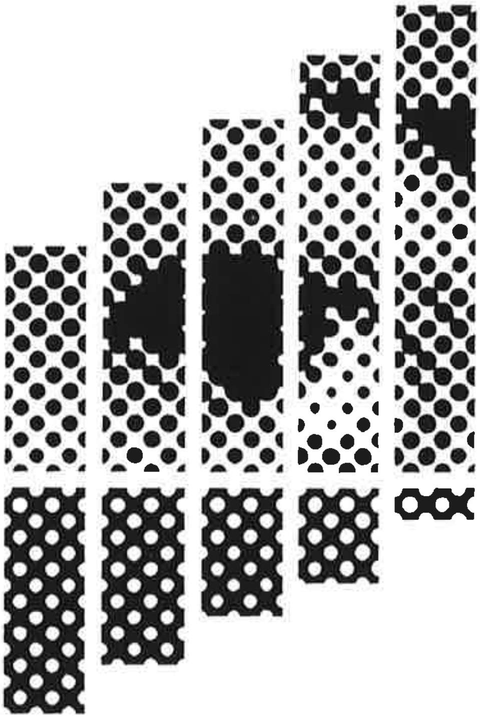
THE ECONOMIC CONSEQUENCES OF DUTY FREE ABOLITION

A CASE STUDY FOR THE NETHERLANDS



CEBR 0309 **OCTOBER 1998**

CENTRE *for* ECONOMICS *and* BUSINESS RESEARCH LTD

Bartlett House, 9-12 Basinghall Street, London EC2V 5NS

Telephone 0171 600 6661. Facsimile 0171 600 6671

E-mail: cebr@cebr.co.uk

CONTENTS

1. INTRODUCTION AND SUMMARY 1

2. THE CASE FOR ABOLITION REVISITED 4

3. IMPACT ON JOBS IN THE NETHERLANDS 12

4. COMPARISON WITH OTHER ETRF STUDIES 21

ANNEX 1 CONSTRUCTION OF BASE CASE 24

ANNEX 2 ESTIMATING THE IMPLICIT IMPACT ON THE COST OF TRAVEL OF THE ABOLITION OF DUTY FREE 25

ANNEX 3 CALCULATION OF IMPACT ON SALES 28

ANNEX 4 CONSTRUCT MATRIX OF EMPLOYMENT EFFECTS 30

ANNEX 5 SIMULATING THE IMPACT OF ABOLITION OF DUTY FREE ON TRANSPORT PATTERNS 32

ANNEX 6 TAX AND DUTY: COMPARISON OF EU MEMBER STATES 38

ANNEX 7 OTHER RELEVANT CEBR STUDIES 39

Centre for Economics and Business Research Ltd
Bartlett House, 9-12 Basinghall Street, London. EC2V 5NS
Telephone + 44 171 600 6661. Facsimile + 44 171 600 6671
Email: cebr@cebr.co.uk

The disruptive effects of abolition

1.8 This study shows that the abolition of duty free in the EU is likely to lead to the loss of 3,325-4,606 jobs in the Netherlands by 2005, with a central estimate of 3,900 jobs lost[4]. This compares with a forecast loss of 120,000 to 159,000 jobs in the whole of the European Union (central estimate 136,892) of which 90% are likely to be lost in the first two years after abolition.[5]

1.9 Of the forecast Dutch job losses (based on the central estimate), about 300 are likely to be in the tourism industries and their suppliers and 340 in the travel sector. In addition, the sectors of the Dutch economy that supply the duty-free sector, such as spirits and tobacco, and those that supply the European travel and tourism sector are likely to lose around 3,300 jobs.

1.10 Because the Netherlands economy is heavily orientated towards exports (exports are 51% of GDP[6]), it is not surprising that the CEBR calculations indicate that the largest single impact of the abolition of duty and tax-free retailing is on the Dutch export sector that in turn supports the EU tourism and travel industries. But in addition there are important effects for Dutch tourism and the travel sector.

Table 1-1 **EMPLOYMENT IMPACT IN 2005 BY SECTOR**

	THE NETHERLANDS	TOTAL EU
TOURISM	-300	-46,350
OTHER SECTORS	-3,600	-90,542
OF WHICH		
TRAVEL	-342	
SUPPLIERS	-3,258	
TOTAL	-3,900	-136,892
SOURCE: CEBR ESTIMATES		

This table is included here in the executive summary and is also referred to as Table 3-2 in the main body of the text.

---

[4] This study is a partial equilibrium study. It therefore focuses on the certain and identifiable job losses in the industries and regions that might be negatively affected by the abolition of intra-EU duty and tax free sales. It deliberately does not attempt to estimate the number of jobs that might be created as a result of the expenditure which has been diverted from travel and duty and tax-free purchases

[5] Some of the figures for the Netherlands in this report are updated from the earlier figures published in the full report for the EU. This is because of the use of more recent information where available. The figures for the EU as a whole have also been updated.

[6] Source: OECD Economic Outlook No 63, June 1998 (figures for 1994). The Dutch export to GDP ratio is much higher than those for the larger economies such as Germany (23%), France (23%), Italy (22%), Spain (22%) and the UK (26%). Smaller economies generally have higher export ratios than larger economies, but the 51% figure for the Netherlands is higher than those for many smaller EU economies as well, such as Austria (37%), Finland (36%), Greece (16%), Portugal (31%), Sweden (36%) and Denmark (36%). It is, however, lower than the ratios for Belgium (65%), Ireland (73%) and Luxembourg (94%).

2. THE CASE FOR ABOLITION REVISITED

INTRODUCTION

2.1 The European Union Council of Ministers decided in 1991 to abolish the duty- and tax-free retailing associated with travel between EU Member States on 1st July 1999 'as part of the taxation and excise measures to make the single market a reality'[7].

2.2 This section of the report revisits the case for abolition in the context of changing EU and national policies. In particular, it considers the consequences of the recent developments in EU transport policy and their implications for the abolition of duty-free.

THE ORIGINAL CASE FOR ABOLITION

2.3 As the quotation from the Commission fact sheet[8] set out above indicates, abolition of abolish the duty- and tax-free retailing associated with travel between EU Member States was originally envisaged in the context of the Single Market.

2.4 When the Single Market Programme was originally envisaged[9] the abolition of duty free was seen in the context of harmonisation of indirect taxes within the Single Market. The existence of duty- and tax-free retailing was considered in this context to be a distortion. In the conventional economics of taxation, such distortions are thought likely to lead to a misallocation of resources[10].

2.5 The Commission however subsequently modified its position from harmonisation of indirect taxes to 'approximation' in the light of 'the existing wide spread of indirect tax rates and structures in the Community'[11].

2.6 'Approximation' of indirect taxes implied ensuring that rates of indirect taxes were sufficiently close to 'keep cross-border shopping to reasonable levels'. The Commission estimated that, on the basis of experience in the US, a differential of 5 percentage points in rates of VAT would minimise the problem[12]. The Commission has continued to argue, however, that ideally excise duties should be harmonised completely.

2.7 Meanwhile, despite the pressure for approximation of VAT rates and excise duties, not only do significant differences still remain but, for petrol and diesel fuel at least[13], the variation between EU Member States in levels of relevant

---

[7] 'Duty-free Sales - The Facts'. EU Memo 97/82, 24 September 1997, Brussels
[8] ibid.
[9] 'Completing the Single Market' EC Commission White Paper, June 1985, Brussels
[10] This is described in the standard economics textbooks: see for example 'Economics' 4th edition, by D. Begg, S. Fischer and R. Dornbusch, McGraw Hill, 1994.
[11] 'Tax: Strategic Corporate Planning' Price Waterhouse in conjunction with the Confederation of British Industry '1992 Initiative', 1989 London.
[12] Ibid.
[13] See 'Rebalancing UK Fuel Motor Duties', UK Road Haulage Association Feb 1998.

4. COMPARISON WITH OTHER ETRF STUDIES

4.1 This section compares the results of this study with those of other studies for the Netherlands commissioned by the ETRF.

4.2 The other studies that are considered in this report are:

- Economic Consequences of the Abolition of Intra-EU Duty and Tax Free Sales for the Netherlands, Netherlands Economic Institute (NEI) Market Strategy and Industry Analysis Division, Rotterdam, July 1997
- The Impact of Abolition of intra-EU Duty and Tax Free on the Dutch Ferry Industry, The Portland Group, March 1998
- Impact of the abolition of duty- and tax-free retailing in the EU on Rotterdam Airport, Symonds Travers Morgan (STM), June 1998

THE NEI STUDY

4.3 This study is a very detailed investigation of the impact of abolition at Dutch ports and airports, Dutch airlines and Dutch Ferries and mini-cruises.

4.4 The NEI study takes into account:

- the impact on the retail industry of the reduction of duty-free purchases at these ports and on these modes of transport net of any alternative spending on similar products elsewhere in the Netherlands;
- the impact on producers in the Netherlands of these net reductions in sales; the impact on the mini-cruise industry; and
- the indirect impact on supply industries of these effects.

4.5 Compared with the CEBR study, the NEI study differs in its coverage mainly in that it does not take into account the impact on the Dutch economy of the effects of the abolition of duty- and tax-free retailing in other parts of the EU. In addition it implicitly assumes a zero price elasticity of demand for travel and tourism although its subsequent calculations of possible effects on the ferry and mini-cruise industries investigate the potential impacts if this assumption is relaxed.

4.6 The NEI study is more micro in that it looks in detail at each sector that might be affected whereas the CEBR study takes a top down approach. The advantage of a micro study is that it can take into account potential inflexibilities in the economic system (such as the potential closing of certain ferry routes). The advantage of the top-down approach is that it is likely to be more comprehensive.

4.7 Otherwise the NEI approach is similar to that of the CEBR: both studies are partial equilibrium studies and in effect attempt to measure the disruptive effect

DUTY FREE WORLD COUNCIL

For additional details, please contact:

Duty Free World Council
23/25 Rue de Berri,
75008(Paris)
France
Tel: +33(0)1 40 74 07 21
Fax: +33(0)1 40 74 09 85
info@dfworldcouncil.com