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approximation of indirect tax rates
and harmonization of indirect tax structure.
Global Communication from the Commission

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VERSION PROVISOIRE

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COMPLETION OF THE INTERNAL MARKET: APPROXIMATION OF INDIRECT TAX RATES AND HARMONIZATION OF INDIRECT TAX STRUCTURES

GLOBAL COMMUNICATION FROM THE COMMISSION

1. Introduction: the economic and historical perspective

The Commission's White Paper on completing the internal market of the Community[1] was a response to the need to reverse the relative decline of western Europe. The undertaking is an ambitious one - to some perhaps frighteningly so - but it had to be ambitious if it was to measure up to the scale of what is needed. And the Governments of the Member States have firmly and repeatedly committed themselves to fulfilling those ambitions. They had already been searching for some time for a strategy - a strategy which would revive the entire economy of Europe and reverse the process of the previous decade or more which had caused our performance in terms of output to fall increasingly behind those of our main competitors in America and Japan.

Their recognition that the solution was to be found in the completion of the internal market goes back as far as the Copenhagen European Council in December 1982 and was reaffirmed at Dublin and Fontainebleau in 1984.

The Commission took up the challenge and gave it more concrete expression by declaring in the European Parliament in January 1985 that within 8 years - the life of two Commissions - a programme for the dismantlement of the Community's internal frontiers would be drawn up and implemented.

The population of the European Community is nearly half as large again as that of the United States and well over twice that of Japan. We are the biggest and oldest-established bloc of trading nations in the world. Our scientific knowledge and our capacity for invention are second to none. But for want of a dynamic regenerative impetus these immense resources in considerable measure lie fallow, failing to produce the growth and the rich

(1) COM(85) 310 final

harvest of prosperity of which they are intrinsically capable. Perhaps the starkest measure of the extent of the waste and of the urgency of the need for action is that, meanwhile, 16 million potential producers of wealth and growth stand unemployed. The simple truth is that we are failing to make use of the immense potential which Europe possesses.

What is the reason for this tragic waste of opportunity and potential? The Community's Heads of State and Government had long sensed that the answer lay in the disunity which still, nearly 30 years after the signing of the Treaty of Rome, marked the European economy itself. The countries of the European Community, for all their common heritage and common interest, remain a fragmented economy, divided into a dozen separate markets; each with its own rules; each manufacturing for its own market; each facing obstacles and difficulties in trying to trade with other Member States. That is why the Community has steadily fallen behind the more integrated markets of the United States and Japan in the growth of its demand, its production and its trade.

The Heads of State and Government, meeting in March 1985 in Brussels, set the target and the objective by identifying as their first priority "action to achieve a single large market by 1992 thereby creating a more favourable environment for stimulating enterprise, competition and trade; it called upon the Commission to draw up a detailed programme with a specific timetable before its next meeting".

The Commission's blueprint in response to this challenge was rapid, bold and radical. It has since been universally accepted as the foundation for a rebirth of European aspirations. The White Paper on completing the internal market did not mince its words:

"Europe stands at the cross-roads. We either go ahead - with resolution and determination - or we drop back into mediocrity. We can now either resolve to complete the integration of the economies of Europe; or through a lack of political will to face the immense problems involved, we can simply allow Europe to develop into no more than a free trade area.

The difference is crucial. A well-developed free trade area offers significant advantages: it is something much better than that which existed before the Treaty of Rome; better even than that which exists today. But it would fail and fail dismally to release the energies of the

people of Europe; it would fail to deploy Europe's immense resources to the maximum advantage; and it would fail to satisfy the aspirations of the people of Europe."

The White Paper and its programme were welcomed and largely endorsed by the European Council meeting in Milan in June 1985. Six months later saw the adoption of the Single European Act which establishes as a legal commitment the objective of "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured." A Europe without internal frontiers - not a Europe with fewer or simpler frontier controls, but one with no such divisive frontier controls at all. The programme in the White Paper is for a comprehensive elimination of all the barriers - the physical barriers, the technical barriers and the fiscal barriers - which cause the face of Europe to be scarred by the frontiers which divide it. One of the declarations that accompanied the Single European Act made specific reference to "decisions necessary to implement the Commission's programme described in the White Paper on the Internal Market".

The Commission and the Governments of the Member States are therefore firmly committed to embark on the completion of the programme.

2. Completing the Internal Market: the fiscal aspects

The Commission has taken as its starting point a snapshot of the existing wide spread of indirect tax rates and structures in the Community. It has then confined itself to setting out the minimum changes which must be made to that picture in order to achieve a sufficient degree of fiscal approximation. It must be clearly understood that the present package is not an attempt to design an ideal fiscal system for the Community, but a blueprint for abolition of fiscal frontiers. It is in that spirit that the Commission has tried to find the most practical possible solutions; and it is in that spirit, and taking possible problems of adjustment into account, that they are presented and must be studied. That is the job which the Commission was asked to do.

Already in Milan in June 1985, the European Council launched an intensive programme of activity based on the White Paper proposals. As far as the fiscal chapter (Part III) was concerned, the Milan conclusions stated: "As

regards the approximation of VAT and excise duties, the European Council invited the Council of Ministers for Financial Affairs (ECOFIN) to examine on the basis of the White Paper any measures which might be necessary for the achievement of a single market and the possible timetable for the application of those measures."

The ECOFIN Council delegated this mandate in the first instance to a high-level group of fiscal experts who, together with representatives of the Commission, considered the fiscal proposals outlined in the White Paper and the possible alternatives to it. The high-level group reported to the ECOFIN Council in June 1986 that the proposal would achieve the removal of formalities and fiscal controls at borders in the case of intra-Community trade and that the alternatives they had considered would fail to result in the removal of fiscal frontiers and could not, therefore, be recommended. Nevertheless, the report also made it clear that there were still considerable difficulties, uncertainties and hesitations, and concluded that "Member States will not be able to decide whether the measures envisaged by the Commission are ultimately acceptable to them until full details of the measures as a whole are available. Only when Member States can see clearly

- the financial, budgetary, economic and social consequences of the measures for them,

- the practical consequences for both the economy and individuals and the national budget entailed by the clearing mechanism,

will each of them be in a position to weigh up the advantages and disadvantages resulting from the Commission's system and decide whether it is prepared to agree to the system."

The ECOFIN Council in June 1986 discussed the group's conclusions and reserved its position until the Commission had submitted to the Council "detailed proposals on the rates and rate structure of indirect taxation and on the clearing system. On that basis the Member States will be able to state their position on the approach which the Commission envisages in Part III of the White Paper".

This Communication provides the detailed proposals for which ECOFIN have asked. It constitutes the beginning of the next, and probably most

decisive, phase of this dialogue. As is clear from the conclusions of the high-level group and the ECOFIN Council, the process of fiscal integration cannot begin in earnest until the Member States have had an opportunity to assess what fiscal approximation will mean to them in real terms. Only when a clear and coherent set of proposals for fiscal approximation is on the Council table will the Member States be in a position to weigh up the implications for themselves, and to determine what benefits and what costs they offer to each of them in their own particular circumstances, both in the shorter and the longer term.

Neither the Commission nor the Member States have ever had any illusion about the magnitude and the difficulty of the task ahead. But they have not hitherto been in a position to measure it. The present proposals are the basis on which that task of analysis, of evaluation and of eventual adjustment can now take place. Every effort will need to be made to find Community solutions to difficulties that may arise. If that should prove in some cases to be impossible, the Commission is prepared to examine with the Member States concerned what special measures might be applied to them. Such measures would have to be of a temporary nature and must cause the least possible disturbance to the functioning of the Common Market. The Commission could then propose appropriate solutions to the Council, notably as provided for in Article 8C of the Treaty as amended by the Single European Act.
As is discussed in more detail later in this paper, the path to abolition of fiscal frontiers in 1992 will be an easier one to tread for some Member States than for others. Some aspects may cause extreme difficulty in some cases, for example in Member States whose budgetary receipts would be significantly reduced or increased. The Community as a whole - the Member States and the Commission working together - will have to find ways, including the possibility of derogations where these can be justified, of easing the path for those of its members for whom the implementations of the proposals could pose political, social or budgetary problems. The proposals already provide a major element of flexibility; it is proposed that Member States be given freedom to determine their own path to 1992 and the pace at which they travel along it. The Council and the Commission will monitor the pattern of progress and may propose solutions to difficulties which manifest themselves. The Commission will consider the possibility of proposing complementary measures at a later date, which would enable the measures proposed here to be amended on a Community basis if economic developments were to make that desirable. This would enable any limitation

which fiscal approximation might impose on Member States' flexibility of response to be compensated for at a Community level.

All this, however, is yet to come. The immediate task for the Community is to study the proposals which accompany this communication and for each of its Members to evaluate their significance.

3. The Proposals

The White Paper demonstrated that if fiscal frontiers are to be abolished and the indirect taxation system of the Community is to serve the single unified market which we are committed to completing, there must be a considerable measure of approximation of indirect taxes. Only then, when indirect tax levels are sufficiently close as between one Member State and another so as not to distort competition and patterns of trade, will it be possible for the European economy to work in a free and unfettered way; only then will goods, services, capital and people be able to move freely to where they enjoy genuine comparative and competitive advantage. If we are to abolish the internal frontiers which at present divide us, it is vital to deal with fiscal frontiers and the underlying reasons for their existence. This is not a new dawning of the truth. It is something which has been accepted ever since the founding of the Community: and it has been re-affirmed on many subsequent occasions, not least in the Single European Act itself.

The abolition of fiscal frontiers will bring with it the abolition for intra-Community trade of the existing system of relieving goods from tax at export and of imposing tax at import, as has indeed been envisaged ever since the First VAT Directive was adopted twenty years ago. Elimination of the distinction made at present between supplies within a Member States and supplies to another Member State should result in significant administrative simplification for traders.

In addition, the removal of fiscal frontiers necessitates approximation of VAT and the main excise duties if unacceptable levels of distortion of competition, diversion of trade, and tax fraud are to be avoided.

The Commission is also proposing a VAT clearing mechanism to ensure that, after frontier controls have been abolished, the Member States continue to

receive the revenue to which they are entitled. It will ensure that output tax collected on export sales in one Member State is passed on to the Member States in which the supplies are finally consumed. The mechanism is described in detail in a separate Working Paper but is in essence a central account through which Member States will draw or pay money periodically, depending on the extent to which they are net importers or exporters. Member States will calculate the amount to be drawn from or paid to the central account on the basis of information supplied in traders' VAT returns. No additional records will need to be kept. For excise duties, no such system is needed, since these are not charged until the goods are released from bond, normally in the country in which they are to be sold to the final consumer.

There are, of course, other indirect taxes within the Community, such as taxes on the registration of vehicles, and on the purchase of houses, which vary considerably from Member State to Member State. Those variations can be such as to cause distortions of competition and deflection of trade. But they do not impede the free movement of goods in the sense that the differences between them do not give rise to controls or formalities at frontiers. The Commission actively pursues cases in which such indirect taxes breach the rules of the Treaty, but does not consider their approximation to be a necessary part of the abolition of fiscal frontiers.

In adopting its approach to the elimination of fiscal frontiers, based on the notion of the sufficient approximation of the existing patterns of indirect taxation in the Member States, the Commission is strictly implementing Article 99 of the Treaty as amended by the Single European Act. That Article calls for proposals "for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market within the time limit laid down in Article 8A (ie, 1992)". The Commission has refrained from proposing anything which is not strictly necessary for that purpose. There are pressures from one quarter or another to use the approximation process as a vehicle for achieving other fiscal changes or even non-fiscal policy objectives. The Commission considers, however, that it would not be justified in seeking to place additional strains of adaptation on Member States in this way. Every effort has been made to avoid running counter to other policy objectives, and to bear the wider economic social and regional implications in mind in formulating these proposals. But these are among the implications which can only be evaluated on the basis of a collective

consideration of the proposals. In what will be a challenging period of transition, the Commission has concentrated on two overriding priorities: its proposals must result in the best possible fiscal environment for economic operators in the internal market; at the same time they must minimize the adverse effects of the approximation exercise for Member States' revenue flows and budget flexibility. This document sets out in general terms the Commission's proposals for a manageable level of approximation. The specific proposals in question are listed in Annex A.

For ease of analysis, VAT and the excise duties are dealt with separately in the following two sections.

4. Approximation of VAT rates and rate structure

The First and Second VAT Directives, which laid down in 1967 the foundations of the Community VAT system, already clearly envisaged the abolition of tax on imports and the remission of tax on exports in trade between Member States and the approximation of legislation concerning turnover taxes in order to eliminate distortion of competition within the Community. This objective has been repeatedly confirmed over the years. Considerable progress has been made towards the creation of a common VAT base, notably with the adoption of the Sixth VAT Directive. The Sixth Directive lays down, in particular, a clear programme for the staged introduction of the fiscal conditions permitting the internal market to function. That programme is already under way. The Commission has put forward several proposals - notably the Seventh, Twelfth, Eighteenth and Nineteenth Draft Directives - designed to eliminate some of the most significant remaining areas of divergence. The Council should deal with these proposals as a matter of urgency. Certain derogations have not yet been tackled. More is said of these questions later in this Communication. Nonetheless, there now exists an identifiable common VAT base which represents a decisive step along the road towards a common fiscal system and thus towards the elimination of fiscal frontiers.

a) Number of rates

The starting point for any approach to the approximation of both the number and level of VAT rates must be the existing situation in the Member States. This is as follows:

	Reduced Rates	Standard rate	Increased rate
Belgium (1) (2)	1 & 6	19	25 & 25+8
Denmark (1)	-	22	-
France	2.1; 4 5.5 & 7	18.60	33 1/3
Germany	7	14	-
Greece	6	18	36
Ireland (1)	2.4 & 10	25	-
Italy (1)	2 & 9	18	38
Luxembourg	3 & 6	12	-
Netherlands	6	20	-
Portugal (1)	8	16	30
Spain	6	12	33
United Kingdom (1)	-	15	-

Rates applicable as at 1.4.1987

From the above it can be seen that all Member States, with the exception of Denmark and the UK, apply more than one rate. Thus, although the Commission accepts that, in theory, a VAT system with only one rate is the simplest and most efficient structure, it is clear that such an approach would have disruptive consequences for all Member States, other than the two mentioned, and is unlikely to be acceptable to the Community as a whole. It is therefore proposed that a multi-rate system should be adopted.

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(1) Also applies an exemption with a right to refund (ie a zero-rate) to certain domestic transactions (NB all Member States apply the zero rate for exports and like transactions).

(2) Also applies an intermediate rate of 17%.

The question of how many rates a Community multi-rate system should have is less clear cut. Whilst a majority of Member States have three or more rates, in practice they fall into two main camps, namely those with a standard and a reduced rate or rates and those with standard, reduced and increased rates. Taking into account the fact that, where Member States have more than three rates the more extreme rates normally apply to only a very limited number of products, the real choice lies between a two-rate and a three-rate system.

There is little doubt that a three-rate system creates more complications for both taxpayers and national administrations and that it would therefore be simpler and more cost-effective to move to a two-rate system than to oblige those Member States who currently do not apply an increased rate to move to a three-rate system. Furthermore, since the existing increased rates are applied to a relatively small proportion of the tax base in each Member State (on average below 10%), their abolition would not create undue budgetary problems. Finally, the coverage of existing increased rates is not particularly homogeneous and it would therefore be difficult objectively to draw up a common list of goods and services which should be subjected to an increased rate. For all these reasons, the Commission has concluded that a two-rate system would be preferable - namely a system with a standard rate and a reduced rate only.

b) Scope of the reduced rate

In most Member States the coverage of the reduced rate or rates is generally restricted to items of basic necessity. The zero-rates in Ireland and the United Kingdom cover much the same ground. Taking this into account, there is a considerable degree of consistency in the different Member States. The Commission proposes therefore that the following basic goods and services should be taxed at a reduced rate under the harmonized Community VAT structure, **but it is important to read this list in conjunction with what is said at 2d) below about zero rates.**

- foodstuffs (with the exception of alcoholic drinks);
- energy products for heating and lighting;

- supplies of water;
- pharmaceutical products;
- books, newspapers and periodicals;
- passenger transport.

Overall, these items represent approximately one third of the common Community tax base.

c) Rate levels

The standard rates currently applied in the Member States vary from 12% (Spain and Luxembourg) to 25% (Ireland). This is clearly too wide a band to permit the abolition of fiscal frontiers without serious economic consequences. The spread of rates therefore has to be narrowed to a point where the difference between the upper and lower limits will itself not create intolerable price differences between the Member States (especially those which are adjacent). On the other hand, the Commission is conscious that the narrower the band becomes, the greater is the number of Member States that will suffer budgetary disruption. In terms of the second of these criteria, the optimum spread of the standard rate band would be 8 points (which would incorporate 10 out of the 12 standard rates currently applied, within a band from 12% to 20%). Unfortunately, however, neighbouring Member States are to be found at either end of this spectrum and the Commission has been forced to conclude that the resulting tax-induced border price differentials would generate trade distortions and fiscal fraud, which Member States would be likely to find unacceptable.

If, however, the standard rate band were narrowed from 8 to 6 points there would still be 8 Member States who would currently fall within this range (if the parameters were set at 14% and 20%) and the resulting price differentials would become that much less distortive and more manageable. The Commission has, therefore, concluded that the optimum norm for the standard rate should be within a permitted range of between 14% and 20%. In fixing their own individual rate within this band, Member States would need to take into account the effect of market forces once fiscal frontiers had been eliminated - and would, of course, be entirely free to do so.

Turning to the reduced rates, these currently vary from 1% to 10% but the lowest rates apply only to a very few products and those with significant coverage vary from 4% to 10%. On the other hand, it also has to be borne in mind that two Member States currently apply a zero rate to most, if not all of the basic goods and services which are included in the list of items to be taxed at the reduced rate. Taking these various factors into account, the Commission has concluded that the permitted range for the reduced rate should be between 4% and 9% though in view of the inclusion in this rate band of certain sensitive sectors, such as the cultural sector, the Commission recommends that Member States fix their rate in the lower half of that band.

The weighted average VAT burden resulting from these calculations (i.e. the total tax yield in proportion to the total harmonized tax base) in the Community is currently around 13%. The proposed rate bands will permit Member States to choose rates which will result in a minimum of disruption for the maximum number of Member States in terms of this existing tax burden. The future weighted average VAT burden will, of course, depend on the actual choices made by the Member States within the permitted bands.

d) Derogations, zero rates and exemptions

The White Paper acknowledged that some countries would face considerable difficulties with fiscal approximation; and it said that derogations might be needed to meet these problems. This is likely to be of particular importance in the case of zero rating.

It has always been an accepted part of Community policy that zero rating, except in the case of exports, was a temporary measure which would disappear with the Completion of the Internal Market. This was clearly stated in the second VAT Directive adopted in 1967 and restated in the Sixth VAT Directive adopted in 1977.

The zero rating of supplies generally acknowledged as basic necessities rests upon considerations of social policy; though it is clearly a less efficient way of achieving such objectives than measures more

closely targeted towards those in need. Only two Member States have followed such policies to any significant degree; the other Member States have successfully accommodated themselves to a broadly based concept of VAT without the extensive use of zero rating. This has been achieved by direct compensation of disadvantaged groups through the social security system and welfare payments, thus directly benefiting the groups primarily affected in a more cost-effective way than is achieved by a fiscal price subsidy. It should also be remembered that zero rating, by giving a price advantage to the products of one Member State, distorts competition within the Community; this is particularly true when applied to supplies which feed through into industrial and commercial costs. Finally, it needs to be remembered that, for any given yield of revenue, zero rating in one area must inevitably lead to a higher overall rate of tax elsewhere; if 50% of consumer expenditure is exempted by zero rating, the rate of tax elsewhere necessarily has to be twice what it would have been if there had been comprehensive coverage.

For all of these reasons, the Commission could not recommend that the Community should abandon what has been its considered and settled policy ever since the VAT was first adopted. It is for this reason, that in the rates and coverage proposed above, the Commission has not proposed zero rates, but has proposed that for the most part basic necessities should be charged at the reduced rate, as is the practice in almost all the Member States.

Nevertheless, the Commission accepts that some Member States face difficulties. The Commission recognises that the Member States concerned may well wish to be granted derogations to meet their particular difficulties. Indeed, this point was clearly recognised in the White Paper itself.

The Commission has indeed considered whether it should already at this juncture propose such derogations but has come to the clear view that it would not in any event be practicable to do so until the Member States have had a chance to study its proposals and consider what particular difficulties they may present. Though the proliferation of derogations would present serious problems that could threaten the operation of the internal market and the objective of abolishing fiscal frontiers, the Commission would of course take a constructive

part in the discussion of any derogations for which Member States in real difficulty might feel the need. But that dialogue cannot commence until the present proposals have been studied and evaluated by all concerned.

This is not the place to deploy at any length the arguments for and against such derogations. The principle which needs to be respected all the time is the integrity of the Internal Market. Clearly where trade between Member States inevitably involves significant additional costs, it may well be possible for the market to accommodate cost differences resulting from derogations without too much risk of deflection or distortion of trade. But where cross-border shopping is easy and involves of itself no significant additional costs, derogations might well create significant distortions. For this reason also derogations are not simply a matter concerning the Member States asking for the derogation, but concern also the other Member States.

The second point which needs to be made is that derogations always carry a cost - which ultimately is borne primarily by the Member State concerned. The objective of the Completion of the Internal Market is to reduce actual and identifiable costs arising from the present frontier controls, and to give industry a more cost-effective basis on which to conduct its operations by having access to an undivided market of 320 million instead of primarily to its own domestic market only. Derogations may well lead neighbouring Member States to insist on the maintenance of frontier controls directed specifically against the Member State concerned. It would be a tragedy for the Community as a whole and in particular for the Member State concerned if by its own policies it forced itself into a position where effectively it had cut itself off from the overwhelming benefits which will flow from the integrated European market.

A word should also be said here about exemptions. The Sixth VAT Directive, in laying down the basic principles of the tax base, designated certain supplies as in principle exempt but gave Member States the option to continue to tax some of them on a transitional basis. Others were to be in principle taxable, but again as a transitional measure, Member States were allowed to continue to exempt

them. The draft Eighteenth VAT Directive, still before the Council, seeks in the interests of fair competition within a single internal market to bring many of these transitional options to an end - either as permanent exemptions or by bringing the supplies concerned definitively into the tax net; others remain to be settled at a later stage, including the treatment of gold (other than for industrial use) and of works of art, where further thought needs to be given to what the definitive régime should be. Further proposals will therefore be needed, as foreseen in White Paper programme.

5. <u>Excise duties</u>

When first putting forward its proposals in 1972 for harmonizing the structures of excise duties, the Commission singled out for retention and harmonization at Community level the excises on manufactured tobacco, mineral oils, spirits, wine and beer. The other excise duties were to be phased out to the extent that they involved tax adjustments at internal frontiers. This programme had as its ultimate objective the creation of conditions permitting the abolition of fiscal frontiers.

This objective can, of course, only be met when common rates of excise duty are charged on harmonized structures throughout the Community. The present proposals, put forward under the White Paper programme, complete the process by laying down the common rates to be applied to those structures. It should be stressed, however, that very little progress has so far been made in the Council towards the adoption of the Commission's structural proposals. Consequently, the considerations in respect of the excise duties are more complicated than those in respect of VAT because not only the rates but also the structures still differ widely between different Member States.

As far as excise duties are concerned, any flexibility in the rates of duty which might be permitted would be compounded with the permitted margin for VAT rates and would therefore result in tax-induced price differentials well in excess of 5%. This is because VAT is imposed on the price of goods inclusive of excise duty. Consequently, the Commission has proposed that, as a general rule, any margin of flexibility in approximating rates should be reserved for the VAT rates because these rates have by far the widest coverage and therefore have an overriding

importance for Member States' budgets. For tobacco products, where the Commission is proposing a composite rate for the ad-valorem excise duty and VAT, taken together, a margin of flexibility is proposed which is equivalent in its effect on retail prices to the margin proposed for VAT on other goods. More generally the possibility of providing a margin of flexibility on excise duties in particular cases of difficulty would depend on whether it was compatible with the objective of the abolition of frontier controls.

As regards the level of excise rates, the present divergence between Member States is much greater than in the case of VAT and it is consequently that much more difficult to arrive at an optimal solution which will cause the least amount of disturbance to the greatest number of Member States. Account must also be taken of other Community policies which affect mineral oils, tobacco products and alcoholic beverages.

In determining the rates the Commission's general approach has been to secure equity between Member States and the minimum disruption in each sector. The method for achieving this has varied according to the particular circumstances or characteristics of each sector in question.

Accordingly, in the case of tobacco products the rates have been calculated on the basis of the Community arithmetic average which gives equal weight to the rates applied by each Member State. The resulting rate produces an increase in the overall taxation of manufactured tobacco at Community level, which is consistent with the Commission's policy in health matters, set out in the report to Parliament in 1982 (COM(82)61 final) and in the Action Programme: "Europe Against Cancer" (COM(86)717 final).

The alcoholic drinks sector is broadly composed of two categories - distilled and fermented beverages. For the former (ie spirits) the Commission has taken the Community arithmetic average. However in the case of the fermented beverages (wine and beer) it was found that the effect of the arithmetic average, and also of an average weighted by consumption, would be highly disruptive. The solution proposed for these products, which are in competition, is therefore to tax them equally per litre of product on an overall revenue-neutral basis.

For mineral oils the Commission is proposing, for each main category of product, a rate which minimises disturbance to national tax revenues or industrial cost patterns. Thus for petrol which is by far the most important producer of revenue in this sector, a rate based on the arithmetic average of existing rates has been chosen. For diesel, heating gas oil and heavy fuel oil on the other hand, whose use is predominantly commercial, the Commission considers that an average weighted by consumption would be more appropriate, as it minimizes the effects on industrial costs.

On the basis of these considerations the Commission accordingly proposes the following rates:

Alcoholic drinks	Amounts in ECU
Alcohol for beverages (per hl of pure alcohol)	1271
Intermediate products (per hl)	85
Wine (per hl) average 11% vol)	17
Beer (per hl) (average 12,5° plato)	17
Manufactured tobaccos	
Cigarettes (specific excise per 1000)	19.5
ad val + VAT (in % of retail price)	52%-54%
Cigars and cigarillos ad val + VAT (in % of retail price)	34%-36%
Smoking tobacco ad val + VAT (in % of retail price)	54%-56%
Other manufactured tobacco ad val + VAT (in % of retail price)	41%-43%

Mineral oils

Petrol, leaded, and medium oils used as propellants, per 1000 l	340 ECU
Petrol, unleaded per 1000 l	310 ECU
Liquified petroleum gas (LPG) per 1000 l	85 ECU
Diesel (gas-oil) per 1000 l	177 ECU
Heating gas-oil and medium oils used as fuels other than propellants per 1000 l	50 ECU
Heavy fuel oil per 1000 kg	17 ECU

It should be noted that the excise duties proposed above are based on the situation as at 1 April 1987. Between now and 1992 the amounts of the specific duties will be adapted annually by the Commission in accordance with the general consumer price index in the Community and the revised figures will be communicated to the Member States.

6. Overall budgetary effects

As indicated previously, the Commission has kept in mind in formulating its proposals the need to minimize budgetary disturbance for the maximum number of Member States.

While the eventual adjustments which may be needed in individual Member States' budgetary arrangements are primarily and properly a matter for the Member States concerned, some tentative global qualitative assessment of the likely overall effects of the Commission's proposals can be given at this stage. Any quantitative estimates would have to be based on purely mechanical calculations which could not take account of the effects of changes in demand which tax and price changes may generate (elasticity effects); or of the effects on frontier trade; or of any macroeconomic stabilising mechanisms which may operate in the absence of

compensatory measures. Taking such effects into account would in principle reduce the initial budgetary gains or losses shown. The Commission is, however, very conscious that in view of the complexity of the present tax rates and structures, and in view of the freedom given to the Member States to determine how they make the fiscal changes they need between now and 31 December 1992, any quantitative estimate of these moderating effects would be particularly difficult and unreliable. In particular an in-depth study of such effects would require a prior knowledge of the nature and extent of any compensatory policies which the Member States might adopt, depending on their budgetary situation and the use they make of indirect taxation. The Commission asked for such information early on in the process of formulating its proposals but has had only an inadequate response. The task of evaluating the effects of these proposals for individual Member States is, in any case, primarily a task for the Member States themselves. With the publication of the proposals, that is a task on which they can now begin. The Commission has already undertaken a certain amount of exploratory work in collaboration with national administrations. It is ready to pursue these studies and to complete them on the basis of any suggestions which the Member States may submit as to the adjustments they may consider desirable.

Subject to these qualifications, it seems probable that three Member States (Belgium, Italy, the Netherlands) would be able to continue to obtain the same level of total tax revenue from the VAT and excise duty rates proposed as they currently receive. One Member State (France) would suffer a slight budgetary loss, while three Member States (Germany, United Kingdom and Greece) would obtain small or moderate increases in budgetary receipts. Two Member States (Ireland and Denmark) would suffer pronounced budgetary losses, while the other Member States (Luxembourg, Spain and Portugal) would obtain substantial increases in budgetary receipts.

7. Timetable

It is intended that Community rates for VAT and the excise duties should enter into force no later than 31 December 1992. It will be the responsibility of the individual Member States to work towards these rates in the intervening period. The Commission will monitor the progress

being made by the Member States and will report periodically to the Council, in accordance with the provisions of Article 8B of the Treaty as amended by the Single European Act. Such reports will consider the need for proposals for any complementary amending measures to take account of economic developments.
Furthermore, the Commission is putting forward a Convergence Proposal which replaces the standstill proposal currently before the Council (1). The convergence proposal, which covers both the VAT rates and the main excise duty rates, aims to ensure that Member States do not diverge from the overall objective in the meantime.

8. Conclusions

The abolition of fiscal frontiers is a vital element in the completion of the internal market. But it will also be an achievement of incalculable value in itself. The most direct and immediate benefit would accrue to industry and commerce as the administrative cost of fiscal frontier formalities virtually disappeared and the time spent in transporting goods was reduced. Relieved of those costs, firms in the Community would become more price-competitive both within the internal market and internationally. That in itself would increase their potential market and lead to economies of scale in production. These, together with the reduction in administrative costs, would be reflected in lower prices for the consumer. Real domestic demand in the Community would rise, with favourable effects on GDP growth. And, of course, the cost of frontier controls to member governments would be reduced. Frontier controls for fiscal reasons constitute the overwhelming majority of such controls. A Community in which it was no longer necessary for the citizen to worry about whether or not he had exceeded his travellers' allowance or whether he could drive his car into one Member State or another; a Community in which traders could do business with customers in other Member States just as they do with customers in the next street or the next town; a Community in which there would no longer be the endless queueing and form-filling and rubber-stamping at frontier posts; a Community in which goods and services no longer bore the extra and unnecessary cost of delay and bureaucracy; such a Community is well worth the effort on all sides that the Commission's proposals will undoubtedly require.

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(1) COM(85) 606 as amended by COM(87) 17

That effort, the Commission acknowledges, will be a considerable one. The Commission has done as much as possible to minimise it, but is nevertheless well aware that for some Member States the measures proposed will create problems, even though they allow a degree of flexibility and a reasonable period for adjustment (i.e., until the end of 1992). The Commission has, therefore, always acknowledged that there may be a need for derogations since these difficulties cannot be allowed to jeopardize the fundamental objective of creating a single European market. Nevertheless, it is in the general interests of the Community that such derogations should be kept to the minimum.

The Commission is nonetheless convinced that the present proposals for the approximation of the VAT and excise rates, taken in conjunction with the proposals already on the table, will serve two major purposes. They will firstly permit the abolition of fiscal frontiers; they will thus contribute towards the attainment of an integrated and expanding European economy. They will also satisfy, so far as possible, the legitimate concern of individual Member States that their existing economic and taxation systems should not be unduly disrupted.

ANNEX A

PROPOSALS TO BE SUBMITTED IN CONNECTION WITH THE APPROXIMATION OF INDIRECT TAX RATES AND HARMONIZATION OF INDIRECT TAX STRUCTURES

A) VAT

1) Proposal for a Council Directive supplementing the Common System of Value Added Tax and amending Directive 77/388/EEC - approximation of VAT rates. COM(87) 321

2) Proposal for a Council Directive supplementing the Common System of Value Added Tax and amending Directive 77/388/EEC - Abolition of Fiscal Frontiers. COM(87) 322

3) Outline Working Paper for a Community VAT clearing mechanism. COM(87) 323

4) Proposal for a Council Directive instituting a process of convergence of rates of value added tax and excise duties. COM(87) 324

B) EXCISES

1) Proposal for a Council Directive concerning the approximation of taxes on cigarettes. COM(87) 325

2) Proposal for a Council Directive concerning the approximation of taxes on manufactured tobacco other than cigarettes. COM(87) 326

3) Proposal for a Council Directive concerning approximation of the rates of excise duty on mineral oils. COM(87) 327

4) Proposal for a Council Directive concerning approximation of the rates of excise duty on alcoholic beverages and on the alcohol contained in other products. COM(87) 328