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Alcohol excise duty policy in Poland in the 21st century

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ABSTRACT

Excise duty is a powerful tool of alcohol policy. The fact that excise is a unit tax means that lack of excise adjustment with inflation means in fact excise reduction in real terms. To understand tax policy with respect to tobacco and alcohol, political perspective must be taken into account. Policymakers consider the political cost and benefits of tax changes. If the public awareness of alcohol epidemic and the social cost of alcohol consumption is low, then it is difficult for politicians to initiate far-reaching alcohol control policies. They may seek popularity among voters, leading to a lose-lose situation: low tax revenue and high social and medical cost of alcohol consumption. This happened in Poland when in 2002 the excise duty on spirit was reduced by 30% resulting in great surge in alcohol related deaths. Social awareness is therefore the key factor for the success of comprehensive alcohol control policy.

KEY WORDS: tax policy, excise on alcohol, excise duty revenues, economic affordability of alcohol, Poland.

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INTRODUCTION

After a sharp reduction in alcohol consumption in Poland 40 years ago we witnessed 20 years of slow decline with a peak in consumption in the 1980s. Between 1980 and 2001 we observed an almost 1/3 drop in consumption (from ca. 9 liters of 100% of alcohol per capita (population 0+) to less than 7 liters in 2001) [1]. Then a fundamental change in excise policy happened – a reduction of excise duty by 30%, followed by a period of small excise increases that were much lower than inflation and wage growth. As a result, alcohol consumption grew by 50% over last 19 years (from 7.8 liters of 100% of alcohol per capita (population 15+) in 2001 to 11.7 liters in 2020) [2]. This paper presents the excise data, along with tax revenues and discusses the (lack of) rationale for such a policy. While the paper focuses on economics aspects, the author, an economist and former policymaker, also points to the key political arguments.

EXCISE DUTY ON ALCOHOL

During the era of planned economy in Poland almost all prices were set by the government. That included

alcohol prices as well. Once Poland regained political and economic freedom in 1989 alcohol was taxed with the turnover tax, until in 1993 Value Added Tax came into force accompanied by an excise duty for some 'sin' goods. Figure 1 shows the tax rates (in PLN and €) and the number of changes of the tax per year. Until 2001 there was at least one excise duty increase per year (3 in 1995) and in 1995, 1996, 1998 and 2002 excise increases were higher than inflation, and real excise burden was rising. However, in October 2002 government unexpectedly reduced the excise on spirits by 30% to boost legal sale and increase the excise revenue. The law essentially made it obligatory to lower the price for consumers. Since then, there were no yearly hikes of excise but only 4 small increases, and neither real nor nominal levels of excise duty on spirits have been regained.

EXCISE DUTY REVENUES

The 30% reduction in excises applied only to spirits, and this gave the vodka business a competitive advantage over beer and wine businesses. Vodka producers claimed that the decision helped reduce smuggling and

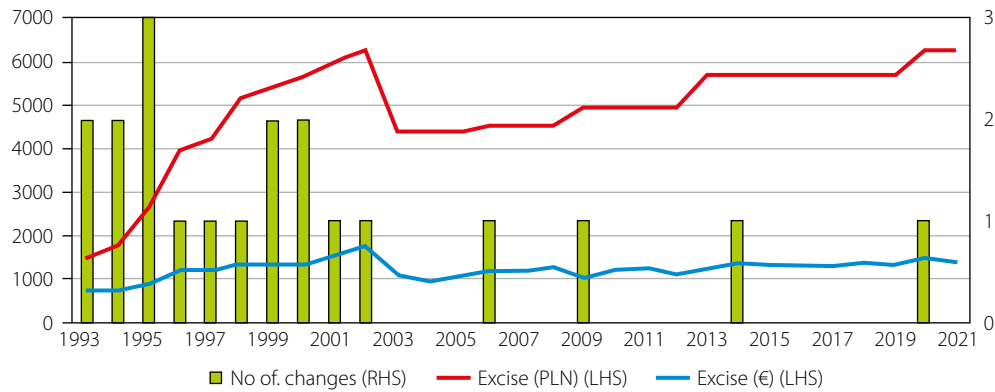


FIGURE 1. Excise rates on spirits (in PLN and € per 100 l of 100% of alcohol), (Left Hand Scale) and the number of changes per year (Right Hand Scale)

Source: Ministry of Finance [3]

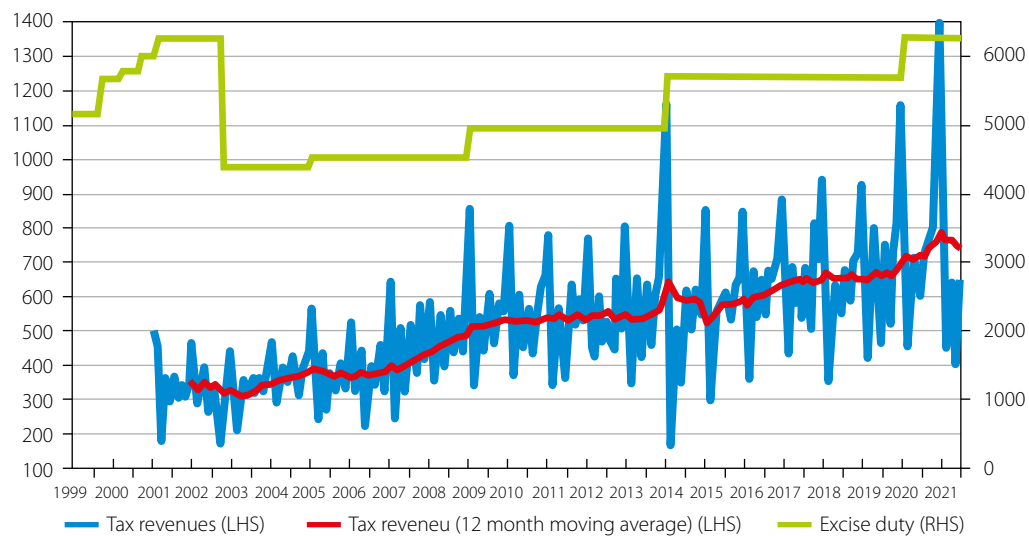


FIGURE 2. Excise on alcohol (100%, PLN/1 hl) (Right Hand Scale) and excise tax revenues (month by month and 12-month moving average) (millions PLN) (Left Hand Scale)

Source: Ministry of Finance [3]

illegal production of vodka and the increase in excise duty revenues [4]. However, the data do not confirm this claim (Fig. 2).

The red line shows the 12-month moving average for tax revenues from spirits. One can see a fall in revenues followed by a moderate increase as Poles started drinking more. This upward trend continues despite some minor hikes in the excise duty. It is likely the figures are on the left slope of the Laffer Curve¹ – there was, and still is room for much higher taxes and higher tax revenues.

In the case of beer there were only 2 excise increases in this century (2009 and 2020) but the growing trend of increasing tax revenues has come to an end in the middle of the last decade. This was due to the lowering of the

average concentration of extract (Plato degrees) that are used as a tax base, due to changing consumer trends and the growing popularity of zero alcohol beers. The other factor was the introduction and promotion of small vodka bottles (SVB), (100 and 200 ml), the so-called “small monkeys”. The growing popularity of SVBs may be the result of a combination of easy availability, wide variety of flavours catering to a range of tastes (in 2017 there were 46 varieties), convenience, and their discrete character [5]. These small bottles could compete in prices with beer which is usually sold in ½ l bottles. Since 2021 a special levy was imposed on vodka sold in bottles up to 300 ml.

ECONOMIC AFFORDABILITY OF ALCOHOL

Poland’s excellent economic situation (to a significant degree due to joining the European Union – EU) resulted in bigger employment and higher income of Poles. This, combined with the very passive excise policy with respect to alcohol, led to a huge increase in the economic affordability of alcohol in Poland (Fig. 3).

¹The curve illustrating theoretical relationship between tax rate (vertical axis) and tax revenues (horizontal axis). It has a shape of a mountain. At a 0% tax rate, tax revenues are zero, when a tax rate goes up, tax revenues increase as well, but after they reach a maximum they fall to zero at a 100% tax rate in case of an income tax (for commodity taxation a zero revenues tax rate may be higher than 100% of a net price). On the left slope of the Laffer curve a higher tax results in higher tax revenues, on the right slope a higher tax results in lower revenues.

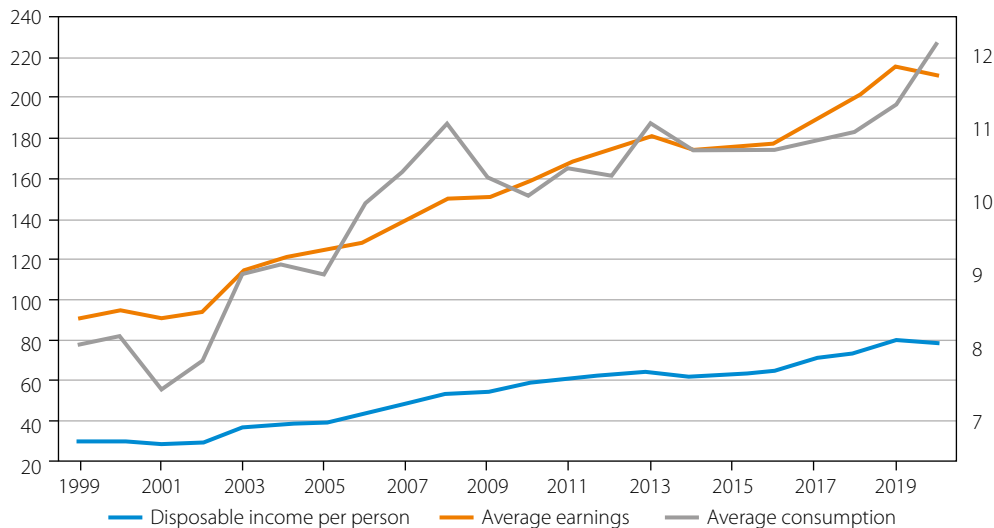


FIGURE 3. Economic affordability of vodka (1/2 l bottle, 37.5% of alcohol, 100% of alcohol, population 15+) per month (left hand scale) and average consumption of alcohol per year (liters of 100% of alcohol, population 15+) (right hand scale)
Source: Own calculation based on data from Central Statistical Office [6]

At the beginning of this century a Pole with an average disposable income could purchase 30 bottles of vodka per month. Now this number went up to almost 80 bottles. In the case of average earnings these numbers are ca. 90 and 210 respectively. It is clear this has stimulated consumption – correlation between economic affordability and consumption is clear. The mistake in tax policy that was committed in 2002, and that has not been fixed until now, resulted in a surge of deaths related to alcohol.

POLITICAL ECONOMY OF THE EXCISE POLICY

Taxing vodka and cigarettes should be relatively easy from a political perspective. These are “sin” goods, these are “bads”, as economists call them. In 2010 due to serious situation of the budget the standard VAT rate was “temporarily”² increased 22–23%. That was a difficult, very unpopular move that affected all Poles, all voters. And yet the government preferred the higher VAT over changes in excises on alcohol³ and fuels.

In 2020 excise duty on alcohol constituted 19% of excise revenues of the Polish state: tobacco – 30% and fuels 47%. Most of the alcohol revenues came from spirits – 70%, followed by beer – 26% [7]. Taxes for alcohol are specific (unit) taxes i.e. they are expressed in units of currency per liter or Plato degree. The magnitude of a tax does not change when the price changes as it is the case of ad valorem taxes. This implies that keeping the rates constant reduces the relative tax burden as inflation increases the gross price. If the tax is € 5 and the market price is € 10, then the tax constitutes 50% of the price. If the price is € 12, but the tax is still € 5, then the share of the tax in the price drops to ca. 42%. This is of great importance for vodka, where the share of a tax in final

price is substantial. The lack of excise indexation with inflation means that the most important cost factor – the excise – is constant and therefore other factors’ (such as energy or labour cost) influence on total cost is relatively not important. This enables to increase alcohol prices at much lower pace than inflation. The lack of excise adjustment with the pace of inflation is in fact an implicit excise reduction in real terms.

How should the excise duty rates policy be conducted? No matter if they are rates on tobacco, fuels or alcohol, they need to be adjusted at least to inflation. The changes can be ad hoc or based on rules. In Poland most of the changes in excises (and in other taxes as well) have been discretionary changes. Most of them were justified by budgetary needs and were announced several weeks before they came into force. A long run excise policy would be a much better solution. Then the road map of tax changes could be announced. This road map could be binding – included in the law, or non-binding. The tax increases could be linked to consumer price index, average wage, nominal GDP and the like. This predictability is essential for the business. We must remember that even if tobacco and spirit business produce ‘bads’ i.e. goods with negative social value, they are legal.

Business would prefer to have the clear rules so that they can plan in the long run. They would also prefer a number of small increases, say once a year, than one big increase, say once five years. But this is not in line with politicians’ preferences.

Tax policy is run by elected politicians. In an ideal world alcohol excise policy might be run by the Ministry of Finance with close cooperation with the Ministry of Health supported by other stakeholders. Long-term goals would be set and the ways of achieving them discussed and approved, including the road map of tax rates changes. However, real life in Poland is far from this ideal. The

²In 2021 the standard rate was still 23% and there are no plans to return to the previous rate.

³In 2009 excise on spirit was increased by 9% and for beer by 13.5% after 8 years without any increases.

author of this article, having been three times deputy minister of finance responsible for tax policy, had no contact at all with the Ministry of Health over excise policy.

Opportunistic politicians' objectives with excise policy are much different that they would in an ideal world. First of all, politicians do care about popularity. Any tax increase is perceived by politicians as a political cost. This political cost is rather the function of the number of tax hikes than their magnitudes. In other words, politicians would prefer one bigger excise increase once every five years to small changes every year. They would also prefer a bigger increase for one group of goods, rather than lower increases for bigger number of goods. That policy was visible in the first years of the second decade of that century in Poland, when high (higher than promised in a non-binding road map) increases in excise duty on tobacco happened. These increases resulted in the fall of excise tax revenues from tobacco. Had the excises increases been lower and accompanied by the increases of excise for fuels and spirits, then the revenue from tobacco and other excisable goods would have been much higher.

In the political process of decision-making the political costs of excise increases are compared with the benefits. Additional revenues are one obvious benefit of the excise increases. Businesses often try to show that the increases result in higher smuggling and illegal production and thus in lower revenues, but with moderate increases over longer periods this is highly unlikely. None of the increases of excise on alcohol in last years in Poland resulted in smaller revenues – the case of the excise on tobacco was different.

Politicians seek reasoning other than money for excise increases. The health (cigarettes and alcohol) and environmental (fuels) considerations can play a potentially important role. But this is contingent on the social awareness of external costs caused by the consumption of alcohol, tobacco and fuels. In the case of the excise duty on alcohol, the key factor is the social awareness of the skyrocketing consumption of alcohol resulting in an alcohol epidemic and a surge in premature deaths attributable to alcohol consumption.

The international context can also play a role in political decision-making process. In the case of tobacco, the situation is straight-forward from the political perspective. The European Union sets increasing minima on the volume of excises per 1000 cigarettes; therefore, the government has to increase the rates. Politicians can blame the EU, still benefiting from additional revenues and lower social costs of smoking. This is not the case in alcohol. There was no political consensus at the EU level to update the minimum excise rates on alcohol and the rates set almost 30 years ago are still in force even though inflation reduced the real burden significantly, and in the majority of EU countries the rates are much higher than the Union's minimum rates [8].

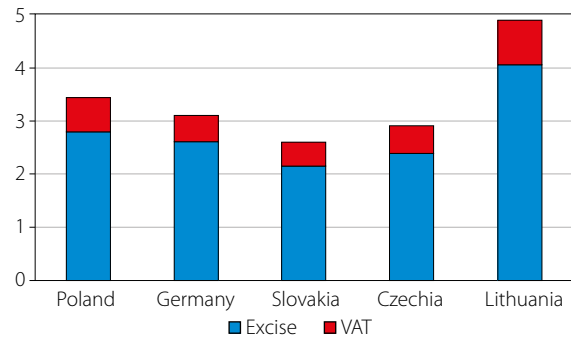


FIGURE 4. Amount of excise and VAT (in € per bottle of vodka 0.5 l, 40% of alcohol, 2021)

Source: Own calculations based on *Excise Duty Tables, Part I – Alcoholic Beverages, 2021* [9]

When the politicians cannot blame the EU for excise increases, they often point to other countries where the rates are higher. But the comparison of the rates on spirit in neighboring countries could hardly be a good argument for the increase (Fig. 4). Both of Poland's southern neighbors, Czechia and Slovakia, have a lower tax burden on alcohol. In Germany the tax burden is slightly lower than in Poland, with the purchasing power of Germans being much higher. Opponents of the increase might highlight the German case and populist media could compare the number of bottles of vodka the average German and Pole can buy. The Lithuanian policy of high excises on alcohol, if not altered, and if results in lower consumption of alcohol could be used in public policy debate on alcohol taxation.

International cooperation in excise policy is of great importance. In Europe, the decision of the European Commission to initiate the revision of the directive to adjust the minimum rates of alcohol excise tax would be crucial. Otherwise, there might be a temptation (especially for small countries) either to reduce the rates or not to increase them to compete with the countries with high or growing rates. The economic significance of this competition does not play any role in Poland – lower rate in Poland does not mean Polish excise duty revenues from alcohol will be significantly higher due to Lithuanians' purchasing alcohol in Poland.

Policymakers will be more eager to run active alcohol control policy including hikes of excises if the costs of such an action are lower and benefits higher. This is partly an issue of public awareness of the harms of alcohol. The statistics showing skyrocketing consumption of alcohol and the medical data showing the surge in deaths related to alcohol as well the economic analyses estimating the cost of drinking should be publicized. Media could play an important role in building the public awareness of the alcohol problem in Poland.

Recently the government announced the road map of tobacco and alcohol excise increases. In the case of alcohol there is a planned 10% increase in 2022 and 5% increases annually in 2023–2027. This is an encourag-

ing decision. The increases could be higher and linked to inflation⁴, but this is still a move in a good direction. Unfortunately, these increases have been criticized by opposition parties and media.

CONCLUSIONS

A 30% reduction of the excise duty on spirits in 2002, followed by small and occasional increases of the excise, resulted in a significant increase of the economic affordability and consumption of alcohol.

The rising alcohol excise revenues after the excise increases suggest that Poland is on the left slope of the Laffer curve i. e. higher excise on alcohol shall result in higher tax revenues. The social awareness of increasing social cost of alcohol may encourage the government to run more active excise policy with respect to alcohol.

DISCLOSURE

The author reports no conflict of interest.

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⁴Inflation in 2021 may reach 8% and is likely to continue for a couple of years, so the real increase in excise might be negligible or even negative.