

Tobacco taxation, consumption and illicit trade in Belgium

London Economics' analysis for ESTA

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Key Messages

Since 2013, there have been a number of sharp increases in tobacco excise duties in Belgium. These increases ranged from **8%** and **10%** per annum between 2013 and 2015, but reached approximately **17-19%** between 2016 and 2017. These most recent and significant duty increases were imposed to fund Belgium's 'tax shift'¹ policy aimed at reducing taxes levied on both households and businesses.

As a consequence, the tax differential between the Netherlands and Belgium has narrowed, with the result that cross-border trade has become less attractive. However, there has also been a shift to the illicit market. Illustrating this, the level of duty paid FCT in Belgium declined from **10,110** tonnes in 2013 to **9,061** tonnes in 2016 - further declining by **17%** to **7,507** tonnes in 2017.

The impact of this policy has been to significantly **reduce taxation receipts** – and in doing so, create a hole in the public finances. In particular, at the beginning of 2016, government revenue from tobacco excise duties was expected to be approximately **€3,238 billion**; however, by the end of 2016, only **€3,087 billion** of tobacco duties had been collected. In other words, even though excise duties were increased with the aim of raising revenues, there was a fiscal shortfall of approximately **€151 million**. By 2017, tobacco duties had further declined to **€3,004 billion**, thereby exacerbating the fiscal shortfall.

These fiscal deficits may limit or postpone the proposed taxation changes contained within the 'tax shift' policy; adversely impact households and businesses in the long run; and negate the original positive impacts that might have been associated with the policy.

The analysis illustrates the sensitivity of the demand for FCT to change in excise duties (and price), but also the importance of the speed of changes in excise duties on consumer behaviour; the **buffer function** of FCT; and the long run consequences on the public finances of sudden and ill-conceived policy changes.

¹ KPMG (2015). *De Belgische 'taxshift'* ([here](#))

Evolution of tobacco excise duties in Belgium

Since 2004, tobacco taxation policy has been closely linked with public health policy in Belgium. Although the then health minister identified tobacco excise duties as an important means of reducing the use of tobacco², up until at least 2010, tobacco excise duties in Belgium lagged behind those of neighbouring countries³ leading to a relatively high incidence of cross border shopping.

Since 2015, there have been a number of fundamental changes in tobacco taxation policies, which have been part of a fundamental ‘tax shift’⁴. Specifically, in a bid to improve Belgium’s competitive position, as well as increasing the level of household disposable income, numerous taxes on both households and businesses were reduced. However, to achieve fiscal neutrality, a number of other taxes, including tobacco excise duties, were significantly increased⁵. However, as a result in the decline in domestic consumption and cross border shopping, the additional income from tobacco excise duties was substantially lower than expected^{6,7,8}.

Following two amendments in 2016 and 2018, the structure of Belgian tobacco excise has changed. The ad valorem component of excise on FMC decreased, and has been compensated for with an increase of the specific excise duty component. For FCT, the ad valorem excise rate has remained unchanged over the whole period but overall duty increases have only been achieved through the imposition of higher specific excise rates. As of January 2018, the minimum excise duty for both FMC and FCT is fully aligned with the respective excise yield (based on the weighted average price of each product category). This change in taxation structure resulted in a growing divergence in the tobacco taxation structure between Belgium and neighbouring Luxembourg. Simultaneously, the increased rates in specific excise duties imposed on FMC, and the greater increases via higher specific excise rates for FCT were designed to finance the government’s ‘tax shift’ policy. A further increase in excise rates, in the context of the ‘tax shift’, is expected in 2019. Despite this, early estimates from 2018 already confirm accelerated loss in FCT taxation revenues, undermining the “tax shift” policy.⁹

Evolution of tobacco excise duties and prices in Belgium

In relation to FCT, between 2002 and 2016, there has been a **156%** increase in the weighted average price of FCT over the period, which compares to a **103%** increase in the corresponding price of FMC. These increases in retail prices have been predominantly driven by the larger increase in the excise duties that have been levied on FCT, which have increased by **190% per kg FCT** over the period, compared to **100%** increase in the excise duties on FMC. This is presented in Figure 20 below.

² Demotte, R. (2004). *Federaal plan ter bestrijding van het tabaksgebruik* ([here](#))

³ Cathy Rigolle (2010). *Het tabaksbeleid in België en Vlaanderen sinds 2004* ([here](#))

⁴ KPMG (2015). *De Belgische ‘taxshift’* ([here](#))

⁵ Het Laatste Nieuws (2015). *De taxshift: zo gaan we hem voelen* ([here](#))

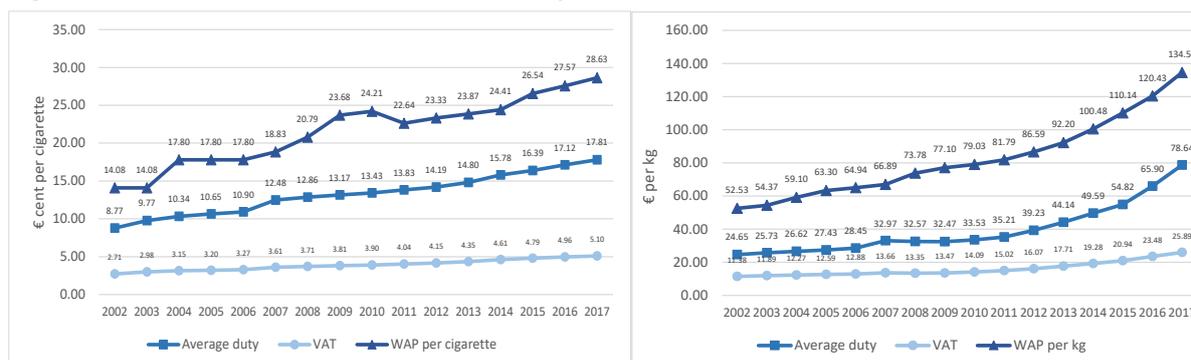
⁶ Le Soir (2016). *Alcool et tabac font un trou dans le budget*

⁷ De Tijd (2017). *Hogere tabaksaccijnzen leveren nog amper iets op* ([here](#))

⁸ De Standaard (2017). *Moeten de accijnzen op tabak verlaagd worden?*

⁹ Wolters Kluwer (2018) *Herstructurering van accijnzen op sigaretten en nieuwe wijze van berekening minimumaccijns op sigaretten en tabak (art. 134-139 PW)* ([here](#))

Figure 19: Evolution of FCT excise duties and prices over time



Source: European Commission, 2018. (http://ec.europa.eu/taxation_customs/tedb/taxSearch.html)

What has happened to Belgian duty paid FCT consumption over time?

However, despite the very large increases in excise duties levied in Belgium over the period, the decline in consumption in tobacco products in Belgium has been concentrated within the FMC market, while FCT consumption was actually higher in 2016 than in 2002 – in part because of the switching behaviour of consumers between FMC and FCT, but also as a result of the cross border purchases from other Member States – in particular the Netherlands. Following the most recent tax changes, consumption in 2017 declined by 17% compared to 2016.

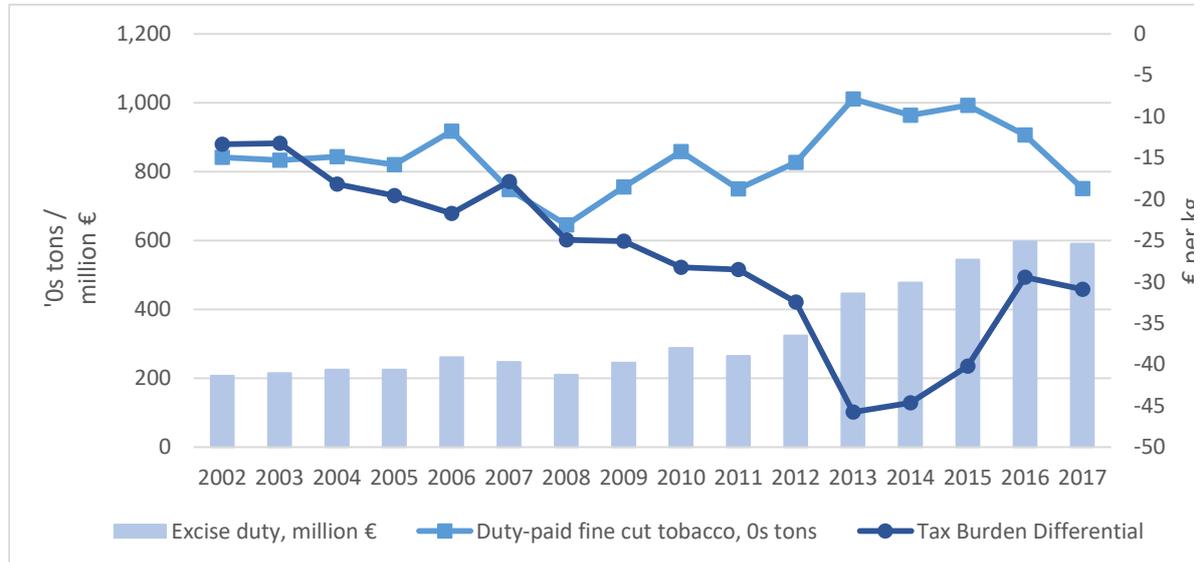
In Figure 20, we present information on the evolution of **duty paid consumption** of FCT in Belgium, as well as the **tax revenues** generated. Alongside this information, we also provide information on the tobacco tax differential that exists between Belgium and the Netherlands. Again, the rationale for the inclusion of this information is to reflect the interdependency of different jurisdictions, and to highlight the fact that the decisions in neighbouring Member States have a spillover or ripple effect on other Member States. Whilst in the previous section, we demonstrated the **negative effect** of sharp duty hikes on the fiscal position of the Dutch governments, the analysis here illustrates that the Belgian government was a beneficiary of Dutch tax policy decisions.

In particular, the analysis presented in Figure 20 highlights the fact that between 2002 and 2012, the total volume of FCT consumption was relatively stable between **8,000** and **9,000 tonnes** per annum. The average across this 10 year period was marginally in excess of **8,000 tonnes** per annum, with the largest declines occurring in 2007 and 2008 (dipping to **7,500** and **6,500 tonnes** in each year following a **16%** increase in excise duties between 2005 and 2006 (and an associated **20% decline** in excise taxation generated from FCT in the subsequent 2 years)). However, between 2006 and 2011, the levels of excise duties charged on FCT remained relatively stable (increasing at **1%** over the five year period). At the same time, the level of FCT consumption stabilised and recovered, increasing from a low of **6,500 tonnes** in 2008 to reach **7,500 tonnes** and **8,500 tonnes** in 2009 and 2010 respectively. By 2012, the level of FCT consumption had remained in excess of **8,000 tonnes**.

However, since 2008, in addition to the stabilisation of excise duties on FCT, a second factor has played a role in the increase in FCT duty-paid consumption (to more than **10,000 tonnes** in 2013, and between **9,000** and **10,000 tonnes** in each of the three years subsequently). In particular, as illustrated in Figure 20, the differential in the tax burden between Belgium and the Netherlands increased significantly (in absolute terms). A negative tax burden differential implies that FCT was more expensive in the Netherlands than in Belgium; the more negative it becomes, the cheaper Belgian FCT is in relative terms and the larger the tax burden differential. Between 2002 and 2008,

the tax differential in FCT between the two Member states had reached approximately **€25 per kilo**; however after 2008, and in response the sharp increases in Dutch tobacco taxation, the gap widened to approximately **€32 per kg** by 2012 and **€46 per kg** by 2013. The very sharp increase in the excise differential between Belgium and the Netherlands between 2012 and 2013 was associated with a **22%** increase in duty paid consumption in Belgium, although it is clear that a significant proportion of this was destined for the Netherlands. This is illustrated by the cross-border trade for FMC between the Netherlands and Belgium.

Figure 20: FCT consumption, government FCT revenue, and Netherlands-Belgium tax differential

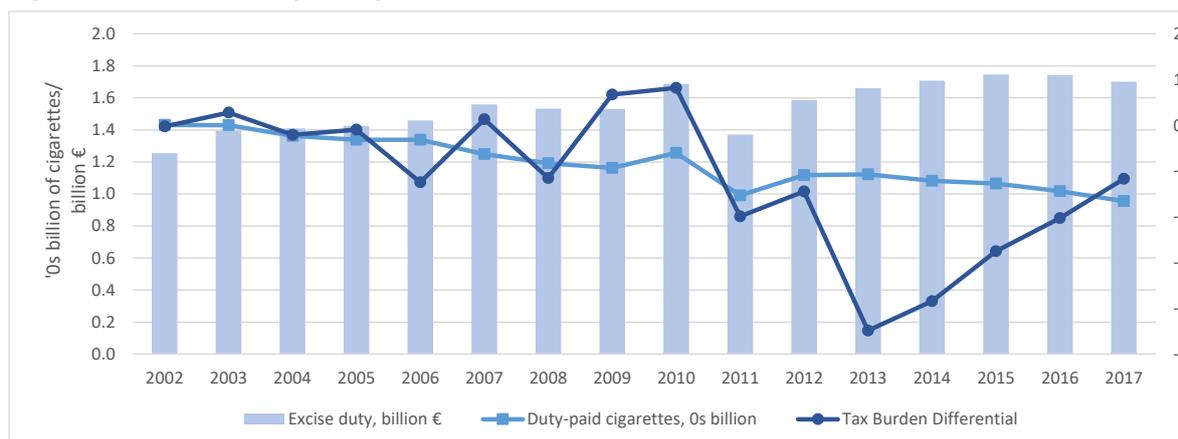


Source: London Economics analysis of EC DG Taxud data

Since 2013, there have been sharp increases in the levels of excise duties imposed in Belgium. These increases have amounted to between **8%** and **10%** per annum between 2013 and 2015, but reached approximately **17-19%** between 2016 and 2017. At the same time, the tax differential between the Netherlands and Belgium has narrowed, with the result that cross-border trade has become less attractive and the level of duty paid FCT released for consumption in Belgium has declined from **10,110 tonnes** in 2013 to **9,060 tonnes** in 2016. There was an even sharper decline in 2017, with FCT consumption declining to **7,507 tonnes** – corresponding to a **17%** decline compared to 2016.

Note that in relation to FMC, as presented in Figure 21, although the tax differential between Belgium and the Netherlands has followed a relatively similar path in terms of widening between 2008 and 2013, with a subsequent narrowing since 2013, the level of consumption has declined relatively continuously over the period (by **20%** from 2008 to 2017).

Figure 21: FMC consumption, government FCT revenue, and tax differentials



Source: London Economics analysis of EC DG Taxud data

What has happened to Belgian FCT tax revenues over time?

In relation to government tobacco taxation receipts, the analysis presented in Figure 21 relating to FMC illustrates that over the entire period, the **100%** increase in excise duties per cigarette was associated with a **33%** reduction in consumption, but a **36%** increase in the taxation receipts associated with FMC (from **€1.25 billion** in 2002 to **€1.701 billion** in 2017).

The **190%** increase in duties on a kg of FCT since 2002, combined with domestic switching between FMC and FCT, as well as the significant increase in cross border shopping, has resulted in an **11%** decrease in consumption over the period. Despite this, there has been a **184%** increase in taxation receipts over the period. In monetary terms, the value of the taxation revenues accrued by the Belgian government on FCT have increased from **€207 million** in 2002 (**17%** of the taxation revenues associated with FMC) to **€590 million** in 2017 (**35%** of the taxation revenues associated with FMC).

However, despite the positive picture demonstrated by FCT over the entire period – in part because of the buffer function of FCT – it is important to note that **on those occasions where there have been sharp increases in FCT excise duties, there have been sharp declines in the level of taxation revenue received by the government.** In particular, the sharp increases in FCT duties per kg have been associated with substantial reductions in both consumption levels and government taxation receipts. This fact illustrates the sensitivity of the demand for FCT to change in excise duties (and price), but also the importance of the rapidity of changes in excise duties on consumer behaviour.