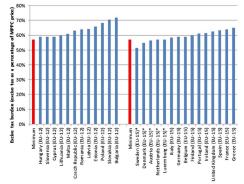
# Cigarette tax harmonization in EU

# Lessons learned from cigarette tax harmonization in the EU



## Figure 1 Excise tax burden in EU-15 and EU-12 member states, 2010. Note: \*indicates countries that invoked the exemption from the EU Directives since their excise tax exceeded €101 per 1000 cigarettes. EU, European Union; MPPC, most popular price category.

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Many tobacco control advocates credit the European Union's (EU's) minimum excise tax burden for increasing cigarette taxes and prices. However, the EU excise tax policy has been effective because it is more nuanced with an excise tax floor that acts as a binding constraint on member states with lower prices.

The European Union (EU) can serve as an example of a successful regional cigarette tax harmonization and integration regime. This level of integration was motivated by an effort to ensure the proper functioning of the EU in-

ternal market, which required a reduction in inter-country variation in tobacco product prices. Yet, despite the effort to harmonise, the variation in cigarette taxes and prices between the EU member states is greater than, for example, that across states in the USA. This is likely due to US states being much more homogenous than the EU member states, particularly with respect to incomes. These differences may drive the price strategies of the tobacco industry, which have implications for the affordability of tobacco products.

EU directives on cigarette taxation have two important features:

- 1. a minimum excise tax burden (percentage share of tax in price): The EU Directives (in effect as of 1 July 2006) specify that member states must meet a minimum excise tax burden of 57% of the most popular price category with an exemption for countries where the total value of the excise tax exceeds €101 per 1000 cigarettes.
- 2. an excise tax floor, measured in Euros per 1000 cigarettes sold: the excise tax floor of €64 per 1000 cigarettes.

Countries must also use a mixed tax system applying both ad valorem and specific excise taxes. Even though there is a lot of economic variation and dynamism in the EU, integrated multi-prong tax policy has been successful in increasing the real price and decreasing the affordability of cigarettes in many member states.

• Minimum excise tax burden and tax floor

A combination of the minimum excise tax burden and tax floor for increasing cigarette taxes and prices.

 These components create different binding constraints for EU-12 and EU-15 countries.







These components create different binding constraints for two groups of countries: the EU-15 states focus on the excise tax burden rule (or the higher excise tax floor), because they easily meet the tax floor due to higher cigarette prices. EU-12 states struggle to meet the excise tax floor, but have little difficulty meeting the excise tax burden due to lower prices. As of 2010, all EU-12 countries easily met the minimum tax burden requirement, with the actual excise tax burden ranging from 59% to 72% (mean 64%). In the same year, the excise tax burden ranged from 52% to 65% (mean 59%) in the EU-15 countries (figure 1). EU-15 states meet the excise tax floor easily with the value of excise tax per 1000 cigarettes ranging from €101.40 to €260.98 (mean 140.57). On the other hand, EU-12 states struggle with this requirement: their excise tax per 1000 cigarettes ranges from €64.00 to €122.00 (mean 76.18) (Figure 2).

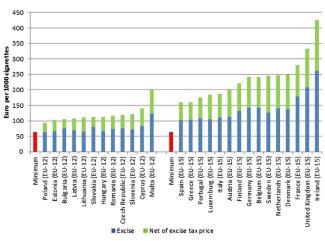


Figure 2 Excise tax and most popular price category price per 1000 cigarettes in European Union (EU) member states, 2010.

### **Policy lessons**

- A nuanced tax policy is required for regional harmonization in diverse regions.
- The EU provides an important blueprint for tax harmonization

While a lot of positive attention as focused on the excise tax burden rule, it is only relevant for EU-15 countries. The most effective mechanism for reducing the price differential between EU-12 and EU-15 states is not the excise tax burden rule, but rather the excise tax floor. In 2010, the EU strengthened the tax requirements for member states, raising the excise tax burden to 60% and raising the excise tax floor by 41% to €90 per 1000 cigarettes. Both groups of countries will need to make adjustments to comply with the new directives. However, the impact will be more dramatic in EU-12 countries (due to the 41% increase in the excise tax floor). This will reduce price differentials within the EU thereby reducing incentives for tax avoidance and evasion, and reduce cigarette affordability, particularly in EU-12 member states where affordability has been sustained or increased by the economic growth and/or tobacco industry price strategy.

The EU provides an important blueprint for tax harmonization and integration in other regions. It shows that in diverse regions one may simply not be able to harmonise taxes on one measure (ie, tax burden) but may require a number of interconnected measures to reduce variation in cigarette prices. Additionally, recent steps taken by the EU will result in reduced variation in prices.

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