

The Consequences of the Proposed Increase in the Minimum Excise Duty Rates For Beer

A report for The Brewers of Europe by Oxford Economic Forecasting



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Executive Summary

- The European Commission proposed in September 2006 that the minimum excise duty rates for alcoholic beverages should be increased in line with the rise in the EU-wide consumer price index since they were first set in 1993.
- These proposals would mean that excise duty rates for beer would have to increase in seven of the countries who were members of the EU at the time of the proposal, and also in Bulgaria and Romania now that they have joined the EU. And for these countries, the required increase in excise duty for beer would be substantial – over 30% in Latvia, Malta and Romania, and over 20% in the Czech Republic, Germany, Bulgaria, Lithuania and Luxembourg
- In contrast, the minimum duty rate on wine would remain at zero, as would that for other fermented beverages except for beer.
- Such a change to minimum duty rates would have a number of adverse impacts:
 - **It would further distort competition** between, on the one hand, beer and, on the other hand, wine and other fermented beverages (eg cider) – encouraging consumers to increase their wine and cider consumption at the expense of beer.
 - **It would be regressive** – raising prices for beer in a number of countries where beer is already very expensive relative to consumers' ability to pay. For example, even at current excise duty rates, beer is around 250% more expensive in Latvia and Lithuania relative to consumers' incomes than the EU-15 average. And in the Czech Republic beer is about 50% more expensive relative to incomes than in the EU-15. Clearly, increasing minimum duty rates would only serve to make beer even less affordable in such countries. Moreover, the move would do nothing to reduce alcohol misuse, while penalising the vast majority of consumers who drink in moderation.
 - **It would reduce employment in the European brewing sector.** While difficult to quantify, lower demand for beer would also have a serious negative impact on employment in bars and pubs, and in firms supplying the brewing sector and its employees. It would also have a significant direct effect on consumer price inflation in those countries that have to raise their excise duty rate for beer.
- Moreover, **increasing the minimum excise duty rate would do nothing to tackle the problems of cross-border shopping, smuggling and fraud** that are currently undermining the Internal Market in alcoholic beverages. Large differentials would continue to exist in excise taxes between Member States, with serious consequences for government revenues in a number of countries, for the stability of their alcoholic beverage markets and for social harm through uncontrolled sales to underage people.

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I. Introduction

The European Commission was mandated by the Council of Ministers (ECOFIN) to make a proposal in 2006 to change the minimum excise duty rates for alcoholic beverages¹. This follows the Commission's 2004 report to the Council, European Parliament and European Economic and Social Committee² in which it highlighted the problems with the functioning of the Internal Market in alcoholic beverages – reflected in large-scale cross-border shopping and smuggling - and suggested that enhanced approximation of excise duties “could provide a significant contribution to a solution to these problems”.

The Commission submitted its proposal in September 2006³. This was that the minimum excise duty rates for alcoholic beverages should be increased from 1 January 2008 in line with the rise in the EU-wide consumer price index since they were first set in 1993 (with transitional arrangements for those Member States required to increase duties by more than 10%). For the period up to December 2005, this implies an increase of about 31% in minimum excise rates for beer. However, the minimum duty rate on wine and other fermented beverages (eg cider) would remain at zero.

This paper reviews the implications of the European Commission's suggestion. It is organised as follows:

- Section II explains briefly the current structure of excise duties for fermented alcoholic beverages across Europe and highlights how differences in duty rates, combined with different rates of VAT, have led to substantial problems of cross-border shopping, smuggling and fraud.
- Section III considers the implications of changing the minimum rate of excise duty for competition between beer and wine. It also considers the implications for cross-border shopping and smuggling, and for the affordability of beer across Europe.
- Finally, Section IV summarises our conclusions.

II. The problems with the current excise tax regime for fermented alcoholic beverages in Europe

The EU rules on excise taxes...

The tax regime for alcoholic beverages in the EU was established in two Directives:

- Council Directive 92/83/EEC is concerned with **harmonisation of the structure of excise taxes**, setting out common definitions for the products subject to duty, the method for calculating the duty and the criteria under which certain products may qualify for exemptions or lower rates. Importantly, this Directive stipulates that excise taxes for alcoholic beverages should be wholly 'specific' – ie a given amount per volume of the product or alcohol content. Alcoholic beverages are, however, still subject to an element of ad valorem taxation – related to the price of the product – as a result of the application of VAT.
- Council Directive 92/84/EEC sought to contribute to **approximation of the rates of excise duties** on alcoholic beverages by setting minimum rates of duty for each product category, as shown in Table 1. Strikingly, while there are significant minimum duty rates required on beer and spirits, the minimum duty rate for wine and other fermented beverages, such as cider, is zero. However, these are only minimum rates – Member States are free to set their national rates at any level at or above these rates, which have not changed since they were introduced in 1993.

¹ Conclusions of the Ecofin Council session 2651, 12 April 2005

² COM(2004) 223 final, 26 May 2004

³ COM(2006) 486 final, 8 September 2006

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- Note: fermented beverages are defined as those natural beverages of agricultural origin and foodstuff use which are produced exclusively from fermentation of grapes, cereals, fleshy fruits or berries. In contrast, distilled beverages or spirits are those which have been distilled or mixed with other liquid substances, as well as any other beverages with an alcohol content which are not subject to specific regulation.

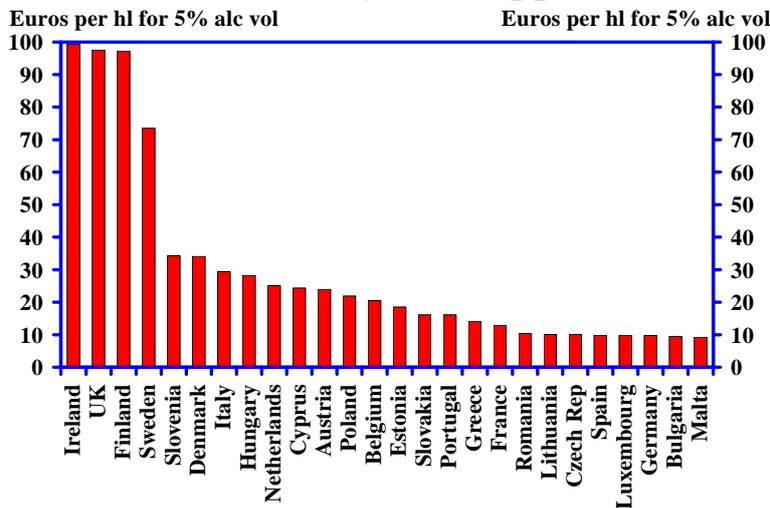
Table 1: Minimum rates for excise duties on alcoholic beverages

Wine and fermented beverages other than wine and beer	Euro 0 per hl of product
Beer	Euro 0.748 per hl per degree Plato, or Euro 1.87 per hl per degree of alcohol
Intermediate products (eg fortified wines, liqueur wines)	Euro 45 per hl of product
Ethyl alcohol and spirituous beverages	Euro 550 per hl of pure alcohol

...have failed to achieve effective duty approximation...

The existing Directives relating to excise taxes on alcoholic beverages have done almost nothing to achieve effective approximation of excise duties across Europe:

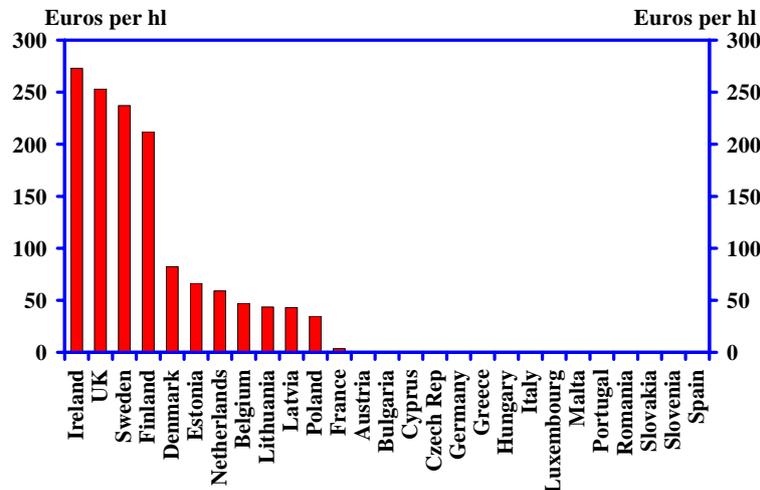
Chart 1: Excise duty rates applied to beer



Source: European Commission and industry sources

- Beer excise duty rates range from almost Euro 100 per hl⁴ in Ireland, the UK and Finland to less than Euro 10 in Spain, Luxembourg, Germany, Bulgaria, Malta and Latvia (Chart 1). The duty rate in the highest tax country is more than ten times that in the lowest tax country!

Chart 2: Excise duty rates applied to wine

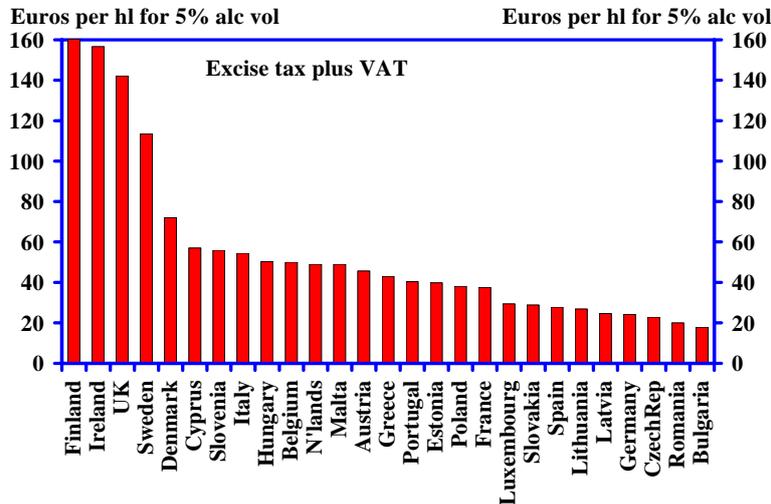


Source: European Commission and industry sources

⁴ at 5% alcohol by volume

- Ireland, the UK, Sweden and Finland also have very high duty rates for wine, at over Euros 200 per hl. But in France duty on wine is only a little over Euro 3 per hl. And fifteen Member States have a zero duty rate on wine, including Italy, Spain, Austria, Portugal, Greece and a number of the new Members (Chart 2).
- Finland, Sweden and Ireland again have very high excise taxes on other fermented beverages such as cider, as does Denmark. But thirteen countries have a zero duty rate (Chart 3).

Chart 4: Total indirect tax on beer

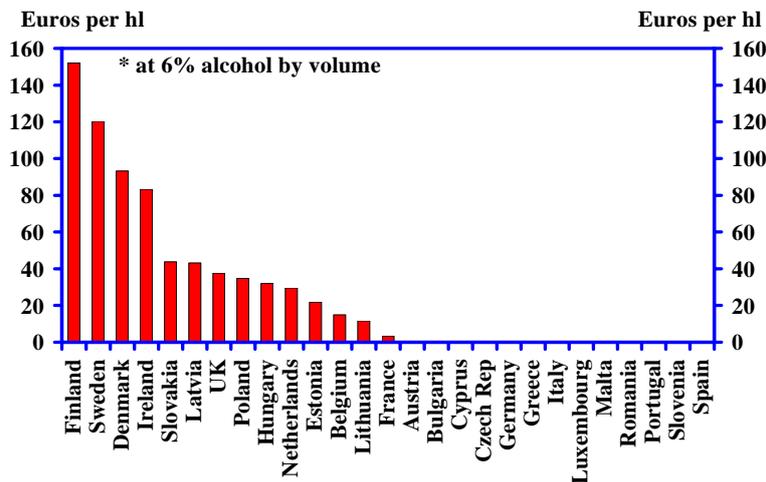


Source: European Commission and industry

...with VAT compounding tax differentials

These differences in excise duty rates across countries are compounded by differences in VAT rates (since VAT is charged on the product price including excise tax). For example, Chart 4 shows the total indirect tax – excise tax plus VAT - on charged on beer is around Euro 160 per hl in countries such as Ireland and Finland, well over Euro 130 per hl more than in the lowest tax countries, such as Germany, the Czech Republic, Romania and Bulgaria.

Chart 3: Excise duty rates applied to cider

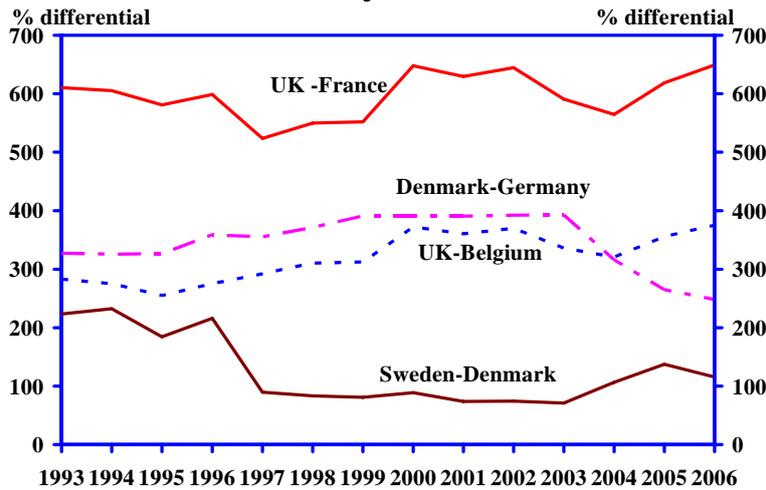


Source: European Commission and industry sources

The lack of progress on duty approximation...

Moreover, while some countries with very high taxes (Finland, Denmark) have reduced their duty rates for alcoholic beverages in recent years, in general the differentials between taxes on alcoholic beverages across Europe have remained very wide. This is most obvious in the case of wine, where some countries have maintained zero excise rates while others (eg Ireland and the UK) have increased their excise taxes significantly. But the duty differential for beer in the UK, for example, has increased from around 280% vis-à-vis Belgium in 1993 to 375% now (Chart 5).

Chart 5: Excise duty differentials for beer



Source: European Commission and industry sources

So, in general, the EU has made very little progress towards approximation of duty rates. And even where there has been some move towards harmonisation, substantial differences in tax rate still exist.

...means that beer prices still vary widely across the EU...

The differences in taxes on alcoholic beverages across Europe generate substantial differences in prices at the retail level. For example, retail selling prices for beer in the off-trade (eg in supermarkets, shops and off-licenses) range from over Euro 3.00 per litre in Ireland and Finland (and also Norway) to less than Euro 1.00 per litre in Germany, Poland, Czech Republic, Bulgaria and Romania. As Chart 6 shows, a large proportion of the difference in retail prices across countries is accounted for by differences in excise duty rates.

Chart 6: Retail prices for beer and excise duty rates



Source: Euromonitor, European Commission and industry sources

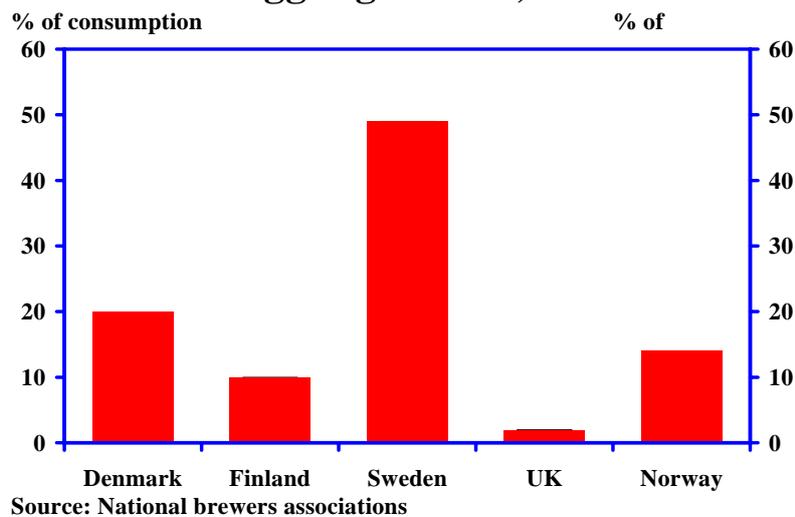
...encouraging large-scale cross-border shopping, smuggling and fraud...

While excise tax policy is the prerogative of national governments, the different approaches taken by different governments have led to serious problems with the functioning of the Internal Market in the EU. In particular, the large differentials between excise taxes/retail prices for alcoholic beverages across countries have - in the context of the European Single Market - encouraged the rapid growth of cross-border shopping and smuggling between EU countries:

- 164 million litres of beer were imported into **Sweden** by cross-border shoppers and smugglers in 2004, primarily from Denmark and Germany. This is almost equivalent to sales of beer by the state monopoly, Systembolaget (173 million litres) and is estimated to cost the Swedish government about Euro 190 million in lost revenues from excise tax and VAT. Cross-border purchases of beer have increased by 40% since 2002 following the phasing out of the special quantitative restrictions on cross-border purchase. And beer smuggling into Sweden is estimated to have doubled over the last two years.

- The Ministry of Taxation in **Denmark** estimates that 95 million litres of beer – about 20% of duty-paid domestic sales – were imported by cross-border shoppers from Germany in 2004. However, this is probably an underestimate – a recent study by the market research institute, GfK Group, in Denmark suggests that cross-border shopping accounts for 19.5% of Danish beer consumption, with smuggled beer accounting for a further 10% of consumption. So, overall, 29.5% of beer consumed in Denmark does not pay Danish taxes, at a cost to the government of DKK 900 million in lost excise taxes and VAT.
- Over 42 million litres of beer were imported into **Finland** by cross-border shoppers in the year to May 2005, equivalent to almost 10% of total beer consumption. Cross-border beer purchases have increased significantly since Estonia's accession into the EU, and are now costing the government Euro 50 million in lost tax revenues.

Chart 7: Cross-border shopping and smuggling of beer, 2004



- It does not necessarily require large tax differentials to generate significant cross-border trade in beer. For example, 30 million litres of beer were imported by cross-border shoppers into **Austria** from Germany and the Czech Republic in 2004, equivalent to about 3½% of consumption.
- Duty-paid imports of beer into the **UK** (excluding large-scale smuggling) have fallen since 1997, reflecting reductions in the price of beer in UK supermarkets, changes in the exchange rate and increased costs of travel to the continent. They are estimated to have been around 100 million litres in 2004, about 2% of total beer consumption. However, the UK's ability to combat cross-border shopping and smuggling is likely to have been weakened by the judgement that it has been applying disproportionate sanctions on people importing excise duty-paid products to the UK, either personally or by post, not for their "own use" but rather to sell the goods to family, neighbours or friends on a not-for-profit basis.
- While **Norway** is not a member of the EU and may therefore maintain border controls for fiscal purposes, its high excise rates still encourage substantial cross-border shopping – purchases from Sweden and Denmark account for 14% of Norwegian beer consumption.

In addition, many countries have reported diversion fraud, with goods supposedly bound for export markets (and therefore not liable for duty) being sold in domestic markets. For example, HM Customs and Excise report that it seized 2.9 million litres of beer that was being fraudulently sold in the UK in 2002-2003.

...undermining legitimate business and encouraging criminal activity

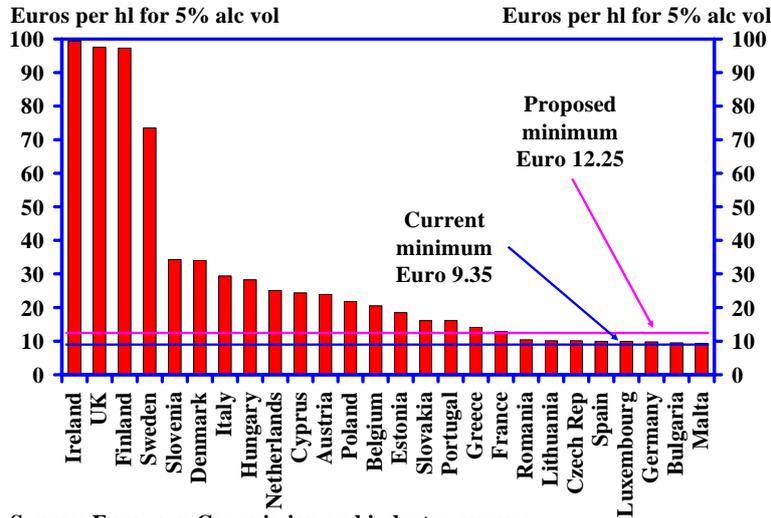
Cross-border shopping, smuggling and fraud not only impacts on government tax revenues, it also undermines domestic businesses in the high tax countries. For example, two large Swedish breweries have closed in recent years and employment in the Swedish brewing industry has fallen 30% since 2001.

Moreover, the potential profits to be earned from smuggling into high tax countries have encouraged the development of organised criminal gangs, undermining government and industry efforts to control the availability of alcohol to underage drinkers and to encourage safe and responsible alcohol consumption. And, once established, experience in countries such as Sweden and the UK suggests that smuggling gangs often become involved in other criminal activities.

III. The impact of raising the minimum excise duty rate for alcoholic beverages

The Commission proposal to raise from 1 January 2008 the minimum duty rate for beer in line with the increase in consumer prices between 1993 and 2005 (31%) would have no implications for most of the members of the EU – and especially not for the high tax countries (Chart 8).

Chart 8: Excise duty rates applied to beer



Source: European Commission and industry sources

But excise rates would have to increase in seven countries who were members of the EU at the time of the Commission’s proposal, and also in Bulgaria and Romania now that they have joined the EU. And for these countries, the required increase in excise duty for beer will be substantial – over 30% in Latvia, Malta and Romania, and over 20% in the Czech Republic, Germany, Bulgaria and Luxembourg (Table 2).

There are transitional arrangements that allow Member States that have to increase their excise duties by more than 10% but less than 20% to do so only from 1 January 2009, and those that have to increase their duty rates by more than 20% to do so only from 1 January 2010. But, even so, the impact on the beer sector in those countries will be very significant.

	Current rate of excise duty on beer	Increase in excise duty required if EU minimum updated for inflation between 1993 and 2005 (31%)
Latvia	1.87 EUR / hl / °Alc	31%
Romania	0.748 EUR / hl / °Plato	31%
Malta	0.746 EUR / hl / °Plato	31%
Bulgaria	0.767 EUR / hl / °Plato	28%
Germany	0.787 EUR / hl / °Plato	25%
Luxembourg	0.7933 EUR / hl / °Plato	24%
Czech Republic	0.81 EUR / hl / °Plato	21%
Lithuania	2.03 EUR / hl / °Alc	21%
Spain*	0.91 EUR / hl / °Plato	8%

* Note: Spanish excise tax for beer is determined according to a banding system. The figure shown here is on the basis of the equivalent rate at 12°Plato

So, what would be the impact of the proposed uprating of the minimum duty rates for beer? There are three aspects to consider:

- **The increase in minimum duty rates will further disadvantage beer relative to wine and other fermented beverages**, as the minimum rate of excise duty for wine, cider etc will remain zero. So, the reform will further distort competition in the market for alcoholic beverages.
- **The increase in minimum duty rates would do nothing to reduce large-scale cross-border shopping and smuggling of alcoholic beverages in the EU.**
- **The increase in minimum duty rates would be regressive.** Most of the countries who will have to rise their excise taxes have living standards below the EU average. Indeed, even before the increase in minimum duty rates, beer is already significantly less affordable in most of these countries than across the rest of the EU. The increase in excise duty required to meet the proposed new EU minimum rates will only make beer even less affordable for some of the EU's less wealthy citizens.

We consider each of these effects in turn.

(i) Higher minimum duty rates will distort competition between alcoholic beverages...

The proposed changes to minimum duty rates will distort competition in the fermented alcoholic beverages market in the EU. While excise duty rates for beer will rise significantly, the minimum duty rate for wine will remain zero. Of the countries affected by the increase in the minimum rate for beer, seven – Luxembourg, Malta, Spain, Czech Republic, Romania, Bulgaria, Germany – have a zero rate for wine. In these countries, it is likely that the Commission proposal will increase the price of beer relative to wine, encouraging consumers to increase their wine consumption at the expense of beer.

The clear competition that exists in the market for alcoholic beverages between beer and wine has already been recognised by the Court of Justice⁵. The Commission proposals on minimum excise duty rates will only exacerbate the distortions to competition caused by the existing EU legislation.

The Commission proposal would also put beer at an increased competitive disadvantage with respect to cider and other fermented beverages, for which the minimum duty rate will remain at zero.

...undermining the brewing industry and employment...

The Commission's proposal will therefore undermine the brewing sector in those countries that have to raise their excise taxes. Substantial increases in duty will inevitably force large increases in retail prices for beer, which will reduce consumer demand. This in turn will mean that brewers will have to cut back their production and employment.

Moreover, it will not only be employment in the brewing sector that will suffer. In addition to those working in bars and pubs, many jobs in other sectors in Europe depend on the brewing industry - either because they are key suppliers or because they depend on spending on goods and services by those who work for brewers. Currently, around 150,000 people are employed in the EU directly by brewers (164,000 including Norway, Switzerland and Turkey), mainly by small and medium-sized brewers. And it has been estimated that, taking into account those who work in bars and pubs, plus suppliers to brewers, the beer industry supports about 2½ million jobs in total in Europe.

The size of the impact of increased minimum excise taxes on beer sales and related employment depends on the sensitivity of demand for beer to changes in its price - the so-called price elasticity of demand. Estimates for price elasticity are very uncertain. In its study for the European Commission, for example, Customs Associates⁶ found that the price elasticity varied between +0.12 and -0.95 – ie a 10% increase in price lead to a change in beer sales of between +1.2% and -9.5%. While there are many technical weaknesses with the research by Customs Associates, which means that its estimates for price elasticities in individual countries should be treated with caution, other studies suggest that a reasonable range for the price elasticity of demand for beer in Europe may be -0.5 to -1.5⁷.

While difficult to quantify precisely, it is clear given these price elasticities that raising the minimum duty rate for beer would have a serious effect on employment. For example, up to 1,850 jobs could be at risk in the brewing

⁵ Case C-166/98: Commission vs France (Socridis)

⁶ Customs Associates Ltd (2001): Study on competition between alcoholic drinks

⁷ See, for example, Oxford Economic Forecasting (2004): Modelling the beer market

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sector alone in Germany, with many more in bars and suppliers to the brewers. Similarly, in the Czech Republic, around 500 jobs could be lost in the brewing sector.

An increase in the minimum excise rates is likely to be taken as a signal by some Member States already above the minimum rate to increase their rates accordingly. This would further impact on beer sales and employment, as well as increasing the distortion between rates in Member States.

...and adversely impacting government finances and inflation

The negative impacts of higher excise duties on employment in the brewing and related sectors will offset to a large extent any increased excise revenues that countries may receive as a result of raising the minimum duty rate on beer, as income tax and social security contributions would be adversely affected.

In addition, it should be noted that, by pushing up retail prices for beer, raising the minimum excise duty rate will also push up consumer price inflation. Research by PriceWaterhouseCoopers⁸ in Spain, for example, found that a 1 unit rise in the excise duty for beer leads to an increase in retail selling prices of 4.4 units – ie if duty increase by 10 cents then retail selling prices increase by 44 cents. With beer accounting for almost 14% of household spending in Spain, this implies that increasing the minimum excise duty for beer could add well over 1% point directly to inflation. Similar impacts might be expected in other countries affected by the change in minimum excise duty for beer.

(ii) Higher minimum duty rates will not reduce cross-border shopping and smuggling

As noted above, the increase in minimum duty rates will have no implications for most EU members, whose excise duty rates for alcohol are already above the levels likely to be recommended by the Commission – not least, the very high excise duty rates in countries that suffer most from cross-border shopping and smuggling, such as Sweden, Denmark, Finland and the UK. In particular, there would be no impact of the excise duty differential that encourages cross-border shopping and smuggling between:

- The UK and France/Belgium
- Sweden/Finland and Estonia
- Norway and Sweden/Denmark

Excise taxes for beer would be unaffected in all of these countries.

There would be an impact from higher minimum duty rates on the excise tax differential between, on the one hand, Sweden and Denmark, and, on the other hand, Germany, since Germany would be required to raise in excise duty rates by 25%. But the effect of this change on incentives for cross-border shopping and smuggling would be minimal. Even after the increase in German rates, excise duty in Sweden would still be around six times higher than in Germany, while duty in Denmark would still be almost three times German rates (Table 3).

Table 3: The impact of increasing minimum duty rates on the excise tax differential for beer between Sweden/Denmark and Germany		
	Current excise duty on beer (5% abv, per HL)	Excise duty if EU minimum updated for inflation between 1993 and 2005 (31%)
Sweden	73.5	73.5
Denmark	34.1	34.1
Germany	9.8	12.25
Excise tax differentials	Now	If EU minimum updated for inflation between 1993 and 2002 (24%)
Sweden-Germany	650%	500%
Denmark-Germany	248%	178%

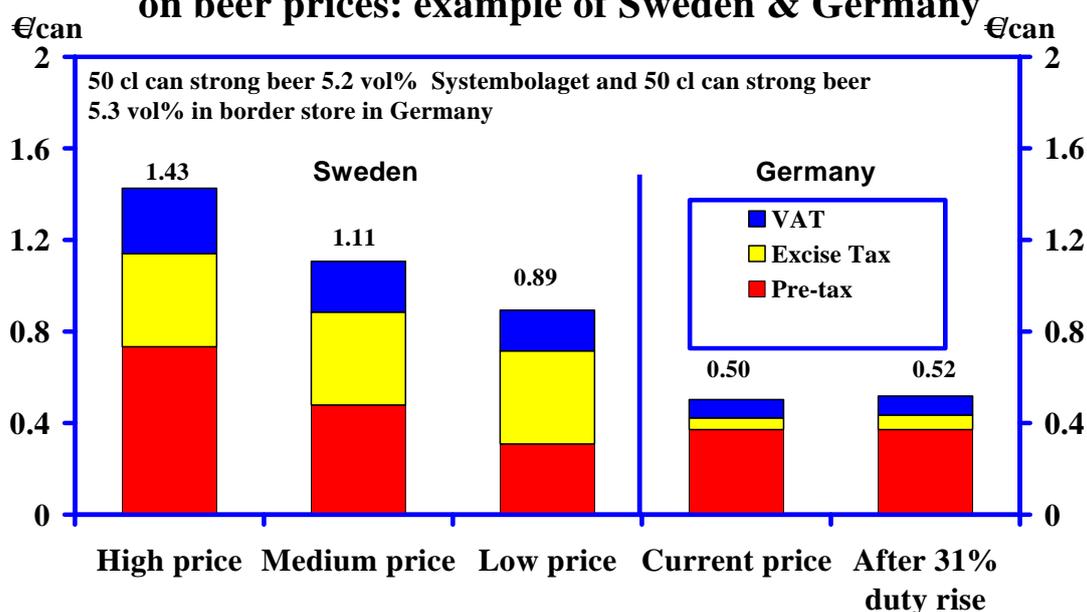
With the increase in minimum rates leaving excise differentials so large, a substantial 'profit' could still be made from cross-border shopping and smuggling. The continuing gain is illustrated in Chart 9, which compares the price of three types of beer bought duty-paid in Sweden at the state monopoly Systembolaget with prices for beer at a store on the German border (although similar comparisons can be made for other countries):

⁸ PriceWaterhouseCoopers (2000): Beer weight in price formation and impact of its price on inflation rates

- Currently, even low price beer in Sweden retails at almost 80% more than beer in a German border store. And this difference is more than accounted for by higher excise duty in Sweden than in Germany. The pre-tax (ie before excise and VAT) price of beer at a Germany border store is typically around Euro 0.37 per 50cl can, compared with Euro 0.31 for low price beer in Systembolaget.
- If the EU minimum duty rate for beer is increased by 31% (ie uprating for 1993-2005 inflation), the price of German beer might rise to Euro 0.52. But Swedish low price beer would still be 73% more expensive.

Obviously, the price differentials for more expensive beers would be even greater. Moreover, it should be noted that it would take an increase of only 3% in the Swedish excise duty rate – ie just two year’s of revalorisation in line with CPI inflation - to wipe out the reduction in the tax differential brought about from the impact of raising the minimum excise rate on German beer.

Chart 9: The impact of higher minimum excise duties on beer prices: example of Sweden & Germany



Source: Swedish Brewery Association, Oxford Economics

With the increase in EU minimum duty rates producing such a marginal reduction in price differentials relative to Germany, it is likely to have virtually no impact on cross-border shopping and smuggling. Indeed, cuts in excise duties introduced by both Sweden and Denmark in recent years have done much more to reduce the duty differential with Germany than will the increase in minimum duty rates. But because these changes have still left a very large absolute differential – and this will remain after minimum rates have been increased – cross-border shopping and smuggling have actually continued to increase.

The increase in minimum duty rates will therefore do nothing to address the biggest single problem with the excise tax regime for alcoholic beverages in the EU – the distortions to the Internal Market caused by cross-border shopping and smuggling.

(iii) Higher minimum duty rates will be regressive

Increasing the minimum duty rate for beer will affect some of the richer EU Member States, such as Germany, Luxembourg and Spain. But it will mainly affect countries who have either only recently joined the EU – ie Latvia, Malta, Czech Republic, Lithuania, Bulgaria and Romania. Average income levels in these new or prospective members are typically much lower than the average across the EU-15. For example:

- GDP per capita in Bulgaria and Romania is only around 10-15% of the EU-15 average, while in Latvia and Lithuania it is only 20-25% of the EU-15 average.
- Consumer spending per adult (a good indicator of relative household disposable income levels) in the Czech Republic is still only 31% of the EU-15 average (Table 4).

	GDP per capita, 2005		Consumer spending per adult, 2005	
	Euro '000s	% of EU-15 average	Euro '000s	% of EU-15 average
Latvia	5,600	21	4,080	22
Romania	3,700	14	2,960	16
Malta	11,300	43	9,100	49
Czech Republic	9,700	37	5,690	31
Germany	27,200	103	18,720	102
Bulgaria	2,800	10	2,280	12
Luxembourg	64,300	243	32,100	174
Lithuania	6,000	23	4,740	26
Spain	20,900	79	14,240	77

Source: Eurostat, Oxford Economics calculations

The implication is that raising the minimum duty rate for beer will primarily disadvantage countries with relatively low living standards – ie it will be regressive. This is, of course, a general problem with excise taxes.

But in many of the below-average income countries that will be affected by the increase in minimum duty, beer is already much more expensive relative to consumers' ability to pay than in the rest of the EU. This is clear when we consider the 'affordability' of beer – that is, look at the cost of buying beer in different countries relative to consumers' living standards.

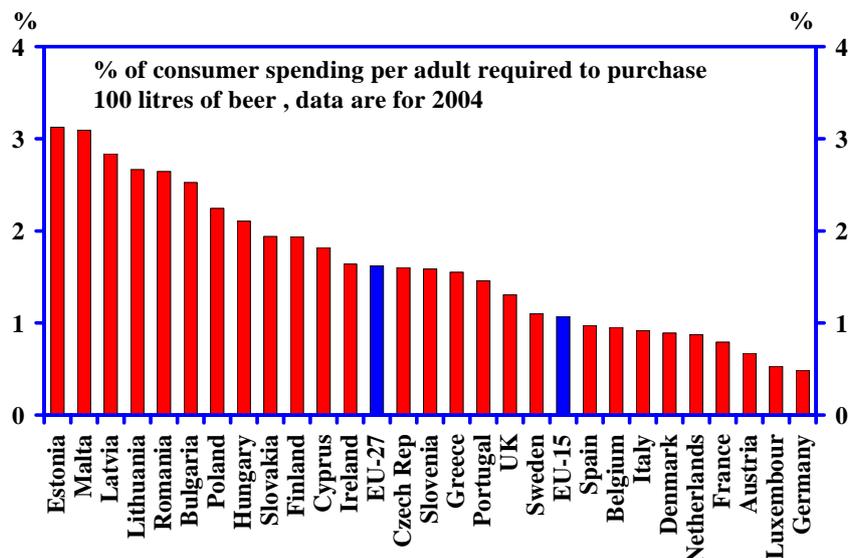
Chart 10 compares the affordability of beer across the EU measured by the percentage of consumer spending per adult required to purchase 100 litres of beer. It shows that, at current duty levels, beer is already:

- Around 250% more expensive in Latvia and Lithuania than the EU-15 average.
- 50% more expensive in the Czech Republic than in the EU-15.

Beer is also very expensive on this basis in Malta (around 290% of the EU-15 average), but the market there is affected by the very large number of tourists relative to the size of the local population.

Clearly, increasing minimum duty rates would only serve to make beer even less affordable in countries such as Latvia, Lithuania and the Czech Republic.

Chart 10: The affordability of beer



Source: European Commission, Euromonitor, Oxford Economics

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As well as highlighting the regressivity of increasing the minimum duty rate for beer, this analysis also highlights an important risk with the Commission proposal. Experience has shown that affordability can be useful as an indicator of the incentives to illegal trade in products. For example, implementing the EU's excise duty rules for tobacco has required very large increases in duty in the new Member States, making cigarettes very difficult for ordinary people to afford. As a result, there has been an explosion in smuggling, which now accounts for 25% of cigarette sales in Hungary and Estonia, and 30% or more in Slovakia and Lithuania.

While it is unlikely that the proposed increases in minimum duty rates will cause the same scale of illegal activity in new Member States as seen in the case of tobacco, beer will nevertheless be seen as even less affordable. Some people will therefore look for ways to reduce the amount of tax they have to pay to buy beer, encouraging greater smuggling and diversion fraud.

IV. Conclusions

The current EU excise tax system for alcoholic beverages with a positive minimum excise duty rate for beer but a zero minimum rate for wine and other fermented alcoholic beverages has no economic logic. Moreover, it distorts competition in the alcoholic beverages market, favouring wine producers, and producers of other fermented alcoholic beverages such as cider, over brewers.

One option to overcoming the problems with the current EU excise system would be to introduce a positive minimum excise duty rate for wine and other fermented products. This certainly should be a precondition for any increase in minimum rates for beer, otherwise such a change would only exacerbate competitive distortions between different types of alcoholic beverage.

However, it is well known that a number of leading EU members are strongly opposed to a positive minimum duty rate for wine, and that any such proposal would therefore be bound to be rejected. An alternative option could be to set the minimum excise duty rate for beer at zero. This would put beer on an equal competitive footing with wine and other fermented beverages.

As well as further distorting competition, any increase in the minimum excise tax rate for beer would also be regressive – raising prices for beer in a number of countries where beer is already very expensive relative to consumers' ability to pay. For example, even at current excise duty rates, beer is around 250% more expensive in Latvia and Lithuania relative to consumers' incomes than the EU-15 average. And in the Czech Republic beer is about 50% more expensive relative to incomes than in the EU-15. Clearly, increasing minimum duty rates would only serve to make beer even less affordable in such countries.

Increasing the minimum duty rate would also reduce employment in the European brewing sector. While difficult to quantify, lower demand for beer would also have a serious negative impact on employment in bars and pubs, and in firms supplying the brewing sector and its employees.

The problems of cross-border shopping and smuggling of alcoholic beverages in the EU really arise from the very high rates that are applied in certain countries, rather than the low rates in countries whose excise duty rates are close to the existing minimum rates. Increasing the minimum duty rate for beer would do nothing to address this situation.



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