COMMISSION OF THE EUROPEAN COMMUNITIES

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2007/0131 (CNS)

Proposal for a

COUNCIL DECISION

authorising France to apply a reduced rate of excise duty on "traditional" rum produced in its overseas departments and repealing Council Decision 2002/166/EC of 18 February 2002

(presented by the Commission)

EXPLANATORY MEMORANDUM

1) CONTEXT OF THE PROPOSAL

- **Grounds for and objectives of the proposal**

Maintaining the cane-sugar-rum sector in the overseas departments is crucial to their economic and social balance. In the three departments most affected, i.e. Réunion, Guadeloupe and Martinique, the sector produces an annual turnover of about € 250 million and provides some 40 000 jobs, 22 000 of them directly. The cultivation of sugar cane is by far the most significant example of activity performed in the French overseas departments which provides not only a direct benefit development in terms of the production of rum and sugar but also provides additional benefits through the by-products, such as the molasses or the straw, which can be used as a source of energy, animal feed or natural fertilizers. Moreover, it is worth underlining the positive impact which the cultivation of cane has in terms of protecting the environment in the overseas departments, namely its qualities in protecting against soil erosion which can be caused by the slopes and strong rains which are prevalent in the overseas departments. In addition, the root system of cane, associated with its relatively low need for fertilizers, ensures that a good level of water quality is maintained. Moreover the use of pesticides for cane cultivation culture is limited. Finally, according to the French authorities, bagasse, resulting from the industrial process, contributes to a significant degree to the production of electricity, thus avoiding the use of fossil fuels and the resultant CO_2 emissions, which is consistent with the international commitments entered into under the Kyoto protocol. **Together with the banana sector, the cane sector is the only significant exporting activity in the regions whose exports represent not more than 7% of the imports.**

The proposed decision authorises France to apply a reduced rate of excise duty on "traditional" rum produced in its overseas departments in respect of a quota of 108 000 HPA (hectolitres of pure alcohol) from 1 January 2007 to 31 December 2012. **It increases the volume and duration of the tax arrangements currently applied to traditional rum because the situation has worsened since 2001.**

Given the small scale of the local market, the overseas departments' distilleries can continue their activities only if they have sufficient access to the market in mainland France, which is the main outlet for their rum production (over 50% of the total).

The inability of traditional rum to compete on the Community market, which is mainly the result of increased market prices, is attributable to the high cost price of rums produced in the overseas departments.

In particular, **trends in wage costs since 2001 have placed the overseas departments at a disadvantage,** since the minimum hourly wage increased by 24% in the period 2001-2006.

In addition, the overseas departments have invested heavily since 2001, laying out more than € 45.5 million. **These departments are subject, inter alia, to Community emissions and**

safety standards, which entail a considerable non-productive investment[1]. While total investment increased 2.6 times in the period 2001-2004, the percentage of the total accounted for by investment necessary to conserve the environment represents € 21.3 million, that is to say 47% of the total. This investment has admittedly been partly covered by the structural funds[2], which contribute to the initial investment by distilleries. This aid does not, however, offset the whole of the investment required nor, moreover, does it cover the increase in operating costs imposed by compliance with standards. It should be borne in mind that this increase in costs in no way increases productivity but does increase the unit cost of every litre of rum produced: depending on the distillery, the costs of maintaining and operating this equipment add 10 to 15% to the cost price of rum. Financial support is therefore required each distilling year.

All these costs place overseas departments businesses in often awkward financial situations, with a regulatory environment that is growing ever stricter. The only solution for the distilleries is to offset these costs against higher output by allowing them sufficient access to the mainland market, as the total volume shipped to the Community market fell 12% between 2002 (176 791 HPA) and 2005 (155 559 HPA).

The overseas departments should therefore be helped to maintain their position on the mainland French market by being granted an extension of the current quota. While the consumption of rum in France increased by 20% in the period 2000-2005, rum from the overseas departments increased its market share by only 16%, constituting a relative fall in the market, whereas in the same period production costs increased. Since 2005 the total quota has been used. However, the reduced rate makes it possible to partly offset the high cost price and relatively strong degree of alcohol of rum produced in the overseas departments thus maintaining the distribution network and marketing positions.

It is therefore proposed that the present quota be raised by 18 000 HPA to a total of 108 000 HPA, which corresponds to the extrapolation over a six-year period of consumption trends recorded in mainland France in recent years.

Given the need to create a climate of legal certainty for operators in the cane-sugar-rum sector, in view of the depreciation periods for plant and buildings, and in the interests of consistency with other Community rules, the derogation should be granted to the end of 2012.

- **General context**

By a Council Decision of 30 October 1995, France was authorised to apply to traditional rum produced in the overseas departments a rate of excise duty lower than the full rate applicable to ethyl alcohol. This measure was to expire on 31 December 2002. It was extended by the Council Decision of 18 February 2002 in respect of a quota of 90 000 HPA. That Decision stipulated that France was to send the Commission by 30 June 2006 at the latest a report enabling it to assess whether the reasons which justified the granting of the reduced rate still exist. France submitted a mid-term report on 27 December 2005 and requested a further quota for traditional rum. The French government’s request was examined in the light of Article 299(2) of the EC Treaty.

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1 By way of example, the production costs of cachaça are equivalent to the cost to the overseas departments of meeting environmental standards alone.

2 Note that measures to increase capacity are not eligible for cofinanced modernisation aid.

- **Existing provisions in the area of the proposal**

Pursuant to Article 299(2) of the EC Treaty, the Treaty applies to the French overseas departments, the Azores, Madeira and the Canary Islands. However, taking account of the structural social and economic situation of the French overseas departments, the Azores, Madeira and the Canary Islands, which is compounded by their remoteness, insularity, small size, difficult topography and climate, economic dependence on a few products, the permanence and combination of which restrain their development, the Council, acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament, shall adopt specific measures aimed, in particular, at laying down the conditions of application of the EC Treaty to those regions, including common policies.

Council Decision 2002/166/EC of 18 February 2002, taken on the basis of Article 299(2) of the EC Treaty, authorises France to apply a reduced rate of excise duty on "traditional" rum produced in its overseas departments. The reduced rate is confined to an annual quota of 90 000 HPA. Compared with the rates of taxation applied to similar products not originating in the French overseas departments, the reduced rate may be lower than the minimum rate of excise duty on alcohol set by Directive 92/84/EEC, but may not be more than 50% lower than the standard national excise duty on alcohol. The Council Decision is to apply until 31 December 2009, with a mid-term report to be drawn up by June 2006 at the latest. The proposed decision is aimed at replacing that Decision.

- **Consistency with the other policies and objectives of the Union**

The specific measures provided for in Article 299(2) of the EC Treaty must take account of the special characteristics and constraints of the outermost regions without undermining the integrity and the coherence of the Community legal order, including the internal market and common policies. This requirement has been met by a particularly thorough examination of the French government’s request. Accordingly, whereas the French government initially asked for the quota to be increased by 30 000 HPA, the Commission believes that only 18 000 HPA are warranted under Article 299(2) of the EC Treaty, since that corresponds to the extrapolation over a six-year period of the consumption trends recorded in mainland France in recent years.

When examining the proposal, the Commission also assessed the impact of other measures taken in favour of the cane-sugar-rum sector (the overhaul, in February 2006, of the common organisation of the markets in the sugar sector goes some way towards safeguarding the industry’s future), and in particular the aid measures laid down in Council Regulation (EC) No 247/2006 of 30 January 2006 laying down specific measures for agriculture in the outermost regions of the Union, and their consistency with this proposal.

For makers of rum from sugar production and rum from molasses, the aid provided under the sugar CMO serves to maintain the purchase price of the raw material in spite of falling sugar prices, but it does not reduce their production costs.

2) CONSULTATION OF INTERESTED PARTIES AND IMPACT ASSESSMENT

- **Consultation of interested parties**

The French government's request was a response to requests from the economic sectors concerned.

- **Collection and use of expertise**

No recourse to external expertise has been necessary.

- **Impact assessment**

Rums from the overseas departments currently account for about 20% of the total Community market.

The current quota represents less than 8.68% of the Community market, and the proposed increase in the quota concerns no more than about 1.5% of that market for a six-year period. The increase amounts to 18 000 HPA, which corresponds to the extrapolation for a six-year period of trends in traditional trade flows recorded in mainland France between 1999 and 2005.

Trends in release for consumption

	Release for consumption at the reduced rate of excise duty	Non-quota	Third countries	Total
2005	90 000	35 500	5 500	131 000
2004	87 900	30 800		
2003	86 400	26 200		
2002	86 900	37 000		
2001	86 200	26 500		
2000	78 300	30 000	1 000	109 300

Variation 2000/2005: 20 %

Projection 18 000 HAP

The measure contributes to regional development. The reduced rate benefits the various actors in the cane-sugar-rum sectors as follows:

– on release to the market, it makes it possible for the mainland consumer to have access to the traditional rum of the overseas departments at an acceptable price;

– it makes it possible to ensure an outlet for the production of the distilleries and at a better value;

– consequently, it ensures the maintenance of the sugar cane industry, continued employment, and contributes to the regional planning of the overseas regions.

The French authorities estimate that the removal of the reduced rate would result in a loss of 50% to the trade outlets (mainly in mainland France) and thus the closure of 75% of the distilleries. Other effects would be felt on the profitability of the whole sector, growers and sugar refineries. In addition to the maintenance of approximately 22 000 direct employed in connection with the production of rum, it contributes indirectly to the development of the production of products such as molasses or straw obtained from the cane and used as a source of energy, animal feed or natural fertilizers. On the contrary, the tax system allows for the maintenance of 11 distilleries in Guadeloupe, 9 in Martinique, 3 in Réunion and one in Guyana. Only one distillery ceased operating during the period 2002-2005.

Note that imports into mainland France of rums of other origins increased by over 500% over the period 2000-2005. The existence of special tax arrangements is not, therefore, preventing competing rums from increasing their penetration of the French market. In addition, the integrity of the internal market is respected: the special tax arrangements granted to the overseas departments since 1995 have not affected the growth in market share of rums of other origins both on the internal market (compared with 1995, the overseas departments' share of the EU internal market (excluding France) has fallen by more than 50%, whereas the market share of ACP and third-country imports has risen by over 20%, accounting for about 80% of the volume marketed in 2005) and the French market.

The proposed increase in the quota eligible for a reduced rate of excise duty in mainland France is not therefore likely to disturb the internal market or the common fiscal policy.

3) LEGAL ELEMENTS OF THE PROPOSAL

- **Summary of the proposed action**

The proposed decision authorises France to apply from 1 January 2007 to 31 December 2012 a reduced rate of excise duty on "traditional" rum produced in its overseas departments in respect of a quota of 108 000 HPA.

- **Legal basis**

Article 299(2) of the Treaty.

- **Subsidiarity principle**

The proposal concerns an area that falls under exclusive Community competence. The subsidiarity principle does not therefore apply.

- **Proportionality principle**

The proposal complies with the proportionality. It does not go beyond what is necessary to offset the high costs associated with the production of traditional rum.

The French authorities also note that the reduced rate of excise duty on traditional rum of the overseas departments, has not encouraged the large international producers setting up their own production in the overseas departments thus seeking to profit from the tax advantage granted to the sector. In addition, the last international company stopped operating in Martinique in 2004; the others operate only in the ACP countries.

All this evidence demonstrates the proportionality of the aid arrangements to the objective pursued, namely improving the competitiveness of the cane-sugar-rum sector, and shows that the arrangements have not affected the development of the market share of rums of other origins on the internal market.

- **Choice of instruments**

Article 299(2) of the Treaty provides for specific measures for the outermost regions to be adopted by decision of the Council.

4) BUDGETARY IMPLICATION

The proposal has no implication for the Community budget.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 299(2) thereof,

Having regard to the proposal from the Commission[3],

Having regard to the opinion of the European Parliament[4],

Whereas:

(1) Pursuant to Article 299(2) of the EC Treaty, the Treaty applies to the French overseas departments, the Azores, Madeira and the Canary Islands. However, taking account of the structural social and economic situation of the French overseas departments, the Azores, Madeira and the Canary Islands, which is compounded by their remoteness, insularity, small size, difficult topography and climate, economic dependence on a few products, the permanence and combination of which restrain their development, the Council, acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament, shall adopt specific measures aimed, in particular, at laying down the conditions of application of the EC Treaty to those regions, including common policies. The Council is required, when adopting such measures, to take into account areas such as fiscal policy. When adopting these measures, it has to take into account the special characteristics and constraints of the outermost regions without undermining the integrity and the coherence of the Community legal order, including the internal market and common policies.

(2) On the basis of these provisions of the EC Treaty, the Council adopted on 18 February 2002, in respect of the French overseas departments, Decision 2002/166/EC authorising France to apply a reduced rate of excise duty on "traditional" rum produced in its overseas departments. Compared with the rates of taxation applied to similar products not originating in the French overseas departments, the reduced rate may be lower than the minimum rate of excise duty on alcohol set by Directive 92/84/EEC, but may not be more than 50% lower than the standard national excise

3 OJ C […], […], p. […].
4 OJ C […], […], p. […].

duty on alcohol. The Council Decision was to apply until 31 December 2009, with a mid-term report to be drawn up by June 2006 at the latest.

(3) On 27 December 2005 the French government presented a mid-term report indicating that it was vital that the tax arrangements for traditional rum marketed in mainland France be maintained. Furthermore, in view of developments on the Community market for rum, which are mainly benefiting products originating in third countries, and given the economic and social importance of the sector and the structural nature of the production conditions that diminish the sector's productivity in the overseas departments and make it difficult to maintain its production on the Community market, France has asked that the volume and duration of the tax arrangements for traditional rum on the mainland market be extended.

(4) Maintaining the cane-sugar-rum sector in the overseas departments is vital to their economic and social balance. In the three departments most affected, i.e. Réunion, Guadeloupe and Martinique, the sector produces an annual turnover of over € 250 million and provides some 40 000 jobs, including 22 000 direct jobs. It is also advisable to note the positive impact which the cultivation of cane has for the safeguarding of the environment in the overseas departments. Together with the banana sector, this sector is the only significant exporting activity in areas whose exports represent not more then 7% of the imports. It is therefore necessary and justified for France to maintain, by way of derogation from Article 90 of the Treaty, a reduced rate of excise duty on "traditional" rum produced in its overseas departments in order to avoid endangering their development.

(5) The overhaul of the common organisation of the markets in the sugar sector in February 2006 goes some way towards securing the sector's future. Thus, there are plans to introduce support measures under the Posei systems (Council Regulation (EC) No 247/2006 of 30 January 2006 laying down specific measures for agriculture in the outermost regions of the Union), in the form of both Community and national aid, in order to improve the competitiveness of the overseas departments' cane-sugar-rum sector. However, these measures still do not offset the gradual dismantling of customs protection and maintain the overseas departments' share of the rum market.

(6) Given the small scale of the local market, the overseas departments' distilleries can continue their activities only if they have sufficient access to the market in mainland France, which is the main outlet for their rum production (over 50% of the total).

(7) The inability to compete on the Community market, which is mainly the result of increased market prices, originates from cost prices which have increased since 2001. Since that date both production and labour costs have grown a lot in the overseas departments. Moreover, overseas departments' rums have to comply with Community regulatory standards, which calls for important non-productive investment. Since 2001 investment in the overseas departments has exceeded € 45.5 million, over half of it to conserve the environment, representing 47% of the total. However, though part of this investment has been covered by structural funds, this is not the case of the resulting operating costs, which, depending on the distillery, can add about 10 to 15% to the cost price of rum.

(8) All these costs, which have increased significantly since 2001, place overseas departments' businesses in financial difficulties. The only way to ensure the sector's long-term survival is to offset these costs against greater output.

(9) Since 2002 the total volume shipped to the Community market has fallen by 12%, from 176 791 HPA to 155 559 HPA. Only the market in mainland France, where rum from the overseas departments qualifies for special tax arrangements that partially compensate its high cost price, has enabled the overseas departments' rum industry to survive. Since the competitiveness of traditional rum from the overseas departments needs to be supported on the market in mainland France in order to safeguard the activity of their sugar-cane-rum sector, the quantities of traditional rum originating in the overseas departments eligible for a reduced rate of excise duty when released for consumption on that market should be reviewed.

(10) The tax advantage authorised by the present decision does not go beyond what is necessary to address the high cost of production faced by traditional rum producers.

(11) In order to ensure that the present decision does not undermine the single market, the quantities of rums originating in the overseas departments eligible for this measure may not, as before, exceed the trade flows recorded in recent years for the different sources of supply.

(12) Given the need to create a climate of legal certainty for operators in the cane-sugar-rum sector and in view of the depreciation periods for plant and buildings, and in the interests of consistency with other Community rules for the sector, the derogation should be granted to the end of 2012.

(13) The granting of such a duration must, however, be subject to the condition that a mid-term report be produced so that the Commission can assess whether the reasons which justify the granting of the tax derogation still apply and, if need be, consider whether the duration or quantities concerned should be revised in the light of developments on the Community rum market.

(14) Council Decision 2002/166/EC should be replaced.

(15) This Decision is without prejudice to the possible application of Articles 87 and 88 of the Treaty,

HAS ADOPTED THIS DECISION:

Article 1

By way of derogation from Article 90 of the Treaty, France is authorised to extend the application on the French mainland, to "traditional" rum produced in its overseas territories, of a rate of excise duty lower than the full rate for alcohol set by Article 3 of Council Directive 92/84/EEC of 19 October 1992 on the approximation of the rates of excise duty on alcohol and alcoholic beverages.

Article 2

The derogation referred to in Article 1 shall be confined to rum as defined in Article 1(4)(a) of Council Regulation (EEC) No 1576/89 of 29 May 1989 laying down general rules on the definition, description and presentation of spirit drinks, produced in the overseas departments from sugar cane harvested in the place of manufacture, having a content of volatile substances other than ethyl and methyl alcohol equal to or exceeding 225 grams per hectolitre of pure alcohol and an alcoholic strength by volume of 40% vol. or more.

Article 3

1. The reduced rate of excise duty applicable to the product referred to in Article 2 shall be confined to an annual quota of 108 000 hectolitres of pure alcohol.

2. The reduced rate may be lower than the minimum rate of excise duty on alcohol set by Directive 92/84/EEC, but may not be more than 50% lower than the standard national excise duty on alcohol.

Article 4

By 30 June 2010 at the latest, France shall send the Commission a report to enable it to assess whether the reasons which justified the granting of the reduced rate still exist and, if need be, whether the quota needs to be adjusted in the light of developments on the market.

Article 5

This Decision shall apply from 1 January 2007 until 31 December 2012.

Article 6

1. Council Decision 2002/166/EC of 18 February 2002 is hereby repealed.

2. References to the repealed Decision shall be construed as references to this Decision.

Article 7

This Decision is addressed to the French Republic.

Done at Brussels,

For the Council
The President