           | 680       | -           | -          | -      |
| 14     | 12,501       | 15,000     | 875       | 980           | 770       | 850         | 650        | 785    |
| 15     | 15,001       | 20,000     | 1,030     | 660           | 800       | -           | -          | -      |
| 16     | 20,001       | & Above    | 1,070     | 1,315         | 1,150     | -           | -          | 2,295  |

Source: Excise Department, GoK

**Table 8.4: Price comparison with neighbouring states (₹) – Beer**

| Sl. No. | Brand Name                    | Karnataka | Andhra Pradesh | Telangana | Maharashtra | Tamil Nadu | Kerala |
|---------|-------------------------------|-----------|----------------|-----------|-------------|------------|--------|
| 1       | Sunny Beach                   | 100       | -              | -         | -           | -          | -      |
| 2       | Royal Challenge Strong        | 120       | -              | 180       | 160         | -          | -      |
| 3       | Legend Strong                 | 120       | -              | -         | -           | -          | -      |
| 4       | Bullet Super Strong           | 120       | -              | -         | -           | -          | 130    |
| 5       | London Pilsner Premium Strong | 140       | -              | -         | -           | -          | -      |
| 6       | Haywards 5000                 | 145       | -              | 190       | 160         | -          | 150    |
| 7       | Power Cool                    | 150       | -              | -         | -           | -          | -      |
| 8       | UB Export Strong              | 165       | -              | -         | -           | -          | -      |
| 9       | Hunter                        | 190       | -              | -         | -           | -          | 160    |
| 10      | UB Export Premium             | 160       | -              | -         | -           | -          | -      |
| 11      | Black Fort Super Strong       | 165       | -              | -         | -           | 180        | 160    |
| 12      | Knock Out High Punch Strong   | 175       | -              | 190       | 180         | -          | -      |
| 13      | Kingfisher Strong             | 190       | -              | 190       | 195         | 170        | 140    |
| 14      | Kingfisher Premium            | 185       | -              | 180       | 190         | 150        | 130    |
| 15      | Tuborg Strong                 | 195       | -              | 190       | 195         | 170        | -      |
| 16      | Tuborg Premium (Green)        | 190       | -              | 180       | 200         | -          | -      |
| 17      | Kingfisher Ultra Lager        | 225       | 220            | 250       | -           | -          | 140    |
| 18      | Budweiser Premium             | 225       | 270            | 250       | 240         | -          | 160    |
| 19      | KF Ultra Max Premium Strong   | 235       | -              | 260       | 240         | 210        | 160    |
| 20      | Carlsberg Premium (Smooth)    | 230       | -              | 220       | 240         | -          | -      |
| 21      | Budweiser Magnum              | 245       | 300            | 260       | 250         | -          | 180    |
| 22      | Carlsberg Elephant            | 250       | 260            | 260       | 245         | 170        | -      |
| 23      | Heineken Silver               | 270       | -              | 270       | -           | -          | -      |

Source: Excise Department, GoK

The dependence on excise revenue also introduces fiscal constraints that shape policy choices. An inter-state comparison further highlights the importance of excise revenue within Karnataka’s fiscal system. Compared with many other large states, Karnataka exhibits a relatively high reliance on excise taxation as a share of its own tax revenue. The data (Table 8.5) show that Karnataka has consistently maintained an excise share of around 20–21 percent of own tax revenue, which is significantly higher than the levels observed in several other large states. For example, Maharashtra records excise contributions of around 8–9 percent, while Tamil Nadu’s excise share has historically been below 12 percent. Kerala exhibits an even lower excise share of approximately 3–5 percent, reflecting differences in fiscal structures and policy priorities. In contrast, states such as Uttar Pradesh and Andhra Pradesh exhibit relatively high reliance on excise taxation, similar to Karnataka. Andhra Pradesh’s excise share has increased significantly in recent years and is projected to exceed Karnataka’s by 2025.

**Table 8.5: Excise Duty as Percentage of Own Tax Revenue: Selected States**

| Year/ States          | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  | 2021  | 2022  | 2023  | 2024<br>(RE) | 2025<br>(BE) |
|-----------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------------|--------------|
| <b>Andhra Pradesh</b> | 10.21 | 10.99 | 10.51 | 11.03 | 10.72 | 12.00 | 20.16 | 20.71 | 18.97 | 18.62 | 22.43        | 24.86        |
| <b>Karnataka</b>      | 19.67 | 20.29 | 19.87 | 20.60 | 20.60 | 21.09 | 24.04 | 21.85 | 20.82 | 21.18 | 20.24        | 19.22        |
| <b>Kerala</b>         | 5.04  | 5.04  | 4.79  | 4.82  | 4.98  | 4.48  | 4.89  | 3.48  | 4.00  | 3.96  | 3.61         | 3.44         |
| <b>Tamil Nadu</b>     | 7.29  | 7.25  | 7.27  | 6.20  | 6.50  | 6.71  | 7.37  | 6.70  | 6.94  | 11.37 | 11.84        | 11.82        |
| <b>Telangana</b>      | 9.59  | 9.53  | 11.53 | 16.67 | 16.45 | 17.74 | 21.56 | 19.15 | 17.27 | 18.16 | 19.80        | 19.00        |
| <b>Gujarat</b>        | 0.23  | 0.20  | 0.24  | 0.12  | 0.16  | 0.17  | 0.19  | 0.16  | 0.15  | 0.15  | 0.14         | 0.16         |
| <b>Haryana</b>        | 12.56 | 14.13 | 13.56 | 12.08 | 14.19 | 14.76 | 16.38 | 14.86 | 15.36 | 15.62 | 15.44        | 15.26        |
| <b>Maharashtra</b>    | 9.90  | 9.85  | 9.00  | 8.01  | 8.17  | 8.17  | 9.19  | 7.79  | 7.75  | 7.71  | 8.30         | 8.40         |
| <b>Uttar Pradesh</b>  | 18.18 | 17.36 | 16.60 | 17.78 | 19.92 | 22.25 | 25.07 | 24.65 | 23.70 | 23.60 | 23.34        | 21.36        |

Source: RBI

These differences reflect variations in consumption patterns, policy choices, and broader fiscal structures. States that rely more heavily on GST and stamp duties tend to exhibit lower dependence on excise taxation. From Karnataka’s perspective, the inter-state comparison yields three important insights. First, the state has historically been among the higher- dependence states in terms of excise revenue. Second, excise taxation served as a counter- cyclical revenue source during the pandemic when other tax collections declined. Third, recent projections suggest a gradual shift toward a more diversified tax structure, although excise continues to play a major role in the state’s fiscal system.

From a fiscal design perspective, the key challenge is to transition from a volume-dependent revenue model to a more balanced and sustainable structure. The evidence indicates that current revenue performance is closely tied to high-volume consumption in lower price segments. A reoriented system based on alcohol content, improved rate rationalization, and reduced distortions could maintain or enhance revenue while moderating harmful consumption patterns.

Ultimately, the fiscal role of alcohol excise must be evaluated not only in terms of revenue generation but also in terms of its interaction with broader economic and social objectives. The comparison between excise revenue and estimated social costs suggests that the net welfare impact of current consumption patterns is uncertain and may be negative at the margin. A well- designed excise system can, however, deliver a “double dividend” by raising revenue while reducing externalities.

This creates a fundamental fiscal-policy tension. The current system derives a substantial portion of its revenue from consumption patterns that are also associated with higher social costs. As a result, any policy aimed at reducing harmful consumption particularly in high- volume, low-priced segments may have short-term revenue implications. A well-designed reform must therefore shift the basis of revenue from volume to alcohol content, allowing the State to maintain fiscal stability while reducing harmful consumption intensity.

The fiscal implications of the preceding analysis point toward the need for a more coherent and internally consistent tax structure. Karnataka should move away from a system in which revenue performance depends on a fragmented combination of price slabs, category-based treatment, and administratively complex levies, and toward one in which each tax instrument performs a clearly defined role. The specific excise duty should be calibrated to alcohol content and aligned over time with the social cost benchmark, while the State-level AED/VAT should provide the ad valorem fiscal component of alcohol taxation.

## **Fiscal Risks and Policy Implications**

The analysis presented in this chapter highlights several fiscal challenges associated with Karnataka’s excise taxation system. While excise duties generate substantial revenue for the state, heavy reliance on alcohol taxation creates structural risks. Excise revenue is sensitive to consumer behaviour, price differentials across states, and broader economic conditions. High tax rates may encourage substitution across price segments, cross-border purchases, or shifts toward unregulated alcohol markets. From a fiscal perspective, Karnataka’s excise system therefore presents a trade-off between revenue maximization and long-term market stability. While periodic duty increases can generate short-term revenue gains, excessive reliance on alcohol taxation may create vulnerabilities over time. Addressing these challenges requires a balanced policy approach. Realistic revenue forecasting, rationalization of duty structures, and improved coordination with neighbouring states may help reduce market distortions. At the same time, diversification of revenue sources and strengthened enforcement mechanisms are essential for ensuring the long-term sustainability of the state’s fiscal system.

## CHAPTER 9

### SOCIAL COSTS OF ALCOHOL CONSUMPTION

Alcohol occupies a complex position in contemporary economies and public policy. On the one hand, it is a legally traded commodity that contributes substantial fiscal revenue to governments and supports a large ecosystem of economic activities including manufacturing, agriculture, distribution, retail, and hospitality services. In Karnataka, excise duties on alcohol constitute one of the most significant non-GST revenue streams for the State and have exhibited steady growth in recent years. On the other hand, alcohol consumption generates a range of social, health, and economic consequences that extend well beyond the individual consumer. These consequences include disease, injury, loss of productivity, domestic violence, road traffic accidents, and broader social disruption. Because many of these costs are borne by families, communities, and public institutions rather than by the consumer alone, they constitute a classic case of social externalities.

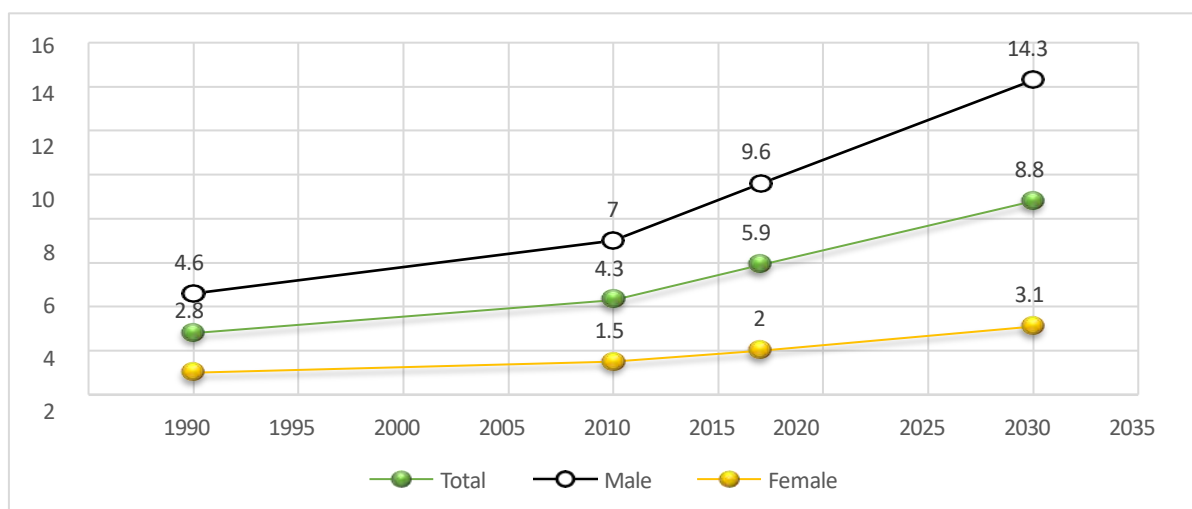
Alcoholic beverages contain ethanol, a psychoactive substance capable of producing dependence and long-term health damage. Although alcohol has historically played a role in cultural and social practices across societies, extensive epidemiological research demonstrates that harmful alcohol consumption contributes to significant morbidity and mortality worldwide. According to the World Health Organization, alcohol consumption was responsible for approximately 2.6 million deaths globally in 2019, including around 2 million deaths among men and 0.6 million among women. The burden is particularly pronounced among young adults. Individuals aged 20–39 years accounted for approximately 13 percent of global alcohol-attributable mortality in that year. In addition, an estimated 400 million people worldwide suffer from alcohol use disorders, including over 200 million individuals experiencing alcohol dependence.

For policymakers, the central issue is therefore not merely the scale of alcohol consumption but the wider societal burden that accompanies it. The social costs of alcohol are often diffuse and not immediately visible in conventional economic indicators such as sales or tax revenues. They emerge through pressures on healthcare systems, policing and judicial institutions, social welfare programs, and household stability. Understanding the magnitude and distribution of these costs is essential for designing excise and regulatory policies that balance revenue considerations with broader public welfare.

#### Alcohol Consumption Trends in India

Alcohol consumption patterns in India have evolved considerably over the past two decades. Historically, per capita alcohol consumption in India has been lower than in many high-income countries. However, rising incomes, rapid urbanization, demographic change, and evolving social norms have contributed to a sustained increase in alcohol consumption. Estimates indicate that per capita consumption of pure alcohol increased from approximately 1.3 litres in 2005 to about 3.1 litres by 2022. Although this level remains below the global average, the rate of increase has been significant. The long-term trajectory of alcohol consumption in India illustrates this trend clearly. Data compiled by Manthey et al. and Gururaj et al. project that per capita alcohol consumption among adults aged 15 years and above has risen steadily over the past three decades and may continue to increase in the coming years.

**Figure 9.1: Consumption trend per capita (1990-2030) - Trends in alcohol per capita (15+ years) consumption (in litres of pure alcohol) between 1990 and 2030 in India.**



Source: Manthey et al. and Gururaj et al. (NIMHANS)

The figure 9.1 illustrates a sustained upward trend in alcohol consumption. Total per capita consumption is projected to increase from approximately 2.8 litres of pure alcohol in 1990 to around 5.9 litres in 2020 and could reach approximately 8.8 litres by 2030. This represents more than a threefold increase over four decades. From a public policy perspective, rising per capita consumption has important implications because higher average consumption levels are associated with increased prevalence of alcohol use disorders, greater incidence of alcohol-related diseases, and higher rates of injury and violence. Market data further reinforce this trend. Industry estimates from the International Wine and Spirits Record (IWSR) indicate that India’s alcoholic beverage market recorded a compound annual growth rate of approximately two percent between 2018 and 2023. Growth accelerated in 2022–23, when year-on-year expansion reached roughly five percent. Forecasts suggest continued expansion of the alcohol market in the coming decade as India’s young population and expanding middle class contribute to rising demand.

At the same time, survey-based evidence provides a more nuanced picture of drinking prevalence. Data from the National Family Health Survey (NFHS-5, 2019-21) indicate that 22.4 percent of men aged 15-49 reported consuming alcohol, while only 0.7 percent of women reported alcohol consumption. These figures represent a decline from NFHS-4 (2015-16), where the corresponding figures were 29.2 percent for men and 1.2 percent for women. While the prevalence of self-reported alcohol use may have declined in some survey periods, overall market consumption has continued to expand. This divergence suggests that alcohol consumption may be becoming more concentrated among a smaller share of drinkers, with those who drink consuming larger quantities on average. These trends point to a dynamic and evolving alcohol market in India. As overall consumption expands and demographic patterns shift, the potential for alcohol-related social and health harms also increases. Understanding these dynamics is therefore essential for evaluating the broader social costs associated with alcohol consumption.

## Alcohol Consumption in Karnataka

Karnataka represents one of the largest and fastest-growing alcohol markets in India. The State plays a central role in the national alcoholic beverage industry both in terms of consumption and fiscal contribution. Industry data for fiscal year 2024-25 indicate that Karnataka recorded approximately 6.88 crore cases of Indian-Made Foreign Liquor (IMFL) sales, accounting for about 17 percent of total IMFL sales in India. This positions Karnataka among the leading states in terms of alcohol market size. Survey evidence suggests that alcohol consumption is widespread among adult men in the State.

According to NFHS-5 data, approximately 16.5 percent of men aged 15-49 in Karnataka reported consuming alcohol, compared with around 0.9 percent of women. These figures mirror national patterns in which alcohol consumption remains heavily gender-skewed. While men account for the overwhelming majority of alcohol consumers, women and children frequently bear a disproportionate share of the social and economic consequences associated with harmful alcohol use.

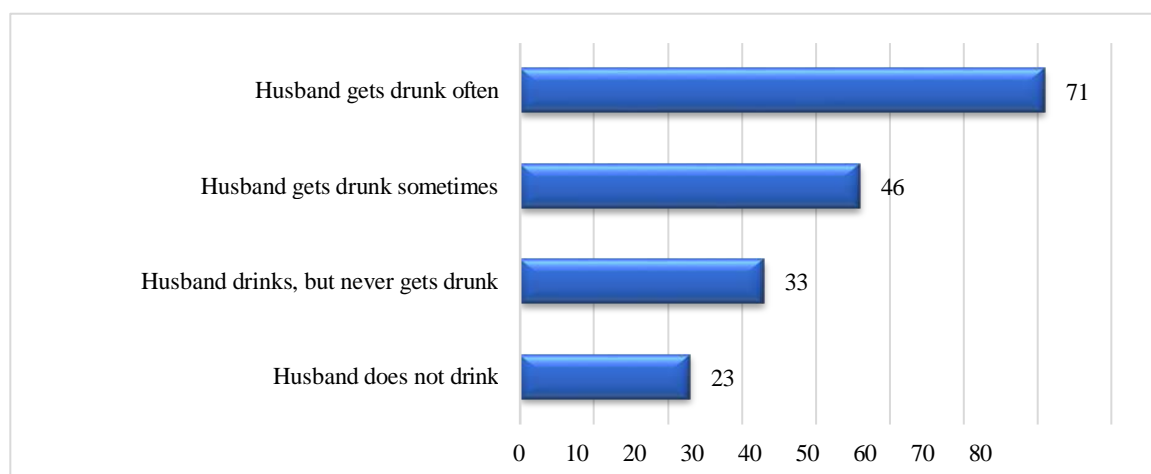
The scale of alcohol consumption in Karnataka has implications that extend beyond fiscal revenues and market activity. As consumption expands across urban and rural areas and across different demographic groups, the potential for alcohol-related harms increases. These harms often manifest in ways that are not captured in routine sales statistics, appearing instead through increased demands on public services, healthcare systems, and social protection programmes.

## Social costs of alcohol consumption in India

A major dimension of alcohol's social cost arises within households, particularly through its association with domestic violence, economic distress, and family instability. As discussed in Chapter 2, the State's regulatory intervention in alcohol markets is justified partly by the presence of social externalities. Domestic violence linked to alcohol consumption represents one of the most direct manifestations of such externalities, as the harms are borne primarily by spouses, children, and other dependents rather than the drinker alone.

Evidence from the National Family Health Survey (NFHS-5, 2019-21) demonstrates a strong relationship between alcohol use and spousal violence. The likelihood that a woman experiences physical or sexual violence increases substantially when her husband consumes alcohol, particularly when intoxication is frequent. The data reveal a clear gradient in the prevalence of spousal violence. Approximately 23 percent of women whose husbands do not drink report experiencing physical or sexual violence, compared with 33 percent among women whose husbands drink but do not become intoxicated, 46 percent among those whose husbands sometimes become drunk, and 71 percent among women whose husbands frequently become intoxicated. This pattern suggests that not only alcohol consumption itself, but also the intensity of intoxication, plays a critical role in determining the risk of domestic violence.

**Figure 9.2: Percentage of ever-married women who have ever experienced spousal physical or sexual violence**



Source: NFHS-5 (2019-21)

Gender disparities in alcohol consumption further amplify these impacts. NFHS-5 data indicate that only about 1 percent of women in India consume alcohol, compared with 22 percent of men. This asymmetry implies that while men constitute the overwhelming majority of alcohol consumers, women are disproportionately exposed to the indirect consequences of harmful drinking, including domestic violence, household conflict, and economic vulnerability.

Drinking patterns also vary among individuals who consume alcohol. Among female drinkers, approximately 17 percent report drinking almost every day, while 37 percent report drinking about once a week. Among male drinkers, 15 percent report drinking almost every day, 43 percent drink about once a week, and 42 percent drink less frequently. These patterns indicate that while the prevalence of alcohol use is much lower among women, those who do drink may exhibit regular consumption patterns.

Sociodemographic factors further shape alcohol consumption patterns in India. NFHS-5 data indicate that drinking prevalence is highest among certain population groups, including Scheduled Tribe communities and individuals with lower levels of education. Among men, drinking prevalence reaches approximately 34 percent among Scheduled Tribe populations and 33 percent among those with fewer than five years of schooling, while prevalence peaks in the 35-49 age group, which corresponds to prime working and family-responsibility years. These demographic patterns are relevant from a policy perspective because they indicate that alcohol-related harms may disproportionately affect socially and economically vulnerable communities. Targeted interventions such as awareness programmes, community-based harm-reduction initiatives, and strengthened social support systems may therefore be necessary to address these risks.

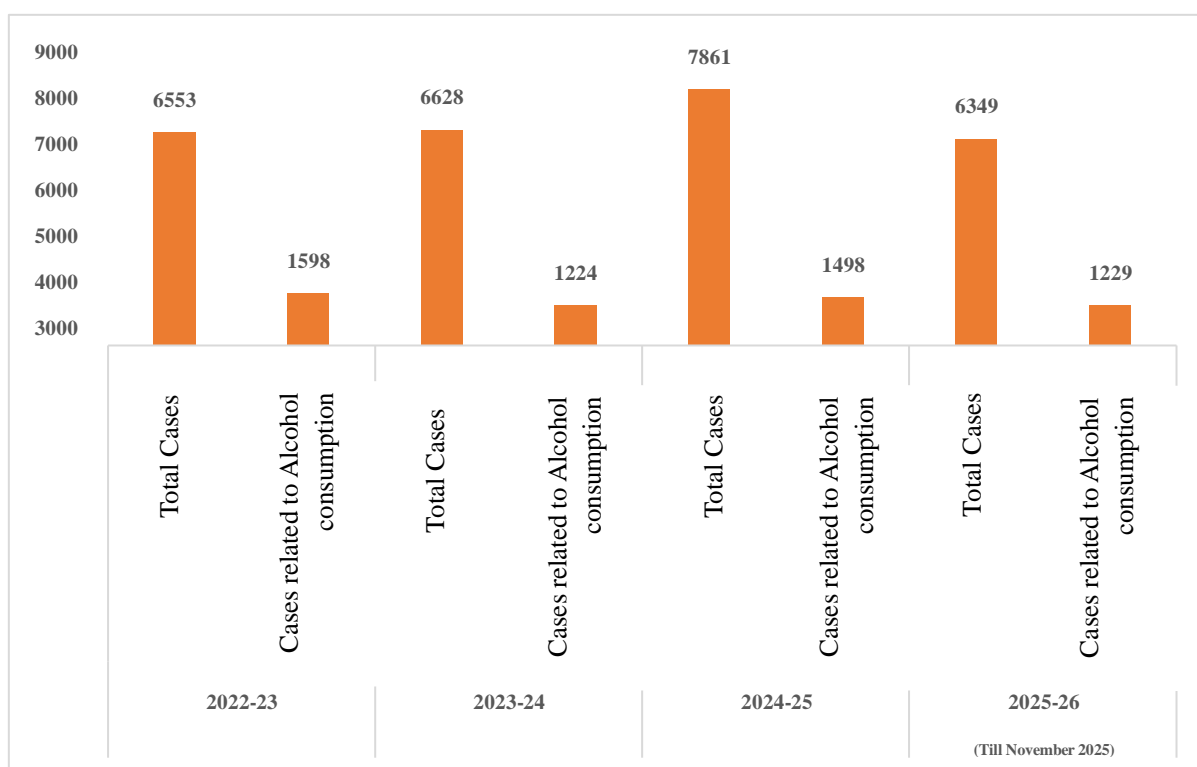
NFHS-5 also provides more detailed data on the relationship between alcohol consumption and different forms of spousal violence. The survey disaggregates violence into emotional, physical, and sexual categories and examines how these forms of violence vary according to husbands' drinking behaviour.

### **Evidence from Karnataka**

Administrative data from Karnataka’s social support programmes further illustrate how alcohol-related harms translate into tangible pressures on public institutions. Domestic violence cases frequently require intervention from multiple government agencies, including law enforcement, healthcare providers, counselling services, and social welfare programmes. One important institutional response is the network of One Stop Centres (OSCs) established under the Nirbhaya framework of the Government of India. These centres provide integrated services for survivors of gender-based violence, including medical assistance, police facilitation, legal aid, counselling, and temporary shelter.

Between 2022-23 and 2024-25, OSCs in Karnataka registered between 6,553 and 7,861 cases annually, covering domestic violence, marital conflict, and other forms of gender-based distress. A substantial share of these cases was associated with alcohol consumption within households. Alcohol-linked cases numbered 1,598 in 2022-23, 1,224 in 2023-24, and 1,498 in 2024-25, with more than 1,200 cases already recorded in the ongoing financial year 2025-26. These figures illustrate that alcohol misuse is a recurring factor in cases requiring state- supported protection services.

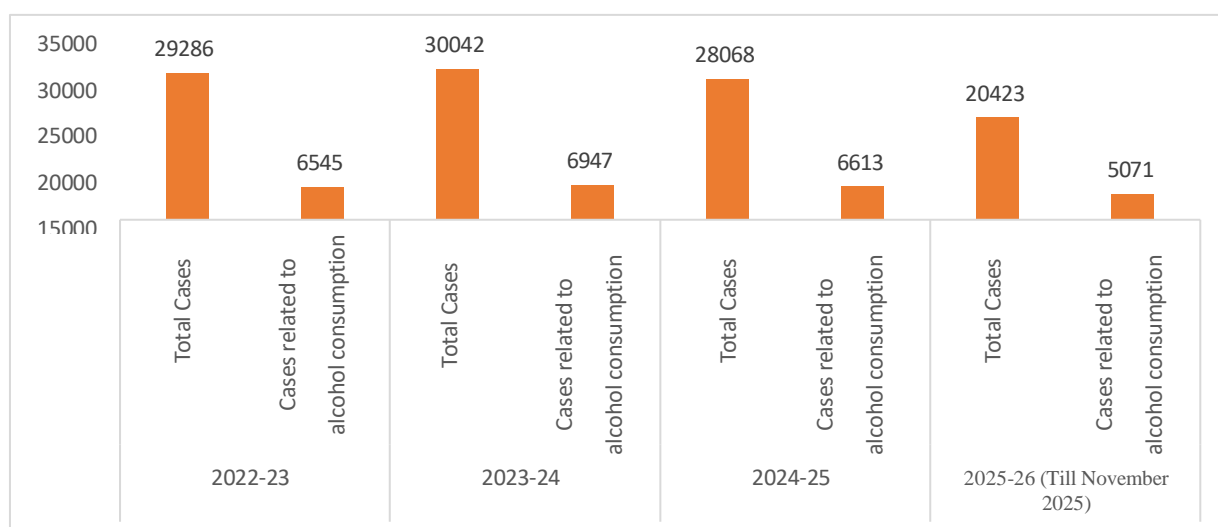
**Figure 9.3: Cases registered at One Stop Centres in Karnataka**



Source: Department of Women and Child Development, GoK

Importantly, they represent only those incidents that reach formal support mechanisms. The true prevalence of alcohol-related domestic violence is likely higher due to under-reporting, social stigma, and limited awareness of available services. Another important support mechanism is the Santhwana Scheme, implemented by the Department of Women and Child Development. The scheme provides financial assistance, legal aid, medical support, and psychosocial counselling to women facing domestic violence and related crises.

**Figure 9.4: Cases registered under Santhwana scheme in Karnataka**



Source: Department of Women and Child Development, GoK

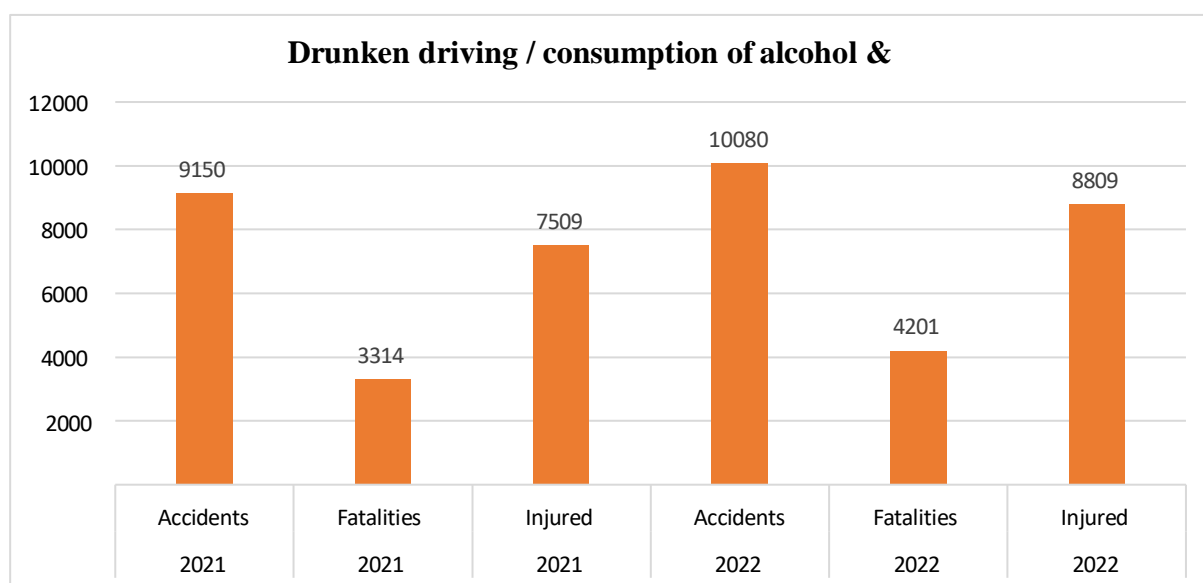
Between 2022-23 and 2024-25, the Santhwana Scheme handled between 28,068 and 30,042 cases annually. Alcohol consumption was cited as a contributing factor in a substantial share of these cases, including 6,545 cases in 2022-23, 6,947 cases in 2023-24, and 6,613 cases in 2024-25. These programmes demonstrate how alcohol-related harms generate direct fiscal and administrative costs for the State. Resources must be allocated not only for counselling and legal support, but also for emergency financial assistance, shelter services, and long-term rehabilitation.

Clinical evidence further reinforces these findings. A recent cross-sectional study conducted at the Centre for Addiction Medicine at NIMHANS, Bengaluru (2024-2025) examined 150 male patients diagnosed with alcohol dependence syndrome. The study found extremely high rates of intimate partner violence among participants, with 67 percent reporting lifetime perpetration of IPV and 59 percent reporting IPV in the previous year. Emotional and physical violence were particularly common. The study also found that the severity of alcohol dependence significantly increased the likelihood of violence, indicating a dose-response relationship between alcohol misuse and intimate partner violence. These findings are consistent with national survey data and demonstrate that alcohol misuse contributes directly to household instability and intergenerational harm.

## Public Safety Costs: Road Traffic Accidents

Alcohol consumption also generates substantial public safety risks, particularly through its impact on road traffic accidents. Driving under the influence of alcohol impairs reaction time, reduces judgement, and increases risk-taking behaviour, significantly increasing the likelihood of road crashes. According to the Ministry of Road Transport and Highways, 10,080 road accidents in 2022 were attributed to drunk driving, resulting in 4,201 deaths and 8,809 injuries. These figures represent an increase compared to the previous year and highlight the continuing role of alcohol in road safety risks.

**Figure 9.5: Road Accidents in India 2022**



Source: Ministry of Road Transport and Highways

**Table 9.1: Trend of road accidents, fatalities and injuries caused in India and Karnataka (2010-2016)**

| Year | India            |            |                 | Karnataka        |            |                 |
|------|------------------|------------|-----------------|------------------|------------|-----------------|
|      | Accidents caused | Fatalities | Persons injured | Accidents caused | Fatalities | Persons injured |
| 2010 | 31,000           | 9,976      | 33,567          | 299              | 69         | 359             |
| 2011 | 24,655           | 10,553     | 21,148          | 541              | 136        | 728             |
| 2012 | 23,979           | 7,835      | 23,403          | 577              | 145        | 798             |
| 2013 | 20,290           | 6,463      | 20,081          | 495              | 118        | 525             |
| 2014 | 18,916           | 6,968      | 19,432          | 2,207            | 511        | 2,838           |
| 2015 | 16,298           | 6,755      | 18,813          | 298              | 62         | 244             |
| 2016 | 14,894           | 6,131      | 11,648          | 396              | 94         | 359             |

Source: Open Government Data (OGD) Platform India, Ministry of Road Transport and Highways

The data show that although national accident counts have declined over time, alcohol-impaired driving continues to result in thousands of preventable deaths and injuries each year. In Karnataka, the pattern has been more volatile, with periods of significant increases in alcohol-related accidents during the early 2010s. Road accidents impose multiple layers of economic and social costs. These include direct medical expenditures associated with emergency response and trauma care, as well as indirect costs arising from lost productivity, long-term disability, and household income shocks.

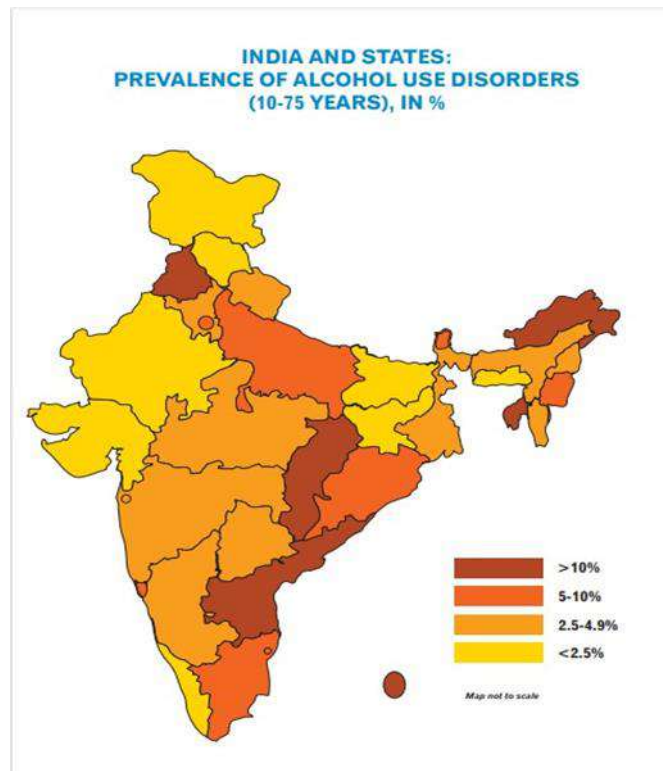
Public sector institutions also incur substantial expenditures related to policing, enforcement, and judicial processes. Studies conducted by the Ministry of Road Transport and Highways, the World Health Organization, and the Indian Institute of Management estimate that road traffic accidents cost India between three and five percent of GDP annually, with alcohol-impaired driving representing a major contributing factor.

## **Health and Economic Burden**

Alcohol consumption also contributes significantly to the burden of disease in India. Alcohol is causally linked to more than 200 disease and injury conditions, including liver cirrhosis, cancers, cardiovascular disease, alcohol dependence, and various mental health disorders.

The Magnitude of Substance Use in India (2019) report estimates that approximately 5.2 percent of India's population suffers from harmful or dependent alcohol use, representing more than 5.7 crore individuals who require treatment or support. Karnataka falls within the 2.5-4.9 percent prevalence band for alcohol use disorders. The economic implications of these health outcomes are substantial. Alcohol-related illness generates direct healthcare costs associated with hospitalization, addiction treatment, trauma care, and long-term rehabilitation. In India, where more than half of total healthcare expenditure is financed through out-of-pocket payments, alcohol-related illness can impose severe financial burdens on households.

**Map 9.1: Prevalence of alcohol use disorders (10-75 Years), in %**



*Source: Magnitude of Substance use in India (2019), Ministry of Social Justice and Empowerment*

Economic modelling studies estimate that alcohol-related disease may impose health system costs exceeding ₹3,127 billion, while the broader societal burden including productivity losses and out-of-pocket expenditure may exceed ₹121 trillion. Even after accounting for tax revenues generated through alcohol sales, alcohol consumption is estimated to produce a net economic loss equivalent to approximately 1.45 percent of India's GDP annually

### **Policy Implications**

The evidence presented in this chapter demonstrates that alcohol consumption generates substantial social costs across multiple domains, including household welfare, public safety, healthcare systems, and economic productivity. These costs reinforce the rationale discussed in Chapter 2, which highlighted the role of state intervention in addressing the externalities associated with alcohol consumption. While alcohol taxation remains an important source of revenue for states such as Karnataka, effective excise policy must also consider the broader social consequences associated with alcohol use. A balanced policy framework must therefore integrate fiscal objectives with measures aimed at reducing harmful consumption and mitigating preventable social harms.

## CHAPTER 10

### FRAMEWORK OF NEW EXCISE POLICY

The preceding chapters have examined three interrelated dimensions of alcohol policy in Karnataka. First, they documented the social and economic costs associated with alcohol consumption, including domestic violence, road traffic accidents, health burdens, and impacts on household welfare. Second, they analyzed the fiscal importance of excise taxation, which constitutes one of the largest sources of the State's own tax revenue. Third, they examined the structure of the alcohol industry and consumption patterns, highlighting the concentration of consumption in specific beverage categories and price segments.

Taken together, these findings reveal a central policy challenge: alcohol simultaneously functions as a major source of public revenue and a source of significant social harm. Effective excise policy must therefore balance fiscal objectives with the need to mitigate broader economic and social consequences.

In principle, the most appropriate approach would be to align taxation closely with alcohol content and externality risk, thereby discouraging harmful consumption while improving allocative efficiency. **The Committee has developed such a theoretically robust framework, presented in the chapters 3 and 4. However, translating this ideal approach into practice is not straightforward.**

The current market is characterized by entrenched price tiers, strong brand segmentation, and well-established consumption patterns. A sudden shift to a fully rationalized, content-based pricing structure would require sharp and uneven price adjustments across products and segments. This could lead to significant price distortions, incentivize substitution toward lower-priced or informal alternatives, disrupt established supply chains, and create administrative and enforcement challenges. Moreover, given the State's heavy reliance on consumption-driven excise revenues, abrupt changes carry non-trivial fiscal risks. **Hence a pragmatic approach is recommended as indicated earlier for the present.**

#### Guarding against unintended consequences

A reform that raises the effective price of alcohol as a strength-based excise calibrated to social cost will do, particularly in the economy IML segment must anticipate the risk of displacement into illicit channels. Higher prices create stronger incentives for bootlegging, cross-border smuggling, and production of spurious or methanol-laced liquor. These are not hypothetical risks. Hooch tragedies in India have repeatedly killed dozens of people at a time, and they disproportionately affect the poorest and most vulnerable consumers precisely the populations that a corrective tax is intended to protect.<sup>61</sup>

This risk does not invalidate the case for reform, but it demands that reform be accompanied by credible countermeasures. Three elements are critical.

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<sup>61</sup> On the public health consequences of illicit and adulterated alcohol, see Lachenmeier, D.W., et al. (2011). A global overview of alcohol and non-beverage alcohol consumption. *Current Drug Abuse Reviews*, 4(2), 87–97.

For India-specific evidence on hooch tragedies, see news reports and public health assessments following mass methanol poisoning events in Bihar (2016), Punjab (2020), and Tamil Nadu (2022).

**First, the digital track-and-trace infrastructure serves a dual purpose:** it ensures compliance within the legal supply chain and makes it easier to identify products outside the system. Every bottle in the legal market becomes verifiable through its unique QR code — which makes every bottle without one suspicious. This is a qualitative improvement over a system where legal and illegal products are physically indistinguishable

**Second, the phased glide path itself is a countermeasure.** Reaching ideal situation over three years rather than in a single step allows enforcement systems to be built, tested, and scaled before the full price impact is felt. A sudden, large price increase with inadequate enforcement infrastructure would be the worst possible combination.

**Third, the strength-based excise itself reduces one important driver of illicit trade.** Under the current system, the wide dispersion in effective tax rates across product segments creates price differentials that can be exploited through product misclassification, label fraud, and downtrading. A uniform rate per litre of pure alcohol eliminates these arbitrage opportunities within the legal market, simplifying enforcement and narrowing the space for evasion.

**None of these measures can eliminate illicit trade entirely.** But the objective is not perfection, it is to ensure that the reformed system, taken as a whole, leaves Karnataka better protected against illicit alcohol than the current framework does. The phased approach allows the state to monitor illicit activity indicators, seizure data, methanol poisoning incidents, cross-border flow estimates at each stage and adjust the pace of reform if evidence warrants it.

**In this context, a degree of methodological compromise becomes necessary.** Rather than adopting the theoretically optimal model in a single step, policy must proceed in a sequenced and calibrated manner that gradually steers the market toward the desired structure while maintaining stability in prices, revenues, and compliance. Accordingly, the Committee recommends a pragmatic alternative policy pathway one that balances theoretical soundness with operational feasibility and advances reform without triggering unintended economic or social disruptions. The contours of this approach are set out in the sections that follow.

## **Revised Excise Duty Structure for Consideration**

### **Estimating the Social Cost of Alcohol Consumption**

International research provides a useful benchmark for assessing the magnitude of alcohol-related externalities. A comprehensive meta-analysis of studies across multiple countries estimates that the economic costs attributable to alcohol consumption range between approximately 1.5 percent and 2.6 percent of Gross Domestic Product (GDP) (Manthey et al., 2021). These estimates encompass a broad range of impacts, including direct healthcare expenditures, productivity losses arising from morbidity and premature mortality, and wider social costs associated with crime, accidents, and law enforcement. Taken together, this body of evidence indicates that alcohol consumption imposes a substantial economic burden on society that extends beyond the private costs borne by individual consumers.

To provide an indicative assessment of this burden in the context of Karnataka, these internationally observed cost ratios can be applied to the State's Gross State Domestic Product (GSDP). Taking Karnataka's GSDP at approximately ₹30 lakh crore, and applying the estimated range of 1.5 percent to 2.6 percent, yields an implied annual economic cost of alcohol consumption in the range of approximately ₹45,000 crore to ₹78,000 crore. This approach does not constitute a direct measurement of state-specific costs; rather, it provides an order-of-magnitude estimate based on established international evidence, allowing for a broad assessment of the potential scale of alcohol-related externalities in the State.

While these estimates are illustrative, they are consistent with the patterns of social harm observed in Karnataka, including alcohol-related impacts on public health, road safety, and household welfare. The comparison between these estimated social costs and observed excise revenues highlights an important policy consideration. Although alcohol taxation generates substantial revenue for the State, it may not fully internalize the broader economic costs associated with alcohol consumption. Consequently, a portion of these costs continues to be borne indirectly by households and the public sector through increased healthcare expenditure, welfare burdens, and productivity losses.

From a policy perspective, this gap underscores the importance of aligning excise taxation more closely with the social costs of alcohol consumption. At the same time, any movement toward such alignment must be carefully calibrated. Abrupt or excessively large tax adjustments may generate unintended consequences, including shifts toward illicit markets or disproportionate impacts on certain consumer groups. A gradual and well-designed reform approach is therefore essential to ensure that taxation policy effectively balances revenue objectives, public health considerations, and market stability

### **Linking Social Cost to Alcohol Consumption**

The relationship between social costs and taxation can also be examined using consumption-based estimates. Available data from the Excise Department indicate that per capita alcohol consumption in Karnataka is approximately 14 litres of alcoholic beverages per year, corresponding to about 4.19 litres of pure alcohol annually. Combined with population estimates, this provides a basis for approximating the total volume of pure alcohol consumed in the State. Using this consumption benchmark, an indicative measure of corrective taxation can be derived by relating aggregate social cost estimates to total alcohol consumption. Taking the lower-bound estimate of the social cost of alcohol consumption (approximately ₹43,500 crore) and distributing it across the estimated total volume of pure alcohol consumed yields an implied benchmark of roughly ₹1,500 per litre of pure alcohol. This may be interpreted as the notional level of taxation required to internalize the lower-bound estimate of social costs.

At this stage, however, it is neither feasible nor desirable to anchor policy to higher estimates such as the midpoint or upper-bound values, as doing so would necessitate sharp increases in prices, with potentially significant adverse effects on affordability, market stability, and compliance. Accordingly, the lower-bound estimate provides a more practical and policy-relevant reference point for calibration.

A comparison of this benchmark with current excise collections suggests that the effective tax realized per litre of alcohol remains below the level implied by social cost estimates. In approximate terms, bridging this gap would require an increase in the effective per-litre tax burden of around 25 percent, although the precise magnitude would depend on updated consumption and revenue data. This calculation is not intended to suggest that excise taxation should mechanically equate to estimated social costs in any given year. Rather, it provides an analytical reference point for evaluating whether the current tax structure adequately reflects the broader economic burden associated with alcohol consumption. From a policy perspective, it underscores the importance of designing taxation systems that progressively align consumer prices with social costs, while accounting for practical considerations such as market responses, administrative feasibility, and the risk of unintended distortions.

While this benchmark provides a useful guide for calibrating excise policy, its practical implementation cannot be considered in isolation from behavioural and market responses. In particular, increases in the effective price of alcohol especially in segments where consumption is highly price-sensitive may generate incentives for substitution not only within the legal market but also outside it. Where price differentials widen sharply without corresponding improvements in enforcement, the risk of displacement into informal or illicit channels becomes more pronounced. Accordingly, any move toward aligning excise rates more closely with social cost must be accompanied by a parallel assessment of enforcement capacity and market structure. The effectiveness of a strength-based excise, therefore, depends not only on its theoretical efficiency but also on the institutional mechanisms that sustain compliance and limit evasion. It is in this context that the potential risks associated with illicit alcohol assume central importance.

## **Assessment of the Current Excise Structure**

When Karnataka's excise structure is examined through the lens of alcohol content, significant distortions in tax design become apparent. In volume terms, Indian Made Foreign Liquor (IMFL) accounts for approximately 61.3 percent of total beverage sales, while beer contributes about 37.9 percent and wine less than one percent. However, this distribution changes markedly when adjusted for alcohol content. Of the estimated 28.20 crore litres of pure alcohol consumed in the State, IMFL alone accounts for over 25.6 crore litres more than 90 percent of total alcohol consumption. Despite this concentration of alcohol intensity in IMFL, the effective tax burden per litre of alcohol varies sharply across beverage categories. Beer is taxed at approximately ₹2,381 per litre of pure alcohol more than twice the effective rate of around ₹1,123 per litre applied to IMFL while wine is taxed at approximately ₹392 per litre. This results in a clear tax inversion, where the product category responsible for the overwhelming majority of alcohol consumption is subject to a lower effective tax rate per unit of alcohol than a relatively lower-strength beverage.

Such a structure weakens the fundamental logic of excise taxation as a harm-based instrument. By disconnecting tax liability from alcohol content, it generates inconsistent price signals across products and may inadvertently encourage consumption patterns that are not aligned with public health objectives. In effect, the current system taxes categories rather than the underlying source of harm. From a policy perspective, this provides a strong analytical basis for reform. Aligning taxation more closely with alcohol content would ensure that tax burdens correspond to the quantity of alcohol consumed, reduce distortions across product categories, and strengthen the effectiveness of price signals in influencing consumer behaviour. In this context, a transition toward an Alcohol-in-Beverage (AIB) based excise framework offers a more coherent and economically grounded approach to alcohol taxation

**Table 10.1: Current excise duty structure**

| Category     | Sales volume 24-25 |                         | Alcohol content of the sales volume (in litres) | ED+AED (₹ Cr) | Excise per litre of Alcohol (₹) |
|--------------|--------------------|-------------------------|---|---------------|---------------------------------|
|              | in litres          | % to total sales volume |   |               |                                 |
| <b>IML</b>   | 60,43,80,068       | 61.34                   | 25,64,78,639.90                                 | 28,802.52     | 1,123.00                        |
| <b>Beer</b>  | 37,35,93,530       | 37.91                   | 2,42,83,579.48                                  | 5,783.58      | 2,381.68                        |
| <b>Wine</b>  | 74,09,253          | 0.75                    | 12,62,633.52                                    | 49.52         | 392.20                          |
| <b>Total</b> | 98,53,82,851       | 100.00                  | 28,20,24,852.90                                 | 34,635.62     | 1,228.11                        |

### Transition to Alcohol-Content-Based Taxation: The Case for a Gradual Glide Path

International experience increasingly favours excise systems based on Alcohol-in-Beverage (AIB), where tax liability is linked directly to the quantity of pure alcohol contained in a product rather than its price or category. This approach reflects the principle that the harmful effects of alcohol consumption arise from ethanol itself, irrespective of the form in which it is consumed. Aligning taxation with alcohol content therefore strengthens policy coherence by linking the tax burden directly to the source of harm. In the Karnataka context, applying earlier estimates of alcohol-related social costs suggests a corrective benchmark of approximately ₹1,542 per litre of pure alcohol, providing a useful long-term reference point for tax design.

**However, the transition toward such a framework requires careful calibration. Karnataka’s consumption patterns are concentrated in lower and mid-price segments, and abrupt increases in taxation could lead to sharp retail price adjustments. This may impose disproportionate burdens on certain consumer groups and, more importantly, create incentives for substitution toward illicit or unregulated alcohol. A sudden shift may also disrupt legitimate market operations, affecting supply chains and compliance behaviour.**

**For these reasons, a gradual glide path is critical to effective reform. Phased adjustments in tax rates allow consumers, producers, and regulators to adapt incrementally to the new pricing structure. Such an approach reduces the risk of demand shocks, limits the expansion of illicit markets, and provides time to strengthen enforcement systems and monitoring mechanisms. It also enables policymakers to assess behavioral responses at each stage and recalibrate policy where necessary.**

**Over time, a calibrated transition toward AIB-based taxation can improve the alignment between excise policy and public health objectives while maintaining revenue stability. In the longer term, this approach can be complemented by a more market-oriented pricing framework in which Excise Duty (ED) is uniformly linked to alcohol content, and Additional Excise Duty (AED) serves as a supplementary instrument rather than the primary determinant of product pricing. This would simplify the regulatory structure, reduce administrative intervention in pricing decisions, and allow taxation to more effectively reflect the underlying risks associated with alcohol consumption**

## Proposed Excise Duty and AED Structure

Building on the principle that taxation should be aligned with alcohol content, the proposed reform seeks to rationalize the existing excise structure while improving both economic efficiency and administrative simplicity. The framework retains a uniform Excise Duty (ED) linked directly to alcohol content, thereby ensuring that the core component of taxation reflects the underlying source of harm. This is complemented by a redesigned Additional Excise Duty (AED) structure that simplifies the existing price-based framework.

A key feature of the proposed reform is the reduction in the number of ex-factory price slabs for Indian Made Foreign Liquor (IMFL) from sixteen to eight. The earlier slab structure created excessive fragmentation, with multiple narrow price bands that enabled manufacturers to strategically position products just below slab thresholds. This practice allowed firms to reduce tax liability through marginal price adjustments, without any corresponding change in alcohol content or product quality. Such behaviour weakened the integrity of the tax system by introducing distortions in pricing decisions and undermining the principle of neutrality.

The consolidation into eight broader slabs addresses these distortions by reducing the scope for slab arbitrage. Wider price bands limit the feasibility of minor price manipulation aimed at tax minimization, thereby ensuring that pricing strategies are driven more by market considerations than by tax design. This improves the alignment between product positioning and consumer preferences, while reinforcing the consistency of price signals across the market.

From an administrative perspective, the simplified slab structure enhances transparency and reduces compliance complexity. Fewer slabs lower the need for frequent classification decisions and reduce disputes arising from marginal price variations. This, in turn, decreases the regulatory burden on both industry participants and the excise administration. The revised framework also improves predictability in tax liability, facilitating better planning for manufacturers and more stable revenue realization for the State.

Overall, the proposed ED–AED structure represents a calibrated reform that combines a harm- based taxation principle through alcohol-content-linked ED with a streamlined and less distortionary AED framework. By reducing opportunities for tax arbitrage, improving administrative efficiency, and strengthening the coherence of price signals, the revised structure provides a more robust foundation for achieving the dual objectives of revenue generation and public health.

**Table 10.2: Proposed slabs- IML**

| Slab | Ex-factory price slabs |         | ED (₹) | AED (₹) |
|------|------------------------|---------|--------|---------|
| 1    | 0                      | 470     | 1,000  | 50      |
| 2    | 471                    | 520     | 1,000  | 220     |
| 3    | 521                    | 570     | 1,000  | 525     |
| 4    | 571                    | 650     | 1,000  | 750     |
| 5    | 651                    | 750     | 1,000  | 850     |
| 6    | 751                    | 1,300   | 1,000  | 1,150   |
| 7    | 1,301                  | 5,000   | 1,000  | 1,750   |
| 8    | 5,001                  | & above | 1,000  | 3,700   |

A central element of the proposed reform is the retention of a uniform Excise Duty (ED) linked directly to alcohol content, ensuring that the primary tax burden reflects the inherent risk associated with ethanol rather than product branding or price positioning. Within this framework, Additional Excise Duty (AED) is repositioned as a supplementary instrument that enables limited price-based differentiation across market segments without driving the core structure of taxation. The rationalization of AED into a smaller number of broader slabs represents a shift away from the earlier regime of excessive price segmentation. By reducing the number of thresholds, the revised structure curtails opportunities for strategic price adjustments aimed at minimizing tax liability. This enhances the neutrality of the tax system and ensures that product differentiation is shaped more by market dynamics than by tax considerations.

From a fiscal standpoint, the redesigned structure improves revenue predictability by limiting sensitivity to marginal price changes that previously triggered slab shifts. At the same time, it reduces administrative complexity by simplifying classification and lowering the incidence of disputes. Importantly, the framework is consistent with the longer-term transition toward an Alcohol-in-Beverage (AIB) approach, where taxation is anchored primarily in alcohol content, with price-based elements playing a secondary and stabilizing role. Overall, the consolidation of AED slabs marks a movement toward a more coherent excise design—one that strengthens alignment between taxation and harm, reduces distortions in pricing behaviour, and enhances administrative efficiency while maintaining stable revenue flows.

A similar approach is reflected in the restructuring of beer taxation. The proposed framework introduces three broad price bands, within which ED remains linked to alcohol content and AED provide calibrated differentiation across segments. This simplified structure preserves the harm-based foundation of taxation while allowing limited segmentation across product categories. By reducing fragmentation, it improves consistency across beverage types, minimizes classification disputes, and supports a more transparent and predictable tax regime.

**Table 10.3: Proposed slabs- Beer**

| Slab | Ex-factory price slabs | ED (₹) | AED (₹) |
|------|------------------------|--------|---------|
| 1    | 0 to 500               | 1,000  | 800     |
| 2    | 501 to 700             | 1,000  | 1,400   |
| 3    | 701 to above           | 1,000  | 2,700   |

### **Pricing of Beverages under the Revised Excise Structure**

The proposed restructuring of IMFL pricing under the revised excise framework results in a calibrated redistribution of the tax burden across price segments, correcting distortions observed in the earlier regime. In the lower and mid-price categories such as ex-factory price bands between ₹471-520, ₹571-650, and ₹751-900, the revised structure produces moderate retail price increases, broadly in the range of 11 to 20 percent. These adjustments reflect the gradual alignment of taxation toward the targeted per-litre alcohol benchmark, ensuring that mass-consumption segments contribute proportionately to the internalization of alcohol-related externalities. Given that these segments account for the largest share of consumption, such adjustments are necessary to strengthen the corrective function of excise taxation.

In contrast, products in the higher and premium price ranges (₹1,051–1,300 and above) experience moderate price reductions, generally ranging between 2 and 16 percent depending on the slab. These adjustments address the structural imbalance embedded in the previous excise framework, where lower-priced products were effectively under-taxed relative to alcohol content, while premium segments carried a disproportionately high Additional Excise Duty burden unrelated to their alcohol intensity. By moderating the tax load on premium segments, the revised system reduces this distortion and improves horizontal equity across product categories, ensuring that tax incidence reflects alcohol strength rather than price positioning.

The net effect is a rebalancing of the IMFL pricing structure toward a more harm-aligned taxation framework. Lower and mid-priced segments move closer to the effective tax levels implied by social cost estimates, while premium segments are rationalized to reflect alcohol content more accurately. Importantly, the adjustments are graduated rather than abrupt, allowing price changes to be absorbed progressively across the market. This reduces the likelihood of sudden demand shocks, substitution toward illicit products, or significant disruption in consumption patterns.

From a policy perspective, the revised structure enhances the internal coherence of the excise system. The uniform Excise Duty linked to alcohol content establishes the core harm-based taxation principle, while the Additional Excise Duty operates as a transitional instrument that smooths price adjustments across segments. This dual structure corrects earlier tax inversions, improves transparency in the tax framework, and maintains administrative simplicity. At the same time, the calibrated nature of the price changes supports revenue stability and market continuity, ensuring that the transition toward a more rational excise framework does not undermine fiscal performance or regulatory effectiveness.

Taken together, the overall pricing pattern indicates a rationalization of price bands rather than an across-the-board escalation in retail prices. The revised framework moderates price increases in lower-end segments where consumption volumes are concentrated, while correcting instances of over-taxation in certain premium categories. By addressing these imbalances, the reform reduces distortions created by the earlier tax structure and improves alignment between taxation and alcohol content. From a policy perspective, this outcome supports a gradual transition toward a more coherent, alcohol-content-linked excise framework, while maintaining market stability and minimizing the risk of abrupt consumer disruption.

**An important policy concern in excise reform is whether revised taxation alters a state's relative price competitiveness and thereby encourages cross-border purchases. The inter-state comparison of Maximum Retail Prices (MRPs) for 180 ml IMFL bottles indicates that, even after the proposed revisions, Karnataka's pricing remains broadly within the regional price band and, in several cases, below neighboring states. In the entry-level segment (₹0–470 DP slab), the revised Karnataka MRP of ₹95 remains substantially lower than Maharashtra (₹175), Tamil Nadu (₹140), and Kerala (₹160), and also below Telangana (₹110). This indicates that the modest price adjustments in lower segments do not significantly alter affordability relative to neighboring markets, thereby limiting incentives for cross-border purchases in the mass-consumption category.**

In the mid-range segments (₹571-900 DP slabs), Karnataka's revised MRPs ranging from ₹155 to ₹205 remain broadly aligned with or lower than those observed in neighbouring states. For example, in the ₹571-650 slab, Karnataka's revised price of ₹155 compares favourably with Andhra Pradesh (₹160), Telangana (₹190), Maharashtra (₹205), and Kerala (₹200). Similar patterns are observed across adjoining slabs, suggesting that the rationalization of duties has not resulted in an excessive price premium for Karnataka products relative to competing state markets. Maintaining parity in these mid-range segments is particularly important because they represent a large share of overall consumption.

In the premium and super-premium segments (above ₹1,300 DP slabs), Karnataka's revised MRPs remain competitive and, in several cases, lower than prices in neighbouring states. For instance, in the ₹12,501-15,000 slab, the revised Karnataka MRP of ₹750 remains below Andhra Pradesh (₹980) and Maharashtra (₹850). Even in the highest price band (₹20,001 and above), Karnataka's revised price of ₹980 is significantly lower than Kerala (₹2,295) and Andhra Pradesh (₹1,315), and remains below Telangana (₹1,150). These comparisons indicate that the proposed excise adjustments do not materially erode Karnataka's competitive positioning in premium segments.

Overall, the comparative evidence suggests that the revised excise framework corrects internal distortions in taxation without creating adverse inter-state price differentials. Karnataka's prices remain broadly within the regional range across most consumption categories, thereby reducing the risk of cross-border arbitrage while preserving revenue adequacy. From a policy standpoint, the revised structure strengthens the internal logic of taxation by aligning it more closely with alcohol content and social cost considerations, while maintaining regional competitiveness and market stability.

In the case of beer, prices in the mainstream premium segment remain moderate and regionally competitive even after the revision. Strong variants in this segment are priced at around ₹180, broadly comparable to neighbouring states such as Telangana (₹190) and Maharashtra (₹195). Premium mild variants, priced at approximately ₹145-₹150, continue to remain significantly lower than corresponding prices in Maharashtra (around ₹190-₹200) and Telangana (around ₹180). These comparisons suggest that the revised pricing structure preserves Karnataka's competitiveness in core urban consumption categories, where demand is relatively strong and brand-sensitive.

In the higher premium and imported beer segment, Karnataka's revised prices remain regionally aligned or lower in several cases. Premium lager variants priced at around ₹200-₹205 are lower than comparable offerings in Telangana (around ₹250) and Andhra Pradesh (around ₹220-₹270). Similarly, select international premium variants priced at approximately ₹220 remain significantly below Telangana (around ₹270). Even in premium strong beer categories, with prices around ₹265, Karnataka's pricing remains broadly comparable to neighbouring markets and is not materially higher.

Taken together, the inter-state comparison indicates that the revised beer pricing framework corrects internal distortions without weakening Karnataka's regional competitiveness. Across both mass and premium segments, the state's prices remain within the prevailing regional band, thereby reducing incentives for cross-border arbitrage. The evidence suggests that the proposed recalibration achieves internal rationalization of taxation while preserving market stability and revenue integrity within the regional competitive environment.

## Policy Implications

The preceding analysis of the revised excise structure, pricing adjustments, and inter-state comparisons yields several important policy implications for Karnataka's alcohol taxation framework. **First, the proposed reforms demonstrate that it is possible to correct structural distortions in the excise system without undermining regional price competitiveness.** By aligning taxation more closely with alcohol content and rationalizing the Additional Excise Duty (AED) structure, the revised framework strengthens the internal logic of the tax system while maintaining prices broadly within the range observed in neighbouring states. This balance is critical to preserving the State's tax base and limiting incentives for cross-border purchases.

**Second, the restructuring of price bands and excise components highlights the importance of harm-aligned taxation.** The earlier structure resulted in an inversion where certain lower-priced, higher-alcohol products faced relatively lower taxation per litre of alcohol compared to other categories. The revised framework partially corrects this imbalance by increasing the contribution of mass-consumption segments toward the internalisation of alcohol-related social costs, while moderating excessive taxation in select premium categories. Such an approach improves horizontal equity across product segments and strengthens the corrective role of excise taxation.

**Third, the inter-state price comparison underscores the importance of maintaining regional parity in alcohol pricing.** Large price differentials between neighbouring states can encourage cross-border procurement, illicit trade, and revenue leakage. The evidence presented indicates that the revised structure keeps Karnataka within the prevailing regional price band across both IMFL and beer segments. Sustaining this parity should remain a key consideration in future excise revisions, particularly in border districts where price sensitivity is higher.

**Fourth, the calibrated nature of the price adjustments demonstrates the value of gradual and predictable tax reforms.** Moderate and differentiated price changes help avoid sudden shocks to consumers and producers, thereby reducing the risk of market disruption or shifts toward unregulated alcohol markets. A phased approach to excise rationalization is therefore preferable to abrupt increases in duty rates, particularly in a market where consumption is concentrated in lower-priced segments.

**Fifth, the analysis suggests that excise policy should increasingly move toward a simplified and transparent tax structure anchored in alcohol content.** Linking the core excise duty to alcohol strength while using a limited number of AED slabs for price differentiation can improve administrative efficiency, reduce opportunities for tax arbitrage, and enhance predictability for producers and retailers. Such a system also aligns Karnataka's taxation framework more closely with internationally recognized principles of alcohol taxation.

**Finally, the broader policy implication is that excise taxation should be viewed not solely as a revenue instrument but as part of a comprehensive alcohol policy framework.** While the State relies heavily on alcohol revenue, the earlier chapters have demonstrated that alcohol consumption also generates measurable social and economic costs. A rational excise framework should therefore aim to balance revenue mobilization, market stability, and harm reduction objectives. This requires continuous monitoring of consumption patterns, price competitiveness, and social impacts, ensuring that excise policy evolves in a manner that supports both fiscal sustainability and broader public welfare objectives.

## CHAPTER 11

### MODERNISING LIQUOR DISTRIBUTION

**The structure of liquor distribution in Karnataka remains anchored in a quota-based, control-oriented model that restricts market entry and relies heavily on administrative allocation.** While this framework has historically supported regulatory control, it also shapes market outcomes in ways that are increasingly inconsistent with efficiency, transparency, and consumer access. In particular, restrictions on entry and location create localized supply constraints, which influence pricing, availability, and the incentives for informal market activity.

**This section focuses specifically on the distribution architecture, examining how market access, retail structure, and oversight mechanisms can be redesigned to improve efficiency and compliance outcomes without compromising regulatory objectives.** A modernized distribution framework must address not only the overall structure of licensing and market access, but also the specific questions of where alcohol may be sold and how it may be accessed in an increasingly digital economy.

#### Market Access: From Quota-Based Licensing to Registration

The defining feature of the current system is the use of quantitative restrictions on retail outlets. By limiting the number of licenses in a given area, the system creates localized concentration of supply, often resulting in higher retail margins and uneven geographic access. These effects are particularly pronounced in rapidly expanding urban and peri-urban areas, where demand growth outpaces the rigid structure of licensing.

A more efficient alternative is a registration-based framework, under which entry is governed by objective eligibility criteria rather than numerical caps. In such a system, the role of the State shifts from determining the number of outlets to defining the conditions under which they may operate. This change removes the scarcity premium associated with licenses and aligns market entry with transparent regulatory standards.

This framework can be operationalized through a “negative list” zoning approach. Under this approach, the State specifies locations in which alcohol sales are not permitted such as areas near schools, hospitals, or other sensitive public institutions while leaving all other areas open to entry subject to compliance with applicable rules. By doing so, the system replaces administrative allocation with rule-based exclusion. The resulting structure reduces concentration arising from license scarcity, improves the alignment of supply with local demand conditions, and allows market forces to determine the appropriate number and location of outlets. At the same time, zoning restrictions and compliance requirements ensure that expansion occurs within socially acceptable boundaries.

## Spatial Regulation of Retail Vends: Toward Evidence-Based Zoning

The regulation of retail liquor vend locations should move beyond a purely restrictive framework toward a more structured and evidence-based spatial model. At present, Karnataka largely relies on distance-based prohibitions, population-linked license caps, and administrative discretion to regulate where alcohol may be sold. This approach has legal clarity and administrative familiarity, but it remains fundamentally negative in design: it identifies where shops cannot be located, without developing a systematic framework for where they should be located in the public interest.

The current framework is built around three main instruments. The first is a system of distance-based prohibitions, under which outlets cannot ordinarily be located within prescribed distances of educational institutions, places of worship, hospitals, and certain other sensitive locations. The second is a population-based cap on licenses, with broad norms differentiated between urban and rural areas. The third is administrative discretion, which permits authorities to refuse licenses even when formal criteria are satisfied, on grounds such as public order, morality, or local objections. In practice, these three elements interact to produce a pattern in which outlets cluster in commercially active areas, not because the law explicitly plans for such an outcome, but because those locations are the most likely to survive the cumulative effect of prohibitions and scrutiny.

The limitations of this framework are increasingly evident. Population-based ratios are at best a rough proxy for access and demand, and do not adequately reflect differences in settlement patterns, mobility, or local exposure. Uniform distance rules do not distinguish between dense urban corridors and sparsely populated rural settings. The current system also lacks any explicit control over outlet density and clustering, even though international evidence consistently shows that concentration of outlets in a locality is associated with higher risks of violence, traffic incidents, and harmful consumption. Equally important, the framework does not formally integrate alcohol retail regulation with land-use planning. What exists today is, in effect, an implicit zoning logic without explicit planning criteria.

A more modern approach would regulate retail availability through spatial planning criteria grounded in evidence rather than through prohibitions alone. Such a framework should include explicit control of outlet density within defined geographic areas, minimum spacing between outlets to prevent clustering, formal land-use criteria restricting outlets primarily to commercial or mixed-use zones, and buffer distances around sensitive institutions that are calibrated to actual exposure risk rather than uniform geometry. It should also differentiate more clearly between urban and rural conditions and allow licensing authorities to take cumulative impact into account in areas already experiencing high concentration of outlets or alcohol-related harm.

For Karnataka, this implies a transition from negative zoning to structured spatial regulation. Such a reform would not eliminate existing safeguards; rather, it would place them within a more coherent framework that links location decisions to public health, urban planning, and regulatory efficiency. Over time, this would allow the State to move toward a system in which retail access is better aligned with both market realities and social objectives.

## **Distribution Efficiency and Market Outcomes**

The structure of distribution has direct implications for both pricing and compliance. Where access is restricted, consumers may face higher effective prices and limited availability, particularly outside major urban centers. In such contexts, informal supply channels may emerge to address gaps in availability, often operating outside regulatory oversight.

A more open and responsive distribution system improves availability by allowing legal supply to expand into underserved areas. As entry barriers are reduced, the cost structure of retail operations adjusts, moderating margins and bringing prices closer to underlying cost conditions. Increased competition also enhances market transparency, reducing the incentives for retailers to rely on informal or non-compliant sourcing.

These improvements in distribution efficiency complement broader policy objectives by strengthening the competitiveness of legal supply channels. When legal markets are accessible, competitively priced, and reliably supplied, the relative attractiveness of informal markets diminishes, supporting both compliance and consumer protection.

## **Regulated Online Sale of Liquor as a Complement to Retail Reform**

The modernization of alcohol distribution policy should also consider the case for regulated online sale and home delivery of liquor as a controlled extension of the licensed retail system. The question is no longer only where alcohol may be sold, but also how it may be accessed in a digital economy. Experience from several Indian states and international jurisdictions shows that online sale of liquor, when tightly regulated, need not amount to deregulation. Rather, it can function as a more transparent, traceable, and administratively manageable extension of the existing excise framework.

A regulated online system offers several potential advantages. First, it creates a digital record of every transaction, improving traceability and reducing opportunities for tax leakage and informal diversion. Second, it can reduce congestion and public order concerns around physical retail outlets, particularly in large urban centres. Third, where legal physical access is constrained, a regulated online channel may reduce reliance on informal or unlicensed supply. Fourth, digital systems can support stronger age verification and quantity controls through identity checks at both the ordering and delivery stages. These features make online sale potentially more auditable than purely cash-based physical retail.

At the same time, online sale raises genuine risks, particularly in relation to underage access, excessive convenience, and the possibility of unlicensed intermediaries. For that reason, any move in this direction should be tightly designed. Online sale should be permitted only through licensed vendors or authorized platforms operating within the excise system. It should be integrated with registration, digital payment, age verification, delivery verification, quantity restrictions, and track-and-trace systems. In this sense, online sale should not be viewed as a parallel market, but as a controlled digital extension of licensed retail.

For Karnataka, regulated online sale could be considered as part of a broader modernization strategy for the distribution system, especially in urban areas where congestion, travel time, and enforcement challenges are significant. It should complement, not substitute for, a coherent spatial policy for physical retail outlets. Properly designed, such a model would be consistent with the broader shift recommended in this report from a control-oriented system based on manual supervision toward a modern regulatory framework based on digital compliance, traceability, and risk-based oversight.

## **Digital Oversight of the Supply Chain**

These considerations reinforce the broader case for moving from a control-oriented distribution regime to a modern framework based on liberalized entry, clearly defined regulatory safeguards, and digital compliance systems. A liberalized distribution framework must therefore be supported by robust digital oversight mechanisms. As regulatory systems move away from physical supervision, monitoring must rely increasingly on data-driven tools that provide visibility across the supply chain.

This can be achieved through the adoption of unit-level product identification, where each bottle is assigned a unique digital code at the point of production. As products move through the supply chain—from manufacturer to wholesale to retail these identifiers are recorded through digital scanning, creating a continuous and verifiable record of movement.

In parallel, transaction-level reporting systems can capture sales data at the retail level and integrate it into centralized databases. This enables regulators to track inventory flows, detect inconsistencies, and identify patterns that may indicate non-compliance.

The objective of such systems is not to replicate physical controls in digital form, but to enable traceability, auditability, and targeted enforcement. By shifting from manual inspection to data-based monitoring, the State can improve oversight while reducing administrative burden.

## **Compliance and Enforcement in a Liberalized Framework**

A shift in distribution policy requires a corresponding shift in enforcement strategy. In a system with broader market access, compliance cannot rely primarily on restrictions at the entry stage. Instead, enforcement must be based on clearly defined operational rules and credible consequences for violations.

Under this approach, regulatory standards such as restrictions on sales to minors, prescribed operating hours, and storage conditions are clearly specified and uniformly applied. Compliance is monitored through a combination of digital reporting and targeted inspections, allowing enforcement efforts to focus on higher-risk areas.

Penalties play a central role in this framework. Where violations occur, enforcement actions must be timely and proportionate, with serious breaches resulting in suspension or cancellation of registration. This creates a system in which compliance is maintained not through constant supervision, but through the predictability and credibility of enforcement.

## Safeguards Against Market Concentration and Abuse

Liberalization must be accompanied by safeguards to preserve competition and regulatory integrity. Without such safeguards, there is a risk that market concentration could re-emerge, potentially undermining the benefits of expanded entry.

Appropriate measures include limits on the share of retail outlets that may be controlled by a single entity or related group within a defined market area. This prevents excessive concentration and supports a competitive retail environment. In addition, transparent ownership disclosure requirements can enhance accountability and reduce the scope for indirect control or regulatory circumvention.

Financial safeguards also play an important role. Requiring registrants to maintain performance guarantees or security deposits ensures that penalties can be enforced effectively, reducing reliance on prolonged legal processes. Together, these measures create a framework in which liberalization is balanced by clear and enforceable safeguards.

## Policy Direction and Transition

The direction of reform in alcohol distribution both internationally and within parts of India is gradually shifting toward greater reliance on market mechanisms supported by digital regulation. Advances in technology have made it increasingly feasible to monitor supply chains and enforce compliance without relying on extensive physical controls.

In this context, Karnataka may consider a phased transition over a 3–5-year horizon, moving from a quota-based licensing system toward a registration-based framework supported by digital oversight. Such a transition can begin with pilot implementation in selected districts, allowing for testing of systems and refinement of operational procedures before wider rollout.

This analysis points to the broader direction of reform in Karnataka's liquor distribution system. The core shift required is from a framework based primarily on quantitative restriction and administrative control to one based on transparent rules, structured market access, and technology-enabled oversight. Such a transition would allow regulatory objectives to be pursued through better design and stronger monitoring rather than through rigid entry barriers and manual supervision.

**The policy implications for Karnataka's distribution system are therefore substantial. Over time, the State should move from a quota-based and control-oriented retail structure toward a more liberalized framework based on registration, structured zoning, objective eligibility criteria, digital oversight, and credible ex post enforcement. This should include a gradual transition over a 3–5-year horizon, supported by safeguards against market concentration, clear operational rules, fit-and-proper requirements, and technology-enabled compliance systems. Regulated online sale may also be considered as a controlled extension of licensed retail were supported by robust age verification, delivery authentication, digital payment systems, and end- to-end traceability. A more open and efficiently regulated distribution framework would not only improve availability and reduce economic rents but would also strengthen legal market channels and improve the fiscal performance of the alcohol tax system.** The detailed distribution reform recommendations are consolidated in Section 12. The next section turns to the fiscal role and revenue dynamics of the current regime, and the implications of tax design for revenue performance, neutrality, and long-term reform.

## CHAPTER 12

### MAJOR ADMINISTRATIVE AND REGULATORY RECOMMENDATIONS

The effectiveness of alcohol policy in Karnataka depends not only on the structure of taxation but also on the efficiency and coherence of the administrative and regulatory framework that supports it. The preceding analysis has highlighted several operational constraints within the current system, including reliance on manual supervision, multiple layers of approvals, fragmented institutional responsibilities, and limited use of modern monitoring technologies. While these arrangements have historically evolved to ensure control and revenue protection, they now impose significant compliance costs, create administrative inefficiencies, and are not fully aligned with contemporary regulatory practices.

The recommendations that follow seek to modernize the excise administration by shifting from a control-oriented, inspection-heavy approach to a system that is risk-based, technology-driven, and facilitative in nature. The emphasis is on reducing unnecessary physical interfaces, simplifying procedures, and leveraging digital systems to enhance transparency, traceability, and real-time oversight. At the same time, the proposed measures aim to strengthen enforcement by improving data availability and minimizing opportunities for discretion and leakage.

A key objective of this reform framework is to improve ease of doing business for legitimate industry participants while maintaining robust regulatory control. This involves rationalizing legacy practices such as on-site staff deployment and escort requirements, streamlining licensing and approval processes, and enabling greater operational flexibility through mechanisms such as self-removal procedures and extended working hours. In parallel, the framework introduces modern tools including digital tracking systems, electronic locks, and pilot blockchain-based traceability to strengthen supply chain integrity.

The recommendations also recognize the need for clearer institutional alignment. In particular, the separation of revenue functions from public health objectives is essential to ensure that each is pursued effectively within an appropriate policy framework. Strengthening coordination across departments, while assigning dedicated responsibility for health-related interventions, will improve policy coherence and long-term outcomes. Given the scale and complexity of the sector, these reforms are designed to be implemented in a phased and calibrated manner. This approach allows for institutional adaptation, capacity building, and system testing, while minimizing disruption to industry operations and revenue flows. Collectively, the measures outlined in this section seek to create a more efficient, transparent, and future-ready excise administration that is better aligned with both economic and public welfare objectives.

## **1. Rationalization of On-Site Excise Staff Deployment:**

The current practice of deploying full-time excise personnel within manufacturing units should be gradually phased out, with a target of complete withdrawal by 31 March 2027. While such arrangements were historically intended to ensure compliance, they are increasingly inconsistent with modern regulatory practices. Transitioning away from on-site supervision toward risk-based and technology-enabled monitoring would reduce administrative overhead, minimise discretion at the operational level, and improve ease of doing business without compromising regulatory oversight.

## **2. Abolition of Escort Requirements for Dispatches:**

The requirement for physical excise escorts during the dispatch of alcohol from manufacturing facilities should be discontinued. Advances in digital tracking, electronic permitting systems, and real-time monitoring technologies make such practices redundant. Removing escort requirements would reduce logistical delays, lower transaction costs for manufacturers, and streamline supply chain operations, while oversight can be maintained through technology- driven verification systems.

## **3. Implementation of Self Removal Procedure (SRP)**

A Self Removal Procedure (SRP) should be introduced, beginning with wineries and subsequently extended to other segments where feasible. Under SRP, manufacturers would be permitted to remove goods from bonded premises based on self-assessment, subject to defined compliance norms and audit mechanisms. This approach reduces procedural delays, enhances operational flexibility, and aligns with modern excise practices followed in several jurisdictions, while retaining regulatory control through post-clearance verification.

## **4. Transition to Technology-Based Monitoring Systems**

The excise administration should shift from manual, inspection-based controls to technology- driven monitoring systems. This includes the use of digital platforms for production reporting, inventory tracking, movement permits, and compliance verification. Such systems can improve transparency, reduce opportunities for revenue leakage, and enable real-time data-driven oversight. Over time, this transition would allow for a more efficient and less intrusive regulatory framework.

## **5. Introduction of Appropriate Technology (Pilot)**

A pilot project may be initiated to deploy appropriate technology in alcohol supply chains to enable end-to-end visibility of product movement from manufacturing to retail, reduce the risk of diversion into illicit channels, and strengthen enforcement capabilities. A pilot approach allows for testing feasibility, assessing costs, and refining the system before wider rollout.

## **6. Reduction in Administrative Touchpoints and Streamlining of Approvals**

The existing approval framework should be rationalized to reduce the number of administrative touchpoints. Decision-making authority for routine operational approvals may be consolidated and vested in designated officers at the unit or district level. Simplifying approval hierarchies would reduce delays, improve accountability, and enhance administrative efficiency, while maintaining necessary regulatory safeguards.

## **7. Simplification of Licence Renewal through Online Payment**

The current system of periodic renewal of manufacturing licences may be simplified by replacing approval-based renewal processes with an online fee payment mechanism. Under this approach, licences would remain valid subject to timely payment of prescribed fees and continued compliance with regulatory conditions. This would reduce administrative burden, eliminate procedural delays, and improve ease of doing business while maintaining regulatory oversight.

## **8. Abolition of Warehouse Rent on Distillery-Owned Premises**

The levy of rent on warehouses located within premises owned by distilleries may be discontinued. Since such facilities are already part of the manufacturer's infrastructure, the imposition of additional rental charges creates unnecessary financial and administrative burdens without clear regulatory justification. Removing this requirement would streamline operations and reduce compliance costs.

## **9. Permission for Storage of Unlabeled Wine Bottles**

Wineries may be permitted to store unlabeled wine bottles within bonded premises, subject to appropriate inventory controls and traceability requirements. This would provide greater operational flexibility, particularly in managing production cycles, seasonal demand, and export requirements, while ensuring that labelling compliance is enforced prior to market release.

## **10. Allowing 24-Hour Operations for Manufacturing Units**

Distilleries and breweries should be permitted to operate on a 24-hour basis, including production and dispatch activities, subject to compliance with safety and regulatory standards. This would improve capacity utilization, enhance supply chain efficiency, and align industry operations with modern manufacturing practices.

## **11. Standardization of Label Specifications and Security Features**

Clear guidelines should be issued to standardize label formats and incorporate appropriate security features. Standardization would improve regulatory clarity, reduce approval delays, and strengthen safeguards against counterfeiting and illicit trade, while providing consistency across product categories.

## **12. Discontinuation of Label Registration Process**

The existing process of label registration may be discontinued, with compliance ensured through standardized guidelines and post-market verification. This would eliminate repetitive approval procedures, reduce administrative bottlenecks, and facilitate faster product introduction in the market.

## **13. Introduction of an Electronic Lock (*E-Lock*) System for Transport Monitoring**

A digital E-lock system should be introduced for monitoring the transportation of alcohol. These tamper-evident electronic locks can be affixed to vehicle cargo doors and integrated with tracking systems, allowing real-time monitoring and remote verification of consignments. The use of E-locks would strengthen supply chain security, reduce the need for physical supervision such as escorts, and enhance the effectiveness of enforcement mechanisms.

## **14. Separation of Revenue and Public Health Functions**

The roles of revenue generation and public health intervention within alcohol policy should be clearly delineated. The Excise and Finance Departments may continue to focus on revenue optimization, regulatory compliance, and efficient tax administration, while responsibility for promoting responsible consumption and addressing alcohol-related harms should be anchored in a dedicated institutional framework within the Department of Health and Family Welfare, Government of Karnataka.

The report recommends a legislated allocation from excise revenue toward four priority areas – de-addiction and mental health services, road safety, domestic violence prevention, and youth education – drawing on Thailand’s Health Promotion Foundation model. It also proposes a standing technical review committee to periodically reassess the social cost benchmark using Karnataka-specific evidence and monitoring of illicit trade, ensuring the reform evolves over time.

## **15. Alignment with Public Health Policy Models**

This approach would be consistent with institutional arrangements followed at the national level, particularly in the regulation of tobacco, where taxation and public health interventions are handled through distinct but coordinated frameworks. Adopting a similar model for alcohol policy would enable more effective integration of behavioural interventions, treatment services, and awareness programs within the broader health system.

## **16. Mandatory Health Warnings on Alcohol Labels**

Alcohol product labels should incorporate mandatory health and temperance advisories, similar in principle to warnings used in tobacco regulation. Standardized messaging on risks associated with alcohol consumption including health impacts and social consequences can serve as an important behavioral intervention tool, complementing price-based measures.

## 17. Earmarking of Excise Revenue for Social Cost Mitigation

A defined proportion of excise revenue may be earmarked for addressing the social and economic costs associated with alcohol consumption. Such funds could support public health initiatives, awareness campaigns, treatment and rehabilitation services, road safety programs, and community-level interventions. Earmarking would strengthen the link between revenue generation and social responsibility, ensuring that a portion of excise collections is reinvested in mitigating alcohol-related harm.

### Conclusion

The administrative and regulatory reforms outlined above represent a shift toward a more modern, efficient, and balanced excise framework in Karnataka. By reducing procedural complexity, minimizing physical interfaces, and leveraging technology-driven systems, the proposed measures aim to improve both regulatory effectiveness and ease of doing business. At the same time, they strengthen oversight through better data, enhanced traceability, and risk-based monitoring, thereby safeguarding revenue and reducing the scope for evasion and illicit activity.

A central feature of this approach is the move away from legacy control mechanisms toward a facilitative and compliance-oriented system. Rationalizing on-site supervision, eliminating redundant processes such as escorts and repetitive approvals, and introducing self-assessment mechanisms are expected to significantly improve operational efficiency without compromising regulatory objectives. The integration of digital tools including real-time tracking, electronic locks, and pilot traceability systems further reinforces the shift toward a transparent and accountable regulatory environment.

Equally important is the recognition that alcohol policy must address both fiscal and public health objectives through appropriate institutional design. The proposed separation of revenue and health functions, along with measures such as mandatory health warnings and earmarking of resources for social cost mitigation, provides a more coherent framework for addressing alcohol-related harms alongside revenue considerations.

Given the scale and complexity of the sector, the success of these reforms will depend on careful sequencing, institutional capacity, and continuous monitoring. A phased implementation strategy allows for learning, adaptation, and refinement, ensuring that reforms remain responsive to ground realities while advancing long-term policy goals.

In sum, the recommended reforms seek to create an excise system that is administratively streamlined, technologically enabled, fiscally robust, and better aligned with broader economic and social objectives

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