



ASH Wales response to the Tobacco Levy consultation

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ASH Wales is the only public health charity in Wales whose work is exclusively dedicated to tackling the harm that tobacco causes to communities. Further information about our work can be found at <http://www.ashwales.org.uk/>

We are engaged in a wide range of activities including:

- Advocating for tobacco control public health policy
- Undertaking tobacco control research projects
- Training young people and those who work with young people to provide factual information about the health, economic and environmental effects of smoking
- Engaging young people and professionals working with young people through the ASH Wales Filter project
- Bringing health information and advice to the heart of the community

We also oversee the Wales Tobacco or Health Network (a network of over 300 individual members) and the Wales Tobacco Control Alliance (an alliance of 35 voluntary and professional bodies in Wales), providing forums for sharing knowledge and best practice.

ASH Wales has no direct or indirect links with, and is not funded by, the tobacco industry.

General observations

1. ASH Wales warmly welcomed the Chancellor's announcement in the Autumn Statement that the Government is minded to introduce a levy on tobacco manufacturers and importers. We strongly agree with the Chancellor's observation that: "Smoking imposes costs on society, and the Government believes it is therefore fair to ask the tobacco industry to make a greater contribution."¹

2. Tobacco Manufacturers and importers in the UK are immensely profitable, such that they could certainly afford to make a greater contribution. Recent research by Branston and Gilmore at the University of Bath suggests that the industry has made at least £1 billion in profits in each of the last 5 years, that this profitability has been increasing during the period of analysis, and that the profitability is likely to be in the region of £1.5bn in recent years.² Tobacco manufacturers and importers are also found to enjoy consistently high profit margins of up to 68%, compared to only 15-20% in most consumer staple industries.

3. Preventing the industry from passing on the cost of any levy would require price controls. It is not clear that this would be technically feasible in the light of the current EU Tobacco Tax Directive.³ However, even if the industry did pass on the full cost of any levy, the public would support such additional taxation if it were spent on measures to prevent youth uptake

and encourage smokers to quit. Indeed there is overwhelming public support for a levy which would raise an additional £500 million and majority support from smokers if it were to be used for such purposes. If any money raised simply went into the Consolidated fund this would be an unfair additional burden on smokers, who are predominantly amongst the poorest and most disadvantaged in society.

4. We strongly support a levy to raise this amount of money to be used for tobacco control. At the same time we recommend that the industry be required to provide data on sales down to local level which could be published at an aggregated level to inform public health policy. The industry should also be required to provide data on marketing spend, including corporate social responsibility and lobbying activity and on its profitability within the UK.

5. The EU Tobacco Tax Directive is due for review shortly. We recommend that the UK government advocate for revisions to which would enable the introduction of a price capping mechanism. Placing a cap on industry prices would enable the excess profit to be transferred from the manufacturer to government, and prevent it simply being passed on to the consumer, so fulfilling the objective of ensuring that the industry pays a greater contribution to the costs it imposes on society.^{4,5}

Answers to Consultation Questions

Question 1: Is it appropriate to define the tobacco market as products on which tobacco excise duty is paid?

We support this definition of the tobacco market. It would be relatively simple to administer compared to any reasonable alternative, and it would maximise the benefits to public health, since smoking “herbal cigarettes” as opposed to tobacco products also carries major health risks.

Question 2: What would be the consequences of using volumes of tobacco cleared in the previous year in order to calculate total market size?

Question 3: Are there any other metrics that you would prefer were used to calculate total market size? If so, why?

We would support the levy being introduced on the basis of a calculation based on previous year clearances. However, we would note that the level of clearances is routinely manipulated by the tobacco industry through the process known as forestalling.

“Forestalling” in this context means a temporary increase in the clearance of rate of cigarettes and other tobacco products, for example so that they can be released into the UK market immediately preceding the Budget, with the intention that duty paid on these products will be at the lower pre-Budget rate. This is of course generally followed by lower than average release of products in the month of so after the Budget. Forestalling can reduce the total tax revenue from tobacco raised in any given year, as well as potentially undermining the potential public health gain from increases in tobacco taxation, since it can delay the effective date of tax increases and therefore any consequential price rises. The recent extent of forestalling is well illustrated by HMRC’s Tobacco Bulletin for November 2013, which shows a spike in tax receipts in April levied at the pre-budget rate, followed by a sharp drop in May, for the financial years 2011/12, 2012/13, and 2013/14. It

should be noted that this pattern is present for tax receipts from home produced cigarettes, imported cigarettes, cigars, hand rolling tobacco, and other tobacco products.⁶

Use of previous year clearance data would help to minimise the effect of forestalling.

Question 4: What are the practical difficulties in splitting the total market into 2 distinct parts: cigarettes; and HRT and other products subject to tobacco duty?

As HRT is sold by weight rather than number of cigarettes or equivalents, it would presumably be necessary to calculate the level at which the levy on HRT would be set based on an assumption about the weight of tobacco in a typical hand rolled cigarette.

The HMRC Tobacco Bulletin for October 2014 reports that in the 2013/14 tax year:

- 35.4 billion cigarettes were released for consumption
- 7.1 million kilos of other tobacco products were release for consumption (more than 90% being HRT)

A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.⁷ This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 30 below.

Question 5: Which of option (i) and (ii) as set out in paragraph 2.14 is your preferred option?

We prefer the initial use of previous year clearance data, at the start of the levy, with evolution towards use of sales volume data.

Question 6: Do you agree that the corporation tax system provides the best mechanism for returning and paying the tobacco levy?

Question 7: What are the alternative approaches?

In principle the use of the corporation tax system to collect the levy is a good idea, as the system would not impose an additional administrative burden. We assume that the Treasury would construct levy rules so that levy payments and any associated administrative or other costs to the tobacco industry could not be used to reduce liability for corporation tax.

However, as different companies have different year ends there is a possibility that the industry could game the system by timing its clearances. An alternative to be considered would be to use the excise tax system.

Question 8: The government welcomes views on the expected impacts of the levy on consumer prices.

Question 9: Would the levy have any other impacts on consumers that have not been considered in this document?

Question 10: Would the levy have any other market impacts?

The impact of the levy on prices will depend on two related factors:

- The effect on brand value and differentiation of the (assumed) introduction of standardised packaging under the Children and Families Act 2014, and
- The proportion of the levy that manufacturers decide to pass on in the retail price of cigarettes and other tobacco products.

According to the Department of Health Impact Assessment on standardised packaging⁸ (paragraph 90), “On the assumption that all cigarette packets cost broadly the same to produce, the difference in profit between a pack of 20 in one of the top two price brands as opposed to the bottom two price brands is around £0.65.”

We consider it likely that the effect of standardised packaging over time will be to reduce the differential in retail prices between “luxury” and “economy” brands. We assume that the likely result will be retail prices converging on what is now the average price level.

The research paper written by Howard Reed, Landman Economics⁹, includes the following table on the impact of a tobacco levy intended to raise £500 million each year for five years, assuming that standardised packaging is introduced (see Table 2 below).

As Table 2 shows, there is only a marginal difference in the levy per stick required if either none of the levy or all of the levy is assumed to be passed on to the consumer in the retail price (1.24 pence per stick compared to 1.25 pence per stick in year one). These calculations suggest that over three quarters of annual revenue raised through the levy would come from cigarette sales, with the remainder coming from HRT and other tobacco sales.

Table 2: Size of tobacco levy required to raise £500 million per year – results, including impact of introducing standardised packaging

All figures in pence

	2015-16	2016-17	2017-18	2018-19	2019-20
Scenario (a): No pass through					
Adult smoking prevalence (%)	17.6	16.7	15.9	15.3	14.7
Cigarette levy (pence per stick)	1.24	1.29	1.34	1.38	1.42
Cigarette levy (per packet of 20)	24.7	25.7	26.8	27.6	28.4
HRT levy (per gramme of tobacco)	1.65	1.72	1.79	1.84	1.89
HRT levy (per 25g packet)	41.2	42.9	44.7	46.0	47.3
Scenario (b): Full pass through					
Adult smoking prevalence (%)	17.4	16.5	15.6	15.1	14.5
Cigarette levy (pence per stick)	1.25	1.30	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.0	26.0	27.1	27.9	28.7
HRT levy (per gramme of tobacco)	1.67	1.74	1.81	1.86	1.92
HRT levy (per 25g packet)	41.7	43.4	45.2	46.5	47.9

The price of tobacco has increased by 80.2% over the last ten years from 2003 to 2013. Using mid-year tobacco prices and average annual earnings net of bonuses, Professor Joy Townsend of the Department of Social and Environmental Health Research at the London School of Hygiene and Tropical Medicine has produced the following “affordability index” for tobacco products (1965 as base year, higher figures indicate greater affordability):¹⁰

Affordability Index: Tobacco Products

Above 100 means more affordable, below means less affordable.

1965	100
1980	189
1989	196
1990	185
1995	164
2000	153
2005	157
2006	157
2007	155
2008	154
2009	150
2010	165
2011	130
2012	123
2013	115

This calculation suggests that while rises in tobacco taxation have reduced affordability substantially since the late 1980s, there remains considerable scope to reduce affordability further through any price rises that may occur if the industry passes levy costs through to the consumer. Price increases are known to be an effective policy lever in reducing smoking prevalence but they need to be accompanied by a comprehensive strategy.

During the 1990s when affordability declined consistently year on year in the UK smoking prevalence did not, it remained stubbornly high with over one in four of the adult population smoking. It only began to fall after Smoking Kills, the first comprehensive government anti-smoking strategy was introduced from 1999 onwards. In the decade following the introduction of the government strategy smoking rates fell by a quarter from 28% to 21% among all adults and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.¹¹ In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved^{12, 13}, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.

The tobacco market is heavily concentrated with two companies accounting for nearly 80% of sales of tobacco in the UK, Imperial Tobacco and JTI with British American Tobacco and Philip Morris accounting for most of the rest. Recent research by Branston and Gilmore at the University of Bath suggests that the industry has made at least £1 billion in profits in each of the last 5 years, that this profitability has been increasing during the period of analysis, and that the profitability is likely to be in the region of £1.5bn in recent years. Tobacco manufacturers and importers are also found to enjoy consistently high profit margins of up to 68%, compared to only 15-20% in most consumer staple industries.

Question 11: The government welcomes views on an alternative to a levy that would enable tobacco manufacturers and importers to make a greater contribution.

We consider that a levy on tobacco products, with a revenue target per year fixed over five years, is the best policy option at the current time to raise funds for essential tobacco control and enforcement work.

However, market failure has given the existing tobacco manufacturers the ability to set prices untroubled by serious competitive threats. In addition, high taxes mean that tobacco industry profits are a small part of the total price. Consequently, significant increases in the pre-tax price make little difference to the price paid by consumers in shops, enabling the industry to increase the price of (and thus profits from) its addictive, price-inelastic product almost at will. Recent evidence from the UK, also suggests the industry is able to absorb taxes on its cheapest cigarette brands (sometimes selling these brands at a loss) by increasing prices and profits on its more expensive brands.¹⁴

Placing a cap on industry profits would enable the excess profit to be transferred from the manufacturer to government, thus raising substantial resources in addition to the current tobacco excise revenues, without placing further burdens on consumers. It would also prevent the industry from absorbing increased taxes on the cheapest brands thereby undermining government tax policy. The means by which this could be achieved is set out in the paper by Gilmore et al.⁴ It is our understanding that this would require revisions to the EU Tobacco Tax Directive, in particular Article 15, and we urge HM Treasury to advocate for the necessary changes when the Directive is next revised.

Tobacco is a unique consumer product, because it is highly addictive and because a half of lifetime smokers will die from smoking-related disease, including respiratory diseases, circulatory diseases and cancer. About half of all lifelong smokers will die prematurely, losing on average about 10 years of life. This tragic burden of illness and death justifies measures to raise additional funds from large and highly profitable tobacco manufacturers,

assuming that sufficient of such funds are used to support evidence-based policy initiatives designed to reduce smoking prevalence by encouraging quitting and discouraging uptake.

References

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- 4 Gilmore A, Branston JR, and Sweanor D. The case for OFSMOKE: how tobacco price regulation is needed to promote the health of markets, government revenue and the public. *Tobacco Control* 2010 19: 423-430
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- 6 HM Revenue and Customs: Tobacco Bulletin, August 2014
- 7 Joossens, L., Lugo, A., La Vecchia, C., Gilmore, A. B., Clancy, L. and Gallus, S., 2012 Illicit cigarettes and hand-rolled tobacco in 18 European countries: a cross-sectional survey *Tobacco Control*, Online First.
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- 10 Communication with Action on Smoking and Health, 14 January 2015
- 11 Smoking drinking and drug use among young people in England in 2013. The Information Centre for Health and Social Care, 2014
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