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**COMMISSION STAFF WORKING DOCUMENT**  
*Accompanying the document*

**Proposal for a Council Decision**

**authorising France to apply a reduced rate of certain indirect taxes on 'traditional' rum  
produced in Guadeloupe, French Guiana, Martinique and Réunion**

{COM(2020) 332 final}

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## Glossary

<i>Term or acronym</i>	<i>Meaning or definition</i>
ABV	Alcohol by volume
CAGR	Compound Annual Growth Rate
DG	Directorate General of the Commission
DGDDI	Direction Générale des douanes et droits indirects
EU	European Union
GDP	Gross domestic product
hlpa	Hectolitres of pure alcohol
IEDOM	Institut d'émission des départements d'outre-mer
INSEE	Institut national de la statistique et des études économiques
ISSG	InterService Steering Group
NGO	Non Governmental organisation
OPC	Open public consultation
OR	Outermost Regions
PPS	Purchasing power standard
SMEs	Small and medium enterprises
TFEU	Treaty on the Functioning of the European Union
VAT	Value Added Tax
VSS	Vignette sécurité sociale

## 1. INTRODUCTION: POLITICAL AND LEGAL CONTEXT

### 1.1. Introduction: Outermost Regions

Several regions of the European Union (EU), known as the outermost regions (OR), are located in areas that are remote from Europe. These are the French regions of Guadeloupe, French Guiana, Réunion, Martinique, Mayotte and Saint-Martin; the Portuguese Madeira and the Azores; and the Spanish Canary Islands. These regions are an integral part of the EU and therefore need to comply with EU legislation. At the same time and unlike the rest of the EU territory, they face permanent constraints related to their characteristics, in particular to remoteness, insularity, small size, difficult topography and climate, and economic dependence on a limited number of products.

*Figure 1. Geographical distribution of EU outermost regions*



The special situation of these regions is recognised under Article 349 of the Treaty on the Functioning of the EU (TFEU). This article allows for specific measures for these regions to be taken as it acknowledges that the permanent and combined constraints affect their economic and social situation and severely restrain their development. It permits such measures provided that they do not undermine the integrity and the coherence of the Union legal order, including the internal market and common policies. Such measures concern various policies, including taxation, support to create jobs, boosting competitiveness, and preserving the environment.

Despite the progress in the OR, these areas continue to face serious constraints, which are magnified by globalisation. The constraints continue to affect the typically small economic operators in the OR, in the form of additional costs and access to markets. Climate change is also becoming a major concern with the increased frequency of extreme weather conditions, which affects these regions.<sup>1</sup>

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<sup>1</sup> SWD(2017) 349 final

## **1.2. Specific measure for certain French Outermost Regions**

This report concerns the existing measure for traditional rum produced in the French OR and transported to mainland France. Since 1923, traditional rum produced in Guadeloupe, French Guiana, Martinique and Réunion benefits from aid in the form of reduced indirect taxes. The measure does not apply to Saint Martin or Mayotte as no sugarcane, which is the main ingredient for traditional rum production, is produced in these regions.

These indirect taxes are excise duties and ‘vignette sécurité sociale’ (VSS).<sup>2</sup> Excise duties are indirect taxes on the sale or use of specific products, such as alcohol and tobacco, and are usually applied as an amount per quantity of the product. All revenues from excise duties go entirely to the Member States. VSS is a social security contribution levied on alcoholic beverages sold in France to counter the health risks of excessive consumption of ethyl alcohol. VSS is levied in addition to the national excise duty.

Union legislation<sup>3</sup> on the classification and taxation of alcohol and alcoholic beverages allows for duty rate reductions under certain circumstances and for certain regions. In addition, Council Decision 189/2014/EU<sup>4</sup> authorises France to apply, until 31 December 2020, a reduced rate of excise duties and VSS, not exceeding 50% of the standard rate, on traditional rum produced in these specific ORs when transported to mainland France and consumed there. The reduced rate is limited to an annual quota of 144,000 hectolitres of pure alcohol (hlpa). This is equivalent to approximately 55% of the 2018 production of traditional rum in the French ORs. In 2018, France applied the maximum relief of 50%, so that the final excise duty of €871.01 per hlpa applied to 128,000 hlpa of traditional rum.

The aim of this regime is to compensate for the higher production cost of traditional rum in these OR and guarantee market access to the French mainland, which is their main market outlet. This regime has been a vital element of France’s strategy for the French OR for almost 100 years, which identified sugarcane and rum production as viable products to develop these regional economies. As the regime is due to expire on 31 December 2020, a decision regarding its prolongation is necessary.

## **2. PROBLEM DEFINITION**

The constraints noted in Article 349 TFEU result in several problems for traditional rum producers in the French OR. The problems differ between the various OR and averaging the impact often masks the significant differences between them. The following problem tree outlines the problems, the drivers and their consequences.

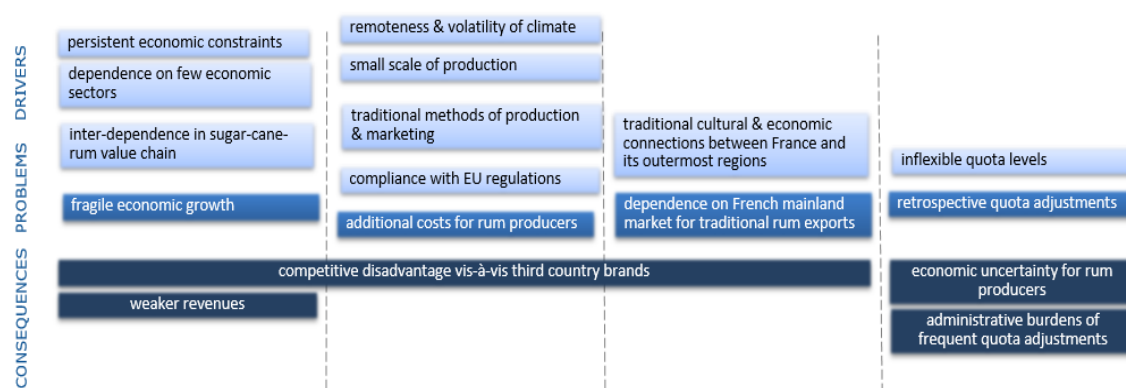
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<sup>2</sup> ‘Vignette sécurité sociale’ (VSS) is also known as ‘Cotisation sur les boissons alcooliques’

<sup>3</sup> Council Directive 92/83/EEC of 19 October 1992 on the harmonization of the structures of excise duties on alcohol and alcoholic beverages

<sup>4</sup> Council Decision No 189/2014/EU of 20 February 2014 authorising France to apply a reduced rate of certain indirect taxes on ‘traditional’ rum produced in Guadeloupe, French Guiana, Martinique and Réunion and repealing Decision 2007/659/EC, OJ L 59, 28.2.2014

**Figure 2 – Problem tree**



## 2.1. Problem 1: Fragile economic growth

The economies of the ORs are significantly below the level of gross domestic product per capita of mainland France. Across the OR, gross domestic product (GDP) per capita in terms of purchasing power standard (PPS) is below the GDP per capita PPS in France. Unemployment, including youth unemployment, in all the OR is worryingly higher than mainland France and the EU average. Moreover, long-term exclusion from the labour market is also a characteristic of these regions.

According to the Institut national de la statistique et des études économiques (INSEE), approximately 30% and 39% of the population of Martinique and Réunion respectively lived below the poverty line in 2016.<sup>5</sup> INSEE estimated that 20% and 30% of the population of Guadeloupe and French Guiana, in 2011 lived below the poverty line respectively.<sup>6</sup> Table 1 below provides a summary of the key indicators for each region and France.

**Table 1: Key socio-economic data (2018)<sup>7</sup> and unemployment data (2017)<sup>8</sup>**

	Guadeloupe <sup>9</sup>	Martinique	Réunion	French Guiana	France
Total GDP (million €)	10,250	9,508	20,331	4,499	2,353,090
GDP per capita (€) PPS	21,900	23,300	21,200	14,400	31,500
GDP per capita PPS compared to all France average	69.5%	74.0%	67.3%	45.7%	100%
Current growth trend (change in real GDP, 2017-2018) <sup>10</sup>	3.4%	0.2%	3.2%	-1.9%	2.2%

<sup>5</sup> INSEE, Fichier localisé social et fiscal (Filosofi) – 2016. There has been some controversy about the use of a regional rather than national income benchmark, potentially reducing the poverty measure. See <https://www.senat.fr/questions/base/2019/qSEQ190209202.html>.

<sup>6</sup> INSEE Dossier Guyane n° 9 - mars 2018

<sup>7</sup> Eurostat 2018

<sup>8</sup> IEDOM: Annual Report 2018

<sup>9</sup> 2017 data.

<sup>10</sup> Compound Annual Growth Rate (CAGR), based on IEDOM: Annual Reports 2017 and 2018.

Average annual GDP growth rate [2014-18] <sup>11</sup>	3.0%	0.3%	3.3%	1.9%	2.0%
Unemployment rate <sup>12</sup>	23.1%	17.7%	24.0%	19.1%	8.8%
Youth unemployment rate	55.2%	49.4%	50.3%	39.2%	20.9%
Young people neither in employment nor in education and training (NEET rate) <sup>13</sup>	20.7%	19.9%	27.8%	33.1%	11.1%
Human Development Index 2010 <sup>14</sup>	0.822	0.813	0.775	0.739	0.883

**Source: IEDOM, Eurostat, INSEE**

### 2.1.1. What are the drivers of the fragile economic growth?

#### *Dependence on a few products – interdependence on sugar cane rum value chain*

The French OR share most of the features of small economies. In particular, like most small economies, the range of production is concentrated on a relatively narrow range of products with little diversification, meaning that the economy is highly exposed to sectoral or asymmetric shocks. While commercial and non-commercial services dominate the economies of the French OR, agriculture and fisheries contribute more than double to the outermost regions' economy compared to the EU average: 3.8% of these regions' added growth against 1.6% at EU level.<sup>15</sup> In French Guiana and Martinique, agriculture accounts for respectively 4.2% and 3.5% of their economies and for a significant proportion of exports. Agriculture accounts for 3% and 1.4% of the economies of Guadeloupe and Réunion, respectively.<sup>16</sup> Even with gross value added of agriculture and fisheries being relatively small, they are important for the regional cultural identity, for the preservation of the landscape and tourism as well as their employment intensity. In Réunion, sugarcane has been the island's primary crop for more than a century. This sector is also considered a wealth and employment maker for the ORs, which further underlines its importance. The agricultural model in the ORs are essentially of family nature and on reduced areas. This type of farming is important for employment and is also environmentally friendly<sup>17</sup>, limiting soil erosion and water run-off, utilising by-products such as bagasse used as a biofuel or filtercake used as fertiliser, or harvesting green sugarcane, which stops the pollution problems caused by burning.

Sugarcane cultivation – the primary ingredient in rum production - takes places on approximately 40,000 hectares of land (25% of the available agricultural land) across the French OR. In 2017, Réunion produced 65% of the total sugarcane in the ORs on

<sup>11</sup> CAGR, based on IEDOM: Annual Reports 2018. This covers the period of the Decision up to the most recent data available.

<sup>12</sup> IEDOM: Annual Reports 2018. INSEE Employment Surveys 2014-18.

<sup>13</sup> Eurostat 2018

<sup>14</sup> Agence Française de développement, document de travail n° 129, Quel niveau de développement des départements et collectivités d'outre-mer ? Une approche par l'indice de développement humain.

<sup>15</sup> SWD(2017) 349 final

<sup>16</sup> INSEE, [https://statistiques-locales.insee.fr/#c=indicator&i=tr063.val\\_ajout\\_agri&s=2015&view=map3](https://statistiques-locales.insee.fr/#c=indicator&i=tr063.val_ajout_agri&s=2015&view=map3)

<sup>17</sup> <http://www.egmontinstitute.be/content/uploads/2018/04/Outermost-Regions-PLS-v2.pdf>



approximately 54% of its total available agricultural land.<sup>18</sup> Guadeloupe, an archipelago of six inhabited islands, uses 26% of its total agricultural land to cultivate 27% of the total sugarcane in the French ORs. Martinique and French Guiana used 13% and 0.5% of their available agricultural lands to cultivate 7% and 0.3% of the total sugarcane during this period.

The cane-sugar-rum value chain involves farms, sugar producers and distilleries, who are highly interdependent on each other. In Martinique and French Guiana, 81% and 100% of the sugarcane produced goes directly into the production of agricole rum.<sup>19</sup> In Guadeloupe, 12% of the sugarcane produced is delivered directly to the distilleries. As Réunion produces mainly sucrerie rum from molasses, the sugarcane is sent to the sugar producers first. Overall, the cane-sugar-rum industry is estimated to employ approximately 40,000 people across the ORs<sup>20</sup>. Worldwide sugar prices have fallen significantly in recent years due to the deregulation of the sugar market in 2017<sup>21</sup> and the decline in the production of sugarcane on Martinique could negatively impact the single sugar factory left, which requires a minimum amount of sugarcane to remain viable.<sup>22</sup> If this factory closes, this would negatively affect the production of sucrerie rum on Martinique, as no molasses would be produced on the island to continue this type of rum production.

#### *Persistent economic constraints*

Significant public support from France as well as the EU has developed infrastructure, provided services for the population, created jobs, invested in education and skills and increased businesses' competitiveness. This support has also helped enhance and diversify agricultural activities, preserve the environment and addresses climate change. Nevertheless, economic constraints remain. The evolution of the economic and social situation in the OR over the past years - rising unemployment rate, especially alarming among the youth, and, for some of them, growing irregular migration and social crises – is a cause for concern.<sup>23</sup>

Given that it is virtually impossible to create import-substituting production for most goods but even more so for exports, the OR have a small export base and high import ratio to GDP. An inability to influence international prices is another factor in the persistent economic constraints facing the French OR.<sup>24</sup> Brazil produced 41% (758 million tonnes) of the world total sugarcane in 2017. In comparison, just under 2.9 million tonnes of sugarcane were grown in the EU's OR.

The *demographic situation* is highly variable and diverse for each OR and is a factor in the persistent economic constraints facing the ORs as a whole. Guadeloupe's population

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<sup>18</sup> IEDOM: Annual Report on Reunion, 2018

<sup>19</sup> PwC et al, 2020

<sup>20</sup> ODEADOM 2018 activity report <http://www.odeadom.fr/wp-content/uploads/2019/08/Rapport-2019-BAT-02-07.pdf>

<sup>21</sup> [https://www.iedom.fr/IMG/pdf/ne421\\_eclairage\\_la\\_filiere\\_canne-sucre\\_en\\_2017\\_la\\_reunion-.pdf](https://www.iedom.fr/IMG/pdf/ne421_eclairage_la_filiere_canne-sucre_en_2017_la_reunion-.pdf)

<sup>22</sup> IEDOM: Annual Report on Martinique, 2018

<sup>23</sup> [https://ec.europa.eu/regional\\_policy/sources/policy/themes/outermost-regions/pdf/rup\\_2017/com\\_rup\\_partner\\_en.pdf](https://ec.europa.eu/regional_policy/sources/policy/themes/outermost-regions/pdf/rup_2017/com_rup_partner_en.pdf)

<sup>24</sup> [http://www.et2050.eu/TechNotes/ET2050\\_DiscNote16\\_OutermostRegions\\_v\(27\\_02\\_12\).pdf](http://www.et2050.eu/TechNotes/ET2050_DiscNote16_OutermostRegions_v(27_02_12).pdf)

growth is low at 0.2% and the region is getting older. Martinique's population has, despite immigration, declined with large numbers migrating to mainland France.<sup>25</sup> French Guiana's population has grown significantly, with approximately 40% of the population aged 20 years or less. While this is mainly due to positive demographic growth, French Guiana is also subject to significant irregular immigration. The population of Réunion is also growing due to natural increases, 34% of its population is younger than 20 years, however its population over 60 years is also increasing.

*Education* is another significant factor affecting the economic development of the ORs. Guadeloupe, Réunion and Martinique all have a high rate of early school dropout, whereas the state of French Guiana's infrastructure significantly hampers the establishment of an effective educational system.<sup>26</sup> Illiteracy is a significant problem contributing to the economic constraints. In 2018, 7% of the population on mainland France between the age of 16 and 65 years were illiterate. In comparison, 14% of the same age profile were illiterate in Martinique and this rises to 22.6% in Réunion.<sup>27</sup> This creates a mismatch between the *skills and competencies* sought by employers and those offered by job seekers. The distance between where the jobs are located and where people live creates a further mismatch as transport difficulties are particularly prevalent in the ORs, which limits the possibility for job seekers to commute to possible job locations.<sup>28</sup> Some producers noted this issue and that this results in an additional cost, if they import skilled labour.

The persistent constraints facing these ORs also stem from *external factors*. Due to the fact that, they are located in areas where the neighbouring countries have significant differences in their level of development, the ORs are also directly exposed to the social and economic conditions that are present there.<sup>29</sup>

Furthermore, traditional OR rum faces substantial *international competition*. Amendments to EU import regimes can have significant impacts. The Cotonou agreement<sup>30</sup> with the African, Caribbean and Pacific Group of States (ACP) countries allows these countries to export rum to the EU duty free. Since the late 1990s, rum producers in the Caribbean community and Dominican Republic (CARIFORUM) have exported rum into Europe under duty free and quota free conditions.<sup>31</sup> Such agreements can have a negative impact on traditional OR rum. The market share of traditional OR rum in mainland France is estimated to have declined by 6% between 2013 and 2018 compared to imports of rum and rum-based spirits from other countries, which have grown by 11.5% a year on average.<sup>32</sup>

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<sup>25</sup> [http://www.euroconsulting.be/wp-content/uploads/2017/01/fullrep\\_en1.pdf](http://www.euroconsulting.be/wp-content/uploads/2017/01/fullrep_en1.pdf)

<sup>26</sup> <http://www.egmontinstitute.be/content/uploads/2018/04/Outermost-Regions-PLS-v2.pdf>

<sup>27</sup> INSEE, 2011

<sup>28</sup> La lettre du Centre d'Economie et de Management de l'Océan Indien n°20, La vie chère en Outre-Mer, un phénomène structurel ? - 2019

<sup>29</sup> [http://www.euroconsulting.be/wp-content/uploads/2017/01/fullrep\\_en1.pdf](http://www.euroconsulting.be/wp-content/uploads/2017/01/fullrep_en1.pdf)

<sup>30</sup> <https://eur-lex.europa.eu/legal-content/en/TXT/?uri=LEGISSUM:r12101>

<sup>31</sup> [https://trade.ec.europa.eu/doclib/docs/2016/february/tradoc\\_154237.pdf](https://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154237.pdf)

<sup>32</sup> PwC et al, 2020

## 2.2. Problem 2: Additional costs for rum producers

The majority of rum production in the French OR is of two main types of traditional rum: *rum agricole* produced from sugarcane juice, and *rum de sucrerie* produced from molasses. Due to several interrelated factors, it is more costly to produce traditional rum in the French OR than elsewhere. These factors include the cost of primary ingredients, which must be sugarcane cultivated in the French ORs, workforce, geographical location and topography, volatile climate, compliance costs (with EU environmental and safety standards) and traditional marketing practices. The way in which all these factors drive the cost of production up is described in the section on drivers below.

Table 2 details these costs to demonstrate the *total additional costs* experienced by producers of traditional rum in the French ORs. Given that these costs are aggregated at the producer level, they do not take account of the fact that more than 50% of the producers are SMEs, which typically face even higher costs. Additionally, not all aspects of the factors affecting production costs, mentioned above, could be quantified or confirmed and are thus not reflected in the estimates.<sup>33</sup> This includes, for example, herbicide costs of €16 per hlpa. There is a possible risk that these costs are over- or underestimated based on the available data, despite extensive efforts to collect them from all relevant sources<sup>34</sup>. Detailed analysis of the additional costs is provided in Annex 4.

**Table 2 Additional cost per hlpa of traditional OR rum**

Component	Additional cost per hlpa (€)		
	Mainland rum	World rum	Mainland vodka
Primary ingredients	75	75	46
Workforce	9	50	32
Remoteness	16	16	16
Tropical climate	43	22	43
EU regulations	0	10	10
Transformation aid	-19	-19	-19
Market practices	697	638	835
Total	821	792	963

Source: PwC et al, 2020

In practical terms, the average additional cost involved in producing both types of traditional rum in the French OR are estimated to be between €792 and €963 per hlpa (or €2.85 and €3.46 per bottle), depending on the comparators.<sup>35</sup>

These estimations do not take into account factors influencing prices in other rum-producing regions, such as production support. For example, the US Virgin Islands

<sup>33</sup> Transports costs are not included in these estimates as these are covered by freight aid.

<sup>34</sup> Including six targeted questionnaires to various stakeholders in the cane-sugar-rum value chain, interviews and public consultation as well as any official statistics available;

<sup>35</sup> The comparators used were world rum, a hypothetical mainland (French) rum and mainland vodka. World rum is the closest actual competitor in the French market. Mainland vodka was also used for comparisons, as rum is not generally produced in mainland France and this allows for comparisons against actual mainland spirit production costs.

provide certain molasses supports to spirits producers on the islands. In addition, rum producers based in Puerto Rico and the Virgin Islands benefit from significant government support financed through transfers of excise collected on sales of rum in the US mainland.<sup>36</sup>

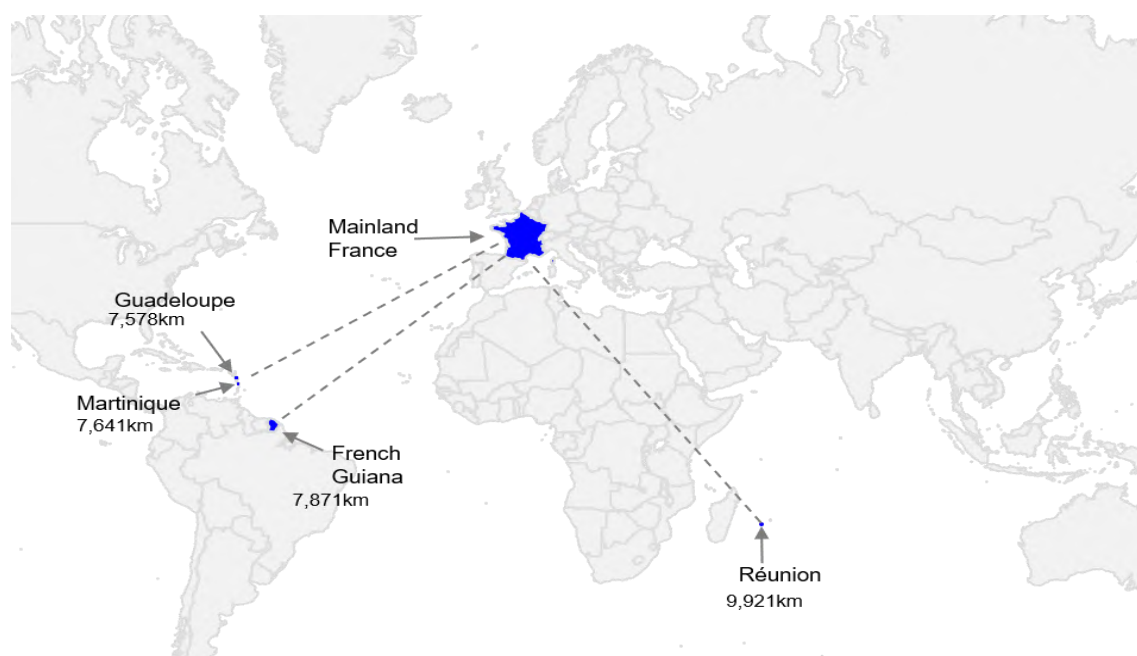
### *2.2.1. What are the drivers of additional costs for rum producers?*

#### *Remoteness, insularity, size, difficult topography and volatility of climate*

The French OR are spread across different regions and all are located over 7,500 km from Paris, with Réunion the furthest at almost 10,000 km away. Remoteness has a negative impact on most sectors because of the transport costs, which affect the mobility of factors (labour, capital and raw materials), trade, and, in general, all forms of integration with the mainland EU.<sup>37</sup> Producers note additional costs include purchase of excess materials and distillery equipment due to the delays in transportation to their remote locations and delays in specialised labour arriving in the ORs to repair the equipment. Their remoteness also affects transport costs towards mainland Europe, with air and sea connections limited by the lack of critical mass on the one hand, and exposed to fluctuations in oil prices on the other hand.

The ORs are isolated also due to their island nature or due to the characteristics of the territory. Apart from French Guiana, 96% of which is covered by dense rainforest, the OR are small oceanic islands. Accessibility issues affect these regions not only in their trade and exchanges with the EU but also within their geographic areas and within the same archipelago.<sup>38</sup>

**Figure 3 – location of the French outermost regions subject to the regime**



<sup>36</sup> PwC et al, 2020

<sup>37</sup> [http://www.et2050.eu/TechNotes/ET2050\\_DiscNote16\\_OutermostRegions\\_v\(27\\_02\\_12\).pdf](http://www.et2050.eu/TechNotes/ET2050_DiscNote16_OutermostRegions_v(27_02_12).pdf)

<sup>38</sup> Guadeloupe is an archipelago with 6 of its islands inhabited.

Guadeloupe, Martinique and Réunion have a small surface area, are of volcanic origin and affected by seismic activity.<sup>39</sup> This results in very diverse relief from steep to flat, sometimes within the same region. 75% of sugarcane is grown on the slopes in Réunion. In many cases, the soil is uncondusive to high agricultural yields due to environmental and water availability problems.

The climate of these regions varies from tropical (e.g. Guadeloupe, Martinique and Réunion), to equatorial (French Guiana). The tropical climate results in high number of pests, which may affect crop yield.<sup>40</sup>

Environmental risks are high and the consequences of natural events such as floods, droughts, cyclones and tsunamis can be dramatic as due to topography most of the social and economic life is concentrated in the coastal areas<sup>41</sup>, which are particularly exposed to extreme weather conditions.<sup>42</sup> Producers note that storm damage to infrastructure is a driver of additional costs for them, which also impacts on their insurance costs. Cyclones Bejisa and Beguitta hit Réunion in 2013 and 2018 respectively and hurricane Maria impacted Guadeloupe and Martinique in 2017 and is estimated to have costed €100 million in Guadeloupe<sup>43</sup> due to the structural damages caused by the strong wind and excessive rainfall.

Consequently, sugarcane grown in the French OR is systematically and substantially more expensive than the world price, while at the same time has a lower sugar content. The cost per hlpa of traditional French OR rum is on average €75 higher than comparators (see table 2 above), who can source sugarcane cheaper from the large-scale producers located in countries such as Brazil (60% of the farms are more than 1,000 hectares)<sup>44</sup>, India and China. In comparisons, many of the OR sugarcane farms are less than 7 hectares.<sup>45</sup> This, combined with the soil characteristics and availability of water, leads to lower crop yields on a per hectare basis and economies of scale are hard to realise. Yields per hectare in Guadeloupe, Martinique and French Guiana remain low (between 40 and 50 tonnes per hectares depending on the years)<sup>46</sup> in comparison with the average worldwide yield (70.6 tonnes per hectare).<sup>47</sup> Moreover, the above-mentioned volatility of climate results in unforeseeable fluctuations in sugarcane production.

### *Compliance with EU legislation*

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<sup>39</sup> Réunion is home to one of the world's most active volcanoes

<sup>40</sup> [http://www.euroconsulting.be/wp-content/uploads/2017/01/fullrep\\_en1.pdf](http://www.euroconsulting.be/wp-content/uploads/2017/01/fullrep_en1.pdf)

<sup>41</sup> The population density is very high in all ORs except Guiana. It ranges from 260 inhabitants per square km in Guadeloupe to 350 in Martinique, while the EU27 average is approximately 114.

<sup>42</sup> [https://ec.europa.eu/regional\\_policy/sources/docgener/studies/pdf/rup\\_growth/rup\\_growth\\_sum\\_en.pdf](https://ec.europa.eu/regional_policy/sources/docgener/studies/pdf/rup_growth/rup_growth_sum_en.pdf)

<sup>43</sup> <https://la1ere.francetvinfo.fr/ouragan-maria-moins-100-millions-euros-degats-guadeloupe-bruno-maire-514807.html>

<sup>44</sup> [https://www.researchgate.net/publication/311159054\\_The\\_evolution\\_role\\_of\\_large\\_and\\_medium\\_farms\\_on\\_Brazilian\\_agriculture](https://www.researchgate.net/publication/311159054_The_evolution_role_of_large_and_medium_farms_on_Brazilian_agriculture)

<sup>45</sup> The average farm is 6 hectares but size ranges from 4 hectares in Guadeloupe to 19 hectares in Martinique. IEDOM report (2018) on Martinique, Guadeloupe and Reunion

<sup>46</sup> IEDOM: Annual Report, 2018

<sup>47</sup> The Food and Agriculture Organization

Point 1 of Annex II of Regulation 110/2008<sup>48</sup> on the definition, description, labelling and the protection of geographical indications of spirit drinks sets out the definition for rum. In general, rum is an unflavoured spirit drink produced exclusively by fermentation and distillation of molasses or syrup produced in the manufacture of cane sugar or from sugarcane juice itself.

For the OR of France, rum is defined as:

*‘a spirit drink produced exclusively by alcoholic fermentation and distillation of sugar-cane juice which has the aromatic characteristics specific to rum and a volatile substances content equal to or exceeding 225 grams per hectolitre of 100 % vol. alcohol. This spirit may be placed on the market with the word ‘agricultural’ qualifying the sales denomination ‘rum’ accompanied by any of the geographical indications of the French Overseas Departments and the Autonomous Region of Madeira as registered in Annex III’.*

Regulation 110/2008<sup>49</sup> also provides for the use of the word ‘traditionnel’ as follows:

*‘The word ‘traditionnel’ may supplement any of the geographical indications mentioned in category 1 of Annex III where the rum is produced by distillation at less than 90 % vol., after alcoholic **fermentation of alcohol-producing materials originating exclusively in the place of production considered**. This rum must have a volatile substances content equal to or exceeding 225 grams per hectolitre of 100 % vol. alcohol and must not be sweetened...’.*

In accordance with Regulation 110/2008, the minimum alcohol content of rum must be 37.5%. However, Council Decision 189/2014/EU<sup>50</sup> requires an alcoholic strength by volume of 40% or more.

In order to avail of the current relief, producers must use sugarcane grown in the OR and must produce higher strength alcohol. This restriction means that cheaper ingredients cannot be sourced elsewhere and that the end product is subject to higher excise duty due to the higher alcoholic content of traditional rum.<sup>51</sup>

Environmental regulations<sup>52</sup> are another driver of additional costs for rum producers in the ORs. Commission Implementing Regulation (EU) No 1045/2011 of 19 October 2011 banned asulox in the EU, a herbicide used to control weeds in sugarcane plantations. A derogation was allowed until 2018 as no alternative in the sugarcane industry had been found.<sup>53</sup> Producers estimate that the banning of asulox results in additional labour costs

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<sup>48</sup> Regulation (EC) No 110/2008 of the European Parliament and of the Council of 15 January 2008 on the definition, description, presentation, labelling and the protection of geographical indications of spirit drinks and repealing Council Regulation (EEC) No 1576/89

<sup>49</sup> Point 1(f) of Annex II

<sup>50</sup> Article 2

<sup>51</sup> Excise duties on ethyl alcohol is calculated per hectolitre of pure alcohol. Higher strength alcohol is therefore subject to higher excise duties than lower strength ethyl alcohol

<sup>52</sup> See also Directive 2014/52/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2011/92/EU on the assessment of the effects of certain public and private projects on the environment

<sup>53</sup> Article 53 of Regulation (EC) 1107/2009



of €16 per hlp<sup>54</sup> to control the weeds in the sugarcane plantations. Distilleries are subject to an authorisation procedure for environmental protection reasons<sup>55</sup>, which reviews the environmental dangers of the installation prior to authorisation. Producers must ensure their distillery equipment is compliant with EU environmental regulations and producers note the significant environmental compliance costs for the waste treatment<sup>56</sup> of turning the ‘vinasse’, a by-product of rum production, into biogas and other nutrients.<sup>57</sup>

EU and French labour regulations also affect the ORs. Workers in the ORs enjoy a higher – and costlier – level of social protection. These regulations result in increased labour costs for small producers in particular. The cost of employing managers in the OR is typically higher than for the equivalent jobs in mainland France.<sup>58</sup> Furthermore, when comparing the labour costs in Brazil to those in the OR, the latter are substantially higher. Overall, labour contributed to an estimated €9 to €50 per hlp in additional costs. This difference is driven mostly by the additional costs of labour required in the production of agricole rum, demanding more staff per hectolitre of pure alcohol compared to sucrerie rum. French Guiana produces only agricole rum, whereas production in Guadeloupe is split almost 50/50 between the two types. Sucrerie rum is produced predominantly in Réunion, whereas Martinique producers distil agricole rum for the main part. This means that producers in French Guiana and Martinique face higher labour costs than producers in Réunion.<sup>59</sup> Health and safety legislation<sup>60</sup> regarding air polluting substances also impacts the OR industry in comparison to competing industries in neighbouring countries.

#### *Traditional production methods and small-scale production*

There are 25 rum producers in the French OR with Guadeloupe having 12 producers, Martinique 9, Réunion 3 and French Guiana only 1. Their production of rum varies substantially from low thousands of hectolitres of pure alcohol to over 50,000 hlp, which is still relatively small.

Thirteen of the producers are SMEs<sup>61</sup>, which is a significant obstacle in terms of development:

- the small size of SMEs, with a consequent lack of financial and human resources, is a strong barrier to entering new markets.
- limited innovation in many enterprises, especially in more traditional sectors such as manufacturing, makes SME products less competitive in external markets.

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<sup>54</sup> CIRT-DOM

<sup>55</sup> Article L 511-1 et seq. of the French Environmental code : <https://www.georisques.gouv.fr/node/7605>

<sup>56</sup> Regional atmosphere protection plan and waste prevention and management plan

<sup>57</sup> <https://www.economiecirculaire.org/data/sources/users/3136/20180401presentation-drm-et-projets.pdf>

<sup>58</sup> Les Études de l’emploi cadre titled ‘Les salaires dans les fonctions cadres: Exécutives salaries. See: <https://corporate.apec.fr/files/live/sites/corporate/files/Espace%20M%C3%A9dias/pdf/les-salaires-dans-les-fonctions>

<sup>59</sup> PwC et al, 2020

<sup>60</sup> Directive (EU) 2015/2193 of the European Parliament and of the Council of 25 November 2015 on the limitation of emissions of certain pollutants into the air from medium combustion plants

<sup>61</sup> [French Senate Report No 574](#) (2012-2013) of MM. [Georges PATIENT](#) and [Éric DOLIGÉ](#) on behalf of the Committee on financial affairs. A new SME rum producer started in 2016.

- in comparison to large enterprises, SMEs perform worse in terms of turnover and value added.<sup>62</sup>

Increasing production and therefore achieving economies of scale are difficult to realise due to the small scale of the regional markets and sugarcane production for many of the producers. The production of traditional rum is aligned to the short sugar cane harvest period of 4 months in Guadeloupe and Martinique and 6 months in Réunion. The harvest period is 9 months in French Guiana. The smaller scale production, together with difficult terrain, result in the underutilisation of machinery designed for higher volumes of production, which has a significant impact on the competitiveness of rum producers in the OR. Moreover, the tropical climate and roughness of the terrain causes machinery used to depreciate quicker. Rum producers in the OR suggested that depreciation and repair costs were 60% higher in tropical climates.<sup>63</sup> Waste management is a further factor affecting producers in the ORs. There is limited landfill capacity and the lack of economies of scale for waste collection, treatment and / or recycling processes, in particular at the specific waste stream level (e.g. for organic waste). This can result in the need to export unusable waste at additional cost to be treated on the mainland.<sup>64</sup>

### *Marketing practices*

Traditional OR rum sold in the French mainland is typically marketed in larger bottles of one litre and at higher strengths than other competing rum. Traditional rum must have an alcoholic strength by volume of 40% or more in order to qualify for reduced rates of excise duty on the French mainland. In comparison, the alcohol content of all other rum must exceed an alcoholic strength by volume of 37.5%. However, the average bottle of OR rum is estimated to have an alcohol content of 0.359 litres of pure alcohol which is equivalent to 70 cl bottle with 51% ABV<sup>65</sup>. Moreover, certain spirit drinks, which do not meet the definition of rum due to their lower alcoholic content and presence of flavourings/sweeteners, are in direct competition with traditional rum because of their use of the term rum in their branding and their marketing strategy of product placement beside rum in retail outlets<sup>66</sup>.

As excise duties and VSS are based on volume and alcohol content, this results in higher taxes on traditional rum. Producers noted in the consultation that the marketing practice for traditional rum, of higher volumes and alcohol content, is critical to maintaining market access in the face of larger alcohol brands' marketing budgets and that the practice generates brand recognition with customers.<sup>67</sup> By selling in higher volumes and strengths, OR rum has been able to successfully compete and differentiate itself, particularly in the lower cost ends of the market, and overcome difficulties caused by the

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<sup>62</sup> EU policy framework on SMEs: state of play and challenges, European Commission, 2019  
<https://cor.europa.eu/en/engage/studies/Documents/EU-SMEs/EU-policy-SMEs.pdf>

<sup>63</sup> PwC et al, 2020

<sup>64</sup> [https://ec.europa.eu/regional\\_policy/sources/policy/themes/outmost-regions/pdf/green\\_circ\\_econ\\_report\\_en.pdf](https://ec.europa.eu/regional_policy/sources/policy/themes/outmost-regions/pdf/green_circ_econ_report_en.pdf)

<sup>65</sup> PwC et al, 2020, confirmed by CIRT-DOM, based on 2018 IRI panel

<sup>66</sup> CIRT-DOM, 2020

<sup>67</sup> PwC et al, 2020



economic and social situation of the ORs. The current Council Decision acknowledged this practice, describing it as a ‘decade-long marketing practice.’<sup>68</sup>

### **2.3. Problem 3: Access to markets – dependence on the French mainland market**

Three of the French OR have smaller based domestic markets than Malta, the least populated Member State. Guadeloupe and Martinique have a total population of approximately 390,000 and 376,000 respectively<sup>69</sup> – the size of a mid-size European city. French Guiana is located on the South American continent and has a total population of 296,700.<sup>70</sup> These OR are located in or close to the Caribbean, the centre of world rum production<sup>71</sup>, which limits the scope for trade opportunities in their immediate geographic areas.

Réunion’s population is larger than the other OR and also three of the EU Member States<sup>72</sup>, with approximately 865,800 people living on the island.<sup>73</sup> Réunion’s closest neighbours are Mauritius and Madagascar, both active in rum production. India to the north also produces rum. As a result, these regions face intense competition from their rum-producing neighbours and access to the EU single market is vital for development, as it was already recognised in the 2017 Commission Communication “A stronger and renewed strategic partnership with the EU’s outermost region.”<sup>74</sup> That situation is also recognised in recital 6 of the current Decision stating that: *“Given the small scale of the local market, the distilleries in the four outermost regions concerned can develop their activities only if they have sufficient access to the market in the French mainland, which is the main outlet for their rum.”*

Producers located in the outermost region, an integral part of the EU, have the right to full participation in the single market with more than 500 million consumers. However, in practice, many small companies on the EU mainland struggle to access the single market even with the EU’s SME support<sup>75</sup> in place. A 2010 study by the Commission found that only 25% of EU-based SMEs sell outside their home Member State, of which only 13% go beyond the single market.<sup>76</sup>

The French authorities have supported rum producers since 1923 in the form of reduced excise rates on sales in the French mainland. This has supported the industry by guaranteeing access to the French mainland market for traditional rum. In 2018, 65% of the total traditional rum production in the ORs was sold on the French mainland, 15% of this outside of the derogation. Despite a growth of 14% in the volume of traditional French OR rum sold on the French mainland market, the estimated share of the OR rum

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<sup>68</sup> Recital 10

<sup>69</sup> INSEE, Guadeloupe (2017), Martinique (2016)

<sup>70</sup> INSEE, French Guiana (2018)

<sup>71</sup> <https://www.statista.com/statistics/259739/leading-rum-brands-worldwide-based-on-sales-volume/>

<sup>72</sup> Malta, Luxembourg, Cyprus

<sup>73</sup> IEDOM: Annual Report on Reunion, 2018

<sup>74</sup> [COM\(2017\) 623 final](#)

<sup>75</sup> COM/2008/0394 final

<sup>76</sup> European Commission, 2010, Internationalisation of European SMEs

<https://ec.europa.eu/docsroom/documents/10008/attachments/1/translations>

in the total rum market declined by 6% between 2013 and 2018. This is due to the success of other global rum brands.<sup>77</sup>

**Table 3: Traditional OR rum production and dispatches to French mainland (hlpa)**

	2014	2015	2016	2017	2018
Traditional rum production (hlpa, thousands)	226	234	244	279	259
French OR traditional rum dispatched to mainland France (hlpa, thousands)	147	149	160	185	169
Total quota (hlpa, thousands)	120	120	144	144	144
French OR traditional rum released for consumption under the derogation (hlpa, thousands)	119	120	124	127	128
French OR traditional rum released for consumption under the derogation as a percentage of OR traditional rum production	53%	51%	51%	46%	50%

**Source: PwC et al, 2020**

#### 2.4. Problem 4: Retrospective quota adjustments

The regime for traditional OR rum only applies to certain quantities of pure alcohol transported and consumed in mainland France each year. This amount or quota is fixed for a seven year period, as set out in the Decision. Changes to the quota is possible with an amendment of the Decision. However, the most recent amendments to the quota were retrospective, which creates uncertainty for the producers. This impacts their ability to plan their production and in some cases may negatively impact on long term investments.

For France and the European Commission, any amendments to the Decisions entail administrative burdens and costs. Revisions of Decisions are estimated to incur costs of about €77,000 per Decision for both stakeholders, on top of the ongoing oversight costs amounting to some €47,000.<sup>78</sup>

As demonstrated in Table 4, the Decisions were generally adjusted before their expiry. That is not conducive to economic certainty in the sector and creates burdens and costs (detailed in Annex 4). Although relatively modest, these costs are avoidable and the permanent need for further increases keeping up with the growth rates, potentially unnecessary.

**Table 4: Council Decisions and their amendments**

Council Decision		2002/166/EC	2007/659/EC	896/2011/EU	189/2014/EU	2017/2152
Date Decision	30/10/1995	18/02/2002	09/10/2007	19/12/2011	20/02/2014	15/11/2017
Quota (hlpa)	90,000	90,000	108,000	120 000	120 000	144 000
Start date	01/01/1996	01/01/2003	01/01/2007	01/01/2011	01/01/2011	01/01/2016

<sup>77</sup> PwC et al, 2020

<sup>78</sup> PwC et al, 2020

End date	31/12/2002	31/12/2009	31/12/2012	31/12/2013	32/12/2020	31/12/2020
			retrospective	retrospective	retrospective	retrospective

#### 2.4.1. *What are the drivers of retrospective quota adjustments?*

The Decision notes that the fiscal advantage needs to remain proportionate so as not to undermine the integrity and the coherence of the Union legal order, including safeguarding undistorted competition in the internal market and State aid policies. The quota is set at the adoption of the Decision, on the basis of market information available at the time. The fixing of the quota allows producers to plan their long-term production and investments.

The markets however evolve and the production of rum worldwide has been increasing steadily overtime. This results in the quota levels running quickly out of sync with the market, restraining production growth in the OR as the producers are limited to remain within the quota. To remedy the situation, French authorities have systematically requested the Commission to update and increase the quota, in line with market developments. The progressive historical increases in the quota in line with the overall growth rate of 3.1% have created an expectation at the producers' level that this will continue, which has influenced long-term business strategies.

Council Decision 2002/166/EC set this quota at 90,000 hectolitres of pure alcohol (hlpa) for the period 1 January 2003 to 31 December 2009. In the mid-term report of 2005, France requested an increase in this quota for various reasons including increase in production costs and the developments on the Community market for rum, which benefitted rum from third countries and resulted in the decline in market share for traditional OR rum.

Council Decision 2007/659/EC increased the quota to 108,000 hlpa for the period 1 January 2007 to 31 December 2012. The French mid-term report of 2010 requested another increase of the quota, to reflect trends on the market for rum in the EU. Council Decision of 896/2011/EU adopted on 19 December 2011 retrospectively increased the quota to 120,000 hlpa from the 1 January 2011 to 31 December 2013.

Council Decision 189/2014/EU retained the amount at 120,000 hectolitres of pure alcohol (hlpa) per annum for the duration of the Decision, seven years. In 2016, the French authorities requested an increase in the quota as the OR producers were unable to benefit from sufficient access to the French mainland market. This was justified on the basis of significant and likely irreparable harm to these producers.<sup>79</sup> This amount was increased in Council Decision (EU) 2017/2152 to 144,000 hlpa per annum and was applied retrospectively from 1 January 2016.

The frequent revisions creates costs for all stakeholders as noted above and uncertainty for producers in terms of forecasting future production of traditional OR rums.

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<sup>79</sup> Council Decision (EU) 2017/2152

## 2.5. How will the problems evolve?

In the 2017 Communication “A stronger and renewed strategic partnership with the EU's outermost regions,”<sup>80</sup> the Commission noted that despite progress made over the years, the ORs continue to face serious and permanent constraints. Furthermore, globalisation and climate change are amplifying these constraints. Diversification opportunities are limited due to the few resources at their disposal and the geographical and natural characteristics specific to their remoteness. Consequently, the economies of the OR are fragile and sustainable economic growth uncertain. Economic crises are bound to affect the economies of the OR to a greater extent than mainland Europe, and recovery is slower.

The Communication stresses the need to build on the assets of the ORs, identifying new sectors to enable growth and job creation. While this approach is important to address the numerous threats and constraints of the ORs, the traditional activities are also vital to the development of the regions, as any sustainable structural changes to the economies of the ORs will take time to materialise.

The blow to the fragile economic growth of the ORs would be significant, if the special regime for traditional rum was to be discontinued, as removal of the relief would severely impact the cane-sugar-rum industry, which is estimated to generate employment for approximately 40,000 people across the ORs. Furthermore, this industry supports tourism, a major contributor to the economies of the ORs.

With no change in the derogation, the fiscal costs of the regime are estimated to increase by approximately €20 million in line with inflation.<sup>81</sup> The administrative costs of the regime will remain relatively low, (approximately €77,000) increasing only with inflation.

As many of the underlying drivers, such as remoteness, insularity or climate, are of a permanent nature, they will always act to the ORs' disadvantage. They also underpin the other problems, such as the additional costs for rum producers before the bottle of traditional rum can reach the French market or the dependence on the French market for exports. As for the additional costs, there are no grounds to consider that they would diminish significantly in the near future, as they are inherent to small insular economies in general, as well as the traditional methods of rum production and marketing in the ORs. Unfortunately, there are no coherent data series assessing all the components of the cost of a traditional rum bottle in a consistent way, making it difficult to predict how these can evolve.

Wages and social protection costs, which need to respect the EU legislation, will also remain higher in the OR than in their neighbouring countries. The overall cost of employment, characterised by mismatches between skills supplied and demanded as well as place of residence and place of employment, is also likely to remain substantive. Same

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<sup>80</sup> COM(2017) 623 final

<sup>81</sup> Article 403 of the French General Tax Code: the tariff shall be increased on 1<sup>st</sup> January of each year by the growth rate of the Consumer Price Index (excluding tobacco) during the penultimate year

for the additional costs related to respecting EU's environmental laws where the ORs are bound to abide irrespective of their remoteness to the mainland.

Transport infrastructures have been steadily built and a mildly positive trend in the maritime and air transport of freight was observed in the last decades in the ORs but accessibility issues will always affect the trade and exchanges of the ORs with the EU as and within their geographic areas alike.

What we can carefully conclude from the nature of the costs is that they may fluctuate but will never disappear altogether.

## **2.6. Why should the EU act?**

On the basis of Article 349 TFEU, the Council can adopt specific measures in favour of the EU outermost regions to adjust the application of the Treaties to those regions, including the common policies, because of the permanent constraints which affect the economic and social conditions of the outermost regions. In its judgement of 15 December 2015<sup>82</sup>, the European Court of Justice clarifies the scope of the application of Article 349 TFEU on the basis of which the Council is entitled to adopt specific measures for the EU outermost regions.

The EU has been building a strong partnership with its outermost regions over the years. In 2004, the Commission presented its first strategy for the regions<sup>83</sup>, which was renewed in 2008<sup>84</sup>, in 2012<sup>85</sup>, when the strategy was aligned with the Europe 2020 goals of sustainable growth, social development and creation of jobs; and in 2017, when the Commission strengthened and renewed its strategic partnership with these regions. Access to the EU single market is vital for the continued development of the ORs as underlined in the 2017 Commission Communication “A stronger and renewed strategic partnership with the EU's outermost region.”<sup>86</sup>

Maximising the potential of each outermost region can only benefit both the OR and the EU as a whole.

## **3. OBJECTIVES: WHAT IS TO BE ACHIEVED?**

### **3.1. General objectives**

The situation of the ORs is recognised in Article 349 TFEU, which envisages specific measures for those regions to take account of the structural, social and economic situation of these regions. Measures adopted must mitigate the constraints of the ORs without undermining the integrity and the coherence of the Union legal order, including the internal market and common policies.

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<sup>82</sup> Joined Cases C-132/14 to C-136/14

<sup>83</sup> COM(2004) 543 final, 6.8.2004.

<sup>84</sup> COM(2008) 642 final, 17.10.2008.

<sup>85</sup> COM(2012) 287 final, 20.6. 2012.

<sup>86</sup> [COM\(2017\) 623 final](#)

### **3.2. Specific objectives**

The specific objectives of Council Decision 189/2014/EU are:

- to offset the competitive disadvantage of traditional rum producers in the French ORs, which are linked to the permanent constraints of the ORs;
- to support the broader cane-sugar-rum sector in the French ORs, which is important to the socio-economic situation of these ORs in terms of employment, land use, and the wider OR economy; and
- to maintain access to the mainland French market for the traditional rum producers in the French ORs;

All objectives need to ensure that the principles of the single market are respected and any assistance to the French OR preserves the smooth functioning of the single market for alcoholic beverages.

## **4. WHAT ARE THE AVAILABLE POLICY OPTIONS?**

### **4.1. What is the baseline from which options are assessed?**

For the purposes of this staff working document, there is a difference between ‘no action’ and the ‘status quo’. Given that the Council Decision authorising the reduced excise duties expires in 2020, a ‘no action’ scenario would imply that the current system of reduced rates expires in 2020 with no other regime put in place. This is not considered a realistic baseline scenario, due to the structural and permanent nature of the constraints faced by the ORs and the long-term existence and recent extensions of the regime.

As such, we assess the non-renewal of the regime as a ‘new policy option’, whereas the baseline option for this regime is defined as a ‘business as usual’ scenario, in which the derogation is renewed for a further seven years. The baseline assumes that the 50% reduced rate for traditional OR rum continues after 2020 with the quota increased to 153,000 hlpa. This increase reflects the annual growth of production of 2% during the period 2014 - 2019 applied to the current used quota of 128,288 hlpa. This will accommodate future production growth and is sufficient to reduce the need for further amendments prior to the expiry of the seven years of the new Decision. The hypothetical changes it brings to the modelled impacts of a situation where the Decision is renewed as-is would be too small to be distinguished and analysed independently, particularly given that all other elements of the regime remain unchanged.

The excise rate is adjusted for inflation in France. We therefore assume a constant real taxation level, particularly given that no tightening of France’s policy on alcohol has been announced or is currently expected. The tax rebate is therefore forecast to remain constant on a per unit basis, growing purely as a function of growing production.

### **4.2. Description of the policy options**

*Option 1 – Termination of OR-specific support*

Under this policy option, the special taxation regime for the French ORs would not be renewed and would therefore expire on 31 December 2020. If the regime is allowed to expire, the preferential tax treatment of traditional rum produced in the French ORs and sold in mainland France would disappear.

The impact of such decision would depend substantially on the reaction of the French authorities. Given current EU regulations on the taxation of spirits, the French authorities have two policy responses available to them:

- **Option 1.1 (full abolition):** French authorities take no further action once Council Decision 189/2014/EU expires and tax OR traditional rum at the standard excise rate. As there would be no derogation and thus no quota, there would be no incentive to limit production of traditional rum to stay within the quota levels; or,
- **Option 1.2 (extension to third-country products):** France applies Article 23 of Directive 92/83/EEC which allows a 50% reduced rate to all rums made from locally harvested sugarcane and with a strength by volume equal to or exceeding 40%, to all producers, including third-country ones (described further in Box 1), without a quota.

#### **Box 1: Application of Article 23 of Directive 92/83/EEC**

If the derogation were not renewed, the French authorities could use Article 23 of Directive 92/83/EEC to apply a reduced excise rate of up to 50% of the standard rate to all ‘traditional’ rum, not just to traditional rum from the French ORs. The Article states:

*The following Member States may apply a reduced rate, which may fall below the minimum rate but not be set more than 50% below the standard national rate of duty on ethyl alcohol, to the following products:*

1. *The French Republic, in respect of rum as defined in Article 1 (4) (a) of Regulation (EEC) No 1576/89 and produced from sugarcane harvested in the place of manufacture as set out at Article 1 (3) (1) of that Regulation, 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 actual alcoholic strength by volume equal to or exceeding 40% vol<sup>87</sup>*

The excise rate reductions possible under Council Decision 189/2014/EU only apply to rum produced in the French ORs using sugarcane harvested in the French OR and with a minimum alcohol content of 40% ABV. There is no such restriction in Article 23 of Directive 92/83/EEC.

#### *Option 2 - Lower the reduced rates of 50% to 40%*

The extent to which compensation is granted for all additional costs is considered under this option. The current Decision applies a reduced rate of excise duty up to a maximum of 50% on rum transported to the French mainland and consumed there. In accordance

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<sup>87</sup> [Council Directive 92/83/EEC](#) of 19 October 1992 on the harmonization of the structures of excise duties on alcohol and alcoholic beverages

with this mutually exclusive policy option, the regime would be renewed with the maximum reduction in excise duty lowered to 40% of the normal excise duty. Based on the 2018 standard excise duty rate in France, this would equate to a rebate of €696.42 per hectolitre of pure alcohol.

#### *Option 3 - Introduce a subsidy ceiling*

This option involves renewing the regime, but would cap the nominal cash value per hectolitre of pure alcohol of the excise rate reduction at 2020 levels (approximately €128 million annually) and remove the quota based on the amount of hectolitre of pure alcohol for the period of the decision, 7 years. This mutually exclusive option would address the problem related to the quota and allow France to determine the operation of the measure in line with the principal of subsidiarity, while controlling the cost of the measure.

#### *Option 4 - Increase the quota at a fixed annual rate*

The current regime sets a fixed quota for the period of the Decision. Any subsequent amendments to the quota must be introduced by means of new legislation, usually with a retrospective effect, which is costly and creates uncertainty for the producers as explained in section 2.4. This option, which is also mutual exclusive from the other options, addresses these problems by including in the legislation an annual increase in the quota. The annual increase would be aligned to the historic growth rate of the quota during the period 2008 and 2017 of 3.1%. Applying this rate to the current quota of 144,000 hlpa means that the quota in 2021 would be approximately 148,500 hlpa and would ultimately increase to approximately 178,000 hlpa by 2027.

The French authorities requested this option, whereby the quota would be increased to mitigate future mid term amendments of any future Decision.

### **4.3.Options discarded at an early stage**

#### *Direct support to production and market access*

The existing regime would be replaced by a direct payment of a subsidy to the traditional rum producers of the ORs, to compensate them for the higher production costs they face as a result of their location in the ORs. As subsidies alone would not address the issue of market access, this option could include promotional subsidies / supports such as the existing EU funded promotional export programmes<sup>88</sup>. The interaction between the two subsidies would need to be defined with new procedures, which would be more complex than the existing regime.

While the option could potentially target support better to the producers, it would result in increased burdens and costs for all stakeholders. The current regime is administered through excise duty returns, with low costs for both producers and authorities. Additionally producers note potential cash flow issues due to delays in processing subsidies.

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<sup>88</sup> [https://ec.europa.eu/info/sites/info/files/food-farming-fisheries/key\\_policies/documents/annex-commission-decision-c2019-8095\\_en.pdf](https://ec.europa.eu/info/sites/info/files/food-farming-fisheries/key_policies/documents/annex-commission-decision-c2019-8095_en.pdf)



The added benefits of this option are limited, as the efficiency and effectiveness of new subsidies appears to be significantly less than the existing regime. Any benefit of implementing this new option would be greatly outweighed by the costs. For these reasons, this option would not be a viable option and will be discarded.

## **5. WHAT ARE THE IMPACTS OF THE POLICY OPTIONS?**

### **5.1. Methodology**

The impacts of the policy options have been assessed mainly on the basis of the study by an external contractor<sup>89</sup>. Appropriate – but limited - adjustments were made on specific points where this was warranted by newer information becoming available or by fine-tuning of the policy options. For the quantitative estimates, the impacts are measured as the deviation of the variable to be assessed from baseline, at the conventional date of 2027. This date has been chosen as representative of the long-term equilibrium. It is sufficiently distant to allow short-term effects to play out with the exception of the emerging effects of COVID-19, as detailed below. Full details on the methodology are provided in Annex 4.

The sections below covers the main economic effects, i.e. those on production and sectoral employment, as well as the budgetary implications. In addition, for each option a qualitative assessment of its impact on businesses' compliance costs has been included. A number of macro impacts, e.g. on OR exports, have been analysed, but will not be reported upon because they are not material.

#### *Effects of the COVID-19 pandemic on the projections underlying the assessment*

It should be noted that the baseline scenario as well as the impacts from the various options have been assessed on the basis of the study carried out in late 2019-early 2020. As such, the effects of the COVID-19 pandemic are not taken into account. At the time of writing, it is too early to assess whether the impact on rum demand will be limited to 2020 or will stretch into the future. While in the first case the projected baseline may not be affected to a large extent, in the second case, the baseline scenario may overstate growth. The impacts of the options, however, are calculated on the basis of long-term elasticities and should, as a result, be less affected than the baseline.

### **5.2. Baseline**

In the medium term, production is forecast to continue growing at a rate similar to the rate witnessed in recent years. The long-term growth rate may decelerate somewhat in comparison with the past because of the gradual reduction in the availability of new land, which is suited to the cultivation of sugarcane. Hence, extrapolating the growth assumed in the baseline for longer periods of time than the 2027 projection horizon would be methodologically incorrect.

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<sup>89</sup> PwC et al, 2020

Under the baseline scenario, total dispatches of OR traditional rum to mainland France are expected to increase over the period by around 28%. Producers continue to dispatch a quantity of traditional rum to the French mainland outside the quota (similar to the current position).

**Table 5: Key assumptions for the baseline scenario (2018 and 2027)**

Year	2018	2027
Tax relief (€ per hlpa)	1,044	1,212
Total dispatches of French OR traditional rum to mainland France (hlpa, thousands)	169	217
Market share of French OR traditional rum sold in France (percentage of all rum, by volume of final product)	87%	76%
Total OR rum production (hlpa, thousands)	328	406
Jobs in the direct OR sugar-cane-rum value chain	1,900	2,400
Budgetary cost of reduced rate scheme (€ million)	118.9	138.1

Jobs in the cane-sugar-rum value chain would increase under the baseline, driven by additional production levels.<sup>90</sup> In the baseline scenario, the majority of the created jobs would be in cane cultivation. The employment projection of the baseline scenario assumes no change in current demand trends and the ongoing growth in demand for traditional OR rum remains at approximately the same rates for the period until 2027.

Nevertheless, the market share of French OR traditional rum sold in France is projected to decline in the baseline scenario based on the assumed continuation of recent strong growth trends of non-French OR rum. By 2027, it is estimated that the market share of French OR traditional rum, by volume of all rum sold in France, will decline by nearly 11 percentage points to 76%.

The estimated moderate increase in fiscal costs over the time period is driven principally by the small increase in quota and the assumption that excise duty rates increase in line with inflation although 50% rebate is kept unchanged. The amount of the rebate measured per hlpa would therefore evolve only in function of inflation.

No noteworthy changes are assumed in the (overall modest) compliance costs entailed by the regime, currently oscillating around €77,000 per Decision when revised and €47,000

<sup>90</sup> This does not take into account any scope for improving efficiency in the sector; it should be considered that the limited utilisable surface area of the ORs means that additional production of cane sugar would have to be based on land that is less well suited, or possibly on land that has already been over-utilised in the past, leading to a lower yield and/or a greater need for labour per unit of production; crop protection from pests may also become more labour-intensive as a result of the EU legislation on certain pesticides.

of oversight costs, for all stakeholders. To prevent the need to amend the Decision before its expiry, and thus to eliminate the administrative costs of its revision, the quota is increased from the outset by 9,000 hlpa. The adjustment is line with the historical trend of quota adjustments accommodating natural growth of the sector. That adjustment will have a negligible impact on parameters of the impact analysis compared to the situation where nothing at all changed. At the same time, it is considered sufficient to ensure economic certainty for the next programming period for the rum producers, eliminating at least some of the investment risks.

With no change in the application of the regime, France will continue to allocate the quota among the stakeholders.

### **5.3. Option 1 – Termination of OR-specific support**

#### *Impact on production and employment*

**Option 1.1** would imply an increase in costs of accessing the French market, estimated to be between €792 - €963 per hlpa in 2018, rising to between €926 - €1,126 in 2027. In response to the removal of the excise duty relief, production relative to the baseline in 2027 is estimated to fall approximately by 68,000 hlpa (-20.1%), with a drop of 8% in the OR traditional rum producers' share of the French rum market. The drop in production would directly affect employment, with an estimated loss of 400 jobs. This drop in employment would affect the global sugar-cane-rum value chain and therefore would not be limited to employment in the rum sector; indeed, the bulk of the employment losses would be felt in the agricultural sector, given that the sugarcane grown in the ORs is not competitive, in price terms, on the world market.<sup>91</sup>

While the agricultural sector employs only a fraction of the workforce<sup>92</sup>, the repercussions of a cut in subsidies would likely be quite acute for sugarcane farmers. In the case of Martinique, in particular, distillers absorb over 80% of production.<sup>93</sup> Given the lower sugar content of Martinique sugarcane, there might be limited opportunities to market the produce and this would at any rate likely take place at lower prices, thus affecting incomes even when employment can be maintained. The impact could be compounded if, as happened e.g. in 2018, bad weather reduced the sugar content of the harvest; demand of cane for traditional rum provides, in this case, a useful demand stabilisation function.<sup>94</sup> In addition, the practical feasibility of turning to other crops may be limited. Agricultural production e.g. in the Martinique is concentrated in only two crops, bananas and sugarcane, with the remaining crops accounting for less than 2% by

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<sup>91</sup> The difficulties in facing competition from mass producers of sugarcane, mainly in Brazil, India and Thailand is not limited to the ORs but even affect historical Caribbean rum producers. See Hamrick, Fernandez-Stark, *Barbados in the Rum Global Value Chain*, Duke Global Value Chain Center, Duke University, <https://www.researchgate.net/publication/322404370>, August 2017

<sup>92</sup> 3.5% in Martinique (as of Q3 2018). In Guadeloupe, in the same period, agricultural employment was lower, at 1.3% of the workforce.

<sup>93</sup> 84.6% in 2018. See <https://www.insee.fr/fr/statistiques/4140220?sommaire=4160760>

<sup>94</sup> Insee 2018 (cit) shows that the sugarcane used for sugar production (as opposed to that which is used by distilleries) fell by almost two-thirds from 2009 to 2018, alongside a decline in sugar content

weight.<sup>95</sup> Overall, about one job in six in the directly affected sectors would go lost (not counting possible knock-on effects).

The impact of this option would likely be felt for several years and producers would take different actions to adapt. It is likely that some consolidation would take place in the industry. This could be in the form of mergers or more efficient rum producers buying out less competitive ones.

Rum producers would likely seek to cut staff costs by, for example, reducing employment levels. Other possible reactions by producers could be to adapt their product(s) to contain lower amounts of alcohol per bottle, although these actions would need to be weighed against potential impacts on their brand. Probably, there would be pressure on local farmers' incomes as producers would seek to shift the reduction in their margins upstream. In practice, producers would likely implement a combination of these cost reducing options to offset the impact of the derogation expiring. The other option rum producers have would be to pass on the increase in excise duties to consumers by raising prices. However, this would have an impact on demand for their product relative to third country rum producers.

The impact of **Option 1.2** would be the opposite. If France chose to apply Article 23 of Directive 92/83/EEC and thus extend the subsidy to imports of all traditional rum, including from third countries, two contrary effects would enter into play: first, the current quota on subsidised production would be lifted, allowing production to grow, and second, the OR producers of traditional rum would face stronger competition in the French market due to uncompensated higher costs.

It is assumed that the first effect would dominate because in past years, production has often exceeded the quota. Furthermore, producers from third countries may need time to adapt their products to the definition required for the 'traditional rum' denomination under Article 23 of Directive 92/83/EEC. Overall, under this option, it is expected that production would grow modestly faster than under the baseline, cumulating to an additional 19 million hlpa (4.7%) by 2027. Employment would correspondingly grow by about 100 units and the market share of French OR traditional rum would increase by 2%.

#### *Fiscal impact*

**Option 1.1** The elimination of the subsidy would mechanically lead to budgetary savings of a little over €138 million annually by 2027. The analysis assumes an initial shock in 2021, which leads to a fall in dispatches to the French mainland and a corresponding fall in the production of rum in the ORs.

In assessing this projection, however, it is worth pointing out that the study stresses that it might have underestimated the intensity and duration of the shock, given that the analysis did not include dynamic modelling of firm closures over time.

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<sup>95</sup> See Insee (2018), cit. fig.2.

**Option 1.2** would result in an increase in budgetary costs mainly owing to extension of the tax rebate to all OR and non-OR traditional rum.

As much as 52% of the current non-OR rum market currently comprises products with an ABV of 40% or above. In the extreme case, assuming this 52% is made from locally harvested sugarcane, then even without any adjustments in the market (to the ABV of other products and/or market shares), the annual fiscal cost of non-OR rum eligible for the reduced rate would be approximately €34 million by 2027.

**Table 6 Key impacts of options 1.1, 1.2**

Factor	Baseline	Option 1.1	Option 1.2
Year	2027	Impact relative to baseline:	
Tax relief to producers (€ per hlpa)	1,212	-1,212	0
Total dispatches of French OR traditional rum to mainland France (hlpa, thousands)	217	-68	+19
Market share of French OR traditional rum sold in France (percentage of all rum, by volume of final product)	76%	-8p.p.	+2p.p.
Total OR rum production (hlpa, thousands)	406	-68	+19
Jobs in the direct OR sugar-cane-rum value chain	2,400	-400	+100
Revenue from dispatches of traditional rum to the mainland (€ million)	111.0	-36.2	+9.5
Contribution of traditional rum (dispatched to mainland France) to the value of extra-OR exports (%)	9.5%	-2.5%	+0.7%
Fiscal cost of reduced rate for OR producers (€ millions)	138.1	+138.1	-87.8

#### *Impact on planning, administrative and compliance costs*

Option 1.1 would entail reversal to the ordinary taxation regime and therefore would not introduce additional compliance costs; on the contrary, the administrative requirements needed to qualify for the excise duty cut would fall away for producers and for the public administrations. These administrative costs however are very limited and their disappearance would not represent a real relief for producers.

The abolition of the excise duty relief would however, apart from its direct impact on production costs, entails considerable management effort in order to adapt the business strategy to the changed landscape. The sizeable extent of the cost impact would require a comprehensive rethink of the business strategy, most likely involving not only the marketing of the product but the production side as well. A period of heightened uncertainty on business prospects would be unavoidable.

Option 1.2 would entail a negligible impact on administrative and compliance costs for businesses. The extension of the reduction to third-country producers would not involve an immediate impact on administrative and compliance costs because the procedures would remain very similar to the status quo. In the longer term, there may be a need to develop a strategy to address potential competition by third-country producers of traditional rum, but this is likely to be a gradual process. The impact would be greater for the public administration, as new procedures would have to be developed to assess the applications for duty reduction stemming from producers of traditional rum situated outside of France.

#### **5.4. Option 2 – Lower the reduced rates of 50% to 40%**

##### *Impact on production and employment*

This option would reduce the excise duty relief granted to producers by €242 per hlpa in 2027. Under this option, total OR traditional rum production would be expected to fall by 14,000 hlpa per year by 2027, relative to the baseline. This would be likely to cause a further modest decline of 1% in the market share of OR rum on the French market. There would also be moderate negative impacts relative to the baseline in terms of jobs (-80) and land use (-200 ha), obviously less significant than under option 1.1 in line with the more modest reduction in subsidisation. As in the case of option 1.1 before, the impact on employment and income will be likely to be felt not only by industrial workers but also, and in particular, by sugarcane growers.

##### *Fiscal impact*

The cut in the reduction granted to traditional rum producers is projected to generate a fiscal saving of €29.5 million per annum, by 2027, relative to the baseline.

##### *Impact on planning, administrative, and compliance costs.*

Given that this option relies on a rate reduction rather than a significant adjustment to the current situation, it is estimated that this option would have no meaningful impact on the administrative burden.

**Table 7 Key impacts of option 2**

Factor	Baseline	Option 2
Year	2027	Impact relative to baseline
Tax relief (€ per hlpa)	1,212	-242
Market share of French OR traditional rum sold in France (percentage of all rum, by volume of final product)	76%	-1p.p
Total OR rum production (hlpa, thousands)	406	-14
Jobs in the direct OR sugar-cane-rum value chain	2,400	-80

Fiscal cost of reduced rate for OR producers (€ millions)	138.1	+9,5
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## 5.5. Option 3 – Introduction of a subsidy ceiling

### *Impact on production and employment*

The freezing of the subsidisation level at current levels would imply that no immediate impact on production costs would be felt by producers; the effect of the measure would by nature develop over time.

This option would also allow the French authorities a greater degree of flexibility compared to the current system. The removal of the quota would allow them to increase the volume of subsidisable production (while correspondingly curtailing the unit subsidy) or to maintain existing support levels, but capping the volume of subsidised production. This flexibility would be useful in the event of a favourable market situation which – as was the case in recent years – allowed producers to expand production in the face of growing demand.

The real value of the subsidies will eventually be eroded by inflation, but at current inflation rates of well below 2% per annum this process will be very slow, allowing producers sufficient time to undertake corrective measures such as cost reductions. Under this option, at the 2027 horizon production of OR traditional rum is estimated to decline by 8,000 hlpa (3.7%), while the projected employment decline in the cane-sugar-rum value chain should amount to around 40 jobs. It is however possible that over the time horizon under consideration, given the modest annual pace of erosion in the real level of subsidies, the impact is effectively compensated by efficiency measures taken by producers.

The revision clause allowing an increase in the tax relief in case of an adverse development of competitiveness due to factors linked with the OR's structural disadvantages would provide additional flexibility and would allow for compensating unforeseen developments within the 7-year decision period. In addition, the lifting of the quota allows producers to better take advantage of any growth in demand.

Finally, granting the French authorities flexibility to increase the per-unit tax relief, so long as the overall volume of subsidies currently paid out is not exceeded, would be very beneficial if the Coronavirus epidemic results in a slump in sales and production. It would allow increasing the support level until normal production levels are achieved again. In this regards, this option would put in place a more flexible regime, that would support producers more in times of difficulty but would make tax rates gradually move up when sales go well.

### *Fiscal impact*

Under this option, the cost of the regime remains constant and neither increases in production nor adjustments in the tax rate will have any fiscal impact. Looking at the past development of the tax relief, by 2027 this option should lead to savings of €16.3 million relative to the baseline.

### *Impact on planning, administrative and compliance costs*

This option would reduce administration administrative and compliance costs as its functioning would be similar to the current system, but with a considerable simplification: the abolition of the quota would relieve stakeholders of the need to constantly monitor quota utilisation when taking production decisions. As this is the most burdensome element of the current regime, the reduction in compliance costs would be substantial. There might be, however, moderate upward changes in the administrative burden if the French authorities would request a change in support levels for increased production costs.

**Table 8 Key impacts of Option 3**

Year	2027	Impact relative to baseline (2027):
Tax relief (€ per hlpa)	1,212	-139
Total dispatches of French OR traditional rum to mainland France (hlpa, thousands)	217	-8
Market share of French OR traditional rum sold in France (percentage of all rum, by volume of final product)	76%	-1p.p
Total OR rum production (hlpa, thousands)	406	-8
Jobs in the direct OR sugar-cane-rum value chain	2,400	-40
Total land used for sugarcane (ha, thousands)	38.0	-0.1
Revenue from dispatches of traditional rum to the mainland (€ million)	111.0	-4.0
Contribution of traditional rum (dispatched to mainland France) to the value of extra-OR exports (%)	9.5%	-0.3%
Fiscal cost of reduced rate for OR producers (€ million)	138.1	+16.3

## 6.6 Option 4 – Annual quota adjustment

The current regime sets a fixed quota for the period of the Decision. Any subsequent amendments to the quota involves a new legislation. Under this option, rather than having to revise the quota on a regular basis, the quota would be adjusted each year by applying a fixed growth rate. For the upcoming seven-year period covered by the decision, the annual increase would be aligned to the historic growth rate of the quota during the period 2008 and 2017 of 3.1%.

### *Impact on production and employment*

A gradual increase of the quota implies that the volume of subsidised production will grow, leading to a slight increase in the market share of OR rum in France. Under this



option, production is projected to increase by 14 thousand hlpa (3.5 %) over baseline. The increased production should lead to the creation of about 80 additional jobs in the sector.

#### *Fiscal impact*

An annual increase in the quota increases the volume of rum subject to reduced rates. This is estimated to increase the fiscal cost by €32.9 million for the French authorities.

#### *Impact on planning, administrative and compliance costs*

Under this option, the main administrative requirements for beneficiaries and for the public administration would remain unchanged, but there would be an advantage for planning purposes because of the predictable nature of the quota adjustment. This would eliminate the uncertainty around quota increase decisions that was mentioned by producers in the stakeholder consultation.

**Table 9 Key impacts of Option 4 - annual quota adjustment**

Year	2027	Impact relative to baseline:
Tax relief (€ per hlpa)	1,212	0
Market share of OR traditional rum in France (percentage of all rum, by volume)	76%	+1p.p
Rum production (hlpa, thousands)	406	+14
Employment in the rum value chain	2,400	+80
Fiscal cost (€ million)	138.1	-32.9

The following table provides a comparison of all options with the baseline.

**Table 10 – Summary of key impacts of each option compared to the baseline**

Factor	Baseline	Option 1.1	Option 1.2	Option 2	Option 3	Option 4
Year	2027	Impact relative to baseline:				
Market share of French OR traditional rum sold in France (percentage of all rum, by volume of final product)	76%	-8p.p.	+2p.p.	-1p.p	-1p.p	+1p.p
Total OR rum production (hlpa, thousands)	406	-68	+19	-14	-8	+14
Jobs in the direct OR sugar-cane-rum	2,400	-400	+100	-80	-40	+80

value chain						
Fiscal cost of reduced rate for OR producers (€ millions)	138.1	+138.1	-87.8	+9,5	+16,3	-32.9

## 6. HOW DO THE OPTIONS COMPARE?

### 6.1. Effectiveness

The specific objectives of the measure are as follows:

1. Offset the competitive disadvantage of traditional rum producers in the French ORs, which are linked to the permanent constraints of the ORs;
2. Support the broader cane-sugar-rum sector in the French ORs;
3. Maintain access to the mainland French market for the traditional rum producers in the French ORs;

#### *Effectiveness in achieving objective 1*

Option 1.1 – termination of the regime without any replacement – would inevitably achieve precisely the opposite effect to the one desired under objective 1 and not solve any of the underlying problems. Termination of the support with no other relief offered would mean an increase in market access costs, as described in detail in section 5.3 (€792- €963 per hlpa in 2018, rising to €926 - €1,126 in 2027). Whereas some market adjustments are expected to happen over a medium-to-long period of time, the factors defining the competitive disadvantage of the OR will largely remain and the producers will always continue to bear additional costs while seeking to sell their products to their traditional outlet market of mainland France. The economic situation of the French OR would become even more fragile. Moreover, the negative impacts will be felt instantly once the derogation expires on the 31<sup>st</sup> of December 2020, particularly given the raising uncertainties linked to expected economic downturn caused by COVID-19 outbreak.

Option 1.2 – extension to third-country products – would allow the producers to continue enjoying the tax rebate when accessing the French market so in that respect it would be comparable to the baseline scenario. However, since the same rebate would apply to all traditional rum imported into France, the increased competition with third-country traditional rum may lead producers of traditional rum in the French ORs to absorb more of the costs in order to offer more competitive price. Overall, in a medium-to-long term this option would leave the French OR producers of traditional rum slightly worse off than in the baseline.

Option 2 – tax relief capped at 40% – means a tax rebate reduced to 40% and thus a naturally lower level of compensation for the producers. Based on the costs that were quantifiable, the 40% tax rebate seems, on face value, more in line with the additional costs borne by the producers. That said, as explained in detail in Annex 5, the minimum identified cost levels used in the analysis are quite likely, underestimated. Consequently,

reducing the tax rebate bears a higher risk of not compensating adequately for the overall competitive disadvantage of the traditional rum producers.

Option 3 – subsidy ceiling – would cap the tax rebate in monetary terms at current levels. In the short term, the traditional rum producers would feel no difference. However, freezing the rebate at 2020 levels for the 7 years period would mean that the rebate’s real value would erode overtime as inflation progresses. With no other adjustment, the producers would overtime receive smaller compensation to offset their additional costs.

Option 4 – annual quota adjustment – would see the quota level adjusted annually by the fixed growth rate, equivalent to the historic growth rate in the period 2008-2017 (3.1%). In terms of its capacity to compensate for the competitive disadvantage, this option would not change anything substantially for the producers as the conditions and level of subsidy per hlpa would remain the same although a greater proportion of the production would benefit from the rebate.

**Table 11 : Objective 1 (offset competitive disadvantages) – summary**

Policy option	Degree of effectiveness	Notes
<b>Option 1.1: Abolish the scheme</b>	---	Fails to compensate for competitive disadvantages altogether without any form of other relief
<b>Option 1.2 Extend subsidy to all producers</b>	-	Compensates for competitive disadvantage but extends the relief to all producers of traditional rum, increasing competition and possibly forcing OR producers to absorb some costs
<b>Option 2: Tax relief capped at 40%</b>	-	Compensates for competitive disadvantage but to a smaller extent, increasing risk of not compensating for all additional costs
<b>Option 3: Subsidy ceiling</b>	-	Compensates for competitive disadvantage but the real value of the relief erodes with inflation
<b>Option 4: annual quota adjustment</b>	0	Compensates for competitive disadvantage on the same conditions as the baseline

#### *Effectiveness in achieving objective 2*

Option 1.1 – termination of the regime without any replacement - would have the consequence of shocking the entire cane-sugar-rum sector, with sizeable negative impacts on pretty much all parameters used to measure the sector’s well-being. The production drop would trigger substantial reductions in employment and/or wages in the broader value chain, worsen trade deficit of the ORs and put in doubt the stability of the regulatory environment, thus potentially undermining business confidence in the OR beyond the confines of the spirits industry. The impact would likely lead to restructuring of the sector over several years as producers take mitigating actions. The impact analysis hinted to some possible adjustments and knock-on effects, and assessed them as globally negative to the ORs traditional industry and beyond. Evidently, option 1.1 would provoke effects quite opposite to the ones desired under objective, which would materialise instantly and continue for several years.

In terms of support to the cane-sugar-rum sector, the key feature of Option 1.2 is removing the quota. With the removal of the quota, the production of traditional rum in the French ORs could potentially grow, triggering a positive impact on the employment as well. In the short-to-medium term, the sector should feel no difference to the previous regime. With time, however, increased competition from third-country producers could put additional pressure on the OR producers as sugarcane grown in the ORs is not competitive, in terms of price, and the regions' price-setting capacity in the global market limited.

Options 2, 3 and 4 all provide for some support to the cane-sugar-rum sector albeit to a different extent and with varying impacts. The major difference is the timing of impacts on the sector. Option 2, reducing immediately support to the producers, would instantly worsen the economic standing of the sector, albeit to a moderate extent. The negative impact could, in the long run, be neutralised by the sector adapting to the new conditions but that impact remains uncertain.

Option 3 and 4 would have quite the opposite timeline in terms of impacts on the sector. Option 3 would mean no effective change on the sector in the short time as the ceiling would reflect the current level of support. That support would diminish in real terms, falling gradually behind the inflation and leading to both production and employment drop by 2027. Again, it is possible that over time, the sector would adapt and the moderate negative impact would level out. As for Option 4, the annual quota adjustment would allow the sector to grow at close to its natural historic pace. The sector would be spared the initial shock of Option 2 and the long-term negative impacts of Option 3, while removing the growth constraints of fixed quotas of the baseline.

**Table 12: Objective 2 (support broader industry) - summary**

Policy option	Degree of effectiveness	Notes
<b>Option 1.1: Abolish the scheme</b>	---	Substantial negative impact on all economic parameters of the sector, worsening of the trade deficit of the OR and undermining business confidence in the OR in general
<b>Option 1.2 Extend subsidy to all producers</b>	-	Ensures continued high support; liberation of quota would lead to increase in production but no specific relief for the OR would increase competition from third countries and put the sector under pressure
<b>Option 2: Tax relief capped at 40%</b>	-	Reduces the relief and slightly worsens the sector's situation
<b>Option 3: Subsidy ceiling</b>	-	The gradual erosion of the real value of the relief would slightly worsen the sector's situation
<b>Option 4: annual quota adjustment</b>	+	Ensures continued support to the entire sector through continued grow of production

### *Effectiveness in achieving objective 3*

Objective 3 is linked to the traditional historic links of the French OR with France, recognised also in the legal base. The French OR are on a crossroad of their geographical region and the European Union. Their small economies are too weak to successfully

compete on the global – or even regional – market, particularly while complying with stringent EU regulations. Access to the French mainland as the main outlet market for their produce, is vital for their economic performance.

With the exception of Option 1.1 discontinuing the regime altogether, all other options maintain the overall conditions allowing the French OR to rely on the French market for their traditional rum. From that point of view, the most effective – leading to an increase of 2% of market share of rum sold in France – is Option 1.2. However, this initial growth may decline as competition from third countries increases. Options 2 and 4 are both estimated to lead to a 1% increase in market share while Option 3 would decrease it by 1%. By far the worst of all would be the discontinuation of the regime under Option 1.1, with a devastating 8% loss in the market share, compared to the baseline.

**Table 13: Objective 3 (access to French mainland) - summary**

Policy option	Degree of effectiveness	Market share
<b>Option 1.1: Abolish the scheme</b>	---	-8%
<b>Option 1.2: Extend subsidy to all producers</b>	+ / ++	+2%
<b>Option 2: Tax relief capped at 40%</b>	+	+1%
<b>Option 3: Subsidy ceiling</b>	-	-1%
<b>Option 4: Annual quota adjustment</b>	+	+1%

The following table summarises the effectiveness of all options with regard to the three specific objectives.

**Table 14: Effectiveness profile of the options - summary**

Policy option	Objective 1	Objective 2	Objective 3	Overall
<b>Option 1.1: Abolish the scheme</b>	---	---	---	---
<b>Option 1.2: Extend subsidy to all producers</b>	-	-	+ / ++	+ / 0
<b>Option 2: Tax relief capped at 40%</b>	-	-	+	0
<b>Option 3: Subsidy ceiling</b>	-	-	-	-
<b>Option 4: Annual quota adjustment</b>	0	+	+	+

## 6.2. Efficiency

Efficiency assesses the inputs vis-à-vis outputs, or results. Option 1.1 – termination of the regime without any replacement - generates no positive outputs to measure costs against. The administrative costs would cease and the French authorities would recuperate the fiscal costs of the reduced rate, although the overall excise revenues would decline in line with the fall in rum sales. The savings are therefore illusory and do not reflect the cost of the cane-sugar-rum sector's decline and/or restructuring. Decreased production would mean increased unemployment and welfare payments while any restructuring of the sector would imply some investment cost (e.g. to increase efficiency of the machinery or change the production process). These costs are presently speculative but should not be

forgotten against the immediate fiscal savings to the French budget. The true efficiency of that option is difficult to gauge properly and is therefore estimated to be neutral vis-à-vis the baseline scenario.

Under option 1.2, the beneficial outputs of the reduced rate are extended to all eligible rum from the French ORs released for consumption in mainland France. There is no quota to administer and monitoring is no longer necessary. However, the reduced rate would be extended to non-OR producers, meaning a larger portion of traditional rum will be sold with a lower excise duty on the French market, generating instant lost revenue to the French budget, which is likely to be significant. Moreover, it will extend to any company producing traditional rum to be sold in France, generating an undue subsidy to companies who may not need support. As the scheme loses its specific character of targeting the producers of traditional rum in the French OR, it is likely to result in increased competition from now cheaper non-OR rum, which will deteriorate the economic standing of the French OR producers, with a risk of increased welfare transfers. This option is, therefore, very costly in the short and long-term run alike and the benefit slips away from the concerned regions.

Options 2 and 3 are both assessed as being neutral in terms of efficiency relative to the baseline. The fiscal costs decrease slightly in proportion with the reduction of the rebate and the administrative costs continue to be in roughly the same proportion to the benefits. The options generate respectively a fiscal saving of approximately €29.5 million and €16.3 million but risk a longer-term cost of decreasing activity or restructuring in the sector.

Option 4 addresses the risk that a further increase in the quota is requested during the 7 years. Therefore, in terms of efficiency, it reduces the administrative costs associated with a legislative revision linked to further quota increase. Other administrative burdens will remain broadly the same while more eligible rum sold at a lower excise rate thanks to increased – and growing quota, will constitute a higher foregone revenue for the French budget, estimated to total by 2027 some €32.9 million.

**Table 15: Efficiency profile of the policy options - summary**

Policy option	Degree of efficiency	Fiscal impact and administrative burden
<b>Option 1.1: Abolish the scheme</b>	0	The lost revenue of €138.1 million is recuperated and administrative burdens not applicable; increased welfare transfers due to decreased sector activity and less excise revenue
<b>Option 1.2: Extend subsidy to all producers</b>	---	More rum will be sold in France at a lower excise rate deepening the cost by some €87.8 million; possible increased welfare transfers due to competitive pressure on the sector in the French OR; no administrative burdens
<b>Option 2: Tax relief capped at 40%</b>	+	Saving of some €29.5 million with unchanged administrative burdens; possible longer-term cost linked to decreasing support
<b>Option 3: Subsidy ceiling</b>	+	Saving of some €16.3 million with unchanged administrative burdens; possible longer-term cost

		linked to decreasing support
<b>Option 4: Annual quota adjustment</b>	-	Foregone revenue increased by some €32.9 million; no administrative cost linked to renewal of Decision

### 6.3. Coherence

Coherence of the options should be considered against the EU regional policy, jobs and growth, public health, trade, State aid, environment and agriculture policies. By providing support to the French OR, all options are a priori coherent with the EU legal framework. Some, however, could lead to consequences that may be undesirable from the point of view of specific EU policies.

**The 2017 Communication** on the stronger and renewed strategic partnership with the EU's OR<sup>96</sup> as well as preceding Communications setting out the EU's policy towards the outermost regions aim to enshrine OR concerns in all relevant policies including supporting job creation, business competitiveness, economic growth, sustainable development, and improving citizens' quality of life. With regard to the OR, these considerations are supplemented by the need to compensate for their permanent constraints and providing tailor-made support to ensure that these regions benefit from being part of the EU. The 2017 Communication, reiterates the fragile economic growth, vulnerability, disadvantageous social and political situation with rising unemployment – in particular amongst the youth – resulting in limited opportunities for the local population and social unrest. The Commission engaged itself in crafting measures that best suit the specific situation of the OR and adapt EU policies to their circumstances, without undermining the coherence of the Union's legal order. The same objectives could be quoted here with regard to promoting **jobs and sustainable growth** and are thus assessed jointly.

Against this background, all options except Option 1.1 strive to find a balance between treating the French OR as European Union regions with all the rights and obligations and acknowledging their specific geopolitical and economic context and needs as acknowledged by Article 349 TFEU. Option 1.2, whereas still allowing the French traditional rum to access the French market with an equivalent excise duty rebate and freeing up the production, fails to acknowledge the specific context of the OR by placing them on an equal footing with other traditional rum producers worldwide. If all producers of traditional rum enjoy the same treatment when brought into France, the effective value of the rebate for the French tradition OR rum is neutralised by the fiercer competition with the now cheaper rum from non-OR producers. As for options 2, 3 and 4, they are all targeted and specific. However, options 2 and 3, both reducing the extent of the support be it immediately or in a long-run, are somewhat less in line with the EU's strategy of supporting the OR, especially given that no substantial changes to their economic standing is expected in the short term. Just the contrary, accentuated also by the yet unknown impacts of the COVID-19 outbreak. Option 4 in turn, is providing conditions

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<sup>96</sup> [COM\(2017\)0623](#)

for a steady support and growth but may have an impact on other EU policies, notably the **public health one**.

The problem with the specific regime in question here is that it concerns alcoholic beverages. From that point of view, any measure that sanctions lower prices for alcohol, is not welcome in principle. The World Health Organization lists increasing excise duties as one of the most cost-effective ways of reducing alcohol consumption, by influencing its economic availability. Put in the context, the derogation as-is today is estimated to support around 16,500 hlpa of spirits consumption per year in mainland France - an equivalent of a modest amount of 0.15% of 2016 spirits consumption per capita (aged 15 and over). On top of it, the excise rates on spirits in France (including VSS) is 70% higher than the median rate in the European Union (for 2018). As a result, even with the reduced rate, taxation on French OR rum remains above the minimum EU level of €1,000 per hlpa.

Nevertheless, irrespective of the magnitude of the potential impact on alcohol consumption, in absolute terms any option increasing alcohol production and consumption beyond the baseline, goes against the public health considerations. Moreover, it is not only the alcohol shipped to and consumed in France mainland that should be considered. If the producers are unable to sell their bottles in France because of the prohibitive prices, it increases the risk of flooding the local markets with rum and encouraging overconsumption of rum by the local population. It is estimated that just under 30% of OR traditional rum does not leave the ORs territories and there is limited scope to absorb any more of production without negative health impacts.

Option 1.1 – removing the regime – bears significant risk that at least in the short-term the local market for traditional rum will oversaturate although overall consumption – as a function of price – should theoretically drop. Option 1.2 bears a double risk on increasing overall alcohol consumption in mainland France. Firstly, through freeing production of traditional rum in the French ORs, which is estimated to increase, and secondly, through influx of cheaper rum from other parts of the world. Option 2, reducing the tax rebate, and under assumption that the extra non-compensated costs are not absorbed by the producers but passed onto the consumers, would lead to higher price per bottle and (slightly) decreased consumption, unless compensated by a cheaper substitute. Option 3, a monetary ceiling with no quotas could lead to similar effects to Option 1.2 in the short-term (increased production and thus consumption) but would erode with time with no indexation of the fixed ceiling. Finally, Option 4, allowing the production to grow in line with the hitherto historic rate of 3.1%, could potentially be most harmful from the perspective of public health, providing a steady shipment of increased volumes of cheaper alcohol onto the mainland France.

The derogation is a form of regional **State aid** with its basis in Article 349 of the TFEU, under the conditions of Article 107(3)(a) of the TFEU. The Commission considers the reduced excise rate to be regional operating aid as it compensates businesses for costs that they would otherwise incur. The most recent State aid decision authorising the



reduced rate is SA.38641 of 16 September 2014.<sup>97</sup> Member States are obliged to identify and report those costs, determined by reference to similar undertakings established in other regions of the Member State concerned. Estimates of additional costs (see Annex 5) indicate that the value of the derogation is broadly comparable with the additional costs experienced, indicating proportionality in terms of State aid. In that respect, none of the proposed options would violate State aid rules, provided any future derogation is notified.

From the point of view of the **EU trade policy** and the smooth functioning of the internal market, it is first of all important to acknowledge that all options are compliant with Article 349 of the TFEU, which is the case. Traditional rum from the French ORs is not a big player on the global market as most of the rum is destined for the French mainland. French OR rum is not competitive in the respective regions due to small scale production, higher costs of primary ingredients (especially the sugarcane), higher labour costs in comparison to third country rum producers and the obligation to comply fully with all EU environmental regulations. Additionally, the traditional rum is not a substitute for other spirits in the French market and is not deemed to distort any competition, be it international or domestic. The French traditional OR rum accounts for around 10% of the spirits market in France by volume and has historically accounted for less than 1% of the European spirits market. Import and market share of non-OR rum in France has also been steadily increasing, suggesting that the tax rebate has no harmful effects on non-OR rum producers nor on trade.

Finally, it is important to consider at least briefly the coherence of the regime with the EU's **environmental policy**. Although remote, the OR are an integral part of the EU and thus bound to comply with its regulations. Sugarcane cultivation is not extensive in the French OR. The agricultural model in the ORs are essentially of family nature and environmentally friendly. The derogation does not do any harm to the local environment and none of the options would imply noteworthy impacts on the land-use or production methods. All options would equally demand of the traditional rum producers to use locally grown products, supporting local farming (particularly after the lifting of the long-standing sugar quotas) and biodiversity. Finally, no option would change whatsoever to the requirement to comply with stricter (than in other neighbouring regions) environmental norms imposed by the EU regulations.

Taking into account all aspects analysed under coherence without weighing them, no option presents itself better than the baseline. Options 2 and 3 – both reducing the effective level of rebate – have the same overall level of coherence as the baseline, while options 1.1, 1.2 and 4 – for various aspects – would leave the situation less aligned to other EU policies

**Table 16 : Coherence profile of the policy options - summary**

Policy option	Regional	Public	State aid	EU trade	Environment	Overall
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<sup>97</sup> European Commission: Aide d'État SA.38641 (2014/N) – France. Available at: [https://ec.europa.eu/competition/state\\_aid/cases/253225/253225\\_1591133\\_86\\_2.pdf](https://ec.europa.eu/competition/state_aid/cases/253225/253225_1591133_86_2.pdf)

	policy, jobs & growth	health				
<b>Option 1.1: Abolish the scheme</b>	---	+	0	+	0	--
<b>Option 1.2: Extend subsidy to all producers</b>	--	--	0/+	+	0	--
<b>Option 2: Tax relief capped at 40%</b>	-	0	0	0	0	0
<b>Option 3: Subsidy ceiling</b>	-	0	0	0	0	0
<b>Option 4: Annual quota adjustment</b>	+	---	0/-	-	0	--

## 6.5. Summary of preferred options

From the point of view of the overall effectiveness, Option 4 could be expected to yield better results than the baseline. Option 4 would keep the specificity of the scheme of continued support to the sector and therefore its stability. However, this option would allow more rum at a reduced rate increasing the overall cost of the regime and with a greater negative impact on public health, compared to the baseline. Option 1.2 – extending the rebate to all producers of traditional rum worldwide, would be most costly to the French budget while removing the targeted nature of the scheme supporting the specific sector in the French OR, decreasing the overall cost-effectiveness of the measure. As any measure that supports alcohol production, this option does not support the overall objectives of public health policy.

The most efficient from the pure fiscal point of view would be options 2 and 3 generating direct savings to the French budget. However, they both bear some risk that decreased support to the cane-sugar-rum industry would trigger a drop in production, with possible lay-offs, or restructuring, with possible need of additional posterior support from the French budget. None of the options are expected to generate better results than the baseline. As above, the overall cost-effectiveness is therefore smaller than for the baseline. These options are also equally coherent as the baseline, with the exception of regional policy, growth and jobs as the reduced support would lead to lower production and/or restructuring of the sector.

Option 1.1 is not a realistic option. While France would indeed recuperate the foregone revenue of the rebate, abolishing the scheme would fail on all the objectives, lead to economic, and possibly socio-political instability in the region, with potentially significant consequences. Most stakeholders were also opposed to the termination of the regime.

Overall, the French authorities and producers noted the importance of the regime. Both stakeholders called for an increase in the quota in order to ensure the future growth of

traditional rum in the OR. The majority of stakeholders also highlighted the need for flexibility to increase the quota. The French authorities also noted that this would avoid retroactive amendments to the Decision and reduce the legal uncertainty for producers.

The preferred option is therefore the baseline - which continues the regime as is - with an increased quota of 153,000 htpa, in line with the annual growth rate of 2% during the period 2014-2019 applied to the used quota of 128,288 htpa in 2018. This continues to support the cane-sugar-rum industry effectively and coherently with EU policy. The small increase in the quota addresses the issue of retrospective amendments of the quota, and ensures coherence with public health and competition policy.

## **7. HOW WILL ACTUAL IMPACTS BE MONITORED AND EVALUATED?**

The monitoring of the implementation and functioning of the derogation will be the role of the French authorities and the Commission, as it has been to date.

The current monitoring and oversight of the use of quota is managed by various departments of the French government. The Direction Générale des douanes et droits indirects (DGDDI) manages software, which encodes the traditional OR rum imports on a monthly basis. This monthly data is used by the French authorities to monitor the quota use on the one hand and allows for the alignment of the production on the other hand. This monitoring system is expected to continue. Any changes or adjustments to this system can only be done by the French authorities.

To date, in accordance with Article 4 of the Decision France was requested to submit a report to the Commission, halfway through the application of the Decision. This report was to enable the Commission to assess whether the reasons justifying the derogation still existed and whether the fiscal advantage granted by France had remained and was expected to remain proportionate and sufficient to support a competitive cane-sugar-rum value chain in the OR in question.

It is important that the French authorities continue preparing a monitoring report as they are best placed to gather the precise information from the impacted stakeholders. France will be asked to submit a monitoring report by 30 September 2025 for the period from 2019 to 2024<sup>98</sup>. This monitoring report will include any relevant information as regards the additional costs involved in the production of traditional rum in the French OR, economic distortions and market impacts. This monitoring report will contain the necessary information for the evaluation of the effectiveness, efficiency, coherence with other EU policies, continued relevance and EU added value of the new legislation. The monitoring report should also seek to collect input from all relevant stakeholders as regards the level and evolution of their additional production costs, compliance costs and any instances of market distortions.

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<sup>98</sup> The monitoring report should include 2019 data so that a baseline is established and that the Commission is able to review the impact of the derogation covering the period post 2020. The report should contain the most up to date data up to and including 2024, where possible.

To make sure that the information collected by the French authorities and analysed in the monitoring report contains the necessary data that the Commission must know to take an informed decision on the validity and viability of the scheme in the future, the Commission will draw up specific guidelines on the required information. Such guidelines will be, to the extent possible, common to other similar schemes to the EU's OR, governed by similar legislation.

This will enable the Commission to assess whether the reasons justifying the derogation still exist, whether the fiscal advantage granted by France is still proportionate and whether alternative measures to a tax derogation system which are also sufficient to support a competitive cane-sugar-rum value chain can be envisaged, taking into account their international dimension as well as the special status granted to the OR under Article 349 TFEU..

## ANNEX 1: PROCEDURAL INFORMATION

### 1. Lead DG, Decide Planning/CWP references

The lead Directorate General (DG) is DG TAXUD.

This initiative got the following political agreements:

- Agenda Planning: Proposal for a Council Decision replacing Council Decision 189/2014/EC authorising France to apply a reduced rate of certain indirect taxes on ‘traditional’ rum produced in Guadeloupe, French Guiana, Martinique and Réunion. (PLAN/2018/3201)
- [Inception Impact Assessment](#): Proposal for a Council Decision replacing Council Decision 189/2014/EC authorising France to apply a reduced rate of certain indirect taxes on ‘traditional’ rum produced in Guadeloupe, French Guiana, Martinique and Réunion. (Ares(2019)4347262)

### 2. Organisation and timing

The following DG were invited to the Inter-Service Steering Group (ISSG): AGRI, BUDG, CLIMA, COMP, DEVCO, EMPL, ENV, GROW, HOME, JRC, MOVE, REGIO, SANTE, SG, SJ, TRADE.

A consortium led by Institut für Höhere Studien (IHS) and including as project leader PricewaterhouseCoopers LLP – PwC and CASE - Center for Social and Economic Research, (hereinafter collectively referred to as “the Consultant”) undertook the assignment titled “Study contributing to an impact assessment concerning a possible legislative proposal authorising France to apply a reduced excise duty rate on traditional rum produced in specific French Outermost Regions” (“the Study”).

This study has established the basis for a so-called back-to-back exercise with evaluation and forward looking assessment carried out simultaneously in accordance with Better Regulation Guidelines.

The objectives of this Study were to analyse whether the reduced excise duty rate applied on traditional rum produced in French OR is fit for purpose and the scale of the issues or weaknesses encountered in its application.

The Study also assessed the evolution of the problems if the current regime (based on reduction of 50% excise rates, for a quota up to 144,000 hlpa per year) is extended without any amendment (dynamic baseline scenario) and the economic, social and environmental impacts of the *possible options to address the problems identified*.

Additionally, the Consultant assisted the Commission in conducting an *Open Public Consultation* (OPC) to collect stakeholders’ comments and feedback on the issues identified and the possible revision or replacement of Council Decision 189/2014/EU.

## ANNEX 2: STAKEHOLDER CONSULTATION

### 1. Outline of the consultation strategy

The stakeholder consultation strategy reflects the back-to-back nature of the overall study. The consultation was undertaken in relation to the current system as well as potential options for the period after 2020. The main objectives of the consultation are set out below:

- Collect data from stakeholders involved in the current derogation in order to undertake the evaluation;
- Collect opinions from stakeholders affected by the derogation (both directly and indirectly) on the current derogation and on options for the derogation after 2020; and
- Identify areas where the current derogation is achieving its objectives and areas where it could be improved or changed.

In order to collect the information set out above, several groups of stakeholders were identified for consultation. The table below sets out stakeholders consulted, and tools used. Across the different stakeholder groups, questionnaires were the primary tool for consultation.

*Table 17: Stakeholders consulted and tools used*

Stakeholder type	Method of consultation	Consultation period	Content	Language regime
EU Commission and French Public Authority officials	Scoping discussions, targeted questionnaires followed up by ad-hoc interviews if required	Q1 to Q3 2019	The functioning of the current system  Coherence with wider EU/French policies  Possible future policy options  The impacts of policy options	EN/FR
Economic operators and related organisations / associations	For economic operators directly involved in the derogation currently*: Initial discussions to understand the derogation; targeted questionnaires followed up by ad-hoc interviews / emails if required	Q1 to Q3 2019	Collection of data to understand additional costs experienced by OR rum producers  The functioning of the current system	EN/FR

Stakeholder type	Method of consultation	Consultation period	Content	Language regime
	For other operators: public consultation to collect the wider range of commentary of a full range of economic operators		Coherence with wider EU/French policies  Possible future policy options  The impacts of policy options	
Nongovernmental organisations (NGOs) active in related areas	Public consultation	Q1 to Q3 2019	The functioning of the current system  Coherence with wider EU policies  Possible future policy options  The impacts of policy options	Official EU languages
EU citizens / general public	Public consultation	Q1 to Q3 2019	The functioning of the current system  Coherence with wider EU policies  Possible future policy options  The impacts of policy options	Official EU languages

\* Relates to producers of traditional rum in the French ORs as well as distributors of traditional French OR rum in mainland France.

## 1. Consultation activities undertaken

In order to implement the strategy outlined above, six questionnaires were developed, including five targeted questionnaires and one public consultation document. Table 18 sets out the activities undertaken and responses received for different recipient groups.

**Table 18: Stakeholders consultation activities**

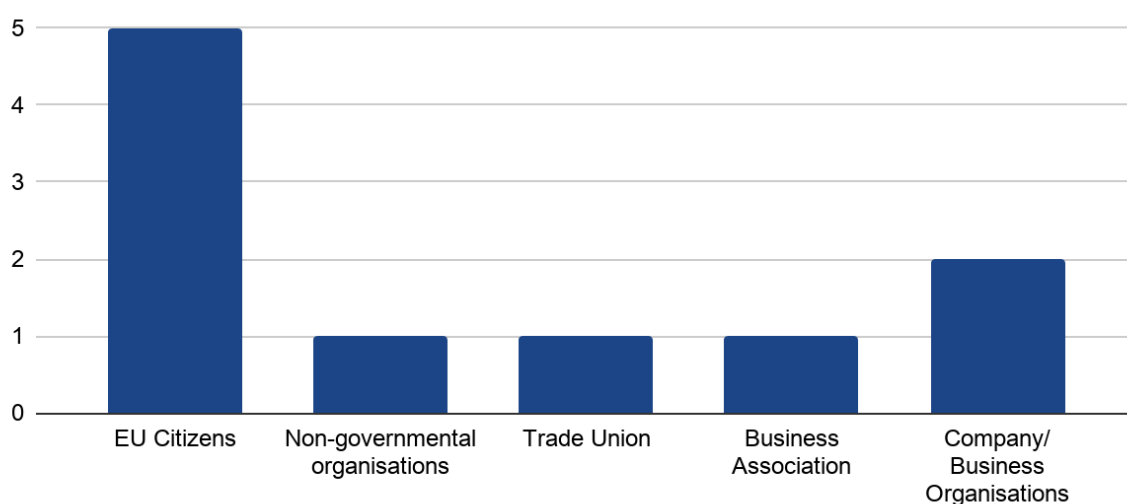
Type of consultation	Target group	Recipients	Total responses received	Response Rate
Targeted questionnaire	European Commission	8	7	87.5%
Targeted questionnaire	French authorities	4	4	100%

Targeted questionnaire	French OR rum producers	29 <sup>99</sup>	21	72.4%
Targeted questionnaire	French OR rum distributors	17	11	58.8%
Targeted questionnaire	French OR rum distributors	8	2	25%
Public Consultation	NGOs, EU citizens, general public, other economic operators	N/A	10	N/A

These activities align to the initial stakeholder consultation strategy set out at project inception.

Across the different consultation activities undertaken, all stakeholder groups targeted were reached. The public consultation allowed for responses from wider stakeholders, although participation was limited (ten in total) to five responses from EU citizens, two from economic operators, one NGO, one trade union organisation and one business association.

**Figure 1: Public consultation respondents by type**



Overall, the responses received represented the interests of stakeholders directly involved in the derogation (distributors, the Commission and French authorities, French OR rum producers) as well as wider interests (through the public consultation).

## 2. Approach used to process the data

Questionnaire responses were processed based on the structure and content of the questions asked. Table 19 outlines the key approaches used.

**Table 19: Main approaches used to process data collected**

Types of data collected	Approach	Questionnaires
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<sup>99</sup> This reflects all 25 producers listed under the derogation in the French legislation, with separate questionnaires being sent where producers operated distinct products



Types of data collected	Approach	Questionnaires
Qualitative and quantitative information collected on current processes surrounding the derogation	Data was collected for each of the stakeholders in terms of the steps and costs of (a) overseeing the derogation and (b) in relation to the Council Decisions required for the derogation. These data were combined across questionnaires (each questionnaire related to the costs of a specific department or Directorate General) in order to describe the steps and costs required across the Commission and French government. Clarification was sought via email/phone to clarify responses that were unclear	European Commission; French authorities;
Opinions on the current derogation and future of the derogation	Thematic analysis of responses was undertaken to identify the main opinions for each stakeholder group. It was observed that the responses for questions on the future of the derogation exhibited a degree of uniformity (in particular for distributors and producers).  New ideas put forward by stakeholders (outside of the options put forward) were also collected	All targeted questionnaires
Qualitative data collected on additional costs	Thematic analysis of responses was undertaken to identify the additional costs cited by producers and to group these against the main cost drivers relating to Article 349 of the TFEU factors. Frequency analysis was undertaken to gauge the importance of these types of drivers by category	French OR producer questionnaires
Quantitative data on operations, additional costs	Quantitative data was collected from French OR producers and distributors on the current scale of their production, operations, revenues, and costs.  This data was first analysed for comparability. This was undertaken by analysing the descriptions of the data provided in different categories.  Data that was comparable was used as the basis of analysis. Differences by OR, by production type (agricole v sucrerie) and by size of producer were considered in the analysis, and analysis undertaken at this granular level where data were sufficient to support analysis <sup>100</sup> . In particular, where differences were found by production type, analysis was conducted accounting for these differences. The data was also examined to test for outliers, and outliers were removed from the analysis where they skewed results.  In certain cases, information provided was unusual or required further clarification; this information was collected via follow-up emails.	French OR producer questionnaires and distributor questionnaires
Public consultation responses to multiple	Responses to public stakeholder questions were tabulated and analysed at an aggregate level although hardly any	Public consultation

<sup>100</sup> Given the limited number of producers, data was not always sufficient to distinguish clear differences that were due to OR specific factors, due to the type of production (agricole v sucrerie) and due to size. This is particularly the case because of the limited numbers of producers in certain ORs and the specialisation of some ORs in certain production methods.

Types of data collected	Approach	Questionnaires
choice and close ended questions	conclusions were possible due to the very small sample.	

### 3. Description of results

Summarised below are the main results of the consultation activities undertaken, by broad stakeholder group. Results are also included in the main body of the report where they answer the evaluation questions and contribute to the assessment of impacts.

#### French authorities

Responses were received from the following French Government authorities:

- Direction Générale des douanes et droits indirects (DGDDI);
- Direction générale de la performance économique et environnementale des entreprises (DGPE) au Ministère de l'Agriculture;
- Ministère des outre-mer (MOM); and,
- Représentation permanente de la France auprès de l'Union européenne

One of the main outputs of consultation with the French authorities was a description of the current system used to oversee the quota. Other main results of the consultation were the following:

- Various departments of the French government are involved in the ongoing oversight of the derogation and its periodic extension. While DGDDI is closely involved in ongoing monitoring of the quota, other departments incur costs in relation to the preparation of reports to the European Union (mid-term report, memo to request a new Council Decision) and the application Council Decisions in French law.
- In the absence of the derogation, the authorities noted that there could be a negative impact for the viability of the French OR rum sector and more widely in the ORs. In addition to potential job losses, the absence of derogation could limit the financial capacity dedicated to crop diversification given the pivotal nature of the cane-sugar-rum sector in the French overseas departments.
- The French authorities noted that the current system should be more flexible. In particular, they suggested that a growth rate be applied to the quota within a flexible corridor. The administrative cost of retro-active decisions could potentially be avoided by this system.

#### European Commission

In relation to the questionnaire issued to the DG of the Commission seven DGs responded and the following DGs provided completed questionnaires:

- DG TAXUD

- DG AGRI
- DG TRADE
- DG COMP
- DG REGIO

Two DGs declined to complete the questionnaire as it was not relevant to them or there because they had no additional information to report.

The main results of the consultation were the following:

- Each of the DGs above was involved in the derogation. Apart from DG TAXUD, involvement was concentrated around Council Decisions to renew (extend) the derogation, with around 150 person days involved in each decision. Oversight between decisions (relating to the review of reports) was limited to around 10 person days.
- Overall, stakeholders affirmed that the derogation was broadly coherent with other existing policies. While the derogation applies only to French OR traditional rums (and may therefore have an impact on competition), proportionality was established in the 2014 State aid decision. The current derogation is coherent with aims around development and supporting the socio-economic situation in the ORs.
- Regarding the future options, it was noted that, if the derogation did not exist, a similar measure could be implemented under Article 349 TFEU. While subsidies could present an alternative to the current system, they would potentially require the need for additional European resources to be allocated and would not enable ‘well identified’ French OR traditional rums to be sold in France (which is a feature of the current system).

### **Producers of traditional rum in the French ORs**

Consultation responses were obtained from producers of traditional rum across each of the four ORs under the derogation as set out in Table 20:

**Table 20: Rum producers consultation results**

OR	Responses received	Quota amount covered by responses (hlpa)	Percentage of quota covered by responses
Martinique	10	43,600	68%
Réunion	3	27,353	100%
Guadeloupe	7	44,058	85%
French Guiana	1	1,000	100%

Two recipients could not respond due to time restraints or lack of data, and data in respect of one producer was received without reference to the questionnaire.

Respondents to the questionnaire provided a range of different types of responses. Not all respondents provided comprehensive information. Table 21 below sets out the type of information provided in the questionnaire responses.

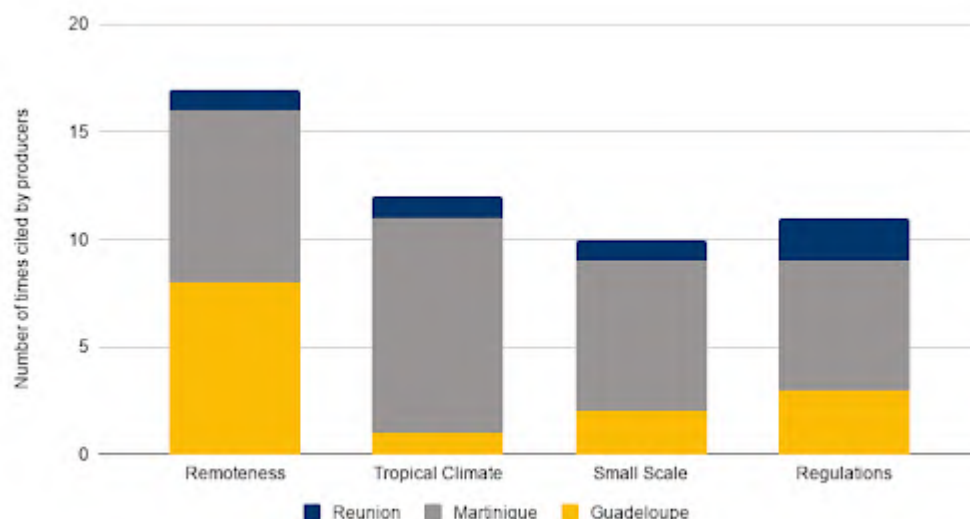
**Table 21: Type of information received in completed questionnaire responses**

Category	Approximate % of completed questionnaires containing information	Notes
Quantitative Responses	80%	The extent of data received ranged across responses, with some more detailed than others
Qualitative Responses	100%	A majority of questionnaires received contained detailed responses on the qualitative questions.
Cost Data	80%	This data varied in detail, with some responses only contain a few data points, while other extensive information
Staffing	75%	Some responses provided a breakdown by staff type, others an overall total.

Respondents provided quantitative and qualitative data describing their direct and indirect costs of production, and how these costs are influenced by operating in the OR. These costs were grouped thematically as shown in Figure 2. Overall, producers indicated that remoteness, scale, regulations, and climate affected producers in all of the ORs for which a response was given to this question.

**Figure 2: Factors of additional costs emphasised by producer (count of specific factors mentioned by type) <sup>101</sup>**

<sup>101</sup> French Guiana did not respond to this question.



Note that each unit represents a ‘factor’ flagged by a producer. Multiple factors are grouped in the same category (for instance, environmental regulations and labour regulation are captured as separate factors under regulation)

Examples of specific factors falling into the categories below are set out in the main report in the analysis of additional costs. Of the factors noted, the following were included within quantification of additional costs (please see the main report for further details):

- cost of primary ingredients (influenced by climate, remoteness and regulation);
- cost of labour (influenced by regulations, remoteness);
- other production costs (influenced by all factors set out above); and
- marketing practices (noted by producers in relation to small scale).

In addition to the above results, the consultation indicated the following with regard to the current derogation and options for its future:

- **Impact of the quota and derogation on producer businesses.** Producers noted that the quota enabled them to access markets outside the ORs, as it was more economically challenging to access these markets. The derogation played a role in producers’ decisions to invest, and (to some extent) to employ staff on permanent contracts.
- **Costs of the derogation system.** The primary costs associated with the current system were identified as the cost of policy uncertainty (as the existence of the derogation influences business investment decisions) and the additional costs that must be paid by producers, if production is in excess of the quota.
- **Continuation of the derogation.** Producers in general noted a preference for the derogation to continue but citing a need for additional flexibility in terms of the amount of the quota.

## Distributors

Targeted questionnaires were sent to distributors of French OR traditional rum. In the first instance, a questionnaire was distributed to 17 recipients that interacted directly with

producers. In September 2019, an abbreviated questionnaire was distributed to a selection of eight large retailers in France to supplement the initial consultation.

The format and level of information supplied in response to the questionnaires varied across respondents, and respondents engaged in different types of activity in the value chain (retail sales, bottling, marketing, import-export other logistics). Overall, the respondents noted that the derogation was an appropriate form of aid for the OR rum producers. Depending on their role in the value chain, some distributors noted their role in administering the derogation (in terms of accounting separately for rum eligible for the reduced rate), although this did not add to costs specifically. While data quality varied across responses, the information provided did not indicate that the benefits of the derogation were falling to intermediaries.

### **Public consultation**

Ten respondents participated in the public consultation. The affiliation of respondents is set out in Figure 1 above, and respondents were from France, Spain, Romania, United Kingdom and Belgium. A majority of the respondents were from France (60%), and most of those were from mainland France (50% of total respondents).

Most of the respondents (80%) knew about the derogation. Given the specialist and specific nature of the derogation, this result suggests that public consultation responses represented an ‘expert’ set of respondents rather than the average citizen.

The majority of respondents tended to support the derogation and emphasised its positive effects (in particular, in terms of maintaining rum production, sugarcane cultivation in the ORs, and facilitating cultural links and variety of choice in France). However, some stakeholders also highlighted negative potential impacts on health and other spirits sold in the European market.

## **4. Other information regarding the consultation**

In addition to the results described above the following should be noted:

- Only ten responses were received to the public consultation. No membership campaign was present in these responses.
- A limited number of contributions were received from French OR rum producers outside of the formal questionnaire after the consultation period had ended. The contributions (received over email) related to the questions set out in the initial questionnaire but were received several months later. These responses were considered to be addendums to the initial consultation.

## **5. Feedback and next steps**

In the context of the questionnaire distributed to French OR rum producers, it was noted that this group of stakeholders received several similar (but not identical) requests for information in the span of eighteen months. It was noted that this increased the administrative burden for what are sometimes small organisations, and that this could affect the quality of responses.

In recognition of this feedback, the data collection undertaken for this evaluation was adapted to build on the format of previous consultations (where possible). In addition, the monitoring framework set out the main report puts forward a standardised format for data collection and the removal of the mid-term report. These actions are designed to limit the administrative cost for producers.

### ANNEX 3: ANALYTICAL METHODS

This analytical document was supported by substantial research, based on a combination of primary research, a review of existing literature and data as well as economic and policy analysis. Economic analysis included also calculations of the additional costs encountered by the traditional rum producers, which are presented in Annex 6.

#### *Primary research*

The primary research consisted from in-depth consultation of the rum producers in the French OR affected by this regime - e.g. distilleries - as well as economic operators involved in the French alcohol market, and French and EU institutions. The groups of stakeholders consulted, the tools and methods used as well as the results of the consultations are presented in detail in Annex 2 on stakeholder consultation.

#### *Literature review*

Literature review was applied predominantly at the onset of the research to determine the economic context of the derogation and set correctly the assumptions of the subsequent econometric analysis. This analysis focused on researching the pass through effects in the market for alcoholic beverages, price elasticity, and demand and tax elasticity.

The *pass through effect* is a measure of the extent to which taxes are reflected in retail prices and it follows the basic definition of the percent of one unit of indirect tax that increases the final price of the product. The tax can be fully passed onto the consumers, fully absorbed by the producers, partially passed onto the consumers (undershifting) or even passed on excessively (overshifting).

Of relevance to this initiative, the supporting study collected a body of empirical research investigating the degree of pass-through of indirect taxation to prices of alcoholic beverages. Overall, it demonstrated very diverse estimates, with studies estimating a pass-through with a minimum of 0.72<sup>102</sup>, a maximum equal to 1.64<sup>103</sup> and a median equal to 1.04 (suggesting slight overshifting, typical for perfectly competitive markets). Pass-through estimates are affected by many factors, such as the type of alcoholic beverages, price, channel of distribution and cross-border trade.

*Price elasticity of demand* expresses the percentage change in the quantity of a product demanded in the market resulting from a 1% increase in its price. An absolute value of price elasticity of demand above one indicates that the demand is elastic (reacts relatively strongly to changes in price) while price elasticity of demand below one shows that it is inelastic (reaction to changes in price is relatively weak). There is a wealth of research on

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<sup>102</sup> See: Chua, J. D. (2000). Essays in Public Economics. Ph.D. dissertation. Harvard University, Cambridge, MA; and Bergman, U. Michael and Niels L. Hansen (2017). Are Excise Taxes on Beverages Fully Passed Through to Prices? The Danish Experience. Discussion Paper. University of Copenhagen.

<sup>103</sup> See: Young, D. J., Bielinska-Kwapisz, A. (2002). Alcohol Taxes and Beverage Prices. National Tax Journal 55 (1), pp. 57-73.



the price elasticity of demand for alcoholic beverages, showing a large dispersion of the estimates with respect to the type of alcoholic beverages, with wine and spirits having a price elasticity typically higher than beer. In one recent study<sup>104</sup>, the mean price elasticity for alcohol was estimated to be -0.51, with beer being slightly less elastic (-0.46), and wine (-0.69) and spirits (-0.80) being more elastic. The price elasticity for spirits of -0.80 was therefore assumed for the econometric analysis of the rum market.

As for the *tax elasticity of demand*, it could be regarded as an aggregate of the pass-through and price elasticity of demand. Tax elasticities show the impact of a 1% increase in indirect taxation on demand for a taxed product. In the context of international trade, researchers often investigate the tax elasticity of demand with respect to tariffs imposed on imported products. There are several studies related to alcoholic beverages that use trade gravity modelling similar to the analysis constructed for the purpose of this analysis, and so were used to test the robustness of estimates from the econometric analysis. Coefficients of elasticity of trade to tariffs are within a range of -1.0 to -2.1 across methodologies concerning spirits, within a range of -1.4 to -8.4 concerning wine and within a range of -3.0 to -5.1 concerning soft drinks.

### ***Econometric analysis***

Economic analysis was conducted to provide the basis to understand the impact of Council Decision 189/2014/EU on the French ORs over the period 2014-18. The analysis was broken down into three main steps: (1) economic analysis to understand the relationship between tax and price changes and the demand for rum; (2) analysis to place the tax elasticity within the context of the derogation, and; (3) value chain analysis to understand the extent to which the derogation supports aspects of the cane-sugar-rum value chain in the ORs.

The primary tool for evaluating the past effects of the fiscal advantage and estimate possible impacts of the alternative scenarios on the volume of trade in traditional rum between French ORs and mainland France was a gravity model of trade. Such model is a conceptual framework that is widely used by economists in international trade analysis. These models are often used to estimate the impact of changes in trade policies.

More specifically, the analysis aimed to examine measurable determinants of trade in rum and to simulate how trade volume changes in counterfactual past scenarios and potential scenarios for the future. The econometric analysis derived the estimates of the relationship between trade volumes and indirect consumption tax (VAT and excise) rates, which implicitly incorporates two effects described above, the pass-through and elasticities. The results of the modelling substantiated the answers to the following evaluation questions:

Effectiveness (1): To what extent have the measures in question contributed to supporting and maintaining a competitive cane-sugar-rum value chain in the French OR and maintaining employment levels?

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<sup>104</sup> See: Wagenaar, A.C., Matthew, J.S., Komro, K.A. (2009). Effects of Beverage Alcohol Price and Tax Levels on Drinking: A Meta- analysis of 1003 Estimates from 112 Studies. *Addiction*. 104, pp. 179– 190.

Effectiveness (2): To what extent has the fiscal advantage influenced the size of the agricultural surfaces used for the cultivation of sugarcane?

Effectiveness (3): To what extent has the dependency of rum producers in the French OR from the reduced tax rates increased since 2014?

Coherence (2): Does the reduced indirect taxes regime in combination with other systems and/or aid affect competition and world trade, and if so, to what extent?

The model allowed to get some estimates of the possible scenarios on the levels of rum production, on producers' revenues, impacts on the value of extra-OR exports, change in demand for primary ingredients and land use as well as jobs across the value chain.

The counterfactual analysis for the ORs and cane-sugar-rum value chain was based on the above described tax elasticities, combined with data collected from the ORs to estimate the impact of the derogation on the ORs and the OR cane-sugar-rum value chain, and the fiscal cost to the French government. The value chain analysis of the no-derogation situation aimed to show impacts on rum production, revenue for producers, value of exports, demand for primary ingredients and land use as well as jobs. The key assumptions behind the analysis included (1) linearity and proportionality of impacts (producers impacted in proportion to the quota they use), (2) changes to the traditional rum dispatches to France modelled as a function of changing production, (3) estimates relating to direct impacts in the sector only, and (4) short-term estimates where factor of production would not be used in other capacities in the economy.

To estimate the impacts of no-derogation situation on the production levels, 42% of reduction in demand for the traditional OR rum under the quota applied. Overall, the impacts of no-derogation were estimated to apply equally to traditional agricole rum and sucrerie rum and across the ORs in proportion to their annual quota limits. No assumptions were made regarding distillery closures that could have been expected had there been no derogation. However, economies of scale did appear to be present in the data provided by the distillers, and so some level of consolidation could be expected.

Estimation of the additional costs for French OR rum was based on the bottom-up approach. New bottom-up estimates of the cost per hlpa of French OR rum and three comparators ('mainland rum', 'world rum', and 'mainland vodka' as detailed in Annex 5) were constructed to assess the extent of additional costs experienced by French OR rum producers in producing and marketing traditional rum for the French mainland market.



## ANNEX 4: FISCAL AND ADMINISTRATIVE COSTS

### *Fiscal cost*

The fiscal cost is borne by France and estimates presented here account for behavioural responses. This approach assumed that dispatches to mainland France of traditional rum from the ORs would be lower in the absence of the derogation. The analysis considered the effect of the derogation on government revenue through two channels:

- **Excise duty:** the derogation reduces excise duty collected on sales of OR traditional rum. Simultaneously, it also reduces excise duty collected on the sale of non-OR rum by stimulating demand for OR traditional rum. The stimulus to demand of OR traditional rum more than offsets the contraction in demand for non-OR rum, driving up overall demand in the market;
- **VAT:** due to the application of VAT to the excise duty-inclusive price, the derogation will also drive lower VAT revenues by reducing the VAT base. Only the VAT revenue attributable to the excise duty component of retail prices has been considered.

The estimates are based on the full quota in order to present the cost of the measure itself. The analysis does not include VSS because VSS rates are currently the same for traditional OR rum and other spirits. While the behavioural approach suggests that consumers would substitute traditional OR rum for rum with lower alcohol content by volume (and therefore have an impact on the amount of VSS collected), this has not been included as it is incidental to the reduced rate.

Table 1 below presents the net fiscal cost of the reduced excise rate, adjusted for behavioural responses. The counterfactual analysis indicated that the absence of the derogation would have reduced dispatches of French OR traditional rum to the mainland by around 60,000 hlpa (reduction of around 42%), and so no tax would be collected on this amount, which is included in the analysis (the maximum fiscal cost is reduced by 42%). Furthermore, if the tax on the French OR traditional rum was higher, economic theory suggests that consumers would likely have increased their consumption of similar products to substitute for the more expensive rum. To account for this, it is assumed that the fall in sales under the derogation is offset by a corresponding increase in other spirit drinks based on an elasticity of 0.75.

After accounting for both the lower sales of French OR traditional rum and the higher sales of other non-OR rum, the fiscal cost of the reduced excise rate is estimated at €119 million in 2018.

*Table 1: Estimates of net fiscal cost*

	Notes		2014*	2015	2016	2017	2018
A	Quota levels		120,000	120,000	144,000	144,000	144,000

B	Excise duty and VAT at reduced rate (€ per hlpa)	Excise tables	1,031.75	1,038.97	1,043.12	1,043.12	1,045.21
	Revenue collected on the quota at reduced rate (€ millions)	A x B	124	125	150	150	151
C	Final revenue that would have been collected** (€ millions)		222	223	269	269	269
D	<b>Net fiscal costs of the measure (€ millions)</b>	<b>C - B</b>	<b>98</b>	<b>99</b>	<b>119</b>	<b>119</b>	<b>119</b>
	Excise duty loss (€ millions)		82	82	99	99	99
	VAT loss (€ millions)		16	16	20	20	20

\* excludes reduced VSS reduction; \*\* based on estimates of tax revenue from substitution to other products

### ***Analysis of administrative costs***

The administrative burdens generated by the excise rate reduction permitted by Council Decision 189/2014/EU have been quantified using the Standard Cost Model. This model took into account the ongoing costs (administrative burden arising from the day-to-day operation and renewal costs associated with changing the derogation when it is renewed or when there is a change in the quota, both of which require a Council Decision).

The data to support the estimation was drawn from data collected via the questionnaires to pertinent stakeholders (including the Commission, French authorities, producers of the traditional rum in the OR and distributors) as well as through the desk research.

Responses from the producers and distributors were limited compared to responses from the Commission and the French authorities on the issue of administrative burdens and costs. Further research suggested that much of the administrative burden faced by OR producers and distributors would face no cost due to the use of automated processes to administer the quota and reduced rate of excise. Commission wages were estimated at €50/hour<sup>105</sup> and the French authorities wages were estimated at €26,81/hour.<sup>106</sup>

Tables 2 and 3 present the estimated costs broken down by the stakeholders, type of cost and administrative activities.

***Table 2: Estimates of ongoing administrative costs***

<sup>105</sup> Based on average annual salary for EC between Grade 6 and Grade 12 of staff; European Voice, *The Companion to the Commission*, 2015

<sup>106</sup> Based on average annual salary for a manager, adjusted to an hourly basis; Emolument, *Average salary of French Government employees*, 2019

Stakeholder	Description of costs	Frequency	Estimated total cost (€)
European Commission	Assessment of reports and possible amendments	Yearly	3,500
French authorities	Setting up the monitoring software	One-off	1,200
	Writing inter-ministerial orders Following the monthly statistical updates Participation in pilot mission and coordination/follow up of derogation	Yearly	13,500
Producers	The cost of modifications of adaptation to customs computer programs	Unknown	Unknown
Distributors/ Industry association*	Specific account for rum in the quota Billing clients at reduced rates, subscription to Organisme de Défense et de gestion, participating in CIRT-DOM work Providing documentation and updating accounts	Yearly	30,000**

\* this amount is primarily borne by one distributor who is involved with the administration of the quota; \*\* based on a limited sample of 3 employees required to participate in CIRT-DOM work, on a part-time basis;

**Table 3: Estimates of administrative costs of renewing and extending the derogation**

Stakeholder	Description of costs	Estimated total cost (€)
European Commission	Comment on Council decision, liaison with Council presidency, participation in evaluations  Drafting terms of reference, and staff working documents, revision of reports, proposal  Assessment of proposal and evidence  Consultation on the Decision	55,000
French authorities	Preparatory meetings with other ministries and industry association Participation in discussion with the Commission ), participation in reports  Modifying/drafting of regulations, consultation with professionals, signature and publication of texts, follow up  Modifying the Code general des impôts	22,000
Producers	Costs of discussions surrounding changes to the quota	Not quantified
Distributors	No cost cited - process is automatic	N/A
	<b>Total</b>	<b>77,000</b>

## ANNEX 5: ADDITIONAL COSTS

Due to several interrelated factors, it is more costly to produce traditional rum in the French OR than elsewhere. Thanks to broad consultations with stakeholders involved in the sugar-cane-rum value chain as well as the French authorities holding most of the relevant indicators, many of the cost elements were identified, while some were quantified. This allowed breaking down the general cost factors recognised in the Council Decision 189/2014/EU, such as remoteness, insularity, tropical climate, small scale of the local market or broadly understood compliance with the EU legislation.

The following approach was undertaken in order to estimate the additional costs for producers operating in the ORs:

- ***producer and market data***: producer data was collected through questionnaires sent to French OR traditional rum producers. They were asked for production costs. Market data was also collected;
- ***categorisation of costs to be quantified***: analysis was categorised on the basis of the broad categories of ‘ingredients’, ‘workforce’, ‘other production costs’ (including depreciation, repairs, bottling, and other costs) and ‘marketing practices’. The impact of other aids which affect the costs of production was also assessed to ensure that net additional costs were captured through the analysis;
- ***data on prices for comparator products***: for the above cost categories, data was collected from independent sources on the costs incurred by producers of other comparator products for each cost category. Estimates are based primarily on bottom-up analysis using primary data, rather than using proprietary data of actual comparator products in the market;
- ***assessments of the additional costs for producers of French OR traditional rum***: these were derived by comparing the producer estimates of costs for traditional rum with the independent data on costs for comparator products. The impacts of other factors were also considered.

Not all of the costs were quantifiable. The costs that were quantifiable are not always a completely accurate representation of the reality as they were aggregated at the producer level, meaning that they did not take account of the fact that more than 50% of the producers were SMEs, which typically face even higher costs. Consequently, the additional costs used in the present analysis should be understood as the minimum additional costs borne by the traditional rum producers, while the real costs are likely to be higher. Table 1 below provides a thorough compilation of the various cost elements reported by the stakeholders and collected through desk research, accompanied by information to what extent they have been reflected in the additional cost values per hectolitre of pure alcohol used in this analysis.

**Table 1: Additional cost factors**

Factor	Description	Reflected in additional costs
<b>Remoteness</b>		
<b>Transport of inputs</b>	The ORs remoteness, insularity and topography results in higher costs of transport for input materials	Yes; quantified at a high-level using proxy of a 10% mark-up was applied to 'other costs' for OR producers compared to a producer in mainland France
<b>Time lag for transport of inputs</b>	There was some evidence of this cost but was not quantifiable on a hupa basis. For instance, one producer mentioned the need to stock extra spare parts, at additional capital cost	No; not quantifiable on an hupa basis
<b>Cost of transport of final goods</b>	Producers benefit from a 'freight aid' already <sup>107</sup> . While there was a delay in payments of this aid, the around 50% support cited triangulated with public data on additional costs of shipping to the French OR as opposed to within France.	No; lack of evidence that this cost was additional to the freight aid received
<b>Higher storage costs</b>	This is related to a shorter production season, as rum is mainly produced during a particular period of the year but sold throughout the year thus requiring storage	Not individually; included as a factor in short production season (below)
<b>Price of land</b>	Research was conducted to determine whether the price of land in the ORs was higher than in mainland France. Some evidence supported the existence of higher cost of land, but it was not possible to assess materiality within the producer cost base	No; there was not sufficient data to quantify within a producer cost base
<b>Cost of capital</b>	Financing base rates are up to 2x higher than in the French mainland, based on business survey data from Banque de France <sup>108</sup> . However, questionnaires did not demonstrate financing charges or noted that finance was obtained in mainland France	No; not sufficient evidence that this cost is borne in the OR

<sup>107</sup> Les-Aides France. Aide à la réduction du coût du fret dans les entreprises des DOM Saint-Saint-Pierre-et-Miquelon, Saint-Barthélemy, Saint-Martin et Wallis-et-Futuna; available at: <https://les-aides.fr/fiche/bZdgAH1GzfreCntQ/>

<sup>108</sup> For example, taux des crédits aux entreprises à La Réunion. Available at: [https://www.iedom.fr/IMG/pdf/infos\\_financieres\\_taux\\_des\\_credits\\_entreprises\\_la\\_reunion\\_octobre\\_2018.pdf](https://www.iedom.fr/IMG/pdf/infos_financieres_taux_des_credits_entreprises_la_reunion_octobre_2018.pdf)



Factor	Description	Reflected in additional costs
<b>Costs related to tropical climate</b>		
<b>Climatic factors (general)</b>	There was some evidence the useful economic life of machinery in tropical climates may be shorter than in non-tropical climates, with one article suggesting depreciation and repairs 60% higher in tropical climates <sup>109</sup>	Yes; quantified at a high level
<b>Storms</b>	These costs could not be identified, however there appeared to be a small increase in potential insurance costs	No; not quantifiable on an hlpa basis
<b>Climatic factors (evaporation)</b>	This was noted as a factor in aged rum in particular production which has to remain in storage longer, but aged rum only makes up a 2.5% of exports <sup>110</sup>	No; not quantifiable on an hlpa basis
<b>Short production season</b>	Potential additional costs originating from a production season aligning to the cane harvest period, with distillation only occurring over a relatively short period (4 months in the Antilles, around 6 months in Réunion, and almost 9 in French Guiana) <sup>111</sup> , were analysed	Yes; quantified at a high level
<b>Small Scale</b>		
<b>Small regional market</b>	A narrow regional market was analysed as a limitation on growth for OR rum producers	No; not quantifiable on an hlpa basis
<b>Marketing capacity</b>	The limited ability of OR producers to market their rums, particularly compared to larger alcoholic drinks brands, were noted by producers	No; insufficient data to quantify and was not clear this cost was born in the OR however this parameter is considered in analysis of marketing practices
<b>EU Regulations</b>		

<sup>109</sup> Brenner, 1971. This is within the range of higher observed depreciation in tropical/cyclone exposed states as compared to less vulnerable areas in the same country, which can have rates up to twice as high. Data on depreciation was triangulated on more recent sources to support these rates. Higher rates of depreciation were noted in 2017 in warmer climates due to harsher environmental factors which consumed assets at a faster rate than more moderate climates. Available at: <https://assets.kpmg/content/dam/kpmg/au/pdf/2017/public-infrastructure-spending-show-me-the-money.pdf>

<sup>110</sup> CIRT-DOM. Some evaporation also occurs for non-aged rum, however public data was not found to confirm that this rate would be higher in the ORs.

<sup>111</sup> Office de développement de l'économie agricole d'outre-mer, 'Filière Canne Sucre Rhum'.

Factor	Description	Reflected in additional costs
<b>Compliance cost</b>	Ongoing environmental costs, which include environmental compliance costs in relation to taxation of 'vinasse' (a by-product of rum production). Several other costs relating to the ORs' environment were identified and addressed at a high level	Yes; quantified at a high level and estimated to be €10 per hlpa compared to world rum
<b>Ban on specific herbicide</b>	A recent ban on the herbicide Asulox without a clear replacement, was described as a factor leading to increased labour intensity needed to harvest sugarcane. This contributed to a reduced yield and higher prices for sugarcane <sup>112</sup>	No; Costs already factored into price of sugarcane

Source: PwC et al, 2020

The above systemisation of the costs borne by producers of traditional rum in the French OR allowed estimating the approximate level of additional costs for the agricole rum and sucrerie rum.

*Table 2: Additional cost per hlpa of traditional OR rum compared to world rum*

Cost component	Additional cost per hlpa (€)	
	Agricole	Sucrerie
Sugarcane	150	-1
Workforce	73	28
Remoteness	16	16
Tropical climate	22	22
EU regulations	10	10
Transformation aid	-38	0
ABV difference (2.5%)#	58	58
Herbicide costs**	16	16
Market practices (excluding ABV difference)	672	606
<b>Total</b>	<b>979</b>	<b>755</b>

Source: PwC et al, 2020

To compare these costs to costs borne by producers of similar alcoholic beverages, three comparators were used: the mainland rum, world rum and mainland vodka.

<sup>112</sup> Asulox, un herbicide retiré mais toujours utilisé en Martinique. Available at: <https://www.rci.fm/martinique/infos/Sante/Asulox-un-herbicide-retire-mais-toujours-utilise-en-Martinique>

**Table 3: Comparators used for the additional costs analysis**

Product	Reason for inclusion
‘Mainland rum’	In this case, a notional producer of rum operating on the French mainland, but with access to global markets in sugarcane and molasses is considered. While rum is not produced in quantity in mainland France this allows the costs associated with producing traditional rum in the ORs rather than the mainland to be investigated.
‘World rum’	This category covers the closest actual competitors in the French market, consistent with the reports from producers, and illustrates how the cost of traditional rum production in the ORs compares with other rum producing areas.
‘Mainland vodka’	As rum is not produced on mainland France, the 2014 State aid decision on the derogation was based on the use of vodka as a comparator product to test for additional costs. This allows the costs as compared to actual mainland spirit production to be estimated.

Source: PwC et al, 2020

In practical terms, the average additional cost involved in producing both types of traditional rum in the French OR are estimated to be between €792 and €963 per hlpa (or €2.85 and €3.46 per bottle), depending on the comparators.

**Table 4: Additional costs estimates (€ per bottle)**

	Mainland Rum	World rum	Mainland Vodka
<b>Total cost per bottle (€, based on the benchmark bottle by type)</b>			
Total additional cost per OR rum bottle (2018 prices)	2.95	2.85	3.46

Source: PwC et al, 2020

## ANNEX 6: EVALUATION

The scope of the evaluation is a retrospective assessment of the derogation during the period 2014 to 2018. In particular, the evaluation assesses the extent Council Decision 189/2014/EU contributed to:

- Reducing the competitive disadvantage of traditional rum producers in the ORs, linked to their permanent constraints;
- Supporting the broader cane-sugar-rum sector in the ORs, which is important to the socio-economic situation of the ORs in terms of employment, land use, and the wider OR economy;
- Maintaining access to the mainland French market for the traditional rum producers in the ORs;
- Ensuring the smooth functioning of the single market for alcoholic beverages.

The evaluation assesses the performance of the Directive against the basic evaluation criteria of relevance, effectiveness, efficiency, coherence and EU added value, in line with the Better Regulation Guidelines<sup>113</sup>.

The evaluation is based on the external ‘back to back’ study with an evaluation and impact assessment of the Decision carried out simultaneously in accordance with Better Regulation Guidelines.

### Relevance

This section analyses the current needs of the stakeholders compared to the objectives the Decision was designed to address. The functioning of the Decision was assessed on the basis of the following evaluation questions:

- *Do the reasons justifying the derogation still exist?*
- *To what extent does the scope of Council Decision 189/2014/EU still match the needs and interests of the French ORs, the French authorities and of the economic operators concerned? Is there a need to add to or remove from its scope specific elements?*

The factors identified in Article 349 TFEU have persisted over the period of the current Decision. These factors have resulted in additional production costs for traditional rum producers in the French ORs and in the absence of the derogation, producers noted that their ability to compete in the French mainland market would have been seriously impeded.

Access to the French mainland market is vital, not only for the producers, but also the broader cane-sugar-rum sector in the French ORs. Rum creates demand for local sugarcane cultivation and sugarcane remains one of the main agricultural products of the French ORs. In terms of employment, the wider cane-sugar-rum value chain generates

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<sup>113</sup> Better Regulation Guidelines

approximately 22,000 jobs across the French ORs. This equates to 3.8% of total employment in regions whose unemployment rates (20%) are more than double that of mainland France (9%). Traditional rum is an important contributor to the GDP of the OR, accounting for 9% of the value of extra-OR exports.

As the constraints of the ORs outlined in Article 349 TFEU are permanent, the needs and interests of the stakeholders have not changed fundamentally. The smooth functioning of the single market also remains an important element for stakeholders.

However, two areas of the regime could be improved to align the regime better with the needs of the stakeholders. The fixing of the quota for the duration of the Decision is somewhat problematic. While the retroactive increase of the quota in 2017 ensured the needs of the stakeholders were addressed, the French authorities supported increased flexibility.

Secondly, the extent to which compensation is granted for all additional costs faced by traditional rum producers in the French ORs could be considered to ensure that the derogation remains proportionate in the future.

### **Effectiveness**

The effectiveness of the Decision was ascertained by assessing the extent to which the regime supported the broader cane-sugar-rum sector in the French ORs and the competitiveness of the traditional rum producers in the ORs was maintained to ensure access to the French mainland market. The evaluation questions were:

- *To what extent have the measures in question contributed to supporting and maintaining a competitive cane-sugar-rum value chain in the French ORs and maintaining employment levels?*
- *To what extent has the fiscal advantage influenced the size of the agricultural surfaces used for the cultivation of quality sugarcane?*
- *To what extent has the dependency of rum producers on the derogation decreased or increased over recent years?*
- *Is the effectiveness of the system of reduced excise duty rates affected by other EU/French public policies and/or aids applicable to French OR?*

The study found that traditional OR rum is priced at a similar price to other rum, which suggests that the cane-sugar-rum value chain in the French ORs remains competitive. The volume of French OR rum dispatched to mainland France increased between 2013 and 2018 by 14%. This market continues to be the main market for OR traditional rum with dispatches to the mainland accounting for 65% of the total movements, up from 54% in 2014. Reliance on the French mainland market has not changed over time.

Despite this increase in volume, the market share of traditional French OR rum has declined by 6% compared to third country imports. This suggests that the measure was generally effective in maintaining access in absolute terms and also highlights the strong competition facing traditional French OR rum.

According to some stakeholders, the quota mechanism of the regime was noted as reducing the effectiveness of the regime. The producers noted that this limited their ability to make long term investments as the quota was fixed in the Decision but often was amended retrospectively. Furthermore, the reliance on this quota could also discourage OR producers from developing markets elsewhere or innovating their products.

In terms of employment, the study estimates that 400 jobs in the value chain were supported by this regime. Additionally the regime increased the demand for sugarcane and molasses. The study found that without the regime, 3% less land would have been used for sugarcane cultivation. The decreasing trend of using agricultural land for sugarcane would have been greater in the absence of the regime. Overall, the study shows that the regime increased the contribution of rum to the value of extra-OR exports by 30%. Martinique was particularly influenced by the regime with the study estimating that the value of extra-OR exports by €15 million in 2018 and over 81% of its sugarcane demand.

The French ORs receive various forms of aid from both the EU and the French government. The EU agricultural support scheme for the EU outermost regions (POSEI) contains several programmes that aid the cane-sugar-rum value chain. These are assistance in maintaining sugar production and transformation of cane. Transformation of cane supports producers of agricole rum and improves the effectiveness of the regime by decreasing the costs for these producers. French government supports include transport aid, research tax credit, which help reduce the costs for producers in the ORs and increase their competitiveness.

These aids help mitigate the additional costs of production in the early stages of the value chain but do not fully mitigate the additional costs faced by rum producers accessing the French mainland markets. Therefore the study found that the effectiveness of the regime is positively affected by other EU/French policies and aid for the French ORs.

## **Efficiency**

The efficiency of the Decision was assessed on the relationship between the resources required by the regime and the results of the intervention.

- *To what extent is the derogation system applied efficiently?*
- *How are the costs and benefits of the derogation distributed among different stakeholders?*
- *Which other factors influence the efficiency of the current system and which effects do they generate?*
- *To what extent are the benefits of the fiscal measures compensating for the loss of fiscal revenue in France?*

Stakeholders reported only limited administrative costs associated with this regime. Producers and distributors estimated their associated staff costs to be approximately

€30,000 per annum. The French authorities estimated ongoing costs to be in the region of €13,500 annually and the Commission estimated the costs of the regime is approximately €3,500 per year.

In terms of oversight, the Commission estimated that each Decision cost approximately €55,000, while the French authorities estimated the costs to be in the region of €22,000.

The study noted two areas of the regime which could be amended to improve efficiency. Increases in the quota post adoption of the Decision creates costs for all stakeholders. Efficiency of the regime could be improved where any future Decisions include a mechanism to anticipate possible changes to the quota without the need for a new Decision.

Secondly, the study notes that the monitoring framework could be improved to increase efficiency and reduce the costs associated with the periodic review of the regime.

The study found that the main benefits of the regime accrue to the French OR producers, the OR cane-sugar-rum value chain and the ORs in general. These beneficiaries receive these benefits at a relatively low cost. The following table summarises the benefits and costs.

**Table 5: Distribution of main costs/burdens and benefits in the cane-sugar-rum value chain**

Stakeholder	Benefits	Costs
French OR rum producers	On average €28 million of added revenue per year driven by 68,000 hlpa increase in annual production	Minor administrative burden (approximately €47,000 per year)
Cane-sugar-rum value chain	Supports an estimated 53,000 tonnes demanded for sugarcane for agricole rum and 4,000 tonnes of molasses for sucrerie rum over 2014-17  Supports around 400 jobs in the cane-sugar-rum value chain  Greater job security driven by the volume of sales	No direct costs
Broader OR	Supports around 29% of rum's contribution to the value of extra-OR exports  3% agricultural use of land for cane	Minor administrative burden (relating to French authorities of the ORs, see below)
Intermediaries in mainland France	No evidence of material benefit	Administrative costs of €30,000 (CIRT-DOM staff costs)

Stakeholder	Benefits	Costs
French government	Stronger links of the ORs with mainland France <sup>114</sup>  Strong rum industry and increased employment in the ORs	Fiscal costs of €98 million in 2014 increasing to €119 million in 2018. Administrative costs of €13,500 per year and €22,000 for renewal.  Public health costs
French mainland consumers	Lower price of French OR rum  Connection with the French ORs	Minor health impacts due to increased spirits consumption

Source: PwC et al, 2020

The overall fiscal cost of the regime is estimated at approximately €119 million per annum. The report notes that in financial terms, the costs exceed the benefit, however this should be taken in the wider context of the French ORs. The French ORs have a significantly lower economic output per capita and higher unemployment than the French mainland.

The study also found that the efficiency of the regime is impacted by certain regulations at EU and national level. This includes for example the banning of certain herbicides, which stakeholders note has increased their production costs. Environmental legislation also impacts the efficiency of the regime, for example stakeholders note the high costs of treating byproducts of rum.

## Coherence

This section analyses how well the Decision is integrated and compatible with other related EU policies. The evaluation questions on coherence are:

- *Are the rules on reduced indirect taxes rates complementing, contradicting or overlapping with other EU policy objectives and instruments?*
- *Does the reduced indirect taxes regime in combination with other systems and/or aids affect competition and world trade and to what extent?*

The derogation is a form of regional State aid, authorised under State aid Decision SA. 38641. The evaluation found that the derogation is coherent with State aid rules.

The results of the study indicate that the Decision is broadly coherent with the overall principles and policies governing the single market. In 2018, the market share of French OR rum was approximately 10% of the total French spirits market and less than 1% of the European market. Access to the French mainland market is vital for the traditional

<sup>114</sup> Based on public consultation responses.



rum producers in the French ORs. Market data shows that the derogation has not negatively impacted other rum producers, whose market share has increased since 2014.

The EU strategy for the ORs is based on four pillars, which includes building on their unique assets and enabling growth and job creation. The study indicates that the Decision is coherent with this strategy. The derogation has developed rum production in the French ORs by approximately 20% during the period 2014 and 2018. The study estimates that 400 jobs are as a direct result of derogation.

The demand for locally grown sugarcane is coherent with both EU agricultural policy<sup>115</sup> and environmental policy. Sugarcane limits soil erosion and water run-off and the by products such as bagasse are used as a biofuel.

The derogation mitigates the additional costs faced by traditional rum producers in the French ORs by reducing the excise duty on this rum on the French mainland. The World Health Organization recommends high excise duties as one of the most cost effective way of reducing harmful alcohol consumption<sup>116</sup>. The study estimates that 16,500 hlpa of rum is as a result of the derogation. This is equivalent to 0.15% of 2016 spirits consumption per capita (aged 15 and over). The study notes that the reduced rate remains above the EU minimum set out in Directive 92/82/EEC and therefore the negative health impacts are mitigated to an extent.

### **EU-value added**

This evaluation criteria examines the benefits as a result of the EU policy, compared to what could have been delivered by national measures of France or no action. As set out in Article 349 TFEU, only the Council is authorised to adopt specific measures in favour of the ORs, because of the permanent constraints affecting the ORs. Therefore, the costs and benefits of the derogation measure its EU added value. The functioning of the derogation was assessed on the following question:

- *To what extent did the derogation provide benefits to the French OR?*

The study found that the derogation is estimated to have increased rum production levels by 0.25 million hlpa during the period 2014 and 2018 and on average €28 million of added revenue per year, which benefitted the traditional OR rum producers.

This increase in rum production, increased the demand for sugarcane and molasses and the study estimated that 53,000 tonnes of sugarcane was as a result of the derogation, which resulted in 400 jobs in the cane-sugar-rum value chain. Rum plays a significant role in the economies of the ORs. The study estimated that the derogation supported approximately 29% of rum's contribution to the value of extra OR exports, which benefitted the OR economies as a whole.

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<sup>115</sup> EU Agricultural policy: <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1425466952920&uri=CELEX:52012DC0287>

<sup>116</sup> WHO, 2017, Global action plan for the prevention and control of NCDs 2013–2020.