

A case against minimum excise duties set by the EU

Minimum excise rates are set by the European Union to cover alcohol and tobacco products, certain energy products (e.g. electricity and natural gas), and transportation fuels. EU sets the minimum level of excise duties for these products, therefore member-states cannot apply lower excise duties. There are many arguments for and against the excise tax *per se*, but there is a very specific case against minimum excise duty rates set by the EU.

1. There is a strong and imperative case for implementing one of the following measures:
 - i. Allowing full or partial reduction of the EU-set minimum excise duties by the member-states bordering non-EU countries that charge considerably lower excise duties.
 - ii. Scrapping the EU-set minimum excise duties.
2. In addition, new initiatives to increase the EU-prescribed minimum excise duties need to carefully evaluate the effects on the demand of transportation fuel, tobacco or alcohol supplied by the grey (shadow) economy. The same careful evaluation should apply to measures with similar effects, e.g. introduction of minimal prices for certain goods. We recommend instituting a rigorous mandatory evaluation for the aforementioned proposals.

The arguments for allowing full or partial reduction of the minimum excise duties for certain member-states are the following:

3. EU minimum excise duties ignore different purchasing power parities of member-states. The same excise duty (in nominal terms) is less affordable if purchasing power is lower. This results in disproportionately high levels of excise duties in poorer member-states and creates strong incentives to obtain the goods in the shadow economy.
4. This disparity between purchasing power and minimum excise duty is especially prevalent in new member-states, thus creating a robust demand for illicit goods. Even more, most of new member-states border non-EU countries, which in turn are a source of illicit goods (e.g. fuel, tobacco or alcohol). This is amplified by the fact that these non-EU countries have significantly lower excise duties than those applied by the EU. These circumstances are one of the driving forces of the shadow economy in new member-states.

Research indicates that the shadow economy comprises around 20% of GDP in the EU. More specifically, in certain member states (i.e. Lithuania) the shadow economy is 28% for tobacco, 27% for spirits, and around 20% for transportation fuel (source - *Survey of Shadow Economy No. 3, LFMI, 2014*). Other countries have similar estimates. Lithuania, Latvia, Estonia, Poland, Sweden and Belarus showed that in Lithuania and Estonia 10 percent of respondents bought illegal alcohol products (calculating those, who had unregistered purchases in the past 12 months). The incidence in Latvia was 11 percent, 18 percent in Poland and 16 in Sweden (source - *Shadow Economies in the Baltic Sea Region 2015, LFMI, 2015*).

5. A disproportionately high excise duty has side-effects of its own. It leads people to consume alcohol products (e.g. surrogates) derived from industrial alcohol, home-made alcohol, rubbing alcohol etc. The consequences involve not only a loss in tax revenues, but also dire side-effects on consumer health.

6. Alternatively people also turn to other sources of transportation fuel. These range from repurposing natural gas usually designated for cooking to be used as transportation fuel to stolen oil from transformer stations (which in turn generate more losses due to technical failures).
The proposed measures are in line with the principles of the single market or free movement of goods in the EU.
7. The EU minimum excise rate exemption for wine (minimum excise duty for wine is 0) serves as an important piece of evidence. First, it does not violate the principle of the single market. Second, most countries apply excise duty on wine regardless. Therefore fears that the abolition of EU-prescribed minimum excise rates would lead to zero excise duties in member states are baseless.
8. An excise duty is paid in the country where the final product is sold. This means that before being sold to the final consumer the products cross national borders of member states effectively without any excise duty. As long as the excise duty is applied in the country of sale, the actual excise duty has no relevance for a single market (assuming that the excise duty is not discriminating according to the principle of the country of origin).
9. Minimum excise duties are not needed for the single market. The single market would be interfered with if governments set excise rates on products based on the country of origin. But such taxation *per se* is contrary to the principles of the single market. To protect the single market, a simple set of rules on how excise duties are to be determined would be sufficient. Therefore setting a specific excise rate is not needed for the operation of a single market.
10. Different rates of excise duties do result in different final prices for the same good. But this is no argument to have minimum excise duties:
 - i. First, limited cross border trade in border regions of member-states is exactly the manifestation of the single market, and movement of goods; there is no basis to counter it.
 - ii. Second, if more equal prices for the same products (i.e. price convergence) *are* the basis for minimum excise duties, then setting *maximum* excise duties, not *minimum* ones, should be a logical measure. Especially given the propensity of national governments to levy excise tax on fuel, tobacco and alcohol (and other good with low price elasticity of demand) for revenue purposes. It is precisely the very high excise duties (in nominal terms) applied in some countries, not the very low ones, that are an obstacle to price convergence.
11. Regardless of the existence of minimum excise duties, the actual rates applied are very different across countries. There is no basis in arguing that current excise duties set by member states are more equal than they would be if minimum excise duties were not set by the EU. Therefore, scrapping or allowing partial reductions for excise duties would not result in divergence of prices.