Efforts of the public authorities of Estonia to avoid generation of surplus sugar stock by the time of acceding to the European Union

Audit Report No. OSIV-2-6/05/49 of June 1, 2005

Executive Summary

In November, 2003 the European Commission adopted Regulation No. 1972/2003 on agricultural products and in January, 2004, Regulation No. 60/2004 on sugar. Based on the first of these, the surplus resources of agricultural and food products listed in the Regulation and existing in the states acceding to the European Union on May 1, 2004, will be taxed with European Union's import charge (paid into state budget). According to the second Regulation, the surplus sugar stock specified by May 1, 2004 could be removed from the market before May 1, 2005 (the time-limit is extended to November 30, 2005 by Regulation No. 651/2005 of European Commission of April 28, 2005), e.g. sell without export funds outside the Union, process into fuel or forage. If the surplus sugar stock is not withdrawn from the market as of the given term, then Estonia has to pay taxes on the resources into the union budget, the amount of which is calculated by multiplying the surplus quantity with the benefits paid from the Union's budget to exporters of sugar by unit of sugar quantity.

European Commission has, by June 1, 2005, adopted a decision on only surplus sugar stock, according to which Estonia's surplus sugar stock at the moment of acceding to the EU on May 1, 2004, was 91,464 tons. In the couple of years previous to acceding to European Union, Estonia's average sugar consumption was approximately 70,000 tons, i.e. the surplus stock exceeded the amount used in the state in a regular year. European Commission has not yet adopted a decision on the surplus stock of other agricultural products.

Based on the assessment of the Ministry of Agriculture, the potential amount of the taxes paid into the budget of European Union from the surplus stock as of the beginning of June, 2005, is approximately one billion kroons, whereof 715 million kroons for sugar and approximately 200 million kroons for butter. Therefore, most of the potential payments – approximately 70 % of the total amount of payments – are attributed to the surplus sugar stock (91,464 tons). The payment to the EU budget for the excess sugar stock could be reduced, if the businesses would eliminate at least some of their excess sugar stock by June 30, 2005.

The Surplus Stock Charges Act, adopted in April, 2004, enables the state to require the operators who owned the surplus stock, to make payments into our state budget. As of June 1 of this year, a total of 89 million kroons worth of such tax notices had been sent to the operators, this might include requirements concerning sugar stock of approximately 220 million kroons.[1] Thus, according to the calculations of the beginning of June, the state has to find an additional 700 million kroons to be paid into the union budget.[2] The sum will be bigger if the state fails to receive the taxes imposed on the operators.

On the proposal of the State Budget Auditing Committee of the Parliament, SAO initiated an audit to identify why the Government of Estonia did not take, or think it expedient to take measures to avoid the generation of surplus stock and potential big expenses arising from it, which are not included in the state budget. As the biggest payment may accompany surplus sugar stock, the activity of government and the ministries was evaluated at preventing the generation of surplus sugar stock.

Relevant findings

1. **No timely measures were taken to avoid the generation of surplus stock based on the evaluation of the European Commission, or achieving a significantly smaller production of stock.** Afterwards it is not possible to assess the potential quantity of the stock if possible measures had been taken to avoid the generation of surplus stock.

2. **Discussions related to taking necessary measures were started too late, only in October, 2003.** Governmental authorities, especially the Ministry of Agriculture, were aware of the possibility of a problem already before signing the Accession Treaty in April, 2003. Governmental authorities should have realised the gravity of the surplus stock problem after European Commission had directed attention to it in August, 2003.

3. **The possibility to impose excise duty on sugar was not used.** Upon its establishment, according to the benefits paid to the exporters of sugar in European Union, the generation of surplus stock would have become unreasonable, also for individuals. If at the same time with the draft legislation of the act imposing the excise duty, the draft legislation of the act laying down the taxation of surplus stock would have been deliberated, the operators would probably not have created such stock. As laying down excise duty was first discussed in the ministries only in autumn of 2003 and the procedure of the draft legislation of the respective act in Government and The Parliament would have taken a long time because of the lack of consensus in political parties, we can't eliminate the possibility that during the procedure of draft legislation, a surplus sugar stock would still have been generated in Estonia. The existence of such possibility can not be considered as the reason for refusing the excise duty as a possible measure. The proposals of the Ministry of Agriculture to impose excise duty on sugar was not carried out mostly because of the opposition of the Ministry of Finance, who claimed that it was too late to impose excise duty and it would be unfair, taking also into consideration the non-profiteers.

4. **Waiving the imposition of customs duty was justified.** The price of sugar could have been approximated with the average level of prices in the EU either by customs duty or excise duty, both of them would have had equivalent effect. To establish either of the duties, a respective act should have been adopted (i.e. it would have taken the same amount of time to establish either of the duties). Establishing customs duty would have been in contravention of the state's obligations taken in international contracts. The negotiations about reaching a necessary agreement with the partners concerning the establishment of customs duty could have taken several months and reaching an agreement would have been questionable. The representatives of the European Commission had at unofficial consultations expressed their opposition to Estonian officials concerning the establishment of customs duty on products from the European Union, incl. sugar.

5. **It was the right decision to establish Surplus Stock Price Act as a measure to prevent the generation of bigger stock than usual.** To implement Regulation No. 1972/2003 of the European Commission, adopting that (taxation of operators) act was actually compulsory, but was delayed because of the opposition of the Ministry of Finance. The reason of the opposition of the Ministry of Finance was the impression stemming from taxation theory that the tax imposed on exceeding the normal transition stock, is actually a fine and should therefore be established as such. The opinion of the Ministry of Finance should not have prevented the Ministry of Agriculture from drawing up the draft legislation of Surplus Stock Price Act and proposing it to the Government for deliberation already in November, 2003, right after adopting the Commission Regulation. The Ministry of Agriculture failed to do that, limiting itself only to describing the requirements arising from the regulations of the European Commission, and the disagreements of ministries and the hectic viewpoints at the meetings of the cabinet of ministers. It would have been possible to adopt the Surplus Stock Price Act earlier. It would have specified the obligation about surplus stock taxation arising directly from the Regulations of the European Commission, and amplified the knowledge among the operators that the state will require the operators a surplus stock to pay a respective sum. Earlier adoption of the act would probably have reduced the import of sugar and the number of potential court actions, because there would have been no or less possibilities for the operators to appeal to the principle of legitimate expectations and legal certainty. This in turn would have enabled the state to collect the surplus stock fee faster (and without excessive expenses).

6. **Government disregarded the possibility of generating stock by inhabitants.** The governmental authorities dealing with stock problems knew at the latest at the beginning of October, 2003 the explanation of the officials of European Commission that the Commission will not leave out the stock in the possession of people when establishing the amount of surplus stock. The government did not pay necessary attention to it. In the documents presented to the cabinet of ministers, the Ministry of Agriculture did not pay attention to the possibility that the inhabitants would buy sugar in masses and create a stock that would be regarded as surplus by the Commission. The documents presented to the cabinet of ministers for discussion do not show that when making decisions, the government had been guided by an assumption that the European Commission will disregard the stock created by people.

7. **The potential economical influences on operators and state as a whole of the implementation of discussed measures were evaluated superficially**, no thorough estimates were drawn up that would be based on calculations. No necessary statistical data existed for making a proper analysis.

8. **The choice of measures and adopting respective decisions was influenced by the liberal economic policy of Estonia, incl. external trade policy.** Certainly, the cabinet of the ministers was influenced by a promise in the coalition agreement of the then ruling parties to refrain from implementing the amendments concerning taxation until 12 months have passed since the adoption of respective legislation. Undoubtedly, every governmental decision causing a sharp price increase and/or impair the competitiveness of operators, is very unpopular.

9. **Governmental authorities – The Ministry of Agriculture, Ministry of Finance and Ministry of**

Foreign Affairs – did not cooperate effectively in choosing the measures to prevent the creation of surplus sugar stock. Officials held a lot of discussions, but agreements accepted by each other and the government were difficult to reach. The situation is described in the memorandum presented to the Prime Minister by European Union Secretariat in December 4, 2003: "As it is obvious that all implementation options are problematic, the ministries do not want to take obligations to carry them out".

10. **Substantial shortcomings were observed in the governmental authorities' information interchange: information was not always communicated to other agencies, movement of documents fixed, or decisions made at the meetings recorded.** For example, the Ministry of Agriculture acknowledged the letter from the European Commission's Directorate-General for Agriculture concerning the risk of creating surplus sugar stock only during this audit, though the letter had arrived to the Permanent Representation of Estonia to the European Union in August, 2003, which is almost a year and a half ago. Similarly, not all important work documents have been preserved.

11. **Cabinet of ministers has not functioned as a unified team.** Ministers dealt with the issues concerning surplus stock only from their ministry's point of view. For example, the Ministry of Foreign Affairs did not form a positive or negative opinion on Ministry of Agriculture's proposal to impose excise duty, because excise duty is a fiscal measure and the issues related to excise duty belonged to the Ministry of Finance's sphere of competence. The conception of prohibiting surplus stock and penalizing those who violate it that was drawn up in the Ministry of Finance and has been repeatedly discussed in the cabinet of ministers, was contested by the Minister of Justice only when the Minister of Agriculture presented the respective draft Act to the Government for final approval; it would have been logical for the Ministry to draw attention to the potential problems concerning the draft earlier. And another example – every ministry who dealt with this problem knew that establishing customs duty on sugar was unlikely because of the obligations taken in the state's international agreements, but it was still discussed as a possible solution to the problem at several meetings of the cabinet of ministers at the end of 2003.

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SAO has sent the draft audit report covering the findings of the SAO to the Prime Minister, Secretary of State, Ministers of Justice, Economy, Economic Affairs and Communications, Agriculture, Finance and Foreign Affairs, and to former Prime Minister Juhan Parts and members of his cabinet, current members of The Parliament Meelis Atonen (former Minister of Economic Affairs and Communications), Kristiina Ojuland (former Minister of Foreign Affairs), Tiit Tammsaar (former Minister of Agriculture), Ken-Marti Vaher (former Minister of Justice) and Taavi Veskimägi (former Minister of Finance) for comments. For the time of signing this audit report, no comments had been received from Meelis Atonen, Juhan Parts and Ken-Marti Vaher. Full texts of the given opinions have been appended to the report.

Rein Lang, the Minister of Justice, stated that he "completely agrees with what has been reflected in the draft and the findings made based on that, and has no proposals concerning the draft". Edgar Savisaar, Minister of Economic Affairs and Communications, stated that does not think it necessary to submit additional assessments and comments on the draft report. Of all the other respondents, no one agreed completely with all the findings of the SAO, and in the case of several questions, the respondents' opinions were dissenting.

- Secretary of State, Heiki Loot, and Taavi Veskimägi, former Minister of Finance noted in their opinion that the report should have had to cover the activities of state authorities in the period of accession negotiations with the European Union and the period after the accession (implementing Surplus Stock Act).

Setting the audit's objective, the Auditor General took into consideration both the requests of the State Budget Auditing Committee of the Parliament and the fact that simultaneously with the SAO, the auditing of the same problem was also initiated by Ministry of Finance's Financial Control Department, who according to the task given by the Prime Minister, was to evaluate the activities of state authorities both during the accession negotiations and in implementing Surplus Stock Price Act. Neither at the beginning nor finishing the audit report, the SAO did not have any basis to believe that the audit organised by the Ministry of Finance does not include a fact-based evaluation of the activities of state authorities during the periods that the SAO audit does not cover.[3]

- Secretary of State, Heiki Loot and Andrus Ansip, the Prime Minister were of the opinion that it would have been best to evaluate the activities of state authorities only after when it was definitively clear whether Estonia has to make payments into the budget of European Union for the stock that is considered surplus at the moment, and if so, then at what scope (the Prime

Minister stated that the Government will contest the payments appointed to Estonia in the European Court of Justice).

In relation to this the SAO notes that it is known that at the end of 2003 and at the beginning of 2004, the Government wished to find suitable measures in order to prevent the generation of surplus stock; none of the documents and explanations submitted to the auditors show such an objective of the Government. Also, the Government did not make a decision that Estonia does not accept the potential decision of the European Commission on regarding the stock in the possession of the population as a part of state stock. The SAO wished to clarify why the generation of surplus stock could not be prevented.

- In the opinion of Secretary of State, the SAO should have made calculations about how the implementation of each discussed measure would have influenced state economy (competitiveness and economic indicators of operators, state revenue, population's purchasing power etc.).

The SAO did not find it necessary to assess the economic influence of different measures afterwards. The SAO is of the opinion that such evaluations should have been at Government's disposal when it was discussing the implementation or non-implementation of potential measures, and European Union Secretariat of State Chancellery should have drawn the attention of the leader of the cabinet to the necessity of requiring such evaluations.

- The Minister of Finance, Minister of Foreign Affairs, former Minister of Agriculture and former Minister of Foreign Affairs did not concur with the SAO evaluations of the organisation of Government activities. Tiit Tammsaar, former Minister of Agriculture, criticised the SAO for avoiding to give a direct evaluation of the activity of the Prime Minister (in his opinion, the activity of the cabinet was ineffective and that mostly because of the non-determination and inactivity of the Prime Minister). The Minister of Finance, Minister of Foreign Affairs and Kristiina Ojuland, former Minister of Foreign Affairs, regarded the critical evaluation of the SAO to the cabinet's ability of cooperation as unreasonable.

The SAO is of the opinion that only the generation of surplus stock alone refers to the weak teamwork of the cabinet. The SAO finds that the most expressive evidence of the lack of teamwork are the comments of the former ministers for the draft audit report (see Annexes), which reflect the tries to find the persons at fault and shift the blame on other members of the cabinet.

- Several responses concurred with the opinion of the SAO that establishing excise duty on sugar at the end of 2003 would have reduced the generation of sugar stock meant for speculation. But both former and current Ministers of Finance are of a different opinion and find that as the estimated increase of sugar price – first because of the established excise duty and as of May 1, 2004 because of the influence of European Union's import duty – would have made generating speculative sugar stock useful for the operators even when the stock would have to have existed several months before accession to European Union, the stock later regarded as surplus would certainly have been created before the state could establish excise duty on sugar. In their opinion, the period between making a decision of principle about establishing excise duty and the entry into force of Act would have been so long that the operators could have had time to sign contracts with sugar vendors and transport it into Estonia.

The SAO can not contradict or confirm these allegations, but it finds necessary to note that in The Parliament it is possible to quickly process necessary amendments, within a week or two. During such time it would probably not be possible to acquire large quantities of sugar from other countries. Based on the information collected during the audit the SAO finds that the excise duty was not imposed on sugar mainly because of the fact that the Government (and The Parliament) decision to multiply the price of sugar prior to accession to the European Union would have been criticised by both operators and inhabitants.

- The Minister of Agriculture and Minister of Finance did not concur with the opinion of the SAO that Surplus Stock Price Act should have been developed and submitted for deliberation to the Parliament already after the adoption of Regulation No. 1972/2003/EC of the European Commission on November 10, 2003 (on taxation of surplus stock of the operators). In the opinion of the Minister of Agriculture, this Act could have been dealt with only after the European Commission had adopted a Regulation on sugar stock at the beginning of 2004. He is also of the opinion that Estonia was not late in adopting the mentioned act because the operators had to be aware that transitional measures were to be implemented in Estonia and due to certain circumstances the obligation to make payments might be extended on them. The Minister of

Finance finds that even in the case of an earlier implementation of the act, the operators would have claimed that the act was adopted too late.

The SAO finds that in the case of the consensus of the coalition, it would have been possible to bring the Surplus Stock Act into force at the latest at the beginning of the year 2004, and after adopting European Commission Regulation No. 60/2004/EC of January 14, 2004 on sugar stock, it would have been possible to quickly make amendments (giving benefits to operators) arising from the Commission Regulation and dealing specifically with sugar stock. The SAO continues to be of an opinion that the act could have been adopted sooner and that is should have been done.

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Auditor General