



Bringing the Northern High Tax Member States into the Single Market



Foreword by the President

The creation of the single market has been one of the great achievements of the European Union but the task is not yet finished. In 1992, when legislation was adopted by the Council to sweep away internal fiscal frontiers on 1 January 1993, it was decided to allow market forces to moderate high excise duties on beer, wine and spirits applied in the Northern Member States. The response of those governments has been to seek ways of reducing the impact of those market forces, preventing European citizens from enjoying the full benefits of the single market, as well as creating enormous distortions of trade and competition by maintaining very high excise duty rates.

The European Commission has recognised that the situation is unsustainable and has brought forward appropriate proposals. The Brewers of Europe call upon the governments of the Northern Member States to give them their full support.

Brussels, November 2004



Piero Perron
President



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The Brewers of Europe is the voice of the European brewing industry to the European institutions and international organisations. Its current members are the national brewing associations of 21 European Countries.



1. Beer Excise and the Single Market

Article 14(2) EC Treaty provides that the single market "shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty". But the beer market in the EU is massively distorted. Very high taxes in Northern Member States, Finland, Sweden, Denmark, Ireland and the UK deter consumers from purchasing beer in their own countries in favour of buying from countries with moderate taxation. Some Member States attempt to retain fiscal border controls. For these reasons these Member States remain outside the single market as beer is concerned.

Before these countries joined the EU their high taxes led to a limited amount of cross border purchase and smuggling, but this was easy to control through vigorous border checks. The European legislation, intended to introduce the single market on 1 January 1993, was hotly contested by the UK and Denmark, who used their veto to negotiate for the right to maintain effective border controls. Even stronger, though temporary, rights were negotiated by Sweden and Finland on their accession to the EU in 1995. The ending, on 1 January 2004, of the special derogations given to Sweden and Finland has weakened border controls and the UK is facing legal action from the European Commission for using illegal methods to prevent imports.

The situation in some Member States is already extreme. Personal imports and smuggling account for 33% of the consumption of normal strength beer in Sweden¹. 23% to 29% of the beer drunk in Denmark is bought in Germany just over the border. The fact that it is Danish, not German, beer demonstrates that the retail outlet is selected by tax rate, not brand. No market distortion could be clearer. In the UK, despite the maintenance of aggressive, and potentially illegal, border controls cross border shopping and smuggling of beer accounts for a volume equal to the total production of Norway. This situation is already unsustainable and is worsening.

The European Commission is currently proposing legislative changes to reflect the free movement principles of the single market. This would make it much more difficult for Governments to restrict cross border purchasing.

¹ Swedes also drink weak beer < 3.5% alcohol by volume which is allowed to be sold by ordinary stores. Normal beer can only be sold in the Systembolaget (State Monopoly).

Some Northern Member States have traditionally justified high taxes by reference to health and social policies. They suggest that high excise rates reduce alcohol misuse. There is no evidence to support this². Crucially, high excise rates are potentially harmful when consumers have access to cheaper beer, wines or spirits purchased or smuggled from other countries. National laws controlling sales to young people cannot apply to cross border purchases or smuggling.

THE CONFLICT BETWEEN THE EC TREATY AND THE POLICIES OF SOME NATIONAL GOVERNMENTS

The brewing industry and retailers of beer are being damaged by conflicts between the principles of the EC Treaty and the distortive taxation policies of national Governments, and must demand a solution. Not to do so would risk damage to the European economy, the brewing industry, retailers in Northern Member States, national popular culture and, most importantly, consumers.

The principles and objectives of the EC Treaty are clear and are supported by all Governments in the new enlarged EU. The Treaty promotes free markets, the free movement of goods across national borders and the principle of free and undistorted competition. These concepts are the foundation of the single market and the bedrock of political stability in Europe. The Treaty requires Member States to promote its objectives and do nothing to jeopardise their attainment. In this respect, European Law has supremacy over all national laws. Unless this was so, the benefits of the single market could not be realised.

Problems of trade distortion were foreseen in the original Treaty of Rome, which requires the Commission and the Council of Ministers to deal, by legislation, with any such distortions. In technical terms, indirect taxation (VAT and excise) has always been a Community, rather than purely national, competence. VAT itself is a tax introduced at EU level. All Member States are obliged to adopt it. It is doubly important because it relates to Member States' contributions to EU finances.

The founding fathers recognised that very high indirect taxation, be it VAT or excise duty, would distort trade and competition and would not be compatible with the European Economic Community. But at that time, the six original Member States did not operate high excise tax regimes, and no specific measures were necessary. Potential problems arose initially only on the accession of Denmark and the UK in 1973. Even then, however,

² For the countries such as SF, DK and the UK, according to the Commission Report on Excise Rates, health objectives have become less of an issue in determining duty levels than they may have been in the past. See under "Health Considerations" later in this paper.

high excise rates were still sustainable because the single market was still embryonic. Member States were still permitted to maintain full fiscal border controls to restrict the free movement of excise goods.

This began to change on 1 January 1993, when the single market was finally established. Directive 92/84 EEC³ imposed minimum rates of excise which all Member States were required to charge. No restrictions on the high rates of tax were included. Member States, and notably the UK, argued that it was sufficient to rely on the market forces unleashed by Single Market liberalisation. High Tax Member States would respond to the loss of revenue caused by cross border purchasing by reducing excise rates. Despite relying on that reasoning, certain Northern Member States threatened to use their veto unless consumers were prevented from exploiting their basic rights to purchase across borders. They wanted fiscal frontier controls to be maintained. Another Directive (92/12 EEC)⁴ implied that, to gain the advantage of lower tax rates, a citizen must physically accompany goods over the relevant border. It set out quantitative "indicative limits", for example 110 litres of beer per person, beyond which the excise authorities could ask the consumer to prove that the goods were not held for a commercial purpose.

What has actually ensued has been a battle between citizens and smugglers, on the one hand, and the excise authorities of Northern Member States, on the other. The Commission hopes to put this to an end by stating clearly, in new legislation, what the fundamental rights of the citizen are.

³ Council Directive 92/84/EEC of 19 October 1992 on approximation of the rates of excise duty on alcohol and alcoholic beverages.

⁴ Directive 92/12/EEC on the general arrangements for products subject to excise duty and on the holding, movement and monitoring of such products.



2. The Commission's Rates Report

On 26 May 2004 the European Commission adopted, its second report on the rates of excise duty applied on alcohol and alcoholic beverages.

This report was already 7 years overdue. According to Article 8 of Directive 92/84/EEC, the European Commission is obliged to produce a report on the operation every two years. The first and only previous report was published in 1995, in effect prior to the accession of Sweden and Finland to the EU.

The latest report does not include concrete proposals. The Commission intends to launch a broad debate in the Council, the European Parliament and the Economic and Social Committee. Depending on the outcome of this debate, the Commission will decide whether or not to submit proposals on all or some of the issues raised in the report.

The report plainly concludes that the proper functioning of the single market is disturbed by the high tax rates in some Member States. High rates of excise have led to extensive cross border shopping and substantial loss of sales and tax revenue in Denmark, Sweden, Finland and the UK.

The report states:

"Most Member States agree that the proper functioning of the Single Market requires further rate approximation. However, there is no agreement as to how this should be achieved. High taxing Member States, reporting increases in cross-border shopping, smuggling and commercial fraud due to rate divergences emphasise the need to increase all minimum rates. But many others emphasise that an effort is also required by Member States applying very high rates ..."

The position apparently taken by the high tax Member States is misconceived.

First, the moderate taxing countries have already submitted to compromise. They accepted the imposition of minimum rates in 1992. The high tax countries have never accepted any restraint. Second, any conceivable increase in the minimum rates would have no impact on the trade distortions. The problem is that the high taxes are too high. The high tax countries are simply saying that the moderate taxing countries should help them by adopting similarly high tax rates.

The current minimum rates regime does not prevent the moderate taxing Member States from increasing their own rates in line with inflation. But, if minimum rates are increased by inflation (measured from 1 January 1993), then 7 out of the 25 EU Member States would have to increase their current national excise duty rates for beer (L, D, E, CZ, LT, LV, MT) by up to 24%. Even this would not significantly reduce the gap between the minimum rate and the excessive rates applied by the high taxing countries.

The Report notes that the real value of the minimum rates have been eroded by inflation. It states that "most Member States" are in favour of increasing the minimum rates in line with inflation, but that some countries say that this should not be done unless a real "substantive" minimum rate is introduced for wine (currently at a zero rate). There is already clear tax discrimination against beer and in favour of wine in many countries. This is happening in spite of the European Court of Justice endorsing the principle of competition between beer and wine. Given the plain fact that a substantive minimum rate for wine is most unlikely to be agreed, there can be no justification for increasing the minimum rate for beer. In any event, increasing minimum rates is not a real solution.

HEALTH CONSIDERATIONS

The Commission's report notes that the majority of Member States usually do not take into account health policy considerations when they fix their excise rates for alcoholic drinks. It highlights that, for high tax countries such as Finland, Denmark and the UK, health objectives have become less of an issue in determining duty levels than they may have been in the past. The report identifies Sweden as the only country where health policy plays a significant role when it comes to fixing duty rates.

Governments should not attempt to pursue health objectives in setting excise rates for beer, wine and spirits. First, as mentioned in the Commission's report, the moderate consumption of alcohol can have beneficial effects. Secondly, consumers now have relatively ready access to beer, wine and spirits purchased in Member States with much lower tax rates, and the high taxes cannot therefore constrain consumption.

The brewing industry takes social responsibility extremely seriously and actively supports sensible measures targeted at alcohol misuse. This includes many initiatives undertaken by the industry, and, in particular, support for campaigns against drinking and driving and national programs aimed at protecting the young. But it is beyond question that the illegal sale of smuggled beer, wine or spirits undermines laws forbidding the purchase of alcoholic drinks by underaged persons. The strong incentive to engage in smuggling resulting from the opportunity to evade high taxa-

tion, coupled with the fundamental incompatibility of border controls with the single market, is undermining social policies in high duty countries. This problem is the inevitable consequence of the trade distortion caused by excessive taxation. The fact that the single market demands the free movement of goods, or grants rights to consumers to purchase beer in other Member States, is not, itself a problem.

THE COMMISSION'S APRIL 2004 PROPOSAL ON DISTANCE PURCHASING

The 1992 Directive dealing with the movement of excise goods implied that payment of the high excise duties of the Member State of destination could be avoided only where the purchasing consumer physically accompanies the goods across the border.

The Commission recognizes that this "rule" is inconsistent with the single market, and has now presented a new draft directive. In its accompanying report⁵, the Commission states that its proposals *"are based on some principles as those underlying the present [legislation] namely,*

- *that excise duty must be paid in the Member State of destination when excise products are moved for commercial purposes;*
- *the general principles of the single market, i.e. that excise duty on products moved for non-commercial purposes by private individuals shall always be paid in the Member State where the goods were acquired"*

The Commission's new proposals simply abolish the requirement that the purchaser must accompany the goods across the border. This will make it far more difficult to operate effective border controls and in particular to make practical use of the "indicative limits" (110 litres of beer per person, brought across a border). The proposals would allow "agency traffic" under which one person could buy alcoholic drinks for any number of other people on a non-commercial basis. It would also enable consumers to use commercial carriers, some of whom might begin to specialise in this type of business to ensure that transport costs are fully economic. This means that excise officers at borders would not be able to assume that large loads were smuggled. The proposals on distance purchasing are likely to place increased pressure on the high tax Member States to reduce their rates and achieve the goal of a properly functioning single market.

⁵ Report from the Commission to the European Parliament, the Council and the European Economic and Social Committee (COM (2004) 227) final.



3. Other recent developments

NORDIC DEROGATIONS

When Sweden and Finland joined the EU in 1995, the accession agreements permitted these Member States to enforce strict, and very limited, personal allowances at their borders. The purpose was to allow time for their taxation policy to be adjusted prior to the opening of their borders. These derogations were eventually extended but were finally phased out at the beginning of 2004. Although Finland reduced its beer tax to some extent in March 2004 from an extremely high level both Sweden and Finland still operate very high rates and are exposed to greatly increased levels of cross border activity.

ENLARGEMENT OF THE EU

The accession of 10 new Member States on 1st May 2004 poses a further challenge to Finland and Sweden. Relatively short ferry trips to Estonia are already common but personal imports have been restricted by border controls. Swedes and Finns are now able to bring effectively unlimited quantities of alcoholic drinks from this new moderately taxing Member State.



4. The Scale of Cross Border Purchases and Smuggling of Beer in Denmark, Finland, Norway, Sweden and the UK

CROSS BORDER SHOPPING AND SMUGGLING IN DENMARK, FINLAND, SWEDEN AND THE UK 2003

Proportion of total beer consumption by percentage

DENMARK	FINLAND	SWEDEN	UK	NORWAY
23% to 29%	10%	33% ⁽⁴⁾	4% ⁽⁵⁾	7.3%

For Denmark, 23% to 29% of beer consumed is now purchased over the border with Germany. The source is a report on cross border trade by The Danish Institute of Border Region Studies.

In Finland, 6.6% of beer consumed is purchased mainly in Estonia and the other Baltic countries. This can be increased by a further 3.5% to reflect duty free beer bought on board ship and taken back to Finland. Until accession of Estonia to the EU in May 2004, travellers were restricted to 16 litres of beer.

In Sweden 33% of normal strength (i.e. > 3.5% abv) beer consumed in the country is purchased in Denmark, Germany or the Baltic States. Between 2002 and 2003 beer smuggling to Sweden increased by 49% as the special quantitative restrictions on cross border purchases were phased out. In the last 3 years the Swedish Brewing industry has lost 40% of its capacity, including the recent closure of two breweries, and with it many jobs. Swedish breweries are fighting for their lives as volumes fall and the national beer culture suffers irremediable damage.

A cornerstone of Sweden's alcohol policy has been the **Systembolaget**. This is a state monopoly which controls the sales of alcoholic beverages to consumers.

The Swedish government regards this as an instrument of health and social policy. The Systembolaget is now no longer in a position to fulfil its role. Sweden, as part of the enlarged EU is now surrounded by countries with significantly lower taxes on beer, such as Denmark, Germany and Poland. The result has been extensive cross-border shopping and smuggling which now accounts for more beer than the Systembolaget.

The situation is not sustainable and actually worsening.

Not only does the Swedish state lose tax revenue, but the ready availability of cheap beer outside the Systembolaget totally undermines the laws and regulations governing sale of beer. Half of all Swedes aged 18 and older have purchased alcohol abroad in the first six months of 2004.

Whilst the Swedish government maintains its high duty rates, the Systembolaget can never be an effective system of control.

The proportion of cross border purchasing and smuggling in the UK may appear surprisingly small. The UK is the second largest beer market in the EU and is unusual in its very high proportion of draught beer, which is packaged in large kegs and not, of course, purchased by consumers. But illicit purchases represent 2.5m hectolitres of beer, twice the same quantity as is bought across the German border into Denmark, and is equivalent to the total beer production of Norway.

The smaller proportion reflects the vigorous action taken by the UK authorities to stamp out small scale ("white van") smuggling. In 2000-2001 the customs authorities seized 10,200 vehicles, 200 each week. Customs admit that it is likely there has been an increase in large scale lorries or sea containers, but these are difficult to detect and no estimation of volumes is available, even though research reveals that illegal trade is widespread. In 2001, 46% of 15-17 year olds claimed that they can buy smuggled beer locally.

The Commission's Case against the UK

The UK has operated a successful policy of containment as far as personal imports of beer are concerned. As the European Commission has found⁶ where the goods are "not for profit" the UK customs policy is to seize the goods and any vehicle used to transport the goods. According to the Commission these seizures are disproportionate and represent an obstacle to the free movement of goods. In practice, this policy discourages completely innocent travellers from exercising their single market rights. Most consumers are not wealthy enough to fight the UK government in the courts.

Companies, operating cross channel ferries and Eurotunnel, have also lost income. Hoverspeed, which operates across the English Channel, has recently brought Court proceedings against the UK Government claiming £50m for loss of profit caused by disproportionately harsh methods of border control.

⁶ IP/04/921 dated 15 July 2004

THE SITUATION IS WORSENING

Removal of the Nordic derogations on 1 January 2004 and the accession to the EU of Baltic states on 1 May 2004 had a profound effect on the levels of cross border shopping and smuggling affecting Finland and Sweden. Consumers are entitled to purchase large quantities of beer from Estonia provided it is for their own or family use. The excise authorities may attempt to retaliate by challenging large volumes, but the legality of such controls is uncertain, particularly given the fact that the UK is under investigation for using such tactics. Sweden has not been able to enforce effective controls. Smuggling of beer increased by 66% in the first six months of 2004. For Denmark, cross border shopping for beer has increased markedly in recent years and is now at a very high level accounting for 23% to 29% total beer consumption in Denmark. There is no reason to believe that the trend will not continue.

Norway is not a member of the EU and is therefore still at liberty to maintain border controls for fiscal purposes. The personal allowance for beer is currently only two litres, and even this small allowance applies only where the traveller has stayed outside Norway for at least 24 hours. However, Norway's excise rates are exceptionally high, and cross border shopping is still therefore significant. Purchases from Sweden and Denmark account for over 7% of beer consumption. Norway's long land borders with Sweden and Finland in the north are not easy to police hence developments (lower beer duty or increased cross border traffic) in these two countries are bound to create an increase in illegal imports of beer to Norway.

For the UK, much depends on the extent to which the current local border controls are allowed to be continued and the effectiveness of any attempts to control the unquantifiable level of large scale smuggling. For the UK, however, the Commission's proposed "liberalisation" of distance purchasing would be likely to lead to a substitutional increase in cross border shopping, probably finally encouraging the government to review its excise policy. Levels of cross border shopping and smuggling will inevitably rise.

THE SPECIAL CASE OF IRELAND

The Republic of Ireland is also a high tax country as far as beer excise is concerned. However, its geographical situation and its proximity to the UK, another high tax country may mean that there has been relatively little cross border shopping, and no assessment made of smuggling. Tax generated arbitrage may occur over the land border with Northern Ireland, when prices differ significantly. Nevertheless, if the UK reduced its excise rate substantially, Ireland would find itself in the front-line and would inevitably lose domestic sales and revenue. Looking forward, Ireland could be affected by the liberalisation of distance purchasing, even if the UK did not alter its rates.



5. Tax Competition

The Brewers of Europe believe that it is a precondition of an effective taxation policy that the economy of Europe and the Member States is working efficiently. Consumers will not get a fair deal and the brewing industry cannot make its full contribution unless conditions of undistorted competition and trade are established throughout the EU. Within a free market, tax competition places pressure on Member States to reduce uncompetitively high taxes, but will not jeopardise the capacity of Member States to apply moderate taxes. Many believe that tax competition is the way to ensure that taxation policy is restrained in order to ensure that companies can compete effectively not only within Europe, but within a global context.

All Member States, as well as the enterprise community, are fully committed to the principle of a competitive single market. They all endorse the principle of the free movement of goods and the rights of the EU citizens to. Certain Northern Member States are, however, likely to oppose the Commission's proposed reforms. The only reason is that the single market will unleash market forces that will threaten their ability to apply high rates of excise duty on beer, wine and spirits.



6. Conclusion

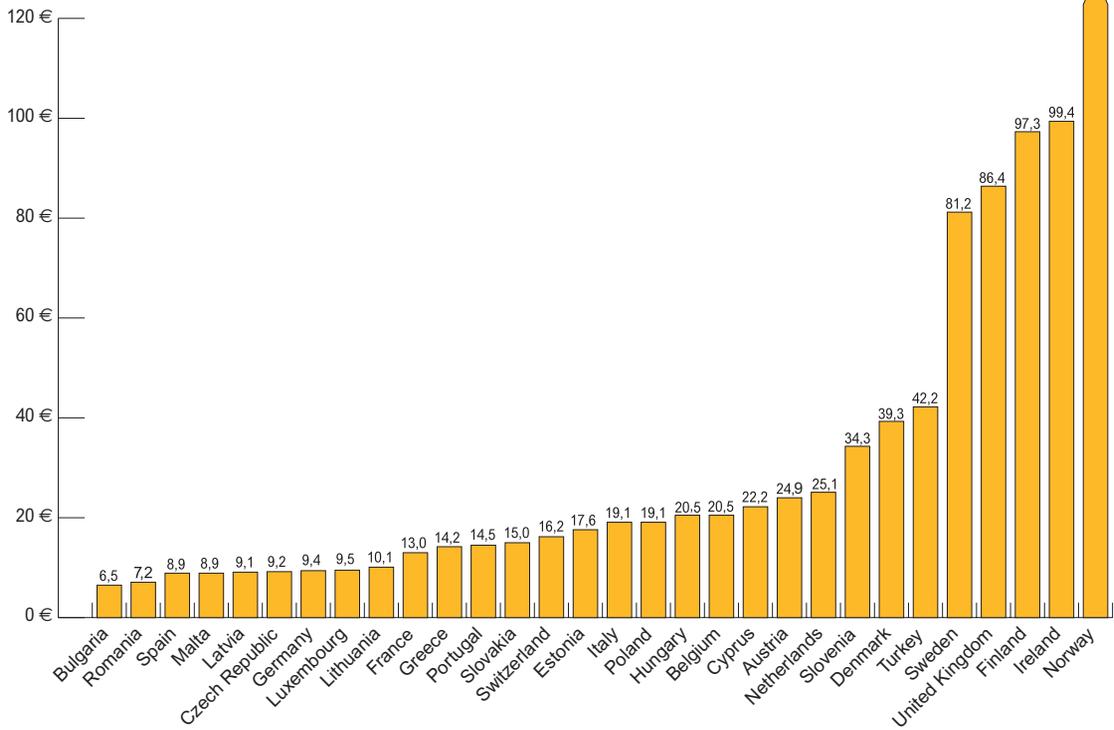
It is apparent that very high rates of excise for alcoholic drinks are incompatible with the single market. The single market is the cornerstone of European economic prosperity and there is no justification for making significant exceptions to this merely to accommodate the taxation policies of a few Member States.

Out of a total of 25 Member States, only five accounting for less than 20% of the population of the EU, are attempting to persuade the remaining 20 Member States to adopt high tax policies. Those five Member States account for about 70% of the beer excise collected in the 15 Member States before Enlargement. The UK alone accounts for above 40% of that total. High taxation of beer, wine and spirits is inconsistent with the traditions of most of Europe and always brings with it substantial fraudulent activity.

The current EU legislation discriminates against beer by compelling Member States to impose a minimum excise rate on beer and distorting competition in favour of wine. The Commission has recently opened an infringement proceeding against Sweden for allegedly applying excise rates that distort this competitive relationship though in this case the Commission claims the distortion favours beer sales. The fundamental principle is that European tax legislation should itself be fair and not discriminatory.

The Brewers of Europe call upon all Member States to support measures designed to improve the working of the single market and to moderate their taxation policies in order to reflect a rational response to competitive forces. The reduction of high excise rates is an inevitability. The high taxing Member States should recognise this and act quickly.

Excise Duties in Europe 2004



Excise duties in european countries

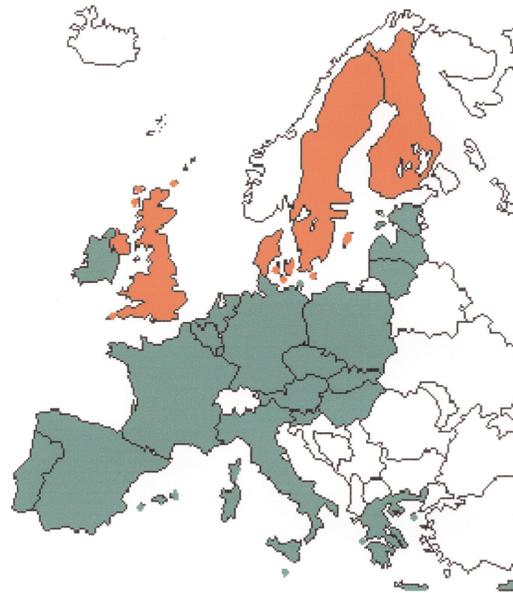
EUROS / 100 LITERS ON 5% ALC. CONTENT BASIS

COUNTRY EXCISE DUTY (€ / HL)

AUSTRIA	24,96
BELGIUM	20,53
BULGARIA	6,46
CYPRUS	22,19
CZECH REPUBLIC	9,15
DENMARK	39,30
ESTONIA	17,58
FINLAND	97,25
FRANCE	13,00
GERMANY	9,45
GREECE	14,24
HUNGARY	20,49
IRELAND	99,36
ITALY	19,08
LATVIA	9,10
LITHUANIA	10,14
LUXEMBOURG	9,52
MALTA	8,93
NETHERLANDS	25,11
NORWAY	218,60
POLAND	19,10
PORTUGAL	14,45
ROMANIA	7,20
SLOVAKIA	15,03
SLOVENIA	34,25
SPAIN	8,87
SWEDEN	81,22
SWITZERLAND	16,18
TURKEY	42,18
UNITED KINGDOM	86,38

EUROPEAN CENTRAL BANK
EXCHANGE CURRENCY RATES UPDATED ON: 1.11.2004
DOCUMENT LAST UPDATED: 2.11.2004

Excise Duties in Europe



- 4 EU countries with serious trade distortions
- 21 EU countries without serious trade distortions



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