

TOBACCO TAXES IN THE EUROPEAN UNION

An evaluation of the effects of the European Commission's proposals for a new Tobacco Tax Directive on the markets for cigarettes and fine cut tobacco

POLICY BRIEF

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Background

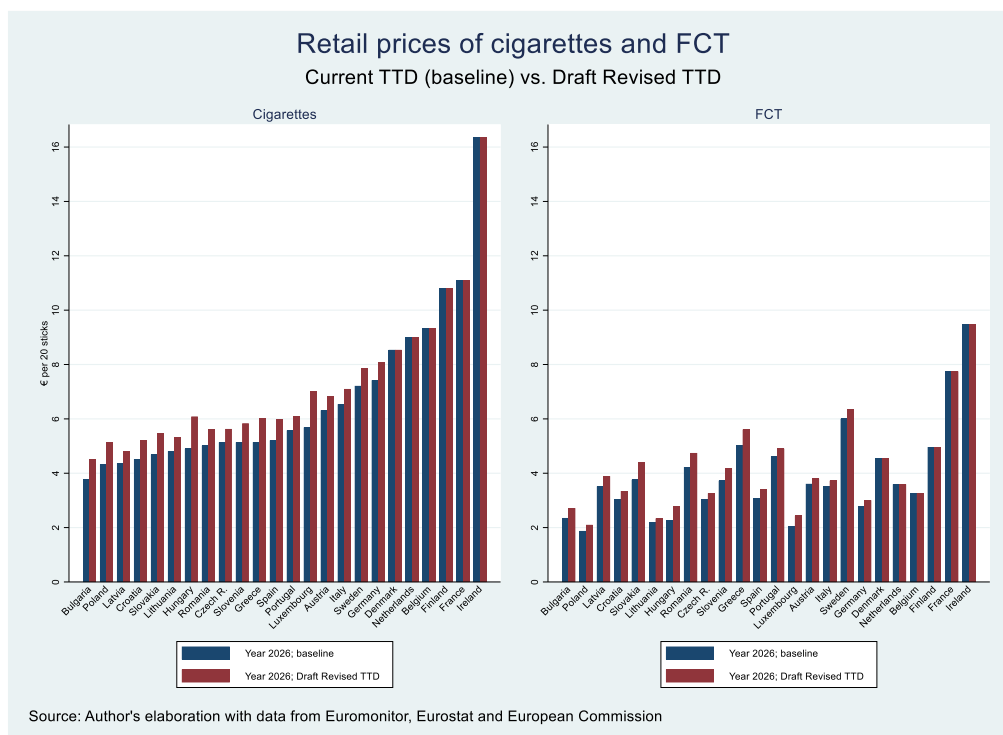
Europe's Beating Cancer Plan aims to create a Tobacco-Free Generation where less than 5% of the European Union's (EU) population use tobacco by year 2040, with an intermediate goal of 20% in 2025. There are several factors weighing against reaching this objective. First, fine cut tobacco (FCT) costs half as much as cigarettes on average in the EU, and the price gap appears to have increased in recent years. These products are highly substitutive, so a large difference in prices blunts the protective effect of taxes as consumers are able to easily trade down from cigarettes to FCT. Second, there are persistent cross border price differences in several regions across the EU for both cigarettes and FCT, which undermine the tobacco control efforts of higher tax countries. Third, more recently, because of both increasing incomes and the erosive action of higher inflation that has greatly affected the bloc, these products have become more affordable in most member states.

The European Commission was expected to launch a proposal for a revised Tobacco Tax Directive (TTD) addressing these issues in December 2022, but this step in the legislative process was postponed until further notice. A draft of the revised TTD has circulated unofficially offering the possibility to analyze the likely effects of the tax reforms therein, which were intended to operate as of 2025. Focusing on cigarettes and FCT, this policy brief presents a comparison of the effects that such reforms would have on product prices, market demand, and excise revenue versus a baseline scenario where the current TTD remains in force and tobacco taxes in member states remain at their 2023 levels.

Effects on retail prices

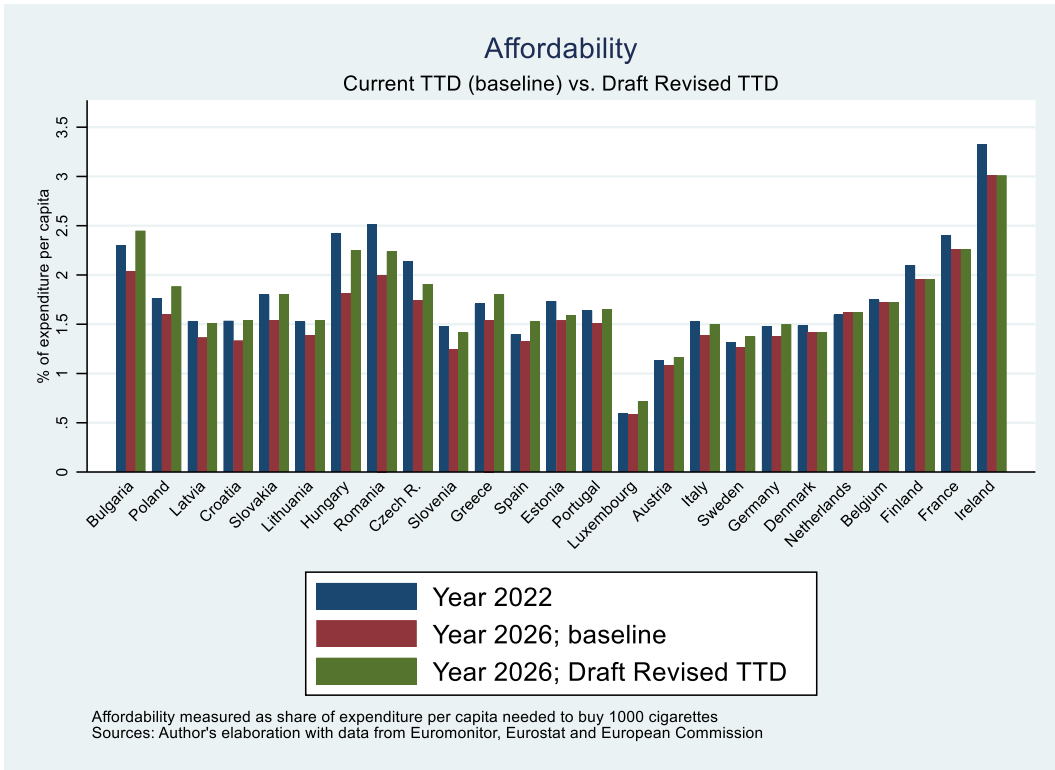
The Commission's proposals would lead to small retail price rises in all but the 6 member states with the highest current tax rates (Denmark, Belgium, Finland, France, the Netherlands, and Ireland). However, such rises would not contribute significantly to a reduction in either the gap between the prices of cigarettes and fine cut tobacco within countries or cross-border price gaps (Figure 1).

Figure 1



Similarly, the modest impact on prices would only restore the affordability levels of 2022 for 8 states (Bulgaria, Poland, Greece, Spain, Austria, Sweden, Luxembourg, and Germany) (Figure 2).

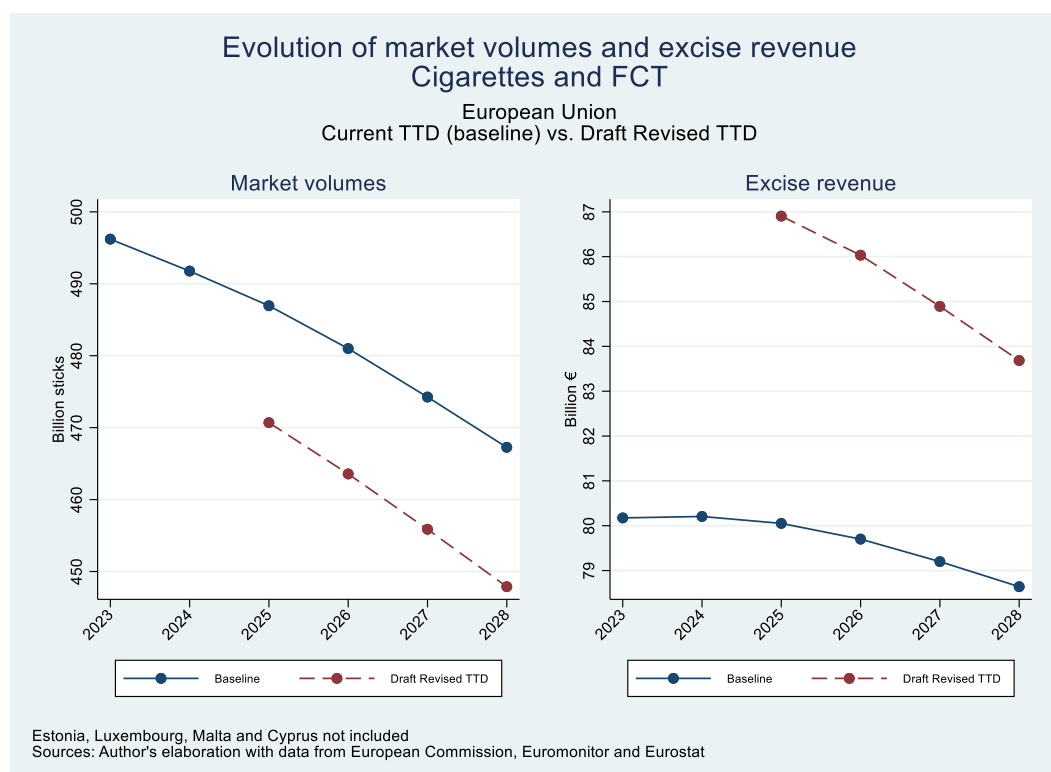
Figure 2



Effects on market demand and excise revenue

The proposals would reduce the combined market demand for the two products in the bloc by between 3.3% in 2025, the first year of implementation of the revised Directive, and 4.1% in 2028, the last year of the simulations horizon (Figure 3, left panel).

Figure 3



Despite these reductions, excise revenue in the bloc would increase by between 8.5% in year 2025 and 6.4% in year 2028 (Figure 3, right panel).

Conclusions and policy recommendations

The European Commission's proposals for reforms in the taxation of cigarettes and FCT are necessary. The sooner the legislative process is restarted, the better for both fiscal and public health. But, as the modest effects on retail prices suggest, they are also insufficient from the point of view of public health. Two shortfalls stand out.

- 1) The proposal for a revised TTD does not sufficiently address the asymmetric tax treatment of cigarettes and fine cut tobacco whereby the minimum tax applicable to the latter may be calculated as a fraction of the retail price. The removal of this asymmetry would raise the price of FCT thus contributing to bridging the price gap with respect to cigarettes.
- 2) The surge in inflation experienced throughout the bloc in recent years renders the proposals for minimum taxes insufficient to reduce product affordability significantly. Considering that the enactment of a revised

TTD will not occur before 2025, these minimum taxes should be increased to not only meet these inflation increases but outpace them.

In addition, there is opportunity for action by national governments in the EU willing to prioritize tobacco control when setting their own domestic taxes and acting on this front is of paramount importance given the uncertainty about the date of enactment and contents of a revised Directive.

Acknowledgements

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