



European Heart Network's response to the European Commission's Consultation Paper on the structure and rates of excise duty applied on cigarettes and other manufactured tobacco.

June 2007

Summary and Recommendations

The European Heart Network (EHN) is a Brussels-based alliance of heart foundations and like-minded non-governmental organisations in 26 European countries.

EHN plays a leading role in the prevention and reduction of cardiovascular disease through advocacy, networking and education so that it is no longer a major cause of premature death and disability throughout Europe.

Cardiovascular disease (CVD) - heart disease, stroke and other atherosclerotic vascular diseases - is the largest cause of death of men and women in the European Union (EU). Every year over 1.9 million people die from CVD in the EU(25). CVD has been estimated to cost the EU economies 169 billion euros every year.

Tobacco kills 650 000 citizens in the EU(25) every year; over 180 000 deaths from CVD are caused by smoking. Taxation is the most effective way for reducing demand of tobacco.

EHN welcomes the consultation in principle and notes the emphasis that the document has on health considerations. EHN regrets that it has not had access to the full report written by KPMG upon which the Commission has based its consultation document.

EHN recommends:

- removing the concept of the most popular price category (MPPC) and applying minimum tax rules to all cigarette price categories;
- not allowing flexibility for the member states to levy minimum taxes (excise duties and VAT) on cigarettes. Too low taxation levels of cigarettes in specific Member States are an incentive for cross border shopping and have a negative effect on the overall taxation levels in the neighbouring countries;

- increasing the minimum taxation (excise duties and VAT combined) expressed in euros as in percentage of the total price;
- removing the 55% maximum threshold for the weight of the specific tax component of the total tax;
- that the required tax incidence (VAT and excise duties) on the retail selling price of cigarettes should be at 71% and the overall minimum tax (VAT and excise duties) shall not be less than 120 € per 1000 cigarettes from 1 January 2008. The required tax incidence (VAT and excise duties) on the retail selling price of cigarettes should be at 72% and the overall minimum tax shall not be less than 130 € per 1000 cigarettes from 1 January 2010;
- increasing gradually the minimum tax for fine cut tobacco to same level as cigarettes by imposing the overall tax (excise duties and VAT) levied on fine-cut smoking tobacco intended for the rolling of cigarettes shall be at least equal to 60 % of the retail selling price inclusive of all taxes and the overall minimum tax shall not be less than 60 € per 1kg from 1 January 2008, to 65 % of the retail selling price inclusive of all taxes and the overall minimum tax shall not be less than 70 € per 1kg from 1 January 2010 and to 70% of the retail selling price inclusive of all taxes and the overall minimum tax shall not be less than 80 € per 1kg from 1 January 2012;
- increasing yearly the specific excise duty by 4% above inflation;
- pipe tobacco should be taxed at least at the same level as fine-cut tobacco;
- tighter cigar definitions, which would avoid the appearance on the market of tobacco products that are presented as cigars but which are similar to cigarettes;
- that herbal cigarettes, which are combustion products, should not be presented as safer products and should be taxed in the same way as cigarettes;
- that taxation on smokeless tobacco should be part of the community health policy on smokeless tobacco;
- reducing the indicative level for cigarettes for personal use when travelling between EU countries to 200 cigarettes;
- establishing a maximum of 40 cigarettes for import from outside the community for personal use.

Introduction

The European Heart Network (EHN) is a Brussels-based alliance of heart foundations and like-minded non-governmental organisations throughout Europe. EHN has member organisations in 26 European countries.

EHN plays a leading role in the prevention and reduction of cardiovascular disease through advocacy, networking and education so that it is no longer a major cause of premature death and disability throughout Europe.

Cardiovascular disease (CVD) - heart disease, stroke and other atherosclerotic vascular diseases - is the largest cause of death of men and women in the European Union (EU) and the second-heaviest disease burden expressed in DALYs (disability adjusted life years). Every year over 1.9 million people die from CVD in the EU(25). CVD causes nearly half of all deaths (42%) and 11 million DALYs are lost due to CVD every year. CVD has been estimated to cost the EU economies 169 billion euros every year. Of the total costs of CVD, just under €105 billion in 2003 are costs to the healthcare systems of the EU. Production losses due to mortality and morbidity associated with CVD cost the EU over €35 billion. Cost of informal care is another important non-healthcare cost. In 2003, the total cost of providing this care was over €29 billion.¹

Tobacco use, a major modifiable risk factor for CVD, causes over 180 000 deaths from CVD every year.

EHN welcomes the consultation in principle and notes the emphasis that the document has on health considerations.

Tobacco kills 650 000 citizens in the EU(25) every year.² Taxation is the most effective way for reducing demand of tobacco.³ Concerned about prompt implementation of important measures that will help alleviate the heavy death toll due to tobacco use, EHN is apprehensive that this consultation procedure may bring delay in the implementation of tobacco measures. Under the terms of the 2002 directive all interested parties knew that the European Commission was obliged to publish a review of the tobacco excise rules by the end of 2006 and have send their views to the commission services in 2006. For instance, a position paper “A public health perspective for the review of the EU tax policy on tobacco products” endorsed by the Association of European Cancer Leagues (ECL), European Network for Smoking Prevention (ENSP), European Heart Network (EHN), European Respiratory Society (ERS), Action on Smoking and Health (ASH), Cancer Research UK (CRUK), Institut National du Cancer (INCA) was sent to commission services in June 2006. We are convinced that all players in the tobacco trade made similar submissions. Hence, the current consultation risks being a repetition of submissions made in 2006.

The consultation procedure is based on a report of KPMG requested by the Commission services regarding the fourth report on the structure and rates of tobacco duties. Despite

¹ European cardiovascular disease statistics 2005; European Heart Network and British Heart Foundation <http://www.ehnheart.org/files/statistics%202005-092711A.pdf>

² The ASPECT consortium. Tobacco or health in the European Union. Past, present and future. Luxembourg, European Commission, 2004.

³ Jha P, Chaloupka F, Curbing the epidemic. Governments and the economics of tobacco control, The World Bank , Washington DC, 1999.

formal written requests from the non-governmental organisations, the entire report has not been made public. Consequently, the EHN recommendations will be based on incomplete information considering that the Commission services have not made available all necessary documents.

Response

EHN's response will address the main questions as set out in the Summary of the Consultation Paper.

1) Cigarette taxation.

1.1 The Commission services question whether the MPPC is still in line with Internal Market objectives and justified as a reference point for setting the minimum requirements. The views of concerned parties are invited on the abolition of the MPPC and on whether EU minimum requirements should either apply to all cigarettes or should be defined in accordance with weighted average prices.

EU tax rules on cigarettes apply only to the most popular price category (MPPC) which represents a third of the overall cigarette market. All cigarettes of all price categories are causing death and disease, not only the cigarettes of the MPPC. The growing popularity of cheap and discount brand is a concern in many Member States. EHN recommends to remove the concept of the most popular price category and to apply minimum tax rules to all cigarette price categories. (See our proposals for minimum level taxation on cigarettes expressed in percentage and in euro under 1.4)

1.2 To what extent should Member States be allowed greater flexibility to determine the structure of the excise duties and to levy minimum excise duties on cigarettes?

The European Union and its 27 Member States must consider thoroughly the health objectives of reduced tobacco consumption. Article 6 of the WHO Framework Convention on Tobacco Control (FCTC), which was adopted unanimously by 192 countries in May 2003, signed by 168 countries and as of today ratified by 147 countries, stipulates very clearly: "The Parties recognize that price and tax measures are an effective and important means of reducing tobacco consumption by various segments of the population, in particular young persons."

The general principle should be not to allow flexibility for the Member States to levy minimum taxes (excise duties and VAT) on cigarettes. Too low taxation levels of cigarettes in specific Member States are an incentive for cross border shopping and have a negative effect on the overall taxation levels in the neighbouring countries.

1.3 Should the current monetary minimum incidence for cigarettes (€ 64/1000 cigarettes) be increased, given that it only came into force in July 2006 and 10 new Member States have been granted transition periods, some of them until the end of 2009? On the other hand, would an increase in the minimum ad valorem requirement of 57% be in line with internal market and health objectives?

While progress has been made in harmonising tobacco taxation at EU level, the disparity in the prices of and the taxes on tobacco products across the European Union is of great concern.

For instance:

- The price of a pack of Marlboro cigarettes in January 2007 varies from 1,17 euro in Latvia to 7,36 euro in the United Kingdom.
- The excise yield per 1000 cigarettes for the most popular price category in January 2007 varies from 21 euro in Latvia, 22 euro in Lithuania, 35 euro in Estonia to 240 euro in the United Kingdom.

The very low levels of excise duties in some new EU Member States in 2007 are striking. During the last two years, the Commission has been very active in combating minimum prices in some Member States (France, Belgium and Ireland), but not so active in encouraging other Member States (such as Latvia and Lithuania) to increase the minimum excise yield from 21 or 22 euro to the required 64 euro. The lack of action in some Member States cannot be used as an excuse to slowdown the necessary harmonisation of taxes on cigarettes at EU level. EHN is in favour of increasing the minimum taxation (excise duties and VAT combined) expressed in euros as in percentage of the total price. See answer below under point 1.4

1.4 How can the current provisions be improved in order to better achieve health objectives?

Taxation rules on tobacco products in the EU are complex. Like most goods, cigarettes are subject to Value Added Tax (VAT). Unlike other excise taxable items, however, they are subject to two types of excise duty - specific and ad valorem. Specific excise duties are imposed as a fixed amount per 1,000 pieces or per 1,000 grams. Ad valorem excise duties are proportional to the final retail price. Ad valorem taxation and VAT have a "multiplier effect". This means that price differences at production level are multiplied with the addition of tax which leads to greater price differences between cheaper brands (which pay proportionately less tax), and more expensive brands. Specific duties do not have a multiplier effect, as the same tax is applied whatever the production cost. This means that price differences between cheaper and more expensive brands are reduced. It also means that manufacturers can increase prices without this having too high an impact on the final retail selling price.

In 1992, in view of the approaching Single European Market, the EU adopted a set of common directives to ensure a level of harmonization of tobacco tax levels across its Member States. It represented a compromise between the ad valorem and the specific taxation components. The directives established an overall excise incidence (specific and ad valorem combined) of at least 57% of the retail price of the most popular price category (MPPC). Taken with the minimum specified VAT rate set at 13.04%, the minimum overall level of taxation on cigarettes was 70%. Countries were free to set the balance between ad valorem and specific taxation - on the condition that the latter falls in the range of 5% to 55 % of the total tax including VAT. Although these directives did lead to price increases in a number of countries, they did not eliminate the large differences in price and tax levels that characterized the EU market.⁴

⁴ Gilmore A, McKee M. Tobacco-control policy in the European Union: the legal, ethical and policy debates. In: Tobacco Control and the Liberal State: The Legal, Ethical and Policy Debates. Feldman E, Bayer R (eds). Harvard University Press

The problems with the tobacco tax rules are the following:

- EU tax rules apply only to the most popular price category which represents a minor part of the overall cigarette market (about one third)
- Minimum tax rules should apply to overall taxes (VAT and excise duties) and not specifically to excise duties (the 57% rule) or to the minimum specified VAT rate (set at 13.04 percent)
- The upper limit of the specific excise duty can not be justified. According to EU legislation, specific taxation cannot be higher than 55% of the total tax including VAT. Specific taxes eliminate large price differentials and should be encouraged.

The Aspect Consortium report “Tobacco or health in the European Union. Past, present and future” which was financed by and prepared for the use of the European Commission, recommended in 2004 that “tax differences should be harmonised on the basis of specific rates as opposed to ad valorem”.⁵

Recommendations:

- Remove the 55% maximum threshold for the weight of the specific tax component of the total tax
- The required tax incidence (VAT and excise duties) on the retail selling price of cigarettes should be at 71% and the overall minimum tax (VAT and excise duties) shall not be less than 120 € per 1000 cigarettes from 1 January 2008. The required tax incidence (VAT and excise duties) on the retail selling price of cigarettes should be at 72% and the overall minimum tax shall not be less than 130 € per 1000 cigarettes from 1 January 2010.

2) Taxation of other tobacco products

2.1 Should the structure of excise duties on fine-cut tobacco intended for the rolling of cigarettes be brought in to line with the structure for cigarettes? If yes, in which way?

Minimum tax rates for fine cut tobacco at EU level are set at much lower level than for manufactured cigarettes: the overall excise duty levied on fine-cut smoking tobacco intended for the rolling of cigarettes shall be at least equal to 36 % of the retail selling price inclusive of all taxes, or EUR 32 per kilogram from 1 January 2004. As a consequence, hand rolling tobacco is taxed at a much lower rate than cigarettes in most countries of the EU. An increase of the price of cigarettes may result in a switch from cigarettes to hand rolling tobacco. Sales of roll-your-own tobacco, for instance, increased by 13% in 2004 in France. Even among youngsters hand rolling tobacco may become popular. One out of two young smokers smokes roll-your-own tobacco in France. The tax rate on roll-your-own tobacco should be made equal to the tax rate on one cigarette to prevent substitution towards this form of tobacco products. In this context, the Commission, upon request of a number of Member States, made the following statement to the Council minutes of 12 February 2002 : "The Commission states that, in its next review report provided for under Article 4 of Directive 92/79/EEC and Directive 92/80/EEC, it will present sufficient elements in order to proceed to an overall

⁵ The ASPECT consortium. Tobacco or health in the European Union. Past, present and future. Luxembourg, European Commission, 2004.

review of the possibility to bring the structure of excise duties for fine-cut smoking tobacco into line with the structure of excise duties for cigarettes”.

The Aspect Consortium report “Tobacco or health in the European Union. Past, present and future” recommended in 2004 that “tax on roll your own cigarettes should be raised to prevent substitution towards this form of tobacco products.”

Recommendation:

Increase gradually the minimum tax for fine cut tobacco to same level as cigarettes by imposing the overall tax (excise duties and VAT) levied on fine-cut smoking tobacco intended for the rolling of cigarettes shall be at least equal to 60 % of the retail selling price inclusive of all taxes and the overall minimum tax shall not be less than 60 € per 1kg from 1 January 2008, to 65 % of the retail selling price inclusive of all taxes and the overall minimum tax shall not be less than 70 € per 1kg from 1 January 2010 and to 70% of the retail selling price inclusive of all taxes and the overall minimum tax shall not be less than 80 € per 1kg from 1 January 2012.

2.2 How could the minimum rates for fine-cut tobacco be brought gradually into line with the rate for cigarettes, taking account of the specific characteristics of fine cut tobacco?

See answer 2.1

2.3 Should the minimum rates for tobacco other than cigarettes be adjusted for inflation?

The use of tobacco is very addictive. Minimum rates adjusted for inflation are insufficient to have an impact on the tobacco users. According to the World Bank, a price rise of 10% above inflation decreases consumption by about 4% in high-income countries.⁶ A yearly specific excise duty increase of 4% above inflation is recommended.

2.4 How could the existing definitions of cigars and smoking tobacco be amended in order to avoid abuse?

- 1) The Commission observes the following: “Currently, excise tax for pipe tobacco is lower than fine-cut tobacco taxation in 13 EU markets. Some of these markets face the problem of pipe tobacco being used for hand rolling or tubing of cigarettes. Therefore, the definition of smoking tobacco should be adapted in order to better differentiate between pipe and fine-cut tobacco and to avoid inappropriate taxation.”

Pipe tobacco should be taxed at least at the same level as fine-cut tobacco. The problem will not be resolved by differentiating between pipe and fine-cut tobacco, but by taxing both products at the level of fine-cut tobacco.

⁶ Jha P, Chaloupka F, Curbing the epidemic. Governments and the economics of tobacco control, The World Bank , Washington DC, 1999.

- 2) The Commission observes the following: “However, several Member States and the trade have reported that new products have appeared which are presented and marketed as cigars - they have the colour of a cigar or cigarillo, rather than the white colour of a cigarette – but in terms of function, taste and presentation must be regarded as cigarette substitutes. The manufacturing process for these products is similar to that for cigarettes. Under the current legislation, these products are taxed in the Member States at the same rate as cigars and cigarillos.”

EHN would welcome tighter cigar definitions which would avoid the appearance on the market of tobacco products which are presented as cigars but which are similar to cigarettes.

- 3) The Commission observes the following: “Herbal cigarettes and other products not containing tobacco are marketed in a number of Member States. These cigarettes are sold without health warnings and marketed as “safer” alternatives to cigarettes with tobacco.”

Herbal cigarettes are combustion products and should not be presented as safer products and should be taxed in the same way as cigarettes.

- 4) The Commission observes the following: “The current taxation requirements do not cover any kind of smokeless tobacco. This kind of products has a limited market share. Nevertheless, the possibility of including them in Community excise legislation has been suggested.”

The total absence of excise duties on these kinds of tobacco products is difficult to justify.

Taxation on smokeless tobacco should be part of the community health policy on smokeless tobacco which is now under review.

2.5 How can the current provisions be improved in order to better achieve health objectives??

In addition to the above, a specific additional health problem is cross border shopping. The number of cigarettes that can be imported for personal consumption when travelling between EU countries is restricted, but its level remains high. Directive 92/12/EEC sets an indicative level to establish whether tobacco products are for personal purposes (< 800 cigarettes). Member States may lay down indicative levels, solely as a form of evidence. The effect of price increases may be weakened by intensified cross border shopping in neighbouring countries. Cross-border shopping in Finland for instance takes mainly place with Estonia. It has been calculated that 2.5 million trips are made annually from Finland to Estonia for cross-border shopping. Luxembourg has consistently pursued a policy to keep tobacco prices at least 25% lower than in neighbouring countries to make cross-border shopping attractive. Sales in Luxembourg (population around 450 000 persons) increased as a result of tax increases in neighbouring countries (from 4.8 billion cigarettes in 2003 to 5.3 billion cigarettes sold in 2004). A survey among smokers in Belgium in 2001 found that 25% of the people living in one of the two provinces closer to the border with Luxembourg had packs with Luxembourg stamps, whereas the percentage goes down to 4% for the rest of the

country.⁷ This shows that legal cross-border trade mainly takes place within a range of 50 to 100 km from the border: the probability of people travelling to buy cheaper cigarettes will decrease with the distance and increase with the price differential.

Recommendations:

- Reduce the indicative level for cigarettes for personal use when travelling between EU countries to 200 cigarettes.
- Establish a maximum of 40 cigarettes for import from outside the community for personal use.

⁷ Ligue Nationale contre le Cancer. Seminar on Tobacco Taxation and Prices in Europe, 28 January 2005, Paris, 2005.