NICK SOPER, spiritsEUROPE - SPEAKING NOTE - CAIT / CEPS SEMINAR: FIGHTING ILLICIT TRADE, 6 NOVEMBER 2017

TVM for opportunity to provide a spirits perspective on illicit trade. This is an area we take seriously, for reasons that will be familiar: consumer health; government revenues; fair competition; protection of investment and intellectual property rights.

Over the next 10 minutes, I'll set out what illicit means in the spirit sector, explain the drivers for the trade and what we hope might be done about it.

While it is hard to measure the scale of illicit trade, in 2016 there were some useful reports:

- the EUIPO's report on IPR infringements in the EU concluded these cost EU wines and spirits producers €1.3 billion a year, with national finance ministries losing about the same amount;

- DG Taxud's paper on Customs seizures suggested about €10 million of the €700 million total was alcoholic beverages;

- the OECD published a major global study, to which we contributed a chapter;

But we lack detail in our sector, with much of the information anecdotal. Part of the problem is the breadth of illicit activity:

- There are illegal, unregistered factories producing fake spirits. These are the most problematic: in 2012, bootleg spirit made by a small plant in the Czech Republic killed over 50 people - it emerged the producer had used methanol, which is poisonous, rather than ethanol. Sometimes these factories counterfeit known brands.

- There is home and micro-distillation. This allowed in many MS, albeit nominally subject to controls. But they are seldom enforced and the spirit ends up in commercial channels. In Greece, sales could be as high as 15 million bottles;

- Refilling genuine bottles with cheaper spirit is another issue. It might be tax-paid and not present health risks, but it deceives consumers and breaches producers' intellectual property rights.

- There is undeclared production from licensed distilleries.

- There are surrogates, in which products such as mouthwash, which contain alcohol, are consumed instead of normal, tax-paid alcohol. In some Baltic countries you can see newspaper kiosks selling bottles of mouthwash straight from the pallet.

- There is smuggling of legally produced spirits. Some of this trade is purely fraudulent and no tax is paid, but some pays tax in the country of purchase rather than the country of consumption, the usual tax point. Here, rogue traders exploit cross-border differences in tax rates.

Illicit therefore covers a wide range of situations. While there are blatant examples of the difficulties in individual Member States, before talking about them, it is important to explain the driver for illicit trade. TAX. It's not the existence of tax *per se* but rather how it is applied.

Member States decide the level of tax in their countries, subject to minimum rates set down in EU law. The minimum rates are, on a like for like basis, 0 for wine, 187 Euros for beer and, in most cases, 1,000 for spirits. 17 MS, which produce wine, apply a zero rate. Every Member State taxes spirits at a much higher rate than they do beer.

All the categories compete and the potential for illegitimate profit by avoiding tax on spirits is therefore substantial. When you add to that: the economic downturn; differences in relative wealth; poor tax collection; and variations in tax rates between Member States, you have a cocktail that lets illicit trade flourish.

In **Greece**, the 2007 crash has had a calamitous impact: unemployment over 25% and a fall in real wages by the same amount. One of the policy measures to try to tackle lower government revenues was huge tax increases.

In 2009 and 2010, tax on spirits was increased by 125%. Greece went from one of the EU's low'ish tax countries, to one of its highest. Entirely predictably, the legitimate market collapsed, not least because Bulgaria, its only direct EU neighbour, had a tax rate one fifth of the Greek level.

Spirit sales in 2008 of 6.5 million cases (each 12 bottles) fell to 3.7 million cases in 2012, a 43% drop. Around 400 legal distilleries closed. Excise revenues in 2016 were lower in real terms than in 2009.

But demand did not fall. It is estimated that a third of the spirits market is now supplied from Bulgaria. Some is legitimate product but tax-unpaid; some is from illicit production. Some low-taxed Greek spirits have seen an explosion in sales. These reduced rates are also illegal - we have a case at the European Court.

While the illicit market in Greece has been created by huge tax rises, it is proving difficult to reverse the increases and thereby start to encourage consumers back into legitimate sales channels. The depth and length of the downturn means illicit activity now carries little stigma and it will be hard for Greece to get out of the hole it and the Troika have excavated.

In **Romania and Bulgaria**, the problems are perhaps even more serious. For years traders have complained about the black market: from undeclared production at licensed distilleries; from illicit production; and from home distillation. There were reports that 80% of the market did not pay tax. Fiscal policy was again the driver.

In the run-up to EU accession, Romania and Bulgaria were required to increase tax rates to meet EU minimum levels. Between 2002 and 2006, Romania increased tax on spirits 6 times, from €65 to €750 per hectolitre, an increase of over 1,000%. Bulgaria's increases of 220% were also massive, but appear modest in comparison.

As with Greece, what happened next was easy to predict. The tax increases came faster than the economic growth EU membership provided and the increased unaffordability of many spirits created black markets in both countries.

In Romania today, there remains a huge problem. Tax revenues from spirits are pitifully low, at around €100 million. By comparison, Slovakia, with a quarter of Romania's population and only slightly higher tax rates, collects more than double that amount.

Despite the experience, Romania increased taxes by a further 42% in 2013; what everyone said would happen did happen. Belatedly, the government conceded its mistake and cut tax by 30%. Much more will be required to tackle the ongoing major difficulties.

Bulgaria has not changed its rates since 2006, but still suffers from a big tax-unpaid sector. It took an important step, however, in introducing a requirement for licensed distilleries to introduce measuring equipment and cameras linked to the Finance Ministry. The sales of banderoles to these distilleries rose substantially. Although these fiscal markings were already required, and were designed to protect revenues in the first place, they had not worked. They never do in our sector.

So, that is just a glimpse at some of the issues. While do not have enough robust data, the evidence of serious problems is clear.

This is too big a difficulty for the legitimate trade alone to try to resolve. In addition, genuine producers are victims of the problems which the fiscal measures have caused. As a first step, we hope that official research can be commissioned into understanding the scale of the illicit market so that policy measures to address it can then be devised.

Thank you. I'd be very happy to try to answer any questions