



HM Treasury

# **Tobacco levy:**

## response to the consultation

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September 2015





HM Treasury

# Tobacco levy: response to the consultation

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September 2015



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# Summary and DEFRA review

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## Summary

As announced in Summer Budget 2015, the government has decided not to introduce a levy on tobacco manufacturers and importers.

Consultation responses were broadly divided along two lines. Tobacco manufacturers and importers and business groups strongly opposed the introduction of a levy, arguing that a levy would have posed an administrative burden and would have been passed on to consumers. Public health groups were strongly in favour of introducing a levy, wanting funds raised to be ring-fenced for smoking prevention measures.

Analysis of the responses shows that the impact of a levy on the tobacco market would be similar to a duty rise, as tobacco manufacturers and importers would pass the costs of a levy on to consumers. This is supported by HMRC analysis which shows that a levy of £150 million would only raise £25 million after behavioural effects. The methodology used to calculate the impact of a levy was reviewed and verified by Ulrike Hotopp, the Chief Economist at the Department of Environment, Food and Rural Affairs. This review is included below (p.7), along with HMRC's costing methodology (p.6).

Given that a tobacco levy would have a similar effect to a duty rise the government also considered the fact that tobacco duties have already increased this year and, through the duty escalator, will continue to increase by 2% more than inflation in each year of this Parliament. In addition, the government is already making significant interventions on tobacco to protect public health by; introducing standardised packaging, legislating to implement the revised Tobacco Products Directive, banning smoking in cars with children and prosecuting adults for proxy purchases for under 18s.

## Tobacco Levy analysis

### Policy description

The Tobacco Levy would be a new direct tax on tobacco manufacturers and importers. It would work by setting a target amount of revenue, assumed to be £150m, which would then be apportioned to each company on the basis of their market share. Legally, the Tobacco Levy would be a direct tax, as traders would be liable for the tax. Economically, it would be entirely equivalent to an increase in the specific tax that currently exists on tobacco products.

### Estimating the static yield

The Tobacco Levy works by setting a target amount of revenue. The static costing is therefore simply the target amount of revenue (assuming full compliance). Given the time needed to consult on and implement a new HMRC system, the earliest the Tobacco Levy could be collected from is 2017-18.

All figures £m	2015-16	2016-17	2017-18	2018-19	2019-20
Tobacco Levy	-	-	+150	+150	+150
Tobacco Duties	-	-	nil	nil	nil
<b>Static costing</b>	<b>-</b>	<b>-</b>	<b>+150</b>	<b>+150</b>	<b>+150</b>

### Estimating the post-behavioural yield

Evidence from the consultation, supported by evidence from changes to tobacco duties in recent years, was clear that manufacturers and importers would pay for the levy by fully passing on the Levy to consumers by raising retail prices.

Higher prices lead to reductions in consumption of duty-paid tobacco and further switching to lower priced products. This reduces revenue from existing tobacco duties. Tax makes up a large proportion of tobacco prices, leading to large behavioural effects that almost completely offset the revenue raised by the Levy.

All figures £m	2015-16	2016-17	2017-18	2018-19	2019-20
Tobacco Levy	-	-	+150	+150	+150
Tobacco Duties	-	-	-125	-125	-125
<b>Post-behavioural costing</b>	<b>-</b>	<b>-</b>	<b>+25</b>	<b>+25</b>	<b>+25</b>

30 June 2015



**Edward Troup**  
**Second Permanent Secretary and**  
**Tax Assurance Commissioner**

100 Parliament Street  
London  
SW1A 2BQ

Ulrike Hotopp  
Chief Economist, Defra

**Tel:**

**Email**

Dear Ulrike,

The government launched a consultation on whether to introduce a levy on tobacco firms at Autumn Statement 2014. This was supported by a further informal consultation after Spring Budget 2014. The consultation responses have shown divergent views on the overall impact a tobacco levy would have on the public finances. We have discussed with Ministers and agree that the government should have a robust evidence base before taking a decision on whether to proceed with a tobacco levy.

Accordingly, we would welcome it if you could undertake a review of methodology used by HMRC to assess the impact of a tobacco levy on the public finances. We would appreciate if you could provide your opinion (in the form of a letter) on whether you consider HMRC's approach to modelling the impact of a tobacco levy on the public finances is appropriate or whether any changes need to be made.

You will have access to all the consultation responses, HMRC tobacco model, HMRC's modelling to date and any other information that HMRC holds that you consider necessary (subject to any taxpayer confidentiality restrictions). HM Treasury and HMRC officials will also be available to you to answer any questions that you may have.

I would like to thank you in advance for your work on this matter.

Yours sincerely,

A handwritten signature in blue ink that reads "Edward Troup".

**Edward Troup**  
**Second Permanent Secretary and Tax Assurance Commissioner**

cc  
Bronwyn Hill, Permanent Secretary, Defra  
Jonathan Athow, KAI Director  
Lin Homer, Chief Executive, HM Revenue & Customs

7 July 2015

Dear Edward,

You formally asked Defra to undertake a review of the methodology used by HMRC to assess the impact of the proposed tobacco levy on the public finances and in particular to provide our opinion (in the form of a letter) on whether we considered HMRC's approach to the modelling of the impact of the tobacco levy on the public finances as appropriate or whether any changes needed to be made.

A Defra senior economist has reviewed HMRC's assessment and has also met with relevant HMRC and Treasury officials, in addition to having email correspondence with HMRC officials leading the assessment. Based on this review and discussions, and the applications of economic theory and evidence, we believe that HMRC's assessment is reasonable and appropriate. In particular, we believe that the crucial assumption that a significant proportion of the levy will be passed-on to consumers in the form of higher tobacco product prices is reasonable.

The attached document sets out Defra's review. We are of course happy to discuss with HMRC officials any of the points raised in the review in more detail should you think this necessary.

Yours sincerely,

Ulrike Hotopp

## Defra's review of HMRC's analysis of the impact of proposed tobacco levy

### Background

HMRC asked, via Defra's chief economist, whether Defra could review HMRC's analysis of the proposed tobacco Levy on tobacco companies and in particular review HMRC's methodology to assess the impact of the levy on the public finances. How the levy is likely to impact on the public finances is most importantly dependent on the assumption about the extent to which the levy is likely to be passed on to tobacco consumers in the form higher cigarette and tobacco product prices. If the levy is not passed on in higher prices then overall tax revenues from the sector are expected to be higher. However, if the levy is passed-on consumption of legally traded tobacco products in the UK and tax revenues from tobacco are expected to fall. This note sets out Defra's review of HMRC's analysis and in particular the extent to which this crucial assumption is appropriate.

A senior Defra economist has reviewed HMRC's analytical note containing the methodology, assumptions and background evidence. The economist also met with HMRC and Treasury officials to discuss the analysis and has had email correspondence to clarify some assumptions and to obtain additional evidence. The underlying modelling was also made available to Defra but given it has been internally quality assured and the Tobacco Duties costing model has been assessed by OBR, Defra did not feel it necessary to QA the modelling. The review was carried out over one day.

The tobacco levy proposal is to place a levy on major tobacco companies supplying to the UK market. The amount of the levy falling on any one company will depend on that company's market share and the total revenue government wants to raise from the levy in that year. The higher the market share, the greater the proportion of the levy paid by that firm. The levy is expected to be on-going and paid by almost the whole sector<sup>1</sup>.

### Analysis

In assessing how tobacco companies are likely to respond to the new tobacco levy two sources of evidence should be considered: economic theory and empirical evidence.

**Price elasticity of demand:** Economic theory explains that in order to maximise profits businesses will look to pass on as much of a tax to consumers as possible. The extent to which a goods tax can be passed on is determined most crucially by the price elasticity of demand. That is, the more inelastic demand the greater the proportion of a tax falling on the consumer. In the extreme case, if demand is perfectly inelastic then the whole of the tax will fall on the consumer. By contrast, the more elastic demand the greater the proportion of the tax falling on the supplier.

HMRC evidence suggests that the short-run price elasticity of demand for tobacco products is -0.57. This suggests that over the short-term demand is relatively inelastic and firms will be able to pass on a large proportion of any additional cost/tax to consumers should they wish to. HMRC data also shows that tobacco companies have passed on 100% or more of previous tobacco duty rate increases<sup>2</sup>.

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<sup>1</sup> More details of the exact proposal can be found in the HMRC analysis paper and consultation document.

<sup>2</sup> HMRC analysis paper.

One could argue that since the levy is not a duty on tobacco products tobacco companies are more likely to absorb the levy rather than pass on to consumers. However, in a capital economy firms are expected to make a return for shareholders. A tax which cannot be passed on will reduce returns and depress market value. Firms will look avoid this outcome and maintain returns. The easiest way to do this would be to pass on a significant portion of the levy to consumers. Over the longer term firms will also look to reduce costs to maintain profitability and returns. We have not reviewed the rate of return on to the tobacco sector but such a review would provide some indication of the ability and willingness of the sector to absorb the levy.

One factor that usually prevents firms from passing on an increase in their costs to consumers is the fear of losing market share. This is a limited risk in the case of the levy as the levy applies to all major players in the market and each player will have a good estimate of how much competitors are paying. In this respect the levy can be seen, and is likely to be viewed by tobacco companies, as an increase in the general cost of all firms in the sector, such as an increase in energy costs. We would expect such general sector-wide cost increases usually result in higher consumer prices<sup>3</sup>. Although time limitations did not enable us to review the literature on the extent the which a general increase in costs apply to the whole sector is passed on in higher prices, HMRC evidence on for example the Climate Change Levy assumes that 100% of the levy applying to the whole sector is passed on to consumers<sup>4</sup>.

As set out above, fear of losing market share is likely to limit the extent to which firms increase prices. Given that the levy will apply to all major producers in the market this fear is likely to be very small, if existent at all. One would also expect tobacco companies to be concerned by the loss of customers to the illicit and cross border markets as they increase prices. The extent to which they will be concerned about this loss will depend to a large degree on the extent to which they also supply the illicit and cross border markets. If they do supply these markets and profits per unit in the illicit, cross border and UK markets are similar, then one can imagine that tobacco companies are likely to be indifferent about which market UK consumers purchase their tobacco products from. Defra have not assessed the extent to which the major tobacco companies supplying to the UK also supply to these other markets.

**Marginal costs and profit maximisation:** economic theory suggests that a profit maximising firm should operate where marginal cost is equal to marginal revenue and since the tobacco levy does not affect marginal cost it should not impact on how much the firm produces and sells to the UK market, or the price it charges. This is a valid argument and one would expect it to hold if firms in the sector operated where marginal cost equals marginal revenue. Should this be the case, and given HMRC evidence suggests that the levy would result in losses, then one would expect that firms would accept losses over the shorter term but as some firms exit the market and market share and marginal revenue of those remaining increases, firms would return to profit over the longer term. Given the structure of the tobacco market this seems an unlikely scenario<sup>5</sup>. Moreover, given firms in the sector are price makers rather than takers they are free to set prices to achieve objectives other than profit maximisation, e.g. market share. Defra have not assessed whether tobacco firms operate where  $MC=MR$  and this evidence is not included in the HMRC analysis.

## Conclusion

Having assessed HMRC's analysis of how the proposed tobacco levy is likely to affect the sector, considered the empirical evidence on how tobacco firms have responded to previous duty rates and applied economic theory, as set out above, we conclude that the assumptions in HMRC's analysis are reasonable and appropriate. In particular, we conclude that the assumption that

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<sup>3</sup> Defra have not reviewed the literature on the extent to which this is the case or over that time period.

<sup>4</sup> Email correspondence with HMRC, although we expect that this will be referenced in public documents on the CCL.

<sup>5</sup> The tobacco sector is characterised by a few large companies holding large market share

tobacco firms are likely to pass on a significant proportion of the levy to consumers in the form of higher tobacco prices as being reasonable. Having concluded this, we believe that the impact on the public finances as set out in the costing explanatory note is also reasonable.



# 2 Consultation responses

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## 2.1 Association of Directors of Public Health



*Association of Directors of Public Health (UK)*

### The Association of Directors of Public Health Submission to the HM Treasury Tobacco Levy Consultation

#### Overview

The Association of Directors of Public Health (ADPH) is the representative body for Directors of Public Health (DsPH) in the UK. It seeks to improve and protect the health of the population through DPH development, sharing good practice, and policy and advocacy programmes. Directors of Public Health (DsPH) are the frontline leaders of public health working across health improvement, health protection, and health care service planning and commissioning. ADPH has a strong track record of collaboration with other stakeholders in public health, including those working within the NHS, local authorities, government and other sectors.

**Please note:** Many of the sources provided within our response have been provided by Action on Smoking and Health (ASH). This document is also informed by a research report for ASH by Howard Reed, Landman Economics, *"A UK Tobacco Levy: The options for raising £500 million per year"* (February 2015).

#### General Observations

##### Summary

1. ADPH 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."*<sup>1</sup>
2. In our 2014 survey of UK Directors of Public Health, 92% of the Directors of Public Health who responded identified the reinstatement of the tax escalator on all tobacco products (at 5% and 2% pa ahead of inflation respectively) as part of their top ten priority issues.

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<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

3. ADPH has previously submitted detailed responses to a range of consultation exercises related to tobacco control measures – consistently calling for governments to implement evidence-based national action to:
  - reduce the harm and health inequalities caused by tobacco – particularly in the most deprived communities;
  - reduce the burden of premature death and disability caused by tobacco;
  - protect the future health of children in the UK (in light of the 200,000-plus children in the UK who take up smoking each year).
4. ADPH is a member of the Smokefree Action Coalition – a group of more than 190 organisations - committed to promoting public health and reducing the harm caused by tobacco. <http://www.smokefreeaction.org.uk/>
5. 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. 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.
6. 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.<sup>2</sup> 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.
7. 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.
8. 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

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<sup>2</sup> EU Tobacco Tax Directive Article 15.

to the consumer, so fulfilling the objective of ensuring that the industry pays a greater contribution to the costs it imposes on society.<sup>3 4</sup>

## Background

9. Action on Smoking and Health have estimated that the total cost of smoking to society in England alone is approximately £12.9 billion a year.<sup>5</sup> This is likely to be an under-estimate as only costs where data is attributable have been included. For example it did not include the cost of collecting smoking-related litter. The following costs are included:
  - £2 billion cost to the NHS of treating diseases caused by smoking
  - £3 billion loss in productivity due to premature death
  - £5 billion cost to businesses of smoking breaks
  - £1 billion cost of smoking-related sick days
  - £1.1 billion of social care costs of older smokers
  - £391 million cost of fires caused by smokers' materials
10. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs, both to the smoker and their loved ones, due to the death and disease caused by tobacco.
11. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated Fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>6</sup>
12. The Tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution<sup>7</sup>. And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries, such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>8</sup>
13. Fewer than one in five adults now smoke, but smoking prevalence rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far

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<sup>3</sup> 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

<sup>4</sup> Branston R, Gilmore A. The case for OFSMOKE: the potential for price cap regulation of tobacco to raise £500 million per year in the UK. Tobacco Control January 2013.

<sup>5</sup> ASH Ready Reckoner. ASH and LeLan Solutions, Sept. 2014

<sup>6</sup> *ibid*

<sup>7</sup> Branston JR, and Gilmore A (2014). The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. Tob control 23(1):45-50

<sup>8</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes.<sup>9</sup>

14. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>10</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
15. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to increase the rate of quitting tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers and popular both with smokers and the general public, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
16. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:  
*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*  
  
*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*  
  
*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation..."*<sup>11</sup>
17. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
18. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the shortterm,

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<sup>9</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>10</sup> The World Bank. *Curbing the epidemic: governments and the economics of tobacco control*. May, 1999.

<sup>11</sup> [NHS: Five Year Forward View](#) NHS England, October 2014

entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.

19. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
20. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, *"The Health Consequences of Smoking – 50 Years of Progress"*, reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."* The Report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."*<sup>12</sup>
21. In reducing smoking prevalence rates in the UK, an essential role is played by tobacco control measures carried out by local authorities, for example the stop smoking services. The Department of Health document *"Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12"* stated that: *"Stop smoking services are a key part of tobacco control and health inequalities ... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers."*<sup>13</sup>
22. Although there are grounds for concern about how many people are being reached by stop smoking services, good evidence regarding the cost effectiveness of tobacco control interventions, including stop smoking services, and a levy will ensure investment at a scale that could make a smoke-free generation a reality and will guarantee smoking prevalence continues to decrease.
23. Although the level of illicit trade has fallen sharply since 2000, it remains unacceptably high and the latest figures from HM Revenue and Customs suggest that it has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>14</sup> Detailed recommendations on how to improve action against illicit trade have been made

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<sup>12</sup> U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

<sup>13</sup> [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

<sup>14</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

by both the National Audit Office<sup>15</sup> and the House of Commons Home Affairs Select Committee<sup>16</sup>. ADPH strongly supports these recommendations, which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.

24. Mass media and social marketing campaigns can also be highly effective in stimulate quitting behaviour, but require significant investment in order to be most effective.<sup>17</sup><sup>18</sup>  
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25. We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help fund a comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost no more than £500 million a year, and would include key measures such as:

- supporting tobacco control measures at regional and local level, for example to fund action against the illicit tobacco trade outside of HMRC;
- ensuring the provision of high quality Stop Smoking Services across the country; and
- financing mass media and social marketing campaigns, which add value to other tobacco control initiatives.

26. ADPH would recommend that the levy also be used towards supporting interventions known to be effective in comprehensive tobacco control. By supporting effective interventions, this will lead to reduced prevalence of tobacco use and ultimately a smoke-free generation.

27. We also strongly suggest that this portion of the levy be established along similar lines to the US “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence, completely independent from any influence by the tobacco industry. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “*establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control*”.

28. It should be noted that as of March 31, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or

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<sup>15</sup> [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

<sup>16</sup> [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

<sup>17</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450. <sup>18</sup>

Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction*, <sup>18</sup> (11), 2043-2050

<sup>19</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun; 109(6):986-94.

just over half a billion dollars, has been spent on public education, \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>20</sup>

## Answers to Consultation Questions

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

29. 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?

### Response to Questions 2 and 3 below

30. 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.

31. “*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.<sup>21</sup>

32. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult, and, crucially, would also ensure the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local consumption and prevalence levels and the consequent harm caused. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and

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<sup>20</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

<sup>21</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>22 23</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a “*unique identifier*” that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.

33. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

**Table 1: Suggested allocation of revenue from tobacco levy across the countries of the UK**

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

34. In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

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

<sup>22</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>23</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

35. As human rolled tobacco 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 human rolled tobacco would be set based on an assumption about the weight of tobacco in a typical hand rolled cigarette.

36. 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 human rolled tobacco)

37. A recent study of human rolled tobacco consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>24</sup> This is the basis on which we have calculated the levy on human rolled tobacco 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?

38. For the reasons stated in paragraphs 16 to 19 above, 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?

#### **Response to Questions 6 and 7 below**

39. We support the use of the corporation tax system to collect the levy, as the system that would impose the least 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.

40. We are unaware of a plausible alternative means for collecting the levy.

**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?

#### **Response to Questions 8, 9 and 10 below.**

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

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<sup>24</sup> 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.](#)

- 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.

42. According to the Department of Health Impact Assessment on standardised packaging <sup>25</sup> (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.”*

43. 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.

44. The research paper, *“A UK Tobacco Levy: The options for raising £500 million per year”*, written by Howard Reed, Landman Economics, provides a table which illustrates 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).

45. 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
<b>Scenario (a): No pass through</b>					
<b>Adult smoking prevalence (%)</b>	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
<b>Scenario (b): Full pass through</b>					
<b>Adult smoking prevalence (%)</b>	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

<sup>25</sup> [Impact assessment: standardised packaging of tobacco products](#): Department of Health June 2014

46. 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):<sup>26</sup>

#### **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

47. 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.
48. 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 antismoking 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<sup>27</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>28</sup> In subsequent years with new policy measures regularly being introduced and the government’s tobacco control strategy having been updated and improved<sup>29 30</sup>, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.

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<sup>26</sup> Communication with Action on Smoking and Health, 14 January 2015

<sup>27</sup> Office for National Statistics. General Lifestyle Survey Overview: A report on the 2011 General Lifestyle Survey. 2013.

<sup>28</sup> Smoking drinking and drug use among young people in England in 2013. The Information Centre for Health and Social Care, 2014.

<sup>29</sup> DH. [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

<sup>30</sup> DH [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

49. The tobacco market is heavily concentrated with two companies accounting for nearly 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products. **Error! Bookmark not defined.** Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits of the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>31</sup> It is therefore clear that the tobacco industry could well afford to pay the proposed levy.

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

50. 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.

51. 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.<sup>32</sup>

52. 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 attached paper by Gilmore et al.<sup>3</sup> 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.

53. 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.

The Association of Directors of Public Health  
February 2015

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<sup>31</sup> BAT Annual Report 2013

<sup>32</sup> Gilmore A, Tavakoly B, Taylor G, Reed H. Understanding tobacco industry pricing strategy and whether it undermines tobacco tax policy: the example of the British cigarette market. *Addiction*

## 2.2 Private individual response

16th February 2015

Tobacco Levy Consultation  
VAT and Excise  
HM Treasury

Ladies and Gentlemen

I am an individual responding to your consultation.

Question 1: The tobacco market clearly consists of tobacco products on which tobacco excise duty, illegally, is not paid as well as tobacco products on which tobacco excise duty is paid. The Tobacco Levy currently being contemplated undoubtedly would increase the size of the non-duty-paid tobacco market at the expense of the duty-paid market.

Question 2: Calculating total market size based on volumes of tobacco cleared would fail to take account of the considerable volumes of non-duty-paid tobacco consumed in the UK each year.

Question 3: An estimate should be made of the total size of consumption. Doing so would reveal the extent to which existing rates of duty have given rise to a flourishing illicit tobacco trade in the UK, to the detriment of legitimate manufacturers, importers and retailers. To add another levy to the legitimate industry would expand the consumer appeal of the illicit trade, to the further detriment of Treasury revenues, public health, and the legitimate trade.

Question 4: There are at least three distinct parts of the total market: factory-made cigarettes, make-your-own tobacco and roll-your-own tobacco.

Question 5: The preferred option is not to have an additional Tobacco Levy.

Question 6: The corporation tax system is not the best mechanism for collecting a levy that inevitably will fall on law-abiding smokers in the UK.

Question 7: The best alternative is not to proceed with a Tobacco Levy.

Question 8: A Tobacco Levy would increase the retail price of tobacco products in the legitimate trade and enhance the price competitiveness of the illicit trade.

Question 9: A Tobacco Levy would be a regressive tax, falling disproportionately on law-abiding smokers on low incomes. A Tobacco Levy would stimulate tobacco consumption by driving down the cost of smoking for consumers switching their custom from the legitimate trade to the illicit trade. A growing illicit trade would increase the availability of affordable tobacco products to children.

Question 10: By singling out an already highly-taxed and regulated activity for further political interference, a Tobacco Levy would further erode the UK's reputation for fair dealings between government and business, while giving criminals a strong incentive to displace legitimate business and encouraging consumers to switch their custom from the legitimate to the illicit trade.

Question 11: Simply because "The government believes it is right that tobacco manufacturers and importers make a greater contribution to the societal costs of smoking" does not make it right. By way of the duty and VAT they already pay, UK smokers more than cover the costs to the government of smoking-related health problems. By reducing their life expectancy, law-abiding UK smokers, on average, spare the government the pension, health-care, and elderly care expenses they would otherwise be entitled to expect the government to cover. Meanwhile, the legitimate tobacco industry is competing to develop products capable of delivering to consumers the nicotine they value without the harmful ingredients associated with burning tobacco. The government would be wise to leave well enough alone.

Yours faithfully,

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## 2.3 Action on Smoking and Health Northern Ireland

### HM Treasury Consultation

## Tobacco Tax Levy (closing date 18<sup>th</sup> February 2015)

### Response from Action on Smoking and Health Northern Ireland

Action on Smoking and Health (Northern Ireland) (ASH NI) is a health charity set up by the Ulster Cancer Foundation in 1973 working towards the elimination of harm caused by tobacco. ASH NI does not have any direct or indirect links to, or receive funding from, the tobacco industry.

### General Observations

#### Summary

1. ASH NI 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."*<sup>1</sup>
2. Tobacco manufacturers and importers in the UK are immensely profitable, such that it could certainly afford to make a greater contribution. Recent research by Branston and Gilmore at the University of Bath suggests that in the UK 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.
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.<sup>2</sup> 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.

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<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

<sup>2</sup> EU Tobacco Tax Directive Article 15.

5. The EU Tobacco Tax Directive is due for review shortly. We recommend that the UK government advocate for revisions which would enable the introduction of a price capping mechanism. Placing a cap on industry profit 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.<sup>3</sup>

## Background

6. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year.<sup>4</sup> This is likely to be an under-estimate as only costs where data is attributable have been included. For example it did not include the cost of collecting smoking-related litter. The following costs are included:
  - £2 billion cost to the NHS of treating diseases caused by smoking
  - £3 billion loss in productivity due to premature death
  - £5 billion cost to businesses of smoking breaks
  - £1 billion cost of smoking-related sick days
  - £1.1 billion of social care costs of older smokers
  - £391 million cost of fires caused by smokers' materials
7. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
8. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated Fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>5</sup>
9. The tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution.<sup>3</sup> <sup>6</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but in 2002 the World Bank estimated that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>7</sup> A comprehensive review of the literature published since this date by IARC in 2011

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<sup>3</sup> 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

<sup>4</sup> [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

<sup>5</sup> *ibid*

<sup>6</sup> Branston JR and Gilmore A. The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tobacco Control* 2014; 23(1): 45-50

<sup>7</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

concludes that based on aggregate demand studies, price elasticity remains around -0.4 in high income countries including the UK.<sup>8</sup>

10. There is widespread support in England for the idea of putting the equivalent in today's prices of 25 pence on a packet of cigarettes with the funds being used to fund tobacco control; 78% of the adult population is in favour of the idea including 54% of those in Social Grade E ('unemployed, on state benefit and lowest grade workers') who had smoked in the past year and 52% of these who were smoking at the time of the survey.<sup>9</sup> This could raise around £500 million (see table 1 below). Similar support is found in surveys across Europe.<sup>10</sup>
11. Fewer than one in five adults now smoke, but smoking prevalence rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes.<sup>11</sup>
12. Poorer smokers are more sensitive to price increases than better off smokers. So, increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>12</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
13. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to increase the rate of quitting tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers and popular both with smokers and the general public, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
14. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:  
*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*  
  
*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*  
  
*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to*

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<sup>8</sup> International Agency for Research on Cancer. IARC Handbooks of Cancer Prevention. Tobacco Control Volume 14. Effectiveness of Tax and Price Policies for Tobacco Control. Lyons: IARC, 2011

<sup>9</sup> West R. Public support for a tobacco levy. Smoking Toolkit Study. 2006

<sup>10</sup> [Policy Recommendations for Tobacco Taxation in the European Union. Integrated research findings from the PPACTE project. 2012](#)

<sup>11</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>12</sup> The World Bank. Curbing the epidemic: governments and the economics of tobacco control. May, 1999.

*include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation...*"<sup>13</sup>

15. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
16. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short-term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products. However, in line with our obligations as a party to the WHO FCTC and in particular Article 5.3, the tobacco industry could have no control over this money, or how it should be allocated.<sup>14</sup>
17. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity.<sup>15</sup> This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
18. International evidence shows that public investment in policies designed to reduce smoking prevalence is likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, "The Health Consequences of Smoking – 50 Years of Progress", reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."* The Report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."*<sup>16</sup>
19. In reducing smoking prevalence rates in the UK, an essential role is played by tobacco control measures, for example the stop smoking services. The Department of Health document "Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12" stated that: *"Stop smoking services are a key part of tobacco control and health inequalities ... Evidence-based stop smoking support is highly effective both in cost and*

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<sup>13</sup> [NHS: Five Year Forward View](#) NHS England, October 2014

<sup>14</sup> WHO FCTC. Article 5.3 guidelines.

<sup>15</sup> [Family Smoking Prevention and Tobacco Control and Federal Retirement Reform](#). 123 Stat. 1776 Public Law 111–31—June 22, 2009. Section 919 user fees.

<sup>16</sup> U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

*clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers.*"<sup>17</sup>

20. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about how many people are being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13.
21. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs, much of the direct savings they deliver accrue mainly to the NHS and not to those who pay for the services. This point also applies to local action by trading standards officers and others to reduce the scale of the illicit tobacco trade. The Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.
22. Although the level of illicit trade has fallen sharply since 2000, it remains unacceptably high and the latest figures from HM Revenue and Customs suggest that it has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>18</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>19</sup> and the House of Commons Home Affairs Select Committee.<sup>20</sup> ASH NI strongly supports these recommendations which include specific recommendations on increasing local and regional action against illicit trade.
23. Mass media and social marketing campaigns can also be highly effective in stimulating quitting behaviour but require significant investment in order to be most effective.<sup>21 22 23</sup>
24. We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help fund a comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost no more than £500 million a year, and would include key measures such as:
  - supporting tobacco control measures at regional and local level, for example to fund action against the illicit tobacco trade outside of HMRC;

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<sup>17</sup> [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

<sup>18</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

<sup>19</sup> [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

<sup>20</sup> [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

<sup>21</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>22</sup> Langley T, McNeill A, Lewis S, Szatkowski L, Quinn C. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction* 2012;107(11): 2043-2050

<sup>23</sup> Sims M, Salway R, Langley T, Lewis S, McNeill A, Szatkowski L, Gilmore A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014; 109(6): 986-94.

- ensuring the provision of high quality Stop Smoking Services across the country; and
  - financing mass media and social marketing campaigns, which add value to other tobacco control initiatives.
25. We would also strongly suggest that this portion of the levy be established along similar lines to the US “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence, completely independent from any influence by the tobacco industry. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control”.
26. It should be noted that as of 31<sup>st</sup> March 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education and \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>24</sup>

## Answers to Consultation Questions

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

27. 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?

28. 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.

29. “*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

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<sup>24</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

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.<sup>25</sup>

30. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes and prices by brands, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult, and, crucially, would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local consumption and prevalence levels and the consequent harm caused. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>26 27</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a "unique identifier" that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.
31. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

**Table 1: Suggested allocation of revenue from tobacco levy across the countries of the UK**

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from 2013 Integrated Household Survey. Adult population totals in each country: mid-2013 estimates.

32. In summary, we recommend that:
- Previous year clearance data be used as the basis on which to raise the levy in year one.
  - The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in

<sup>25</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

<sup>26</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>27</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.

- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

33. 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.

34. 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)

35. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>28</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 43 below.

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

36. For the reasons stated in paragraphs 28 to 30 above, 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?

37. 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 control of tobacco industry* could not be used to reduce liability for corporation tax. Should corporation tax rates be devolved it will be important that this doesn't allow the tobacco industry to reduce its contribution in any of the devolved regions or countries.

38. 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.

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<sup>28</sup> Joossens L, Lugo A, La Vecchia C, Gilmore A, Clancy, L and Gallus S. 2012 [Illicit cigarettes and hand-rolled tobacco in 18 European countries: a cross-sectional survey Tobacco Control, Online First.](#)

**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?

39. 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.

40. According to the Department of Health Impact Assessment on standardised packaging <sup>29</sup> (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.”*

41. 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.

42. The research paper attached to this consultation response written by Howard Reed, Landman Economics, 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).

43. 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.

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<sup>29</sup> [Impact assessment: standardised packaging of tobacco products](#): Department of Health June 2014

**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
<b>Scenario (a): No pass through</b>					
<b>Adult smoking prevalence (%)</b>	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
<b>Scenario (b): Full pass through</b>					
<b>Adult smoking prevalence (%)</b>	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

44. 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):<sup>30</sup>

#### **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

45. 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.

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<sup>30</sup> Communication with Action on Smoking and Health, 14 January 2015

46. 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<sup>31</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>32</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved,<sup>33 34</sup> smoking rates have continued to decline so that fewer than one in five adults now smoke and only 3% of 11-15 year olds.
47. Two companies: Imperial Tobacco and JTI account for around 80% of sales of tobacco in the UK. Both make large profits and have very large profit margins on their products.<sup>6</sup> Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits in the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>35</sup> It is therefore clear that the tobacco industry could well afford to pay the proposed levy.

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

48. 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.
49. 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.<sup>36</sup>
50. 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 attached paper by Gilmore et al.<sup>3</sup> It is our understanding that this would require revisions

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<sup>31</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

<sup>32</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>33</sup> [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

<sup>34</sup> [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

<sup>35</sup> BAT Annual Report 2013

<sup>36</sup> Gilmore A, Tavakoly B, Taylor G, Reed H. Understanding tobacco industry pricing strategy and whether it undermines tobacco tax policy. The example of the UK cigarette market. *Addiction* 108; (7): 1317-1326.

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.

51. 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.



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13 February 2015

Tobacco Levy Consultation  
VAT and Excise  
HM Treasury  
1 Horse Guards Road  
LONDON  
SW1A 2HQ

Dear Chancellor

### Consultation on a tobacco levy

The Association of North East Councils is the representative body for local government in the North East. It encompasses all 12 local authorities in the region throughout Northumberland, Tyne and Wear, Durham and the Tees Valley on issues of concern to them and the communities they serve. It is a cross-party organisation, with all of its members democratically elected and accountable politicians, and its Leaders and Elected Mayor's Group provide the overarching governance for Fresh, the North East comprehensive tobacco control programme.

Fresh co-ordinates the Making Smoking History in the North East Partnership, of which the Association is a strategic partner, and together they share the vision of reducing smoking prevalence in the North East to 5% by 2025.

### Supporting the principle of a tobacco levy

We welcome the consultation from HM Treasury on the proposal to introduce a levy on tobacco manufacturers and importers. We agree with the principle behind the proposals that is that these groups *"benefit from the activity [smoking] that imposes costs on society... the government believes it is fair to ask tobacco manufacturers and importers to make a greater contribution to these costs."*

Around 22% of the adult population of the North East smokes, down from 29% ten years ago. The cost of smoking to the region however is still avoidably high at almost £160

million per year, which includes the cost to business through lost productivity and costs to the NHS of treating smokers and those exposed to secondhand smoke. The cost to local authorities is also significant and includes actions such as the commissioning of stop smoking services, the provision of regulatory services to support compliance with tobacco-related legislation and street-cleaning services to remove litter such as cigarette butts and tobacco packs.

We support the principle of introducing a tobacco levy to enable public services to deal with some of these costs, particularly since the tobacco industry is one of the most profitable industries on earth, and we support its introduction as soon as is practicably possible. A precedent for such a system already exists in America where the tobacco industry is required to pay a 'user fee' to the Food and Drug Administration to fund tobacco control activity as directed by the FDA.

### **Key recommendations on implementing a levy**

We would like to make two key recommendations to ensure that any levy realises its potential to make the tobacco industry pay for the damage it inflicts upon society and builds upon the successful model in America:

1. At the same time as its introduction, we urge the government to commit at least a proportion of the income generated by the levy to fund a comprehensive tobacco control strategy which would operate at local, regional and national levels. This would ideally lead to local authorities being able to deliver funded evidence-based tobacco control activity based on local need, supported by regional programmes to maximise resources and avoid duplication, all of which will be set within a national context whereby tobacco products become increasingly less affordable, accessible and appealing.
2. We would urge the government to ensure independence in the administration and disbursement of the levy, in line with the UK's obligations under Article 5.2 of the World Health Organisation Framework Convention on Tobacco Control (WHO FCTC) to "*establish or reinforce and finance a national co-ordinating mechanism or focal points for tobacco control.*" This is particularly important in terms of protecting decisions from the vested interests of the tobacco industry, as per Article 5.3 of the WHO FCTC.

Action on Smoking and Health (ASH) have made feasible recommendations on the annual amount that a tobacco levy could generate, and how this could be distributed across the UK and we would direct the consultation team towards the ASH response for more details.

In summary, we fully support the proposal to introduce a tobacco levy and we would like to see the income that it generates being used to fund tobacco control strategies at all levels, free from the influence of the tobacco industry. Such a measure has real potential to support us in our vision of making smoking history in the North East.

Yours sincerely

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Chair

## 2.5 British Heart Foundation



# Response to HM Treasury Tobacco Levy Consultation

Response from the British Heart Foundation  
February 2015

The British Heart Foundation (BHF) is the nation's leading heart charity. We are working to achieve our vision of a world in which people do not die prematurely or suffer from cardiovascular disease. In the fight for every heartbeat we fund ground breaking medical research, provide support and care to people living with cardiovascular disease and advocate for change.

We are actively involved in tobacco control issues because of the strong association between smoked tobacco and ill-health including cardiovascular disease (CVD). Smoking is a major risk factor for CVD, and smokers are almost twice as likely to have a heart attack as non-smokers. Every year in the UK, over 100,000 smokers die as a result of smoking, with around 22,000 smoking-related deaths from CVD.<sup>1</sup>

The BHF welcomes the opportunity to respond to this consultation and would like to express our strong support for the introduction of a levy on tobacco manufacturers and importers. We would like to emphasise that, in our view, it is essential that the funds raised by this levy are hypothecated for public health purposes and used to reduce the harm caused by smoking. In this way, the levy can help the UK to address the substantial health and financial costs caused to the UK by tobacco.

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

Yes, the BHF supports this definition, which represents a sensible and practical approach.

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

We believe that calculating total market size based on volumes of cleared tobacco is appropriate as it protects against tobacco companies adjusting their pricing structures and sales data to reduce their liability. We also recognise that this approach will reduce the administrative burden for HM Revenue and Customs (HMRC).

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

We are satisfied with the calculation being based on the volume of cleared tobacco.

### **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?

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<sup>1</sup> BHF estimate based on HSCIC Statistics on Smoking 2014.

It would 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 handrolled cigarette. We take this figure to be 0.75 grams.<sup>2</sup>

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

We believe that the calculation of the levy should be based on clearances from the previous year. As the consultation document states, if current year clearances are used to calculate the levy, revenue targets risk not being met. We are proposing that funds raised by the levy are hypothecated. If revenue targets may not be met, this will negatively impact on the ability to budget and allocate funds to services due to a lack of stability.

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

We support the use of the corporation tax system to collect the levy. We assume that the Treasury would construct levy rules so that levy payments and any associated administrative or costs to the tobacco industry could not be used to reduce liability for corporation tax.

**Question 7: What are the alternative approaches?**

We are not aware of any alternative approaches.

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

The impact of the levy on prices will depend on the proportion of the levy that manufacturers decide to pass on in the retail price of cigarettes and other tobacco products.

Raising tobacco taxes is a highly effective way of reducing tobacco consumption<sup>3</sup> and there is evidence that increasing prices of tobacco products has a positive effect on inequalities in smoking.<sup>4</sup>

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

We believe that funds raised by this levy should be hypothecated and used to tackle societal harms of tobacco through investment in smoking cessation services, mass media campaigns and tackling the illicit trade in tobacco. The planned impact of this would be to support existing smokers to quit and reduce the number of young people taking up the habit, with consequent public health benefit.

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

If the costs of the levy were passed onto consumers there is good evidence that increases to the unit price of tobacco products would have the potential to reduce smoking related health inequalities and to reduce the overall number of smokers.

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<sup>2</sup> 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.

<sup>3</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

<sup>4</sup> The World Bank. *Curbing the epidemic: governments and the economics of tobacco control*. May, 1999.

If the costs of the levy were absorbed by the profits of tobacco companies, this may decrease the incentive for investment in tobacco companies, accelerating organisations' disinvestment from tobacco.

**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 are supportive of this proposed levy as it would hold the tobacco industry accountable for the negative impact which it has on public health. However, beyond holding the industry to account, we also have the opportunity to mitigate the harm caused to society and individuals.

The BHF is calling for the funds raised from this levy to be hypothecated for the purposes of public health. Specifically, we want to see the money spent on funding for smoking cessation services, mass media campaigns and resources to tackle the illicit tobacco trade.

We know that stop smoking services are both cost and clinically effective;<sup>5</sup> that mass media campaigns can be highly effective in stimulating quitting behaviour;<sup>6</sup> and that, despite recent sharp falls, the level of illicit tobacco remains unacceptably high.<sup>7</sup> As such, these areas provide an appropriate focus for the spend. This investment would also help to support local authorities as both stop smoking services and some action to counter smuggling (such as local action by trading standards officers) are paid for at the local level, while the consequent savings are seen at the national level, by the NHS and the Exchequer, respectively.

The cost to the UK of tobacco use is huge, both in financial terms and in terms of lives lost. We believe that, by raising this money and spending it on appropriate interventions, we can take significant steps towards ending the damage caused by smoking in the UK.

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For more information, please contact \_\_\_\_\_, Policy Manager, Research and Prevention.

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<sup>5</sup> [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

<sup>6</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun;109(6):986-

<sup>7</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

## 2.6 Cancer Focus Northern Ireland

### HM Treasury Consultation

#### Tobacco Tax Levy (closing date 18<sup>th</sup> February 2015)

##### Response from Cancer Focus Northern Ireland

Cancer Focus Northern Ireland (Cancer Focus) is a health charity working to reduce the impact of cancer in Northern Ireland including the elimination of harm caused by tobacco. Cancer Focus does not have any direct or indirect links to, or receive funding from, the tobacco industry.

### General Observations

#### Summary

1. Cancer Focus 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."*<sup>1</sup>
2. Tobacco manufacturers and importers in the UK are immensely profitable, such that it could certainly afford to make a greater contribution. Recent research by Branston and Gilmore at the University of Bath suggests that in the UK 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.
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.<sup>2</sup> 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 which would enable the introduction of a price capping

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<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

<sup>2</sup> EU Tobacco Tax Directive Article 15.

mechanism. Placing a cap on industry profit 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.<sup>3</sup>

## Background

6. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year.<sup>4</sup> This is likely to be an under-estimate as only costs where data is attributable have been included. For example it did not include the cost of collecting smoking-related litter. The following costs are included:
  - £2 billion cost to the NHS of treating diseases caused by smoking
  - £3 billion loss in productivity due to premature death
  - £5 billion cost to businesses of smoking breaks
  - £1 billion cost of smoking-related sick days
  - £1.1 billion of social care costs of older smokers
  - £391 million cost of fires caused by smokers' materials
7. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
8. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated Fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>5</sup>
9. The tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution.<sup>3</sup> <sup>6</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but in 2002 the World Bank estimated that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>7</sup> A comprehensive review of the literature published since this date by IARC in 2011 concludes that based on aggregate demand studies, price elasticity remains around -0.4 in high income countries including the UK.<sup>8</sup>

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<sup>3</sup> 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

<sup>4</sup> [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

<sup>5</sup> *ibid*

<sup>6</sup> Branston JR and Gilmore A. The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tobacco Control* 2014; 23(1): 45-50

<sup>7</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

<sup>8</sup> International Agency for Research on Cancer. IARC Handbooks of Cancer Prevention. *Tobacco Control* Volume 14. Effectiveness of Tax and Price Policies for Tobacco Control. Lyons: IARC, 2011

10. There is widespread support in England for the idea of putting the equivalent in today's prices of 25 pence on a packet of cigarettes with the funds being used to fund tobacco control; 78% of the adult population is in favour of the idea including 54% of those in Social Grade E ('unemployed, on state benefit and lowest grade workers') who had smoked in the past year and 52% of these who were smoking at the time of the survey.<sup>9</sup> This could raise around £500 million (see table 1 below). Similar support is found in surveys across Europe.<sup>10</sup>
11. Fewer than one in five adults now smoke, but smoking prevalence rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes.<sup>11</sup>
12. Poorer smokers are more sensitive to price increases than better off smokers. So, increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>12</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
13. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to increase the rate of quitting tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers and popular both with smokers and the general public, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
14. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:
- "The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*
- While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*
- For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation..."*<sup>13</sup>

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<sup>9</sup> West R. Public support for a tobacco levy. Smoking Toolkit Study. 2006

<sup>10</sup> [Policy Recommendations for Tobacco Taxation in the European Union. Integrated research findings from the PPACTE project. 2012](#)

<sup>11</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>12</sup> The World Bank. Curbing the epidemic: governments and the economics of tobacco control. May, 1999.

<sup>13</sup> [NHS: Five Year Forward View](#) NHS England, October 2014

15. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
16. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short-term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products. However, in line with our obligations as a party to the WHO FCTC and in particular Article 5.3, the tobacco industry could have no control over this money, or how it should be allocated.<sup>14</sup>
17. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity.<sup>15</sup> This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
18. International evidence shows that public investment in policies designed to reduce smoking prevalence is likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, "The Health Consequences of Smoking – 50 Years of Progress", reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."* The Report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."*<sup>16</sup>
19. In reducing smoking prevalence rates in the UK, an essential role is played by tobacco control measures, for example the stop smoking services. The Department of Health document "Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12" stated that: *"Stop smoking services are a key part of tobacco control and health inequalities ... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers."*<sup>17</sup>
20. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally

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<sup>14</sup> WHO FCTC. Article 5.3 guidelines.

<sup>15</sup> [Family Smoking Prevention and Tobacco Control and Federal Retirement Reform](#). 123 Stat. 1776 Public Law 111–31—June 22, 2009. Section 919 user fees.

<sup>16</sup> U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

<sup>17</sup> [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

tight public spending regime that local authorities now face. There are already grounds for concern about how many people are being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13.

21. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs, much of the direct savings they deliver accrue mainly to the NHS and not to those who pay for the services. This point also applies to local action by trading standards officers and others to reduce the scale of the illicit tobacco trade. The Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.
22. Although the level of illicit trade has fallen sharply since 2000, it remains unacceptably high and the latest figures from HM Revenue and Customs suggest that it has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>18</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>19</sup> and the House of Commons Home Affairs Select Committee.<sup>20</sup> Cancer Focus strongly supports these recommendations which include specific recommendations on increasing local and regional action against illicit trade.
23. Mass media and social marketing campaigns can also be highly effective in stimulating quitting behaviour but require significant investment in order to be most effective.<sup>21 22 23</sup>
24. **We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help fund a comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost no more than £500 million a year, and would include key measures such as:**
  - supporting tobacco control measures at regional and local level, for example to fund action against the illicit tobacco trade outside of HMRC;
  - ensuring the provision of high quality Stop Smoking Services across the country; and
  - financing mass media and social marketing campaigns, which add value to other tobacco control initiatives.
25. **We would also strongly suggest that this portion of the levy be established along similar lines to the US “user fee”, so that it is effectively made independent of the wider fiscal**

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<sup>18</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

<sup>19</sup> [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

<sup>20</sup> [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

<sup>21</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>22</sup> Langley T, McNeill A, Lewis S, Szatkowski L, Quinn C. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction* 2012;107(11): 2043-2050

<sup>23</sup> Sims M, Salway R, Langley T, Lewis S, McNeill A, Szatkowski L, Gilmore A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014; 109(6): 986-94.

regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence, completely independent from any influence by the tobacco industry. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK's obligation under Article 5.2 of the Framework Convention on Tobacco Control to "establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control".

26. It should be noted that as of 31<sup>st</sup> March 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education and \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>24</sup>

## Answers to Consultation Questions

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

27. 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?

28. 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.

29. "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

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<sup>24</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

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.<sup>25</sup>

30. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes and prices by brands, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult, and, crucially, would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local consumption and prevalence levels and the consequent harm caused. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>26 27</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a “*unique identifier*” that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.
31. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

**Table 1: Suggested allocation of revenue from tobacco levy across the countries of the UK**

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from 2013 Integrated Household Survey. Adult population totals in each country: mid-2013 estimates.

32. In summary, we recommend that:
- Previous year clearance data be used as the basis on which to raise the levy in year one.
  - The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.

<sup>25</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

<sup>26</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>27</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

33. 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.
34. 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)
35. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>28</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 43 below.

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

36. For the reasons stated in paragraphs 28 to 30 above, 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?

37. 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 control of tobacco industry* could not be used to reduce liability for corporation tax. Should corporation tax rates be devolved it will be important that this doesn't allow the tobacco industry to reduce its contribution in any of the devolved regions or countries.
38. 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.

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<sup>28</sup> Joossens L, Lugo A, La Vecchia C, Gilmore A, Clancy, L and Gallus S. 2012 [Illicit cigarettes and hand-rolled tobacco in 18 European countries: a cross-sectional survey Tobacco Control, Online First.](#)

**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?

39. 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.

40. According to the Department of Health Impact Assessment on standardised packaging <sup>29</sup> (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.”*

41. 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.

42. The research paper attached to this consultation response written by Howard Reed, Landman Economics, 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).

43. 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.

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<sup>29</sup> [Impact assessment: standardised packaging of tobacco products](#): Department of Health June 2014

**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
<b>Scenario (a): No pass through</b>					
<b>Adult smoking prevalence (%)</b>	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
<b>Scenario (b): Full pass through</b>					
<b>Adult smoking prevalence (%)</b>	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

44. 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):<sup>30</sup>

#### **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

45. 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.

<sup>30</sup> Communication with Action on Smoking and Health, 14 January 2015

46. 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<sup>31</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>32</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved,<sup>33 34</sup> smoking rates have continued to decline so that fewer than one in five adults now smoke and only 3% of 11-15 year olds.
47. Two companies: Imperial Tobacco and JTI account for around 80% of sales of tobacco in the UK. Both make large profits and have very large profit margins on their products.<sup>6</sup> Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits in the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>35</sup> It is therefore clear that the tobacco industry could well afford to pay the proposed levy.

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

48. 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.
49. 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.<sup>36</sup>
50. 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

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<sup>31</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

<sup>32</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>33</sup> [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

<sup>34</sup> [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

<sup>35</sup> BAT Annual Report 2013

<sup>36</sup> Gilmore A, Tavakoly B, Taylor G, Reed H. Understanding tobacco industry pricing strategy and whether it undermines tobacco tax policy. The example of the UK cigarette market. *Addiction* 108; (7): 1317-1326.

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 attached paper by Gilmore et al.<sup>3</sup> 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.

51. 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.

## 2.7 Cancer Research UK



### About Cancer Research UK<sup>1</sup>

1. Every year around 300,000 people are diagnosed with cancer in the UK and more than 150,000 people die from cancer. Cancer Research UK is the world's leading cancer charity dedicated to saving lives through research. Together with our partners and supporters, our vision is to bring forward the day when all cancers are cured. We support research into all aspects of cancer through the work of over 4,000 scientists, doctors and nurses. In 2012/13, we spent £351 million on research in institutes, hospitals and universities across the UK. The charity's pioneering work has been at the heart of the progress that has already seen survival rates in the UK double in the last forty years. We receive no government funding for our research.
2. Cancer Research UK is a registered charity in England and Wales (1089464) and in Scotland (SC041666). Registered as a company limited by guarantee in England & Wales No.4325234. Registered address: Angel Building, 407 St John Street, London EC1V 4AD.

### Background information on CRUK's work in Tobacco Control

3. Smoking is the single greatest avoidable risk factor for cancer; in the UK, it is the cause of more than a quarter (28%) of all deaths from cancer and has killed an estimated 6.5 million people over the last 50 years<sup>1</sup>. Two-thirds of smokers start before they are 18<sup>2</sup> – the beginning of an addiction that kills half of all long-term smokers.<sup>3</sup> The cumulative efficacy of comprehensive tobacco control measures in driving down smoking rates across the UK is manifest in the prevalence trend which has accompanied the restrictions on tobacco sales, marketing, promotion and exposure since the 1960s and 70s<sup>4</sup>.
4. Cancer Research UK (CRUK) invests in a range of research from behavioural health research (e.g. the Health Behavioural Research Centre at University College London) to policy relevant translational research. We currently support the UK Centre for Tobacco and Alcohol Studies (UKCTAS) - a consortium of 13 University teams (12 in the UK, one in New Zealand) conducting research on tobacco and alcohol use and addiction. UKCTAS is one of five national public health research centres of excellence funded by the UK Clinical Research Collaboration. As member of the Collaboration we have provided approximately £2.4m to the initiative in the first five-year phase and are providing £2.5m in the second five-year phase. In addition to this we have funded policy relevant translational research through our Tobacco Advisory Group (TAG) funding committee. The committee invests almost £1m a year in tobacco control policy research and advocacy.

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<sup>1</sup> Registered charity in England and Wales (1089464), Scotland (SC041666) and the Isle of Man (1103)

5. In December 2014 CRUK, in partnership with the US National Cancer Institute, launched a £5 million funding commitment which incorporates the establishment of the International Consortium for Action and Research on Tobacco (ICART). The ICART will provide funding and assistance to lower-and-middle income countries (LMICs), to enable fulfilment of a 2012 commitment of the World Health Assembly, to reduce tobacco use by 30 per cent globally, by 2025. With current trends, over 80 per cent of tobacco-related mortality will burden LMICs by 2030, which informs the ICART's objective to translate the research and experience from higher-income countries - which have benefitted from success in driving-down smoking rates - into tailored policies for countries with diverse social, cultural and economic characteristics.
6. CRUK welcomes comprehensive tobacco control measures worldwide, in line with the principles laid out in the World Health Organisation, Framework Convention on Tobacco Control (WHO FCTC).

### Declaration of interests

7. CRUK, consistent with its Vision and Mission, opposes the promotion and use of tobacco in all its forms, and wishes to do everything it can, as far as reasonably practicable, to avoid links with the tobacco industry. We have strict guidelines which detail that all staff, including employees, contractors, agency staff, volunteers, secondees, students and consultants should not work with the tobacco industry, either directly, or through a third party. CRUK will not accept applications from research teams in receipt of tobacco industry funding. In the WHO FCTC, there are strong, comprehensive guidelines to protect tobacco control policies from the vested interests of the tobacco industry<sup>5</sup>.

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

8. Yes, defining the tobacco market as products on which tobacco excise duty is paid is the right approach, consistent with the proposals for calculating market share which are discussed in the consultation.

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

9. We believe that calculating the total market size based on volumes of cleared tobacco is appropriate as this approach goes some way to mitigate the risk of tobacco companies adjusting their pricing structures and sales data to reduce their liability – particularly in year one of collection of the levy. We also recognise the additional benefits of reducing the administrative burden for HM Revenue & Customs (HMRC) and HM Treasury. More detail about what we believe to be the relative benefit of using previous year clearances, as opposed to current year, is given in our response to question 5.

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

10. None that we are aware of: an approach based on the volume of cleared tobacco seems a sensible one. We would oppose the calculation of market size being based on profits, owing to the susceptibility to manipulation in tobacco company accounts.

**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?

11. While we do not anticipate any practical difficulties as such, there are considerations which need to be made in view of the separate conditions for these market segments. Excise on cigarettes in the UK is currently 16.5% of retail price (ad-valorem) plus £184.10 per 1,000 cigarettes (specific duty) which is legislated, in part, under Directive 2011/64/EU ('on the structure and rates of excise duty applied to manufactured tobacco' i.e. tobacco). While timetables have not been confirmed, we expect the first stages of consultation on the Directive to commence in 2015, leading to a full revision at a later date. In respect of HRT and other tobacco products, there is a significant difference between the excise rates on HRT (£180.46/kg) compared with 'other smoking tobacco and chewing tobacco products' (£100.96/kg) which has potential for being exploited for the purpose of reducing levy liability, particularly if an approach is taken to calculate liability based on excise payments.
12. Rates of HRT smoking, across a study of 18 European countries, were found to be highest in England, where 7% of the adult population and 27% of smokers were most frequently consuming HRT cigarettes<sup>6</sup>. The report concludes that the average weight of one hand-rolled cigarette across Europe to be 0.75g. The reliability of this figure is consistent with the analysis of the literature on the subject pre-dating this study, as well as data from Imperial Tobacco and Philip Morris International which puts the average conversion weight at ~0.7g and 0.75g respectively<sup>7</sup>. For example assuming a pouch weight of 20g – which will be mandated as the minimum weight under the agreement in the revised EU Tobacco Products Directive – a smoker could roll 26 cigarettes (with a small amount of tobacco remaining). To illustrate the point, at an RRP of £6.90<sup>8</sup>, the per cigarette cost of *Marlboro Gold* HRT would be ~26.5 pence. The equivalent manufactured cigarettes are available at the UK's largest retailer for £9.04<sup>9</sup>; a cost of 45 pence per cigarette, or 41.1% more expensive. Reducing the price differential between HRT and manufactured tobacco is a complimentary policy which should be pursued through accelerated escalators on HRT, alongside the introduction of the levy.
13. There is also evidence from overseas indicating that the tobacco industry will try to exploit opportunities to reduce their tax liability by selling HRT as pipe tobacco<sup>10</sup>, and for this reason keeping taxes on pipe tobacco in line with those on HRT is an important step.
14. We also welcomed HMRC's recent consultation on the extension of anti-forestalling restrictions, to which we responded. We noted in the response to the consultation that the government supports powers to extend restrictions to HRT<sup>11</sup>. However these same restrictions will not apply to other tobacco products (e.g. cigars and pipe tobacco) which could further incentivise avoidance of excise, continuing the practice of

forestalling products not covered by new legislation - the effect of which would be to manipulate a levy liability calculated on the basis of excise. As part of the government's response, we also welcomed action to stop manufacturers forestalling against their own price rises (as excise is payable in part on 16.5% of retail price) by either introducing a cap of a maximum percentage of the total allocation which can be cleared in any one month or requiring equal monthly restrictions within the overall period of the restriction<sup>11</sup>.

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

15. We believe that the calculation of the levy should be based on clearances from the previous year. While we note the requirement for additional rules to address companies entering or leaving the market, we do not believe this will be a significant issue, owing in part to the monopoly on the market in which just two companies control around 85% of the UK market<sup>12</sup> and just six companies produced 81% of the total number of cigarettes manufactured globally (2008)<sup>13</sup>.
16. As explained in our response to question 11, we will be advocating that the funds raised through the proposed tobacco levy are hypothecated to fund services which directly tackle the societal harms of tobacco use including - but not necessarily limited to - funding for cessation services, mass media campaigns and resources to tackle the illicit tobacco trade. The monthly clearances provided in HMRC's monthly bulletins operate on provisional figures, which are then revised in the following month. Using clearances based on the previous year may aid the allocation of the fund in this scenario, by mitigating against over, or under allocation of funds raised through the levy mechanism. The consultation document outlines that the *revenue target* risks not being met if current year clearances are used to calculate the levy which, further to the point above, diminishes the ability to effectively budget and allocate the raised funds to services which benefit from stability afforded by long-term financial security.
17. To this end we believe a target for the levy of £500m should be set over each of the five years of the next Parliament – 2015-16 to 2019-20 inclusive. This sum would guarantee funding to resource a comprehensive tobacco control programme to reduce youth initiation and encourage adults to quit. Setting a target for collection, as opposed to a percentage of revenues, mitigates against the potential for the industry to reduce their liability through manipulation of the corporation tax system (see question 6) and/or offshoring of liability to non-UK jurisdiction(s).

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

18. The use of the corporation tax system as the mechanism for administering the tobacco levy seems a sensible approach. We believe it to be beneficial to model the tobacco levy on the bank levy. The consultation document highlights changes which have been made to the bank levy since its inception, adjusting to the behavioural responses of the liable institutions. These adaptations heighten awareness of the potential loopholes in the levy mechanism, in order to minimise the risk of exploitation.
19. We are aware of a number of tactics designed to - in many cases successfully - manipulate the bank levy from its intended liability and while adjustments have been

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<sup>11</sup> Subject to the granting of these general powers in primary legislation

made, which we understand have been effective, they remain pertinent to considerations in devising the mechanism for a tobacco levy; namely:

- The amount paid in levy fees must not be deductible in determining a company's corporation tax liability.
- Similarly, jurisdictions must not treat the levy as a creditable tax in reducing any other form of tax liability.

20. Regardless of the collection system used, HMRC and HM Treasury must be mindful of government obligations under the WHO FCTC and specifically Article 5.3<sup>14</sup>, which recognises the fundamental conflict between the aims of the tobacco industry and public health policy. While it may be necessary to speak with tobacco industry representatives in order to administer the levy, measures should be established to limit interactions with the tobacco industry and ensure the transparency of those interactions that occur, consistent with Article 5.3 recommendation two. Furthermore, while we acknowledge that officials have little or no control over the way in which the tobacco companies choose to present the payment of the fee, officials should correct any claim that the payment of the levy is anything other than a mandatory obligation consistent with recommendation six of the guidelines for the implementation of Article 5.3<sup>15</sup>.

**Question 7:** What are the alternative approaches?

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

21. Raising tobacco taxes is one of the most effective ways of reducing tobacco consumption, something the tobacco industry itself admits<sup>15</sup>. There is strong evidence that an increase in the price of tobacco products have a pro-equity effect on smoking behaviour in adults<sup>16</sup>. A similar observation has been made in regard to interventions to create positive equity impact among young people<sup>17</sup>.
22. Research suggests that increasing the unit price of tobacco may have the potential to reduce smoking related health inequalities<sup>18</sup>. However tobacco industry pricing strategies undermine such policies. By choosing to absorb tax increases so that the cost of a pack on the shelf does not change (a practice known as „undershifting“) tobacco companies are adversely affecting the impact price can have on motivating smokers to quit.
23. There is evidence that the tobacco industry, as well as their influence on price, is also attempting to shift the argument about tobacco related health inequalities away from their product, „...tobacco companies are appropriating the language of social determinants to divert responsibility for smoking inequalities onto the state“. The same study, published in the *Tobacco Control* journal noted that by placing emphasis on other factors of deprivation, „Tobacco manufacturers are seeking to create a false dichotomy between the goals of reducing inequalities in individual smoking behaviours and reducing social inequality“<sup>19</sup>.

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<sup>15</sup> Denormalize and, to the extent possible, regulate activities described as “socially responsible” by the tobacco industry, including but not limited to activities described as “corporate social responsibility”.

24. In recent years 'Ultra Low Price' (ULP) cigarette brands have proliferated in the UK market<sup>20</sup>. Examining the real price of individual ULP brands shows that some have fallen by as much as 5%<sup>21</sup> giving smokers access to cheaper tobacco. Research shows that between 2006 and 2009 the ULP market doubled<sup>22</sup>. There has been an increase in the sales volumes of economy brand cigarettes and the use of hand rolling tobacco which is undermining efforts to reduce smoking rates<sup>23</sup>.

25. If the tobacco industry chooses to absorb the cost of the levy and not raise the cost of tobacco products to the consumer, then market conditions will remain consistent with the status quo. We support the introduction of a tobacco tax escalator of 5% above inflation on manufactured tobacco products and 10% above inflation on HRT product in order to close the price differential between the products. If the industry chooses to pass the cost of the levy liability onto the consumer through price rises then, consistent with research noted in paragraphs 21 and 22, this can catalyse a reduction in smoking rates among those on lower-incomes – reducing inequalities in a progressive way.

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

26. As expanded in our response to question 11, we believe that that the funds raised through this levy should be hypothecated to the provision of initiatives which directly tackle the societal harms of tobacco use including, funding for cessation services, mass media campaigns and resources to tackle the illicit tobacco trade. The aim of this would be to decrease both the number of smokers in the UK, and the number of young people that take up smoking each year in the UK.

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

27. Further to our response to question 8, there has been a trend toward ULP brands in the UK market, wherein sales of manufactured cigarettes have fallen, conforming to a pattern of declining sales of premium (or luxury) cigarette brands and corresponding growth in the economy segment. This has coupled an increase in the proportion of smokers using HRT, sales of which increased 3.8% in 2013<sup>24</sup>.

28. As noted at points 3.4 and 3.5 of the consultation document, the levy can either be passed onto consumers in the form of a price rise, or absorbed by the liable companies. Echoing our response to question 8, there is strong evidence that increases to the unit price of tobacco products have the potential to reduce smoking-related health inequalities, and in this respect an increase being passed onto consumers would likely result in a fall in the number of smokers. While we would anticipate that among those who continue to smoke, those trends toward ULP brands and HRT would persist.

29. If the levy were absorbed from the profits of tobacco companies, one impact this could have is to decrease the incentive for investment in tobacco companies and accelerate organisations' disinvestment from tobacco. For example, local authorities' pension schemes have been a keenly debated topic in recent years.

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

30. While this consultation is chiefly concerned with the mechanism by which a levy could be collected, its administration and spending must also be properly considered at this

stage. The intention of this policy – echoing the Chancellor’s comments - was that the tobacco industry must be held accountable for the negative externality which they, and in turn their products have, and continue to create.

31. The mechanism should also allow for the hypothecation of the collected funds for the purposes of tobacco control services. The compatibility between this intention and the use of existing mechanisms for the collection of corporation tax (see question 6) must be adequately considered at this early stage. We believe that for the levy to meet the intentions as outlined in the comments accompanying the Autumn Statement 2014, (surmised in the consultation document under 1.10), the funds raised through the levy must be hypothecated to directly tackle the burden of tobacco use. Specifically the money raised through the levy should be used for the following:
- Funding for smoking cessation services
  - Mass media tobacco control campaigns
  - Resources to tackle the illicit tobacco trade.

Hypothecated taxes provide taxpayers with inherent accountability for public spending. As the money is being generated through a levy system, this negates the criticism that hypothecated taxes sever the link between need and provision<sup>25</sup>.

32. The Smokefree Action Coalition (SFAC), of which CRUK is a member organisation, has promoted the NHS Statement of Support on Tobacco Control<sup>26</sup>, through which public health commissioners can affirm their support for tobacco control. This support should be in line with NICE guidance, delivered through community health services, acute trusts, local authorities and wider community partners. Such positive commitments from local authorities, who took responsibility for commissioning of public health services in April 2013, must be matched with the requisite investment to ensure they can provide smokers with ‘gold standard’ NHS stop smoking services. A quit smoking attempt with NHS stop smoking services is around three times likelier to be successful than attempting to stop unassisted<sup>27,28</sup>. Around half of NHS stop smoking service users in England in 2010/11 were in receipt of free prescriptions (an indicator of relative disadvantage)<sup>29</sup>.
33. Research from Action on Smoking & Health (ASH) highlights that the total cost of tobacco use to society in England is £12.9 billion a year<sup>30</sup>. By comparison, tobacco receipts for 2013/14 were £9.5 billion<sup>31</sup>. It is estimated that around £380 million a year is being saved by the NHS as a result of public health strategies such as the ban on tobacco advertising and the creation of stop smoking services which have resulted in fewer people smoking<sup>32</sup>. Although there are challenges to overcome, successful tobacco control policy can save a significant number of lives and help relieve health services of significant financial pressure.
34. Unpublished analysis from CRUK shows that local authority’s tobacco control budgets have been robust since transition, but this needs to be monitored ahead of expected cuts. The report found that tobacco control or smoking cessation budgets had been cut in 7 per cent of local authorities due to cuts in supposedly ring-fenced public health budgets. While this is only a minority of incidence, the author notes, ‘...if public health budgets can be cut when they are protected by a ring-fence, there is clearly a risk that

many more budgets may suffer when this ring-fence is removed'<sup>33</sup>. [An embargoed copy of this report is provided as an appendix to the submission].

35. Modelling by the Local Government Association predicts that a funding gap in local government expenditure, opening up in 2015/16, could grow to £12.4 billion by 2019/20, meaning that (a) more will need to be done with less and/or (b) alternative funding avenues will need to be sought to maintain service provision<sup>34</sup>. The impact on NHS stop smoking services, health promotion and lifestyle-change campaigns and the provision of exercise and leisure facilities must be managed responsibly against a backdrop of these funding pressures.
36. Toward the goal of a comprehensive tobacco control strategy, we welcomed the recent consultation on minimum excise tax, and endorsed the response from the UKCTAS and ASH in calling for the introduction of a minimum consumption tax (MCT). We believe that the introduction of a MCT is another important step to reducing the incentive to downtrade to an ULP brand of manufactured cigarettes or a HRT product and would encourage smokers to quit. This requires the support of the funds raised through the levy to meet the demand for continued investment in 'gold standard' NHS stop smoking services.
37. Existing tobacco manufacturers hold an ability to set prices untroubled by serious competitive threats, by nature of the market monopoly. 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 an 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<sup>35</sup>.
38. Placing a cap on industry profits would enable 'excess profits' 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 tax rises on the cheapest brands, thereby undermining tax policy and the role of fiscal levers in tackling health inequalities. The means by which this could be achieved is set out in research from Gilmore, A et al<sup>36</sup>. 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 during the process of the Directive's revision, expected to commence in 2015-16.

If you have any questions, please contact \_\_\_\_\_ (Senior Policy Officer) at  
(Email) \_\_\_\_\_ or; (Tel) \_\_\_\_\_

Appendix:

- o Anderson, W and Asquith, A. 'Taking a Reading': The impact of public health transition on tobacco control and smoking cessation services in England. February 2015 [EMBARGOED]

Supplied separately. This report is now available at:

[http://www.cancerresearchuk.org/sites/default/files/policy\\_march2015\\_localtransition\\_report.pdf](http://www.cancerresearchuk.org/sites/default/files/policy_march2015_localtransition_report.pdf)

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- 14 World Health Organisation. WHO Framework Convention on Tobacco Control. [Guidelines for Implementation of Article 5.3](#).
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- 21 Ibid
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## 2.8 North Tyneside Clinical Commissioning Group

Dear HM Treasury

### Tobacco levy consultation

North Tyneside Clinical Commissioning Group is responsible for commissioning health services for 215 000 people.

We fully support the proposals to introduce a levy on tobacco manufacturers and importers. As an NHS organisation, we see first-hand the harms that smoking inflicts upon society and our organisation experiences the vast financial drain of treating smokers suffering from preventable tobacco-related diseases.

Smoking kills one in every two long-term smokers and many other smokers will suffer from related illnesses which will significantly reduce their quality of life as a result of their addiction. Treating smokers, and those who breathe in other people's tobacco smoke, costs the NHS in the North East £93.6 million every year, a toll which is unsustainable and which unfairly comes out of taxpayers' pockets. This is on top of the millions of pounds spent by other partners, including local authorities, on dealing with the subsequent damage, such as social care costs, putting out cigarette fires, picking up litter and losses to the economy through sickness.

We would prefer for this cost not to exist at all, and for there to be no smoking-related diseases for the health service to treat. However, until we reach this point, then we feel it is only fair that the tobacco industry are required to pay a reasonable contribution towards meeting this financial burden, and that prevention of disease is a key step. We agree with the position set out in the NHS Five Year Forward Plan, published in October 2014, which states that:

*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*

*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing..."*

*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation."*

As such, we make the following recommendations:

1. Treatment is only one part of the jigsaw. Improvements in prevention of smoking uptake, encouraging more smokers to quit, and protecting non-smokers from the effects of tobacco will play a vital role in reducing the burdens of tobacco that we in the health service face daily. Any funds raised from the tobacco levy should be directed towards a comprehensive approach of reducing the harms of smoking on society. The funds should not be absorbed as general taxation.
2. Given that the tobacco industry benefits from the activity that imposes these vast costs, it is only right that they are given no influence over how money generated by this levy is spent. The UK government is a signatory to the World Health Organisation's Framework Convention on Tobacco Control and is bound by its obligations to "*protect public health policy from the vested interests of the tobacco industry.*" The industry cannot be a partner in tobacco control.

We urge the Government to seize the opportunity to compel the industry behind these costs to pay for the damage it inflicts, and for this contribution to be used to its maximum potential of reducing the burden of smoking on society.

Yours faithfully

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Clinical Chair  
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## HM Treasury: Tobacco levy consultation

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### Consultation response from the Centre for Competition Policy

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Date: 17 February 2015

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The document has been edited by Dr Anna Rita Bennato following discussions held in the Centre and it has the broad agreement of the group of contributors.

#### The Centre for Competition Policy (CCP)

*CCP is an independent research centre established in 2004. CCP's research programme explores competition policy and regulation from the perspective of economics, law, business and political science. CCP has close links with, but is independent of, regulatory authorities and private sector practitioners. The Centre produces a regular series of Working Papers, policy briefings and publications. An e-bulletin keeps academics and practitioners in touch with publications and events, and a lively programme of conferences, workshops and practitioner seminars takes place throughout the year. Further information about CCP is available at our website:*

[www.competitionpolicy.ac.uk](http://www.competitionpolicy.ac.uk)

### Consultation Response

#### *Introduction*

The loss in social welfare yielded by the consumption of tobacco products has been one of the most disputed topics among policy makers and academics. Governments have been invited to design effective mechanisms, with the dual objective of being able to raise tax revenues and affect individual smoking behaviour either by reducing cigarettes' consumption or by stimulating quitting behaviour.

Despite the common belief that an increase in the taxation rate should deter smoking behaviour, the empirical evidence has not supported such relationship (see Calliston and Kaestner, 2014). Furthermore, though the statutory incidence of a tax weighs on the producer, it is not necessarily the agent facing the full burden of the tax. The incidence of taxation, that is how much of the tax is shared between consumers and producers, is determined by several factors, such as the market characteristics and number of firms present in the market. Economists have long-recognized that in markets with competition the amount of a tax introduced on producer

output is shifted on to the consumer entirely. This result is even more certain when an industry is characterized by free entry and exit. With elastic supply and inelastic demand, it is more likely that firms increase the price by the same measure as the new tax. In the opposite market structure – monopoly – the proportion of the tax shifted towards consumers depends on the demand elasticity and marginal production cost which determine the monopolist's potential to absorb part of the tax. However, when certain extreme demand conditions are met, consumers end-up paying more than 100% of the tax (this effect is known in the economic literature as 'overshifting'). The pass-on of the tax becomes less clear when markets are characterized by imperfect competition. Here also price cross-effects need to be taken into account, as shown in Bennato and Mariuzzo (forthcoming CCP working paper). From their analysis, it emerges how the interaction between heterogeneous tax rates and products of different quality, in a market with asymmetric characteristics, affects consumers differently. More precisely, consumers whose demand is less elastic bear the change in the taxation system (differentiated to homogeneous taxation). Besides, in a market where products are imperfect substitutes because of price interdependence, changes in the taxation rate affect the underlying competition in the market, and thus the firms' price and possibly entry and exit decisions.

Given the peculiarity of the product object of this open consultation, it is important to bear in mind the aforementioned features of the tobacco industry. The number of firms along with the range of products available in the market (i.e. cigarettes, cigars, hand-rolling tobacco, pipe tobacco and chewing tobacco, etc.) affect consumer switching behaviour, and subsequently the incidence of the new taxation system, and then tax revenues.

When analysing consumer behaviour in this market, it is important to also consider the role played by the brand name and consumer loyalty, as they jointly identify consumers flexibility to switch to a different product within the same country of residence (i.e. from cigarettes to hand rolling tobacco, or snuff) or the same product from a border country. Tobacco consumers, especially cigarette smokers, are price sensitive, and because of the addiction to the product, they are willing to invest a greater amount of time and resources to price searching. This latter attitude implies that tobacco excise taxes are shifted toward consumers who do not engage in price searching (i.e. young smokers, or lighter smokers). On these last consumer types, the change in taxation is passed more than one-for-one (DeCicca, Kenkel, and Liu, 2013).

### Answers to the specific questions

Below we provide answers to the specific questions posed in the open consultation.

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

**Answer:** In addition to the list of products included in the category "tobacco" defined on page 5, Section 2.2. of the open consultation, we suggest including e-cigarettes, whose longterm effect on public health is still under investigation. E-cigarettes have become rapidly popular, due to the possibility of using e-cigarettes in places where smoking is prohibited (Britton and Bogdanovica, 2014). Following the recent revision of the European Tobacco Products Directive (2014/40/EU) issued last year by the European Commission, we recommend grouping all products that contain nicotine, substance considered to be toxic, which creates addiction and potential health and safety risks (among other works see Cryer, et. al, 1976). However, products containing nicotine, but designed to promote quit smoking behaviour such as chewing gum with nicotine or nasal spray, should be excluded from the list. The suggested approach permits to incorporate all tobacco products consumed for not medical purposes, excluding thus herbal cigarettes, whose consumption may be related to medical/therapeutical scopes. Besides, under

the proposed method the e-cigarettes are included, targeting so a product assumed to be responsible for the increasing consumption behaviour of younger smokers, and “non-real” smokers (European Commission, 2014). E-cigarette were originally marketed as a health promotion category as believed to facilitate smoke quitting behaviour. It is nowadays obvious that they do not belong to such category and should be assimilated to the other nicotine products.

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

**Answer:** Before providing a precise answer, we would like to question what the HM Treasury means by “volumes of tobacco cleared”. Does it imply the total amount of units of tobacco products sold in all categories over the previous year? Or does it mean total revenues? A misinterpretation can lead to different results in terms of potential tax revenues to collect. We would prefer the use of total revenues of the tobacco products sold in the previous year, as proxy of the tobacco market size. This is because the use of total units sold, as measure of the market size, could hide some anticompetitive behaviour (i.e. illegal market sharing agreements among manufacturers), which would let suppliers manipulate their market share. For example, recently the CMA has welcomed the judgment of the High Court related to illegal agreements formed between some tobacco manufacturers and retailers over the period 2003 – 2010. This illegal conduct has involved several contracting arrangements between different economic agents located along the tobacco product distribution chain. By manipulating quantity and prices, these agreements resulted in a damage for the market competition.<sup>1</sup> Previous period revenue is a good base to calculate market shares, particularly in industries where market shares are rather stable period to period. It is important to be aware of the effect of entry and exit, but even with this in mind market shares are not expected to vary much year-to-year.

One additional advantage of using previous period revenues to compute market shares is that they are inclusive of brand values and perceived quality. Product quality is often embedded in the brand name. We can expect that the incidence of taxation weighs more on products whose brand is less popular, along the lines discussed in Bennato and Mariuzzo (2015). The use of the total revenues approach would permit a greater tax contribution from suppliers, whose brand name is well-established, and for that reason having a greater dominion (in term of revenues) in the market.

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

**Answer:** Not really, we are supportive of the idea of using previous period revenues as base to compute the market shares.

**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?*

**Answer:** The practical difficulties that could arise in splitting the tobacco market in two segments is that it may unsettle the underlying level of competition in the market, creating a distortion in the market, without an obvious justification and with some risk for the tax revenue.

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<sup>1</sup> More details on the investigation on <https://www.gov.uk/government/news/cma-statement-on-high-court-judgment-in-tobacco>.

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

**Answer:** The use of previous or current year as layout for the identification of the total market size would each lead to a list of pros and cons. We begin by discussing the current year method. One pros is that it allows for adjustment in deterministic demand cycles or recessions/booms that may distort previous year market shares. This type of exercise needs to be conducted by an independent authority, which could expose the Treasury to extra consulting costs. Moreover, it will consist of an estimation of the amount of revenues, and not on the actual value. On the other hand, previous year revenues could be retrieved by the HM Treasury, saving money on the consultancy. As mentioned earlier, this method is fast and has many advantages when market shares are rather stable year-to-year.

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

**Answer:** For this question, we do not have the expertise.

**Question 7:** What are the alternative approaches?

**Answer:** For this question, we do not have the expertise.

**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?

**Answer to questions 8, 9 and 10.**

Given the commonalities among the three questions above, a combined answer is provided. As mentioned in the introduction the pass-on of a tax depends on the level of competition in the market, along with the demand and cost characteristics. Economists already know that under a monopoly market if production cost rises, or industry demand becomes more elastic, the producer internalizes part of the incidence of taxation. Also, if the market is characterized by imperfect competition, a rise in the production costs (or a reduction of the quality products) leads to more intense price competition, and by this means firms shift the level of incidence of taxation onto consumers.

With this regard, we want to recommend an accurate analysis of the tobacco market characteristics in the UK, before introducing a new taxation system. The analysis needs to be based on the identification of the number of suppliers in the market, along with the type and quality of the product supplied. This information plays a determinant role in the effectiveness of the new taxation. In particular, if the aim consists of making manufacturers and importers to contribute to the cost produced by the smoking behaviour in England (see page 3 of the consultation call), then it is crucial to study the market structure of this industry in the UK, before any policy intervention is introduced. As anticipated in the introduction of this document, this approach would prevent firms passing on the burden of the rise in taxation to consumers. If the market is characterized by the presence of a few big firms with ability to decide market prices (oligopoly), versus by several firms each of them supplying different products perceived by consumers as potential substitutes, then we have to be aware that the application of the same taxation system will bring to opposite results for consumers. How the burden of the tax is shared among agents (consumers and suppliers), and then the expected level of revenues, is affected by changes in relative output prices. Several studies demonstrate that under imperfect competition a tax overshifting onto consumer's prices is more likely (see among others Besley and Rosen, 1999). Differentiating their own goods, producers earn some monopoly power, and their ability to pass the new tax toward consumers is influenced by other firms' strategies.

From a first glance, it seems that monopolistic competition is the market structure that better describes the tobacco industry in the UK. The varieties of products and packets size available in the market suggest that suppliers extend their product portfolio according to consumer demand elasticity. With regard to this aspect, we recall the analysis developed by Bennato and Mariuzzo (2015). Their research shows, theoretically and empirically, how the interaction between a differentiated taxation and different quality products, along with other market characteristics weighs on consumers differently. Since high quality firms react to the change in taxation of the product supplied by their competitors, it is the consumers who buy the low quality good who bear entirely the taxation change.

In deciding which tax intervention is more appropriate, the Government needs to take into account possible anticompetitive behaviour. In 2010, the OFT found that two tobacco producers along with 10 retailers displayed an anticompetitive behaviour. Subsequently from the OFT's investigation, it appears that by means of individual agreements between producers and retailers, the price of a tobacco brand was linked to that of another producers brand.<sup>2</sup> These conducts, clearly, have affected the duty paid on the tobacco product sold over the investigated period (2003-2010), creating a distortion against consumers.

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

**Answer:** Following up our previous discussion, to make the proposed policy intervention effective some readjustments and changes are needed. From pages 4 and 5, Sections 1.11 and 2.22 of the open consultation, we read, "...any levy would be based on market share. This means that those who benefit most from smoking activity would pay more of the levy...", and again in the same pages "...the levy would apply to all products subject to tobacco duty, including cigarettes, hand rolling tobacco, pipe tobacco, shisha, chewing tobacco and herbal cigarettes", we can deduce that the levy would assume the feature of a homogeneous taxation, applied to all tobacco products and target firm's output, measured by market share. We read this as a per unit indirect tax. In an imperfect competitive market where marginal costs are not constant, with an upward supply curve, the introduction of a per unit tax shifts the supply vertically upward by the amount of the tax, and the extent to which the tax is passed onto consumer prices depends on the slope of demand and supply curve (i.e. ability of consumers to change product consumed, and producer's ability to readjust its production). With an inelastic demand, that is when consumers still buy the product independently of its price (for example, in that case smokers more likely will reduce the consumption of other goods to sustain the price's increment of the cigarettes), the amount of the tax is passed in full to the consumer price. If consumers are willing to change product type, the consumer price will rise by less. Clearly, as the competition becomes more intense, the burden of the tax weighting on consumers increases.

Summing up, we suggest an accurate analysis of the tobacco industry in the UK. If an advalorem tax is preferred, we would suggest also the introduction of a price cap on the low quality product as the alternative to a levy. The use of an ad-valorem differentiated tax consists of applying a low taxation rate for low quality product, and a greater tax rate for higher quality product, having continuous increases from the low rate to the high rate for all product qualities in between. Given the market characteristics, we already know that smokers are not much willing to change their favourite brand product (inelastic demand), but lighter smoker (or younger smokers) could opt for a cheaper product. Under the scheme mentioned above (different tax rates for different quality products), the ad-valorem tax will penalize consumers more whose outside option will be not smoking. Given the peculiarity of this market, where a price increment does not work as mechanism to impede smoking, consumers in this category

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<sup>2</sup> Full details on

<http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.of.gov.uk/OFTwork/competition-actand-cartels/ca98/decisions/tobacco>.

will face the burden of the tax, with some possible overshifting (i.e. some consumers will have to face a greater price increment, bigger than that of the tax rate). To prevent this harmful result, a price ceiling on the lower end of the market product would constrain the shifting towards consumers in this category, redirecting them toward the more expensive product. In this case, in the long run heavier smokers would choose a cheaper option, reducing the demand for expensive products. Thus, it follows, that the consumers share of the tax burden decreases with respect to the elasticity of demand.

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## 2.10 The Chartered Institute of Public Finance and Accountancy



### Consultation on the Tobacco Levy

February 2015

CIPFA is one of the leading professional accountancy bodies in the UK and the only one which specialises in the public services. It is responsible for the education and training of professional accountants and for their regulation through the setting and monitoring of professional standards. Uniquely among the professional accountancy bodies in the UK, CIPFA has responsibility for setting accounting standards for a significant part of the economy, namely local government. CIPFA's members work (often at the most senior level) in public service bodies, in the national audit agencies and major accountancy firms. They are respected throughout for their high technical and ethical standards, and professional integrity. CIPFA also provides a range of high quality advisory, information, and training and consultancy services to public service organisations. As such, CIPFA is the leading independent commentator on managing and accounting for public money.

#### 1. Tobacco Levy: Consultation

CIPFA notes the consultation's emphasis on the technical means of implementing a levy, and believes that the proposals make sense if considered from that narrow point of view. However, CIPFA believes that it is important to frame policy questions within a full and correctly costed financial context, and this is not demonstrated in this paper.

The levy is proposed in response to the assumption that the tobacco industry is not making a tax contribution equivalent to the financial impact of tobacco on society. However, the current position is not spelled out, and the proposition is, at least, debatable.

The Government cites the annual costs of tobacco in England as £12.9bn:

£2 bn cost to the NHS of treating diseases caused by smoking

£3 bn loss in productivity due to premature death

£5 bn cost to businesses of smoking breaks

£1 bn cost of smoking-related sick days

£1.1 bn of social care costs of older smokers

£0.4bn cost of fires caused by smokers' materials

It may well be - given the significant proportion of costs it makes up - that the £5bn cost of smokers' breaks could be challenged on grounds of how much productivity is actually lost.

That might reduce the £12.9bn estimate. Then the existing financial gains from tobacco should be taken into account:

Income of £12.3bn from excise duties (£9.7bn in UK in 2012-13) and VAT (£2.6bn).

Reduced costs due to premature death, ie pension payments, the health, social care and housing costs associated with longer lives

The result of such an analysis is likely to be that the tobacco industry is already covering its net costs to society through tax streams and savings. Moreover, if financial balance is the aim, it looks as if reducing the perceived cost of smokers' breaks, eg by requiring all such breaks to be counted as non-working time, would be a valid alternative.

That does not in itself invalidate the case for a tobacco levy. It does suggest that any such proposal should be as the answer to a different question: not 'what fiscal action can be taken to compensate for the net cost imposed on the economy by the tobacco industry?' but 'what fiscal action can be taken to reduce the negative public health consequences of the tobacco industry?'

That would lead to a differently framed analysis of options. The Government should consider what those options would be, one of which might be the levy, and consult on the public health benefits of the options identified.

## 2.11 Smoke Free County Durham



[tobaccolevy@hmtreasury.gsi.gov.uk](mailto:tobaccolevy@hmtreasury.gsi.gov.uk)

Dear Consultation Team

### Re: Response from Smokefree County Durham Tobacco control Alliance to HM Treasury Consultation on a tobacco levy

I am responding in capacity of Chair of Smokefree County Durham Tobacco Control Alliance. The tobacco alliance brings together partners from across the county to work together to implement action locally. We are committed to reducing the health harms caused by tobacco and reducing smoking prevalence, which includes reducing the uptake of smoking amongst children and young people. We have an ambition that by 2030 smoking prevalence in County Durham is reduced to 5%, and amongst Routine and Manual Groups reduce smoking prevalence to 10%. This ambition is driven by a vision to make children the future focus for protection and the statement below is the commitment to this:-

*"The tobacco-free generation is a vision well worth striving for – that a child born now in any part of County Durham will reach adulthood breathing smokefree air, being free from tobacco addiction and living in a community where to smoke is unusual. We owe it to our children to make this happen"*

We have a five year tobacco control action plan (2013 – 2017) that is supported and delivered by partners across the county. The tobacco alliance of County Durham is also part of a North East network of alliance representing one of twelve North East local authorities.

We are grateful to Fresh and ASH for their support in developing this response.

### General Observations

1. The alliance warmly welcomes the opportunity to respond to this consultation on introducing 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."*<sup>1</sup>
2. There is widespread public appetite for more policies to reduce the harm of smoking in society with appetite for these measures having increased over the past few years. In 2014 a survey by YouGov commissioned by Action on Smoking and Health found nearly half of North East adults (43%) believing that not enough is being done to cut the harm of smoking, and another 33% saying the Government is doing about right (this was compared to 2011 when 36% said not enough is being done and another 36% thought the government was doing about right).

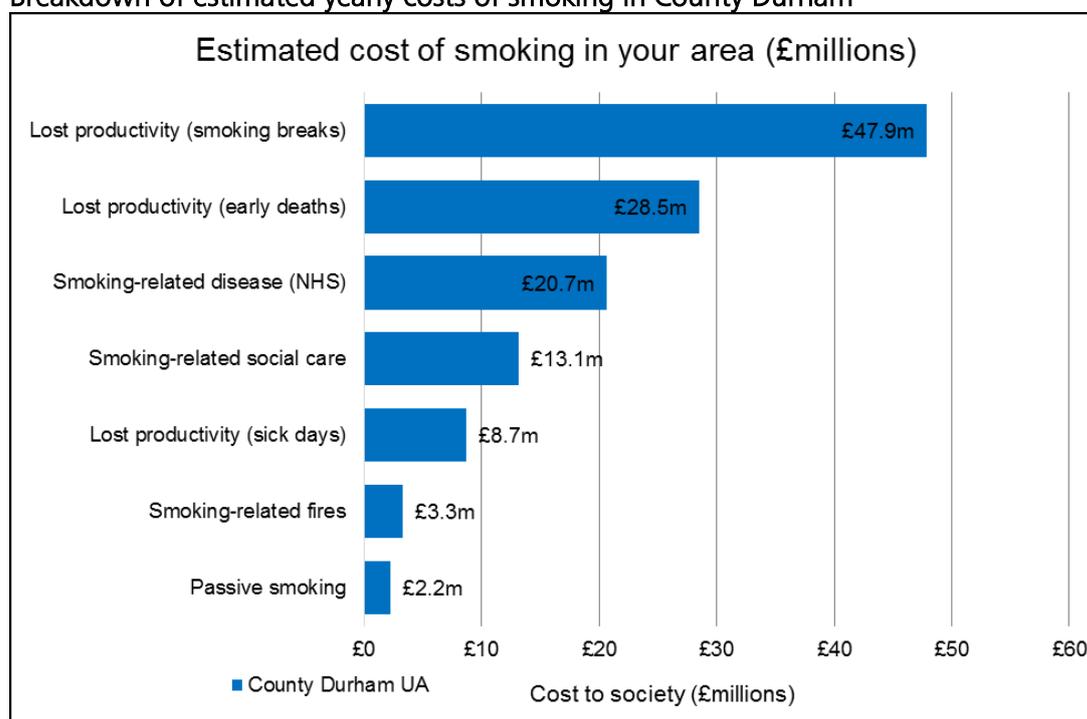
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<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

Only 12% of adults in the North East thought “the Government is doing too much” compared to 22% in 2011 and even amongst smokers in England fewer than half (35%) believed that the government is doing too much.

3. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year<sup>2</sup>. This is likely to be an under-estimate as only costs where data is attributable have been included.
4. In the North East, the conservative cost of smoking is avoidably high at almost £160 million per year, and in County Durham this is £124.4 million which includes the cost to business through lost productivity and costs to the NHS of treating smokers and those exposed to secondhand smoke. However it **does not** include costs borne by e.g. local authorities who commission stop smoking services, provide regulatory services to support compliance with tobacco-related legislation and street cleaning services to remove litter such as cigarette butts and tobacco packs.

#### Breakdown of estimated yearly costs of smoking in County Durham



5. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
6. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>3</sup>

<sup>2</sup> ASH Ready Reckoner. ASH and LeLan Solutions, Sept. 2014

<sup>3</sup> ibid

7. The tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution.<sup>4</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>5</sup>
8. Fewer than one in five adults now smoke, but smoking rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes<sup>6</sup>, killing one in two of all long-term smokers<sup>7</sup>.
9. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>8</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
10. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to reduce tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
11. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:

*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*

*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*

*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation..."*<sup>9</sup>

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<sup>4</sup> Branston JR and Gilmore A (2014) The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tob control* 23(1):45-50

<sup>5</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

<sup>6</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>7</sup> Doll R, Peto R, Wheatley K, Gray R, Sutherland I. Mortality in relation to smoking: 40 years observations on male British doctors. *British Medical Journal* 1994; 309:901-911

<sup>8</sup> The World Bank. *Curbing the epidemic: governments and the economics of tobacco control*. May, 1999.

<sup>9</sup> [NHS: Five Year Forward View](#) NHS England, October 2014

12. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
13. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short-term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.
14. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
15. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, *"The Health Consequences of Smoking – 50 Years of Progress"*, reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."*
16. Similar declines in prevalence have been seen in the North East, North West and South West of England where there is investment at a regional level in comprehensive tobacco control programmes which add value and substantially enhance and amplify efforts and outcomes nationally and locally. Investment at this level ensures that national policies and evidence-based practice are implemented effectively and allows local commissioners to benefit from economies of scale and to reach much greater population numbers<sup>10</sup>. The NICE Tobacco Return on Investment Tool provides evidence that tobacco control delivery is most cost-effective when it is delivered across a bigger geographical footprint at the subnational level<sup>11</sup>.
17. Much more can be achieved if this regional investment is sustained, increased and widened: the US Surgeon General report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."*<sup>12</sup>
18. In reducing the harm from smoking in the UK, an essential role is played by the delivery of tobacco control measures carried out by local authorities, for example the stop smoking

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<sup>10</sup> Royal College of Physicians and the UK Centre for Tobacco Control Studies: Fifty years since Smoking and health: Progress, lessons and priorities for a smoke-free UK, March 2012

<sup>11</sup> NICE [Tobacco return on investment tool](#) v3.03

<sup>12</sup> U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

services. The Department of Health document "Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12" stated that: "*Stop smoking services are a key part of tobacco control and health inequalities... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers.*"<sup>13</sup>

19. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about the reduction over the last two years in the number of smokers being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13
20. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs much of the direct savings they deliver accrue mainly to the NHS and not by the increasingly cash-strapped local authorities that commission the services. This point also applies to local action, by trading standards officers and others, to regulate the tobacco market and support compliance with legislation. In respect of illicit tobacco, the Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.
21. The level of illicit trade nationally has declined by half since 2000. Regions in England have also seen reductions in the illicit market particularly in the North East, North West and South West, where the three regional comprehensive tobacco control programmes lead the Tackling Illicit Tobacco for Better Health Partnership<sup>14</sup> to reduce the demand for and supply of illegal tobacco. For example in the North East, 15% of tobacco products in 2009 were estimated to be illicit; by 2013 this had dropped to 9%<sup>15</sup>. However, the latest figures from HM Revenue and Customs suggest that nationally the illicit tobacco market has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>16</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>17</sup> and the House of Commons Home Affairs Select Committee.<sup>18</sup> Fresh strongly supports these recommendations, which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.
22. Regular tobacco control mass media and social marketing campaigns alongside increases in the real price of cigarettes are critical for reducing population smoking prevalence, but require

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<sup>13</sup> [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

<sup>14</sup> [www.illegal-tobacco.co.uk](http://www.illegal-tobacco.co.uk)

<sup>15</sup> NEMS illicit tobacco survey 2013

<sup>16</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

<sup>17</sup> [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

<sup>18</sup> [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

significant investment in order to be most effective<sup>19 20 21</sup> Higher mass media campaign exposure also appears to confer greater benefit on socioeconomically disadvantaged population subgroups. Studies comparing different media message types have found messages concerning negative health effects most effective at generating increased knowledge, beliefs, higher perceived effectiveness ratings, or quitting behaviour. Evidence for other message types is more mixed. They do, also, perform very well among young people. In contrast, ads dealing with the cosmetic effects of smoking, addiction and athletic performance, have been found to be less effective. However, with funding for national campaigns having reduced substantially over the past five years, it is vital that campaigns as a vital component of effective tobacco control are able to run at national and regional level.

**23. We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help supplement existing investment in tobacco control, and ensure that the UK can deliver a genuinely comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost an additional £500 million a year, and would include key measures such as:**

- supporting comprehensive tobacco control measures at national, regional and local levels based on the best available evidence
- financing sustained mass media and social marketing campaigns, complemented by other tobacco control initiatives; and
- ensuring and improving the provision of high quality Stop Smoking Services across the country as part of broader tobacco control strategies.

**24. We would also strongly suggest that this portion of the levy be established along similar lines to the US manufacturer “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence.** We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “*establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control*”.

**25. It should be noted that as of 31<sup>st</sup> March, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education, \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.**<sup>22</sup>

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<sup>19</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>20</sup> Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction*, 107(11), 2043-2050

<sup>21</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun;109(6):986-94.

<sup>22</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

## Answers to Consultation Questions

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

26. 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?

27. 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.

28. Forestalling in this context means a temporary increase in the clearance rate of cigarettes and other tobacco products 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 or 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.<sup>23</sup>

29. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult. Crucially it would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local and regional consumption and prevalence levels and the consequent harm caused whilst ensuring cost-effectiveness through delivery across a wider geographical footprint. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>24</sup> <sup>25</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a ‘unique identifier’ that would allow

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<sup>23</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

<sup>24</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>25</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

enforcement authorities to access detailed information about the manufacturing process and intended market.

30. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

**Suggested allocation of revenue from tobacco levy across the countries of the UK**

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

31. In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

32. 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.
33. 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)

34. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>26</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 37 below.

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

35. For the reasons stated in paragraphs 16 to 19 above, 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?

36. We support the use of the corporation tax system to collect the levy, as the system that would pose the least 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.

37. We are unaware of a plausible alternative means for collecting the levy.

**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?

38. 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.

39. According to the Department of Health Impact Assessment on standardised packaging<sup>27</sup> (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.”*

40. 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.

41. The response from ASH 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

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<sup>26</sup> 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.](#)

<sup>27</sup> [Impact assessment: standardised packaging of tobacco products:](#) Department of Health June 2014

introduced, and is based on the research paper written by Howard Reed, Landman Economics. It will be noted that 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 (1.26 pence per stick compared to 1.27 pence per stick). 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.

### Size of tobacco levy required to raise £500 million per year

Results, assuming impact of introducing standardised packaging  
(all figures in pence)

Year	15/16	16/17	17/18	18/19	19/20
Smoking prevalence (%) (adults)	17.3	16.4	16.7	16.2	15.7

#### Scenario (a): No pass through of levy to consumers

Cigarette levy (pence per stick)	1.26	1.31	1.35	1.39	1.43
Cigarette levy (per packet of 20)	25.2	26.2	26.9	27.7	28.5
HRT levy (per gram of tobacco)	1.68	1.75	1.80	1.85	1.90
HRT levy (per 25g packet)	42.0	43.7	44.9	46.2	47.5

#### Scenario (b): Full pass through

Cigarette levy (pence per stick)	1.27	1.33	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.5	26.5	27.3	28.0	28.9
HRT levy (per gram of tobacco)	1.70	1.77	1.82	1.87	1.92
HRT levy (per 25g packet)	42.4	44.2	45.4	46.7	48.1

42. 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):<sup>28</sup>
43. 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.

#### Affordability Index: Tobacco Products

1965	100
1980	189
1989	196
1990	185
1995	164
2000	153
2005	157
2006	157

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<sup>28</sup> Communication with Action on Smoking and Health, 14 January 2015

2007	155
2008	154
2009	150
2010	165
2011	130
2012	123
2013	115

44. 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<sup>29</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>30</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved<sup>31 32</sup>, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.
45. Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products.<sup>4</sup> Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits or the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>33</sup> Tobacco is unlike any other product on the market in that it kills half of all long-term users unless they quit. It is therefore clear that the tobacco industry should, and could well afford to, pay the proposed levy.

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

46. We anticipate that tobacco multinationals may suggest alternatives to a levy but we would be highly wary of any suggestion that they make a 'contribution' to society other than death and disease on an industrial scale. We would recommend vigilance against any attempts by the tobacco industry to reposition the levy as part of a separate 'corporate social responsibility deal' to enable it to exert influence on government public health policy, in violation of the WHO FCTC Article 5.3. We would also recommend government vigilance against the tobacco industry attempting to influence how this money is spent. Historically, the tobacco industry has sponsored youth prevention programmes to forestall legislation such as smokefree spaces and restrictions on marketing in the US. The 2012 Surgeon General's Report, *Preventing Tobacco Use Among Youth and Young Adults*, concluded "*the tobacco companies' activities and programs for the prevention of youth smoking have not demonstrated an impact on the*

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<sup>29</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

<sup>30</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>31</sup> DH. [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

<sup>32</sup> DH [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

<sup>33</sup> BAT Annual Report 2013

*initiation or prevalence of smoking among young people*<sup>34</sup>.” There is evidence these programmes have been ineffective at best and harmful at worst.

47. We consider that a levy on tobacco products, with a revenue target per year fixed over five years, is by far the most desirable policy option. 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 a sufficient proportion of such funds are used to support comprehensive tobacco control delivery which includes evidence-based policy initiatives designed to reduce smoking prevalence. We therefore do not offer any alternative to a levy in this consultation response.

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<sup>34</sup> 2012 US Surgeon General Report

## 2.12 County Durham Health and Well-being Board

[tobaccolevy@hmtreasury.gsi.gov.uk](mailto:tobaccolevy@hmtreasury.gsi.gov.uk)

Dear Consultation Team

### Re: Response from County Durham Health and Well-being Board to HM Treasury Consultation on a tobacco levy

I am responding in capacity of Chair of County Durham Health and Well-being Board (H&WBB). The H&WBB brings together partners from across the county to work together to improve the health and wellbeing of people in our communities. We are committed to reducing the health harms caused by tobacco and reducing smoking prevalence, which includes reducing the uptake of smoking amongst children and young people. We have an ambition for County Durham that by 2030 smoking prevalence in County Durham is reduced to 5%, and amongst Routine and Manual Groups reduce smoking prevalence to 10%. This ambition is driven by a vision to make children the future focus for protection and the statement below is the commitment to this:-

*"The tobacco-free generation is a vision well worth striving for – that a child born now in any part of County Durham will reach adulthood breathing smokefree air, being free from tobacco addiction and living in a community where to smoke is unusual. We owe it to our children to make this happen"*

The board approved the five year tobacco control action plan (2013 – 2017) that is supported and delivered by partners across the county. Our four NHS partners (two CCGs, the hospital foundation Trust and the Mental Health Foundation Trust) have signed the NHS Statement of Support for Tobacco Control. Durham County Council has also signed the Local Government Declaration on Tobacco Control.

Last year the board also signed up to support the vision "Making Smoking History in the North East Partnership" which is to reduce tobacco related harm and ultimately to reduce tobacco smoking to a suggested regional level of below 5% by 2025 through shifting the social norms of tobacco use to make it less accessible, affordable and attractive and to centre action around:

- Motivating and supporting smokers to stop
- Reducing uptake of smoking
- Protecting individuals and communities from tobacco related harm

We are grateful to Fresh and ASH for their support in developing this response.

### General Observations

1. The Board warmly welcomes the opportunity to respond to this consultation on introducing 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."*<sup>1</sup>
2. There is widespread public appetite for more policies to reduce the harm of smoking in society with appetite for these measures having increased over the past few years. In 2014 a survey

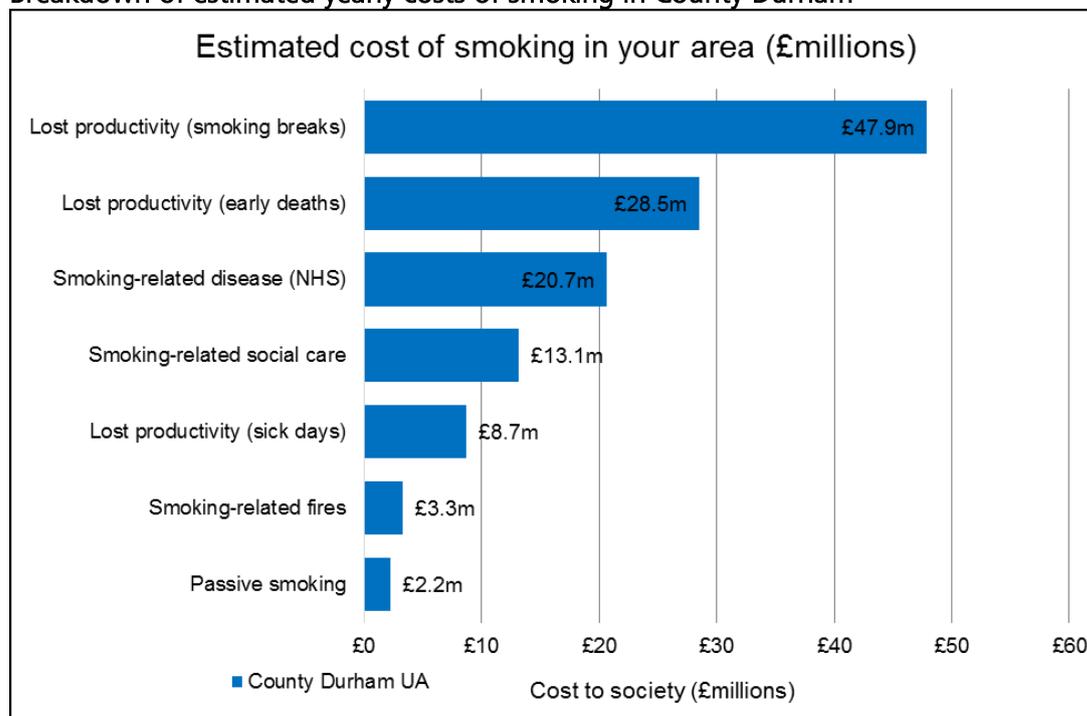
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<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

by YouGov commissioned by Action on Smoking and Health found nearly half of North East adults (43%) believing that not enough is being done to cut the harm of smoking, and another 33% saying the Government is doing about right (this was compared to 2011 when 36% said not enough is being done and another 36% thought the government was doing about right). Only 12% of adults in the North East thought “the Government is doing too much” compared to 22% in 2011 and even amongst smokers in England fewer than half (35%) believed that the government is doing too much.

3. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year<sup>2</sup>. This is likely to be an under-estimate as only costs where data is attributable have been included.
4. In the North East, the conservative cost of smoking is avoidably high at almost £160 million per year, and in County Durham this is £124.4 million which includes the cost to business through lost productivity and costs to the NHS of treating smokers and those exposed to secondhand smoke. However it **does not** include costs borne by e.g. local authorities who commission stop smoking services, provide regulatory services to support compliance with tobacco-related legislation and street cleaning services to remove litter such as cigarette butts and tobacco packs.

#### Breakdown of estimated yearly costs of smoking in County Durham



Source: ASH Ready Reckoner. ASH and LeLan Solutions, Sept. 2014

5. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
6. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office

<sup>2</sup> ASH Ready Reckoner. ASH and LeLan Solutions, Sept. 2014

for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>3</sup>

7. The tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution.<sup>4</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>5</sup>
8. Fewer than one in five adults now smoke, but smoking rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes<sup>6</sup>, killing one in two of all long-term smokers<sup>7</sup>.
9. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>8</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
10. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to reduce tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
11. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:

*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*

*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing..."*

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<sup>3</sup> *ibid*

<sup>4</sup> Branston JR and Gilmore A (2014) The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tob control* 23(1):45-50

<sup>5</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

<sup>6</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>7</sup> Doll R, Peto R, Wheatley K, Gray R, Sutherland I. Mortality in relation to smoking: 40 years observations on male British doctors. *British Medical Journal* 1994; 309:901-911

<sup>8</sup> The World Bank. *Curbing the epidemic: governments and the economics of tobacco control*. May, 1999.

*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation...”<sup>9</sup>*

12. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
13. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short-term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.
14. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual ‘user fee’ to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
15. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, *“The Health Consequences of Smoking – 50 Years of Progress”*, reports that *“States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased.”*
16. Similar declines in prevalence have been seen in the North East, North West and South West of England where there is investment at a regional level in comprehensive tobacco control programmes which add value and substantially enhance and amplify efforts and outcomes nationally and locally. Investment at this level ensures that national policies and evidence-based practice are implemented effectively and allows local commissioners to benefit from economies of scale and to reach much greater population numbers<sup>10</sup>. The NICE Tobacco Return on Investment Tool provides evidence that tobacco control delivery is most cost-effective when it is delivered across a bigger geographical footprint at the subnational level<sup>11</sup>.
17. Much more can be achieved if this regional investment is sustained, increased and widened: the US Surgeon General report also finds that long term investment is critical. It states,

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<sup>9</sup> [NHS: Five Year Forward View](#) NHS England, October 2014

<sup>10</sup> Royal College of Physicians and the UK Centre for Tobacco Control Studies: Fifty years since Smoking and health: Progress, lessons and priorities for a smoke-free UK, March 2012

<sup>11</sup> NICE [Tobacco return on investment tool](#) v3.03

*“Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact.”*<sup>12</sup>

18. In reducing the harm from smoking in the UK, an essential role is played by the delivery of tobacco control measures carried out by local authorities, for example the stop smoking services. The Department of Health document “Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12” stated that: *“Stop smoking services are a key part of tobacco control and health inequalities... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers.”*<sup>13</sup>
19. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about the reduction over the last two years in the number of smokers being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13
20. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs much of the direct savings they deliver accrue mainly to the NHS and not by the increasingly cash-strapped local authorities that commission the services. This point also applies to local action, by trading standards officers and others, to regulate the tobacco market and support compliance with legislation. In respect of illicit tobacco, the Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.
21. The level of illicit trade nationally has declined by half since 2000. Regions in England have also seen reductions in the illicit market particularly in the North East, North West and South West, where the three regional comprehensive tobacco control programmes lead the Tackling Illicit Tobacco for Better Health Partnership<sup>14</sup> to reduce the demand for and supply of illegal tobacco. For example in the North East, 15% of tobacco products in 2009 were estimated to be illicit; by 2013 this had dropped to 9%<sup>15</sup>. However, the latest figures from HM Revenue and Customs suggest that nationally the illicit tobacco market has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>16</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>17</sup> and the House of Commons Home Affairs Select Committee.<sup>18</sup> Fresh strongly supports

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<sup>12</sup> U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

<sup>13</sup> [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

<sup>14</sup> [www.illegal-tobacco.co.uk](http://www.illegal-tobacco.co.uk)

<sup>15</sup> NEMS illicit tobacco survey 2013

<sup>16</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

<sup>17</sup> [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

<sup>18</sup> [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

these recommendations, which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.

22. Regular tobacco control mass media and social marketing campaigns alongside increases in the real price of cigarettes are critical for reducing population smoking prevalence, but require significant investment in order to be most effective<sup>19 20 21</sup> Higher mass media campaign exposure also appears to confer greater benefit on socioeconomically disadvantaged population subgroups. Studies comparing different media message types have found messages concerning negative health effects most effective at generating increased knowledge, beliefs, higher perceived effectiveness ratings, or quitting behaviour. Evidence for other message types is more mixed. They do, also, perform very well among young people. In contrast, ads dealing with the cosmetic effects of smoking, addiction and athletic performance, have been found to be less effective. However, with funding for national campaigns having reduced substantially over the past five years, it is vital that campaigns as a vital component of effective tobacco control are able to run at national and regional level.
23. We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help supplement existing investment in tobacco control, and ensure that the UK can deliver a genuinely comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost an additional £500 million a year, and would include key measures such as:
- supporting comprehensive tobacco control measures at national, regional and local levels based on the best available evidence
  - financing sustained mass media and social marketing campaigns, complemented by other tobacco control initiatives; and
  - ensuring and improving the provision of high quality Stop Smoking Services across the country as part of broader tobacco control strategies.
24. We would also strongly suggest that this portion of the levy be established along similar lines to the US manufacturer “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “*establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control*”.
25. It should be noted that as of 31<sup>st</sup> March, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education, \$449 million has been spent

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<sup>19</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>20</sup> Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction*, 107(11), 2043-2050

<sup>21</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun;109(6):986-94.

on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>22</sup>

## Answers to Consultation Questions

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

26. 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?

27. 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.

28. Forestalling in this context means a temporary increase in the clearance rate of cigarettes and other tobacco products 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 or 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.<sup>23</sup>

29. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult. Crucially it would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local and regional consumption and prevalence levels and the consequent harm caused whilst ensuring cost-effectiveness through delivery across a wider geographical footprint. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the

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<sup>22</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

<sup>23</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

Illicit Trade Protocol.<sup>24 25</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a 'unique identifier' that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.

30. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

**Suggested allocation of revenue from tobacco levy across the countries of the UK**

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

31. In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

32. 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.

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

<sup>24</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>25</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

- 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)

34. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams. <sup>26</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 37 below.

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

35. For the reasons stated in paragraphs 16 to 19 above, 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?

36. We support the use of the corporation tax system to collect the levy, as the system that would pose the least 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.

37. We are unaware of a plausible alternative means for collecting the levy.

**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?

38. 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.

39. According to the Department of Health Impact Assessment on standardised packaging <sup>27</sup> (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."*

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<sup>26</sup> 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.](#)

<sup>27</sup> [Impact assessment: standardised packaging of tobacco products:](#) Department of Health June 2014

40. 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.
41. The response from ASH 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, and is based on the research paper written by Howard Reed, Landman Economics. It will be noted that 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 (1.26 pence per stick compared to 1.27 pence per stick). 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.

#### Size of tobacco levy required to raise £500 million per year

Results, assuming impact of introducing standardised packaging  
(all figures in pence)

Year	15/16	16/17	17/18	18/19	19/20
Smoking prevalence (%) (adults)	17.3	16.4	16.7	16.2	15.7

#### Scenario (a): No pass through of levy to consumers

Cigarette levy (pence per stick)	1.26	1.31	1.35	1.39	1.43
Cigarette levy (per packet of 20)	25.2	26.2	26.9	27.7	28.5
HRT levy (per gram of tobacco)	1.68	1.75	1.80	1.85	1.90
HRT levy (per 25g packet)	42.0	43.7	44.9	46.2	47.5

#### Scenario (b): Full pass through

Cigarette levy (pence per stick)	1.27	1.33	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.5	26.5	27.3	28.0	28.9
HRT levy (per gram of tobacco)	1.70	1.77	1.82	1.87	1.92
HRT levy (per 25g packet)	42.4	44.2	45.4	46.7	48.1

42. 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):<sup>28</sup>
43. 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.

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<sup>28</sup> Communication with Action on Smoking and Health, 14 January 2015

## Affordability Index: Tobacco Products

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

44. 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<sup>29</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>30</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved<sup>31 32</sup>, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.
45. Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products.<sup>4</sup> Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits of the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>33</sup> Tobacco is unlike any other product on the market in that it kills half of all long-term users unless they quit. It is therefore clear that the tobacco industry should, and could well afford to, pay the proposed levy.

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

46. We anticipate that tobacco multinationals may suggest alternatives to a levy but we would be highly wary of any suggestion that they make a 'contribution' to society other than death and

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<sup>29</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

<sup>30</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>31</sup> DH. [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

<sup>32</sup> DH [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

<sup>33</sup> BAT Annual Report 2013

disease on an industrial scale. We would recommend vigilance against any attempts by the tobacco industry to reposition the levy as part of a separate 'corporate social responsibility deal' to enable it to exert influence on government public health policy, in violation of the WHO FCTC Article 5.3. We would also recommend government vigilance against the tobacco industry attempting to influence how this money is spent. Historically, the tobacco industry has sponsored youth prevention programmes to forestall legislation such as smokefree spaces and restrictions on marketing in the US. The 2012 Surgeon General's Report, *Preventing Tobacco Use Among Youth and Young Adults*, concluded "*the tobacco companies' activities and programs for the prevention of youth smoking have not demonstrated an impact on the initiation or prevalence of smoking among young people*<sup>34</sup>." There is evidence these programmes have been ineffective at best and harmful at worst.

47. We consider that a levy on tobacco products, with a revenue target per year fixed over five years, is by far the most desirable policy option. 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 a sufficient proportion of such funds are used to support comprehensive tobacco control delivery which includes evidence-based policy initiatives designed to reduce smoking prevalence. We therefore do not offer any alternative to a levy in this consultation response.

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<sup>34</sup> 2012 US Surgeon General Report

## 2.13 Action on Smoking and Health Wales



### ASH Wales response to the Tobacco levy consultation

Name: \_\_\_\_\_  
Organisation: ASH Wales  
Email/telephone number: \_\_\_\_\_ / \_\_\_\_\_  
Address: \_\_\_\_\_

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."<sup>1</sup>

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.<sup>2</sup> 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.<sup>3</sup> 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.<sup>4,5</sup>

## **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.<sup>6</sup>

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.<sup>7</sup> 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 packaging<sup>8</sup> (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 Economics<sup>9</sup>, 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
<b>Scenario (a): No pass through</b>					
<b>Adult smoking prevalence (%)</b>	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
<b>Scenario (b): Full pass through</b>					
<b>Adult smoking prevalence (%)</b>	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):<sup>10</sup>

#### 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%.<sup>11</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved<sup>12, 13</sup>, 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.<sup>14</sup>

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.<sup>4</sup> 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.

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- 1 HM Treasury Autumn Statement December 2014, paragraph 2.252.
- 2 Branston, J.R. and Gilmore, A. (2015). The extreme profitability of the UK tobacco market and the rationale for a new tobacco levy.
- 3 EU Tobacco Tax Directive Article 15.
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- 6 HM Revenue and Customs: Tobacco Bulletin, August 2014
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- 8 Impact assessment: standardised packaging of tobacco products: Department of Health June 2014
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- 12 DH. A smokefree future: a comprehensive tobacco control strategy for England. HM Government. February 2010.
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## 2.14 Camden and Islington Tobacco Control Alliance, London Borough of Islington and London Borough of Camden

### HM Treasury Consultation

#### Tobacco Tax Levy (closing date 18<sup>th</sup> February 2015)

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/384769/tobacco\\_levy\\_consultation.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/384769/tobacco_levy_consultation.pdf)

Send responses to:

tobaccolevy@hmtreasury.gsi.gov.uk

This response has been put together by \_\_\_\_\_, Education & Enforcement Manager, Environment Service, London Borough of Camden. The submission is made on behalf of the London Borough of Camden, London Borough of Islington and the Camden and Islington Tobacco Control Alliance.

Camden and Islington sit at the heart of the world's most vibrant city. This gives us a rare advantage in challenging economic times and we need to capitalise on that creating the conditions for and harnessing the benefits of economic growth.

#### General Observations

1. Environment service would welcome the Chancellor's announcement in the Autumn Statement that the Government is considering the introduction of a levy on tobacco manufacturers and importers. We strongly agree that: *"Smoking imposes costs on society, and the Government believes it is therefore fair to ask the tobacco industry to make a greater contribution."*<sup>1</sup>
2. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year.<sup>2</sup> The cost of tobacco use for both Camden and Islington is considerable; listed below are the estimated costs for one of the two boroughs, the London Borough of Camden. It has been estimated that smoking costs the borough around £56.8 million every year. This figure includes
  - £6 million in costs to the NHS for treating smoking-related illnesses
  - £861 thousand in costs for treating passive-smoking related illnesses
  - £2 million in social care for smokers with smoking-related illnesses
  - £2 million lost to the local economy as a result of smoking-related fires
  - £27 million in costs to business because of smoking breaks
  - £15 million costs for the loss in productivity due to premature death
  - £4 million costs for smoking-related sick days
  - £2 million lost to the local economy as a result of smoking-related fires.

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<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

<sup>2</sup> [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

3. In addition to the above costs, the cost of cleaning up smoking-related litter from Camden Streets is substantial. Annual costs are in the range of £8.3 million, and the vast majority of street litter is cigarette-related – approximately 24 tonnes every year. Of the estimated 900 Fixed Penalty Notices for litter we issue every year, most are given to smokers. It should also be noted that a significant amount of smoking-related litter is from smokers who are not resident in Camden because borough boundaries incorporate tourist areas such as Camden Market, Tottenham Court Road, the British Library, Kings Cross station, the British Museum and parts of Covent Garden. It is not right that our non-smoking residents pay to clean up after smokers especially when those smokers may not even live in Camden.
4. The London Borough of Camden published its five-year vision for the borough, the Camden Plan, in 2012.<sup>3</sup> In this document is a strategic objective to deliver value for money services to local residents and a commitment to reduce costs. The cost of cleaning up smoking-related litter is one which we cannot afford in the current economic climate. We strongly believe that this cost should be met by the tobacco industry.
5. The tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution towards cleaning up the terrible devastation that their products cause.<sup>4</sup>
6. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
7. A Tobacco Company Obligation would follow the same model. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the shortterm, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.
8. **We therefore submit that if a tobacco levy is introduced, a proportion of the proceeds should be used to address the environmental harm caused by tobacco, and pay for cleaning up smoking-related street litter.**

## Answers to Consultation Questions

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

9. 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

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<sup>3</sup> [The Camden Plan](#) is available to download from our website.

<sup>4</sup> Branston JR and Gilmore A (2014) The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tob control* 23(1):45-50

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?

10. 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.
11. “*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. In the month or so after the Budget, this is generally followed by lower than average release of products. 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.<sup>5</sup>
12. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult, and, crucially, would also the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local consumption and prevalence levels and the consequent harm caused. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>6 7</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a “*unique identifier*” that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.
13. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the

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<sup>5</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

<sup>6</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>7</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

#### Suggested allocation of revenue from tobacco levy across the countries of the UK

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

14. In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

15. 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.
16. 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)

17. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>8</sup> 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?

18. For the reasons stated in paragraphs 16 to 19 above, 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?

19. We support the use of the corporation tax system to collect the levy, as the system that would pose the least 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.

20. We are unaware of a plausible alternative means for collecting the levy.

**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?

21. 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.

22. According to the Department of Health Impact Assessment on standardised packaging<sup>9</sup> (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.”*

23. 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.

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<sup>8</sup> 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*.

<sup>9</sup> [Impact assessment: standardised packaging of tobacco products](#): Department of Health June 2014

24. The research paper attached to this consultation response written by Howard Reed, Landman Economics, 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. It will be noted that 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 (1.26 pence per stick compared to 1.27 pence per stick). 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.

#### Size of tobacco levy required to raise £500 million per year

Results, assuming impact of introducing standardised packaging (all figures in pence)

Year	15/16	16/17	17/18	18/19	19/20
Smoking prevalence (%) (adults)	17.3	16.4	16.7	16.2	15.7

#### Scenario (a): No pass through of levy to consumers

Cigarette levy (pence per stick)	1.26	1.31	1.35	1.39	1.43
Cigarette levy (per packet of 20)	25.2	26.2	26.9	27.7	28.5
HRT levy (per gram of tobacco)	1.68	1.75	1.80	1.85	1.90
HRT levy (per 25g packet)	42.0	43.7	44.9	46.2	47.5

#### Scenario (b): Full pass through

Cigarette levy (pence per stick)	1.27	1.33	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.5	26.5	27.3	28.0	28.9
HRT levy (per gram of tobacco)	1.70	1.77	1.82	1.87	1.92
HRT levy (per 25g packet)	42.4	44.2	45.4	46.7	48.1

25. 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):<sup>10</sup>

26. 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.

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<sup>10</sup> Communication with Action on Smoking and Health, 14 January 2015

## Affordability Index: Tobacco Products

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

27. 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<sup>11</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>12</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved<sup>13 14</sup>, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.
28. Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products.<sup>4</sup> Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits or the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>15</sup> It is therefore clear that the tobacco industry could well afford to pay the proposed levy.

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

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<sup>11</sup> Office for National Statistics. General Lifestyle Survey Overview: A report on the 2011 General Lifestyle Survey. 2013.

<sup>12</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>13</sup> DH. [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

<sup>14</sup> DH [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

<sup>15</sup> BAT Annual Report 2013

29. We consider that a levy on tobacco products, with a revenue target per year fixed over five years, is by far the most desirable policy option to raise funds for essential tobacco control and enforcement work. We therefore do not offer any alternative to a levy in this consultation response.
30. 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 stop smoking services, illicit trade enforcement and other evidence-based policy initiatives designed to reduce smoking prevalence.

## 2.15 Darlington Borough Council

### HM Treasury Consultation

#### Tobacco Tax Levy (closing date 18th February 2015)

#### Response from Darlington Borough Council

1. The Darlington Health Profile for 2014 indicates that Darlington is worse than England average for smoking at time of delivery, smoking prevalence and smoking related deaths. We welcome a levy that would fairly distribute support for this on a local and national scale.
2. Please find below our responses to the questions posed in your consultation.
3. We are grateful to ASH (Action on Smoking and Health) and Fresh Smoke Free North East for their support in developing this response.

#### Answers to Consultation Questions

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

4. We support this definition of the tobacco market. 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?*

5. 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.
6. “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 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 possibly 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.

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

7. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult, and, crucially, would also ensure the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local consumption and prevalence levels and the consequent harm caused.
8. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction.

**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?*

9. 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.

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

10. 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?*

**Answers to Q 6 and 7 below**

11. 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.
12. 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?*

**Answer to Qs 8,9,10 below**

13. 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

14. 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.

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

15. We conclude 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.

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

## 2.16 Director of Public Health for Gateshead Council

### HM Treasury Consultation on a tobacco levy

#### General Observations

1. As Director of Public Health for Gateshead Council, I am encouraged for the opportunity to respond to this consultation on introducing 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."*<sup>1</sup>
2. There is widespread public appetite for more policies to reduce the harm of smoking in society with appetite for these measures having increased over the past few years. In 2014 a survey by YouGov commissioned by Action on Smoking and Health found nearly half of North East adults (43%) believing that not enough is being done to cut the harm of smoking, and another 33% saying the Government is doing about right (this was compared to 2011 when 36% said not enough is being done and another 36% thought the government was doing about right). Only 12% of adults in the North East thought "the Government is doing too much" compared to 22% in 2011 and even amongst smokers in England fewer than half (35%) believed that the government is doing too much.
3. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year. This is likely to be an under-estimate as only costs where data is attributable have been included.
4. In Gateshead alone it is estimated that the total cost of smoking to society is approximately £47.4 million a year
5. In 2013/2014, smokers in Gateshead paid approximately £42.1 million in duty on tobacco products. Despite this contribution to the exchequer, smoking still costs Gateshead roughly 1 times as much as the duty raised. This results in a shortfall of about £5 million a year<sup>2</sup>.
6. The costs to society listed above are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
7. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>3</sup>
8. The tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution.<sup>4</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary,

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<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

<sup>2</sup> [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

<sup>3</sup> *ibid*

<sup>4</sup> Branston JR and Gilmore A (2014) The case for Of smoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tob control* 23(1):45-50

but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>5</sup>

9. In Gateshead smoking prevalence is 22.8%. Smoking rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes<sup>6</sup>, killing one in two of all long-term smokers<sup>7</sup>.
10. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>8</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
11. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to reduce tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
12. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:  
  
*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*  
  
*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*  
  
*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation..."*<sup>9</sup>
13. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.

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<sup>5</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

<sup>6</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>7</sup> Doll R, Peto R, Wheatley K, Gray R, Sutherland I. Mortality in relation to smoking: 40 years observations on male British doctors. *British Medical Journal* 1994; 309:901-911

<sup>8</sup> The World Bank. *Curbing the epidemic: governments and the economics of tobacco control*. May, 1999.

<sup>9</sup> [NHS: Five Year Forward View](#) NHS England, October 2014

14. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short-term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.
15. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
16. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, *"The Health Consequences of Smoking – 50 Years of Progress"*, reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."*
17. Similar declines in prevalence have been seen in the North East, North West and South West of England where there is investment at a regional level in comprehensive tobacco control programmes which add value and substantially enhance and amplify efforts and outcomes nationally and locally. Investment at this level ensures that national policies and evidence-based practice are implemented effectively and allows local commissioners to benefit from economies of scale and to reach much greater population numbers<sup>10</sup>. The NICE Tobacco Return on Investment Tool provides evidence that tobacco control delivery is most cost-effective when it is delivered across a bigger geographical footprint at the subnational level<sup>11</sup>.
18. Much more can be achieved if this regional investment is sustained, increased and widened: the US Surgeon General report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."* <sup>12</sup>
19. In reducing the harm from smoking in the UK, an essential role is played by the delivery of tobacco control measures carried out by local authorities, for example the stop smoking services. The Department of Health document *"Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12"* stated that: *"Stop smoking services are a key part of tobacco control and health inequalities... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers."* <sup>13</sup>

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<sup>10</sup> Royal College of Physicians and the UK Centre for Tobacco Control Studies: Fifty years since Smoking and health: Progress, lessons and priorities for a smoke-free UK, March 2012

<sup>11</sup> NICE [Tobacco return on investment tool](#) v3.03

<sup>12</sup> U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

<sup>13</sup> [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

20. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about the reduction over the last two years in the number of smokers being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13
21. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs much of the direct savings they deliver accrue mainly to the NHS and not by the increasingly cash-strapped local authorities that commission the services. This point also applies to local action, by trading standards officers and others, to regulate the tobacco market and support compliance with legislation. In respect of illicit tobacco, the Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.
22. The level of illicit trade nationally has declined by half since 2000. Regions in England have also seen reductions in the illicit market particularly in the North East, North West and South West, where the three regional comprehensive tobacco control programmes lead the Tackling Illicit Tobacco for Better Health Partnership<sup>14</sup> to reduce the demand for and supply of illegal tobacco. For example in the North East, 15% of tobacco products in 2009 were estimated to be illicit; by 2013 this had dropped to 9%<sup>15</sup>. However, the latest figures from HM Revenue and Customs suggest that nationally the illicit tobacco market has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>16</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>17</sup> and the House of Commons Home Affairs Select Committee.<sup>18</sup> Fresh strongly supports these recommendations, which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.
23. Regular tobacco control mass media and social marketing campaigns alongside increases in the real price of cigarettes are critical for reducing population smoking prevalence, but require significant investment in order to be most effective<sup>19 20 21</sup> Higher mass media campaign exposure also appears to confer greater benefit on socioeconomically disadvantaged population subgroups. Studies comparing different media message types have found messages concerning negative health effects most effective at generating increased knowledge, beliefs, higher perceived effectiveness ratings, or quitting behaviour. Evidence for other message types

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<sup>14</sup> [www.illegal-tobacco.co.uk](http://www.illegal-tobacco.co.uk)

<sup>15</sup> NEMS illicit tobacco survey 2013

<sup>16</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

<sup>17</sup> [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

<sup>18</sup> [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

<sup>19</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>20</sup> Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction*, 107(11), 2043-2050

<sup>21</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun;109(6):986-94.

is more mixed. They do, also, perform very well among young people. In contrast, ads dealing with the cosmetic effects of smoking, addiction and athletic performance, have been found to be less effective. However, with funding for national campaigns having reduced substantially over the past five years, it is vital that campaigns as a vital component of effective tobacco control are able to run at national and regional level.

24. We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help supplement existing investment in tobacco control, and ensure that the UK can deliver a genuinely comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost an additional £500 million a year, and would include key measures such as:

- supporting comprehensive tobacco control measures at national, regional and local levels based on the best available evidence
- financing sustained mass media and social marketing campaigns, complemented by other tobacco control initiatives; and
- ensuring and improving the provision of high quality Stop Smoking Services across the country as part of broader tobacco control strategies.

25. We would also strongly suggest that this portion of the levy be established along similar lines to the US manufacturer “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “*establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control*”.

26. It should be noted that as of 31<sup>st</sup> March, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education, \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>22</sup>

## Answers to Consultation Questions

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

27. 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?

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<sup>22</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

(answer 2&3 combined)

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

28. 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.
29. Forestalling in this context means a temporary increase in the clearance rate of cigarettes and other tobacco products 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 or 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.<sup>23</sup>
30. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult. Crucially it would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local and regional consumption and prevalence levels and the consequent harm caused whilst ensuring cost-effectiveness through delivery across a wider geographical footprint. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>24</sup> <sup>25</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a 'unique identifier' that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.
31. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

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<sup>23</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

<sup>24</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>25</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

## Suggested allocation of revenue from tobacco levy across the countries of the UK

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

32. In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

33. 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.

34. 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)

35. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>26</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 37 below.

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

36. For the reasons stated in paragraphs 16 to 19 above, we prefer the initial use of previous year clearance data, at the start of the levy, with evolution towards use of sales volume data.

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<sup>26</sup> 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.](#)

**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?

37. We support the use of the corporation tax system to collect the levy, as the system that would pose the least 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.

38. We are unaware of a plausible alternative means for collecting the levy.

**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?

39. 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.

40. According to the Department of Health Impact Assessment on standardised packaging <sup>27</sup> (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.”*

41. 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.

42. The response from ASH 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, and is based on the research paper written by Howard Reed, Landman Economics. It will be noted that 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 (1.26 pence per stick compared to 1.27 pence per stick). 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.

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<sup>27</sup> [Impact assessment: standardised packaging of tobacco products](#): Department of Health June 2014

## Size of tobacco levy required to raise £500 million per year

Results, assuming impact of introducing standardised packaging  
(all figures in pence)

Year	15/16	16/17	17/18	18/19	19/20
Smoking prevalence (%) (adults)	17.3	16.4	16.7	16.2	15.7

### Scenario (a): No pass through of levy to consumers

Cigarette levy (pence per stick)	1.26	1.31	1.35	1.39	1.43
Cigarette levy (per packet of 20)	25.2	26.2	26.9	27.7	28.5
HRT levy (per gram of tobacco)	1.68	1.75	1.80	1.85	1.90
HRT levy (per 25g packet)	42.0	43.7	44.9	46.2	47.5

### Scenario (b): Full pass through

Cigarette levy (pence per stick)	1.27	1.33	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.5	26.5	27.3	28.0	28.9
HRT levy (per gram of tobacco)	1.70	1.77	1.82	1.87	1.92
HRT levy (per 25g packet)	42.4	44.2	45.4	46.7	48.1

43. 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):<sup>28</sup>
44. 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.

### Affordability Index: Tobacco Products

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

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<sup>28</sup> Communication with Action on Smoking and Health, 14 January 2015

45. 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<sup>29</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>30</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved<sup>31 32</sup>, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.
46. Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products.<sup>4</sup> Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits of the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>33</sup> Tobacco is unlike any other product on the market in that it kills half of all long-term users unless they quit. It is therefore clear that the tobacco industry should, and could well afford to, pay the proposed levy.

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

47. We anticipate that tobacco multinationals may suggest alternatives to a levy but we would be highly wary of any suggestion that they make a 'contribution' to society other than death and disease on an industrial scale. We would recommend vigilance against any attempts by the tobacco industry to reposition the levy as part of a separate 'corporate social responsibility deal' to enable it to exert influence on government public health policy, in violation of the WHO FCTC Article 5.3. We would also recommend government vigilance against the tobacco industry attempting to influence how this money is spent. Historically, the tobacco industry has sponsored youth prevention programmes to forestall legislation such as smokefree spaces and restrictions on marketing in the US. The 2012 Surgeon General's Report, *Preventing Tobacco Use Among Youth and Young Adults*, concluded "*the tobacco companies' activities and programs for the prevention of youth smoking have not demonstrated an impact on the initiation or prevalence of smoking among young people*<sup>34</sup>." There is evidence these programmes have been ineffective at best and harmful at worst.
48. We consider that a levy on tobacco products, with a revenue target per year fixed over five years, is by far the most desirable policy option. 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

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<sup>29</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

<sup>30</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>31</sup> DH. [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

<sup>32</sup> DH [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

<sup>33</sup> BAT Annual Report 2013

<sup>34</sup> 2012 US Surgeon General Report

burden of illness and death justifies measures to raise additional funds from large and highly profitable tobacco manufacturers, assuming that a sufficient proportion of such funds are used to support comprehensive tobacco control delivery which includes evidence-based policy initiatives designed to reduce smoking prevalence. We therefore do not offer any alternative to a levy in this consultation response.

Thank you for your time in reading my response

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Director Public Health  
Gateshead Council

## 2.17 Director Of Public Health Durham County Council

Contact: \_\_\_\_\_  
Direct Tel: \_\_\_\_\_  
Fax: \_\_\_\_\_  
email: \_\_\_\_\_



Dear Consultation Team

### Response from Director of Public Health, Durham County Council to HM Treasury Consultation on a tobacco levy

I am responding in my capacity of Director of Public Health for Durham County Council. As a council we serve a population of approximately 513,200. We are committed to reducing the health harms caused by tobacco and reducing smoking prevalence, which includes reducing the uptake of smoking amongst children and young people. We have a dedicated tobacco alliance with partner organisations and a five year tobacco control action plan that is supported and delivered by these partners across the county. The tobacco alliance of County Durham is also part of a North East network of alliances. Durham County Council is also the lead commissioner of Fresh – the North East Office of Tobacco Control, on behalf of the 12 North East local authorities. The commissioning of the regional Fresh programme demonstrates both our, and the North East's commitment to implementing evidence based tobacco control that will impact on the health and wellbeing of our communities.

We are grateful to Fresh and ASH for their support in developing this response.

#### General Observations

1. Durham county Council warmly welcomes the opportunity to respond to this consultation on introducing 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."*<sup>1</sup>
2. There is widespread public appetite for more policies to reduce the harm of smoking in society with appetite for these measures having increased over the past few years. In 2014 a survey by YouGov commissioned by Action on Smoking and Health found nearly half of North East adults (43%) believing that not enough is being done to cut the harm of smoking, and another 33% saying the Government is doing about right (this was compared to 2011 when 36% said not enough is being done and another 36% thought the government was doing about right). Only 12% of adults in the North East thought "the Government is doing too much" compared to 22% in 2011 and even

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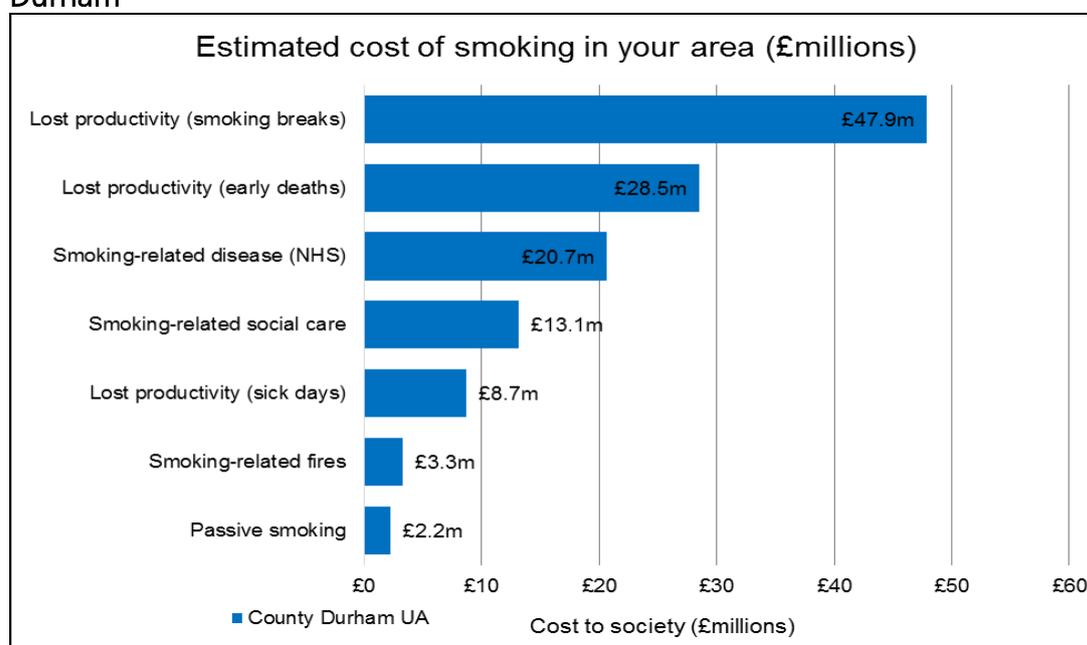
<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

amongst smokers in England fewer than half (35%) believed that the government is doing too much.

- As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year<sup>2</sup>. This is likely to be an under-estimate as only costs where data is attributable have been included.
- In the North East, the conservative cost of smoking is avoidably high at almost £160 million per year, and in County Durham this is £124.4 million which includes the cost to business through lost productivity and costs to the NHS of treating smokers and those exposed to secondhand smoke. However it **does not** include costs borne by e.g. local authorities who commission stop smoking services, provide regulatory services to support compliance with tobacco-related legislation and street cleaning services to remove litter such as cigarette butts and tobacco packs.

### Breakdown of estimated yearly costs of smoking in County

#### Durham



Source: ASH Ready Reckoner. ASH and LeLan Solutions, Sept. 2014

- The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
- Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household

<sup>2</sup> ASH Ready Reckoner. ASH and LeLan Solutions, Sept. 2014

expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>3</sup>

7. The tobacco industry enjoys massive profit margins in the UK and would be very well able to make more of a contribution.<sup>4</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>5</sup>
8. Fewer than one in five adults now smoke, but smoking rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes<sup>6</sup>, killing one in two of all long-term smokers<sup>7</sup>.
9. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>8</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
10. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to reduce tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
11. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:

*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*

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<sup>3</sup> *ibid*

<sup>4</sup> Branston JR and Gilmore A (2014) The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tob control* 23(1):45-50

<sup>5</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

<sup>6</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>7</sup> Doll R, Peto R, Wheatley K, Gray R, Sutherland I. Mortality in relation to smoking: 40 years observations on male British doctors. *British Medical Journal* 1994; 309:901-911

<sup>8</sup> The World Bank. *Curbing the epidemic: governments and the economics of tobacco control*. May, 1999.

*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*

*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation..."<sup>9</sup>*

12. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
13. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short-term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.
14. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
15. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, *"The Health Consequences of Smoking – 50 Years of Progress"*, reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."*
16. Similar declines in prevalence have been seen in the North East, North West and South West of England where there is investment at a regional level in comprehensive tobacco control programmes which add value and substantially enhance and amplify efforts

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<sup>9</sup> [NHS: Five Year Forward View](#) NHS England, October 2014

and outcomes nationally and locally. Investment at this level ensures that national policies and evidence-based practice are implemented effectively and allows local commissioners to benefit from economies of scale and to reach much greater population numbers<sup>10</sup>.

The NICE Tobacco Return on Investment Tool provides evidence that tobacco control delivery is most cost-effective when it is delivered across a bigger geographical footprint at the subnational level<sup>11</sup>.

17. Much more can be achieved if this regional investment is sustained, increased and widened: the US Surgeon General report also finds that long term investment is critical. It states, *“Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact.”*<sup>12</sup>
18. In reducing the harm from smoking in the UK, an essential role is played by the delivery of tobacco control measures carried out by local authorities, for example the stop smoking services. The Department of Health document *“Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12”* stated that: *“Stop smoking services are a key part of tobacco control and health inequalities... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers.”*<sup>13</sup>
19. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about the reduction over the last two years in the number of smokers being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13
20. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs much of the direct savings they deliver accrue mainly to the NHS and not by the increasingly cash-strapped local authorities that commission the services. This point also applies to local action, by trading standards officers and others, to regulate the tobacco market and support compliance with legislation. In respect of illicit tobacco, the Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.

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<sup>10</sup> Royal College of Physicians and the UK Centre for Tobacco Control Studies: Fifty years since Smoking and health: Progress, lessons and priorities for a smoke-free UK, March 2012

<sup>11</sup> NICE [Tobacco return on investment tool](#) v3.03

<sup>12</sup> U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

<sup>13</sup> [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

21. The level of illicit trade nationally has declined by half since 2000. Regions in England have also seen reductions in the illicit market particularly in the North East, North West and South West, where the three regional comprehensive tobacco control programmes lead the Tackling Illicit Tobacco for Better Health Partnership<sup>14</sup> to reduce the demand for and supply of illegal tobacco.

For example in the North East, 15% of tobacco products in 2009 were estimated to be illicit; by 2013 this had dropped to 9%<sup>15</sup>. However, the latest figures from HM Revenue and Customs suggest that nationally the illicit tobacco market has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>16</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>17</sup> and the House of Commons Home Affairs Select Committee.<sup>18</sup> Fresh strongly supports these recommendations, which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.

22. Regular tobacco control mass media and social marketing campaigns alongside increases in the real price of cigarettes are critical for reducing population smoking prevalence, but require significant investment in order to be most effective<sup>19 20 21</sup>. Higher mass media campaign exposure also appears to confer greater benefit on socioeconomically disadvantaged population subgroups. Studies comparing different media message types have found messages concerning negative health effects most effective at generating increased knowledge, beliefs, higher perceived effectiveness ratings, or quitting behaviour. Evidence for other message types is more mixed. They do, also, perform very well among young people. In contrast, ads dealing with the cosmetic effects of smoking, addiction and athletic performance, have been found to be less effective. However, with funding for national campaigns having reduced substantially over the past five years, it is vital that campaigns as a vital component of effective tobacco control are able to run at national and regional level.

23. We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help supplement existing investment in tobacco control, and ensure that the UK can deliver a genuinely comprehensive strategy to

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<sup>14</sup> [www.illegal-tobacco.co.uk](http://www.illegal-tobacco.co.uk)

<sup>15</sup> NEMS illicit tobacco survey 2013

<sup>16</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

<sup>17</sup> [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

<sup>18</sup> [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

<sup>19</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>20</sup> Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction*, 107(11), 2043-2050

<sup>21</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun;109(6):986-94.

reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost an additional £500 million a year, and would include key measures such as:

- supporting comprehensive tobacco control measures at national, regional and local levels based on the best available evidence
- financing sustained mass media and social marketing campaigns, complemented by other tobacco control initiatives; and
- ensuring and improving the provision of high quality Stop Smoking Services across the country as part of broader tobacco control strategies.

24. We would also strongly suggest that this portion of the levy be established along similar lines to the US manufacturer “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to *“establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control”*.

25. It should be noted that as of 31<sup>st</sup> March, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education, \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>22</sup>

## Answers to Consultation Questions

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

26. 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?

27. 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

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<sup>22</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

routinely manipulated by the tobacco industry through the process known as forestalling.

28. Forestalling in this context means a temporary increase in the clearance rate of cigarettes and other tobacco products 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 or 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.<sup>23</sup>

29. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult. Crucially it would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local and regional consumption and prevalence levels and the consequent harm caused whilst ensuring cost-effectiveness through delivery across a wider geographical footprint. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>24 25</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a 'unique identifier' that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.

30. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

#### Suggested allocation of revenue from tobacco levy across the countries of the UK

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<sup>23</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

<sup>24</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>25</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

31. In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

32. 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.

33. 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)

34. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>26</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 37 below.

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

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<sup>26</sup> 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.](#)

35. For the reasons stated in paragraphs 16 to 19 above, 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?

36. We support the use of the corporation tax system to collect the levy, as the system that would pose the least 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.

37. We are unaware of a plausible alternative means for collecting the levy.

**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?

38. 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.

39. According to the Department of Health Impact Assessment on standardised packaging<sup>27</sup> (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.”*

40. 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.

41. The response from ASH 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, and is based on the research paper written by Howard Reed,

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<sup>27</sup> [Impact assessment: standardised packaging of tobacco products](#): Department of Health June 2014

Landman Economics. It will be noted that 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 (1.26 pence per stick compared to 1.27 pence per stick). 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.

### Size of tobacco levy required to raise £500 million per year

Results, assuming impact of introducing standardised packaging  
(all figures in pence)

Year	15/16	16/17	17/18	18/19	19/20
Smoking prevalence (%) (adults)	17.3	16.4	16.7	16.2	15.7

#### Scenario (a): No pass through of levy to consumers

Cigarette levy (pence per stick)	1.26	1.31	1.35	1.39	1.43	
Cigarette levy (per packet of 20)		25.2	26.2	26.9	27.7	28.5
HRT levy (per gram of tobacco)	1.68	1.75	1.80	1.85	1.90	
HRT levy (per 25g packet)		42.0	43.7	44.9	46.2	47.5

#### Scenario (b): Full pass through

Cigarette levy (pence per stick)	1.27	1.33	1.36	1.40	1.44	
Cigarette levy (per packet of 20)		25.5	26.5	27.3	28.0	28.9
HRT levy (per gram of tobacco)	1.70	1.77	1.82	1.87	1.92	
HRT levy (per 25g packet)		42.4	44.2	45.4	46.7	48.1

42. 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):<sup>28</sup>

43. 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.

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<sup>28</sup> Communication with Action on Smoking and Health, 14 January 2015

## Affordability Index: Tobacco Products

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

44. 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<sup>29</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>30</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved<sup>31 32</sup>, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.
45. Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products.<sup>4</sup> Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits or the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>33</sup> Tobacco is unlike any other product on the market in that it kills half of all long-term users unless they quit. It is therefore clear that the tobacco industry should, and could well afford to, pay the proposed levy.

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<sup>29</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

<sup>30</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>31</sup> DH. [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

<sup>32</sup> DH [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

<sup>33</sup> BAT Annual Report 2013

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

46. We anticipate that tobacco multinationals may suggest alternatives to a levy but we would be highly wary of any suggestion that they make a 'contribution' to society other than death and disease on an industrial scale. We would recommend vigilance against any attempts by the tobacco industry to reposition the levy as part of a separate 'corporate social responsibility deal' to enable it to exert influence on government public health policy, in violation of the WHO FCTC Article 5.3. We would also recommend government vigilance against the tobacco industry attempting to influence how this money is spent. Historically, the tobacco industry has sponsored youth prevention programmes to forestall legislation such as smokefree spaces and restrictions on marketing in the US.

The 2012 Surgeon General's Report, *Preventing Tobacco Use Among Youth and Young Adults*, concluded "*the tobacco companies' activities and programs for the prevention of youth smoking have not demonstrated an impact on the initiation or prevalence of smoking among young people*<sup>34</sup>." There is evidence these programmes have been ineffective at best and harmful at worst.

47. We consider that a levy on tobacco products, with a revenue target per year fixed over five years, is by far the most desirable policy option. 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 a sufficient proportion of such funds are used to support comprehensive tobacco control delivery which includes evidence-based policy initiatives designed to reduce smoking prevalence. We therefore do not offer any alternative to a levy in this consultation response.

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<sup>34</sup> 2012 US Surgeon General Report

## Global Tobacco

## Grumpier: A submission to HMT's Tobacco Levy consultation

In the Autumn Statement (but not in his speech to Parliament) the Chancellor revealed plans for a levy on tobacco manufacturers and importers due to the "social costs of smoking". The consultation on this runs to 18 February 2015, and we have made a submission which reflects our views on the subject. As with our being grumpy about the politically motivated plans for the introduction of plain packaging, so we are grumpy about this levy. The sums which may be raised from any levy are inconsequential compared with the tax and duty already raised from tobacco sales in the UK; past taxation policies have led to material levels of duty evasion; the direct costs of smoking are a fraction of the tax revenues earned; and the implied "social" costs of smoking are both highly speculative estimates and essentially private.

- **A levy on tobacco manufacturers and importers** – The levy has to be on "manufacturers and importers" as very soon the last two cigarette manufacturing plants in the UK – Imperial at Nottingham and Japan Tobacco at Ballymena - will close. Thereafter all cigarettes sold in the UK will be imported, both to the legal and the illegal markets.
- **Not whether, just when** – The HMT document published in December 2014 "considers the case for, and seeks opinions on, the introduction of a new levy". But none of the 12 questions subsequently posed actually questions the case for a levy, and so shareholders should assume that it is going to be introduced whatever opinions are expressed. In this respect this consultation follows the pattern of similar government consultations, as discussed in our "Grumpy" note.
- **Not clear how, not clear how much** – The consultation document raises questions of establishing market size, but does not include any suggestion as to the intended value of the levy. The policy clearly follows the suggestion of a levy from the Labour party, which had been put at £150m per annum.
- **The levy is meant to address the "social costs" of smoking** – We would argue that in the "costs to society" in England of £12.9bn per annum suggested by ASH and quoted in the document, only £2bn is a genuine figure being the cost to the NHS of treating smoking-related diseases. This should be considered against the £12bn raised in tax and duty from smokers and the estimated £2bn of tax and duty foregone because of illicit trade. The other costs purported to be costs to society are actually costs to individuals and to private enterprises.
- **It is likely that any levy will be passed on to consumers in higher prices** – The legal UK market is likely to decline further to the benefit of illicit trade. That does engender a cost to society.

- Submissions to the consultation need to be made by 18 February 2015 – by email to [tobaccolevy@hmtreasury.gsi.gov.uk](mailto:tobaccolevy@hmtreasury.gsi.gov.uk).

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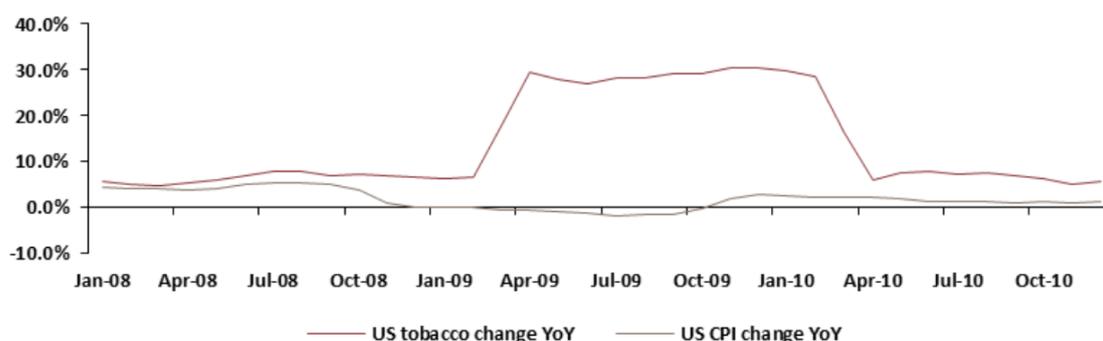
## Introduction

*“And we will raise extra resources from the tobacco companies, who make soaring profits on the back of ill health.” From Ed Milliband’s speech to the 2014 Labour Conference, 23 September 2014, as reported on the Labour Party website.*

Press coverage at the time suggested that the Labour Party estimated that its putative levy would raise £150m per annum and was suggested to be modelled on a scheme introduced in the US in 2009. The Guardian reported at the time “As in the US, the fee for individual firms will be based on their market share, a technique that makes it more difficult to pass the costs onto the consumer”.

The reference to the US in 2009 was the State Children’s Health Insurance Programme, or “SCHIP”. In 2009 the US expanded the health coverage programme to include 4m more children, and the extra spending was financed in part by an increase in Federal Excise Tax on cigarettes of 62c per pack, taking the total FET to \$1.01 per pack. It is important to note that this was not in any way a levy on tobacco companies, but on smokers. The increase in tax was passed directly on to smokers, as clearly shown by CPI data for tobacco products.

Chart 1: US CPI and Tobacco CPI, year-on-year change (%)



Source: Bloomberg

Despite the clear misunderstanding of what actually happened in the US, it appears that the Conservative-Liberal government has chosen to follow Labour’s lead with respect to the introduction of a levy, but a levy which it believes will be aimed at the companies rather than consumers. Clearly there is a question as to whether this will be the actual outcome, and we address that in our responses below.

The [document](#) as issued by HM Treasury in December 2014 is itself an interesting example of how “consultation” actually works. The introduction to the document states in paragraph 1.2 “*This consultation considers the case for, and seeks opinions on, the introduction of a new levy on tobacco manufacturers and importers*”. It then sets out, with background information, 12 questions on which views are to be expressed. None of these questions actually asks whether the respondent believes that the levy should be introduced.

The motive for this levy is explained as being “*The government believe it is right that tobacco manufacturers and importers make a greater contribution to the societal costs of smoking*” (paragraph 3.8). The introduction to the document trots out the usual list of costs outlined by Action on Smoking and Health, a charity which is part funded by the government –

- £2 billion cost to the NHS of treating diseases caused by smoking.
- £3bn loss in productivity due to premature death.
- £5bn cost to businesses of smoking breaks.
- £1bn cost of smoking-related sick days.
- £1.1bn of social care costs of older smokers.
- £391m cost of fires caused by smokers’ materials.

Of these costs, the only genuine cost to society is the £2bn cost estimated by the NHS for treating diseases caused by smoking, and should be seen against the £12bn raised from smokers in the form of tax and duty. The other costs are either entirely speculative and/or private costs.

The estimate for the loss of productivity from smoking breaks stems from 2008 work by Maguire, Raikou and Jofre-Bonet in a paper telling entitled “An Economic Analysis of the Cost of Employee Smoking **borne by Employers**” (our emphasis). There is no “cost to society” of a smoker having a smoking break just as there is no “cost to society” of a non-smoker checking their social media accounts while at work. We can all find ways to pass the time when at work, either on a smoking break or in complaining about others taking smoking breaks. If our employer believes that, for whatever reason, we are unproductive they can choose not to promote us, to penalise our income or to remove us from their employ. But these are not costs to society.

We are constantly reminded that “Smoking Kills” but it is clear from mortality data that the vast majority of smoking related deaths are of smokers over 70. Of those under 70, the data typically refer to an age group that spans 35-69, which is a wide range. Work by [Nash and Featherstone](#) on the loss of productivity from “young” smoker deaths suggests that the weighted average age of demise of a working smoker was 54, suggesting that much of that smoker’s “productivity” had already been delivered. Moreover it is not a “cost” to all of us as society should someone undertake voluntarily a course of action which potentially shortens their own life. Some choose to smoke (and hence to generate tax revenues) while some choose to commute to work through London traffic on a bicycle.

We were struck by this week’s headlines that “[smokers ... could have impaired thinking](#)” which looked at a study of smokers **with an average age of 73**. The data comes from the Lothian Brain

Cohort of people born in 1936. Life expectancy for someone born in the UK in the 1930s is around 70-75, and so for the smokers still to be included in the survey is no mean feat.

In our view the actual costs of smoking are modest relative to the current income. The very foundation of the argument that smoking imposes "large costs on society" (paragraph 1.6) is weak. But as we pointed out, that is the answer to a question which is not posed by the consultation.

We include below our specific answers to each of the questions posed in the consultation document.

### Q1: Is it appropriate to define the tobacco market as products on which tobacco excise duty is paid?

Paragraph 2.2 lays out that tobacco excise duty is levied on cigarettes, hand rolling tobacco, pipe tobacco, shisha, chewing tobacco and herbal cigarettes. It is stated that "there is no evidence that herbal smoking products are any less harmful" and we would suggest that inclusion of the products really makes no effective difference to the value of the assessed market anyway.

### Q2: What would be the consequences of using volumes of tobacco cleared in the previous year in order to calculate total market size?

The consultation document makes clear that basing the size of the market on profits makes no sense and we agree, albeit for different reasons.

The argument in 2.6 is that this would not reflect differing cost profiles. In reality establishing direct costs will become increasingly difficult when the last two remaining tobacco manufacturing facilities (Imperial at Nottingham, Japan Tobacco at Ballymena) close. Thereafter all cigarettes sold in the UK will have been imported.

Using clearances at least bears some resemblance to activity levels (paragraph 2.8) but monthly data will reflect the timing of competitor activity, trade loading and deloading, promotional activity and the timing of duty increases. This will at least measure volumes in the legal market.

### Q3: Are there any other metrics that you would prefer were used to calculate total market size? If so, why?

An estimate should be made of the total size of consumption. The (weak) argument for this levy is for tobacco companies to "pay a greater amount to society". It is the case that there is a thriving illicit market in the UK, and on the estimates of HMRC this costs the government (and hence society) around £2bn per annum in revenue foregone, which "[could be spent on services that we all use, such as healthcare](#)". To the extent that the legally supplied, and heavily regulated, market is penalised by duty rates which encourage illicit trade, the proportion of the levy applying to the legal market should be discounted by its proportion of the total market.

### Q4: What are the practical difficulties in splitting the total market into 2 distinct parts: Cigarettes; and HRT and other products subject to tobacco duty?

This is one of the more sensible approaches to separating the constituent parts of the tobacco market, but does not make allowance for the "make your own" segment.

#### Q5: Which of option (i) and (ii) as set out in paragraph 2.14 is your preferred option?

The options are to use (i) previous year or (ii) current year clearances to determine the levy. This is an inevitably loaded question as there is no option to suggest that the basis of the levy itself is questionable. Of these two options (i) is the less objectionable.

The argument included in paragraph 2.15 is that using the prior year would involve difficulties in assessing the impact of companies leaving or entering the market. There are four global tobacco companies and each is present in the UK market already with a combined market share of essentially 100%. None is likely to leave. New entrants are unlikely at the best of times, and all the more so given the added hurdles of the point of sale display ban and the threat of plain packaging. The fact that the government is also threatening the industry with an arbitrary levy must surely discourage further any company not already put off.

#### Q6: Do you agree that the corporation tax system provides the best mechanism for returning and paying the tobacco levy?

The parallel is made in 2.19 with the bank levy. It is our understanding that the operation of the bank levy involves determination of contribution after the end of each bank's financial year, and is not easily assessed from publicly available information. This results in material uncertainty for shareholders of individual companies with respect to the actual cost in any period, and impacts on the ability of those companies to communicate effectively with their shareholders with respect to potential earnings. This inability to communicate effectively with shareholders could increase the companies' cost of equity and impact on their ability to operate effectively.

#### Q7: What are the alternative approaches?

One approach would be to abandon the idea of a levy before it is too late.

#### Q8: The government welcomes views on the expected impacts of the levy on consumer prices.

Paragraphs 3.2 - 3.5 outline a number of scenarios for how the tobacco companies themselves deal with the levy.

It is suggested that the tobacco companies could absorb the levy within profits (albeit that the consultation document previously made the case that profits were a poor indicator of market size). This seems a wholly unlikely outcome.

The alternative outcome, as suggested, is that the levy is passed through to consumers in the form of higher prices with the risk that volumes decline. The level of levy which the government is proposing is not made clear, but assuming that there is little more ambition than the £150m previously suggested by Labour then this would be equivalent to 1% price increases on the £15bn annual retail spend on tobacco products in the UK.

It is probable that further price increases will stimulate more illicit trade in the UK, which will in due course be aided by the mooted introduction of plain packaging. The impact of price increases in the legal market may therefore be offset by a smaller weighting of tobacco within inflation data. But that, perhaps, misses the point of the levy.

#### Q9: Would the levy have any other impacts on consumers that have not been considered in this document?

As per Q8 it is probable that consumers will increasingly seek out illicit cigarettes which are sold much more cheaply. It has been widely reported that illicit cigarettes - and in particular counterfeit cigarettes - have much greater health risks as the quality of the cigarette is the last thing on the counterfeiters' mind. The consumer buys on the visual trigger of the box; they do not have the chance to sample the product in advance. The consumer is, therefore, exposed to greater personal risk while the Exchequer loses more revenue but shoulders higher potential healthcare costs in due course. It is the case that the nature of illicit trade has changed markedly over time. It is no longer the "booze cruise" but organised crime. If there is a societal cost being borne by tobacco taxation it is surely this.

It is widely accepted that tobacco taxation is regressive. Statistically smokers are less well educated, live in poorer areas and have lower incomes than non-smokers. Any further price increases as a result of tobacco taxation will therefore disproportionately impact upon poorer people.

#### **Q10: Would the levy have any other market impacts?**

The decision by government to arbitrarily seek to introduce a levy on a market which is already highly taxed (and regulated) has potentially much wider ramifications for the UK. While two of the four tobacco companies operating in the UK are also UK-domiciled, two are international companies. The impact on the reputation of the UK as a place to do business cannot help but be impacted negatively by the decision of the government to undertake a poorly constructed attack on a company's earned profits.



CONSULTATION ON THE TOBACCO LEVY  
RESPONSE OF BRITISH AMERICAN TOBACCO UK LIMITED  
18 FEBRUARY 2015

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## 1. INTRODUCTION

- 1.1. This submission is made by British American Tobacco UK Limited in response to the Government Consultation on the introduction of the Tobacco Levy, published on 10 December 2014.
- 1.2. British American Tobacco UK Limited is a member of the British American Tobacco group of companies and is responsible for the importation, distribution and sale of tobacco products in the United Kingdom (principally cigarettes, but also Roll-Your-Own tobacco). British American Tobacco UK Limited has an 8.9% share of the UK market in cigarettes and a share of 12.1% of the UK market in Roll-Your-Own tobacco.
- 1.3. As explained in detail below, British American Tobacco UK Limited is strongly opposed to the introduction of the Tobacco Levy. We believe the proposal is unlawful. Furthermore, the proposal is fundamentally flawed in that it is based on a false premise that the tobacco industry should contribute more to the costs of smoking, ignoring that the existing contribution made by the tobacco sector, in excess of £12.1 billion, far exceeds a reasonable estimate of the costs that smoking imposes on society.
- 1.4. A response to specific Consultation questions is provided in section 8 of this Response. However, British American Tobacco UK Limited first sets out why the introduction of the Tobacco Levy would be unlawful, would not work and therefore should not proceed.

## DEFINITIONS AND ABBREVIATIONS

<b>A1 P1</b>	Article 1 of the First Protocol of the European Convention on Human Rights.
<b>ASH</b>	Action on Smoking and Health.
<b>British American Tobacco,</b>	British American Tobacco UK Limited.
<b>BAT or We</b>	
<b>BAT'S MET Submission</b>	BAT's response to the consultation into Minimum Excise Tax, submitted on 15 October 2014.
<b>Consultation</b>	The Government Consultation on the Tobacco Levy, published on 10 December 2014, to which this is the Response.
<b>CJEU</b>	Court of Justice of the European Union.
<b>Crookshank Report</b>	The expert report of Mr Stuart Crookshank OBE, a recently retired former Her Majesty's Revenue and Customs officer, attached as Appendix 2 to this Response.
<b>ECHR</b>	European Convention on Human Rights.
<b>Excise Directive</b>	EU Directive 2008/118/EC.

EU	The European Union.
Gibson Report	The expert report of Mr Stephen Gibson, an economist, consultant and founder of SLG Economics Limited, and formerly Chief Economist and Director of Economic Policy at Postcomm, attached as Appendix 1 to this Response.
Government	The government of the United Kingdom.
HMRC	Her Majesty's Revenue and Customs.
KPMG Report	The expert report of KPMG LLP, attached as Appendix 3 to this Response.
Response	This document.
Tobacco Excise Directive	EU Directive 2011/64/EU.
Tobacco Levy	The proposed tobacco levy as described in the Consultation.
TFEU	The Treaty on the Functioning of the European Union.
UK	The United Kingdom.
VAT Directive	EU Directive 2006/112/EC.

## 2. EXECUTIVE SUMMARY

**BAT is strongly opposed to the Tobacco Levy on a number of grounds, including:**

- 2.1 **The Consultation process is flawed.** The Consultation process is in breach of the Government's own consultation principles which it purports to follow, and is inconsistent with case law setting out the well-established requirements for proper consultation as a matter of public law.
- 2.2 **The Tobacco Levy is unlawful.** The Tobacco Levy would violate the EU Directive 2008/118/EC ("**Excise Directive**") because it is an indirect tax both on general legal principles and a purposive reading of the Excise Directive which does not come within the exception of Article 1(2) of the Excise Directive.
- 2.3 **There is no factual justification for the introduction of the Tobacco Levy.** As demonstrated by the expert report from Mr Stephen Gibson of SLG Economics (Appendix 1 to this Response) (the "**Gibson Report**"), the apparent basis for the decision to consider the introduction of the Tobacco Levy is unreasoned and wholly unreasonable. This is not least due to: the uncertainty surrounding how the Tobacco Levy would be set, making it arbitrary, unpredictable and potentially capricious; tobacco taxes already far exceed a reasonable estimate of the costs that smoking imposes on society, so there is no need for a Tobacco Levy; the assumption that the Tobacco Levy would not feed through to tobacco prices is incorrect and therefore the argument for introducing a Tobacco Levy is unsound; and a Tobacco Levy could reduce rather than increase the total tax contribution from the tobacco sector undermining the objective of the new tax. In addition,

there are alternatives that are lawful and would result in an increase in tax revenues.

- 2.4 **The Tobacco Levy infringes property rights and the EU principle of proportionality.** The Tobacco Levy would constitute an unjustified and disproportionate interference with rights protected both under the ECHR and under EU law. The Consultation fails to demonstrate that the Tobacco Levy is necessary, adequate and proportionate. Accordingly, any decision to implement the Tobacco Levy would be manifestly inappropriate.

### 3. THE CONSULTATION PROCESS IS FLAWED

- 3.1 BAT's position is that the Consultation process is flawed. Not only is it in breach of the Government's own Consultation Principles which it purports to follow, but it is inconsistent with case law setting out the well-established requirements for proper consultation as a matter of public law, most recently confirmed at the highest level by the Supreme Court (*R (Moseley) v Haringey London Borough Council* [2014]<sup>1</sup>).

- 3.2 The Consultation asserts at paragraph 5.10 that the Consultation is being run in accordance with the Government's consultation principles<sup>2</sup>. These principles include that "[e]ngagement should begin early in policy development when the policy is still under consideration and views can genuinely be taken into account"<sup>3</sup>; that "[e]very effort should be made to make available the Government's evidence base at an early stage to enable contestability and challenge"<sup>4</sup>; that "[s]ufficient information should be made available to stakeholders to enable them to make informed comments"<sup>5</sup>.

- 3.3 In *Moseley*, the Supreme Court endorsed the four basic requirements for a consultation to be fair in public law terms: (a) consultation must be at a time when proposals are still at a formative stage; (b) the proposer must give sufficient reasons for any proposal to permit of intelligent consideration and response; (c) adequate time must be given for consideration and response; and (d) the product of consultation must be conscientiously taken into account in finalising any statutory proposals. The Supreme Court decided that the consultation in that case was unlawful for its failure to put forward alternative options and reasons for their rejection.

- 3.4 For the reasons summarised below the Consultation meets neither the requirements of the law nor the Government's consultation principles. This summary is not intended to be exhaustive.

#### 3.5 The Consultation process is fundamentally flawed, including because:

- 3.5.1 Although the Consultation purports at the outset to be about "whether" to introduce a levy on tobacco manufacturers and importers, it is clear from the Consultation questions that this is not the case at all. Rather, the government has pre-determined that companies should pay and is only consulting on the design of the payment.

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<sup>1</sup> WLR 3947

<sup>2</sup> Available at <https://www.gov.uk/government/publications/consultation-principles-guidance>.

<sup>3</sup> Consultation Principles, page 1.

<sup>4</sup> *Ibid.*, page 1-2.

<sup>5</sup> *Ibid.*, page 2.

3.5.2 Although the Consultation mentions "alternatives", this is only done in the context of a pre-determination that the companies should pay more and without providing any proper reasons. More fundamentally, the Consultation fails to address at all the alternative of not imposing a further payment on top of the tax and excise burdens already borne by the tobacco industry.

3.5.3 The Consultation contains a proposal that would, if implemented, result in a greater tax burden being imposed on the tobacco industry, yet the document dedicates a mere five pages to the proposal. It provides inadequate reasons and information to inform stakeholders so that they can meaningfully respond to the Consultation. In particular:

- (1) It provides no reasoning as to why it is considered "*fair to ask tobacco manufacturers and importers to make a greater contribution towards*" alleged "*costs on society*" which it attributes to smoking based on research conducted by Action on Smoking and Health ("**ASH**"), which cannot be taken to be impartial. There is no explanation at all for consultees as to why the Government is yet again singling out the tobacco industry from other industries. There is no discussion or analysis of what problem the Tobacco Levy is trying to solve or of the appropriateness of the objective of making a greater contribution towards the costs.
- (2) The Consultation provides only a single reference to a paper by ASH on costs of tobacco, without any critical analysis/evaluation. Further to the comments above, the ASH research cannot be taken to be independent and impartial. ASH is an anti-tobacco advocacy group. It is inappropriate for the Government to rely on the work of ASH without interrogating it robustly.
- (3) The Consultation fails to consider the contribution towards the costs of smoking already made by the tobacco sector in Duty, and VAT of more than £12.1 billion which far exceeds a reasonable estimate of the costs that smoking imposes on society.
- (4) There is no disclosure of, or transparency as to, how the Government would set the appropriate contribution to be made towards the costs that tobacco may impose and therefore the size of the Tobacco Levy. Accordingly, the proposal is arbitrary, capricious and inaccessible.
- (5) There is no discussion of the interaction of the Tobacco Levy with other tobacco taxes and the impact of the Tobacco Levy on the total tax revenue from the tobacco sector.

3.6 BAT has commissioned the Gibson Report from Mr Stephen Gibson (SLG Economics Limited), formerly Chief Economist and Director of Economic Policy at Postcomm, who specialises in competition and regulatory economics. The Gibson Report is submitted with this Response (see Appendix 1). The Gibson Report assesses whether the process followed by HM Treasury and the Consultation are consistent with UK guidelines on undertaking consultations and better regulation principles, and whether the Consultation provides an adequate basis to conclude that the proposed

Tobacco Levy is necessary, appropriate and proportionate. Mr Gibson finds that the consultation has not followed proper process, including that it does not meet the requirements of the Tax Consultation Framework, does not follow the Government's Consultation Principles and goes against the letter and spirit of the Government's Regulatory Commitment.

3.7 Taking the factors outlined above into account, Mr Gibson concludes that:

*"Overall the standard of process, evidence and analysis in the Consultation falls well below that required to move forward with a policy decision of this type and the Consultation is clearly not fit for purpose."*

and

*"...it would be manifestly inappropriate to rely on the Consultation to move forward with a Tobacco Levy."<sup>6</sup> (emphasis added).*

3.8 Accordingly, a decision to proceed with the Tobacco Levy on the basis of the procedure followed is liable to be struck down at least for procedural impropriety. The findings in the Gibson Report also tie in with the irrationality of the proposed measure, discussed in section 5 below.

## 4. THE TOBACCO LEVY IS UNLAWFUL

### 4.1 Introduction – the Excise Directives and the Tobacco Directive

4.1.1 Taxation of tobacco products within the EU is subject to the provisions of the Excise Directive and Directive 2011/64/EU (the "**Tobacco Excise Directive**"). The main aim of the Excise Directive is to create a genuine internal market for products in which cross-border trade in goods is as easy as trade within a Member State of the European Union ("**Member State**").<sup>7</sup> Similarly, the Tobacco Excise Directive has as its main aim harmonising the taxation of tobacco products so as to ensure the proper functioning of the internal market.

4.1.2 The Excise Directive requires the harmonisation of indirect taxes on excise goods. Therefore, Article 1(2) of the Excise Directive does not permit the introduction of any other indirect taxes on excise duty products (which include cigarettes and other tobacco products) save to the extent they fall within a limited exception, which requires that they (i) are introduced for a specific purpose, and (ii) comply with EU legislation applicable to excise duty (or VAT) as far as determination of the tax base, calculation of the tax, chargeability and monitoring of the tax are concerned. In outline, the rest of this part of the Response shows that the Tobacco Levy:

- (A) Is an indirect tax both on general legal principles and a purposive reading of the Excise Directive (see section 4.2); and
- (B) Does not come within the exception of Article 1(2) of the Excise Directive (see section 4.3),

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<sup>6</sup> See the Gibson Report at section 2.

<sup>7</sup> Thus giving effect to the legal basis provided in the Treaty on the Functioning of the European Union, ("**TFEU**") Article 113.

and as such is not permitted by the Excise Directive, and is unlawful.

## 4.2 The Tobacco Levy is an indirect tax

- 4.2.1 There is no definition of indirect tax in the Excise Directive, or otherwise, under EU law. However, it is widely accepted in UK and common law legal jurisprudence that indirect taxes are those which are demanded from one person in the expectation and intention that he should indemnify himself at the expense of another.
- 4.2.2 Further, EU jurisprudence concerning the context and purpose of the Excise Directive is instructive as to how "indirect tax" should be interpreted in the context of Article 1(2). It is accepted that in the absence of a definition, or applicable case-law, what is or is not an indirect tax for the purposes of the Excise Directive can only finally be determined by a decision of the CJEU.
- 4.2.3 From this EU jurisprudence and wider jurisprudence on direct and indirect taxes, it is possible to formulate the following principles:
- (A) **Expectation that a person other than the taxpayer will ultimately bear the tax.** The key feature of an indirect tax is that there is an expectation, arising out of what the authorities refer to as "a general tendency", for that tax to ultimately be borne by a person other than the person upon whom the tax is initially levied.<sup>8</sup>
- (1) The general tendency which gives rise to the expectation may be extrapolated from structural features of the tax.<sup>9</sup> This could include, for example, the basis of chargeability or the calculation of such tax. For example, charging by reference to products consumed is indicative of an indirect tax, whereas a tax imposed without regard to turnover may be more in keeping with a direct tax. The underlying policy aims of the tax may also be relevant.<sup>10</sup>
- (2) A general tendency does not require there to be a mechanism which onward charges the tax to consumers. It does not matter if in some cases the charge is not in fact passed on; what is important is that there is a general tendency to pass the tax on and an expectation that this will happen<sup>11</sup>.

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<sup>8</sup> JS Mill, *Principles of Political Economy*, as cited in *R (British Aggregates Association) v Customs and Excise Commissioners* [2002] EWHC 926 (Admin) at §70; *Bank of Toronto v Lambe* (1887) 12 App Cas 575; and numerous others.

<sup>9</sup> *R v Caledonian Collieries, Limited* [1928] AC 358; obiter dicta in *Bank of Toronto v Lambe*; *Attorney-General for British Columbia v Esquimalt and Nanaimo Railway Company* [1950] AC 87; *British Aggregates Association*.

<sup>10</sup> *British Aggregates Association*, paragraphs 75-78.

<sup>11</sup> *R v Caledonian Collieries, Limited*; *British Aggregates Association*, paragraph 75.

- (3) The expectation or intention is an objective one, assessed at the time of the introduction of the tax. The purported rationale of Government is not relevant.<sup>12</sup>
- (B) **Labels are not relevant.** The fact that the Tobacco Levy is labelled as a direct tax does not influence its characterisation as an indirect tax.<sup>13</sup> EU case law on the application of Article 1(2) confirms that any attempt to construe a tax as being direct when in reality it has a similar function to an excise duty will not be effective in circumventing the application of the Excise Directive.<sup>14</sup>
- (C) **Mechanics for collection are not relevant.** The proposal to collect the tax via corporation tax returns does not influence its characterisation as an indirect tax.
- (D) **Passing on to consumers need not be precise.** It is not necessary to demonstrate that the tax is passed on to the consumers in a precise or direct way. For example, even if the amount of tax is not known at the time of sale but it is anticipated or expected that the tax will tend to be reflected in the price as an estimate, the tax will still be characterised as an indirect tax.<sup>15</sup>
- (E) **Purposive Interpretation.** The context and purpose of Article 1(2) of the Excise Directive show that it prohibits the imposition of any tax which replicates the effect of excise duties yet imposes additional or different formalities as this contravenes very purpose of the Excise Directive which is to abolish remaining barriers in the internal market.<sup>16</sup>

**4.2.4** Based on the above, the Tobacco Levy would clearly fall to be characterised as an indirect tax within the meaning of the Excise Directive. It has the structural nature of an indirect tax, being calculated by reference to market

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<sup>12</sup> *British Aggregates Association*, paragraph 75.

<sup>13</sup> *R v Caledonian Collieries, Limited*.

<sup>14</sup> See in particular Case C-82/12 *Transportes Jordi Besora SL v Tribunal Económico Administrativo Regional de Cataluña* ("TEARC") ("**Jordi Besora**"), including the Opinion of Advocate General Wahl delivered on 24 October 2013.

<sup>15</sup> *R v Caledonian Collieries, Limited*.

<sup>16</sup> *Jordi Besora*, Opinion of Advocate General Wahl delivered on 24 October 2013, at paragraph 22 and 44. This case concerned the compatibility with Article 1(2) of the Excise Directive of a levy imposed by Spain on retail sales of certain hydrocarbons (the "**Hydrocarbon Levy**") and the interpretation of the criteria for exception under Article 1(2). The CJEU's judgment in this case is entirely in line with Advocate General Wahl's Opinion (discussed further below). As with the Tobacco Levy, the Hydrocarbon Levy was designed to operate as an additional tax on an excise product, to be levied in proportion to the volume of products sold in the territory. It is to be noted that in that case the Spanish authorities acknowledged that the Hydrocarbon Levy constituted an indirect tax within the scope of the Directive.

See also Case 437/97, *Evangelischer Krankenhausverein Wien and Others v Oberösterreichische Landesregierung* [2000] ECR I-1157 (Case C-437/97), at paragraph 46, and Case 434/97, *Commission of the European Communities v French Republic* (judgment of 24 February 2000)(*Commission v France*), at paragraph 26.

share and therefore imposed on turnover rather than assets, and would contravene and frustrate the very purpose of the Excise Directive.<sup>17</sup>

4.2.5 At Appendix 3 to this Response, BAT also submits the expert report of KPMG (the "**KPMG Report**") which analyses the impact of the Tobacco Levy on the UK tobacco industry and, in particular, if there would be any impact on retail prices. KPMG has conducted a dynamic simulation analysis of the effect of the proposed Tobacco Levy on cigarette prices; and an assessment using economic theory of the impact of the levy on prices. Both analyses arrive at the same conclusions:

- the proposed Tobacco Levy would be passed on to consumers in the form of higher prices;
- in that respect, the proposed Tobacco Levy mechanism would have the same effect on prices as an indirect tax and does not share the features of a direct tax when it comes to the effect on market prices; and
- accordingly, it is not accurate to characterise the proposed levy as a direct tax on tobacco manufacturers, as stated in paragraph 3.3 of the Treasury's Consultation.

4.2.6 The KPMG Report states that:

*"we calculate that every one of the big four cigarette manufacturers would be better off passing on the levy than it would be keeping its prices at the existing level."*

*"regardless of whether other manufacturers put their prices up when the levy is introduced, our calculations show that a structural feature of the levy is that it will always be worthwhile for any individual manufacturer to pass on the levy unilaterally."*

*"The findings from our simulation analysis are invariant to the total size of the levy target that is introduced."* and

*"This is a similar response as we would expect for a VAT or excise duty increase."*

4.2.7 Accordingly, it is clear that the Tobacco Levy would be passed on to consumers. In the light of such a clear expectation there cannot be a genuine intention or expectation to the contrary. Furthermore, the Tobacco Levy is precisely the type of supplementary tax on excise duty products, causing additional administrative burdens that the Excise Directive seeks to avoid.

### 4.3 The Tobacco Levy does not satisfy the exception (Article 1(2))

4.3.1 As already discussed, Article 1(2) of the Excise Directive, contains an exception to the general prohibition on indirect taxes on excise goods, which allows an indirect tax to be introduced provided (i) it is introduced for a specific purpose, **and** (ii) it complies with EU legislation applicable to excise duty (or VAT) as far as determination of the tax base, calculation of

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<sup>17</sup> In this regard, a comparison can be made to *Bank of Toronto v Lambe* where a tax imposed by reference to share capital and number of bank branches (i.e. no link to turnover) was found to be a direct tax.

the tax, chargeability and monitoring of the tax are concerned. The Tobacco Levy does not satisfy either cumulative condition.

- 4.3.2 In interpreting this Article, it is important again to have regard to the overall purpose of the directive which is *"to prevent additional indirect taxes from improperly obstructing trade. That would, in particular, be the case if traders were subject to formalities other than those provided for by the Community legislation on excise duty or VAT"*.<sup>18</sup>

#### The Tobacco Levy is not for a specific purpose

- 4.3.3 A specific purpose is a purpose other than a budgetary one.<sup>19</sup>
- 4.3.4 The stated purpose of the Tobacco Levy is raising additional revenue to meet the costs of smoking (paragraph 1.9 – 1.10 of the Consultation). Raising additional funds to meet the costs of smoking is a budgetary objective and therefore not a specific purpose for the purposes of Article 1(2) of the Excise Directive.
- 4.3.5 Moreover, EU case law has determined that if a government wishes to assert that a tax serves a specific purpose other than general revenue generation, in the absence of any mechanism for the predetermined allocation of revenues to such purposes, such specific purpose could only be shown if the measure were designed, so far as concerns its structure, in such a way as to achieve such objective.<sup>20</sup> The Tobacco Levy has not been designed in a way that achieves a specific purpose, nor does it purport to have one. It cannot therefore come within the exception in Article 1(2) of the Excise Directive, as it fails the first condition of that exception.

#### The Tobacco Levy does not comply with EU legislation

- 4.3.6 Even if the Tobacco Levy were to be introduced for a specific purpose, and therefore cleared the first condition of the exception in Article 1(2), it would fail to clear the second condition for the exception, namely the need to comply with the EU rules that apply to either excise duties or VAT in so far as they relate to the determination of the tax base, the calculation of the tax, chargeability and monitoring of the tax.

It has been held by the CJEU that to be compliant with EU law, an indirect tax pursuing specific objectives should accord with the general scheme of one of the taxation techniques as structured by EU legislation<sup>21</sup>. This requires accordance with the general scheme set out in both the Excise Directive and the Tobacco Directive. Further, the Tobacco Levy must not interfere with the objective of the Excise Directive. Advocate General Wahl observed:

*"The Court has held that the directive is intended to prevent additional indirect taxes from improperly obstructing trade. That would, in particular, be the case if traders were subject to formalities other than those*

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<sup>18</sup> Cases C-437/97, at paragraph 46, and C-434/97, *Commission v France*, at paragraph 26.

<sup>19</sup> Case C-437/97, at paragraphs 31-38. See also *Jordi Besora*, Opinion of Advocate General Wahl delivered on 24 October 2013, at paragraph 22.

<sup>20</sup> CJEU judgment in *Jordi Besora*, at paragraph 32 and also the Opinion of Advocate General Wahl, at paragraph 22.

<sup>21</sup> *Commission v France* and Case C-437/97, at paragraph 48.

*provided for by EU legislation on excise duty or VAT. Where the indirect tax in question interferes with this objective, it cannot be compatible with either one of these taxation systems. The relevant criterion is therefore whether or not the tax interferes with the proper functioning of the market."*

- 4.3.7 The proposed Tobacco Levy would interfere with proper functioning of the market and does not comply with the general scheme as set out in the relevant rules and therefore contravenes the Excise Directive. Particular examples of such non-compliance are that the Tobacco Levy does not comply with the relevant rules relating to (1) the determination of the tax base (Article 7(1) and 14 of the Tobacco Excise Directive), (2) the calculation of the tax (Articles 7(3), 8 and 14 of the Tobacco Excise Directive), (3) the chargeability to the tax (Article 9 of the Excise Directive)<sup>22</sup> and (4) the monitoring of the tax (Article 16 of the Tobacco Directive and 9 of the Excise Directive).<sup>23</sup>

## 5. THE TOBACCO LEVY IS IRRATIONAL

- 5.1 The Tobacco Levy proposal is a measure which the Government cannot rationally adopt. It is manifestly flawed not least because it is apparent from the Consultation that the Government has not properly analysed the position and is failing to take relevant considerations into account.

- 5.2 The Gibson Report concludes that:

*"The Consultation document does not include the necessary evidence or analysis to support further development of the policy; it is not fit for purpose and does not provide proportionate evidencebased policy recommendations. It has not shown that a Tobacco Levy is necessary, appropriate or proportionate.*

*Taking all the concerns raised in this report together, it would be manifestly inappropriate to rely on the Consultation to move forward with a Tobacco Levy."<sup>24</sup>*

- 5.3 As explained by Mr Gibson, specific criticisms of the Consultation include that it fails:

- 5.3.1 to consider the contribution already paid by the tobacco sector in Duty and VAT of more than £12.1 billion, which far exceeds a reasonable estimate of the costs that smoking imposes on society:

- (1)** The Consultation does not consider at all the existing contribution made by the tobacco sector in excess of £12.1 billion, which far exceeds a reasonable estimate of the costs

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<sup>22</sup> In *Jordi Besora*, Opinion of Advocate General Wahl suggests that chargeability of the tax is of particular focus, given its significance for the proper functioning of the internal market.

<sup>23</sup> Further, the Tobacco Levy would contravene Article 401 of the VAT Directive which prohibits other indirect taxes which give rise to formalities connected with the crossing of frontiers. Accordingly, to the extent there is a breach of Article 16 or impact contrary to the purpose of the prohibition in Article 1(2) of the Excise Directive, Article 401 would also be breached.

<sup>24</sup> See Gibson Report at section 9.

that smoking imposes on society. The tobacco sector contributed £9.53 billion in duty in 2013-14; and VAT contributes a further £2.6 billion per annum. However this is not mentioned at all in the Consultation.

- (2) As Mr Gibson notes: "[u]nlike the subjective estimates of the costs of smoking to society, these estimates of the contribution already made by the tobacco sector are objective (in some cases audited) with no requirement for judgement or wide margins of estimation."<sup>25</sup>

5.3.2 to justify the proposed level of the Tobacco Levy, leaving tobacco manufacturers and importers subject to an arbitrary, unpredictable and potentially capricious tax that is subjective, disproportionate and takes no account of the contribution that they already make:

- (1) Mr Gibson states: "[t]he Consultation proposes that manufacturers and importers should make a greater contribution towards the costs that smoking imposes on society, but makes no proposals as to what that level of contribution should be – even were such an additional contribution to be justified. The Consultation states that "The government would set a revenue target for the levy", but there is no discussion of how that revenue target would be determined leaving this key question undefined. Although the government believes that "it is fair" for TM&Is to make a greater contribution to the costs that smoking imposes, it is clearly unfair for them to be subject to an arbitrary, unpredictable and potentially capricious tax that is subjective, disproportionate and takes no account of the contribution that they already make."<sup>26</sup>

5.3.3 to justify the requirement for any additional contribution, including:

- (1) The Consultation quotes an ASH estimate of £12.9 billion per year as the estimate for the costs of smoking without any critical analysis or evaluation.<sup>27</sup> However, there are a large number of deficiencies with the ASH estimate, including:
- (a) The total cost of the individual elements quoted amount to £12.491 billion, not £12.9 billion as stated in the Consultation and in the ASH fact sheet on which it is based.<sup>28</sup>
- (b) The ASH estimate fails to distinguish between the costs of smoking that are public costs borne by the taxpayer. £9 billion of the estimated costs, even if they could be considered an actual economic cost,

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<sup>25</sup> See Gibson Report at section 6.1.

<sup>26</sup> See Gibson Report at section 6.2.

<sup>27</sup> Consultation, paragraph 1.9.

<sup>28</sup> *The Economics of Tobacco*, Fact Sheet, Action on Smoking and Health, November 2013.

[http://www.ash.org.uk/files/documents/ASH\\_121.pdf](http://www.ash.org.uk/files/documents/ASH_121.pdf).

are private costs borne by smokers themselves or businesses. Those estimated costs are the alleged:

- (i) £5.0 billion cost to businesses of smoking breaks;
- (ii) £3.0 billion loss in productivity due to premature death; and
- (iii) £1 billion cost of smoking related sick days.

In addition, the ASH estimate as to the social care costs of older smokers (£1.1 billion) includes £450 million for the cost of smoking to self-funders<sup>29</sup>, which is self-evidently a private cost borne by smokers themselves rather than a cost to society. Removing these amounts reduces the estimate of costs to £3.041 billion.

Mr Gibson notes that: "[i]t is clear that the tax contributions from the tobacco sector far exceed the costs clearly borne by society (by a factor of over four)."<sup>30</sup>

- (2) The largest of the estimated costs, £5 billion (40% of the total) is in respect of alleged loss of productivity as a result of smoking breaks. As noted above, this is not a cost to society. Furthermore, the estimate proceeds on a false premise in that it ignores:
  - (a) that non-smokers also take breaks while at work and that smoking breaks can be taken in substitution for or with breaks for other reasons (e.g. during lunch-breaks); and
  - (b) There are benefits from employees taking breaks in raising productivity and relieving stress.

Furthermore, it falsely implies that the alleged loss of productivity from smoking breaks is not otherwise made up by employees; that productivity is constant during the day and that it is not already factored into the employees' remuneration (for example through piecework, time-based pay or performance-related pay). Accordingly, this claim is entirely flawed.

However, even in the event that the factual basis for this estimate were to be accepted, it is based on very tenuous calculations and is not supported by evidence. We note that the estimate is far higher than previous estimates of the costs of smoking breaks to UK business: £914 million

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<sup>29</sup> *The Costs of Smoking to the Social Care System and Society in England*, A report by H Reed of Landman Economics for ASH, Aug 2014 <http://www.ash.org.uk/localtoolkit/docs/SocCareCosts.pdf>.

<sup>30</sup> See Gibson Report at section 2.

in 2008<sup>31</sup> and ASH's own 2012 estimate of £2.9 billion<sup>32</sup>. Mr Gibson notes that ASH's 2012 estimate of £2.9 billion was described as "*extravagantly high*" by the Institute of Economic Affairs.<sup>33</sup>

(3) The assertion that lost productivity due to premature death constitutes a "cost to society" is also flawed as such lost productivity is not borne by society or the taxpayer. Further, it wrongly assumes full employment in the economy. In reality, the vacant role would be taken by someone else who would pay similar taxes and make a similar contribution to the productive process.

5.3.4 As set out above, it is clear that the existing contribution made by the tobacco industry, in excess of £12.1 billion through the payment of tobacco Duty and VAT far exceeds a reasonable estimate of the costs that smoking imposes on society, and is 4 times the £3.041 billion of the alleged costs included within ASH's estimate which actually fall to be paid by society via the taxpayer.

5.3.5 This conclusion is in line with previous government studies in Australia and New Zealand which both found that tobacco tax revenue exceeded the costs of smoking to society.<sup>34</sup>

5.3.6 Taking the above factors into account Mr Gibson concludes that: "*there is no justification for a Tobacco Levy to "make a greater contribution towards<sup>35</sup> the costs smoking imposes on society, since tax payments from the tobacco sector already far exceed a reasonable estimate of those costs.*"<sup>36</sup>

5.4 There is no assessment of the impacts of the Tobacco Levy. The Tobacco Levy would be irrational and illogical because:

5.4.1 The Tobacco Levy would be passed on to consumers, so the claimed objective of imposing a levy on tobacco companies without it affecting tobacco prices would not be met. As set out above, this is confirmed by analysis undertaken by KPMG as detailed in the KPMG Report (attached as Appendix 3 to this Response).

5.4.2 The Tobacco Levy would exacerbate downtrading and an already significant cross-border and illicit trade problem in the UK, relevant considerations which the Government must properly take into account:

(1) The Tobacco Levy would increase the price of tobacco products, encouraging consumers to downtrade to cheaper products, and further incentivising crossborder shopping and the illicit market. The continuing trend and risks to

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<sup>31</sup> *An Economic Analysis of the Cost of Employee Smoking borne by Employers* by Enterprise LSE Limited.

<sup>32</sup> Available at <http://news.surreycc.gov.uk/2012/10/05/smoking-costs-nation-nearly-14bn-a-year/>.

<sup>33</sup> See Gibson Report at section 6.3.2.

<sup>34</sup> See Gibson Report at section 6.3.4.

<sup>35</sup> The Consultation, paragraph 1.10

<sup>36</sup> See Gibson Report at section 6.3.4.

revenue of downtrading in the UK was acknowledged by HM Treasury in its recent consultation on the Minimum Excise Tax.<sup>37</sup> By further increasing the price of cigarettes, the Tobacco Levy would erode the premium segment further and have the effect of further reducing the revenue take from tobacco.

- (2) At Appendix 2 to this Response, BAT submits the expert report of Mr Stuart Crookshank (the "**Crookshank Report**"). Mr Crookshank is a former HMRC officer with nearly 40 years' experience. He previously held several senior roles within HMRC, devising and implementing strategies for tackling tobacco smuggling in the UK. In his report, Mr Crookshank sets out his observations on the illicit trade in tobacco products in the UK and the likely impact of the Tobacco Levy, based upon his many years of experience in tackling the illicit tobacco market in the UK.
- (3) Mr Crookshank is of the view that the Tobacco Levy: *"runs the very real risk of further incentivising the illicit market and driving currently compliant tax-paying smokers down the non-compliant illicit route"*; and that it would also further incentivise cross-border shopping by further driving up the price of legal products in the UK. Mr Crookshank's concerns in relation to the potential introduction of the Tobacco Levy include that:
  - (a) It is neither difficult nor high risk for consumers to obtain illicit cigarettes. The significant size and established nature of the illicit market in the UK means that the impact of the proposed Tobacco Levy on the illicit trade must be carefully considered. The Consultation mistakenly ignores this.
  - (b) Cigarette prices in the UK are already amongst the highest prices for tobacco products in Europe. Further increasing prices would only push more consumers towards the illicit market which is well positioned to take advantage of any increase in demand.

The Tobacco Levy must also be considered in light of additional regulations put in place, or being considered, by the Government which also incentivise the illicit trade by creating further opportunities for the illicit trade to sell products into the market. This includes the full implementation of the retail display ban in the UK; implementation of the new European Union Tobacco Products

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<sup>37</sup> Minimum Excise Tax Consultation 2014, available at:

<https://www.gov.uk/government/consultations/minimum-excise-tax/minimum-excise-tax>.

Directive with increased graphic health warnings and restrictions on tobacco products; further excise increases; the proposed introduction of a Minimum Excise Tax and the proposed introduction of standardised packaging recently announced by the Government.

Imposing an additional cost on legal products will only continue to push consumers further towards the easily accessible illicit market, as they become less willing to continue to pay the increasingly high price of legal products.

- (c) The Consultation assumes that the illicit market in the UK is being effectively combatted. This is over optimistic. It cannot be expected that the illicit market (particularly cheap white cigarettes) will be contained in the UK, let alone reduced, through enforcement unless the Government commits significant additional resources to these efforts and makes widespread changes to the current control and enforcement regime. The Consultation contains no proposal to deal with the increased risk of illicit trade as a result of the proposed introduction of the Tobacco Levy.
- (d) The proposed Tobacco Levy would also further incentivise legal cross-border shopping by further driving up the price of legal products in the UK. Cross-border shopping is currently estimated by HMRC to lead to a loss of revenue (of both VAT and tobacco Excise duties) of £600 million.<sup>38</sup> However, there is no consideration of this additional issue in the Consultation.

Mr Crookshank concludes by stating: "*Given the current lack of priority, resourcing and an effective approach to deterring and disrupting the illicit market within the UK, I cannot see how the Government can justify taking the unquantifiable risk of increasing criminality and conversely reducing revenues collected by HM Treasury by introducing the proposed Tobacco Levy.*"

#### 5.4.3 The imposition of the Tobacco Levy may in fact **reduce** the overall tax take from the tobacco sector:

As Mr Gibson notes: "[t]he Consultation recognises (paragraph 3.6) that higher prices lead to a reduction in sales, due to down-trading, increased legal cross-border shopping and increases in the illicit market. As HM

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<sup>38</sup> HMRC, 2014, Measuring tax gaps tables 2014, Tables 4.4 and 4.7 available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/363915/141014\\_MTG2014\\_Online\\_tables\\_v3.xls](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/363915/141014_MTG2014_Online_tables_v3.xls)

*Treasury's recent Minimum Excise Tax consultation makes clear, down-trading (and cross-border shopping /moving to the illicit market) 'pose a risk to future tobacco tax revenue.'*<sup>39</sup>

Analysis undertaken by KPMG, set out in the KPMG Report (attached as Appendix 3 to this Response) also confirms that the introduction of the Tobacco Levy would result in tobacco tax revenues falling. KPMG conclude:

*"...the loss of cigarette tax revenues arising from the increase in prices will outweigh the additional tax revenues collected from the Levy itself. The net effect is that total tax revenues could decline by around £31 million."*<sup>40</sup>

5.5 Furthermore, the Tobacco Levy is irrational since:

5.5.1 It is proposed that the Tobacco Levy would be calculated based on tobacco clearances. It would therefore disproportionately impact on the lower value product sector, where customers are more pricesensitive. As a result it would disproportionately affect poorer consumers and make the tobacco tax regime more regressive.

5.5.2 The disproportionate impact on lower value products would also distort competition in the tobacco market – both between lower and higher value brands and between different manufacturers who focus on products at the lower or higher ends of the market.

5.5.3 Furthermore, the tobacco industry is being targeted at an unprecedented level by regulation that imposes further costs on it, with the unintended consequences being an increase in the illicit market (undermining public health objectives) and reducing Government revenue.

5.5.4 There is no consideration in the Consultation of alternative measures, including:

- (1) Stabilising tobacco excise. As explained in BAT's October 2014 response to HM Treasury's Consultation on the Minimum Excise Tax (BAT's MET Submission),<sup>41</sup> and below in our response to Question 11 of the Consultation, one option for the Government to consider would be to implement a policy of keeping tobacco excise as stable as possible. If excise levels kept track with inflation, rather than exceeding it, the pressure on consumers would ease, which may stall the growth of the illicit market. According to our calculations, a 1% increase in the ad valorem rate would result in an additional £126m for government revenues in excise and VAT. It is irrational to introduce a measure, such as the proposed Tobacco Levy, that would result in tobacco tax revenues falling and disregard an alternative measure that is lawful and would result in an increase in tax revenues.

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<sup>39</sup> *Minimum Excise Tax*, Section 1.3, HM Treasury Consultation.

<https://www.gov.uk/government/consultations/minimum-excise-tax/minimum-excise-tax>.

<sup>40</sup> KPMG Report at section 1.3.

<sup>41</sup> BAT's response to the consultation into Minimum Excise Tax, submitted 15 October 2014, page 12.

- (2) Increasing measures to prevent the trade of illicit tobacco. The illicit trade in tobacco is a major concern to society in undermining public health attempts to reduce smoking prevalence and financing organised crime. As the recent Home Affairs Committee Report on Tobacco Smuggling notes "[t]obacco smuggling is associated with organised crime, including the smuggling of controlled drugs, weapons and human beings."<sup>42</sup>

HMRC estimates that in 2013-14 up to 14% of cigarettes and 43% of hand-rolled tobacco consumed in the UK were illicit. This represents an estimated loss of revenue of up to £2.9 billion, an increase of £500 million from 2011-12.<sup>43</sup> This amounts to nearly 20 times the level of the Tobacco Levy of £150 million that has been suggested.<sup>44</sup>

The recent Home Affairs Committee Report also concluded that the Government was not doing enough to combat the illicit tobacco trade, stating that: "[w]e are worried that not enough is being done by the Government and its appropriate agencies to combat the problem of tobacco smuggling at source"<sup>45</sup>

Further, the Crookshank Report states: "It cannot be expected that the illicit market...will be contained in the UK by enforcement unless the Government commits significant additional resources and makes widespread changes to the current control and enforcement regime to contain any growth in the illicit market in the future, let alone reduce it." It is therefore vitally important that the Government does not implement policies that encourage illicit trade and that strong border controls and effective law enforcement are in place. Increasing measures to prevent the trade of illicit tobacco would provide a far more effective means of increasing tax revenue as well as reducing the criminality and other harms associated with illicit trade.

5.6 Taking the above factors into account, Mr Gibson concludes that:

*"the policy [to introduce the Tobacco Levy] is flawed, not least due to:*

- *The uncertainty surrounding how the Tobacco Levy would be set, making it arbitrary, unpredictable and potentially capricious;*

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<sup>42</sup> Home Affairs Committee First Report of Session 2014-15 on Tobacco Smuggling dated June 2014 at paragraph 6.

<sup>43</sup> *Tobacco Tax Gap Estimates 2013-14*, HMRC, Oct 2014, [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/364011/141016\\_Tobacco\\_Tax\\_Gap\\_2014.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/364011/141016_Tobacco_Tax_Gap_2014.pdf)

<sup>44</sup> Autumn Statement 2014: Tobacco groups attack proposed profit levy, Financial Times , 4 December 2014, <http://www.ft.com/cms/s/0/fd97d072-7b98-11e4-b6ab-00144feabdc0.html#axzz3RQrd9mFp>

<sup>45</sup> Home Affairs Committee First Report of Session 2014-15 on Tobacco Smuggling, June 2014.

- *Tobacco taxes already far exceed a reasonable estimate of the costs that smoking imposes on society, so there is no need for a Tobacco Levy;*
- *The assumption that the Tobacco Levy would not feed through to tobacco prices is incorrect and therefore the argument for introducing a Tobacco Levy is unsound; and*
- *A Tobacco Levy could reduce rather than increase the total tax contribution from the tobacco sector undermining the objective of the new tax.*<sup>1146</sup>

## 6. INFRINGEMENT OF PROPERTY RIGHTS AND THE PRINCIPLE OF PROPORTIONALITY

### *Legal context*

- 6.1 The proposal, if implemented, would constitute an unjustified and disproportionate interference with rights protected both under the ECHR and under EU law. There is nothing in the Consultation to suggest that the Government has considered this.
- 6.2 Under the Human Rights Act 1998, which incorporates the ECHR into UK law, it would be unlawful for the Government to implement this proposal because to do so would be to act in a way which would be incompatible with a right protected under the ECHR, in particular, the right to peaceful enjoyment of property under Article 1 of the First Protocol ("**A1 P1**").
- 6.3 The Consultation sets out no proper or adequate reasoning as to why the Government would consider that the aim of the proposed interference (tobacco manufacturers and importers making a "greater contribution" to alleged "costs to society") is legitimate in circumstances where the industry is heavily regulated and already contributes far more than the costs imposed by smoking or smokers on society. It does not strike a fair balance between the rights of tobacco manufacturers and importers and the public interest – indeed, it is impossible for stakeholders meaningfully to engage with this question given the brevity of the Consultation paper and its overall opacity.
- 6.4 It is no answer for the Government to rely on the second paragraph of A1 P1 on the basis that the Tobacco Levy would be a form of tax. Whilst that paragraph provides that A1 P1 shall not impair the UK's right to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties, in relation to this proposal, the Tobacco Levy would manifestly not be a necessary, justified or proportionate law and as such it patently should not be enacted. In any event, the Tobacco Levy is manifestly without reasonable foundation.
- 6.5 Since the Tobacco Levy is within the ambit of A1 P1, the prohibition against discrimination under Article 14 ECHR is also engaged. The Tobacco Levy singles out tobacco manufacturers and importers in relation to alleged "costs to society" of smoking which are asserted but unproven. It is discriminatory in doing so particularly because, even if these costs were to be established, the Government has chosen not to target other contributors to them. The Government has also chosen not to target other industries, the activities of which also arguably contribute to "costs to society".
- 6.6 The Tobacco Levy also violates the principle of proportionality in EU law and the EU Charter in light of the EU law issues covered above. In particular, under the EU

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<sup>46</sup> See Gibson Report at section 9.

Charter, the freedom to conduct a business (Article 16) and the right to property (Article 17) are engaged.

6.7 There are, of course, different legal tests that must be applied by the Government in relation to each of the Human Rights Act / ECHR; the EU Charter; and EU law, in order to meet the requirements of justification and / or proportionality. Nonetheless, as BAT's Response shows, howsoever analysed, the practical result in respect of each such test is the same. It is clear that the Tobacco Levy does not meet the well-established requirements of justification and proportionality in ECHR and EU law terms, for example:

6.7.1 The Tobacco Levy interferes with protected rights but there is no evidence that it corresponds "*to a pressing social need and go[es] no further than strictly necessary in a pluralistic society to achieve its permitted purpose*" (*B v Secretary of State for the Home Department* [2000]<sup>47</sup>).

6.7.2 The Government has not demonstrated in the Consultation or otherwise that the interference with the rights at stake is justified, let alone that any justification is "*convincingly established*" (*R (BBC) v Secretary of State for Justice* [2012]<sup>48</sup>).

6.7.3 Justifying a measure requires substantiating its intended impacts, or to put it another way, providing "*real and cogent evidence of a pressing need*" (*R v Local Authority in the Midlands ex parte LM* [2000]<sup>49</sup>), however the Consultation fails to get anywhere close to doing so.

6.8 BAT refers to the points made in section 5 above regarding the irrationality of the Tobacco Levy, which apply with equal force in the context of proportionality and justification.

## 7. SUBSTANTIVE ANSWERS TO CONSULTATION QUESTIONS

### QUESTIONS 1 TO 7

As set out in this Response, BAT believes that the proposed Tobacco Levy is unlawful, irrational and disproportionate and therefore does not comment on specific provisions of the proposal.

### RESPONSE TO QUESTION 8

*The government welcomes views on the expected impacts of the levy on consumer prices.*

As explained above in sections 4 and 5, and confirmed in the KPMG Report (Appendix 3 to this Response), the proposed Tobacco Levy would be passed on to consumers in the form of higher prices.

### RESPONSE TO QUESTION 9

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

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<sup>47</sup> 1 FLR 612. UKHRR 498, 502C.

<sup>48</sup> EWHC 13 (Admin) [2012] 2 All ER 1089, at paragraph 76.

<sup>49</sup> 1 FLR 612.

As discussed in section 5 of this Response, the proposed Tobacco Levy would exacerbate downtrading and the already significant incidence of cross-border and illicit trade in the UK. As explained in the Crookshank Report (Appendix 2 to this Response), cigarette prices in the UK are already amongst the highest in Europe and further increasing prices would widen the price gap between UK duty paid and non UK duty paid tobacco products, further incentivising consumers to switch to non UK duty paid products. The Consultation wrongly disregards this.

## RESPONSE TO QUESTION 10

*Would the levy have any other market impacts?*

The Tobacco Levy that is under consideration could have varying levels of impact depending on its final structure, should it be progressed (which we submit it should not). The Consultation does not consider the following aspects:

1. Not all economic actors within the scope of the Tobacco Levy have an equal ability to pay. It is assumed in the Consultation that all tobacco manufacturers and importers are at all times profitable. Profitability however depends on a large number of factors aside from sales volume levels, which is proposed to be the basis on which the levy is calculated. The regressive character of the Tobacco Levy could make the difference between a market participant remaining in or withdrawing from the UK market and, as a result, could significantly distort the UK tobacco market.
2. The Tobacco Levy would act as a barrier to trade for new market entrants. The prospect of each percent market share resulting in a higher levy payment due to the Exchequer - the exact size of which might vary from year to year - would be a deterrent to any company contemplating making an investment in the UK tobacco market.

## RESPONSE TO QUESTION 11

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

It is clear that tobacco duty revenues have been declining for the past two years, with legal sales declining and illegal sales rising steadily. It is understandable that Government is seeking to arrest this decline. We believe that Government policy should seek to optimise duty revenues, rather than trying to maximise them. As explained in BAT's MET Submission,<sup>50</sup> (and outlined again below), the point of revenue maximisation has already been passed in the UK. We propose a number of possible mechanisms which the Government could instead deploy to optimise revenue derived from the tobacco sector.

### Impact of excise policy

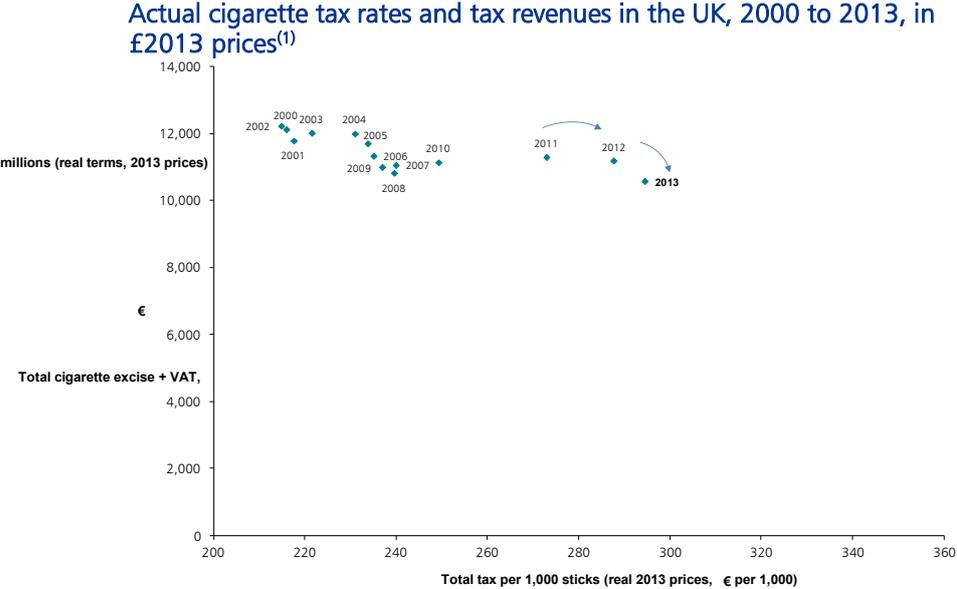
As noted above, tobacco duty revenues have been in decline since 2012. This is due to very high, escalator-driven tobacco price levels, the second highest in the EU. As a result

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<sup>50</sup> BAT's response to the consultation into minimum excise tax, submitted 15 October 2014.

of above-inflation duty and price increases, and rising priceelasticity, consumers are increasingly electing to purchase legal products with a lower out-of-pocket price, or products outside the UK legal market (be those counterfeit products, illicit whites or legal products from other Member States).

KPMG’s analysis outlined in BAT’s MET Submission demonstrates that UK cigarette duty revenues are now beyond the maximisation point. The graph below shows actual cigarette tax rates and tax revenues in the UK, in 2013 prices, between 2000 and 2013. The decline in duty paid sales has outweighed tax increases and resulted in lower tax revenues, in real terms, over the past two years. This demonstrates that higher tax rates have not translated into higher tax revenues.



Source: (1) KPMG Analysis, HMRC Tobacco Factbook, November 2013, HMRC Tobacco Bulletin, November 2013.

As demonstrated in BAT’s MET Submission, abandoning the tobacco duty escalator would keep excise revenues stable. Further duty rate increases will not generate additional revenue and would place an extra, unnecessary burden on the market. KPMG’s analysis referred to in BAT’s MET Submission demonstrated that while maintaining the duty escalator would result in a £22m *negative* impact on revenues, increasing excise in line with inflation alone would be revenue neutral.

**Recommendation: abandon the 2% escalator on duty increases and match duty increases to inflation on an annual basis, to stabilise Government revenues and reduce the current annual decline.**

**Minimise excise is not the answer**

As explained in BAT’s MET Submission, the UK market has a very high rate of specific duty which in itself establishes a very high pricing threshold compared to other parts of the single market. As such, a minimum excise tax (“MET”) would not be appropriate for the UK.

The Government is limited by Directive 2011/64/EU in relation to the level at which an MET can be set. We believe that the level at which an MET is set must not be such as to render

the mixed structure redundant. As demonstrated in BAT's MET Submission, an MET set at 100% of the total duty paid on weighted average price ("WAP") would have a minimal impact on prices in the UK, equating to approximately 52 pence per thousand sticks or 1p per pack of 20. We believe that an MET level higher than 100% of WAP would contravene Directive 2011/64/EU.

Further, the example of other markets in the EU demonstrates that even if an MET did have an impact on pricing, it does not insure the market against downtrading within the legal market and it increasingly encourages price sensitive consumers towards the black market.

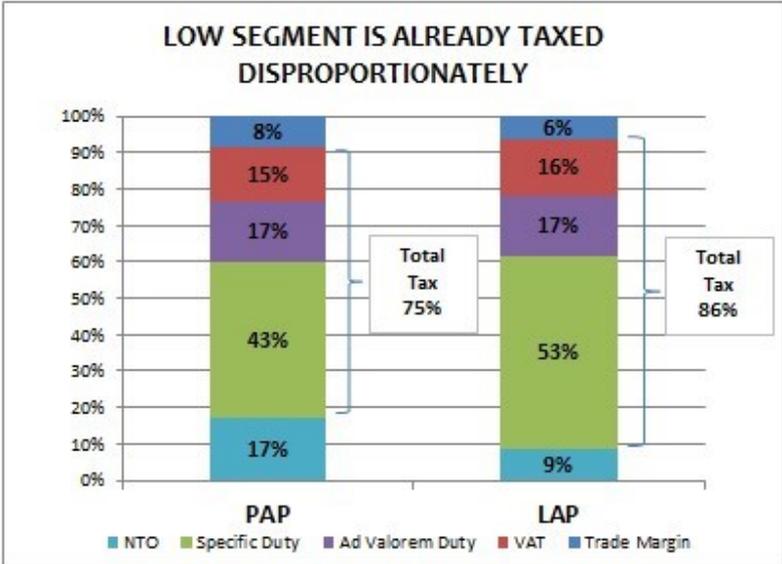
**Recommendation: that the Government elect not to introduce a minimum excise tax.**

**Rebalancing the excise structure**

BAT recommends that the Government considers rebalancing the excise structure, increasing the percentage of ad valorem in the total tax burden. This would bring the UK further towards EU averages which tend to have a higher weight of ad valorem excise, which ensures that the amount of duty paid is spread more progressively over the different price segments.

As discussed in BAT's MET Submission, elasticity of demand is lower in the premium segment than it is in the value-for-money segment. It is unlikely therefore that this alternative proposal would increase the existing downtrading trend.

The graph below shows the regressive impact of weighting the tobacco tax burden towards specific rather than ad valorem. Consumers purchasing 'lowest average price' or 'LAP' products pay proportionately more tax than those consuming 'premium average price' or 'PAP' products. Rebalancing the excise mix would make tobacco taxation more progressive and help to optimise Government revenues.



According to our calculations, a 1% increase in the ad valorem rate would raise duty and VAT revenue by £126 million annually. The same 1% rise applied to the specific

component would yield a revenue increase of only £60 million. For the purpose of this comparison, both scenarios assume constant volumes.

**Recommendation: Rebalance the tobacco excise structure to increase the weight of the ad valorem duty as a proportion of the total duty to ensure Government revenue levels are protected and sustainable.**

### Resources for law enforcement

As discussed in section 5 above, the HMRC Measuring Tax Gaps report 2013/2014 shows that up to 14% of cigarettes and 43% of hand rolling tobacco consumed in the UK were illicit, up from 13% and 42% respectively in 2012-2013. This is the second consecutive rise after a decade of decline in smuggling levels, with a total cost to the Treasury of up to £2.9 billion per annum. This amounts to nearly 20 times the level of the Tobacco Levy of £150 million that has been suggested.<sup>51</sup>

As noted in section 5 above, the recent Home Affairs Committee Report concluded that the Government was not doing enough to combat the illicit tobacco trade.<sup>52</sup> Further, the Crookshank Report states: "*[i]t cannot be expected that the illicit market (particularly cheap white cigarettes) will be contained in the UK, or even reduced, through enforcement unless the Government commits significant additional resources to these efforts and makes widespread changes to the current control and enforcement regime.*"<sup>53</sup>

Given the amount of revenue foregone each year as a result of illicit tobacco, the first and most obvious mechanism by which to generate additional revenue from the sector is to invest more resource in enforcement of penalties against tobacco smugglers. Cracking down on criminals and removing illicit sources of tobacco will encourage consumers to return to the legitimate, duty paid market, which will increase Government revenue.

**Recommendation: allocate increased resources to enforcement authorities to reduce availability of illicit product in the UK market.**

### Extending anti-forestalling restrictions to hand-rolling tobacco

It is our view that the same forestalling regime should apply to cigarettes and hand-rolling tobacco in order to establish a level competitive playing field.

The hand-rolling tobacco segment has seen significant growth over recent years and now represents almost a quarter of the market. In 2013, the segment remained static, against a 6% decline in factory manufactured cigarettes. As a result, the percentage of hand-rolling tobacco in the market continues to increase.

It is therefore appropriate that HMRC applies a similar managed approach to this product category as it does to factory manufactured cigarettes.

**Recommendation: extend anti-forestalling restrictions to hand-rolling tobacco**

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<sup>51</sup> Autumn Statement 2014: Tobacco groups attack proposed profit levy, Financial Times, 4 December 2014, <http://www.ft.com/cms/s/0/fd97d072-7b98-11e4-b6ab-00144feabdc0.html#axzz3RQrd9mFp>

<sup>52</sup> Home Affairs Committee First Report of Session 2014-15 on Tobacco Smuggling, June 2014.

<sup>53</sup> Crookshank Report at para 7(f).

## 8. CONCLUSION AND RECOMMENDATIONS

8.1 For the reasons set out above, BAT believes that the Tobacco Levy should not be progressed. In summary, those reasons include:

- 8.1.1 The Government has followed a flawed and unfair process.
- 8.1.2 The Tobacco Levy is unlawful, both *per se* and also because it is irrational, unjustified and disproportionate.
- 8.1.3 The Tobacco Levy would not succeed in raising additional revenue from the tobacco industry overall and would encourage the illegal market.
- 8.1.4 The proposed Tobacco Levy would not help the Government achieve its aims of maximising revenues and it makes no financial sense.

8.2 BAT makes the following recommendations to optimise current Government revenues and stabilise the tobacco market to ensure sustainable growth in future income:

- 8.2.1 Abandon the 2% escalator on duty increases and match duty increases to inflation on an annual basis, to stabilise Government revenues and reduce the current annual decline;
- 8.2.2 Not introduce a minimum excise tax;
- 8.2.3 Rebalance the tobacco excise structure to increase ad valorem rates to ensure Government revenue levels are protected and sustainable;
- 8.2.4 Allocate increased resources to enforcement authorities to reduce the availability of illicit product in the UK market; and
- 8.2.5 Extend anti-forestalling restrictions to hand-rolling tobacco

8.3 BAT is grateful for the opportunity to respond to this Consultation and would be very happy to provide further detail or information as necessary.

### Contact

\_\_\_\_\_, Regulatory Engagement Manager  
(Tel) \_\_\_\_\_, (Email) \_\_\_\_\_

**UK Consultation on the proposed Tobacco Levy Appendix 1**

EXPERT REPORT OF SLG ECONOMICS ON HMT CONSULTATION ON  
TOBACCO LEVY

Provided separately.

**UK Consultation on the proposed Tobacco Levy Appendix 2**

EXPERT REPORT OF STUART CROOKSHANK ON THE IMPACT OF THE PROPOSED TOBACCO  
LEVY ON ILLICIT TRADE.

Provided separately.

**UK Consultation on proposed Tobacco Levy Appendix 3**

CONFIDENTIAL EXPERT REPORT OF KPMG ON THE IMPACT OF THE PROPOSED TOBACCO  
LEVY ON THE UK TOBACCO MARKET.

Provided separately.



18<sup>th</sup> February 2015

Tobacco Levy Consultation  
VAT and Excise  
HM Treasury  
Horse Guards Road  
London SW1A 2HQ

Email: [tobaccolevy@hmtreasury.gsi.gov.uk](mailto:tobaccolevy@hmtreasury.gsi.gov.uk)

Dear Sirs

**Tobacco Levy Consultation**

Hunters & Frankau Limited (H&F) is an SMER (medium-sized) under the current EU definition with a turnover of £35 million in 2014 and employing 45 people. We are the main importer and distributor in the UK of premium, hand-made cigars from Cuba and other developing countries in the Caribbean and Central America. We also import and distribute machine-made cigars principally from Holland and Germany. We do not distribute any tobacco products other than cigars.

We have read the document published in December 2014 by HM Treasury entitled “Tobacco levy: consultation”. Attached to this letter you will find an Appendix in which we answer the specific questions raised in the consultation document. However we would like, as part of our submission, to address a number of matters relating to the proposed tobacco Levy that are not covered by the questions.

H&F is opposed to the introduction of a levy on UK tobacco manufacturers and importers because we consider it to be discriminatory and unnecessary. It is discriminatory because tobacco is not alone in imposing costs on society. At present no other industry, with the exception of banking where recent economic history provides the justification, is singled out in this manner. It is unnecessary because tobacco already endures exceptional taxation through excise duty on all its products.

The Consultation Document relies heavily for its justification of the Tobacco Levy on Paragraph 1.9, which provides an itemised list of the societal costs of smoking in England. These are not government figures that comply with the Code of Practice for Official Statistics. They are “estimates” provided by Action on Smoking and Health (ASH), a body that cannot be said to be impartial or objective on this subject. The estimated total for the cost of smoking in England is £12.9 billion per annum. Large though this figure is it should be compared to the total UK revenue earned in 2013 from Tobacco Products Duty and VAT, which comes to an actual figure of £12.3 billion. Given the spurious nature of some of ASH’s estimates (£3 billion loss in

productivity due to premature death / £5 billion cost to business for smoking breaks), we consider that it is highly likely that excise revenue on tobacco not only covers the actual societal costs but also makes a substantial net contribution to the Exchequer. We would hope that ASH's estimates would be subjected to rigorous government scrutiny before they are used as a basis for new legislation.

In addition we would suggest that consideration should be given to excluding cigars and pipe tobaccos from the Levy. These categories together account for less than 1.5% of the UK Tobaccos Products Market by volume and have declined at twice the rate of cigarettes in recent years. It should be noted that cigars and pipe tobaccos are smoked predominantly by mature, adult males and that cigars in particular are consumed infrequently, a factor ignored by ASH's analysis of societal costs.

As an SME, H&F would draw your attention to the burden that recent tobacco regulation has placed on smaller companies. Supporting full implementation of the Tobacco Display Ban is currently costing H&F an incremental six-figure sum in order to help the small shops that sell cigars to comply with the regulations. Furthermore by the beginning of next year we face a challenging administrative task combined with substantial costs in preparing to meet the demands of the new EU Tobacco Products Directive (2014/40/EU), which, due to an unrealistic implementation timetable, is also likely to disrupt our business.

We are aware that we share the tobacco market with several large multi-national companies. These enterprises have the resources to address these challenges whereas companies such as ours do not.

We would ask you to bear this environment in mind along with the points we have raised in response to your question in our Appendix when you develop your policy options for the Tobacco Levy.

Yours faithfully,

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Managing Director, Hunters & Frankau Limited.

## Appendix

### Hunter & Frankau's Submission to the Tobacco Levy Consultation

#### Responses to Consultation Questions

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

Yes.

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

It seems efficient although it could place some companies in difficulties if sales were to decline drastically year on year. The reverse effect could, of course, benefit some companies, but in the current regulatory environment for tobacco in the UK this is unlikely to occur.

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

No.

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?

None that we can see, although we consider that “other products”, notably cigars and pipe tobaccos should be excluded from the Levy.

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

Our preferred option is (i) – the previous year.

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

No, because it is not clear to us how such a mechanism would work.

If the Corporation Tax system were to be adopted a major concern would be the impact of any increase in liabilities on the “employer’s covenant” which constantly needs to be monitored in respect of Hunter & Frankau Limited’s role as a sponsor of a Defined Benefit Pension Scheme. The weakening of the employer’s covenant, which would result directly in the increased pension contributions and Pension Protection Fund (PPF) levy, would in turn reduce taxable profits.

Question 7: What are the alternative approaches?

We would prefer the Government not to proceed with the Tobacco Levy. However, if it should decide to do so, we would ask that consideration be given to introducing a limit on the size of the companies that are liable to pay it similar to that which applies in the case of the UK Bank Levy where companies with less than £20 billion of chargeable liabilities are exempted. We would recommend that tobacco companies with an annual UK turnover of £50 million or less should be excluded from the Levy,. This would ensure that SMEs are not affected by the measure.

Otherwise we believe that some form of safety catch must be included in the regulations to protect small or micro companies that are making only marginal profits or are unprofitable.

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

It should be understood that in small and medium companies taxation, regardless of its intention, becomes a charge on the cost of doing business in the UK. As a result its impact has to be built into the company’s business model part of which is made up of the consumer price. Small companies simply do not have the resources to absorb such costs.

In the absence of any information about the quantum of the Tobacco Levy it is impossible to address what proportion of it might have to be passed on to the market through consumer price increases. Suffice it to say that it would put further pressure on prices in excess of that already exerted by annual increases in excise duty.

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

If a Tobacco Levy were set at a level that jeopardised the commercial viability of some of the smaller companies that serve the UK market with low-volume, niche products, the viability of some specialist retailers could also be damaged. Closures of such businesses would deprive consumers of the services they provide, and these businesses' employees of their livelihoods.

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

The extent of the levy's market impact would depend on the quantum. If the Government decided to proceed with the scheme, it would only be then that the level and the scale of individual company contributions would be known. We would hope that a further consultation would be mounted at the t stage in order to address the impact more accurately.

We would draw attention to the fact that there are a number of very small or micro importers, notably of premium cigars, operating in the UK. These companies import on a casual basis bringing small shipments into the country at various ports and airports. Sometimes they accompany the goods themselves and pay excise duties at the point of entry, we fear that this type of activity could escape the net for the purposes of the Tobacco Levy thus providing an opportunity for evasion that would distort the market place and be likely to have an adverse impact over time on companies like Hunters & Frankau caused by the unfair competition that it would stimulate.

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

No comment.

Hunters & Frankau Limited / 18<sup>th</sup> February 2015

## 2.21 Smoke Free Hartlepool Alliance

### HM Treasury Consultation on a tobacco levy

Closing date 18<sup>th</sup> February.

Link to more information and how to respond:

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/384769/tobacco\\_levy\\_consultation.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/384769/tobacco_levy_consultation.pdf)

### Response from Smoke Free Hartlepool Alliance

1. Hartlepool Smoke Free Alliance is one of 12 local authority-led tobacco control alliances in the North East working in partnership with Fresh which is the North East of England's comprehensive tobacco control programme, commissioned by all 12 local authorities in the region. Fresh was the UK's first dedicated tobacco control office, set up to tackle the worst smoking rates in England which, in 2005, were 29% amongst the adult population. By 2013 this had dropped to 22%. Fresh works in partnership with each local authority-led tobacco control alliance to deliver comprehensive activity at regional and local levels in order to support smokers to quit, prevent young people from starting to smoke and to protect people from tobacco-related harm.
2. The chair of the local alliance attends the following North East Forums, all of which endorse this response:  
North East Tobacco Control Commissioners Forum  
North East Tobacco Regulation Forum  
Smoke Free North East Network
3. We are grateful to Fresh and ASH for their support in developing this response.

### General Observations

4. Smoke Free Hartlepool warmly welcomes the opportunity to respond to this consultation on introducing 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."*<sup>54</sup>
5. There is widespread public appetite for more policies to reduce the harm of smoking in society with appetite for these measures having increased over the past few years. In 2014 a survey by YouGov commissioned by Action on Smoking and Health found nearly half of North East adults (43%) believing that not enough is being done to cut the harm of smoking, and another 33% saying the Government is doing about right (this was compared to 2011 when 36% said not enough is being done and another 36% thought the government was doing about right). Only 12% of adults in the North East thought "the Government is doing too much" compared to 22% in 2011 and even amongst smokers in England fewer than half (35%) believed that the government is doing too much.

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<sup>54</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

6. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year<sup>55</sup>. This is likely to be an under-estimate as only costs where data is attributable have been included.
7. In the North East, the conservative cost of smoking is avoidably high at almost £160 million per year, which includes the cost to business through lost productivity and costs to the NHS of treating smokers and those exposed to secondhand smoke but does not include costs borne by other agencies e.g. local authorities who commission stop smoking services, provide regulatory services to support compliance with tobacco-related legislation and street cleaning services to remove litter such as cigarette butts and tobacco packs.
8. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
9. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>56</sup>
10. The tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution.<sup>57</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>58</sup>
11. Fewer than one in five adults now smoke, but smoking rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes<sup>59</sup>, killing one in two of all long-term smokers<sup>60</sup>.
12. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>61</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.

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<sup>55</sup> [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

<sup>56</sup> *ibid*

<sup>57</sup> Branston JR and Gilmore A (2014) The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tob control* 23(1):45-50

<sup>58</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

<sup>59</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>60</sup> Doll R, Peto R, Wheatley K, Gray R, Sutherland I. Mortality in relation to smoking: 40 years observations on male British doctors. *British Medical Journal* 1994; 309:901-911

<sup>61</sup> The World Bank. *Curbing the epidemic: governments and the economics of tobacco control*. May, 1999.

13. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to reduce tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
14. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:
- "The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*
- While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing..."*
- For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation..."*<sup>62</sup>
15. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
16. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short-term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.
17. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.

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<sup>62</sup> [NHS: Five Year Forward View](#) NHS England, October 2014

18. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, *"The Health Consequences of Smoking – 50 Years of Progress"*, reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."*
19. Similar declines have been seen in the North East, North West and South West of England where there is investment at a regional level in comprehensive tobacco control programmes which add value and substantially enhance and amplify efforts and outcomes nationally and locally. Investment at this level ensures that national policies and evidence-based practice are implemented effectively and allows local commissioners to benefit from economies of scale and to reach much greater population numbers<sup>63</sup>. The NICE Tobacco Return on Investment Tool provides evidence that tobacco control delivery is most cost-effective when it is delivered across a bigger geographical footprint at the subnational level<sup>64</sup>.
20. Much more can be achieved if this regional investment is sustained, increased and widened: the report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."* <sup>65</sup>
21. In reducing the harm from smoking in the UK, an essential role is played by the delivery of tobacco control measures carried out by local authorities for example the stop smoking services. The Department of Health document *"Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12"* stated that: *"Stop smoking services are a key part of tobacco control and health inequalities... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers."* <sup>66</sup>
22. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about the reduction over the last two years in the number of smokers being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13
23. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs, much of the direct savings they deliver accrue mainly to the NHS and not by the increasingly cash-strapped local authorities that commission the services. This point also applies to local action, by trading standards

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<sup>63</sup> Royal College of Physicians and the UK Centre for Tobacco Control Studies: Fifty years since Smoking and health: Progress, lessons and priorities for a smoke-free UK, March 2012

<sup>64</sup> NICE [Tobacco return on investment tool](#) v3.03

<sup>65</sup> U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

<sup>66</sup> [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

officers and others, to regulate the tobacco market and support compliance with legislation. In respect of illicit tobacco, the Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.

24. The level of illicit trade nationally has declined by half since 2000. Regions in England have also seen reductions in the illicit market particularly in the North East, North West and South West, where the three regional comprehensive tobacco control programmes lead the Tackling Illicit Tobacco for Better Health Partnership<sup>67</sup> to reduce the demand for and supply of illegal tobacco. For example in the North East, 15% of tobacco products in 2009 were estimated to be illicit; by 2013 this had dropped to 9%<sup>68</sup>. However, the latest figures from HM Revenue and Customs suggest that nationally the illicit tobacco market has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>69</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>70</sup> and the House of Commons Home Affairs Select Committee.<sup>71</sup> Fresh strongly supports these recommendations, which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.
25. Mass media and social marketing campaigns can also be highly effective in stimulate quitting behaviour, but require significant investment in order to be most effective.<sup>72 73 74</sup> Higher mass media campaign exposure also appears to confer greater benefit on socioeconomically disadvantaged population subgroups. Studies comparing different media message types have found messages concerning negative health effects most effective at generating increased knowledge, beliefs, higher perceived effectiveness ratings, or quitting behaviour. Evidence for other message types is more mixed. They do, also, perform very well among young people. In contrast, ads dealing with the cosmetic effects of smoking, addiction and athletic performance, have been found to be less effective. However, with funding for national campaigns having reduced substantially over the past five years, it is vital that campaigns as a vital component of effective tobacco control are able to run at national and regional level.
26. We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help supplement existing investment in tobacco control, and ensure that the UK can deliver a genuinely comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost an additional £500 million a year, and would include key measures such as :

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<sup>67</sup> [www.illegal-tobacco.co.uk](http://www.illegal-tobacco.co.uk)

<sup>68</sup> NEMS illicit tobacco survey 2013

<sup>69</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

<sup>70</sup> [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

<sup>71</sup> [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

<sup>72</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>73</sup> Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction*, 107(11), 2043-2050

<sup>74</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun;109(6):986-94.

- supporting comprehensive tobacco control measures at national, regional and local levels based on the best available evidence
- financing sustained mass media and social marketing campaigns, complemented by other tobacco control initiatives; and
- ensuring and improving the provision of high quality Stop Smoking Services across the country as part of broader tobacco control strategy

27. We would also strongly suggest that this portion of the levy be established along similar lines to the US manufacturer “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control”.

28. It should be noted that as of 31<sup>st</sup> March, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education, \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>75</sup>

## Answers to Consultation Questions

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

29. 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?

30. 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.

31. Forestalling in this context means a temporary increase in the clearance rate of cigarettes and other tobacco products so that they can be released into the UK market immediately

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<sup>75</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

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 or 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.<sup>76</sup>

32. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult. Crucially it would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local and regional consumption and prevalence levels and the consequent harm caused whilst ensuring cost-effectiveness through delivery across a wider geographical footprint. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>77 78</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a 'unique identifier' that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.
33. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

#### Suggested allocation of revenue from tobacco levy across the countries of the UK

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

34. In summary, we recommend that:

<sup>76</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

<sup>77</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>78</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

35. 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.
36. 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)
37. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>79</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 37 below.

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

38. For the reasons stated in paragraphs 16 to 19 above, 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?

39. We support the use of the corporation tax system to collect the levy, as the system that would pose the least 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.

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<sup>79</sup> 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.](#)

40. We are unaware of a plausible alternative means for collecting the levy.

**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?

41. 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.

42. According to the Department of Health Impact Assessment on standardised packaging <sup>80</sup> (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.”*

43. 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.

44. The response from ASH 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, and is based on the research paper written by Howard Reed, Landman Economics. It will be noted that 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 (1.26 pence per stick compared to 1.27 pence per stick). 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.

#### **Size of tobacco levy required to raise £500 million per year**

Results, assuming impact of introducing standardised packaging  
(all figures in pence)

Year	15/16	16/17	17/18	18/19	19/20
Smoking prevalence (%) (adults)	17.3	16.4	16.7	16.2	15.7

#### **Scenario (a): No pass through of levy to consumers**

Cigarette levy (pence per stick)	1.26	1.31	1.35	1.39	1.43
Cigarette levy (per packet of 20)	25.2	26.2	26.9	27.7	28.5

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<sup>80</sup> [Impact assessment: standardised packaging of tobacco products](#): Department of Health June 2014

HRT levy (per gram of tobacco)	1.68	1.75	1.80	1.85	1.90
HRT levy (per 25g packet)	42.0	43.7	44.9	46.2	47.5

**Scenario (b): Full pass through**

Cigarette levy (pence per stick)	1.27	1.33	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.5	26.5	27.3	28.0	28.9
HRT levy (per gram of tobacco)	1.70	1.77	1.82	1.87	1.92
HRT levy (per 25g packet)	42.4	44.2	45.4	46.7	48.1

45. 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):<sup>81</sup>
46. 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.

**Affordability Index: Tobacco Products**

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

47. 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<sup>82</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>83</sup> In subsequent years with new policy measures regularly being introduced and the government’s tobacco control

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<sup>81</sup> Communication with Action on Smoking and Health, 14 January 2015

<sup>82</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

<sup>83</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

strategy having been updated and improved<sup>84 85</sup>, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.

48. Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products.<sup>4</sup> Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits of the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>86</sup> Tobacco is unlike any other product on the market in that it kills half of all long-term users unless they quit. It is therefore clear that the tobacco industry should, and could well afford to, pay the proposed levy.

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

49. We anticipate that tobacco multinationals may suggest alternatives to a levy but we would be highly wary of any suggestion that they make a 'contribution' to society other than death and disease on an industrial scale. We would recommend vigilance against any attempts by the tobacco industry to reposition the levy as part of a separate 'corporate social responsibility deal' to enable it to exert influence on government public health policy, in violation of the WHO FCTC Article 5.3. We would also recommend government vigilance against the tobacco industry attempting to influence how this money is spent. Historically, the tobacco industry has sponsored youth prevention programmes to forestall legislation such as smokefree spaces and restrictions on marketing in the US. The 2012 Surgeon General's Report, Preventing Tobacco Use Among Youth and Young Adults, concluded "*the tobacco companies' activities and programs for the prevention of youth smoking have not demonstrated an impact on the initiation or prevalence of smoking among young people*<sup>87</sup>." There is evidence these programmes have been ineffective at best and harmful at worst.
50. We consider that a levy on tobacco products, with a revenue target per year fixed over five years, is by far the most desirable policy option. 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 a sufficient proportion of such funds are used to support comprehensive tobacco control delivery which includes evidence-based policy initiatives designed to reduce smoking prevalence. We therefore do not offer any alternative to a levy in this consultation response.

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<sup>84</sup> DH. [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

<sup>85</sup> DH [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

<sup>86</sup> BAT Annual Report 2013

<sup>87</sup> 2012 US Surgeon General Report

## 2.22 Action on Smoking and Health Ireland

### HM Treasury Tobacco Levy Consultation

#### Responses from ASH Ireland

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

Yes. We support this definition.

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

Our concern in this respect would relate mainly to the Tobacco Industry practice of “forestalling”. The use of forestalling by the Tobacco Industry primarily relates to the release of large amounts of tobacco products into the market immediately preceding the UK budget statement so as to avoid any possible increase in taxes. It is most likely that the best way of raising a tobacco levy would be to relate it directly to sale volumes at local, regional and national level – this would make the manipulation of the figures more difficult.

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

See reply to question 2

**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?**

The main issue here emerges in that cigarettes are sold by numbers i.e. packs of 20 and HRT is sold by weight. Clearly some common factor must be found such as weight, so that the levy can be applied equitably.

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

**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?**

#### *Replies to Question 5, 6, and 7 together*

It is imperative that in dealing with the Tobacco Industry there is a clear cut and unambiguous method of collecting the levy. This most likely would point to the use of the corporation tax system.

# Consultation Submission – Response to HM Treasury’s consultation on the Tobacco Levy

By Christopher Snowdon

February 2015



## About the author

Christopher Snowdon is Director of Lifestyle Economics at the Institute of Economic Affairs and an independent writer and researcher. He is the author of *The Art of Suppression* (2011), *The Spirit Level Delusion* (2010) and *Velvet Glove, Iron Fist* (2009). His work focuses on pleasure, prohibition and dodgy statistics. His blog is *Velvet Glove, Iron Fist*.

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The IEA is a free market think tank that has opposed standardised packaging from the outset because it violates property, sets a precedent for other products, and will help the illegal trade in tobacco at the expense of the legal industry. The IEA is a privately funded organisation which receives no statutory funding. Amongst our donors are companies that have an interest in the sale of tobacco products.

## Consultation Submission – Response to HM Treasury’s consultation on the Tobacco Levy

Before responding to the specific questions, I would like to make three general points. Firstly, the consultation document states that Action on Smoking and Health (ASH), the state-funded pressure group, says that the ‘total cost of smoking to society in England alone is approximately £12.9 billion’. This claim is unworthy of inclusion in a Treasury document. The ‘total cost’ of an activity is the cost minus savings. ASH’s figure does not include savings, despite it being well established in the economics literature that these savings are very considerable (eg. van Baal, 2008). Moreover, ASH’s ‘costs’ are highly questionable. For example, the largest single cost is £5 billion from ‘smoking breaks’. This is calculated by estimating the number of hours spent on smoking breaks and multiplying them by the average hourly wage. This is flawed for several reasons. Even if it could be assumed that employee productivity is evenly distributed throughout the day (a highly dubious assumption), all employees take breaks at work during which they may or may not smoke. Indeed, it is a legal requirement for employees to be given work breaks. And even there is an excess cost from smoking breaks, the cost falls on the employer - and, ultimately, the employee - not the government.

Secondly, the consultation document states that ‘Tobacco manufacturers and importers benefit from the activity that imposes these costs on society.’ Whilst these businesses certainly profit from the sale of their products, the main beneficiary of such trade is HM Treasury. Approximately 80 per cent of the price of a pack of cigarettes is made up of tobacco duty and VAT. This amounts to £14 billion a year and exceeds even ASH’s inflated estimate of the ‘costs’ of smoking.

Thirdly, the document further states that ‘the government believes it is fair to ask tobacco manufacturers and importers to make a greater contribution towards these costs.’ Whether or not such a request is ‘fair’ is a matter of opinion, but the purpose of a windfall tax is not to ‘ask’ for a greater contribution, rather it is to *compel* these companies to make a greater contribution *by force of law*. ‘Ask’, in this context, is a euphemism that is unworthy of HM Treasury.

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

Yes. The tobacco market, by definition, only includes tobacco. It does not extend to any product that can be burned and inhaled.

Questions 2 to 7 assume that respondents agree with the principle of windfall taxes, as does question 11. Since I do not agree with this, I have not answered them.

### **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?**

The IEA has previously written about the problems with windfall taxes in relation to banks and energy companies. The same flaws apply to the proposed windfall tax on tobacco companies. Windfall taxes increase the risks to businesses of investing, thereby requiring them to either make higher returns or to invest in other countries. A company might increase prices if it is able to do so, in which case it is the consumer who effectively pays the tax. HM Treasury notes that higher prices will likely lead to lower sales, with an unknown number of consumers shifting to the black market. Oxford Economics (2015) have estimated that if a £100 million windfall tax led to prices rising by a commensurate amount, HM Treasury would lose more money than it gained (a loss of £117 million a year; a net loss of £17 million a year).

It is impossible to predict whether the affected companies would raise prices in the face of a windfall tax, but if they were not able to raise prices, shareholders would effectively pay the tax through lower dividends. In either case, it should be understood that it is people who pay tax, not companies. Since tobacco stock is widely owned, the negative effects would be widely felt. Many institutions, from the BBC

to local councils, own shares in tobacco companies as part of their pension schemes and other investments.

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

One major ethical objection to windfall taxes is that they are capricious and arbitrary. As David B. Smith wrote in 'Restructuring the UK Tax System: Some Dynamic Considerations' (IEA Discussion Paper No. 35, 2011), they are 'an affront to the rule of law. People who advocate such taxes are no better than Tudor tyrants such as Henry VIII or the Bourbon monarchs of France.' Since the eighteenth century, Britain's protection of property rights has made it an attractive place to do business. British governments have generally not engaged in looting legitimate post-tax profits from businesses just because they happen to be unpopular or successful.

The moral objection to smash-and-grab raids on company profits is accompanied by profound practical considerations. Smith notes that 'arbitrary windfall taxes and retrospective tax changes are economically damaging, because of the uncertainties they create for economic agents.' Such taxes give domestic companies a keen incentive to relocate to other jurisdictions, taking jobs with them. They also send a message to potential investors from other sectors that Britain is not a secure place to do business because the government is liable to move the goalposts at any time. In the case of a windfall tax on tobacco companies, industries which are also under attack from 'public health' campaigners, such as alcohol, food and gambling, are likely to be particularly wary of investing in the UK.

'Without protection of private property,' wrote Tom Papworth on the IEA blog in 2009, 'investors cannot guarantee that they will get to keep the proceeds of their investment (or even the initial stake). Whether it is petrochemical firms being bullied out of half their shares in Siberian oil and gas fields, or banks having their profits taxed heavily, the effect is the same: the investor will look elsewhere in the future. The same follows for the rule of law: if politicians can use the tax authorities to attack those that are both successful and unpopular, investors will steer clear ... in the minds of investors, even a one-off windfall tax conveys the message that British politicians view high profits or incomes like bandits view a passing caravan' (Papworth 2009). We trust HM Treasury will bear these considerations in mind and reject the use of windfall taxes.

#### References

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## 2.24 Imperial Tobacco Limited

*Imperial Tobacco Limited Response to:*  
**HM Treasury – Levy Consultation**



# Imperial Tobacco Limited Response to: HM Treasury – Levy Consultation

Submitted: 18 February 2015

<http://www.imperial-tobacco.com>

### Introduction

Thank you for the invitation to respond to HM Treasury's consultation on the 'Levy Consultation' (the "**consultation**"), published in December 2014, we welcome the opportunity to respond.

We appreciate the opportunity to answer the specific questions asked in the consultation. Our experience is that tobacco legislation is often negotiated behind closed doors, based on emotions, without proper economic and fiscal analysis and influenced by vested interests of the anti-tobacco industry. Therefore, we very much appreciate that we can express our views, address the inaccuracies in facts, assumptions and conclusions and make our contribution to an evidence based tobacco policy. We would like to highlight several substantial problems with both the principle and the practicalities of the levy as proposed. Fundamentally, we consider this proposal to be thoroughly wrong-headed.

We believe that the effects of the levy on the behaviour of market participants are likely to be similar, if slightly more pronounced, that the imposition of additional specific excise duty on tobacco products, with all the attendant hazards of lost revenues and lost volumes to the illicit trade. In the worst case, this could mean that the levy is actually counterproductive in terms of fiscal revenue.

Even if the most negative effects of a levy were somehow mitigated, the mechanism proposed for the operation of the levy unnecessarily creates several practical problems both for industry participants and for the officials that would have to administer such a scheme. In addition, the imposition of such an arbitrary levy, justified by questionable calculations of social cost, sets a dangerous precedent that would have a poisonous effect of the business confidence of "UK plc" – an amalgam that owes more than 5% of its total dividend payments to tobacco.

### Company background

Imperial Tobacco Group PLC ("ITG") is a FTSE top 25 company, the world's fourth largest international - and second largest European – tobacco company. ITG manufactures and sells a range of cigarettes and other tobacco products. ITG has sales in over 160 countries worldwide

and is the world leader in the premium cigar, fine-cut (roll-your-own) tobacco and rolling papers sectors.

Imperial Tobacco UK (“ITUK”) (together with ITG “Imperial Tobacco”) is the Bristol-based trading operation of ITG which distributes Imperial Tobacco’s products to the UK market. ITUK is market leader, holding approximately 45 per cent market share. ITUK’s leading UK cigarette brands include Lambert & Butler, JPS, Richmond, Embassy and Regal. ITUK also distributes tobacco products on behalf of Philip Morris Ltd.

Imperial Tobacco has its headquarters in Bristol with manufacturing and distribution facilities in Nottingham. Imperial Tobacco directly employs over 1,600 people in the UK and in 2013 collected over £6 billion for the UK Exchequer in duties and other taxes. Imperial Tobacco has around 26,000 shareholders with 53 per cent of issued shares held in the UK. Over 34,000 individuals are members of the company pension fund, and it is estimated that the tobacco industry indirectly supports the livelihoods of over 70,000 people elsewhere in the economy via the supply chain, production and packaging, retailers and so on.<sup>1</sup>

Imperial Tobacco Group owns a subsidiary company, Fontem Ventures. Fontem Ventures is dedicated to developing and growing a portfolio of innovative products including electronic cigarettes (“e-cigarettes”), and focuses on non-tobacco opportunities. Currently Fontem Ventures has one vapour product available on the UK market: Puritane e-cigarettes. The only ecigarette to be sold by Boots, Puritane uses pharmaceutical-quality nicotine, and is produced in a FDA<sup>2</sup>-approved manufacturing facility, while the final product – which conforms to UK quality and safety standards - is assembled in an MHRA<sup>3</sup>-approved facility in Liverpool.

As a responsible, legitimate business, Imperial Tobacco supports sound, evidence-based, reasonable and proportionate regulation and tobacco taxation of all tobacco, nicotine and vapour products. We seek constructive dialogue with regulatory authorities in order to support such outcomes. We are not willing to accept regulation that is flawed, unreasonable or disproportionate, nor measures that are not based on sound legal foundations. We continue to vigorously oppose such measures in order to protect our business and defend the rights of our consumers.

- We seek constructive dialogue with the UK Government and other regulatory authorities in order to support reasonable, proportionate and evidence-based regulation.
- We support regulation that is reasonable, proportionate and evidence-based. As a responsible, legitimate business we are not willing to accept regulation that is flawed, unreasonable or disproportionate, or regulation that is not based on sound legal foundation.
- We believe that tobacco products, nicotine products and e-cigarettes are for informed adults to enjoy.
- We do not want children to smoke or to use tobacco, nicotine products or e-cigarettes.
- We will continue to vigorously oppose such regulation in order to protect our business and defend the rights of our consumers.

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<sup>1</sup> <http://www.the-tma.org.uk/wp-content/uploads/2014/08/Cogent-TMA-Factsheet-UK.pdf>

<sup>2</sup> The US Food and Drug Administration

<sup>3</sup> The UK Medicines and Healthcare Products Regulatory Agency

## Questions

### THE PRINCIPLE OF AN INDUSTRY LEVY

The UK's corporate sector is currently suffering the after-effects of Britain's largest economic crisis in a generation. Consumer spending is only slowly recovering from the knock-on impact that the recession has had on incomes and consumer confidence. The consumer-facing parts of UK plc, from supermarket operators to FMCG manufacturers such as Imperial Tobacco, are competing harder than ever to offer their customers value in the face of record low interest rates and the growing spectre of deflation.

It is in this context that we highlight tobacco's existing contribution to the recovery of the UK corporate sector. In 2013 (the last year for which data is available) the tobacco industry provided 5.15% of all dividends paid by the UK's public companies<sup>4</sup>. This is no anomaly: the 2012 figure was also above 5%. As such, the tobacco industry provides £1 in every £20 of income to balanced UK equity funds, and the millions of pensioners and savers who rely upon such investments in the face of paltry returns on their savings and bonds. Imperial Tobacco alone contributes roughly £1 billion of dividend income to its millions of shareholders every year.

A healthy and productive corporate sector relies on a solid and stable business environment. Sound tax policy is the cornerstone of such stability. We believe that the characteristics of sound tax frameworks are even-handedness and predictability. Industry-specific levies – which isolate specific industries for arbitrary taxation – have no place in such frameworks. They create unnecessary and undesirable complexity and unpredictability in tax policy that have an immediate impact on the abilities of businesses to allocate their activities efficiently, and this in turn negatively affects business confidence, domestic reinvestment and job creation, and foreign direct investment into the UK.

It is particularly inappropriate for the Government to consider introducing a levy on tobacco products. While the consultation document seems to suggest that such a levy is motivated by a desire to correct inefficient market outcomes (popularised by Pigou in 1920), particularly in relation to the externalities of tobacco use, this suggestion has three serious flaws:

1. The consultation uncritically recycles the £12.9 billion figure for the social cost of smoking provided by ASH, an anti-smoking special interest group. This figure goes far beyond the direct costs to government of smoking.

The largest component of this cost estimate is also the most methodologically dubious: the alleged £5 billion of productivity losses for UK companies that ASH claims arise from smoking breaks. Using very simple arithmetic, if one assumes that smoking prevalence among the UK's workforce is the same as the 20% the consultation document states for the general population, then 1.45 million of the UK's 29 million-strong workforce smoke. At a median wage of £12.50 per hour, to produce such an absurd figure, each one of Britain's working smokers would have to dedicate more than one working hour of each of their 245 working days per year *exclusively* to smoking.<sup>5</sup> The ASH costings have additionally been criticised by a policy research institute, the Cambridge Centre for

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<sup>4</sup> Issue 18 of Capita Asset Services' *Dividend Monitor Report* for January 2014 gives total UK dividends of £79.6 billion in 2013 (p5), of which the tobacco sector constituted £4,110 million (p11)

<sup>5</sup> Even if we were to believe this fiction, the correcting response to an externality that falls upon companies should be to compensate the companies that suffer it, not to raise an unrelated tax. Does the Treasury propose too that all tobacco manufacturers should be able to offset their proportion of this theoretical lost employee productivity against any levy payments?

Health Services Research<sup>6</sup>, following the use of the costings by the BHF as reported in The Guardian.<sup>7</sup>

In a study for Wales, ASH estimates the smoking break losses to the businesses to be £41m. Taking into account the population, the number would be 0.7bn for England. We do not believe that such “estimates” of activists is a robust platform for government conclusion that there is a need for an additional tax.

2. No attempt is made to measure the social contribution of the tobacco industry.

With this omission the consultation jettisons not only any credible claim that the levy is designed to correct a market imbalance, but also the principles of cost benefit analysis that should underpin all sound policymaking.

3. There already exists a method for correcting any imbalance between the social cost and the social contribution of tobacco: excise.

According to figures reported to the European Commission, the UK raised £9.53 billion in tobacco excise in 2013.<sup>8</sup> It is incredible – in the most literal sense – that such an established, practical and effective method of raising taxation from tobacco products has been overlooked, and that an entirely new system for redressing externalities is now being considered in isolation.

Taken together, we believe that these three factors indicate that the consultation on a tobacco levy exists not to satisfy any credible economic requirement, but rather to scratch a political itch. We consider this highly unfortunate, not only on the grounds that the very principle of a levy is fundamentally misguided (as illustrated above) but also because (as we discuss below) we consider that the introduction of such a levy is likely to be highly counterproductive for government.

## LEVY DESIGN AS PROPOSED

It is a mistake to see this levy as a tax on profits, or on the: “*benefit[s tobacco manufacturers and importers gain] from the activity that imposes these costs on society*”. By proposing to set a target revenue figure for the levy – or rather two figures, one for cigarettes and one for all other products – and then attributing liability for raising this figure on the basis of volumes released for consumption, the consultation is effectively imposing an additional tax on each tobacco product sold. While the exact amount of additional tax on each product is unknown the time the manufacturer or importer releases it for consumption (on which more below), the levy does, in effect, reduce to a tax on tobacco products, not a tax on profits. This is most clearly demonstrated by that fact that the levy would still be payable by companies who made no profit, or for whom their profit was at a level at which the levy itself would cause them to make a loss.

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

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<sup>6</sup> <http://www.cchr.iph.cam.ac.uk/1315>

<sup>7</sup> <http://www.theguardian.com/society/2014/mar/03/smoking-breaks-cost-businesses-british-heart-foundation> <sup>8</sup> Figures from DG TAXUD tables, and comprise £8.34bn from cigarettes, £82m from cigars and cigarillos and £1.1bn from other smoking tobacco.

The proposal for the additional “tobacco levy” is de facto a proposal for an additional excise. Therefore, it is clear that for the purpose of excise duty, the tobacco market has to be defined as products on which tobacco excise duty is paid.

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

This question allows for the discussion of some important and detrimental consequences of the levy. If, as proposed, a volume measure of market size is used, then the levy becomes, in effect, a “specific” (per unit) tax on tobacco products: each product released attracts its vendor an equal share of the overall levy liability for the category, regardless of the product’s price. At first inspection, it appears that manufacturers and importers would therefore react to the levy in the same way as they typically react to increases in specific excise – by attempting, subject to competitive constraints – to pass this cost on to consumers.

It is pleasing to see that the consultation document recognises, in Section 3.5, that *“[i]f a levy were to be passed through to consumers, the price of tobacco would rise. A rise in prices is likely to lead to a reduction in sales...”*. This is of course a result of the high elasticity of demand for legal tobacco products in the UK, as a result of already-high tax levels, squeezed disposable incomes, and the resilience of the criminal networks providing a thriving illicit trade in tobacco products. We quite agree with the consultation document when it states: *“If the levy is passed onto consumers through higher prices, then this could mean that some stop smoking, some smoke less or smoke cheaper brands, and some move to the illicit market.”* However, the consultation document does not, unfortunately, go further and explain the consequences of this for the government’s overall revenue objectives – such as the 2% drop in excise revenues that the UK reported between 2012 and 2013 (the last year for which data are available)<sup>8</sup> and the £2.9bn that the government is estimated to lose to the illicit trade each year.<sup>9</sup> It is these effects – the impact of higher prices on consumer shifts to the illicit trade, and the corresponding falls in government revenues – that we would highlight later in our submission in response to **Questions 9 and 10**. Additional around £1bn is lost for the UK to cross-border shopping.

No doubt there will be respondents to this consultation who will hypothesize, in line with the section 3.4 of the consultation document, that somehow this rising tax burden would simply be absorbed by manufacturers and importers, either by an unlikely spontaneous shareholder acceptance of lower profits, or through competitive pressure that nevertheless leads to this outcome. This fails the logic test: if there were such competitive pressures to sacrifice profit in order (presumably) to gain share, one would expect this to be happening already. It is not. Recent history has shown that the market has regularly passed on the full cost of specific excise rises to consumers; all manufacturers announce a revised price list detailing higher recommended retail price and trade purchase price reflective of the duty change.

The risk premium – relevant to **Question 8** – arises because of imperfect information. Under the proposed design of the levy, it is not specified when the Government would announce its revenue target(s) for the levy. As such, at the point at which a manufacturer or importer releases a tobacco product for consumption, they may not know the relevant revenue target(s). In any case they certainly won’t know the proportion of levy for which they are liable – as they would have no way to tell what the total market will be and what proportion of the overall market their releases represent. As such, manufacturers and importers will be releasing tobacco products in the knowledge that such releases will make them liable to pay some proportion of the levy, but

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<sup>8</sup> DG TAXUD figures report that the UK raised €11.9bn in tobacco excise in 2012 against €11.7bn in 2013

<sup>9</sup> In “Measuring tax gaps 2014 edition (foe 2012/2013) HMRC states £2bn:

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/364009/4382\\_Measuring\\_Tax\\_Gaps\\_2\\_014\\_IW\\_v4B\\_accessible\\_20141014.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/364009/4382_Measuring_Tax_Gaps_2_014_IW_v4B_accessible_20141014.pdf)

they will have no way of determining how much this will be. As such, any manufacturer or importer releasing product is exposing themselves to a definite but unknowable liability. Of course, they may estimate their liability on the basis of past market shares. However, it is also certain that they will build a provision for funding any higher than expected levy charges. This provision will come at a cost, and, for the same reasons mentioned above, this cost is most likely to be passed on to consumers.

Without knowing the revenue targets and the future market composition, it is impossible to estimate the size of the risk premium. However, there is reason to think that it would create a situation in which the risk premium results in a higher increase in consumer prices under the levy than under the imposition of additional specific excise, for any given level of fiscal revenue.

In principle, manufacturers and importers would pay a known amount per unit of *regular current* excise at the time of release for consumption and an *additional unknown* de facto excise that is variable per unit on the same products and volumes but deferred to the following year.

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

There are two ways to calculate total market size: volume and value, for example expressed in retail prices.

The characteristics of the proposed tobacco levy are what economists call excise duty. Excise duty on tobacco has been implemented for hundreds of years in many countries and has been implemented in England since 1604. The general purpose of excise is to compensate for external costs caused by products and/or services. The consultation document makes it explicitly clear that the only purpose of the tobacco levy is to contribute to "costs on society".

The basis for (tobacco or any other) excise can be the volume (called specific excise) or the value (ad valorem excise) or the combination of both (mixed excise). As the EU legislation requires mixed excise, the UK applies both specific and ad valorem excise.

The impact of specific and ad valorem excise on individual products is different. Whilst specific excise is the same for all products disregarding the price, ad valorem excise is higher on higher priced products.

Following that, the proposed levy is in the terminology of economists a *specific excise duty*. Imperial Tobacco believes that it is helpful to use the correct economic rather than political expressions to better understand the impact.

**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?**

The current (specific) excise duty on cigars/cigarillos, HRT (hand-rolling tobacco) and other smoking and chewing tobacco ("OTPs") has significantly different rates for these three categories:

Cigars	£229.65/kg
HRT	£180.46/kg
Other smoking and chewing tobacco	£100.96/kg.

The implementation of the proposed additional (specific) excise would result in an increase of the current excise for all three product categories by the same amount but by different percentage. For example, the increase on other smoking and chewing tobacco would be more than twice of those on cigars and nearly twice of that for HRT. This may be government objective or unintended consequence of a flawed design.

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

Imperial Tobacco thinks that UK tobacco (or any other) taxation should follow the same principles as any other excise in any other country instead of inventing any new mechanism which is unpredictable and has damaging impact on government, consumers, shareholders, industry, UK plc and leads to unintended consequences.

Statements under 2.15 indicate that under the “current year” approach, economic operators would pay the additional excise according to the common principles for specific excise which is a fixed amount per quantity sold in the previous month as only this scenario allows for the expressed conclusion that the target may not be reached (due to unknown volume).

The option of excise collection in the year after release for consumption based on data of previous year is not an option, if thought thoroughly through. Under this scenario, economic operators would engage in business transactions creating a future and, more importantly, unknown and unpredictable tax liability as explained above.

The chaos under this scenario would be for example represented by the simple fact that the government would not even be able to calculate the share of taxes of the retail price as some are charge by the conventional way and some by the proposed invention of “tobacco levy”.

It is good practice, an integral part of economic theory and common sense around the world that tax liability based on quantity or value of products has to be known at the time of business transactions. This applies to VAT, excise, import duty or any other creative labelling of these consumption taxes.

The “previous year” approach would ensure that the target is reached but leads to a variable and unpredictable excise per product unit. Even if the financial target was announced by the government in advance, the total market size and the individual market share would disallow for adequate calculation per unit. Under this scenario, the calculation and payment of the additional excise would be deferred to the following year.

Taking into account that cigarette volumes decreased by 11.3% in 2013 versus 2012 (volume reported by the UK government to the EU Commission and published on the TAXUD website), economic operators would be put out of business, if they underestimated the volume decline and thereof resulting deferred tax. However, they would make a huge profit, at least per unit, if they overestimated the decrease and the volume went down only by 3.7% as it was the case in 2012 versus 2011.

It is obvious that all economic operators need predictable legislation and taxation and therefore, it is obvious that all companies including Imperial Tobacco will clearly oppose any unpredictability caused by the “(ii) previous year” approach. This would be Russian (tax) roulette rather than tax policy.

## LEVY ADMINISTRATION AS PROPOSED

Furthermore, it is absurd to suggest, as the consultation document does in sections 2.17-1.20, that administration costs are minimised by bringing a levy within the administration of corporation tax, while neglecting to point out that the cost of any levy system would be wholly duplicative of the parallel bureaucracy for collecting tobacco tax via the well-established system of excise. In our responses below to **Questions 6 and 7**, we can only highlight the folly of bringing in a levy to raise money from excisable products, when the products are excisable in the first place, and the excise rates are already at HM Treasury's discretion<sup>10</sup>.

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

The current tobacco excise is based on volume released for consumption. Therefore, it is obvious that it does not make any sense to split a tax based on exactly the same products and exactly the same volumes into two parts payable in (potentially different) periods, different administrative procedures and different responsibilities at the side of manufacturers, importers and tax authorities.

It is absurd to suggest, as the consultation document does in sections 2.17-1.20, that administration costs are minimised by bringing a levy within the administration of corporation tax, while neglecting to point out that the cost of any levy system would be wholly duplicative of the parallel bureaucracy for collecting tobacco tax via the well-established system of excise.

The idea that this additional excise would not be deductible for corporation taxation would accelerate the impact of the additional excise on retail price of affected products for those reporting profit and paying taxes in the UK. Economic operators would have to estimate the deferred tax liability and reflect it in retail prices to avoid bankruptcy (explained later). However, the increased gross sales would not, due to non-deductibility of this additional excise, lead to a correction of these artificial high net sales. Therefore, the "profit" of economic operators would be inflated and so would be the corporation tax.

However, this unfair taxation would only apply to those economic operators declaring profit and would have no impact on those without profit or loss residing in the UK. As a result and side effect, the non-deductibility would impose an additional de facto ad valorem excise on those reporting profits. To compensate for the decrease in profit after tax (which is the base for dividends) additional retail price increase would be necessary which would again lead to a higher corporation tax. This effect is called the "multiplier effect" by economists. It is obvious that this additional penalisation of profit declaring UK companies would lead to reconsideration of transfer pricing and could even become indispensable to remain competitive.

In summary, we do not think that this tax innovation and its potential impacts have been thoroughly thought through.

### **Question 7: What are the alternative approaches?**

It is obvious, that a tax with the same base for exactly the same products should not be split. Tobacco excise duty has been implemented in England since 1604 and, when correctly applied,

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<sup>10</sup> Within the confines of Directive 2011/64/EU

works well. There is no need to invent a new additional ill-designed duplicate with modifications that are obviously damaging for all parties involved.

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

As stated above, the proposed tobacco levy fulfils all characteristics of tobacco excise. Labelling this additional excise as a direct tax is not helpful and only distracts from a proper analysis of the consequences.

Tobacco excise belongs to the category of consumption taxes. The characteristics are that this duty is imposed on domestic consumption (not on exports), at the time of release for consumption or sale and disregarding any profits or other circumstances. The purpose is to compensate for external costs on society. Consumption taxes belong to indirect taxes. Collection forms and technicality of administrative procedures are irrelevant. A few anomalies attached to the tobacco levy do not make any difference to the fact that it is excise duty (deferred, if "previous year" approach applied). The only significant difference would be that it is a highly unpredictable excise with all consequences.

Paragraph 3.4 makes confusing links between direct taxes and absorption in profits. These are obviously inaccurate as all (direct/indirect) taxes can be absorbed and all (direct/indirect) taxes can be passed to consumers. If a levy had no impact on product prices, governments could implement levies on mobile phones, the internet, fuel, spirits, cars or even any products and budget deficits would be a thing of the past. Alternatively, governments could simply replace existing excise duties by "levies" to decrease prices for consumers. Unfortunately, economic reality is not that simple. The indicated differentiation between the impact of direct and indirect taxation on retail prices simply does not exist either in economic theory or in practice.

Therefore, in answer to the question, the tobacco levy would have exactly the same impact on retail prices as an increase of the regular specific excise plus the additional impact resulting from non-deductibility for corporation tax.

Excise duty is currently between 55% for premium and 70% for bottom priced brands. The nominal VAT rate of 20% represents 16.67% of retail price resulting in total tax incidence between 72% and 87%. Trade margin to wholesale and retail trade is typically 7% for premium and 6% for bottom priced brands. From the remaining part of 21% to 7% of the retail price, manufacturers have to manufacture and transport the products, finance investments and cover all overhead costs keeping only a very small share of the retail price as profit. This profit, if there is any, is subsequently subject to corporate taxation.

However, tobacco manufacturers do not exist in the UK anymore. Those releasing tobacco products manufactured in other EU Member States for consumption in the UK and importers from non-EU have even lower margins as they share the profit with the non-UK manufacturer. In addition, importers have to pay import duty.

It is therefore obvious that the room for tax absorption is very limited and the experience demonstrates that excise increases have always been passed to consumers via price increases.

However, under the “previous year approach” with deferred tax liability, economic operators would have to make assumptions about the total market for cigarettes and HRT/OTP, their market share in cigarettes and HRT/OTP and the total amount (if not announced in advance) of the proposed additional excise for cigarettes and HRT/OTP to translate it into the tax obligation per unit.

The additional implicit ad valorem-like corporate tax on inflated “profits” due to non-deductibility for (profit making) companies would accelerate this uncertainty.

Therefore, the total impact on retail prices would also be unpredictable. Some companies would predict high referred liability and some would predict low. As a consequence, the gap between cheap and expensive tobacco products would most likely increase as companies would have different assessment of the associated risks and not all would be subject to the implicit ad valorem-like corporation tax. The result would definitely be chaos in the market and chaos in pricing. As a result, some companies would make higher profits and some would be out of the business without paying the deferred excise.

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

The impact of the levy would be exactly the same as the impact of excise increases. The only difference would result from the unpredictability created by the ill-designed construction of the levy.

As after all excise increases, the retail prices for tobacco products would increase. As cigarette prices in the UK are coming closer to £10 per pack, it would not only put higher tax and financial burdens on consumers but also hit an important psychological threshold accelerating the usual unintended consequences of tax increases: down-trading, increase in illicit trade, cross-border shopping and regressivity (unfairness) of indirect taxation.

We are aware that the anti-tobacco lobby has developed the theory that increases of tobacco taxation are progressive as low income groups profit most from quitting tobacco consumption. This is absolutely correct, provided that these income groups quit. However, this is not the case in real life and has been demonstrated by several statistics across the UK. For example, ASH states:

*“[h]istorically there has been a slower decline in smoking among manual groups, resulting in smoking becoming increasingly concentrated in this population. In recent years, smoking rates have fallen by a similar amount across all social groups, so that the differential between non-manual and manual has not changed significantly”.*<sup>11</sup>

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<sup>11</sup> [http://www.ash.org.uk/files/documents/ASH\\_106.pdf](http://www.ash.org.uk/files/documents/ASH_106.pdf)

## Prevalence of cigarette smoking by socio-economic classification

Persons aged 16 and over. Great Britain: 2013 (%) 2

	<i>Men</i>	<i>Women</i>	<i>Total</i>
Large employers and higher managerial	14	9	12
Higher professional	11	14	12
Lower managerial and professional	18	13	15
Intermediate	19	14	16
Small employers / own account	26	15	22
Lower supervisory and technical	28	30	28
Semi-routine	29	27	28
Routine	32	29	31

*Source: ASH, Fact Sheets, Smoking statistics, January 2015*

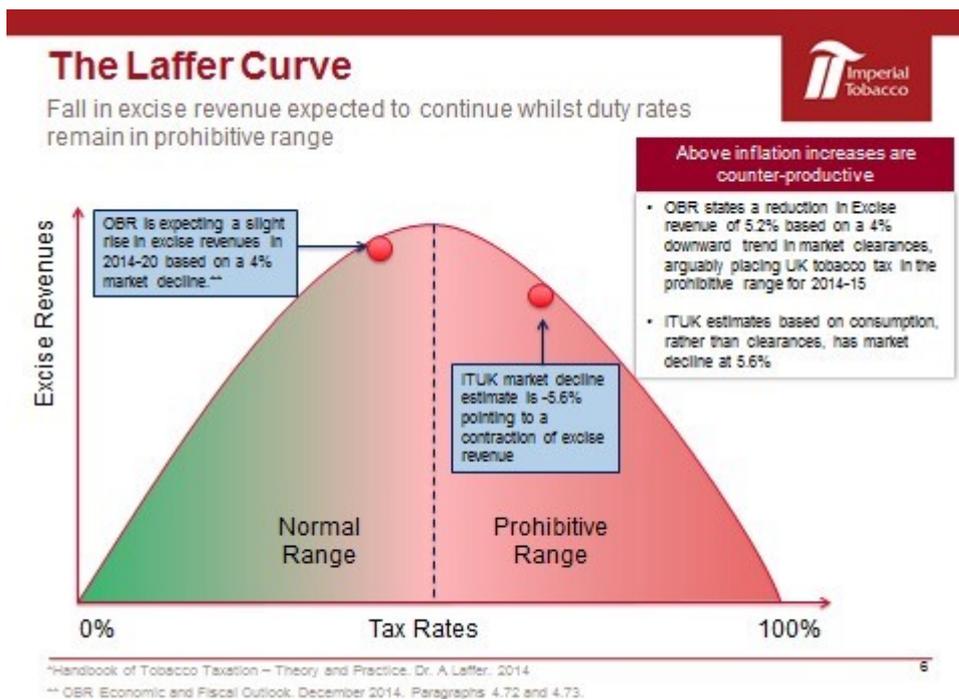
As demonstrated by the ASH table, smoking incidence is two and a half fold higher in the lower income groups. To understand the full impact on society, the income distribution has to be taken into account. As in most countries, two-thirds of all households have lower than average income. As these income groups have the highest smoking incidence, the result is that low income groups pay a major share of tobacco excise. It is obvious that funds spent on tobacco excise are not available for education, sports, culture, holiday or housing. High UK tobacco excise (highest within the EU) has led to tobacco poverty in the UK and is the reason why other EU Member States do not follow this path of extremely unfair excise duty.

Imperial Tobacco believes that it is time to reconsider the sustainability of tobacco taxation in the UK.

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

We would recommend including cross-border shopping into the assessment of the tobacco levy proposal. Whilst illicit trade (can be influenced by the government) has been included, crossborder shopping (cannot be influenced by the government) has obviously been overseen.

We are also missing any consideration of price elasticity. In 2013, tobacco revenue decreased for the first time sending a clear warning that the zenith of the Laffer Curve, as demonstrated below, may have been passed. Adding an additional tax would accelerate the trend.



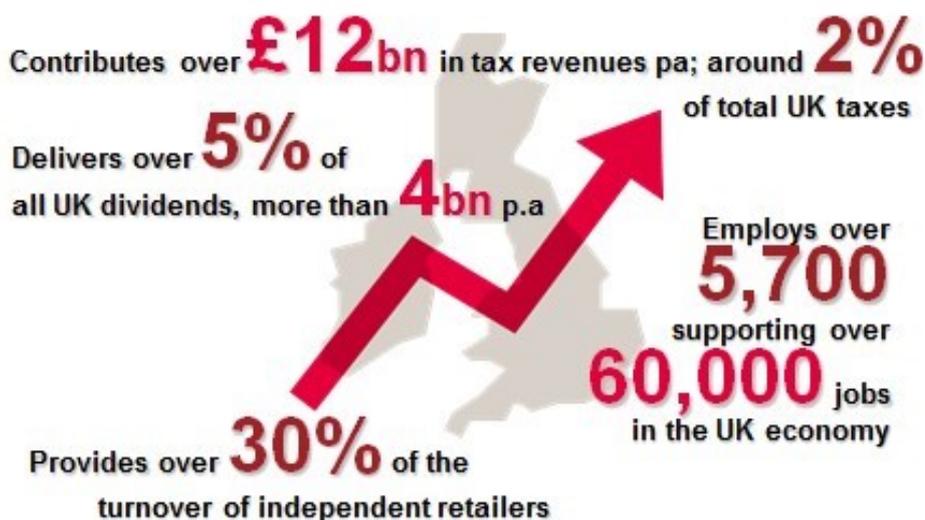
Already price elasticity around -1 would lead to government revenue losses. It is important to understand what price elasticity means. Price elasticity indicates the decrease in demand due to *price increase* and it does not include reduction in demand due to *other factors* such as smoking bans, display bans or the impact of the new EU Tobacco Product Directive.

**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 would expect that the government of one of the major world economies with sophisticated national statistic offices has its own calculations of external costs of tobacco products. Relying on estimates of the anti-tobacco industry with vested interests is a disappointing platform for an evidence based tobacco policy.

Tobacco products contribute around £12bn to government revenue. This amount is fourfold of NHS costs of treating diseases caused by smoking (NHS costs estimated by the anti-tobacco industry).

## Tobacco's contribution to UK economy is significant



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The major cost element estimated by the anti-tobacco industry is allegedly caused by smoking breaks to businesses (not to the government). Even if we agreed that cost of smoking breaks caused by employees to businesses justify a tax to the government, we wonder why only products consumed by some 20% of employees are singled out. We would expect that similar taxes would be proposed for manufacturers of other products which cause working breaks by de facto 100% of all employees such as mobile phone, coffee or providers of the Internet. Regarding the amount estimated by the anti-tobacco industry, this inflated number has been completely dismissed by CBI, amongst others.

It is clearly evident that the majority of all employees cannot take any smoking breaks outside of regular breaks for all employees. Teachers, drivers of taxis, buses, trains, ships, air crews, miners, surgeons, soldiers, police, firemen and many others cannot even take any such break.

Additionally, the self-employed do not cause any damage to the society and office employees work regularly longer if they take smoking breaks. Finally, those working in the open air do not have to leave the working place for smoking. Therefore, smoking breaks causing damage to businesses involve only a very insignificant part of all employees.

Other cost estimates of the anti-tobacco industry, uncritically adopted by the government, are similarly flawed regarding methodology and assumptions. For example, the estimated costs of social care include even costs paid by smokers themselves.

We would like to comment also on paragraph 3.11, a proposal for some kind of corporation tax surcharge. A simple implementation of another common corporation rate as percentage of profit would not work for obvious reasons. If the surcharge was designed based on volume released for consumption, this relabeling of excise duty would not make any difference to the impact analysed in all other parts of our submission.

Paragraphs 3.8 and 3.9 indicate the motivation for the tobacco levy based on belief that companies somehow differentiate between cost elements reducing the profit and dividends.

So far, the government has justified increases of tobacco excise by its desire to increase retail prices, decrease affordability and subsequently to reduce consumption. However, the government now seems to want a levy that has none of these effects, suggesting that what have been seen as objectives are now viewed as risks.

All relevant tobacco companies operating in the UK are publicly listed companies. Publicly listed companies are owned by shareholders. Shareholders are interested in dividends (and investments as they are necessary for future dividends). Dividends (and investments) are paid for by profits. As stated on the Imperial Tobacco website the ultimate objective is “Maximising Shareholder Returns” and this applies to other businesses as well. Therefore, revenue and costs and the impact on dividends have to be treated as such whatever label is attached to it.

Imperial Tobacco has around 26,000 shareholders with 53 per cent of issued shares held in the UK and ITG dividend payment is around £1 billion per year (from profits made worldwide). For the tobacco industry in total, more than 5% of all UK dividends are from tobacco companies.

## CONCLUSION

Imperial Tobacco opposes both the principle and the design of the proposed tobacco levy.

It is imperative that any proposals to raise additional government revenue from tobacco avoid the pitfalls and counterproductive effects. The proposed levy fails these tests: it erodes business confidence, distorts competitive markets and pricing by unpredictable taxation of products, and threatens the sustainability of government revenues by driving consumers into the illicit trade. Its design shows both a lack of understanding of the dynamics of markets, and a lack of comprehension of its likely impacts and unintended consequences.

Imperial Tobacco views the proposed levy as flawed both in principle and in practice, and should not proceed to consideration beyond the current Stage One of the Government’s *Tax Policy Framework*. Insofar as **Question 11** asks for alternatives to the levy, we propose that the social costs of tobacco are set alongside the benefits that the sector provides – through jobs, dividends, exports and excise – and that any difference is addressed through measured, incremental, and well-considered adjustment to the excise system.

We would welcome the opportunity to meet to further discuss how the Government could meet its revenue, health, and crime reduction objectives without the need for such an ill-construed and counterproductive levy.

**Imperial Tobacco Limited**

**18 February 2015**

13 Winterstoke Road

Bristol

BS3 2NU

## APPENDIX

We have set out our views to the following consultation in some detail and invite the UK Government to consider our previous submission carefully.

Her Majesty’s Treasury open consultation on Minimum Excise Tax – submitted 14<sup>th</sup> October 2014

## 2.25 The Imported Tobacco Products Advisory Council

# ITPAC

*THE IMPORTED TOBACCO PRODUCTS ADVISORY COUNCIL*

## HM TREASURY CONSULTATION ON A TOBACCO LEVY

### ITPAC RESPONSE

#### A. ITPAC ASSOCIATION

ITPAC is a trade association which represents the interests of 14 distributors of imported tobacco products in the UK. The Association's Core Members consist mainly of small and medium sized private companies, most of whom employ less than 50 people. These suppliers focus on specialist tobacco product ranges such as cigars, pipe tobacco and snuff.

ITPAC's Core Members are: Bull Brand Ltd, Davidoff Distribution (UK) Ltd, Gawith Hoggarth TT Ltd, Heintz van Landewyck, Hunters & Frankau Ltd, Karelia Tobacco Company (UK) Ltd, Ritmeester Cigars UK Ltd, Samuel Gawith & Co. Ltd, Scandinavian Tobacco Group UK Ltd, Tabac World Ltd, Tor Imports Ltd.

ITPAC's Associate Members, in their capacity as distributors of imported tobacco products, are: British American Tobacco UK Ltd, Gallaher Ltd (a member of the JTI Group of companies) and Imperial Tobacco UK Ltd, but they are represented separately by the Tobacco Manufacturers' Association.

The name and address of the respondent is:

\_\_\_\_\_, Secretary-General, The Imported Tobacco Products Advisory Council, Rondle Wood House, Milland, Liphook, Hampshire GU30 7LA

Contact email address: \_\_\_\_\_

Contact Phone Number: \_\_\_\_\_

#### B. STATEMENT OF PRINCIPLES

ITPAC is fundamentally opposed to the principle of a Levy on tobacco companies and considers it to be an unreasonable and discriminatory measure.

The Association will therefore respond to the principle of such a Levy, rather than comment on the individual questions in the Consultation which relate primarily to implementation issues in the event that the introduction of a Levy goes ahead.

#### **TOBACCO SECTOR TAX CONTRIBUTION**

It is relevant to emphasise the existing significant contribution made by the tobacco industry to HM Treasury through Excise and VAT (over £12bn p.a.) as well as additional contributions from Corporation Tax. The figure for Excise and VAT should be even higher given that a further estimated £2.4bn p.a. is lost through illicit trade.

## **SMALL TOBACCO COMPANIES**

As stated above ITPAC's Core Members consist mainly of small and medium sized private companies. The specialist nature and the extent of their product ranges involve slow and expensive production processes, very low market shares, and long sell through times, with a good percentage of sales made through the small secondary retail supply channel. A number of these companies are very small and financially vulnerable businesses which have been significantly and disproportionately affected by the level of regulation in recent years, and are already under severe economic pressure.

## **DIMINISHING RETURNS**

There is a strong likelihood that a Levy would have a similar market effect as a rise in excise whereby, in spite of the implication made in the Consultation, the industry could well pass the costs onto the consumer. The result of this would be a decline in volumes and a corresponding diminished return in tobacco tax receipts to HM Treasury, thereby undermining any contribution resulting from the Levy.

## **ILLICIT GOODS**

As is stated above, if a Levy is imposed and the costs were to be passed onto consumers, the price of tobacco would rise. A rise in prices is likely to lead to an increase in illicit trade for which HMRC's estimates for the 2012/13 year show the total non-UK duty paid share of consumption of cigarettes to be up to 21% and of hand-rolling tobacco to be up to 47%.

## **MINIMUM MARKET SHARE THRESHOLD**

A number of the companies ITPAC represents have an infinitesimal share of the total tobacco market in the UK. The calculation of a Levy payment based on this, whilst relatively limited in the overall context of the intended receipts, would still represent an unacceptable financial commitment for many of these businesses. It is therefore recommended that, in the event of a Levy being imposed, a minimum threshold should be established below which no contribution would be expected.

## **MINIMUM MONETARY PAYMENT REGARDLESS OF MARKET SHARE**

Based on the logic outlined in the previous paragraph, any minimum Levy payment regardless of market share would represent a disproportionate imposition for these smaller companies and exacerbate their problems even further.

## **C. CONCLUSION**

A significant level of tobacco regulation has been introduced over the past 10 years, in addition to relentless annual excise increases. A full display ban will be in effect from April 2015 and an extensive range of complex and costly measures, including 65% health warnings, will be implemented from May 2016 as a result of the revision of the EU Tobacco Products Directive.

ITPAC's Core Members have been significantly and disproportionately affected by this level of regulation because of their size and the specialist nature of their trade. ITPAC is therefore extremely concerned that, if a Levy were to be applied to these companies, it would have devastating consequences and a number of them would be finally forced to close down their businesses.

Under these circumstances it is ITPAC's view that the introduction of a Levy is a step too far, and the Government should give serious consideration to resisting the ideological temptation to take

forward a policy which is (i) unlikely to deliver its stated objectives, and (ii) likely to cause significant damage to a number of small and vulnerable UK businesses.

13<sup>th</sup> February 2015



Tobacco Levy Consultation  
VAT and Excise  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

18<sup>th</sup> February 2015

Dear Sir/Madam,

**JTI's response to HM Treasury's Consultation on a Tobacco Levy**

Japan Tobacco International (JTI) is part of the Japan Tobacco group of companies, a leading international tobacco product manufacturer.

JTI has its UK headquarters in Weybridge, Surrey, and has a long-standing and significant presence in the UK. Its cigarette brand portfolio includes Benson & Hedges, Silk Cut, Mayfair, Sovereign and Sterling, as well as a number of other tobacco products including roll-your-own tobacco (RYO), also known as hand-rolling tobacco (such as Amber Leaf), cigars (such as Hamlet) and pipe tobacco (such as Condor). Currently, JTI manufactures product for the UK market in Northern Ireland and other EU Member States (Germany, Romania and Poland).

In the UK alone, JTI employs over 1,800 people

In 2014, JTI's UK excise contributions on its tobacco products amounted to around £3.9 billion (with a further £940 million of VAT).

Gallaher Limited is the registered trading company of JTI in the UK.

**Executive Summary**

JTI is strongly opposed to a tobacco levy which is unnecessary and inappropriate as well as anti-business and anti-investment. The assumptions that claim to support the concept are seriously flawed.

Our response sets out seven reasons why a tobacco levy is an inappropriate taxation tool, with far reaching economic consequences:

- 1 A consultation without clear policy objectives** – it fails to address the central question as to whether there is a need for a levy at all. Tobacco excise is already subject to an annual, excessive duty escalator policy and **any new tax, however designed, will be passed on to the consumer.**

JTI UK

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[jti.com/uk](http://jti.com/uk)



2. **An inappropriate, complex tool for tobacco taxation** – the design of the tobacco levy raises serious questions about compatibility with EU law.
3. **A tobacco levy will not be effective, efficient or fair** – excise levels in the UK are the highest in the EU, which with VAT already account for over 80% of the retail price and generated £12.1 billion of revenue in 2013. A levy is an additional tax which will most probably lead to a further growth of illicit trade, diminishing revenues and impact legal businesses and the supply chain right down to retailers.
4. **Reliance on inappropriate and flawed estimates** – a consultation which draws solely and apparently without question on a document produced by a member of the tobacco control lobby.
5. **Societal cost compensation is a flawed measure** – a tobacco levy sets a precedent for a huge range of industries to have levies imposed upon them, making the UK a far less attractive investment location at a time when economic growth is meant to be the UK's top priority.
6. **A lack of a proper impact assessment** – the consultation lacks a regulatory impact assessment or tax impact assessment, contrary to expert views on their importance early in policy making analysis.
7. **A levy is not the best approach to further revenue generation** – Government has lost £9.8 billion to the illegal trade over the last five years and efforts to close this gap should be the primary focus. For the consultation on Minimum Excise Tax, JTI set out recommendations for Minimum Collectable Tax, structural change and the abandonment of the duty escalator – revenue optimizing measures which are the least disruptive, most appropriate and compliant with EU requirements.

view of our strong concerns and opposition to the proposal, JTI sets out its response on a 'point of principle' basis rather than on a question by question basis, without prejudice to its position if the proposal, despite JTI's views, were to be taken forward.

## 1. A consultation without clear policy objectives

This consultation does not explore or address the central question, which is whether there is a need for a levy at all and fails to establish the premise or any clear policy objectives for such a levy. Indeed, it appears to accept the premise that a levy is necessary, and proceeds to seek views regarding the mechanics of such a levy.

The only stated 'rationale' for a levy is "*it is fair to ask tobacco manufacturers and importers to make a greater contribution towards these costs (i.e. alleged costs of smoking to society)*".

This would appear to set a whole new policy precedent for a huge range of industries to have levies imposed upon them to "contribute" to the social costs associated with the legal and legitimate use of their legally compliant products (e.g. alcohol, motor vehicles, processed food, confectionery, sugar, cooking oil etc.).

The result would be an unsustainable and enormous number of levies being used to lay estimated costs to society at the door of product manufacturers.

However, it appears that government did not adequately consider who (for example, the companies or the consumer) would end up paying a levy and how this would affect the market. **Ultimately the so called 'fair contribution' will be paid by the consumer, as any levy would be passed through by manufacturers.**

In the case of tobacco, the government benefits from its indirect taxation of over 80% of the product retail price in addition to corporate and other taxes. Tobacco excise is already subject to an annual excessive duty escalator policy and this very high tax policy continues to encourage the illegal trade in tobacco which causes annual tax losses in the UK of over £2 billion.

It is clear the policy objective of this proposed levy has not been properly thought through and no cost-benefit analysis performed. Akin to yet another excise hike, it sets a bad policy precedent and will most likely provide a negative revenue return.

## **2. An inappropriate, complex tool for tobacco taxation**

Looking at the way the levy would be calculated, it appears to be an indirect tax. At the same time, it is clearly stated that *"The levy would be a direct tax"* and in terms of the administration it *"would not be deductible for corporation tax purposes, and would instead be payable out of profits after tax"*.

**The proposed design of the levy raises serious questions about its legality and compatibility with EU law.**

Further, the consultation document suggests that because the proposed levy would be a direct tax on tobacco manufacturers and importers, it *"could be absorbed in profits"*. In this scenario the consultation accepts the premise that *"consumers would not see a rise in prices but company's profits would be lower"*.

This is a fundamentally flawed assumption as any tax, except for a personal income tax, can be passed on to the consumer. This is evident for tobacco taxes, manufacturer and trade pricing. In fact, the introduction of an uncertain levy can result in a tendency to overcompensate pricing as companies have a clear responsibility to their shareholders to maintain profits as far as possible.

**Therefore, it will not matter how the levy would be designed because the impact will be exactly the same as an excise tax increase and it will be passed on to consumers.**

## **3. A tobacco levy will not be effective, efficient or fair**

Tobacco products are already subject to heavy excise duty and tobacco companies are some of the biggest unpaid tax collectors for the Exchequer. Excise levels in the UK are the highest in the EU, which together with VAT, typically represent over 80% of the product retail price.

HM Revenue & Customs (HMRC) acknowledges that tobacco duty makes an important contribution to the public finances and forms part of HMRC's plan to reduce the UK's debt<sup>1</sup>. In 2013, the Government raised approximately £12.1 billion from tobacco excise and VAT. Furthermore, the tobacco industry generates direct taxes and will contribute significant corporation tax in 2014. The tobacco sector as a whole contributes a further £2 billion annually to the UK in Gross Value Added<sup>2</sup>.

It is important to highlight that excise revenue from tobacco peaked at £9.7 billion in 2012 and has since declined due to down-trading and falling legal sales. In economic terms, this simply means the tax burden has entered the 'prohibitive range' whereby further tax increases cannot prevent revenue falling. This highlights that in countries with the highest tax and price levels such as the UK, further rises in tobacco taxes have only a limited impact. As the Adam Smith Institute pointed out "*the real question for policy-makers in Britain is whether continuous price hikes offers value for money where prices are already very high.*"<sup>3</sup>

A major cost to society not referenced in the consultation document and which can only be attributed to government policy, is the cost of illegal tobacco. One study on assessing the impact of organised crime in the UK estimated that revenue, social and economic costs associated with illegal tobacco was £2.9 billion in 2003-2004, £2.54 billion of which was tax revenue loss. Following discussions with HMRC, the researchers of this study assumed that 80% of the hand-rolling tobacco (HRT) fraud market and 90% of the fraudulent cigarette market was attributed to organised crime.<sup>4</sup>

As a tobacco levy is another name for an additional tax, **it would have the same impact as an excise duty increase and will most probably lead to greater criminal activity, affecting UK duty-paid sales volume and legal businesses throughout the supply chain right down to retailers.** In addition, the levy will incur additional administration costs and efforts by law enforcement to tackle tobacco smuggling.

In view of the current scale of tax contributions, JTI strongly disagrees with the Government's view that it is "*fair to ask tobacco manufacturers and importers to make a greater contribution.*" Furthermore, it should be noted that the tobacco industry does not enjoy any special industry tax deductions, nor have tobacco companies gained any windfall profits or benefitted from public aid.

In addition to being unjust, the levy has a high risk of yielding diminishing returns.

#### **4. Reliance on inappropriate and flawed estimates**

The Consultation appears to be founded on the premise that "*smoking imposes large costs on society*", and quotes an estimated cost of £12.9 billion a year in England. This premise appears to be based on a single source, an ASH four page "*fact sheet*". JTI is astonished that the Consultation has relied solely and apparently without question on such a document produced by a member of the tobacco control lobby<sup>5</sup>.

Regulation should under no circumstances be proposed if based only on information provided by particular pressure groups, with no counter arguments considered, and it is of great concern that the consultation relies on such minimal, and unsubstantiated analysis.

JTI would expect that HM Treasury (HMT), and other Government departments would commission their own research in order to propose informed policy decisions. In doing so, HMT must obviously act in a transparent manner (using a public process in which experts from beyond the pre-existing pool of known tobacco control contacts could volunteer to participate), and in accordance with UK best practice guidelines on the choice and selection of experts. Such guidelines require the drawing upon of a "range of appropriate expert sources" that "should be sufficiently wide to reflect the diversity of opinion among experts in the appropriate field(s) in a balanced way" so that "lobbying will become apparent".<sup>6</sup>

To enable stakeholders to understand the extent to which ASH has participated in proposing a levy, and the degree to which HMT has tested the ASH estimates, HMT should now make publicly available the nature and extent of its discussions with ASH. Doing so would also help satisfy the need to ensure: "Sufficient information [is] made available to stakeholders to enable them to make informed comments. Relevant documentation should be posted online to enhance accessibility and opportunities for reuse".<sup>7</sup>

Aside from the source of the fact sheet, **JTI has serious doubts as to the validity of the figures that have been presented, many of which have no financial basis nor are borne by the taxpayer.**

#### **i. Workplace Breaks**

Of particular note is the largest single cost cited - a £5 billion assumption for the cost of smoking breaks, effectively a number which is two and a half times greater than the alleged cost to the NHS of treating diseases said to be caused by smoking.

In JTI's view there is no basis for this £5 billion figure whatsoever. There are currently estimated to be 30.9 million employees in the UK, all of whom need to take breaks. It is important to note that breaks are a legal requirement<sup>8</sup> and JTI fails to see how the time taken for smoking breaks can be distinguished from the time that would be taken for an alternative break if that person was a non-smoker. Regular breaks are also generally acknowledged to increase productivity and are otherwise recommended by, for example, HM Government's own website, the NHS and the Institute of Occupational Safety and Health.<sup>9</sup>

It is not the Government's role to determine the requirements for a productive work place and if the private or public sector considers such breaks to incur losses - which is not at all evident - they already have the legal means to take corrective action. This could be achieved, for example, by limiting the number of breaks or by building it into the remuneration packages of workers.

What is completely wrong is a Government prepared to cite the alleged losses incurred by businesses as a result of smoking breaks as justification for a levy, yet without clarifying or justifying why Government intervention in the form of a levy would actually bring additional benefits – is this revenue intended to be redistributed to those businesses?

#### ii. Inappropriately sourced data - ASH

Examination of the ASH figures also highlights huge fluctuations in annual data sets. The table below compares estimates championed by ASH in 2014 against 2013. Within this data, the cost of smoking breaks, in itself representing the largest component of the estimate at 40%, has increased year over year by 72%, whilst smoking related sick days decreased 60%.

Such dramatic fluctuations in the data source raise further, serious questions regarding the suitability and credibility of such information and subsequently how the Consultation is distorted by the inclusion of irrelevant statistics.

	November 2014 (£Bn)	September 2013 (£Bn)	Difference
cost to the NHS of treating diseases caused by smoking	2.00	2.70	-26%
loss in productivity due to premature deaths	3.00	4.10	-27%
cost to businesses of smoking breaks	5.00	2.90	72%
smoking-related sick days	1.00	2.50	-60%
social care costs of older smokers	1.10		
costs of fires caused by smokers' materials	0.39	0.70	-44%
Other		1.00	
<b>Total</b>	<b>12.49</b>	<b>13.90</b>	<b>-10%</b>

### 5. A better approach to revenue generation

#### A co-ordinated and collaborative anti-illicit trade strategy

The Government has lost £9.8 billion<sup>10</sup> over the last five years because of the illegal tobacco trade and JTI believes that efforts to close this tax gap should be the Government's primary focus. In 2013/14 alone the trade in illegal tobacco products amounted to a £2.1 billion tax loss, the recovery of which would make a substantial contribution to revenue. It presents a major opportunity and a more effective alternative if further revenue generation is deemed necessary.



In achieving this, a more integrated approach to tackling illicit trade is critical and JTI welcomes the opportunity to work more closely with stakeholders across government in order to generate a more effective strategy. Educating smokers not to buy illicit tobacco is imperative and requires coordinated efforts by all stakeholders.

JTI is driving awareness of these issues through comprehensive regional media activity and test purchase programmes, for example. However, our engagement with key stakeholders such as Trading Standards, to help tackle illicit trade, is being hindered by the Local Government Declaration on Tobacco Control (LGDTC), notably resulting in resistance or refusal to take our evidence of illegal tobacco.

Tackling illegal tobacco is a legitimate operational reason for authorities to engage with JTI and other tobacco manufacturers and a collaborative approach is key to addressing such a major revenue opportunity.

#### Revenue optimising excise tools

Providing EU compliant tax solutions that optimise excise revenues is the best way forward and in response to the consultation on Minimum Excise Tax, JTI set out a series of recommendations which should be implemented to meet government tobacco policy objectives:

- I. The introduction of a Minimum Collectable Tax (MCT)
- II. Structure change by increasing the specific excise weight to 76.5% of total tax
- III. Abandoning the tobacco duty escalator and a total freeze on RYO excise duty rates.

**These revenue optimizing measures are the least disruptive and most appropriate and with these proven tools at its disposal, it does not make sense for the government to implement a new, complex levy.**

#### **6. Societal Cost Compensation is a flawed measure**

In JTI's view an additional tobacco levy would appear to set a precedent for a huge range of industries to have levies imposed upon them to "contribute" to the estimated costs associated with the legal and legitimate use of their products, despite the manufacturer's production of a legally compliant product.

It would require complex and subjective research to define which costs can be considered as costs to society as opposed to the individual's costs. For example, *"the fact that [employers] do not generally discriminate against smokers, moderate drinkers and the overweight"*<sup>11</sup> raises the question as to why the Government would intervene in that way.



Such a societal cost taxation system would be a departure from the UK's aim of balancing the state's need for funds with a healthy economic environment in which corporations and individuals can thrive. Such levies will make the UK a far less attractive investment location, particularly to manufacturers of lifestyle products, at a time when economic growth is meant to be the UK Government's top priority. Effectively it could create a dis-incentive for businesses to invest in the UK economy. Doing so is at odds with statements made by the Chancellor of the Exchequer that:

*"The Government's goal is to make the UK the best place in the world to locate an international business" and that "the UK provides the certainty needed for long-term financial planning and investment. The Government is sending out the signal loud and clear that Britain is open for business."*<sup>12</sup>

There is much evidence to support the negative consequences of such levies, including decline in long term investment. Evidence from both the UK and abroad supports these assertions from a windfall on UK utilities<sup>13</sup>, a levy on Australian mining companies<sup>14</sup> to supermarket taxes in Scotland.<sup>15</sup>

Of note, the levy on Australian mining companies was abandoned and the Scottish Government made a decision not to continue their retailer levy. David Lonsdale of the Scottish Retail Consortium commented that:

*"it has been an unprecedented and iniquitous tax which has targeted one part of a single sector and has acted as disincentive to invest in Scottish communities, leaving Scotland at a competitive disadvantage."*<sup>16</sup>

## **7. A lack of a proper impact assessment**

The consultation document states that the tobacco levy consultation is being conducted in line with the tax consultation framework, of which there are 5 stages to tax policy development, and as such this consultation is taking place during stage 1 'setting out objectives and identifying options'. JTI is extremely concerned that the consultation document fails to follow this process.

The consultation has neglected to properly address what the Green Book<sup>17</sup> and UK Cabinet Office Guidance has previously described as the 'do nothing option'<sup>18</sup> i.e. if the introduction of a levy cannot be shown to be necessary, the correct outcome is to take no further steps.



In contrast, the consultation jumps to a conclusion by making its stated purpose “to seek views on the policy design” and on potential wider impacts. This approach is entirely inconsistent with Better Regulation principles<sup>19</sup> and at odds with a recent decision of the UK Supreme Court on principles applicable to regulatory consultations<sup>20</sup>. Contrary to Stage 1 of tax policy development, available options have not been properly identified or considered.

JTI is surprised that the Consultation is not accompanied by a regulatory impact assessment (**RIA**) or tax impact assessment<sup>21</sup>, with paragraph 3.1 of the Consultation document merely stating: “*This chapter seeks evidence to inform any future impact assessment of a levy*”. This failing is contrary to expert views on the importance of RIAs early in policy making analysis<sup>22</sup> and the Green Book’s requirements.

The failure to prepare a RIA with the Consultation has also deprived the Regulatory Policy Committee of the chance to conduct its scrutiny process and to evaluate the policy. A reliable and meaningful evidence base which purports to justify the policy is lacking entirely<sup>23</sup> (made worse by reliance upon seriously flawed assumptions).

Furthermore, the Consultation does not address properly the views of other government departments and agencies on the levy, its unintended consequences and its interrelationship with other policies<sup>24</sup>. Doing so helps ensure regulation is both consistent and targeted only at cases where action is needed. The Green Book rightly places great emphasis on the importance of consultation with: “...*external experts and... those affected...*” at the early stages of policy development. In particular, it encourages: “...*joining up with other consultations, for instance in other government departments.*”<sup>25</sup>

Our response confirms that a tobacco levy is completely unnecessary and inappropriate. JTI firmly believes that less disruptive, more appropriate revenue optimising measures are available and which are fully compliant with EU requirements. Accordingly, JTI strongly urges the Government not to proceed.

Yours faithfully

[Redacted signature block]

## REFERENCES

- <sup>1</sup> Consultation document on Control of Raw Tobacco.
- <sup>2</sup> Cogent Report 2014.
- <sup>3</sup> The Wages of Sin Taxes, Christopher Snowden (page 48).
- <sup>4</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/99094/9886.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/99094/9886.pdf)
- <sup>5</sup> Underlying analysis appears to have been conducted by LeLan Solutions who identify on their website they have carried out "repeat custom" for clients including ASH, Smokefree South West, Tobacco Free Futures, and FRESH North East.
- <sup>6</sup> Guidelines available at <http://www.bis.gov.uk/assets/bispartners/goscience/docs/g/10-669-gcsaguidelines-scientific-engineering-advice-policy-making.pdf> provide that: "Departments should draw on a range of appropriate expert sources, both within and outside government. The selection of advisers should match the nature of the issue and should be sufficiently wide to reflect the adversity of opinion amongst experts in the appropriate field(s) in a balanced way".
- <sup>7</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/255180/Consultation-Principles-Oct-2013.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/255180/Consultation-Principles-Oct-2013.pdf).
- <sup>8</sup> "Workers have the right to one uninterrupted 20 minute rest break during their working day (this could be a tea or lunch break), if they work more than 6 hours a day": <https://www.gov.uk/rest-breaks-work/overview>.
- <sup>9</sup> "An employer should give an employee enough breaks to make sure their health and safety isn't at risk if that work is 'monotonous' (eg work on a production line)": <https://www.gov.uk/rest-breaks-work/overview>. "Sitting for long periods in front of a computer is storing up trouble. No matter how good your positioning, it is important to get up every so often. Health experts recommend breaking up sedentary time every 30 minutes for at least one to two minutes": <http://www.nhs.uk/Livewell/workofacehealth/Pages/backpainatwork.aspx>. A study by the Institute of Occupational Safety and Health, founded in 1945 and is a registered charity with international NGO status, reveals that taking regular breaks can improve posture (<http://www.iosh.co.uk/News/IOSH-Study.aspx>).
- <sup>10</sup> HMRC Measuring Tax Gaps report.
- <sup>11</sup> The Wages of Sin Taxes, Christopher Snowden (page 20).
- <sup>12</sup> Foreword to "A guide to UK taxation", [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/183408/A\\_guide\\_to\\_UK\\_taxation.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/183408/A_guide_to_UK_taxation.pdf). In this document, it is also stated that "High-quality policy-making is vital for business. Lack of clear direction, frequent changes to the tax system and lack of attention paid to the real impact on business can all act to create uncertainty and deter investment" and "A stable tax system is vital to business and the Government will avoid unnecessary changes to tax legislation. In bringing forward reform, the Government will work with business to ensure that any changes improve the sustainability and long-term stability of the corporate tax system".
- <sup>13</sup> L. Chennells, *The Windfall Tax*, *Fiscal Studies* (1997), Vol. 18, No.3, p.288
- <sup>14</sup> Figures cited on <http://www.financeminister.gov.au/media/2014/0718-repeal-of-the-minerals-resource-rent-tax.html>
- <sup>15</sup> Figures cited in G. Ruddick, *Alex Salmond Faces Fresh Attack on Supermarket Tax*, *The Telegraph* (14 December, 2013).
- <sup>16</sup> <http://www.bbc.com/news/uk-scotland-scotland-business-25676222>
- <sup>17</sup> See HM Treasury, *The Green Book*, Appraisal and Evaluation in Central Government (the **Green Book**), [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/220541/green\\_book\\_complete.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220541/green_book_complete.pdf) at paragraphs 2.7 and 4.1 to 4.4. As noted in its Preface, "the *Green Book*...constitutes binding guidance for departments and executive agencies."
- <sup>18</sup> See UK Cabinet Office 'A Quick Guide to Regulatory Impact Assessment' (2003) and paragraph 16 of the *Green Book*. Paragraph 2.8 of the *Green Book* also states that: "The 'do minimum' option should always be carried forward in the shortlist, to act as a check against more interventionist action". Similarly, the OECD makes clear that that: "good regulation should serve...clearly identified policy goals and be effective in achieving those goals." See the Organisation for Economic Co-operation and Development (**OECD**) Guiding Principles for Regulatory Quality and Performance (2005), <http://www.oecd.org/lr/reformereg/34976533.pdf> at page 5.
- <sup>19</sup> See "Principles of good regulation", Better Regulation Task Force, available via: <http://webarchive.nationalarchives.gov.uk/20100407162704/http://archive.cabinetoffice.gov.uk/brc/upload/assets/www.brc.gov.uk/principlesleaflet.pdf>
- <sup>20</sup> *R (on the application of Moseley (in substitution of Stirling Deceased)) (Appellant) v London Borough of Haringey* (Respondent) [2014] UKSC 56.
- <sup>21</sup> See paragraph 2.1.3 of HM Government's Better Regulation Framework Manual, published 10 July 2013, available via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31626/10-1155-reducing-regulation-made-simple.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31626/10-1155-reducing-regulation-made-simple.pdf).

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<sup>22</sup> See paragraphs 4.9 to 4.10 of the 2010 report "Better Regulation and Certain Tobacco Control Measures", <http://www.jti.com/how-we-do-business/resources/> prepared by Professor Martin Cave OBE at the request of JTI.

<sup>23</sup> Contrary to expert views that: "*clear and up-to date evidence is necessary to support regulatory intervention*" (paragraph 6.1 of Professor Cave's report referred to in footnote 22 above).

<sup>24</sup> Paragraph 1.8 of the Consultation makes a cursory reference to other tobacco control measures, including "*standardised packaging*", but does not, for example, explain what impacts those measures are assumed to have (if any) on pre-existing declines in tobacco consumption and/or prevalence in the UK or on the illegal trade in tobacco products.

<sup>25</sup> See the Green Book at page 40. JTI has previously raised as a concern, in its Response to the Regulatory Reform Committee's inquiry into Better Regulation dated 14 June 2014, the "*lack of both: (a) adequate cross departmental involvement in relation to tobacco control measures, in spite of the impact tobacco regulation can have on a host of other stakeholders...; and (b) meaningful consultation with other appropriate stakeholders*" and "*encourage[d] fuller cross-departmental participation in, and scrutiny of, policy proposals with wide ranging impacts*".



### The TMA Response to HM Treasury's Consultation on a Tobacco Levy.

18 February 2015

#### Introduction:

The Tobacco Manufacturers' Association (TMA) is the trade association for tobacco companies that operate in the UK. It is funded by its three member companies: British American Tobacco UK Ltd, Gallaher Ltd (a member of the Japan Tobacco International group) and Imperial Tobacco Ltd. <http://www.the-tma.org.uk/>

The TMA understands that these companies and/or their related entities may also be responding to the consultation in their own right.

With reference to paragraph 1.1 of the consultation document "the government will consult on whether to introduce a levy on tobacco manufacturers and importers", the TMA would like to be clear that it is firmly opposed to the principle of a levy. It is also notable that the consultation does not even ask the fundamental question as to whether there should be a levy in the first place. We strongly recommend that the Government should not pursue a policy which will not deliver its stated objective and this is reflected in our response.

Mindful that the consultation welcomes views on an alternative to a levy that would enable tobacco manufacturers and importers to make a greater contribution; we have set out a number of options to tackle the illegal market. This has lost the Government £21.8 billion in revenue over the past 10 years and addressing this is something we believe the Government must do, as it would significantly enhance revenues to the Treasury.

#### Consultation Rationale for Consideration of a Levy

The consultation suggests that the rationale for introducing a levy is due to the costs of smoking and paragraph 1.9 of the consultation document provides a breakdown of the reported costs<sup>1</sup>. The TMA believes that the evidence surrounding the estimates on the social costs of smoking as set out in the consultation is both inconclusive and inconsistent. We seriously question whether this is an appropriate rationale on which to propose a measure such as the levy.

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<sup>1</sup> Figures taken from a report released by Action on Smoking and Health in November 2013: [The Economics of Tobacco](#)

Moreover, it is disturbing that HM Treasury has relied solely on *guesstimates* provided by a third party pressure group, with a clear vested interest, rather than undertaking its own research to underpin a policy with far reaching implications. The manner in which HM Treasury has accepted the findings of ASH is distinctly uncritical. For example, the breaks that smokers take for the purpose of smoking are akin to those that others take to have a cup of tea or coffee. HM Treasury has not estimated the costs to business of tea/coffee breaks or sourced information on the impact of these on employees' productivity. It is unlikely that employers consider such breaks to be unproductive and, we would suggest, it is likely that they entertain a similar feeling towards smoking breaks.

### **Tobacco Sector - Economic Contribution**

The tobacco industry is already a significant contributor to the UK economy; delivering billions in tax revenues and supporting tens of thousands of jobs both directly and indirectly. To illustrate this point:

- UK tobacco taxes have increased by 38% under the Coalition Government, equivalent to more than three times the rate of inflation;
- A typical premium cigarette brand is taxed at around 77%, rising to over 85% on lower priced brands;
- The UK's tobacco taxes are around the highest in the EU and up to three times higher than some members with a similar GDP per capita;
- The tobacco sector consistently contributes around £12bn annually in excise and VAT to the UK economy, equivalent to £60bn over the Coalition's five year term;
- The tobacco sector contributes a further £2bn GVA (Gross Value Added) annually to the UK;<sup>2</sup>
- The UK tobacco industry directly supports over 6,100 people in high value jobs and indirectly supports around nine times as many;<sup>3</sup>
- The tobacco industry manages pensions for over 40,000 of its former and current employees in the UK;
- The tobacco industry invested around £130m in research and development in 2012 with a further £52m in capital expenditure;<sup>4</sup>
- The tobacco industry has made significant investment in the emerging products sector, particularly in the UK, which includes products such as e-cigarettes.

### **Levies in Practice**

There is clear evidence to suggest that levies of the sort proposed in the consultation paper ordinarily result in a number of unfortunate effects. They often fail to raise the level of revenue expected by governments in the first place and have a detrimental effect on tax collection as a

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<sup>2</sup> Cogent 2014 Report

<sup>3</sup> Cogent 2014 Report

<sup>4</sup> Cogent 2014 Report

result of the poor incentives they offer to business investment. In addition, such levies are marked by a plethora of unintended consequences, which are negative in nature, such as a decline in long term investment in that particular market.

There is a body of evidence from both the UK and abroad that supports these assertions - from a windfall on UK utilities<sup>5</sup> and a levy on Australian mining companies<sup>6</sup> to supermarket taxes in Scotland<sup>7</sup>. To illustrate this point, the decision in 2011 to increase the supplementary charge levied on North Sea Oil and Gas firms did not, according to the CBI<sup>8</sup>, raise the revenue the Government had expected and, according to PricewaterhouseCoopers<sup>9</sup>, resulted in sufficient uncertainty to cause firms to reconsider future investment decisions. Moreover, 83% of supply chain companies surveyed expected the tax supplement to exert a negative commercial impact on their businesses.<sup>10</sup>

A windfall tax imposed on utility firms in 1997 was reportedly passed on to consumers at the earliest opportunity, once wholesale markets had increased to a sufficient rate. Moreover, contemporary estimates projected that this levy would cost the average person in a pension fund approximately £80 a year as a result of the impact it would have on utility firms' dividend payments.<sup>11</sup>

Empirical evidence shows that levies are typically passed on the consumer in some form or another, and there is no reason to suggest that this will not happen if a tobacco levy was introduced, particularly as the tobacco sector is already subject to such high levels of taxation.

We have addressed the tobacco levy in more detail in response to question 8 of the consultation document.

## TMA response to the consultation questions

### Questions 1-7

The TMA does not believe that a Levy is necessary or appropriate and therefore will not comment on specific provisions.

### Question 8

#### 8). The government welcomes views on the expected impacts of the levy on consumer prices.

Paragraph 3.2 of the Consultation paper states that the "government is particularly interested in the impact the introduction of a levy would have on consumer prices." It suggests that because the proposed levy would be a direct tax on tobacco manufacturers and importers, it "could be absorbed in profits." In this scenario, it is claimed, "consumers would not see a rise in prices but company's profits would be lower." This would affect tobacco firms' owners and shareholders instead of consumers.

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<sup>5</sup> L. Chennells, *The Windfall Tax*, *Fiscal Studies* (1997), Vol. 18, No.3, p.288

<sup>6</sup> Figures cited on <http://www.financeminister.gov.au/media/2014/0718-repeal-of-the-minerals-resource-rent-tax.html>

<sup>7</sup> Figures cited in G. Ruddick, *Alex Salmond Faces Fresh Attack on Supermarket Tax*, *The Telegraph* (14 December, 2013).

<sup>8</sup> CBI Response to HM Treasury Review of the Oil & Gas Fiscal Regime (2014).

<sup>9</sup> *The Total Tax Contribution of the UK Oil and Gas Industry*, p.13.

<sup>10</sup> *The Total Tax Contribution of the UK Oil and Gas Industry*, p.15.

<sup>11</sup> <http://hansard.millbanksystems.com/commons/1997/jul/02/windfall-tax>

The implication that an increase in the level of taxation exerted on tobacco firms would not be passed on to consumers is not supported by the available evidence. Over the course of the past two decades significant increases in taxation have taken place. In each instance, the cost of the tax burden filtered through to consumers. As described earlier, the tax incidence on some cigarettes brands is over 85% of the retail price.

Recently, the TMA commissioned independent advisors Oxford Economics to undertake an analysis of the proposed levy. Their report considered two scenarios: the consequences of an increase in taxation of £100 million and those of a rise of £1 billion. Oxford Economics found that the price of tobacco products would increase in both instances.

Paragraph 3.5 of the consultation paper asserts that any “rise in prices is likely to lead to a reduction in sales”.<sup>12</sup> Oxford Economics did not estimate the overall impact these projected reductions in sales volumes would have on tobacco companies. However, its analysis did consider the effect they would have on government tax revenues. The decline in cigarette sales volumes provoked by the suggested levy would result in a corresponding reduction in duty and VAT revenues of between £117 million (given a £100 million levy) and £1,063 million (given a £1 billion levy). The reduction in the sales volumes of hand rolling tobacco products would entail a concordant decline in tax revenue of between £11 million (given a £100 million levy) and £103 million (given a £1 billion levy).<sup>13</sup>

#### **9). Would the levy have any other impacts on consumers that have not been considered in this document?**

Paragraph 3.6 of the consultation paper claims that the consequences of transferring the costs of a levy from shareholders and company owners to consumers through higher prices are likely to be that those consumers “stop smoking, some smoke less or smoke cheaper brands, and some move to the illicit market.” According to HMRC, the illicit market in both cigarettes and hand rolling tobacco increased in 2013/14, costing HM Treasury £2.1 billion in lost tax revenue. It is therefore, counterproductive to consider the implementation of a levy that would in effect exacerbate the illicit trade, bringing further, untaxed and unregulated products into the market.

The costs of illegal tobacco are not just economic, they are also social. For example, the Royal United Services Institute (RUSI) showed in a recent report that the illicit trade in tobacco products has strong links with organised crime.<sup>14</sup> Organised crime exerts a detrimental impact on communities and has knock on costs associated with it, be they those of law enforcement or judicial countermeasures. Any proposal that would increase illicit tobacco availability should, therefore, be subject to significant scrutiny.

#### **10). Would the levy have any other market impacts?**

Any levy on tobacco manufacturers and importers could impact on public sector pension funds as it is reported that local authorities have a minimum of £1.3 billion worth of pension investments in the tobacco industry. Tobacco firms’ consistent performance, low risk and high returns bolster local authority pension portfolios with safe, stable investment.

Local authorities are not the only public sector entities taking advantage of tobacco companies’ relative strength in order to bolster their pension funds. The Universities Superannuation

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<sup>12</sup> The Estimated Impact of a Windfall Tax or Levy on Tobacco Manufacturers, *Oxford Economics* (2014).

<sup>13</sup> The Estimated Impact of a Windfall Tax or Levy on Tobacco Manufacturers, *Oxford Economics* (2014).

<sup>14</sup> C. Edwards and C. Jeffray, 'On Tap: Organised Crime and the Illicit Trade in Tobacco, Alcohol and Pharmaceuticals in the UK' (London, 2015), p.31.

Scheme (USS), the largest pension fund in the UK in 2014, counts both British American Tobacco (BAT) and Imperial Tobacco Group (ITG) among its top twenty five investments. BAT is the USS funds third largest holding (£197.1 million) and ITG comes in at twenty one (£108.4 million).<sup>15</sup> BAT and ITG also represent large investments for a number of other equity funds.<sup>16</sup>

Any measure that would ultimately impact on the balance sheets of tobacco firms would be likely to influence dividend payments negatively. In turn, this would be harmful to those pension funds heavily invested in such companies.

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

Paragraph 3.8 of the consultation paper states that the “government believes it is right that tobacco manufacturers and importers make a greater contribution to the societal costs of smoking.” To reiterate what was said before, the tobacco sector contributes upwards of £14bn per annum (taxation plus GVA) to the UK economy employing around 60,000 people both directly and indirectly. Given this already significant contribution, the TMA considers that a levy would be neither an efficient nor a fair means of increasing tobacco manufacturers’ and importers’ contributions, for the reasons outlined above.

The TMA believes that a renewed focus on the illicit trade of tobacco products would be a more efficacious means of realising increased revenue from the industry as a whole. Tax revenue lost to illicit trade in tobacco products diminished significantly over the past decade. However, in recent years it has proved difficult to reduce even further, especially given significant above inflation tax increases. RUSI drew attention to the impact of high levels of taxation on the illicit tobacco trade in a recent report. “Despite its goal of lowering tobacco consumption of health grounds,” RUSI reported, “this policy of high taxation has the unintended yet inevitable consequence of generating an illicit market that generates substantial profits for sellers.”<sup>17</sup>

In 2013/14 the trade in illicit tobacco products in the UK amounted to £2.1bn (based on the midpoint estimate)<sup>18</sup>. Clearly, further action is required in order to recover such a large sum. We understand that HMRC is to announce shortly their refreshed *Tackling Tobacco Smuggling Strategy* and have set out the following recommendations, which we believe the Government should adopt in order to drive down the illicit market and in turn protect tobacco revenues.

- 1. A coordinated Anti-Illicit Trade strategy.** A more integrated approach to tackling tobacco smuggling is critical. The TMA would like to work more closely with stakeholders across government in order to generate a more effective strategy to tackle the illicit trade in tobacco products. Presently, however, the TMA and tobacco firms are unable to work with some local government organisations as a result of the Local Government Declaration on Tobacco Control (LGDTC).

The TMA believes that a cross-departmental working group on the trade of illicit tobacco should be established. It should incorporate representatives from HMRC, Border Force, Police and DCLG as well as industry representatives. Furthermore, local authorities should be encouraged by central government to work with the industry in order to tackle the illicit trade of tobacco products across the country.

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<sup>15</sup><http://www.uss.co.uk/UssInvestments/InvestmentsTypes/Equities/Pages/USStop100investments.aspx>

<sup>16</sup> <http://www.morningstar.co.uk/uk/news/129445/fund-managers-back-tobacco-stocks.aspx>

<sup>17</sup> Edwards and Jeffray, 'On Tap', p.37.

<sup>18</sup> HMRC Measuring Tax Gaps Report 2014

In order to deliver this effectively, the Government should consider appointing a Smuggling Tsar who would be well placed to coordinate and deliver a comprehensive response. This is in line with recommendations produced by RUSI. In its recent report on illicit trade, RUSI recommended that the “government should collaborate more with the private sector on tackling the illicit trade in goods”. It suggested that a “Senior Responsible Officer for industry engagement should be identified in HMRC and be accountable for the work the agency does with the private sector.”<sup>19</sup> The TMA entirely supports RUSI’s position on this issue.

- 2. Restrictions on importation.** In the most recent Tackling Tobacco Smuggling Strategy, published in 2011, HMRC intelligence showed how the problem of smuggling had changed over the past decade, moving from large scale shipments to smaller and more frequent consignments. In order to tackle this problem, HMRC restricted the number of cigarettes that could be imported into the UK by individuals to 800 and the amount of RYO tobacco to 1kg in Autumn 2011. However, it remains a problematic issue, particularly with the high movement of people to and from low taxed countries.

EU law allows Member States to limit the number of cigarettes that can be imported by individuals from other EU countries to 300 sticks if the country of origin does not charge the minimum level of excise duty required by EU regulation.

- 3. Tackling demand through effective communications.** Tackling the supply of illicit tobacco products is only one means of securing an increase in duty and VAT revenues for the Exchequer. On the demand side of the illicit tobacco equation, more needs to be done to facilitate behavioural change immediately and over the longer term. Persuading smokers not to buy illicit tobacco is a tall order and requires coordinated efforts by all stakeholders. Previously, HM Government recognised the value of effective communications strategies in promoting desirable behaviour (See Box 1).

The TMA and its members have invested significant time and resources in targeting some of the areas where illicit tobacco is a significant problem. This has included newspaper campaigns, extensive work with the trade media and even activities targeting major transport hubs. These campaigns have delivered tangible results but, in order to deliver a more effective long term solution, the TMA would welcome a cross departmental approach that would provide for comprehensive, targeted communications campaigns and associated activities.

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<sup>19</sup> Edwards and Jeffray, 'On Tap', pp.xii-xiv.

### Box 1: Case Study – “No ifs, no buts”

The “No ifs, no buts” campaign warned benefit customers that no excuse would be tolerated if they deliberately hid changes in their circumstances that might affect their benefits. It made it clear that failure to do so could constitute fraud.



The campaign featured television adverts and billboard posters highlighting the problem of taxpayers’ money being stolen by benefit thieves. The success of such campaigns is hard to quantify, because their principal object is to raise awareness. In 2008, the NAO reported on the Department for Work and Pensions’ (DWP) efforts to raise awareness of benefit fraud through its “No ifs, no buts” campaign.

It found that this drive resulted in an 8% increase in the number of people who strongly agreed that it was wrong to claim benefits to which they were not entitled. Moreover, the NAO estimated that in the first two months of the DWP’s campaign the National Benefit Fraud Hotline received approximately 11,000 calls reporting fraudulent activities. This rate of reporting was above average compared to the precampaign period. In these two months, the above average call rate resulted in the identification of £900,000 in overpaid benefits.\*

\*Progress in Tackling Benefit Fraud 2008

- 4. Embracing technology.** The tobacco industry has invested significant resources into developing comprehensive technological solutions to address aspects of the illicit market, particularly in the area of anti-counterfeiting and track and trace. Building on anti-counterfeiting technology, which was first implemented in the UK in 2007, the four major companies operating in the UK (BAT, ITL, JTI and PMI) have begun incorporating onpack alpha-numeric coding to provide law enforcement with the ability to check a products’ authenticity. The industry has been working with HMRC during a training and implementation phase.
- 5. Learning from other markets.** TMA members engage with customs authorities at a global level, developing strong and effective working relationships to tackle the illicit market. It is clear that certain EU Member States have put in place specific, effective measures to drive down the illegal market and we would support their implementation in the UK (See Box 2).

## Box 2: Case Study – Italy

The illicit tobacco trade in Italy is run principally by criminal organisations. In order to tackle this issue, tobacco firms partnered with the Anti-Mafia Prosecution Team, the Fiscal Police and Customs Agency, the Ministry of Economic Development, the Administration of the State Monopoly Autonomy (AAMS – a state producer), and logistics firms.

Italian experience suggests that the most effective means of tackling illicit trade is collaboratively, on an inter-organisational basis. Increasing regulatory burdens on tobacco firms does little or nothing to facilitate this sort of change. The tobacco industry's contribution to this effort in Italy has been to provide state authorities with detailed information about the tobacco market. It has also been active in raising awareness of the problem of illicit trade amongst the public and retailers alike.

- Additional law enforcement initiatives such as operation “Wrong Smoke” from the Guardia di Finanza, especially in Naples.
- The withdrawal of Classic from sale, a brand that was being heavily counterfeited in Ukraine and had become an increasingly recognised illicit brand.
- The impact of the “super-low” price segment, which led to a smaller decline in legal domestic sales in the later part of the year.

In recent years, there has been a rise in the illicit tobacco trade in the UK, which followed a period of significant decline. The tobacco industry is eager to work with HMRC and other relevant departments and agencies to explore further counter measures like those that have been successful in a number of states, such as Italy. Any one of the five recommendations suggested above would deliver benefit to HM Government in tackling the illegal market and we would like the opportunity to help take these forward.

## Conclusion

The evidence from other sectors and markets clearly shows that levies are an ineffective solution. Empirical evidence demonstrates that levies are typically passed on to consumers, which, in this instance, Oxford Economics believes will simply reduce tobacco tax revenues – outweighing revenue derived from the levy itself. A levy will also pose significant issues for pension funds and investment decisions moving forward, which will place further jobs at risk.

Given the already extremely high tax regime in the UK, we strongly recommend that the Government does not proceed with a levy on tobacco manufacturers and importers. Instead, it should refocus its efforts on driving down the illicit market, which in turn would protect and even increase Government tax revenues from the tobacco sector.

Yours sincerely,

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Director General

## 2.28 Middlesbrough Smokefree Alliance

### HM Treasury Consultation on a tobacco levy

#### Response from Middlesbrough Smokefree Alliance

1. Middlesbrough Smokefree Alliance is a multiagency tobacco control group with aim of tackling tobacco control issues in Middlesbrough. It's broad aims are
  - i) Reduce the number of smokers through the provision of effective Stop Smoking Services
  - ii) Reduce the prevalence of smoking in targeted groups (young people, pregnant women, mental health service users and BME population)
  - iii) Tackle the supply & sale of illicit tobacco and underage sales of tobacco.
2. Adult smoking prevalence in Middlesbrough has come down from between 28% and 34% in 2006 to between 25.5% and 31.1% in 2014. Middlesbrough smokefree Alliance has a strategic vision to reduce tobacco smoking to a level of 5% by 2025, to shift the social norms of tobacco use by making it less accessible, affordable and attractive. Smoking remains the key contributor to premature death and disease causing around 243 deaths annually in Middlesbrough.
3. The Alliance includes the following organisations
  - I. Middlesbrough Council
  - II. Middlesbrough College
  - III. Teesside University
  - IV. North Tees & Hartlepool Hospitals NHS Foundation Trust
  - V. James Cook University Hospital
  - VI. Cleveland Fire Brigade
  - VII. Thirteen Housing

#### General Observations

1. Middlesbrough Smokefree Alliance warmly welcomes the opportunity to respond to this consultation on introducing 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."*<sup>1</sup>
2. There is widespread public appetite for more policies to reduce the harm of smoking in society with appetite for these measures having increased over the past few years. In 2014 a survey by YouGov commissioned by Action on Smoking and Health found nearly half of North East adults (43%) believing that not enough is being done to cut the harm of smoking, and another 33% saying the Government is doing about right (this was compared to 2011 when 36% said not enough is being done and another 36% thought the government was doing about right). Only 12% of adults in the North East thought "the Government is doing too much" compared

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<sup>1</sup> HM Treasury Autumn Statement December 2014, paragraph 2.252

to 22% in 2011 and even amongst smokers in England fewer than half (35%) believed that the government is doing too much.

3. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year<sup>2</sup>. This is likely to be an under-estimate as only costs where data is attributable have been included. In Middlesbrough the smoking costs are approximately £33.6 million annually<sup>2</sup>
4. In the North East, the conservative cost of smoking is avoidably high at almost £160 million per year, which includes the cost to business through lost productivity and costs to the NHS of treating smokers and those exposed to secondhand smoke but does not include costs borne by other agencies e.g. local authorities who commission stop smoking services, provide regulatory services to support compliance with tobacco-related legislation and street cleaning services to remove litter such as cigarette butts and tobacco packs.
5. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
6. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>3</sup>
7. The tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution.<sup>4</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>5</sup>
8. Fewer than one in five adults now smoke, but smoking rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes<sup>6</sup>, killing one in two of all long-term smokers<sup>7</sup>.

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<sup>2</sup> [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

<sup>3</sup> *ibid*

<sup>4</sup> Branston JR and Gilmore A (2014) The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tob control* 23(1):45-50

<sup>5</sup> Economics of Tobacco Toolkit World Bank 2002

<sup>6</sup> Smoking and Health Inequalities Action on Smoking and Health

<sup>7</sup> Doll R, Peto R, Wheatley K, Gray R, Sutherland I. Mortality in relation to smoking: 40 years observations on male British doctors. *British Medical Journal* 1994; 309:901-911

9. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>8</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
10. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to reduce tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
11. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:
- "The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*
- While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*
- For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation..."*<sup>9</sup>
12. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
13. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the shortterm, entirely substituted

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<sup>8</sup> The World Bank. Curbing the epidemic: governments and the economics of tobacco control. May, 1999.

<sup>9</sup> NHS: Five Year Forward View NHS England, October 2014

by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.

14. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
15. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, *"The Health Consequences of Smoking – 50 Years of Progress"*, reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."*
16. Similar declines in prevalence have been seen in the North East, North West and South West of England where there is investment at a regional level in comprehensive tobacco control programmes which add value and substantially enhance and amplify efforts and outcomes nationally and locally. Investment at this level ensures that national policies and evidence-based practice are implemented effectively and allows local commissioners to benefit from economies of scale and to reach much greater population numbers<sup>10</sup>. The NICE Tobacco Return on Investment Tool provides evidence that tobacco control delivery is most cost-effective when it is delivered across a bigger geographical footprint at the subnational level<sup>11</sup>.
17. Much more can be achieved if this regional investment is sustained, increased and widened: the US Surgeon General report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."*<sup>12</sup>
18. In reducing the harm from smoking in the UK, an essential role is played by the delivery of tobacco control measures carried out by local authorities, for example the stop smoking services. The Department of Health document *"Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12"* stated that: *"Stop smoking services are a key part of tobacco control and health inequalities... Evidence-based stop smoking support is highly*

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<sup>10</sup> Royal College of Physicians and the UK Centre for Tobacco Control Studies: Fifty years since Smoking and health: Progress, lessons and priorities for a smoke-free UK, March 2012

<sup>11</sup> NICE Tobacco return on investment tool v3.03

<sup>12</sup> U.S. Department of Health and Human Services: *The Health Consequences of Smoking: 50 Years of Progress: A Report of the Surgeon General*, Atlanta, GA: U.S. Department of Health and Human Services

*effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers.”<sup>13</sup>*

19. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about the reduction over the last two years in the number of smokers being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13
20. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs much of the direct savings they deliver accrue mainly to the NHS and not by the increasingly cash-strapped local authorities that commission the services. This point also applies to local action, by trading standards officers and others, to regulate the tobacco market and support compliance with legislation. In respect of illicit tobacco, the Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.
21. The level of illicit trade nationally has declined by half since 2000. Regions in England have also seen reductions in the illicit market particularly in the North East, North West and South West, where the three regional comprehensive tobacco control programmes lead the Tackling Illicit Tobacco for Better Health Partnership<sup>14</sup> to reduce the demand for and supply of illegal tobacco. For example in the North East, 15% of tobacco products in 2009 were estimated to be illicit; by 2013 this had dropped to 9%<sup>15</sup>. However, the latest figures from HM Revenue and Customs suggest that nationally the illicit tobacco market has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>16</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>17</sup> and the House of Commons Home Affairs Select Committee.<sup>18</sup> Fresh strongly supports these recommendations, which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.

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<sup>13</sup> Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012: Executive Summary page 5 Department of Health 2011

<sup>14</sup> [www.illegal-tobacco.co.uk](http://www.illegal-tobacco.co.uk)

<sup>15</sup> NEMS illicit tobacco survey 2013

<sup>16</sup> HMRC Tobacco Tax Gaps Estimates 2013/14

<sup>17</sup> National Audit Office: Progress in tackling tobacco smuggling. Report published 6 June 2013, and Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling Report published 4th September 2013.

<sup>18</sup> Home Affairs Select Committee: First Report, Tobacco Smuggling. 11th June 2014

22. Regular tobacco control mass media and social marketing campaigns alongside increases in the real price of cigarettes are critical for reducing population smoking prevalence, but require significant investment in order to be most effective<sup>19,20, 21</sup> Higher mass media campaign exposure also appears to confer greater benefit on socioeconomically disadvantaged population subgroups. Studies comparing different media message types have found messages concerning negative health effects most effective at generating increased knowledge, beliefs, higher perceived effectiveness ratings, or quitting behaviour. Evidence for other message types is more mixed. They do, also, perform very well among young people. In contrast, ads dealing with the cosmetic effects of smoking, addiction and athletic performance, have been found to be less effective. However, with funding for national campaigns having reduced substantially over the past five years, it is vital that campaigns as a vital component of effective tobacco control are able to run at national and regional level.

23. We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help supplement existing investment in tobacco control, and ensure that the UK can deliver a genuinely comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost an additional £500 million a year, and would include key measures such as:

- supporting comprehensive tobacco control measures at national, regional and local levels based on the best available evidence
- financing sustained mass media and social marketing campaigns, complemented by other tobacco control initiatives; and
- ensuring and improving the provision of high quality Stop Smoking Services across the country as part of broader tobacco control strategies.

24. We would also strongly suggest that this portion of the levy be established along similar lines to the US manufacturer “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “*establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control*”.

25. It should be noted that as of 31<sup>st</sup> March, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just

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<sup>19</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. Am J Public Health. 2008 August; 98(8): 1443–1450.

<sup>20</sup> Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. Addiction, 107(11), 2043-2050

<sup>21</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. Addiction 2014 Jun;109(6):986-94.

over half a billion dollars, has been spent on public education, \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>22</sup>

## Answers to Consultation Questions

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

26. 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?

27. 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.

28. Forestalling in this context means a temporary increase in the clearance rate of cigarettes and other tobacco products 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 or 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.<sup>23</sup>

29. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult. Crucially it would also enable the disbursement of proceeds of

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<sup>22</sup> General Accounting Office reports FDA tobacco user fee spending. Accessed 16 January 2015

<sup>23</sup> HM Revenue and Customs: Tobacco Bulletin, August 2014

the levy to fund tobacco control work in a way that was sensitive to local and regional consumption and prevalence levels and the consequent harm caused whilst ensuring cost-effectiveness through delivery across a wider geographical footprint. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>24</sup> <sup>25</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a 'unique identifier' that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.

30. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

#### Suggested allocation of revenue from tobacco levy across the countries of the UK

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

31. In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.

<sup>24</sup> EU Revised Tobacco Products Directive 3 April 2014

<sup>25</sup> Protocol to Eliminate Trade in Tobacco Products: World Health Organisation 2013

- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

32. 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.

33. 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)

34. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>26</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 37 below.

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

35. For the reasons stated in paragraphs 16 to 19 above, 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?

36. We support the use of the corporation tax system to collect the levy, as the system that would pose the least 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.

37. We are unaware of a plausible alternative means for collecting the levy.

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

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<sup>26</sup> 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.

**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?

38. 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.

39. According to the Department of Health Impact Assessment on standardised packaging <sup>27</sup> (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.”*

40. 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.

41. The response from ASH 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, and is based on the research paper written by Howard Reed, Landman Economics. It will be noted that 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 (1.26 pence per stick compared to 1.27 pence per stick). 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.

#### **Size of tobacco levy required to raise £500 million per year**

Results, assuming impact of introducing standardised packaging (all figures in pence)

Year	15/16	16/17	17/18	18/19	19/20
Smoking prevalence (%) (adults)	17.3	16.4	16.7	16.2	15.7

#### **Scenario (a): No pass through of levy to consumers**

Cigarette levy (pence per stick)	1.26	1.31	1.35	1.39	1.43
Cigarette levy (per packet of 20)	25.2	26.2	26.9	27.7	28.5
HRT levy (per gram of tobacco)	1.68	1.75	1.80	1.85	1.90
HRT levy (per 25g packet)	42.0	43.7	44.9	46.2	47.5

<sup>27</sup> Impact assessment: standardised packaging of tobacco products: Department of Health June 2014

### Scenario (b): Full pass through

Cigarette levy (pence per stick)	1.27	1.33	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.5	26.5	27.3	28.0	28.9
HRT levy (per gram of tobacco)	1.70	1.77	1.82	1.87	1.92
HRT levy (per 25g packet)	42.4	44.2	45.4	46.7	48.1

42. 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):<sup>28</sup>
43. 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.

### Affordability Index: Tobacco Products

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

44. 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<sup>29</sup> and smoking rates among young people 11-15 years old declined much

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<sup>28</sup> Communication with Action on Smoking and Health, 14 January 2015

<sup>29</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

faster, falling by nearly a half from 11% to 6%.<sup>30</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved<sup>31 32</sup>, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.

45. Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products.<sup>4</sup> Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits for the same year were £345m, with a profit margin of over 38%.

British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>33</sup> Tobacco is unlike any other product on the market in that it kills half of all long-term users unless they quit. It is therefore clear that the tobacco industry should, and could well afford to, pay the proposed levy.

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

46. We anticipate that tobacco multinationals may suggest alternatives to a levy but we would be highly wary of any suggestion that they make a 'contribution' to society other than death and disease on an industrial scale. We would recommend vigilance against any attempts by the tobacco industry to reposition the levy as part of a separate

'corporate social responsibility deal' to enable it to exert influence on government public health policy, in violation of the WHO FCTC Article 5.3. We would also recommend government vigilance against the tobacco industry attempting to influence how this money is spent. Historically, the tobacco industry has sponsored youth prevention programmes to forestall legislation such as smokefree spaces and restrictions on marketing in the US. The 2012 Surgeon General's Report, Preventing Tobacco Use Among Youth and Young Adults, concluded "*the tobacco companies' activities and programs for the prevention of youth smoking have not demonstrated an impact on the initiation or prevalence of smoking among young people*<sup>34</sup>." There is evidence these programmes have been ineffective at best and harmful at worst.

47. We consider that a levy on tobacco products, with a revenue target per year fixed over five years, is by far the most desirable policy option. 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 a sufficient proportion of such funds are used to support comprehensive tobacco control delivery which includes evidence-based policy

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<sup>30</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>31</sup> DH. A smokefree future: a comprehensive tobacco control strategy for England. HM Government. February 2010.

<sup>32</sup> DH Healthy Lives, Healthy People: a tobacco control plan for England. HM Government. March 2011.

<sup>33</sup> BAT Annual Report 2013 34

<sup>34</sup> 2012 US Surgeon General Report

initiatives designed to reduce smoking prevalence. We therefore do not offer any alternative to a levy in this consultation response.

## 2.29 Middlesbrough Council

### HM Treasury Consultation on a tobacco levy

#### Response from Middlesbrough Council

1. Middlesbrough Council is a Unitarian Authority in The North East of England. It is a member of the Middlesbrough Smokefree Alliance and along with 11 other local Authorities in the region funds FRESH North East, the regional Tobacco Control Office.

#### General Observations

1. Middlesbrough Council warmly welcomes the opportunity to respond to this consultation on introducing 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."*<sup>1</sup>
2. There is widespread public appetite for more policies to reduce the harm of smoking in society with appetite for these measures having increased over the past few years. In 2014 a survey by YouGov commissioned by Action on Smoking and Health found nearly half of North East adults (43%) believing that not enough is being done to cut the harm of smoking, and another 33% saying the Government is doing about right (this was compared to 2011 when 36% said not enough is being done and another 36% thought the government was doing about right). Only 12% of adults in the North East thought "the Government is doing too much" compared to 22% in 2011 and even amongst smokers in England fewer than half (35%) believed that the government is doing too much.
3. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year<sup>2</sup>. This is likely to be an under-estimate as only costs where data is attributable have been included. In Middlesbrough the smoking costs are approximately £33.6 million annually<sup>2</sup>
4. In the North East, the conservative cost of smoking is avoidably high at almost £160 million per year, which includes the cost to business through lost productivity and costs to the NHS of treating smokers and those exposed to secondhand smoke but does not include costs borne by other agencies e.g. local authorities who commission stop smoking services, provide regulatory services to support compliance with tobacco-related legislation and street cleaning services to remove litter such as cigarette butts and tobacco packs.
5. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
6. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office

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<sup>1</sup> HM Treasury Autumn Statement December 2014, paragraph 2.252

<sup>2</sup> [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>3</sup>

7. The tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution.<sup>4</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>5</sup>
8. Fewer than one in five adults now smoke, but smoking rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes<sup>6</sup>, killing one in two of all long-term smokers<sup>7</sup>.
9. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>8</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
10. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to reduce tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
11. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:

*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health...We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*

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<sup>3</sup> *ibid*

<sup>4</sup> Branston JR and Gilmore A (2014) The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tob control* 23(1):45-50

<sup>5</sup> Economics of Tobacco Toolkit World Bank 2002

<sup>6</sup> Smoking and Health Inequalities Action on Smoking and Health

<sup>7</sup> Doll R, Peto R, Wheatley K, Gray R, Sutherland I. Mortality in relation to smoking: 40 years observations on male British doctors. *British Medical Journal* 1994; 309:901-911

<sup>8</sup> The World Bank. *Curbing the epidemic: governments and the economics of tobacco control*. May, 1999.

*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*

*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation...”<sup>9</sup>*

12. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
13. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the shortterm, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.
14. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
15. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, *"The Health Consequences of Smoking – 50 Years of Progress"*, reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."*

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<sup>9</sup> NHS: Five Year Forward View NHS England, October 2014

16. Similar declines in prevalence have been seen in the North East, North West and South West of England where there is investment at a regional level in comprehensive tobacco control programmes which add value and substantially enhance and amplify efforts and outcomes nationally and locally. Investment at this level ensures that national policies and evidence-based practice are implemented effectively and allows local commissioners to benefit from economies of scale and to reach much greater population numbers<sup>10</sup>. The NICE Tobacco Return on Investment Tool provides evidence that tobacco control delivery is most cost-effective when it is delivered across a bigger geographical footprint at the subnational level<sup>11</sup>.
17. Much more can be achieved if this regional investment is sustained, increased and widened: the US Surgeon General report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."*<sup>12</sup>
18. In reducing the harm from smoking in the UK, an essential role is played by the delivery of tobacco control measures carried out by local authorities, for example the stop smoking services. The Department of Health document "Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12" stated that: *"Stop smoking services are a key part of tobacco control and health inequalities... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers."*<sup>13</sup>
19. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about the reduction over the last two years in the number of smokers being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13
20. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs much of the direct savings they deliver accrue mainly to the NHS and not by the increasingly cash-strapped local authorities that commission the services. This point also applies to local action, by trading standards officers and others, to regulate the tobacco market and support compliance with legislation. In respect of illicit tobacco, the Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.

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<sup>10</sup> Royal College of Physicians and the UK Centre for Tobacco Control Studies: Fifty years since Smoking and health: Progress, lessons and priorities for a smoke-free UK, March 2012

<sup>11</sup> NICE Tobacco return on investment tool v3.03

<sup>12</sup> U.S. Department of Health and Human Services: The Health Consequences of Smoking: 50 Years of Progress: A Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

<sup>13</sup> Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012: Executive Summary page 5 Department of Health 2011

21. The level of illicit trade nationally has declined by half since 2000. Regions in England have also seen reductions in the illicit market particularly in the North East, North West and South West, where the three regional comprehensive tobacco control programmes lead the Tackling Illicit Tobacco for Better Health Partnership<sup>14</sup> to reduce the demand for and supply of illegal tobacco. For example in the North East, 15% of tobacco products in 2009 were estimated to be illicit; by 2013 this had dropped to 9%<sup>15</sup>. However, the latest figures from HM Revenue and Customs suggest that nationally the illicit tobacco market has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>16</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>17</sup> and the House of Commons Home Affairs Select Committee.<sup>18</sup> Fresh strongly supports these recommendations, which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.
22. Regular tobacco control mass media and social marketing campaigns alongside increases in the real price of cigarettes are critical for reducing population smoking prevalence, but require significant investment in order to be most effective<sup>19,20,21</sup> Higher mass media campaign exposure also appears to confer greater benefit on socioeconomically disadvantaged population subgroups. Studies comparing different media message types have found messages concerning negative health effects most effective at generating increased knowledge, beliefs, higher perceived effectiveness ratings, or quitting behaviour. Evidence for other message types is more mixed. They do, also, perform very well among young people. In contrast, ads dealing with the cosmetic effects of smoking, addiction and athletic performance, have been found to be less effective. However, with funding for national campaigns having reduced substantially over the past five years, it is vital that campaigns as a vital component of effective tobacco control are able to run at national and regional level.
23. We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help supplement existing investment in tobacco control, and ensure that the UK can deliver a genuinely comprehensive strategy to reduce the harm caused by tobacco. Such a

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<sup>14</sup> [www.illegal-tobacco.co.uk](http://www.illegal-tobacco.co.uk)

<sup>15</sup> NEMS illicit tobacco survey 2013

<sup>16</sup> HMRC Tobacco Tax Gaps Estimates 2013/14

<sup>17</sup> National Audit Office: Progress in tackling tobacco smuggling. Report published 6 June 2013, and Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling Report published 4th September 2013.

<sup>18</sup> Home Affairs Select Committee: First Report, Tobacco Smuggling. 11th June 2014

<sup>19</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>20</sup> Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction*, 107(11), 2043-2050

<sup>21</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun;109(6):986-94.

strategy, at a rough estimate, would cost an additional £500 million a year, and would include key measures such as:

- supporting comprehensive tobacco control measures at national, regional and local levels based on the best available evidence
- financing sustained mass media and social marketing campaigns, complemented by other tobacco control initiatives; and
- ensuring and improving the provision of high quality Stop Smoking Services across the country as part of broader tobacco control strategies.

24. We would also strongly suggest that this portion of the levy be established along similar lines to the US manufacturer “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “*establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control*”.

25. It should be noted that as of 31<sup>st</sup> March, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education, \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>22</sup>

## Answers to Consultation Questions

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

26. 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?

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<sup>22</sup> General Accounting Office reports FDA tobacco user fee spending. Accessed 16 January 2015

27. 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.
28. Forestalling in this context means a temporary increase in the clearance rate of cigarettes and other tobacco products 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 or 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.<sup>23</sup>
29. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult. Crucially it would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local and regional consumption and prevalence levels and the consequent harm caused whilst ensuring cost-effectiveness through delivery across a wider geographical footprint. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>2425</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a 'unique identifier' that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.
30. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

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<sup>23</sup> HM Revenue and Customs: Tobacco Bulletin, August 2014

<sup>24</sup> EU Revised Tobacco Products Directive 3 April 2014

<sup>25</sup> Protocol to Eliminate Trade in Tobacco Products: World Health Organisation 2013

## Suggested allocation of revenue from tobacco levy across the countries of the UK

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

31. In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

32. 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.

33. 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)

34. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>26</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 37 below.

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<sup>26</sup> 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.

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

35. For the reasons stated in paragraphs 16 to 19 above, 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?

36. We support the use of the corporation tax system to collect the levy, as the system that would pose the least 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.

37. We are unaware of a plausible alternative means for collecting the levy.

**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?

38. 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.

39. According to the Department of Health Impact Assessment on standardised packaging <sup>27</sup> (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.”*

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<sup>27</sup> Impact assessment: standardised packaging of tobacco products: Department of Health June 2014

40. 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.
41. The response from ASH 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, and is based on the research paper written by Howard Reed, Landman Economics. It will be noted that 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 (1.26 pence per stick compared to 1.27 pence per stick). 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.

### Size of tobacco levy required to raise £500 million per year

Results, assuming impact of introducing standardised packaging (all figures in pence)

Year	15/16	16/17	17/18	18/19	19/20
Smoking prevalence (%) (adults)	17.3	16.4	16.7	16.2	15.7

#### Scenario (a): No pass through of levy to consumers

Cigarette levy (pence per stick)	1.26	1.31	1.35	1.39	1.43
Cigarette levy (per packet of 20)	25.2	26.2	26.9	27.7	28.5
HRT levy (per gram of tobacco)	1.68	1.75	1.80	1.85	1.90
HRT levy (per 25g packet)	42.0	43.7	44.9	46.2	47.5

#### Scenario (b): Full pass through

Cigarette levy (pence per stick)	1.27	1.33	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.5	26.5	27.3	28.0	28.9
HRT levy (per gram of tobacco)	1.70	1.77	1.82	1.87	1.92
HRT levy (per 25g packet)	42.4	44.2	45.4	46.7	48.1

42. 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):<sup>28</sup>
43. 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

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<sup>28</sup> Communication with Action on Smoking and Health, 14 January 2015

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.

### Affordability Index: Tobacco Products

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

44. 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<sup>29</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>30</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved<sup>31 32</sup>, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.
45. Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products.<sup>4</sup> Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits for the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3%

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<sup>29</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

<sup>30</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>31</sup> DH. A smokefree future: a comprehensive tobacco control strategy for England. HM Government. February 2010.

<sup>32</sup> DH Healthy Lives, Healthy People: a tobacco control plan for England. HM Government. March 2011.

on 2012.<sup>33</sup> Tobacco is unlike any other product on the market in that it kills half of all long-term users unless they quit. It is therefore clear that the tobacco industry should, and could well afford to, pay the proposed levy.

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

46. We anticipate that tobacco multinationals may suggest alternatives to a levy but we would be highly wary of any suggestion that they make a 'contribution' to society other than death and disease on an industrial scale. We would recommend vigilance against any attempts by the tobacco industry to reposition the levy as part of a separate 'corporate social responsibility deal' to enable it to exert influence on government public health policy, in violation of the WHO FCTC Article 5.3. We would also recommend government vigilance against the tobacco industry attempting to influence how this money is spent. Historically, the tobacco industry has sponsored youth prevention programmes to forestall legislation such as smokefree spaces and restrictions on marketing in the US. The 2012 Surgeon General's Report, *Preventing Tobacco Use Among Youth and Young Adults*, concluded "*the tobacco companies' activities and programs for the prevention of youth smoking have not demonstrated an impact on the initiation or prevalence of smoking among young people*<sup>34</sup>." There is evidence these programmes have been ineffective at best and harmful at worst.

47. We consider that a levy on tobacco products, with a revenue target per year fixed over five years, is by far the most desirable policy option. 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 a sufficient proportion of such funds are used to support comprehensive tobacco control delivery which includes evidence-based policy initiatives designed to reduce smoking prevalence. We therefore do not offer any alternative to a levy in this consultation response.

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<sup>33</sup> BAT Annual Report 2013

<sup>34</sup>2012 US Surgeon General Report

## 2.30 North East Public Protection Partnership

### HM Treasury Consultation on a tobacco levy

The North East Public Protection Partnership, NEPPP, is a partnership of the following Local Authority Regulatory Services:

Darlington, Durham, Gateshead, Hartlepool, Middlesbrough, Newcastle-upon-Tyne, North Tyneside, Northumberland, Redcar and Cleveland, South Tyneside, Stockton on Tees and Sunderland

Local Authority Regulatory Services are at the forefront of many important tobacco control measures including advertising bans, promotion and sales restrictions, the services leads on enforcing regulatory age restrictions to prevent the supply of tobacco products to children and of the Point Of Sale Display ban.

The work done by LA Environmental Health Officers was instrumental in making the smoking in public places ban a great success, well supported by the public. Licensing Colleagues add value to this work supporting hospitality businesses in maintaining compliance and working with taxi companies to monitor that trade.

The services also works in partnership with colleagues in HMRC and the Police to tackle the trade in illicit tobacco, these efforts have been successful in reducing the sales of smuggled and counterfeit tobacco products in the region.

These measures require adequate and secure funding to ensure successful enforcement; the proposed levy could provide consistency of resources across the UK for this important public health linked regulatory work.

NEPPP works closely with FRESH Smokefree Northeast in coordinating the regions approach to tobacco control and has cooperated with them in producing this response, we support that organisations comprehensive approach to tackling the harm caused by tobacco products and feel that the proposed levy should be used for all aspects of tobacco control including our important regulatory and public health work.

NEPPP would like to thank ASH and FRESH for the provision of data and background information, used to inform this response, which is based on that organisations submission.

As the Chair of NEPPP I'm writing to express our support for a the idea of a tobacco tax levy and would welcome the use of the tax raised to control the supply of tobacco products by regulatory means and to enhance the work of the wider public health community.

### General Observations

1. NEPPP warmly welcomes the opportunity to respond to this consultation on introducing 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."*<sup>1</sup>

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<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

2. There is widespread public appetite for more policies to reduce the harm of smoking in society with appetite for these measures having increased over the past few years. In 2014 a survey by YouGov commissioned by Action on Smoking and Health found nearly half of North East adults (43%) believing that not enough is being done to cut the harm of smoking, and another 33% saying the Government is doing about right (this was compared to 2011 when 36% said not enough is being done and another 36% thought the government was doing about right). Only 12% of adults in the North East thought “the Government is doing too much” compared to 22% in 2011 and even amongst smokers in England fewer than half (35%) believed that the government is doing too much.
3. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year<sup>2</sup>. This is likely to be an under-estimate as only costs where data is attributable have been included.
4. In the North East, the conservative cost of smoking is avoidably high at almost £160 million per year, which includes the cost to business through lost productivity and costs to the NHS of treating smokers and those exposed to secondhand smoke but does not include costs borne by other agencies e.g. local authorities who commission stop smoking services, provide regulatory services to support compliance with tobacco-related legislation and street cleaning services to remove litter such as cigarette butts and tobacco packs.
5. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
6. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated Fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>3</sup>
7. The tobacco industry enjoys massive profit margins in the UK and would be very well able to make more of a contribution.<sup>4</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>5</sup>
8. Less than one in five adults now smoke, but smoking rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes<sup>6</sup>, killing one in two of all long-term smokers<sup>7</sup>.

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<sup>2</sup> [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

<sup>3</sup> *ibid*

<sup>4</sup> Branston JR and Gilmore A (2014) The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tob control* 23(1):45-50

<sup>5</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

<sup>6</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>7</sup> Doll R, Peto R, Wheatley K, Gray R, Sutherland I. Mortality in relation to smoking: 40 years observations on male British doctors. *British Medical Journal* 1994; 309:901-911

9. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>8</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
  
10. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to reduce tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
  
11. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:
 

*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*

*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*

*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation..."*<sup>9</sup>
  
12. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
  
13. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short-term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.

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<sup>8</sup> The World Bank. Curbing the epidemic: governments and the economics of tobacco control. May, 1999.

<sup>9</sup> [NHS: Five Year Forward View](#) NHS England, October 2014

14. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
15. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, *"The Health Consequences of Smoking – 50 Years of Progress"*, reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."*
16. Similar declines in prevalence have been seen in the North East, North West and South West of England where there is investment at a regional level in comprehensive tobacco control programmes which add value and substantially enhance and amplify efforts and outcomes nationally and locally. Investment at this level ensures that national policies and evidence-based practice are implemented effectively and allows local commissioners to benefit from economies of scale and to reach much greater population numbers<sup>10</sup>. The NICE Tobacco Return on Investment Tool provides evidence that tobacco control delivery is most cost-effective when it is delivered across a bigger geographical footprint at the subnational level<sup>11</sup>.
17. Much more can be achieved if this regional investment is sustained, increased and widened: the US Surgeon General report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."*<sup>12</sup>
18. In reducing the harm from smoking in the UK, an essential role is played by the delivery of tobacco control measures carried out by local authorities, for example the stop smoking services. The Department of Health document *"Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12"* stated that: *"Stop smoking services are a key part of tobacco control and health inequalities... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers."*<sup>13</sup>
19. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about the reduction over the last two years in the number of smokers being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13

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<sup>10</sup> Royal College of Physicians and the UK Centre for Tobacco Control Studies: Fifty years since Smoking and health: Progress, lessons and priorities for a smoke-free UK, March 2012

<sup>11</sup> NICE [Tobacco return on investment tool](#) v3.03

<sup>12</sup> U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

<sup>13</sup> [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

20. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs much of the direct savings they deliver accrue mainly to the NHS and not by the increasingly cash-strapped local authorities that commission the services. This point also applies to local action, by trading standards officers and others, to regulate the tobacco market and support compliance with legislation. In respect of illicit tobacco, the Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.
21. Local Authority Regulatory Services are at the forefront of many important tobacco control measures including the advertising ban, promotion and sales restrictions, the service leads on enforcing regulatory age restrictions to prevent the supply of tobacco products to children and will soon be monitoring the second phase of the Point Of Sale Display ban. We were instrumental in providing evidence of the use by young people of tobacco vending machines; this supply route was subsequently closed by new regulation. This work is resource intensive restrictions on Local Authority budgets could mean that this regulatory work is not carried out consistently across the country leading to gaps in enforcement, which could further damage the health of our most vulnerable communities.
22. Trading standards officers cooperate with other agencies to reduce the scale of the illicit tobacco trade. The Exchequer gains financially from its investment in measures to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.
23. The level of illicit trade nationally has declined by half since 2000. Regions in England have also seen reductions in the illicit market particularly in the North East, North West and South West, where the three regional comprehensive tobacco control programmes lead the Tackling Illicit Tobacco for Better Health Partnership<sup>14</sup> to reduce the demand for and supply of illegal tobacco. For example in the North East, 15% of tobacco products in 2009 were estimated to be illicit; by 2013 this had dropped to 9%<sup>15</sup>.
24. However, the latest figures from HM Revenue and Customs suggest that nationally the illicit tobacco market has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>16</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>17</sup> and the House of Commons Home Affairs Select Committee.<sup>18</sup> Fresh strongly supports these recommendations, which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.
25. Local Authority Environmental Health Services are responsible for enforcing the laws on smokefree premises and vehicles, these laws have been welcomed by the public but compliance requires constant and well funded monitoring.

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<sup>14</sup> [www.illegal-tobacco.co.uk](http://www.illegal-tobacco.co.uk)

<sup>15</sup> NEMS illicit tobacco survey 2013

<sup>16</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

<sup>17</sup> [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

<sup>18</sup> [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

- 26 Regular tobacco control mass media and social marketing campaigns alongside increases in the real price of cigarettes are critical for reducing population smoking prevalence, but require significant investment in order to be most effective<sup>19 20 21</sup> Higher mass media campaign exposure also appears to confer greater benefit on socioeconomically disadvantaged population subgroups. Studies comparing different media message types have found messages concerning negative health effects most effective at generating increased knowledge, beliefs, higher perceived effectiveness ratings, or quitting behaviour. Evidence for other message types is more mixed. They do, also, perform very well among young people. In contrast, ads dealing with the cosmetic effects of smoking, addiction and athletic performance, have been found to be less effective. However, with funding for national campaigns having reduced substantially over the past five years, it is vital that campaigns as a vital component of effective tobacco control are able to run at national and regional level.
- 27 We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help supplement existing investment in tobacco control, and ensure that the UK can deliver a genuinely comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost an additional £500 million a year, and would include key measures such as:
- Supporting the widest possible tobacco control measures at regional and local level, to monitor and regulate the licit market and smokefree legislation
  - To fund action against the illicit tobacco trade;
  - Ensuring the provision of high quality Stop Smoking Services across the country; and
  - Financing national and regional mass media and social marketing campaigns, which add value to other tobacco control initiatives.
- 28 We would also strongly suggest that this portion of the levy be established along similar lines to the US manufacturer “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “*establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control*”.
- 29 It should be noted that as of 31<sup>st</sup> March, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education, \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>22</sup>

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<sup>19</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>20</sup> Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction*, 107(11), 2043-2050

<sup>21</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun;109(6):986-94.

<sup>22</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

## Answers to Consultation Questions

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

30 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?

31 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.

32 Forestalling in this context means a temporary increase in the clearance rate of cigarettes and other tobacco products 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 or 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.<sup>23</sup>

33 Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult. Crucially it would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local and regional consumption and prevalence levels and the consequent harm caused whilst ensuring cost-effectiveness through delivery across a wider geographical footprint. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>24 25</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a ‘unique identifier’ that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.

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<sup>23</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

<sup>24</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>25</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

34 Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

#### Suggested allocation of revenue from tobacco levy across the countries of the UK

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

35 In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

36 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.

37 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)

38 A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>26</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 37 below.

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<sup>26</sup> 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.](#)

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

39 For the reasons stated in paragraphs 16 to 19 above, 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?

40 We support the use of the corporation tax system to collect the levy, as the system that would pose the least 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.

41 We are unaware of a plausible alternative means for collecting the levy.

**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?

42 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.

43 According to the Department of Health Impact Assessment on standardised packaging <sup>27</sup> (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.”*

44 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.

45 The response from ASH 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, and is based on the research paper written by Howard Reed, Landman Economics. It will be noted that 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 (1.26 pence per stick compared to 1.27 pence per stick). These calculations

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<sup>27</sup> [Impact assessment: standardised packaging of tobacco products](#): Department of Health June 2014

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.

### Size of tobacco levy required to raise £500 million per year

Results, assuming impact of introducing standardised packaging

(All figures in pence)

Year	15/16	16/17	17/18	18/19	19/20
Smoking prevalence (%) (Adults)	17.3	16.4	16.7	16.2	15.7

#### Scenario (a): No pass through of levy to consumers

Cigarette levy (pence per stick)	1.26	1.31	1.35	1.39	1.43
Cigarette levy (per packet of 20)	25.2	26.2	26.9	27.7	28.5
HRT levy (per gram of tobacco)	1.68	1.75	1.80	1.85	1.90
HRT levy (per 25g packet)	42.0	43.7	44.9	46.2	47.5

#### Scenario (b): Full pass through

Cigarette levy (pence per stick)	1.27	1.33	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.5	26.5	27.3	28.0	28.9
HRT levy (per gram of tobacco)	1.70	1.77	1.82	1.87	1.92
HRT levy (per 25g packet)	42.4	44.2	45.4	46.7	48.1

- 46 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):<sup>28</sup>
- 47 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.

#### Affordability Index: Tobacco Products

1965	100
1980	189
1989	196
1990	185
1995	164
2000	153
2005	157
2006	157
2007	155
2008	154

<sup>28</sup> Communication with Action on Smoking and Health, 14 January 2015

2009	150
2010	165
2011	130
2012	123
2013	115

- 48 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<sup>29</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>30</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved<sup>31 32</sup>, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.
- 49 Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products.4 Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits or the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>33</sup> Tobacco is unlike any other product on the market in that it kills half of all long-term users unless they quit. It is therefore clear that the tobacco industry should, and could well afford to, pay the proposed levy.

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

- 50 We anticipate that tobacco multinationals may suggest alternatives to a levy but we would be highly wary of any suggestion that they make a 'contribution' to society other than death and disease on an industrial scale. We would recommend vigilance against any attempts by the tobacco industry to reposition the levy as part of a separate 'corporate social responsibility deal' to enable it to exert influence on government public health policy, in violation of the WHO FCTC Article 5.3. We would also recommend government vigilance against the tobacco industry attempting to influence how this money is spent. Historically, the tobacco industry has sponsored youth prevention programmes to forestall legislation such as smokefree spaces and restrictions on marketing in the US. The 2012 Surgeon General's Report, Preventing Tobacco Use Among Youth and Young Adults, concluded "*the tobacco companies' activities and programs for the prevention of youth smoking have not demonstrated an impact on the initiation or prevalence of smoking among young people*<sup>34</sup>." There is evidence these programmes have been ineffective at best and harmful at worst.

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<sup>29</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

<sup>30</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>31</sup> DH. [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

<sup>32</sup> DH [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

<sup>33</sup> BAT Annual Report 2013

<sup>34</sup> 2012 US Surgeon General Report

- 51 We consider that a levy on tobacco products, with a revenue target per year fixed over five years is by far the most desirable policy option. 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 a sufficient proportion of such funds are used to support comprehensive tobacco control delivery which includes evidence-based policy initiatives designed to reduce smoking prevalence. We therefore do not offer any alternative to a levy in this consultation response.
- 52 Tobacco products like all consumer products are regulated, the key pieces of consumer protection legislation being the General Product Safety Regulations<sup>35</sup> which follows from the General Product Safety Directive<sup>36</sup>, there is a requirement placed on producers to supply ‘safe products’;
- *“safe product” means a product which, under normal or reasonably foreseeable conditions of use including duration and, where applicable, putting into service, installation and maintenance requirements, does not present any risk or only the minimum risks compatible with the product’s use, considered to be acceptable and consistent with a high level of protection for the safety and health of persons.*

The Trading Standards Service has the duty of ensuring the safety of consumer products and is the enforcement body for the General Product Safety Regulations, this requires us to monitor the market place for consumer and industrial goods, the enforcement of relevant regulations and the provision of advice and guidance to business, all these functions are resource intensive and a tobacco levy could be used to fund the protection of consumers from this most dangerous consumer product.

Environmental Health Officers require support in their ongoing monitoring of smokefree premises, this popular legislation provides a high level of protection to workers in the hospitality sector as well as to the general public, the rise of shisha premises and a slackening off of monitoring could reverse this, funding is needed to maintain vigilance.

Local Authorities have a lead role in public health provision and protection, we feel that the wide remit of Regulatory services in this roll needs continued support a levy paid by the industry causing the damage is an appropriate mechanism to continue our work.

Submitted on behalf of NEPPP by \_\_\_\_\_ FRESH Trading Standards Tobacco Lead  
on behalf of the NEPPP Chair:-

\_\_\_\_\_  
Service Director  
Development and Public Protection  
Communities and Environment

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<sup>35</sup> General product Safety Regulations 2005:1803

<sup>36</sup> [Directive 2001/95/EC](#)

## 2.31 North East Trading Standards Association



### HM Treasury Consultation on a tobacco levy

The North East Trading Standards Association, NETSA, is a partnership of the following Local Authority Trading Standards Services:

Darlington, Durham, Gateshead, Hartlepool, Middlesbrough, Newcastle-upon-Tyne, North Tyneside, Northumberland, Redcar and Cleveland, South Tyneside, Stockton on Tees and Sunderland

The Local Authority Trading Standards services are at the forefront of many important tobacco control measures including advertising bans, promotion and sales restrictions, the service leads on enforcing regulatory age restrictions to prevent the supply of tobacco products to children and of the Point Of Sale Display ban. The service also works in partnership with colleagues in HMRC and the Police to tackle the trade in illicit tobacco, these efforts have been successful in reducing the sales of smuggled and counterfeit tobacco products in the region.

These measures require adequate and secure funding to ensure successful enforcement; the proposed levy could provide consistency of resources across the UK for this important public health linked regulatory work.

NETSA works closely with FRESH Smokefree Northeast in coordinating the regions approach to tobacco control and has cooperated with them in producing this response, we support that organisations comprehensive approach to tackling the harm caused by tobacco products and feel that the proposed levy should be used for all aspects of tobacco control including our important regulatory and public health work.

NETSA would like to thank ASH and FRESH for the provision of data and background information, used to inform this response, which is based on that organisations submission.

As the Chair of NETSA I'm writing to express our support for a the idea of a tobacco tax levy and would welcome the use of the tax raised to control the supply of tobacco products by regulatory means and to enhance the work of the wider public health community.

### General Observations

1. NETSA warmly welcomes the opportunity to respond to this consultation on introducing 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."*<sup>1</sup>

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<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

2. There is widespread public appetite for more policies to reduce the harm of smoking in society with appetite for these measures having increased over the past few years. In 2014 a survey by YouGov commissioned by Action on Smoking and Health found nearly half of North East adults (43%) believing that not enough is being done to cut the harm of smoking, and another 33% saying the Government is doing about right (this was compared to 2011 when 36% said not enough is being done and another 36% thought the government was doing about right). Only 12% of adults in the North East thought “the Government is doing too much” compared to 22% in 2011 and even amongst smokers in England fewer than half (35%) believed that the government is doing too much.
3. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year<sup>2</sup>. This is likely to be an under-estimate as only costs where data is attributable have been included.
4. In the North East, the conservative cost of smoking is avoidably high at almost £160 million per year, which includes the cost to business through lost productivity and costs to the NHS of treating smokers and those exposed to secondhand smoke but does not include costs borne by other agencies e.g. local authorities who commission stop smoking services, provide regulatory services to support compliance with tobacco-related legislation and street cleaning services to remove litter such as cigarette butts and tobacco packs.
5. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
6. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated Fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>3</sup>
7. The tobacco industry enjoys massive profit margins in the UK and would be very well able to make more of a contribution.<sup>4</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>5</sup>
8. Less than one in five adults now smoke, but smoking rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes<sup>6</sup>, killing one in two of all long-term smokers<sup>7</sup>.

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<sup>2</sup> [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

<sup>3</sup> *ibid*

<sup>4</sup> Branston JR and Gilmore A (2014) The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tob control* 23(1):45-50

<sup>5</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

<sup>6</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>7</sup> Doll R, Peto R, Wheatley K, Gray R, Sutherland I. Mortality in relation to smoking: 40 years observations on male British doctors. *British Medical Journal* 1994; 309:901-911

9. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>8</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
  
10. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to reduce tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
  
11. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:
 

*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health...We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*

*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*

*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation..."*<sup>9</sup>
  
12. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
  
13. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short-term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.

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<sup>8</sup> The World Bank. Curbing the epidemic: governments and the economics of tobacco control. May, 1999.

<sup>9</sup> [NHS: Five Year Forward View](#) NHS England, October 2014

14. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
15. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, *"The Health Consequences of Smoking – 50 Years of Progress"*, reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."*
16. Similar declines in prevalence have been seen in the North East, North West and South West of England where there is investment at a regional level in comprehensive tobacco control programmes which add value and substantially enhance and amplify efforts and outcomes nationally and locally. Investment at this level ensures that national policies and evidence-based practice are implemented effectively and allows local commissioners to benefit from economies of scale and to reach much greater population numbers<sup>10</sup>. The NICE Tobacco Return on Investment Tool provides evidence that tobacco control delivery is most cost-effective when it is delivered across a bigger geographical footprint at the subnational level<sup>11</sup>.
17. Much more can be achieved if this regional investment is sustained, increased and widened: the US Surgeon General report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."*<sup>12</sup>
18. In reducing the harm from smoking in the UK, an essential role is played by the delivery of tobacco control measures carried out by local authorities, for example the stop smoking services. The Department of Health document *"Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12"* stated that: *"Stop smoking services are a key part of tobacco control and health inequalities... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers."*<sup>13</sup>
19. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about the reduction over the last two years in the number of smokers being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13

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<sup>10</sup> Royal College of Physicians and the UK Centre for Tobacco Control Studies: Fifty years since Smoking and health: Progress, lessons and priorities for a smoke-free UK, March 2012

<sup>11</sup> NICE [Tobacco return on investment tool](#) v3.03

<sup>12</sup> U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

<sup>13</sup> [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

20. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs much of the direct savings they deliver accrue mainly to the NHS and not by the increasingly cash-strapped local authorities that commission the services. This point also applies to local action, by trading standards officers and others, to regulate the tobacco market and support compliance with legislation. In respect of illicit tobacco, the Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.
21. Local Authority Trading Standards services are at the forefront of many important tobacco control measures including the advertising ban, promotion and sales restrictions, the service leads on enforcing regulatory age restrictions to prevent the supply of tobacco products to children and will soon be monitoring the second phase of the Point Of Sale Display ban. We were instrumental in providing evidence of the use by young people of tobacco vending machines; this supply route was subsequently closed by new regulation. This work is resource intensive restrictions on Local Authority budgets could mean that this regulatory work is not carried out consistently across the country leading to gaps in enforcement, which could further damage the health of our most vulnerable communities.
22. Trading standards officers cooperate with other agencies to reduce the scale of the illicit tobacco trade. The Exchequer gains financially from its investment in measures to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.
23. The level of illicit trade nationally has declined by half since 2000. Regions in England have also seen reductions in the illicit market particularly in the North East, North West and South West, where the three regional comprehensive tobacco control programmes lead the Tackling Illicit Tobacco for Better Health Partnership<sup>14</sup> to reduce the demand for and supply of illegal tobacco. For example in the North East, 15% of tobacco products in 2009 were estimated to be illicit; by 2013 this had dropped to 9%<sup>15</sup>.
24. However, the latest figures from HM Revenue and Customs suggest that nationally the illicit tobacco market has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>16</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>17</sup> and the House of Commons Home Affairs Select Committee.<sup>18</sup> Fresh strongly supports these recommendations, which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.
25. Our Colleagues in the Local Authority Environmental Health Services are responsible for enforcing the laws on smokefree premises and vehicles, these laws have been welcomed by the public but compliance requires constant and well funded monitoring.

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<sup>14</sup> [www.illegal-tobacco.co.uk](http://www.illegal-tobacco.co.uk)

<sup>15</sup> NEMS illicit tobacco survey 2013

<sup>16</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

<sup>17</sup> [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

<sup>18</sup> [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

- 26 Regular tobacco control mass media and social marketing campaigns alongside increases in the real price of cigarettes are critical for reducing population smoking prevalence, but require significant investment in order to be most effective<sup>19 20 21</sup> Higher mass media campaign exposure also appears to confer greater benefit on socioeconomically disadvantaged population subgroups. Studies comparing different media message types have found messages concerning negative health effects most effective at generating increased knowledge, beliefs, higher perceived effectiveness ratings, or quitting behaviour. Evidence for other message types is more mixed. They do, also, perform very well among young people. In contrast, ads dealing with the cosmetic effects of smoking, addiction and athletic performance, have been found to be less effective. However, with funding for national campaigns having reduced substantially over the past five years, it is vital that campaigns as a vital component of effective tobacco control are able to run at national and regional level.
- 27 We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help supplement existing investment in tobacco control, and ensure that the UK can deliver a genuinely comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost an additional £500 million a year, and would include key measures such as:
- Supporting the widest possible tobacco control measures at regional and local level, to monitor and regulate the licit market and smokefree legislation
  - To fund action against the illicit tobacco trade;
  - Ensuring the provision of high quality Stop Smoking Services across the country; and
  - Financing national and regional mass media and social marketing campaigns, which add value to other tobacco control initiatives.
- 28 We would also strongly suggest that this portion of the levy be established along similar lines to the US manufacturer “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “*establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control*”.
- 29 It should be noted that as of 31<sup>st</sup> March, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education, \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>22</sup>

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<sup>19</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>20</sup> Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction*, 107(11), 2043-2050

<sup>21</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun;109(6):986-94.

<sup>22</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

## Answers to Consultation Questions

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

30 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?

31 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.

32 Forestalling in this context means a temporary increase in the clearance rate of cigarettes and other tobacco products 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 or 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.<sup>23</sup>

33 Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult. Crucially it would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local and regional consumption and prevalence levels and the consequent harm caused whilst ensuring cost-effectiveness through delivery across a wider geographical footprint. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>24 25</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a ‘unique identifier’ that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.

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<sup>23</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

<sup>24</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>25</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

34 Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

**Suggested allocation of revenue from tobacco levy across the countries of the UK**

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

35 In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

36 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.

37 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)

38 A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>26</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 37 below.

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<sup>26</sup> 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.](#)

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

39 For the reasons stated in paragraphs 16 to 19 above, 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?

40 We support the use of the corporation tax system to collect the levy, as the system that would pose the least 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.

41 We are unaware of a plausible alternative means for collecting the levy.

**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?

42 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.

43 According to the Department of Health Impact Assessment on standardised packaging <sup>27</sup> (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.”*

44 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.

45 The response from ASH 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, and is based on the research paper written by Howard Reed, Landman Economics. It will be noted that 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 (1.26 pence per stick compared to 1.27 pence per stick). These calculations

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<sup>27</sup> [Impact assessment: standardised packaging of tobacco products](#): Department of Health June 2014

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.

### Size of tobacco levy required to raise £500 million per year

Results, assuming impact of introducing standardised packaging

(All figures in pence)

Year	15/16	16/17	17/18	18/19	19/20
Smoking prevalence (%) (Adults)	17.3	16.4	16.7	16.2	15.7

#### Scenario (a): No pass through of levy to consumers

Cigarette levy (pence per stick)	1.26	1.31	1.35	1.39	1.43
Cigarette levy (per packet of 20)	25.2	26.2	26.9	27.7	28.5
HRT levy (per gram of tobacco)	1.68	1.75	1.80	1.85	1.90
HRT levy (per 25g packet)	42.0	43.7	44.9	46.2	47.5

#### Scenario (b): Full pass through

Cigarette levy (pence per stick)	1.27	1.33	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.5	26.5	27.3	28.0	28.9
HRT levy (per gram of tobacco)	1.70	1.77	1.82	1.87	1.92
HRT levy (per 25g packet)	42.4	44.2	45.4	46.7	48.1

- 46 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):<sup>28</sup>
- 47 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.

#### Affordability Index: Tobacco Products

1965	100
1980	189
1989	196
1990	185
1995	164
2000	153
2005	157
2006	157
2007	155
2008	154

<sup>28</sup> Communication with Action on Smoking and Health, 14 January 2015

2009	150
2010	165
2011	130
2012	123
2013	115

- 48 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<sup>29</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>30</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved<sup>31 32</sup>, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.
- 49 Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products.4 Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits or the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>33</sup> Tobacco is unlike any other product on the market in that it kills half of all long-term users unless they quit. It is therefore clear that the tobacco industry should, and could well afford to, pay the proposed levy.

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

- 50 We anticipate that tobacco multinationals may suggest alternatives to a levy but we would be highly wary of any suggestion that they make a 'contribution' to society other than death and disease on an industrial scale. We would recommend vigilance against any attempts by the tobacco industry to reposition the levy as part of a separate 'corporate social responsibility deal' to enable it to exert influence on government public health policy, in violation of the WHO FCTC Article 5.3. We would also recommend government vigilance against the tobacco industry attempting to influence how this money is spent. Historically, the tobacco industry has sponsored youth prevention programmes to forestall legislation such as smokefree spaces and restrictions on marketing in the US. The 2012 Surgeon General's Report, Preventing Tobacco Use Among Youth and Young Adults, concluded "*the tobacco companies' activities and programs for the prevention of youth smoking have not demonstrated an impact on the initiation or prevalence of smoking among young people*<sup>34</sup>." There is evidence these programmes have been ineffective at best and harmful at worst.

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<sup>29</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

<sup>30</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>31</sup> DH. [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

<sup>32</sup> DH [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

<sup>33</sup> BAT Annual Report 2013

<sup>34</sup> 2012 US Surgeon General Report

- 51 We consider that a levy on tobacco products, with a revenue target per year fixed over five years is by far the most desirable policy option. 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 a sufficient proportion of such funds are used to support comprehensive tobacco control delivery which includes evidence-based policy initiatives designed to reduce smoking prevalence. We therefore do not offer any alternative to a levy in this consultation response.
- 52 Tobacco products like all consumer products are regulated, the key pieces of consumer protection legislation being the General Product Safety Regulations<sup>35</sup> which follows from the General Product Safety Directive<sup>36</sup>, there is a requirement placed on producers to supply 'safe products';
- *"safe product" means a product which, under normal or reasonably foreseeable conditions of use including duration and, where applicable, putting into service, installation and maintenance requirements, does not present any risk or only the minimum risks compatible with the product's use, considered to be acceptable and consistent with a high level of protection for the safety and health of persons.*

The Trading Standards Service has the duty of ensuring the safety of consumer products and is the enforcement body for the General Product Safety Regulations, this requires us to monitor the market place for consumer and industrial goods, the enforcement of relevant regulations and the provision of advice and guidance to business, all these functions are resource intensive and a tobacco levy could be used to fund the protection of consumers from this most dangerous consumer product.

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<sup>35</sup> General product Safety Regulations 2005:1803

<sup>36</sup> [Directive 2001/95/EC](#)

## 2.32 Philip Morris Limited

### Philip Morris Limited's Response to the Tobacco Levy Consultation

Philip Morris International Inc. ("PMI") is the leading international tobacco company. Its products, which include the world's number one cigarette brand Marlboro are sold in more than 180 countries. PMI operates in the UK (and Ireland) through its subsidiary Philip Morris Limited ("PML"). PML welcomes the opportunity to respond to the tobacco levy consultation ("the Consultation").

We fully recognise the health risks of smoking.<sup>1</sup> We therefore support proportionate, evidence based regulation, and efficient tobacco taxation that does not make legal tobacco products unaffordable to adult smokers and does not increase illicit trade. We are also committed to developing potentially reduced risk alternatives to conventional tobacco products for adult consumers who either cannot or do not want to give up smoking - indeed, we have started to commercialise them already.<sup>2</sup>

Despite most of the costs of smoking cited in the Consultation being unsubstantiated, and in any event borne by private business not the Government, PML recognises the Government's need to find extra revenue in the current fiscal climate. However, if more revenues need to be generated from tobacco sales, introducing a new tobacco levy is not the right approach because at best it will function like an additional excise tax, but without the certainty, simplicity and ease of collection that excise offers. Further, as an industry specific tax the tobacco levy will undermine international perceptions of UK tax certainty and political risk.

We want to engage constructively although we question the policy driver of this proposal which appears aimed at targeting a legal industry rather than raising revenue. After all, there appears no robust evidentiary basis to support this Consultation except the speculative estimates of ASH, which would not withstand independent scrutiny.

That said, we remain open to exploring alternative ways of raising revenue, particularly by reforming excise taxes and increasing efforts to fight illicit trade.

#### **1. The objective of the levy is unclear**

The Consultation asserts that it is being conducted in accordance with the tax consultation framework, and is taking place during Stage 1 ("Setting out objectives and identifying options").

While we appreciate the opportunity to comment at this early stage in the development of the policy design, we note that the Government's tax consultation framework provides that, at each stage, the Government will set out clearly the policy objectives, the scope of the consultation and its current assessment of the proposed policy.

The Consultation does not clearly state the policy objective, other than that of asking tobacco manufacturers and importers to make a greater contribution towards the costs of smoking to society. If the objective is to raise Government revenue, then there are better alternatives to the levy which we set out below.

There is no impact assessment of the proposed policy and very little evidence has been provided to support it. This has made it difficult to discern the basis on which the proposal is being put

forward, but in our response we have sought to comment on the assumptions made, as far as we are able to discern them.

Finally, the Consultation would benefit from a proper economic impact assessment that includes as an alternative to a levy the business case for Government investing more in anti-illicit trade measures and reforming the existing excise structures.

## **2. The proposal lacks an evidence base**

In 2013-14, tobacco excise alone raised £9.53bn,<sup>3</sup> and receipts including VAT were approximately £12bn (excluding other fiscal and economic contributions).<sup>4</sup> If the Government revenue currently lost to the illicit trade was included it would reach over £14bn,<sup>5</sup> far exceeding ASH's (highly questionable) estimate of the costs tobacco consumption imposes on society cited in the Consultation.

The only reasoning provided for the levy is an assertion of the total costs of smoking to England provided by ASH, an anti-tobacco pressure group. ASH's advocacy document is in no way unbiased, credible or authoritative and the estimates cited lack the robustness necessary for evidence based policy making. Compounding this, the Government fails to scrutinise ASH's figures and provides no counterbalancing analysis, nor does it distinguish between costs to the Government and costs to private businesses (e.g., loss of working hours). The evidential base and reasoning for the proposal is therefore insufficient for a proper consultation on an important issue.

## **3. The Consultation does not include sufficiently detailed information to produce an informed response**

The inadequate level of detail in the Consultation constitutes a major procedural flaw:

- No details are provided as to revenue targets to be set by the Government, the expected potential revenues from the levy or the proposed calculation base, structure and rate of the levy;
- No analysis has been conducted as to the potential undesired effects of the proposed measures, for example on its potential to increase illicit trade (which as detailed in section 8 below has already reached alarming proportions and represents a huge drain on Government revenues);
- There is no detailed analysis of alternatives to the imposition of an additional levy on tobacco manufacturers, and
- The analysis of alternatives to the levy which is contained within the Consultation is contained in four short paragraphs which do not provide adequate information and advice to stakeholders on those alternatives vis-à-vis the proposed levy.

In view of the significant lack of detail in the Consultation, PML is unable to produce an informed response. We assume that there will be an opportunity to comment further on a more considered proposal (if the Government were to proceed with one of the policy options outlined in the consultation paper). The novel and untested nature of the proposed levy means that any new measures in this area require full and proper consultation and independent, unbiased assessment of the economic impact. Proceeding with the levy without taking those essential steps would be liable to result in serious prejudice to PML.

#### 4. The proposed levy will fail in its apparent objective

The stated justification for the levy is that the tobacco industry should pay for the societal costs that the consumption of tobacco products causes.<sup>6</sup> Excise taxes on tobacco already represent two thirds of the retail price of cigarettes, or £9.5bn per year, and another £1.7bn in excise (£2.1bn in total tax) is lost to the illicit trade.<sup>7</sup> With VAT also included, approximately 75% of the retail price of tobacco is given to tax (approaching 90% for some super-low priced brands, which is significant when the super-low category accounts for approximately half the FMC market).<sup>8</sup> There is no reason to suppose that the proposed levy would function in any different way than the existing tobacco excise tax, and we therefore question why the Government does not increase excise tax. The Consultation is surprisingly silent on why a tobacco levy would function differently from the existing excise tax, which creates the impression that the Consultation has not been fully thought through.

##### (a) *No basis for the Government to presume that the levy would not be passed on*

The Government has no basis to assume that any business operating in any industry would refrain from passing on to its customers in the form of price increases any tax (or other cost) increase. The commercial need to pass on tax increases is especially pertinent when taxes represent approximately 75% of the retail price, as is the case for cigarettes in the UK. As any other economic player, we have the right to pass on tax increases to the consumer, irrespective of whether such tax is labelled excise tax, VAT or a tobacco levy. This has been reflected in our past practice following UK excise announcements over a number of years.

##### (b) *The proposed levy is unlikely to raise more revenue*

The Consultation concedes that if the levy was passed on, higher retail prices may lead to down-trading and increased illicit trade which would both lower tobacco excise receipts.<sup>10</sup> Such results, are borne out by recent market trends. Based on HMRC estimates, the illicit trade in factory manufactured cigarettes ("FMC") increased from 7% to 10% between 2011/12 and 2013/14, while for hand-rolling tobacco ("HRT") it grew from 35% to 39% during the same period.<sup>11</sup>

In addition there has been significant down-trading within the legal market, both from premium FMC to super-low priced brands, and from FMC to the much cheaper HRT category.<sup>12</sup> These developments and their consequences (not only reducing the base for future tax revenue, but also undermining health and other public policy objectives) were recognised in the recent Minimum Excise Tax ("MET") consultation.<sup>13</sup>

Although there are no easy ways to increase revenue, we recommend that the Government considers policy alternatives such as re-balancing the excise structure and countering the illicit trade more effectively. We discuss these options in greater detail below.

#### 5. The proposed levy will exacerbate impending illicit trade threats

As discussed in more detail at section 8 below, the scale of illicit trade is a highly significant issue in the UK.

We cannot quantify the impact the proposed levy would have on the illicit trade or downtrading because the Consultation does not provide an estimate of the expected tax revenue the Government hopes to raise, and therefore, the likely pass-on in higher retail prices to consumers cannot be estimated. There is a mere brief acknowledgement that the levy could drive more consumers into the illicit market. Again, no detail or any empirical analysis is provided as to this potentially critical side effect of the proposal.

Evidently, a larger levy would likely lead to a more significant price rise and risks creating a larger increase in illicit trade. However, pass-through of even a small levy cost, when combined with the existing escalator of RPI + 2%, could translate into material retail price increases. While retail price increases in-line with GDP and inflation growth can be sustainable, there are many examples where retail price increases beyond these levels have fostered illicit trade.<sup>14</sup>

Due to the impact of anticipated non-fiscal regulatory measures in the next few years, we consider the UK market to be especially vulnerable to illicit trade. In April 2015 the Point of Sale Display Ban of tobacco products will come into full force and by May 2016 the Government must implement the Tobacco Products Directive (2014/40 EU) ("the TPD"). Recently the Government announced its backing for plain packaging and its intention to lay secondary legislation so that the policy can come into force at the same time as the TPD in May 2016.<sup>15</sup>

Each of the above initiatives would likely cause a deterioration in lawful sales and an increase in illicit trade.<sup>16</sup> Combined these proposed regulatory measures pose a severe impediment to reversing the recent increase in illicit trade. Assuming a pass-on of the proposed levy cost would make HMRC's task even more challenging. We therefore strongly caution against tax increases beyond the RPI + 2% roadmap set out in Budget 2014.

## **6. New sector specific taxes contradict Government policy and weaken UK competitiveness**

The Government's Corporate Tax Roadmap recognises that stability, simplicity and certainty are critical elements of a competitive tax system. Taxes aimed at a particular sector erode stability. The context in which the proposed levy was announced will only add to negative perceptions within the business and investor community that the UK is currently subject to unusually high levels of political risk and uncertainty. Should the Government decide to proceed with the levy it will damage UK competitiveness still further.

This proposal would also introduce a new system that would be complex and expensive to administer, imposing an additional bureaucratic burden on businesses that have already well-established systems to pay excise from tobacco products. This contradicts the Corporate Tax Roadmap's promise that "the Government will seek to avoid complexity where it can"<sup>17</sup> and undercuts the intent behind the 'One in Two Out' approach to regulation.<sup>18</sup>

Industry specific levies have an undistinguished recent history in the UK, often triggering unintended consequences. This was sharply illustrated by the reaction to the North Sea windfall tax in 2011. Although the increase in tax for companies was intended to pay for a reduction in fuel duty for consumers, the impact on investment was severe, and the Government has had to modify the policy since.

Similarly the bank levy, effective from 2011, has never managed to raise the £2.5bn amount targeted, falling considerably short in the first years of operation despite continued increases in the rate charged and repeated predictions by Ministers that it would exceed the target.<sup>19</sup> It is also likely to have damaged the UK's competitiveness, as the recent consultation on reform of the bank levy acknowledged:

*"The frequency of bank levy rate increases in order to meet the Government's revenue target may be creating uncertainty and damaging the perception of UK competitiveness; and*

*The marginal cost of the bank levy, which has increased from 0.075 percent to 0.156 percent, may be creating distortions and having undesirable impacts on behaviour. This may include the relocation of certain low-margin activities overseas or to the non-banking sector".<sup>20</sup>*

## **7. Legal issues**

The Consultation is silent on what consideration has been given by the Government, in setting out its proposals, to the constraints imposed by EU law. We would welcome details of why it is thought that the levy would be lawful. In our view the levy as envisaged could not be lawfully introduced; nor is it clear to us how it could be altered to achieve its objectives in a lawful manner.

## **8. Better alternatives to a levy**

Further investment in anti-illicit trade measures and restructuring of tobacco excise would likely raise more revenue than a levy. These two proposals are connected because if the threat from illicit trade was addressed, the Government would be less constrained in its excise policy. Conversely, if the Government does not take further steps to reduce the illicit trade, then impending regulatory measures (such as the implementation of the TPD and plain packaging) will further curtail its scope to increase excise, as the Department of Health's own Impact Assessment in relation to plain packaging admits.<sup>21</sup>

### *(a) Greater investment in anti-illicit trade*

The illicit trade already costs the UK over £2bn p.a. (potentially almost £3bn based on HMRC's upper estimate). Each 1% increase in the illicit trade as a proportion of the total FMC market costs the Government £120m in foregone tax revenue, and a corresponding increase in HRT costs £25m.<sup>22</sup> The deterioration in the illicit trade over the last 2 years has resulted in a loss of tax revenue of £500m more in 2013/14 than 2011/12, when it was brought to a recent low.<sup>23</sup>

The scale of the illicit trade is a huge problem for the UK. Based on HMRC's mid-range estimate, the lost tax revenue from illicit tobacco exceeds the cost to the NHS of treating smoking related diseases.<sup>24</sup> Yet the costs that illicit trade impose on society are not limited to the fiscal 'tax gap'.

Illicit tobacco is neither regulated nor taxed and therefore completely undermines tobacco control policies.<sup>25</sup> It makes tobacco cheaper<sup>26</sup> (test purchasing by PMI indicates that illicit white brands often sell for half the price of super-low priced FMC),<sup>27</sup> more accessible to children (since vendors do not demand proof of age identification or care who they sell to, age restriction controls provide no protection),<sup>28</sup> and frequently side-steps regulatory measures such as pictorial

health warnings.<sup>29</sup> For example, a recent HMRC report warned that following the proposed introduction of plain packaging more young people could be tempted into smoking illicit white brands<sup>30</sup> which would expose them to a parallel market which operates without the consumer protection that regulation provides. Needless to say, this completely defeats the purported intent behind plain packaging which is claimed to protect young people in particular.

The illicit trade also deprives smaller retailers of vital business, threatening their livelihoods, and fuels organised crime and terrorism.<sup>31</sup> As local government in Scotland has warned, it brings children and other vulnerable members of society into contact with dangerous people.<sup>32</sup>

The link to organised crime and paramilitary and terrorist groups was highlighted to Government as far back as 1999 by the Taylor report,<sup>33</sup> but recently there have been a string of reminders. For example, on 29 December, 2014, Spanish police arrested two former IRA bombers allegedly involved in tobacco smuggling,<sup>34</sup> and on 15 February, 2015 The Sunday Times newspaper ran multiple articles covering the links between Northern Irish paramilitaries and illicit tobacco, as well as the damaging effects it has on society, with for example children being used as scouts and runners.<sup>35</sup> Also in February, 2015, The Royal United Services Institute for Defence and Security Studies published the 'Organised Crime and the Illicit Trade in Tobacco, Alcohol and Pharmaceuticals in the UK' report, a comprehensive and authoritative study commissioned by the Home Office, which documents in detail the corrosive social and economic effects of illicit trade.<sup>36</sup> That report warned that organised crime costs the UK £24 billion a year,<sup>37</sup> and that "*the high profit margins associated with illicit trade are used to fund other criminal and terrorist activities*".<sup>38</sup>

The illicit trade imposes both financial and non-financial costs on society at a time when the UK faces the twin challenges of a fragile economic recovery and a variety of security threats. We contend that reducing the illicit trade should be the priority, not a tobacco levy that threatens to make the illicit trade worse and is likely, as a result, to raise little if any additional net revenue.

PML appreciates that spending constraints limit the scope for the Government to invest more in anti-illicit trade measures. PML is keen to explore with law enforcement agencies what steps we can take to help redress this. In Q4 2014, two thirds of illicit HRT (which is particularly endemic) was seized at the border (as opposed to inland).<sup>39</sup> Despite continued investment we are aware that funding priorities have previously led to cuts in resources considered useful by law enforcement, such as sniffer dogs. A previous report by the National Audit Office found that in 2011/12, HMRC and UKBF prevented approximately £13 in revenue loss for every £1 HMRC invested in tackling tobacco smuggling, meaning that extra investment could yield much more than a levy.<sup>40</sup> We would be open to discussing participation in such increased investment, on an industry basis. This would potentially make a broader contribution to society as well, not only reducing the illicit trade in tobacco (and its fiscal and social costs) but also helping counter other security threats at the border.

#### (b) *Excise reform*

Tobacco excise revenue declined in 2014 (calendar year), the second consecutive year, notwithstanding the duty escalator, and broadly stable consumption patterns.<sup>41</sup> Tobacco excise receipts in 2014 were more than £250m lower than in 2012. This reflects a number of market conditions including an increase in illicit trade, continuing down-trading to lower priced tobacco products, in particular, consumers switching from FMC to HRT, and the growth of e-cigarettes. We would support increased excise on HRT and re-balancing of excise (increasing the specific component and reducing ad valorem) on FMC designed to raise additional revenue

and reduce incentives to down-trade, as long as the threat of displacement to the illicit trade was reduced.

We would encourage the Government to increase taxation on super-low priced FMC through a re-balancing of excise (increasing the specific component and reducing ad valorem). As stated in our response to the MET consultation, we believe that this re-balancing is a simpler alternative to an MET, and it has worked well in other EU countries.

We also recommend increasing excise on HRT relative to FMC as switching across tobacco categories continues to undermine receipts. Currently, the Weighted Average Price (“WAP”) of a pack of 20 FMC is £7.80 compared to £4.08 on HRT.<sup>42</sup> As a result, volume sales of FMC have been declining year on year, while HRT sales have been increasing.<sup>43</sup> This price advantage for HRT is the result of the UK’s tax policy, which levies a total tax of £6.27 per 20 FMC, compared to £2.85 for its HRT equivalent, even though the health risks from smoking HRT are no lower than from smoking FMC. If the excise on HRT was equalised with FMC without any leakage to the illicit trade, this could yield approximately £1.5bn in additional tax revenue. Even a partial step towards eliminating this tax advantage for HRT would make a considerable difference to public finances.

Increasing the excise on HRT would be consistent with public health objectives. We understand that one reason for the Government maintaining the effective subsidy on HRT is the especially high rate of illicit trade in this segment.<sup>44</sup> The constraint that the illicit trade already imposes on excise policy and the need to protect the revenue base from further consumer switching makes it vital that the Government now tackles this issue with additional resources. With increased investment to fight illicit trade, as proposed above, we consider that the HRT market could sustain more of the excise burden, protect the revenue base, and reduce the threat from continued down-trading.

#### (c) *Nicotine Delivery Systems (E-cigarettes)*

A further and more sustainable alternative would be the application of excise duty (or an equivalent tax) to non-medicinal nicotine delivery systems (“NDS”), the vast majority of which are currently e-cigarettes. Following the acquisition of Nicocigs in 2014, PMI now owns one of the UK’s leading brands of e-cigarettes, Nicolites.<sup>45</sup> Currently e-cigarettes are not subject to duty in the UK, and the Consultation proposes that they are excluded from the scope of the levy as well. We note that Italy and Portugal introduced taxation of NDS in 2014 which are lower than combustible tobacco products, fairly reflecting the nature of these products. Given that the UK is currently the largest market for e-cigarettes in the EU, it would not be unrealistic for the UK Government to secure material additional tax revenue from this category. We would be pleased to have an opportunity to discuss our proposals for how NDS may be taxed efficiently and fairly.

## Conclusion

First, the Consultation provides no credible basis for the assessment of societal costs. The central cost estimate is biased and provided by ASH, whose advocacy lacks the robustness appropriate for sound evidence based policy making. The absence of any balancing views or comprehensive economic and social analysis raises serious questions about the propriety of the Consultation process.

Second, it is not clear why a new tax should be introduced to address the social costs. Excise taxes are generally accepted as the most appropriate fiscal instrument to pay for any social costs. Excise taxes alone on tobacco already represent two thirds of the retail prices of cigarettes, or £9.5 billion per year, and with VAT included on top, approximately 75% of the retail price of tobacco products is tax (often more). If after careful analysis, the Government finds the need to raise extra revenue it should optimise the excise tax, rather than introduce a new tax.

Third, we do not understand Government's expectation that a new tobacco levy would function in any different way to an additional excise tax. As previously stated, the Government has no basis to believe that any business will refrain from passing on cost and tax increases to the consumer – whether such tax is labelled as excise, VAT or a new tobacco levy.

Fourth, with the structure and tax base for the new tobacco levy being unclear, the levy may not provide Government with a revenue stream that is as certain, and easy to collect as excise.

Fifth, the Government needs to give far greater consideration to the potential impact on illicit trade. Additional taxes, whether by introducing a new tobacco levy or increasing the level of excise taxes, are generally expected to be passed on to the consumer, resulting in higher retail prices, which fuels an increase in illicit trade. It is a major contributor to the costs imposed on society. Indeed, it weighs disproportionately, making tobacco more accessible to children, fuelling organised crime and damaging small retailers. It would be perverse to punish a legal, regulated and taxed industry to the benefit of organised criminals who cause so much damage to society. However, that is exactly the risk that the current proposal poses.

Instead of introducing a tobacco levy, we recommend the Government increases investment in tackling illicit trade, and considers taxation of e-cigarettes. It should also re-balance the cigarette excise structure and increase the duty on HRT to discourage consumer down-trading and protect Government tax revenues. As the MET consultation made clear, consumers' increasing preference for cheaper FMC products and HRT will weaken excise revenues unless either (i) this trend slows or (ii) the Government re-designs excise.

The Government has little choice but to reform excise since the pace of down-trading is likely to increase not slow after May 2016 (following the introduction of the TPD, and the possible introduction of plain packaging). According to the Impact Assessment produced in June 2014, down-trading is likely to continue twice as fast with plain packaging as without it.<sup>46</sup> This echoes the Australian experience, where the industry has seen even more vigorous price competition and increased popularity of the cheapest brands.<sup>47</sup>

We are sympathetic to the difficulties the Government faces in maintaining tobacco receipts in the current environment, but the proposed levy would make a bad situation worse. There are other, better ways of securing a greater contribution from tobacco sales and PML remains ready to work with Government to secure this. We would welcome the opportunity to discuss our ideas further.

## Annex 1 – Responses to Questions

### Questions 1 to 7

These questions focus on the detailed design of a tobacco levy. As the proposal is fundamentally flawed and we do not think that the levy will achieve its objective of raising revenue, we have not responded to these questions.

### Question 8

The Government has no basis to believe that any business will refrain from passing on cost and tax increases to the consumer whether such tax is labelled excise tax, VAT or tobacco levy. Other than this, it is difficult to answer this question as the Consultation fails to provide any details as to potential revenues from the levy or proposed rates. To the extent we are able to do so, we have commented at section 3 above.

### Questions 9 and 10

We consider that the levy would have significant impacts on illicit trade. Our comments are set out at section 5 above.

### Question 11

We believe that further investment in anti-illicit trade measures and changes in tobacco excise policy would be more effective than a tobacco levy. We have set out our initial proposals at section 8 above.

## Annex 2 - References

<sup>1</sup> PMI's website is unequivocal that smoking causes disease and is addictive. See [http://www.pmi.com/eng/our\\_products/health\\_effects\\_of\\_smoking/pages/health\\_effects\\_of\\_smoking.aspx](http://www.pmi.com/eng/our_products/health_effects_of_smoking/pages/health_effects_of_smoking.aspx)

<sup>2</sup> During the last decade PMI has invested approximately \$2bn in researching and developing new products that could offer smokers a potentially reduced risk alternative to conventional tobacco. The Marlboro iQOS HeatStick was launched in Q4 2014, in two pilot cities (Nagoya, Japan and Milan, Italy).

<sup>3</sup> HMRC Tobacco Bulletin (December 2014), available at <https://www.uktradeinfo.com/statistics/pages/taxanddutybulletins.aspx>

<sup>4</sup> Based on TMA estimate for 2012/13 available at <http://www.the-tma.org.uk/tma-publicationsresearch/facts-figures/tax-revenue-from-tobacco/>

<sup>5</sup> Based on HMRC's (mid-range) estimate of the illicit trade in tobacco 'tax gap' for 2013/14 available at <https://www.gov.uk/government/collections/measuring-tax-gaps>

<sup>6</sup> *"Smoking imposes costs on society, and the government believes it is therefore fair to ask the tobacco industry to make a greater contribution. The government will shortly launch a consultation on introducing a levy on tobacco manufacturers and importers"*. Autumn Statement 2014 at para 1.252, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/382327/44695\\_Accessible.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/382327/44695_Accessible.pdf)

<sup>7</sup>

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/364011/141016\\_Tobacco\\_Tax\\_Gap\\_2014.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/364011/141016_Tobacco_Tax_Gap_2014.pdf)

<sup>8</sup> Based on Nielsen data.

<sup>10</sup> Para 3.6 of the Consultation.

<sup>11</sup>

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/364011/141016\\_Tobacco\\_Tax\\_Gap\\_2014.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/364011/141016_Tobacco_Tax_Gap_2014.pdf)

<sup>12</sup> Based on Nielsen data, between December 2006 and August 2014, the super-low segment expanded from 9.7% to 49.6% of the FMC market. At the same time, all other price segments contracted: the premium segment from 33.6% to 18.4%, the medium segment from 19.3% to 11.9%, and the low priced segment from 36.3% to 20.0%.

<sup>13</sup> <https://www.gov.uk/government/consultations/minimum-excise-tax/minimum-excise-tax>

<sup>14</sup> The experience of the UK after the introduction of the duty escalator in the 1993 is well known, but others more recently include Singapore (2000-06), and Ireland (2000-09) as explained in Dr Laffer's Handbook of Tobacco Taxation: Theory and Practice, at pages 224-232.

<sup>15</sup> <https://www.gov.uk/government/news/government-backs-standardised-packaging-of-tobacco>

<sup>16</sup> PMI and PML have explained the link between these regulatory measures and an increase in illicit trade in response to various consultations, however, we would be willing to come and discuss this further if helpful.

<sup>17</sup> See Box 2A at page 11 available at

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/193239/Corporation\\_tax\\_road\\_map.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193239/Corporation_tax_road_map.pdf)

<sup>18</sup> <https://www.gov.uk/government/collections/one-in-two-out-statement-of-new-regulation>

<sup>19</sup> For example in the 2011 Autumn Statement the Chancellor said that "*I have always said that we wished to raise £2.5 billion each and every year from this levy. To ensure we do that, I need to raise the rate of the levy...*" However, the levy raised only £1.8bn in 2011-12 and £1.6bn in 2012-13, and was forecast to miss its target again in 2013/14. See Taxation of Banking Parliamentary note, SN5251 at page 29.

<sup>20</sup> A bank levy banding approach: consultation – para 2.2 available at

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/298679/bank\\_levy\\_banding\\_approach\\_consultation\\_270314.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/298679/bank_levy_banding_approach_consultation_270314.pdf)

<sup>21</sup> Standardised packaging of tobacco products, Impact Assessment (17 June 2014) at paras 120 and 126 available at

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/323518/impact\\_assessment.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/323518/impact_assessment.pdf)

<sup>22</sup> Standardised packaging of tobacco products, Impact Assessment (17 June 2014) at para 131, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/323518/impact\\_assessment.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/323518/impact_assessment.pdf)

<sup>23</sup> Based on HMRC Tobacco Tax Gaps data for 2013/14 available at

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/364011/141016\\_Tobacco\\_Tax\\_Gap\\_2014.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/364011/141016_Tobacco_Tax_Gap_2014.pdf)

<sup>24</sup> Based on HMRC Tobacco Tax Gaps data 2013/14 and the Consultation at para 1.9.

<sup>25</sup> For example, the North of England Tackling Illicit Tobacco for Better Health Programme was launched in July 2009: "*in recognition of the role of illicit tobacco (IT) in undermining tobacco control strategies and in maintaining and encouraging tobacco use among deprived communities*"

[https://www.newcastle.gov.uk/sites/drupalncc.newcastle.gov.uk/files/wwwfileroot/business/trading\\_standards/illicit\\_tobacco\\_execsummary1.pdf](https://www.newcastle.gov.uk/sites/drupalncc.newcastle.gov.uk/files/wwwfileroot/business/trading_standards/illicit_tobacco_execsummary1.pdf)

<sup>26</sup> According to an inquiry by the All-Party Parliamentary Group on Smoking and Health ("the 2013 APPG Inquiry"): "*research by the North of England Programme shows that the low price and easy availability of illicit*

*tobacco in many communities keeps people smoking and smoking more*". See

<http://www.ash.org.uk/APPGillicit2013> at page 5.

<sup>27</sup> PML uses ex-law enforcement officers, led by Will O'Reilly, a former Detective Chief Inspector in the Metropolitan Police to conduct regular intelligence led test purchasing of illicit tobacco across the UK and Ireland.

<sup>28</sup> "*Illicit tobacco products are available at a number of locations in communities across the UK...This creates a completely unregulated distribution network, and makes tobacco far more accessible to children and young people.*" Department of Health, Consultation of the future of tobacco control, 31 May 2008,

paragraph 2.30, available at [http://www.dh.gov.uk/prod\\_consum\\_dh/groups/dh\\_digitalassets/documents/digitalasset/dh\\_085651.pdf](http://www.dh.gov.uk/prod_consum_dh/groups/dh_digitalassets/documents/digitalasset/dh_085651.pdf).

<sup>29</sup> This is evident from the packs obtained during test purchasing.

<sup>30</sup> See para 3.9 of

The Introduction of Standardised Packaging for Tobacco

HMRC's Assessment of the Potential Impact on the Illicit Market available at

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/403495/HMRC\\_impact\\_report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/403495/HMRC_impact_report.pdf)

<sup>31</sup> The 2013 APPG Inquiry into the illicit trade in tobacco products reported that: "*Illicit tobacco causes damage both to its consumers and to the wider society. It makes tobacco more available to poorer people and to children. It helps to widen health inequalities. It funds and supports organised crime.*" See <http://www.ash.org.uk/APPGillicit2013> at page 5. In June 2013 the European Commission declared that the trade in illicit tobacco is "*almost exclusively the domain of organised criminal groups operating across borders*". See page 4 of the Communication from the Commission to the Council and the European Parliament 'Stepping up the fight against cigarette smuggling and other forms of illicit trade in tobacco products - A comprehensive EU Strategy' 6 June 2013 available at [http://ec.europa.eu/anti\\_fraud/documents/2013\\_cigarette-communication/1\\_en\\_act\\_part1\\_v9\\_en.pdf](http://ec.europa.eu/anti_fraud/documents/2013_cigarette-communication/1_en_act_part1_v9_en.pdf)

<sup>32</sup> A survey in Scotland by ASH Scotland, Cancer Research UK, North Ayrshire Council 'Researching under-age access to tobacco in North Ayrshire' concluded that: "*the relationship that develops ... requires thought about how best to raise awareness of the dangers of liaison with strangers and contact with persons selling other illicit goods, or involving children in the trafficking of these goods*". See <http://www.ashscotland.org.uk/media/4470/Young%20people%20and%20tobacco%20case%20study%20North%20Ayrshire%20web.pdf>

<sup>33</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/220997/foi\\_240712.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220997/foi_240712.pdf)

<sup>34</sup> <http://www.rte.ie/news/2015/0106/670654-spain-smuggling/>

<sup>35</sup> The Sunday Times, 15 February 2015, "The smoking gun: how cigarettes became the IRA's new weapon"

<sup>36</sup> [https://www.rusi.org/downloads/assets/201412\\_WHR\\_On\\_Tap.pdf](https://www.rusi.org/downloads/assets/201412_WHR_On_Tap.pdf) <sup>37</sup> Page 5.

<sup>38</sup> Page xii.

<sup>39</sup> HMRC Alcohol and Tobacco Quarterly Update. Based on annual aggregation of the most recent available four quarters (October 2013-September 2014).

<sup>40</sup> See Key Facts, at page 4 available at <http://www.nao.org.uk/wp-content/uploads/2013/06/10120-001Tobacco-smuggling-Executive-summary.pdf>

<sup>41</sup> Adult smoking prevalence declined from 20% in 2012, to 19% in 2013, but average consumption increased from 11.7 to 12.1 cigarettes. Based on the most recent data available ONS, Opinions and Lifestyle Survey, Smoking Habits Amongst Adults, 2013 (published 25 November 2014), available at <http://www.ons.gov.uk/ons/rel/ghs/opinions-and-lifestyle-survey/adult-smoking-habits-in-great-britain--2013/stb-opn-smoking-2013.html>

<sup>42</sup> PML calculation of the weighted average price of the FMC market and internal estimate in respect of HRT.

<sup>43</sup> HMRC Tobacco Bulletin (December 2014), available at <https://www.uktradeinfo.com/statistics/pages/taxanddutybulletins.aspx>

<sup>44</sup> HMRC's mid-range estimate was that 10% of the FMC market was illicit in 2013/14 compared to 39% of HRT.

<sup>45</sup> Based on Nielsen data.

<sup>46</sup> Standardised packaging of tobacco products, Impact Assessment (17 June 2014) at para 88 available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/323518/impact\\_assessment.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/323518/impact_assessment.pdf)

<sup>47</sup> "Plain wrong? Here are the facts: cheap smokes are on the rise since plain packaging", *The Australian*, June 18, 2014.

## 2.33 UK Faculty of Public Health

**From:** \_\_\_\_\_  
**Sent:** Tue 17/02/2015 18:20  
**To:** TobaccoLevy  
**RE:** UK Faculty of Public Health - Response to the Tobacco Levy Consultation

Apologies I omitted to mention that we support the response submitted by Action on Smoking and Health!

---

\_\_\_\_\_  
**Senior Policy  
Officer**  
Faculty of Public  
Health

Tel: \_\_\_\_\_  
Fax: \_\_\_\_\_  
Email: \_\_\_\_\_  
Web: [www.fph.org.uk](http://www.fph.org.uk)



**From:** \_\_\_\_\_  
**Sent:** 17 February 2015 18:08  
**To:** 'tobaccolevy@hmtreasury.gsi.gov.uk'  
**Subject:** UK Faculty of Public Health - Response to the Tobacco Levy Consultation

Dear HM Treasury

On behalf of the UK Faculty of Public Health, I am pleased to confirm that FPH supports the response submitted to HM Treasury's consultation seeking views on the potential design for a levy on tobacco manufacturers and importers and possible wider impacts.

Please do not hesitate to contact me should you require any further assistance.

Kind regards

\_\_\_\_\_

## 2.34 Asthma UK

### HM Treasury Consultation

## Tobacco Tax Levy

### Response from Asthma UK

Asthma UK's mission is to stop asthma attacks and cure asthma. We do this by funding world leading research, campaigning to improve the quality of care and supporting people to reduce their risk of a potentially life threatening asthma attack.

**Please note:** This document is informed by a research report for ASH by Howard Reed, Landman Economics, "A UK Tobacco Levy: The options for raising £500 million per year" (January 2015).

### General Observations

1. 1 in 11 people in the UK have asthma, and the health impact of smoking on asthma is enormous: it can cause people to develop asthma, reduces lung function, increases the risk of asthma attacks and can lessen the effectiveness of some asthma medicines (inhaled corticosteroids).<sup>1</sup> Living with a smoker increases the risk of adult-onset asthma, and the risk to children from smoking parents is also considerable. 8 out of 10 people with asthma tell us that smoke triggers their symptoms.<sup>2</sup>
2. We therefore agree with ASH's position - it is essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help fund a comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost no more than £500 million a year, and would include key measures such as:
  - supporting tobacco control measures at regional and local level, for example to fund action against the illicit tobacco trade outside of HMRC;
  - ensuring the provision of high quality Stop Smoking Services across the country; and
  - financing mass media and social marketing campaigns, which add value to other tobacco control initiatives.
3. Again, as ASH proposes, we would also strongly suggest that this portion of the levy be established along similar lines to the US "user fee", so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK's obligation under Article 5.2 of the Framework Convention on Tobacco Control to "establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control".

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<sup>1</sup> Polosa, R., and Thomson, N.C., **Smoking and Asthma: dangerous liaisons**, European Respiratory Journal, 41: 716-726

<sup>2</sup> Asthma UK National Asthma Panel data. Available upon request from Asthma UK.

## Answers to Consultation Questions

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

4. In line with ASH's position, we consider that a levy on tobacco products, with a revenue target per year fixed over five years, is by far the most desirable policy option to raise funds for essential tobacco control and enforcement work. We therefore do not offer any alternative to a levy in this consultation response.
5. 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 such as asthma. 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 stop smoking services, illicit trade enforcement and other evidence-based policy initiatives designed to reduce smoking prevalence.

## 2.35 Rotherham Tobacco Control Alliance

### HM Treasury Consultation

#### Tobacco Tax Levy (closing date 18<sup>th</sup> February 2015)

##### Response from Rotherham Tobacco Control Alliance

Rotherham Tobacco Control Alliance is the multiagency group overseeing tobacco control strategy in the Rotherham borough. The Alliance is managed by Public Health in Rotherham Metropolitan Borough Council. It does not have any direct or indirect links to, or receive funding from, the tobacco industry.

This consultation response is based upon a template response produced by Action on Smoking and Health (ASH) for the Smokefree Action Coalition, of which Rotherham Metropolitan Borough Council is a member

**Please note:** This document is informed by a research report for ASH by Howard Reed, Landman Economics, *"A UK Tobacco Levy: The options for raising £500 million per year"* (January 2015).

#### General Observations

1. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year.<sup>1</sup> This is likely to be an under-estimate as only costs where data is attributable have been included. For example it did not include the cost of collecting smoking-related litter. The following costs are included:
  - £2 billion cost to the NHS of treating diseases caused by smoking
  - £3 billion loss in productivity due to premature death
  - £5 billion cost to businesses of smoking breaks
  - £1 billion cost of smoking-related sick days
  - £1.1 billion of social care costs of older smokers
  - £391 million cost of fires caused by smokers' materials
2. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
3. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>2</sup>

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<sup>1</sup> ASH Ready Reckoner. ASH and LeLan Solutions, Sept. 2014

<sup>2</sup> *ibid*

4. The tobacco industry enjoys massive profit margins in the UK and would be very well able to make more of a contribution.<sup>3</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>4</sup>
5. Fewer than one in five adults now smoke, but smoking prevalence rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. In Rotherham, local estimates of smoking prevalence vary from 15% to nearly 50% between are most and least deprived areas.<sup>5</sup> Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes.<sup>6</sup>
6. Poorer smokers are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>7</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
7. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to increase the rate of quitting tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
8. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:  
*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*  
  
*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*  
  
*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation..."*<sup>8</sup>

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<sup>3</sup> Branston JR and Gilmore A (2014) The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tob control* 23(1):45-50

<sup>4</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

<sup>5</sup> QOF data 2013. [www.gpcontract.co.uk](http://www.gpcontract.co.uk)

<sup>6</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>7</sup> The World Bank. *Curbing the epidemic: governments and the economics of tobacco control*. May, 1999.

<sup>8</sup> [NHS: Five Year Forward View](#) NHS England, October 2014

9. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
10. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short-term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.
11. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
12. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, *"The Health Consequences of Smoking – 50 Years of Progress"*, reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."* The Report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."* <sup>9</sup>
13. In reducing smoking prevalence rates in the UK, an essential role is played by tobacco control measures carried out by local authorities, for example the stop smoking services. The National Centre for Smoking Cessation Training (NCSCT) document *Local Stop Smoking Services: service and delivery guidance 2014* stated that: *"Stop smoking services are extremely cost-effective and form a key part of tobacco control and health inequalities policies at both local and national levels; this should be reflected in effective local commissioning"* <sup>10</sup>
14. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about how many people are being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the

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<sup>9</sup> U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

<sup>10</sup> Local Stop Smoking Services: Service and delivery guidance 2014. Executive Summary page 6. NCSCT 2014

end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services. This figure was down 19 per cent on 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13

15. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs, much of the direct savings they deliver accrue mainly to the NHS and not to the local authorities that have to pay for the services. This point also applies to local action, by trading standards officers and others, to reduce the scale of the illicit tobacco trade. The Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.
16. Although the level of illicit trade has fallen sharply since 2000, it remains unacceptably high and the latest figures from HM Revenue and Customs suggest that it has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>11</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>12</sup> and the House of Commons Home Affairs Select Committee.<sup>13</sup> We strongly supports these recommendations, which include specific recommendations on increasing local and regional action against illicit trade, but these would require financial contributions from local authorities to be implemented.
17. Mass media and social marketing campaigns can also be highly effective in stimulate quitting behaviour, but require significant investment in order to be most effective.<sup>14 15 16</sup>
18. **We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help fund a comprehensive strategy to reduce the harm caused by tobacco. Such a strategy should include key measures such as:**
  - supporting tobacco control measures at regional and local level, for example to fund action against the illicit tobacco trade outside of HMRC
  - ensuring the provision of high quality Stop Smoking Services across the country
  - financing mass media and social marketing campaigns, which add value to other tobacco control initiatives
19. **We would also strongly suggest that this portion of the levy be established along similar lines to the US "user fee", so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence. We believe that**

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<sup>11</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

<sup>12</sup> [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

<sup>13</sup> [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

<sup>14</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>15</sup> Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction*, 107(11), 2043-2050

<sup>16</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun;109(6):986-94.

such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK's obligation under Article 5.2 of the Framework Convention on Tobacco Control to "*establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control*".

20. It should be noted that as of March 31, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education, \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>17</sup>

## Answers to Consultation Questions

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

21. 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?

22. 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.

23. "*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.<sup>18</sup>

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<sup>17</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

<sup>18</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

24. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult, and, crucially, would also the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local consumption and prevalence levels and the consequent harm caused. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>19 20</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a “*unique identifier*” that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.

25. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as ASH suggests, the estimated distribution would be as shown in the table below.

**Suggested allocation of revenue from tobacco levy across the countries of the UK**

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

26 In summary:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.

<sup>19</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>20</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focused on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

27. 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.

28. 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)

29. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams. <sup>21</sup> This is the basis on which ASH has 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?

30. For the reasons stated in paragraphs 16 to 19 above, 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?

31. We support the use of the corporation tax system to collect the levy, as the system that would pose the least administrative burden. It is assumed 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.

32. We are unaware of a plausible alternative means for collecting the levy.

**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?

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<sup>21</sup> 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.

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

33. 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.

34. According to the Department of Health Impact Assessment on standardised packaging<sup>22</sup> (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.”*

35. It is thought 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.

36. The research paper by Howard Reed, Landman Economics, 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<sup>23</sup>. It will be noted that 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 (1.26 pence per stick compared to 1.27 pence per stick). 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.

### Size of tobacco levy required to raise £500 million per year

Results, assuming impact of introducing standardised packaging  
(all figures in pence)

Year	15/16	16/17	17/18	18/19	19/20
Smoking prevalence (%) (adults)	17.3	16.4	16.7	16.2	15.7

#### Scenario (a): No pass through of levy to consumers

Cigarette levy (pence per stick)	1.26	1.31	1.35	1.39	1.43
Cigarette levy (per packet of 20)	25.2	26.2	26.9	27.7	28.5
HRT levy (per gram of tobacco)	1.68	1.75	1.80	1.85	1.90
HRT levy (per 25g packet)	42.0	43.7	44.9	46.2	47.5

#### Scenario (b): Full pass through

Cigarette levy (pence per stick)	1.27	1.33	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.5	26.5	27.3	28.0	28.9
HRT levy (per gram of tobacco)	1.70	1.77	1.82	1.87	1.92
HRT levy (per 25g packet)	42.4	44.2	45.4	46.7	48.1

<sup>22</sup> [Impact assessment: standardised packaging of tobacco products](#): Department of Health June 2014

<sup>23</sup> Howard Reed, Landman Economics, *“A UK Tobacco Levy: The options for raising £500 million per year”* (January 2015).

37. 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):<sup>24</sup>
38. 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.

#### Affordability Index: Tobacco Products

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

39. 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<sup>25</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>26</sup> In subsequent years with new policy measures regularly being introduced and the government’s tobacco control strategy having been updated and improved<sup>27 28</sup>, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.
40. Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products.<sup>4</sup> Imperial’s UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI’s

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<sup>24</sup> Communication with Action on Smoking and Health, 14 January 2015

<sup>25</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

<sup>26</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>27</sup> DH. [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

<sup>28</sup> DH [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

(Gallaher) UK profits or the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>29</sup> It is therefore clear that the tobacco industry could well afford to pay the proposed levy.

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

41. We consider that a levy on tobacco products, with a revenue target per year fixed over five years, is by far the most desirable policy option to raise funds for essential tobacco control and enforcement work. We therefore do not offer any alternative to a levy in this consultation response.
42. 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 stop smoking services, illicit trade enforcement and other evidence-based policy initiatives designed to reduce smoking prevalence.

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<sup>29</sup> BAT Annual Report 2013

## 2.36 Making Smoking History in the North East Partnership



### Response from Making Smoking History in the North East Partnership to the HM Treasury Consultation on a tobacco levy

The Making Smoking History in the North East Partnership ('the Partnership') exists to work collectively towards the long term aim to 'make smoking history for the North East' where tobacco smoking ultimately becomes a thing of the past. Its mission is to maintain and nurture an ongoing broad partnership of organisations and individuals committed to promoting and implementing comprehensive tobacco control measures which reduce smoking prevalence and health inequalities and help to improve health and wellbeing across communities of the North East. The strategic aims of the partnership are to reduce tobacco related harm, to reduce tobacco smoking to a suggested level of below 5% by 2025, to shift the social norms of tobacco use by making it less accessible, affordable and attractive and to centre action around:

- Motivating and supporting smokers to stop
- Reducing uptake of smoking
- Protecting individuals and communities from tobacco related harm

The Partnership acknowledges that whilst the North East has made significant progress in recent years to reduce adult smoking prevalence from 29% in 2005 to 22% in 2013, that smoking remains the key contributor to premature death and disease causing over 5,000 deaths annually. There is a need for further progress and to maintain the short, medium and long term commitment and focus on tobacco control.

The Partnership warmly welcomes the opportunity to respond to this consultation on introducing 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."*<sup>1</sup>. This response is informed by and supports the response submitted by Action on Smoking and Health (ASH). Where appropriate we have used text from the ASH submission. All members of the Partnership endorse this response as listed:

Action on Smoking and Health  
Alex Cunningham MP  
Association of North East Councils  
Councillor Andy Scott, Darlington Council  
Councillor John McClurey, Gateshead Council  
County Durham and Darlington NHS Foundation Trust  
Fresh, the North East comprehensive tobacco control programme  
FUSE Centre for Translational Research  
Ian Mearns MP  
North East Directors of Public Health Network

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<sup>1</sup> HM Treasury Autumn Statement December 2014, paragraph 2.252

North East Environmental Health Group  
North East Trading Standards Association  
NHS England Northern Clinical Network  
Northumberland, Tyne and Wear NHS Trust  
Pat Glass MP  
Public Health England North East Centre Smoke  
Free North East Network  
Trades Union Congress North East.

We are grateful to ASH for their support in developing this response.

## General Observations

1. There is widespread public appetite for more policies to reduce the harm of smoking in society with appetite for these measures having increased over the past few years. In 2014 a survey by YouGov commissioned by Action on Smoking and Health found nearly half of North East adults (43%) believing that not enough is being done to cut the harm of smoking, and another 33% saying the Government is doing about right (this was compared to 2011 when 36% said not enough is being done and another 36% thought the government was doing about right). Only 12% of adults in the North East thought “the Government is doing too much” compared to 22% in 2011 and even amongst smokers in England fewer than half (35%) believed that the government is doing too much.
2. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year<sup>2</sup>. This is likely to be an under-estimate as only costs where data is attributable have been included.
3. In the North East, the conservative cost of smoking is avoidably high at almost £160 million per year, which includes the cost to business through lost productivity and costs to the NHS of treating smokers and those exposed to secondhand smoke but does not include costs borne by other agencies e.g. local authorities who commission stop smoking services, provide regulatory services to support compliance with tobacco-related legislation and street cleaning services to remove litter such as cigarette butts and tobacco packs.
4. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
5. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>3</sup>
6. The tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution.<sup>4</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will

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<sup>2</sup> [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

<sup>3</sup> *ibid*

<sup>4</sup> Branston JR and Gilmore A (2014) The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tob control* 23(1):45-50

have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>5</sup>

7. Fewer than one in five adults now smoke, but smoking rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes<sup>6</sup>, killing one in two of all long-term smokers<sup>7</sup>.
8. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>8</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
9. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to reduce tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
10. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:

*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*

*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*

*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation..."<sup>9</sup>*

11. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy

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<sup>5</sup> Economics of Tobacco Toolkit World Bank 2002

<sup>6</sup> Smoking and Health Inequalities Action on Smoking and Health

<sup>7</sup> Doll R, Peto R, Wheatley K, Gray R, Sutherland I. Mortality in relation to smoking: 40 years observations on male British doctors. British Medical Journal 1994; 309:901-911

<sup>8</sup> The World Bank. Curbing the epidemic: governments and the economics of tobacco control. May, 1999.

<sup>9</sup> NHS: Five Year Forward View NHS England, October 2014

efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.

12. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short-term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.
13. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
14. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, *"The Health Consequences of Smoking – 50 Years of Progress"*, reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."*
15. Similar declines in prevalence have been seen in the North East, North West and South West of England where there is investment at a regional level in comprehensive tobacco control programmes which add value and substantially enhance and amplify efforts and outcomes nationally and locally. Investment at this level ensures that national policies and evidence-based practice are implemented effectively and allows local commissioners to benefit from economies of scale and to reach much greater population numbers<sup>10</sup>. The NICE Tobacco Return on Investment Tool provides evidence that tobacco control delivery is most cost-effective when it is delivered across a bigger geographical footprint at the subnational level<sup>11</sup>.
16. Much more can be achieved if this regional investment is sustained, increased and widened: the US Surgeon General report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."*<sup>12</sup>
17. In reducing the harm from smoking in the UK, an essential role is played by the delivery of tobacco control measures carried out by local authorities, for example the stop smoking services. The Department of Health document *"Local Stop Smoking Services: service delivery*

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<sup>10</sup> Royal College of Physicians and the UK Centre for Tobacco Control Studies: Fifty years since Smoking and health: Progress, lessons and priorities for a smoke-free UK, March 2012

<sup>11</sup> NICE Tobacco return on investment tool v3.03

<sup>12</sup> U.S. Department of Health and Human Services: *The Health Consequences of Smoking: 50 Years of Progress: A Report of the Surgeon General*, Atlanta, GA: U.S. Department of Health and Human Services

and monitoring guidelines 2011-12" stated that: *"Stop smoking services are a key part of tobacco control and health inequalities... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers."*<sup>13</sup>

18. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about the reduction over the last two years in the number of smokers being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13
19. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs much of the direct savings they deliver accrue mainly to the NHS and not by the increasingly cash-strapped local authorities that commission the services. This point also applies to local action, by trading standards officers and others, to regulate the tobacco market and support compliance with legislation. In respect of illicit tobacco, the Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.
20. The level of illicit trade nationally has declined by half since 2000. Regions in England have also seen reductions in the illicit market particularly in the North East, North West and South West, where the three regional comprehensive tobacco control programmes lead the Tackling Illicit Tobacco for Better Health Partnership<sup>14</sup> to reduce the demand for and supply of illegal tobacco. For example in the North East, 15% of tobacco products in 2009 were estimated to be illicit; by 2013 this had dropped to 9%<sup>15</sup>. However, the latest figures from HM Revenue and Customs suggest that nationally the illicit tobacco market has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>16</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>17</sup> and the House of Commons Home Affairs Select Committee.<sup>18</sup> We strongly supports these recommendations, which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.
21. Regular tobacco control mass media and social marketing campaigns alongside increases in the real price of cigarettes are critical for reducing population smoking prevalence, but require

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<sup>13</sup> Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012: Executive Summary page 5 Department of Health 2011

<sup>14</sup> [www.illegal-tobacco.co.uk](http://www.illegal-tobacco.co.uk)

<sup>15</sup> NEMS illicit tobacco survey 2013

<sup>16</sup> HMRC Tobacco Tax Gaps Estimates 2013/14

<sup>17</sup> National Audit Office: Progress in tackling tobacco smuggling. Report published 6 June 2013, and Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling Report published 4th September 2013.

<sup>18</sup> Home Affairs Select Committee: First Report, Tobacco Smuggling. 11th June 2014

significant investment in order to be most effective <sup>19</sup>2021 Higher mass media campaign exposure also appears to confer greater benefit on socioeconomically disadvantaged population subgroups. Studies comparing different media message types have found messages concerning negative health effects most effective at generating increased knowledge, beliefs, higher perceived effectiveness ratings, or quitting behaviour. Evidence for other message types is more mixed. They do, also, perform very well among young people. In contrast, ads dealing with the cosmetic effects of smoking, addiction and athletic performance, have been found to be less effective. However, with funding for national campaigns having reduced substantially over the past five years, it is vital that campaigns as a vital component of effective tobacco control are able to run at national and regional level.

22. We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help supplement existing investment in tobacco control, and ensure that the UK can deliver a genuinely comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost an additional £500 million a year, and would include key measures such as:

- supporting comprehensive tobacco control measures at national, regional and local levels based on the best available evidence
- financing sustained mass media and social marketing campaigns, complemented by other tobacco control initiatives; and
- ensuring and improving the provision of high quality Stop Smoking Services across the country as part of broader tobacco control strategies.

23. We would also strongly suggest that this portion of the levy be established along similar lines to the US manufacturer “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control”.

24. It should be noted that as of 31<sup>st</sup> March, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education, \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>22</sup>

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<sup>19</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>20</sup> Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction*, 107(11), 2043-2050

<sup>21</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun;109(6):986-94.

<sup>22</sup>General Accounting Office reports FDA tobacco user fee spending. Accessed 16 January 2015

## Answers to Consultation Questions

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

25. 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?

26. 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.

27. Forestalling in this context means a temporary increase in the clearance rate of cigarettes and other tobacco products 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 or 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.<sup>23</sup>

28. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult. Crucially it would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local and regional consumption and prevalence levels and the consequent harm caused whilst ensuring cost-effectiveness through delivery across a wider geographical footprint. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>24 25</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a ‘unique identifier’ that

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<sup>23</sup> HM Revenue and Customs: Tobacco Bulletin, August 2014 3 April 2014

<sup>24</sup> EU Revised Tobacco Products Directive 3 April 2014

<sup>25</sup> Protocol to Eliminate Trade in Tobacco Products: World Health Organisation 2013

would allow enforcement authorities to access detailed information about the manufacturing process and intended market.

29. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

**Suggested allocation of revenue from tobacco levy across the countries of the UK**

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

30. In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

31. 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.
32. 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)

33. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>26</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 40 below.

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

34. For the reasons stated in paragraphs 16 to 19 above, 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?

35. We support the use of the corporation tax system to collect the levy, as the system that would pose the least 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.

36. We are unaware of a plausible alternative means for collecting the levy.

**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?

37. 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.

38. According to the Department of Health Impact Assessment on standardised packaging<sup>27</sup> (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.”*

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<sup>26</sup> 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. 27 Impact assessment: standardised packaging of tobacco products: Department of Health June 2014

<sup>27</sup> Impact assessment: standardised packaging of tobacco products: Department of Health June 2014

39. 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.
40. The response from ASH 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, and is based on the research paper written by Howard Reed, Landman Economics. It will be noted that 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 (1.26 pence per stick compared to 1.27 pence per stick). 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.

#### Size of tobacco levy required to raise £500 million per year

Results, assuming impact of introducing standardised packaging (all figures in pence)

Year	15/16	16/17	17/18	18/19	19/20
Smoking prevalence (%) (adults)	17.3	16.4	16.7	16.2	15.7

#### Scenario (a): No pass through of levy to consumers

Cigarette levy (pence per stick)	1.26	1.31	1.35	1.39	1.43
Cigarette levy (per packet of 20)	25.2	26.2	26.9	27.7	28.5
HRT levy (per gram of tobacco)	1.68	1.75	1.80	1.85	1.90
HRT levy (per 25g packet)	42.0	43.7	44.9	46.2	47.5

#### Scenario (b): Full pass through

Cigarette levy (pence per stick)	1.27	1.33	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.5	26.5	27.3	28.0	28.9
HRT levy (per gram of tobacco)	1.70	1.77	1.82	1.87	1.92
HRT levy (per 25g packet)	42.4	44.2	45.4	46.7	48.1

41. 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):<sup>28</sup>
42. 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.

<sup>28</sup> Communication with Action on Smoking and Health, 14 January 2015

## Affordability Index: Tobacco Products

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

43. 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<sup>29</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>30</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved<sup>31 32</sup>, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.
44. Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products.<sup>4</sup> Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits of the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>33</sup> Tobacco is unlike any other product on the market in that it kills half of all long-term users unless they quit. It is therefore clear that the tobacco industry should, and could well afford to, pay the proposed levy.

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

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<sup>29</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

<sup>30</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>31</sup> DH. A smokefree future: a comprehensive tobacco control strategy for England. HM Government. February 2010.

<sup>32</sup> DH Healthy Lives, Healthy People: a tobacco control plan for England. HM Government. March 2011.

<sup>33</sup> BAT Annual Report 2013

45. We anticipate that tobacco multinationals may suggest alternatives to a levy but we would be highly wary of any suggestion that they make a 'contribution' to society other than death and disease on an industrial scale. We would recommend vigilance against any attempts by the tobacco industry to reposition the levy as part of a separate 'corporate social responsibility deal' to enable it to exert influence on government public health policy, in violation of the WHO FCTC Article 5.3. We would also recommend government vigilance against the tobacco industry attempting to influence how this money is spent. Historically, the tobacco industry has sponsored youth prevention programmes to forestall legislation such as smokefree spaces and restrictions on marketing in the US. The 2012 Surgeon General's Report, *Preventing Tobacco Use Among Youth and Young Adults*, concluded "*the tobacco companies' activities and programs for the prevention of youth smoking have not demonstrated an impact on the initiation or prevalence of smoking among young people*<sup>34</sup>." There is evidence these programmes have been ineffective at best and harmful at worst.
46. We consider that a levy on tobacco products, with a revenue target per year fixed over five years, is by far the most desirable policy option. 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 a sufficient proportion of such funds are used to support comprehensive tobacco control delivery which includes evidence-based policy initiatives designed to reduce smoking prevalence. We therefore do not offer any alternative to a levy in this consultation response.

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<sup>34</sup> 2012 US Surgeon General Report

## 2.37 Fresh – Smoke Free North East



### Response from Fresh- Smoke Free North East to the HM Treasury Consultation on a tobacco levy

1. Fresh is the North East of England's comprehensive tobacco control programme, commissioned by all 12 local authorities in the region. Fresh was the UK's first dedicated tobacco control office, set up to tackle the worst smoking rates in England which, in 2005, were 29% amongst the adult population. By 2013 this had dropped to 22%. Fresh works in partnership with the 12 local authority-led tobacco control alliances to deliver comprehensive activity at regional and local levels and to influence action nationally in order to support smokers to quit, prevent young people from starting to smoke and to protect people from tobacco-related harm.
2. Fresh chairs the following North East Forums, all of which endorse this response:  
  
North East Tobacco Control Commissioners Forum  
North East Tobacco Regulation Forum  
Smoke Free North East Network
3. We are grateful to ASH for their support in developing this response.

### General Observations

4. Fresh warmly welcomes the opportunity to respond to this consultation on introducing 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."*<sup>1</sup>
5. There is widespread public appetite for more policies to reduce the harm of smoking in society with appetite for these measures having increased over the past few years. In 2014 a survey by YouGov commissioned by Action on Smoking and Health found nearly half of North East adults (43%) believing that not enough is being done to cut the harm of smoking, and another 33% saying the Government is doing about right (this was compared to 2011 when 36% said not enough is being done and another 36% thought the government was doing about right). Only 12% of adults in the North East thought "the Government is doing too much" compared to 22% in 2011 and even amongst smokers in England fewer than half (35%) believed that the government is doing too much.
6. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year<sup>2</sup>. This is likely to be an under-estimate as only costs where data is attributable have been included.

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<sup>1</sup> HM Treasury Autumn Statement December 2014, paragraph 2.252

<sup>2</sup> [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

7. In the North East, the conservative cost of smoking is avoidably high at almost £160 million per year, which includes the cost to business through lost productivity and costs to the NHS of treating smokers and those exposed to secondhand smoke but does not include costs borne by other agencies e.g. local authorities who commission stop smoking services, provide regulatory services to support compliance with tobacco-related legislation and street cleaning services to remove litter such as cigarette butts and tobacco packs.
8. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
9. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>3</sup>
10. The tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution.<sup>4</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>5</sup>
11. Fewer than one in five adults now smoke, but smoking rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes<sup>6</sup>, killing one in two of all long-term smokers<sup>7</sup>.
12. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>8</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
13. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to reduce tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers, but vital if the societal

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<sup>3</sup> *ibid*

<sup>4</sup> Branston JR and Gilmore A (2014) The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tob control* 23(1):45-50

<sup>5</sup> Economics of Tobacco Toolkit World Bank 2002

<sup>6</sup> Smoking and Health Inequalities Action on Smoking and Health

<sup>7</sup> Doll R, Peto R, Wheatley K, Gray R, Sutherland I. Mortality in relation to smoking: 40 years observations on male British doctors. *British Medical Journal* 1994; 309:901-911

<sup>8</sup> The World Bank. *Curbing the epidemic: governments and the economics of tobacco control*. May, 1999.

harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.

14. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:

*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*

*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*

*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation..."<sup>9</sup>*

15. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
16. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the shortterm, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.
17. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
18. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US

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<sup>9</sup> NHS: Five Year Forward View NHS England, October 2014

Surgeon General Report, *"The Health Consequences of Smoking – 50 Years of Progress"*, reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."*

19. Similar declines in prevalence have been seen in the North East, North West and South West of England where there is investment at a regional level in comprehensive tobacco control programmes which add value and substantially enhance and amplify efforts and outcomes nationally and locally. Investment at this level ensures that national policies and evidence-based practice are implemented effectively and allows local commissioners to benefit from economies of scale and to reach much greater population numbers<sup>10</sup>. The NICE Tobacco Return on Investment Tool provides evidence that tobacco control delivery is most cost-effective when it is delivered across a bigger geographical footprint at the subnational level<sup>11</sup>.
20. Much more can be achieved if this regional investment is sustained, increased and widened: the US Surgeon General report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."*<sup>12</sup>
21. In reducing the harm from smoking in the UK, an essential role is played by the delivery of tobacco control measures carried out by local authorities, for example the stop smoking services. The Department of Health document *"Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12"* stated that: *"Stop smoking services are a key part of tobacco control and health inequalities... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers."*<sup>13</sup>
22. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about the reduction over the last two years in the number of smokers being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13
23. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs much of the direct savings they deliver accrue mainly to the NHS and not by the increasingly cash-strapped local authorities that commission the services. This point also applies to local action, by trading standards officers and others, to regulate the tobacco market and support compliance with legislation. In

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<sup>10</sup> Royal College of Physicians and the UK Centre for Tobacco Control Studies: Fifty years since Smoking and health: Progress, lessons and priorities for a smoke-free UK, March 2012

<sup>11</sup> NICE Tobacco return on investment tool v3.03

<sup>12</sup> U.S. Department of Health and Human Services: *The Health Consequences of Smoking: 50 Years of Progress: A Report of the Surgeon General*, Atlanta, GA: U.S. Department of Health and Human Services

<sup>13</sup> *Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012: Executive Summary* page 5 Department of Health 2011

respect of illicit tobacco, the Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.

24. The level of illicit trade nationally has declined by half since 2000. Regions in England have also seen reductions in the illicit market particularly in the North East, North West and South West, where the three regional comprehensive tobacco control programmes lead the Tackling Illicit Tobacco for Better Health Partnership<sup>14</sup> to reduce the demand for and supply of illegal tobacco. For example in the North East, 15% of tobacco products in 2009 were estimated to be illicit; by 2013 this had dropped to 9%<sup>15</sup>. However, the latest figures from HM Revenue and Customs suggest that nationally the illicit tobacco market has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>16</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>17</sup> and the House of Commons Home Affairs Select Committee.<sup>18</sup> Fresh strongly supports these recommendations, which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.
25. Regular tobacco control mass media and social marketing campaigns alongside increases in the real price of cigarettes are critical for reducing population smoking prevalence, but require significant investment in order to be most effective<sup>19,20,21</sup>. Higher mass media campaign exposure also appears to confer greater benefit on socioeconomically disadvantaged population subgroups. Studies comparing different media message types have found messages concerning negative health effects most effective at generating increased knowledge, beliefs, higher perceived effectiveness ratings, or quitting behaviour. Evidence for other message types is more mixed. They do, also, perform very well among young people. In contrast, ads dealing with the cosmetic effects of smoking, addiction and athletic performance, have been found to be less effective. However, with funding for national campaigns having reduced substantially over the past five years, it is vital that campaigns as a vital component of effective tobacco control are able to run at national and regional level.
26. We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help supplement existing investment in tobacco control, and ensure that the UK can deliver a genuinely comprehensive strategy to reduce the harm caused by tobacco. Such a

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<sup>14</sup> [www.illegal-tobacco.co.uk](http://www.illegal-tobacco.co.uk)

<sup>15</sup> NEMS illicit tobacco survey 2013

<sup>16</sup> HMRC Tobacco Tax Gaps Estimates 2013/14

<sup>17</sup> National Audit Office: Progress in tackling tobacco smuggling. Report published 6 June 2013, and Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling Report published 4th September 2013.

<sup>18</sup> Home Affairs Select Committee: First Report, Tobacco Smuggling. 11th June 2014

<sup>19</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>20</sup> Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction*, 107(11), 2043-2050

<sup>21</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun;109(6):986-94.

strategy, at a rough estimate, would cost an additional £500 million a year, and would include key measures such as:

- supporting comprehensive tobacco control measures at national, regional and local levels based on the best available evidence
- financing sustained mass media and social marketing campaigns, complemented by other tobacco control initiatives; and
- ensuring and improving the provision of high quality Stop Smoking Services across the country as part of broader tobacco control strategies.

27. We would also strongly suggest that this portion of the levy be established along similar lines to the US manufacturer “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “*establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control*”.

28. It should be noted that as of 31<sup>st</sup> March, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education, \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>22</sup>

## Answers to Consultation Questions

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

29. 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?

30. 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.

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<sup>22</sup> General Accounting Office reports FDA tobacco user fee spending. Accessed 16 January 2015

31. Forestalling in this context means a temporary increase in the clearance rate of cigarettes and other tobacco products 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 or 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.<sup>23</sup>

32. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult. Crucially it would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local and regional consumption and prevalence levels and the consequent harm caused whilst ensuring cost-effectiveness through delivery across a wider geographical footprint. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>2425</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a ‘unique identifier’ that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.

33. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

**Suggested allocation of revenue from tobacco levy across the countries of the UK**

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8

<sup>23</sup> HM Revenue and Customs: Tobacco Bulletin, August 2014

<sup>24</sup> EU Revised Tobacco Products Directive 3 April 2014

<sup>25</sup> Protocol to Eliminate Trade in Tobacco Products: World Health Organisation 2013

TOTAL	100.0	500.0
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**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

34. In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

35. 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.

36. 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)

37. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>26</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 40 below.

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

38. For the reasons stated in paragraphs 16 to 19 above, 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?

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<sup>26</sup> 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.

39. We support the use of the corporation tax system to collect the levy, as the system that would pose the least 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.

40. We are unaware of a plausible alternative means for collecting the levy.

**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?

41. 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.

42. According to the Department of Health Impact Assessment on standardised packaging <sup>27</sup> (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.”*

43. 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.

44. The response from ASH 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, and is based on the research paper written by Howard Reed, Landman Economics. It will be noted that 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 (1.26 pence per stick compared to 1.27 pence per stick). 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.

#### **Size of tobacco levy required to raise £500 million per year**

Results, assuming impact of introducing standardised packaging (all figures in pence)

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<sup>27</sup> Impact assessment: standardised packaging of tobacco products: Department of Health June 2014

Year	15/16	16/17	17/18	18/19	19/20
Smoking prevalence (%) (adults)	17.3	16.4	16.7	16.2	15.7

**Scenario (a): No pass through of levy to consumers**

Cigarette levy (pence per stick)	1.26	1.31	1.35	1.39	1.43
Cigarette levy (per packet of 20)	25.2	26.2	26.9	27.7	28.5
HRT levy (per gram of tobacco)	1.68	1.75	1.80	1.85	1.90
HRT levy (per 25g packet)	42.0	43.7	44.9	46.2	47.5

**Scenario (b): Full pass through**

Cigarette levy (pence per stick)	1.27	1.33	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.5	26.5	27.3	28.0	28.9
HRT levy (per gram of tobacco)	1.70	1.77	1.82	1.87	1.92
HRT levy (per 25g packet)	42.4	44.2	45.4	46.7	48.1

45. 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):<sup>28</sup>

46. 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.

**Affordability Index: Tobacco Products**

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

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<sup>28</sup> Communication with Action on Smoking and Health, 14 January 2015

47. 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<sup>29</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>30</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved<sup>31 32</sup>, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.
48. Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products.<sup>4</sup> Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits of the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>33</sup> Tobacco is unlike any other product on the market in that it kills half of all long-term users unless they quit. It is therefore clear that the tobacco industry should, and could well afford to, pay the proposed levy.

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

49. We anticipate that tobacco multinationals may suggest alternatives to a levy but we would be highly wary of any suggestion that they make a 'contribution' to society other than death and disease on an industrial scale. We would recommend vigilance against any attempts by the tobacco industry to reposition the levy as part of a separate 'corporate social responsibility deal' to enable it to exert influence on government public health policy, in violation of the WHO FCTC Article 5.3. We would also recommend government vigilance against the tobacco industry attempting to influence how this money is spent. Historically, the tobacco industry has sponsored youth prevention programmes to forestall legislation such as smokefree spaces and restrictions on marketing in the US. The 2012 Surgeon General's Report, *Preventing Tobacco Use Among Youth and Young Adults*, concluded "*the tobacco companies' activities and programs for the prevention of youth smoking have not demonstrated an impact on the initiation or prevalence of smoking among young people*<sup>34</sup>." There is evidence these programmes have been ineffective at best and harmful at worst.

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<sup>29</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

<sup>30</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>31</sup> DH. A smokefree future: a comprehensive tobacco control strategy for England. HM Government. February 2010.

<sup>32</sup> DH Healthy Lives, Healthy People: a tobacco control plan for England. HM Government. March 2011.

<sup>33</sup> BAT Annual Report 2013

<sup>34</sup> 2012 US Surgeon General Report

50. We consider that a levy on tobacco products, with a revenue target per year fixed over five years, is by far the most desirable policy option. 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 a sufficient proportion of such funds are used to support comprehensive tobacco control delivery which includes evidence-based policy initiatives designed to reduce smoking prevalence. We therefore do not offer any alternative to a levy in this consultation response.



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From The Registrar

(Email) \_\_\_\_\_

18 February 2015

Dear Sir or Madam

**Re: Tobacco levy consultation**

The Royal College of Physicians (RCP) plays a leading role in the delivery of high quality patient care by setting standards of medical practice and promoting clinical excellence. We provide physicians in the United Kingdom and overseas with education, training and support throughout their careers. As an independent body representing over 30,000 Fellows and Members worldwide, we advise and work with government, the public, patients and other professions to improve health and healthcare.

The RCP is grateful for the opportunity to respond to the above consultation. Tobacco smoking is a highly addictive and lethal behaviour which, since the early 20th century, has become the largest avoidable cause of premature death and disability in our society. Despite marked reductions in smoking prevalence over recent decades smoking still causes around 100,000 or one in six deaths in UK adults [1], around 5000 fetal deaths, 40 cot deaths and over 160,000 new cases of childhood illness in the UK each year [2]. Being particularly prevalent among the most disadvantaged in society [3;4], smoking is also the largest avoidable cause of social inequalities in health [5]. For these reasons alone, preventing smoking should be the highest health priority in the UK. Our responses to the questions posed are as follow:

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

Yes.

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

Use of the previous year's clearances would appear to provide a reliable estimate of the licit market

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

No

**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?**

Hand-rolling tobacco (and loose pipe tobacco) provide smokers with much less expensive alternatives to manufactured cigarettes, and hence undermine the effects of tobacco price rises on smoking prevalence. We support splitting the market if it allows a differential levy to reduce the cost discrepancies between these two product categories.

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

We have no preference.

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

Yes.

**Question 7: What are the alternative approaches?**

We are not expert in the collection of tax or other financial levy and hence make no comment

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

We would expect that the cost of the levy to be passed, in substantial part if not completely, on to consumers. If the levy is large enough, it may force substantial price rises in the least expensive cigarettes and hence encourage smokers to quit. This effect on smoking prevalence will be enhanced if the levy is also used to reduce the price differential between manufactured and hand-rolled cigarettes.

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

Price rises will encourage existing smokers to quit, and discourage young people from starting to smoke.

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

Price rises caused by the levy would make alternative nicotine sources, including licensed over-the-counter medicines and electronic cigarettes, relatively more affordable, and hence promote

switching to these less hazardous products among smokers who are unable or unwilling to stop using nicotine. This will enhance the public health gains achieved by the levy.

**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 think it highly unlikely that the costs of the levy will be passed to consumers to the extent that the market will bear. We see no advantage in this respect from adopting alternative levy or tax structures.

The RCP therefore supports the levy, with the key proviso that the proceeds of the levy should be used to help smokers quit. Tobacco smoking is powerfully addictive, and many smokers find it extremely difficult to quit smoking. Raising the cost of smoking encourages smokers, and particularly the most price-conscious smokers to quit. However price rises also exacerbate poverty and deprivation among smokers, and the dependents of smokers, who find themselves unable to quit. For moral as well as health and wellbeing reasons it is therefore essential that income raised from the tobacco levy is used directly to improve the support available for all smokers, and particularly those on low incomes, to help them to stop smoking.

Yours faithfully

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Registrar

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*From the Office of the President*

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16 February 2015

Tobacco Levy Consultation  
VAT and Excise  
HM Treasury  
1 Horse Guards Road  
LONDON  
SW1A 2HQ

By email: [tobaccolevy@hmtreasury.gsi.gov.uk](mailto:tobaccolevy@hmtreasury.gsi.gov.uk)

Dear Sir/Madam

**Tobacco Levy Consultation**

I enclose a copy of the response from Action on Smoking and Health (ASH) to the aforementioned consultation.

The College is in full support of ASH's response to this consultation, and has no additional comments to make.

With kind regards,

Yours faithfully

\_\_\_\_\_  
President  
(Email) \_\_\_\_\_

Enc

## 2.40 SICPA

From: \_\_\_\_\_

Sent: 17 February 2015 13:47

To: TobaccoLevy

Subject: Input to the Government consultation on the introduction of a tobacco levy: deadline 18 February

Dear Sir/Madam

In the Government consultation regarding the imposition of a levy on tobacco companies, question 11 asks for **views on alternatives**.

We would like to suggest that any package of measures should include the **introduction of much tighter controls on the supply chain activities of the tobacco industry** and that, in accordance with WHO FCTC principles, this be **fully funded by the tobacco industry**. A package could have numerous elements, but should include the introduction of an **independently supplied Track and Trace system** for tobacco products. Such a system, provided it was fully controlled by Government and did not rely on tobacco industry controlled data (which would be difficult for Government to exploit) nor on a tobacco industry designed system, such as Codentify (which would likely have different objectives based on industry interests), would:

- **Support HMG's fight against illicit trade**, thus increasing overall excise tax revenue and improving the efficiency of tax as a tool for Health policy. An effective system would allow further increases in tax rates without corresponding increases in illicit trade. This could include changes to the structure of taxes to e.g. increase the tax on lower brand cigarettes – a version of minimum pricing/minimum excise tax which would benefit the Exchequer rather than the tobacco companies (countering the negative impact of '*trading down*' which may accompany the introduction of plain packs). It would have beneficial effects not only on fighting *contraband* and *counterfeit* product (which are likely to rise as a problem if plain packs are introduced) but could also support the fight against *illicit whites*.
- **Not represent an incentive for tobacco companies to tax optimize and move their profits overseas out of reach to HMG** (which could be the result of some forms of levy)
- **Ensure the UK meets the requirements of the WHO FCTC Protocol to Eliminate the Illicit Trade in Tobacco Products** which the UK signed in December 2013. In its Article 8 the Protocol requires the introduction of a T&T system under the full control of the signatory Parties i.e. HMG.

### Declaration of interests:

SICPA is a privately owned company. A global leader in the production and supply of high security inks, SICPA is also a supplier of authentication and supply chain security solutions. These solutions include the SICPATRACE® platform which has been implemented at the behest of Government in a number of countries as a means of securing excise tax receipts and combatting illicit trade in a range of goods including cigarettes and tobacco products. SICPA is independent of the tobacco industry.

Yours faithfully

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Director Corporate Affairs

SICPA UK

Tel:

[www.sicpa.com](http://www.sicpa.com)

### Alternatives to the levy

**3.8** The government believes it is right that tobacco manufacturers and importers make a greater contribution to the societal costs of smoking.

**3.9** An alternative option to ensure tobacco manufacturers and importers make a greater contribution would be to change their tobacco duty liabilities, but experience suggests that a duty rise would be passed on in full to consumers, meaning the tobacco manufacturers and importers would not bear the costs themselves. **9**

**3.10** There has recently been a consultation on the introduction of a minimum excise tax. The government is still considering responses received and will respond in due course.

**3.11** Another alternative to the levy could be a corporation tax surcharge. A corporation tax surcharge would be more complex to design and operate. This complexity could lead to additional administration and compliance costs for HMRC and additional burdens for taxpayers.

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

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## 2.41 Stockton Borough Council

### HM Treasury Consultation on a tobacco levy – response on behalf of Stockton Borough Council (SBC)

#### General Observations

1. SBC warmly welcomes the opportunity to respond to this consultation on introducing 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."
2. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
3. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.
4. The tobacco industry enjoys massive profit margins in the UK and would be very well able to make more of a contribution. And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.
5. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level. However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
6. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to reduce tobacco use, and prevent uptake among young people, over

and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.

7. We also consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help supplement existing investment in tobacco control, and ensure that the UK can deliver a genuinely comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost an additional £500 million a year, and would include key measures such as:
  - supporting comprehensive tobacco control measures at national, regional and local levels based on the best available evidence
  - financing sustained mass media and social marketing campaigns, complemented by other tobacco control initiatives; and
  - ensuring and improving the provision of high quality Stop Smoking Services across the country as part of broader tobacco control strategies.

## Answers to Consultation Questions

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

8. 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?

9. 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.
10. Forestalling in this context means a temporary increase in the clearance rate of cigarettes and other tobacco products 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 or 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.

11. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult. Crucially it would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local and regional consumption and prevalence levels and the consequent harm caused whilst ensuring cost-effectiveness through delivery across a wider geographical footprint. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol. For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a ‘unique identifier’ that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.
12. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

#### Suggested allocation of revenue from tobacco levy across the countries of the UK

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

13. 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.

14. 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)

15. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams. (Illicit cigarettes and hand-rolled tobacco in 18 European countries: a cross-sectional survey [Tobacco Control, Online First. \(Joossens L and et al, 2012\)](#))

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

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

17. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult.

**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?

18. We support the use of the corporation tax system to collect the levy, as the system that would pose the least 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.

19. We are unaware of a plausible alternative means for collecting the levy.

**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?

20. 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.

21. According to the Department of Health Impact Assessment on standardised packaging (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.”*

22. 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.

23. The response from ASH 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, and is based on the research paper written by Howard Reed, Landman Economics. It will be noted that 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 (1.26 pence per stick compared to 1.27 pence per stick). 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.

## Size of tobacco levy required to raise £500 million per year

Results, assuming impact of introducing standardised packaging  
(all figures in pence)

Year	15/16	16/17	17/18	18/19	19/20
Smoking prevalence (%) (adults)	17.3	16.4	16.7	16.2	15.7
<b>Scenario (a): No pass through of levy to consumers</b>					
Cigarette levy (pence per stick)	1.26	1.31	1.35	1.39	1.43
Cigarette levy (per packet of 20)	25.2	26.2	26.9	27.7	28.5
HRT levy (per gram of tobacco)	1.68	1.75	1.80	1.85	1.90
HRT levy (per 25g packet)	42.0	43.7	44.9	46.2	47.5
<b>Scenario (b): Full pass through</b>					
Cigarette levy (pence per stick)	1.27	1.33	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.5	26.5	27.3	28.0	28.9
HRT levy (per gram of tobacco)	1.70	1.77	1.82	1.87	1.92
HRT levy (per 25g packet)	42.4	44.2	45.4	46.7	48.1

24. 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):

25. 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.

### Affordability Index: Tobacco Products

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

26. 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%. In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.
27. Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products.<sup>4</sup> Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits for the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012. Tobacco is unlike any other product on the market in that it kills half of all long-term users unless they quit. It is therefore clear that the tobacco industry should, and could well afford to, pay the proposed levy.

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

28. We anticipate that tobacco multinationals may suggest alternatives to a levy but we would be highly wary of any suggestion that they make a 'contribution' to society other than death and disease on an industrial scale. We would recommend vigilance against any attempts by the tobacco industry to reposition the levy as part of a separate 'corporate social responsibility deal' to enable it to exert influence on government public health policy, in violation of the WHO FCTC Article 5.3. We would also recommend government vigilance against the tobacco industry attempting to influence how this money is spent. Historically, the tobacco industry has sponsored youth prevention programmes to forestall legislation such as smokefree spaces and restrictions on marketing in the US. The 2012 Surgeon General's Report, *Preventing Tobacco Use Among Youth and Young Adults*, concluded "*the tobacco companies' activities and programs for the prevention of youth smoking have not demonstrated an impact on the initiation or prevalence of smoking among young people.*" There is evidence these programmes have been ineffective at best and harmful at worst.
29. We consider that a levy on tobacco products, with a revenue target per year fixed over five years is by far the most desirable policy option. 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 a sufficient proportion of such funds are used to support comprehensive tobacco control delivery which includes evidence-based policy initiatives designed to reduce smoking prevalence. We therefore do not offer any alternative to a levy in this consultation response.

## 2.42 Stoke on Trent City Council

### HM Treasury Consultation

#### Tobacco Tax Levy

##### Response from Stoke on Trent city council

This response has been drafted by the Public Health Directorate on behalf of Stoke on Trent city council. The response is endorsed by the following people:

- \_\_\_\_\_, Director of Public Health
- \_\_\_\_\_, Cabinet Member for Health and Wellbeing

### Background

- Stoke on Trent city council was pleased to hear of the Chancellor's announcement in the Autumn Statement that the Government is considering introducing 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."*<sup>1</sup>
- Smoking causes more deaths locally than the next six most common causes of preventable death combined (i.e. drug use, road accidents, other accidents and falls, preventable diabetes, suicide and alcohol abuse), and about half of all smokers will eventually be killed by their addiction<sup>2</sup>.
- Smoking remains the single biggest preventable cause of disease and premature death in Stoke-on-Trent, with around half of the health inequalities between rich and poor resulting from smoking. Smoking prevalence in Stoke-on-Trent is 28%, significantly worse than the England average of 19.5%, which equates to around 54,000 adult smokers across the city.
- Local rates of smoking in pregnancy<sup>3</sup> are also high at 19% (compared to the England average of 12%), and 24% of young people are exposed to harmful secondhand smoke in their homes (9% in their own bedrooms)<sup>4</sup>.
- In addition to causing significant harm to health, high rates of smoking locally also leads to high rates of cigarette related fires, cigarette litter and a significant financial impact on the local economy. Each year in Stoke-on-Trent it is estimated that smoking costs society approximately £80 million, including around £42 million to local business in lost productivity from smoking breaks and smoking-related sickness absence, and £3 million for clearing cigarette related litter.

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<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

<sup>2</sup> ASH (2013) *Smoking and Disease: Facts at a Glance* available [online] at [http://www.ash.org.uk/files/documents/ASH\\_94.pdf](http://www.ash.org.uk/files/documents/ASH_94.pdf)

<sup>3</sup> Indicator is 'smoking at time of delivery'

<sup>4</sup> Stoke on Trent City Council (2013) *Stoke on Trent Young People's Lifestyle Survey 2013*. [Internal document, unpublished].

- Smoking rates are much higher among poorer people, and tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes.<sup>5</sup>
- Poorer smokers are more sensitive to price increases and therefore likely to quit if tobacco prices are raised through taxation. However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
- The benefits of a tobacco tax levy, therefore, will only be fully realised if a proportionate amount of the proceeds are used to fund tobacco control activity (to support cessation and prevention) over and above what might be expected as a result of any price rises.
- A similar system to the proposed tobacco tax levy is already in place in the UK: the Energy Company Obligation (ECO). This places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households, to reduce the legal pollution caused by its everyday business. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.<sup>6</sup>
- In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.<sup>7</sup>
- It could be argued, therefore, that the UK Energy Company Obligation and the American tobacco levy provide strong evidence of the opportunities available for a tobacco tax levy in the UK in that the considerable profits of the tobacco industry could be used to reduce the demand for tobacco products.
- Following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, robust and effective tobacco control activity is increasingly vulnerable because of the significant budget reductions that local authorities now face.
- 'Upstream' tobacco control activity at this level, as opposed to solely focusing on treatment of smoking-related ill health, is vital to prevent and reduce the long term burden of tobacco on the NHS, local economic prosperity and the demand for social care.
- Stoke on Trent city council therefore consider it essential that a tax levy be applied to the tobacco industry but recommend that this **must be accompanied by strict criteria which outline an appropriate proportion of the proceeds to be used to fund a comprehensive strategy to reduce the harm caused by tobacco.**

## Answers to Consultation Questions

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<sup>5</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>6</sup> Summarised from ASH (2015) *ASH Tobacco Tax Levy Consultation Response*.

<sup>7</sup> Summarised from ASH (2015) *ASH Tobacco Tax Levy Consultation Response*.

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

**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?

Stoke on Trent city council would recommend that proceeds of the levy were to be spent on tobacco control and enforcement, and distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need. To achieve this, proceeds of the levy should be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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.<sup>8</sup>

**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?

Stoke on Trent city council support the use of the corporation tax system to collect the levy, as the system that would pose the least 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.

We are unaware of a plausible alternative means for collecting the levy.

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

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<sup>8</sup> Summarised from ASH (2015) *ASH Tobacco Tax Levy Consultation Response*

The impact on consumer price will depend on the proportion of the levy that manufacturers decide to pass on to the consumer.

While it is difficult to predict what this proportion will be, research conducted by Howard Reed from Landman Economics on behalf of ASH shows that 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 (1.26 pence per stick compared to 1.27 pence per stick).

Furthermore, calculations carried out by Professor Joy Townsend of the Department of Social and Environmental Health Research at the London School of Hygiene and Tropical Medicine suggest 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.<sup>9</sup>

As mentioned previously in this document, price increases are known to be an effective policy lever in reducing smoking rates. Therefore the impact of any retail price increases seen as a result of the levy are likely to serve to increase the reduce prevalence, as long as they are accompanied by a comprehensive tobacco control strategy.

**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?

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

Stoke on Trent city council do not consider that there is a suitable or more appropriate alternative to a tobacco tax levy. The huge burden of death and ill health caused by smoking in this country must be tackled through comprehensive and effective tobacco control activity, and the most appropriate source of funding for this activity is to raise additional capital from large and highly profitable tobacco manufacturers.

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<sup>9</sup> Summarised from ASH (2015) *ASH Tobacco Tax Levy Consultation Response*.

## 2.43 Action on Smoking and Health

### HM Treasury Consultation

#### Tobacco Tax Levy (closing date 18<sup>th</sup> February 2015)

##### Response from Action on Smoking and Health

ASH (UK) is a health charity set up by the Royal College of Physicians in 1971 working towards the elimination of harm caused by tobacco. ASH receives core funding from the British Heart Foundation and Cancer Research UK and has received project funding for work to support government tobacco strategy for England from the Department of Health. ASH does not have any direct or indirect links to, or receive funding from, the tobacco industry.

**Please note:** This document is informed by two additional supporting reports. A research report for ASH by Howard Reed, Landman Economics, *"A UK Tobacco Levy: The options for raising £500 million per year"* (January 2015), and a report on *"The Extreme Profitability of the UK Tobacco Market"*, by Branston and Gilmore, copies of which are attached.

##### General Observations

###### Summary

1. ASH 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."*<sup>1</sup>
2. Tobacco manufacturers and importers in the UK are immensely profitable, such that it could certainly afford to make a greater contribution. Recent research by Branston and Gilmore at the University of Bath suggests that in the UK 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.
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.<sup>2</sup> 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.

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<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

<sup>2</sup> EU Tobacco Tax Directive Article 15.

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 which would enable the introduction of a price capping mechanism. Placing a cap on industry profit 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.<sup>3</sup>

## Background

6. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year.<sup>4</sup> This is likely to be an under-estimate as only costs where data is attributable have been included. For example it did not include the cost of collecting smoking-related litter. The following costs are included:
  - £2 billion cost to the NHS of treating diseases caused by smoking
  - £3 billion loss in productivity due to premature death
  - £5 billion cost to businesses of smoking breaks
  - £1 billion cost of smoking-related sick days
  - £1.1 billion of social care costs of older smokers
  - £391 million cost of fires caused by smokers' materials
7. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
8. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated Fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>5</sup>
9. The tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution.<sup>3 6</sup> And, of course they may well decide to pass on to

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<sup>3</sup> 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

<sup>4</sup> [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

<sup>5</sup> *ibid*

<sup>6</sup> Branston JR and Gilmore A. The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. Tobacco Control 2014; 23(1): 45-50

consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but in 2002 the World Bank estimated that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>7</sup> A comprehensive review of the literature published since this date by IARC in 2011 concludes that based on aggregate demand studies, price elasticity remains around -0.4 in high income countries including the UK.<sup>8</sup>

10. There is widespread support in England for the idea of putting the equivalent in today's prices of 25 pence on a packet of cigarettes with the funds being used to fund tobacco control; 78% of the adult population is in favour of the idea including 54% of those in Social Grade E ('unemployed, on state benefit and lowest grade workers') who had smoked in the past year and 52% of these who were smoking at the time of the survey.<sup>9</sup> This could raise around £500 million (see table 1 below). Similar support is found in surveys across Europe.<sup>10</sup>
11. Fewer than one in five adults now smoke, but smoking prevalence rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes.<sup>11</sup>
12. Poorer smokers are more sensitive to price increases than better off smokers. So, increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>12</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
13. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to increase the rate of quitting tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers and popular both with smokers and the general public, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
14. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:  
*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*

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<sup>7</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

<sup>8</sup> International Agency for Research on Cancer. IARC Handbooks of Cancer Prevention. Tobacco Control Volume 14. Effectiveness of Tax and Price Policies for Tobacco Control. Lyons: IARC, 2011

<sup>9</sup> West R. Public support for a tobacco levy. Smoking Toolkit Study. 2006

<sup>10</sup> [Policy Recommendations for Tobacco Taxation in the European Union. Integrated research findings from the PPACTE project.](#) 2012

<sup>11</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>12</sup> The World Bank. Curbing the epidemic: governments and the economics of tobacco control. May, 1999.

*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*

*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation...”<sup>13</sup>*

15. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
16. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the shortterm, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products. However, in line with our obligations as a party to the WHO FCTC and in particular Article 5.3, the tobacco industry could have no control over this money, or how it should be allocated.<sup>14</sup>
17. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity.<sup>15</sup> This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
18. International evidence shows that public investment in policies designed to reduce smoking prevalence is likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, "The Health Consequences of Smoking – 50 Years of Progress", reports that "States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased." The Report also finds that long term investment is critical.

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<sup>13</sup> [NHS: Five Year Forward View](#) NHS England, October 2014

<sup>14</sup> WHO FCTC. Article 5.3 guidelines.

<sup>15</sup> [Family Smoking Prevention and Tobacco Control and Federal Retirement Reform](#). 123 Stat. 1776 Public Law 111–31—June 22, 2009. Section 919 user fees.

It states, "Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."<sup>16</sup>

19. In reducing smoking prevalence rates in the UK, an essential role is played by tobacco control measures carried out by local authorities, for example the stop smoking services. The Department of Health document "Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12" stated that: "Stop smoking services are a key part of tobacco control and health inequalities ... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers."<sup>17</sup>
20. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about how many people are being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13.
21. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs, much of the direct savings they deliver accrue mainly to the NHS and not by the increasingly cash-strapped local authorities that have to pay for the services. This point also applies to local action by trading standards officers and others to reduce the scale of the illicit tobacco trade. The Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.
22. Although the level of illicit trade has fallen sharply since 2000, it remains unacceptably high and the latest figures from HM Revenue and Customs suggest that it has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>18</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>19</sup> and the House of Commons Home Affairs Select Committee.<sup>20</sup> ASH strongly supports these recommendations which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.

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<sup>16</sup> U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

<sup>17</sup> [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

<sup>18</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

<sup>19</sup> [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

<sup>20</sup> [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

23. Mass media and social marketing campaigns can also be highly effective in stimulating quitting behaviour but require significant investment in order to be most effective.<sup>21 22 23</sup>
24. We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help fund a comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost no more than £500 million a year, and would include key measures such as:
- supporting tobacco control measures at regional and local level, for example to fund action against the illicit tobacco trade outside of HMRC;
  - ensuring the provision of high quality Stop Smoking Services across the country; and
  - financing mass media and social marketing campaigns, which add value to other tobacco control initiatives.
25. We would also strongly suggest that this portion of the levy be established along similar lines to the US “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence, completely independent from any influence by the tobacco industry. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control”.
26. It should be noted that as of 31<sup>st</sup> March 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education and \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>24</sup>

## Answers to Consultation Questions

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

27. 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.

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<sup>21</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>22</sup> Langley T, McNeill A, Lewis S, Szatkowski L, Quinn C. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction* 2012;107(11): 2043-2050

<sup>23</sup> Sims M, Salway R, Langley T, Lewis S, McNeill A, Szatkowski L, Gilmore A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014; 109(6): 986-94.

<sup>24</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

**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?

28. 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.

29. “*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.<sup>25</sup>

30. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes and prices by brands, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult, and, crucially, would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local consumption and prevalence levels and the consequent harm caused. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>26 27</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a “*unique identifier*” that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.

31. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

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<sup>25</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

<sup>26</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>27</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

**Table 1: Suggested allocation of revenue from tobacco levy across the countries of the UK**

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from 2013 Integrated Household Survey. Adult population totals in each country: mid-2013 estimates.

32. In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

33. 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.

34. 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)

35. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>28</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 43 below.

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<sup>28</sup> Joossens L, Lugo A, La Vecchia C, Gilmore A, Clancy, L and Gallus S. 2012 [Illicit cigarettes and hand-rolled tobacco in 18 European countries: a cross-sectional survey Tobacco Control, Online First.](#)

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

36. For the reasons stated in paragraphs 28 to 30 above, 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?

37. 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.

38. 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?

39. 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.

40. According to the Department of Health Impact Assessment on standardised packaging <sup>29</sup> (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.”*

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<sup>29</sup> [Impact assessment: standardised packaging of tobacco products](#): Department of Health June 2014

41. 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.
42. The research paper attached to this consultation response written by Howard Reed, Landman Economics, 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).
43. 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
<b>Scenario (a): No pass through</b>					
<b>Adult smoking prevalence (%)</b>	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
<b>Scenario (b): Full pass through</b>					
<b>Adult smoking prevalence (%)</b>	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

44. 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):

<sup>30</sup>

<sup>30</sup> Communication with Action on Smoking and Health, 14 January 2015

## 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

45. 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.
46. 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<sup>31</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>32</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved,<sup>33 34</sup> smoking rates have continued to decline so that fewer than one in five adults now smoke and only 3% of 11-15 year olds.
47. Two companies: Imperial Tobacco and JTI account for around 80% of sales of tobacco in the UK. Both make large profits and have very large profit margins on their products.<sup>6</sup> Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits in the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3%

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<sup>31</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

<sup>32</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>33</sup> [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

<sup>34</sup> [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

on 2012.<sup>35</sup> It is therefore clear that the tobacco industry could well afford to pay the proposed levy.

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

48. 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.
49. 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.<sup>36</sup>
50. 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 attached paper by Gilmore et al.<sup>3</sup> 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.
51. 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.

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<sup>35</sup> BAT Annual Report 2013

<sup>36</sup> Gilmore A, Tavakoly B, Taylor G, Reed H. Understanding tobacco industry pricing strategy and whether it undermines tobacco tax policy. The example of the UK cigarette market. *Addiction* 108; (7): 1317-1326.

## Supporting Document 1

A UK tobacco levy: The options for raising £500 million per year A research report for ASH by Howard Reed, Landman Economics.

Available at: [http://www.ash.org.uk/files/documents/ASH\\_954.pdf](http://www.ash.org.uk/files/documents/ASH_954.pdf)

## Supporting Document 2

“The Extreme Profitability of the UK Tobacco Market”, by Branston and Gilmore.

Available at: <http://opus.bath.ac.uk/43061/>



# HM Treasury Consultation Tobacco Tax Levy

## Response from Smokefree South West

Smokefree South West was launched in 2009 and works to reduce smoking prevalence and health inequalities across the region, by delivering a comprehensive tobacco control programme on behalf of Public Health commissioners.

### General comments

1. Smokefree South West welcomes the Chancellor's announcement in the Autumn Statement that the Government is considering taking steps to introduce a levy on tobacco manufacturers and importers. We are in strong agreement with the Chancellor's comment that: *"Smoking imposes costs on society, and the Government believes it is therefore fair to ask the tobacco industry to make a greater contribution."*
2. Leading academics, such as Professor Anna Gilmore from Bath University based in the South West, have established that the various tobacco manufacturers and importers operating in the UK are highly profitable. Recent research by Professor Gilmore and colleagues suggests that in the UK 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 it is likely to be in the region of £1.5bn in recent years. In marked contrast with most consumer staple industries where typical level of profit are usually round 15-20%, tobacco manufacturers and importers would appear to benefit from consistently high profit margins of over 60%. On this basis it seems clear that the tobacco industry and those importing tobacco products could afford to contribute to the societal tobacco-related burden of costs.
3. A consequence of the introduction of the levy might be for the tobacco industry to simply seek to recoup the cost through increasing the price of their brands and passing on the cost to their customers. However, given that there is a strong evidence base to support the effectiveness of price increases on stimulating increased quitting activity amongst smokers, the introduction of the levy could, of itself, constitute a useful public health intervention towards reducing smoking prevalence. A 10% increase in the price of cigarettes will reduce tobacco consumption by 4%. Even if the industry did pass on the full cost of any levy to smokers, we think it is likely that a commitment to spend all, or a high proportion of the levy funds on measures to support the two thirds of smokers who want to quit to do so or indeed to fund measures to prevent children from taking up smoking, the public would be supportive of this specific type of additional taxation.
4. In terms of public support, if all the money raised through a tobacco levy went into general treasury consolidated funds then this could be seen as penalising smokers. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated Fund. A further £2.5 billion is generated for the public purse in tobacco-related VAT. This is money which comes from directly the pockets of smokers. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion.

5. Large national surveys, such as the Health Survey for England, reliably show smokers are mainly amongst the poorest and most disadvantaged in society. Although fewer than one in five adults are current smokers, prevalence rates remain much higher among less affluent people. In 2013, 29% adults in routine and manual occupations smoked compared with 14% of adults in managerial and professional occupations. Tobacco use accounts for about half the difference in life expectancy between social classes and is by far the greatest single factor in health inequality. On the basis of fairness and to expedite the reduction in the tobacco-related burden of disease, we strongly support an approach whereby any new levy is primarily dedicated to raise money to be used for tobacco control.

6. There is survey evidence to show there is widespread support in England for the concept of increasing the price of a standard packet of cigarettes by the equivalent in today's prices of 25 pence with the funds generated then being used to fund tobacco control. A large majority (78%) of the adult population support the idea. This includes 54% of those from Social Grade E ('unemployed, on state benefit and lowest grade workers') who had smoked in the past year.

7. We are encouraged to note that the recently published NHS Five Year Forward View for England includes a section entitled; "Getting serious about prevention", which states that:

*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*

*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...* (NHS: Five Year Forward View NHS England, October 2014).

8. We support recommendations made by other bodies, such as ASH, that the tobacco industry also be required to provide sales data and marketing spend which could then be officially analysed and published to help shape future policies for public health.

9. Tobacco smoke is classified as a pollutant which remains legal although by contemporary health and safety standards it would not be legalised if it had been invented in 2015. This should not exempt the polluter from paying for the costs of the pollution caused. There is a well-recognised precedent in the UK of a major industry, the energy industry, that already pays to reduce the legal pollution caused by its everyday business. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.

10. A Tobacco Company Obligation could be based on this model and rationale. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short-term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products. However, in line with our obligations as a party to the WHO Framework Convention on Tobacco Control and in particular Article 5.3, the tobacco industry should have no control over this money, or how it should be allocated.

11. This approach is an established concept already adopted elsewhere internationally in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.

12. International evidence shows that public investment in policies designed to reduce smoking prevalence is likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, "The Health Consequences of Smoking – 50 Years of Progress", reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."* The Report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."*

13. We support the view that the real benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to increase the rate of quitting tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This would appear to be fair and equitable to smokers and popular both with smokers and the general public, but essential if harm caused by tobacco to the community is to be eliminated. Comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.

14. We believe on the basis of experience in USA, that the levy be established along similar lines to the US "user fee", so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence, completely independent from any influence by the tobacco industry. We believe that such an arrangement would minimise any bureaucratic costs. This approach would also be consistent with the UK's obligation under Article 5.2 of the Framework Convention on Tobacco Control to *"establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control"*.

15. We support an approach whereby the introduction of the new tobacco levy be accompanied by a strategic spending announcement on how a proportion of the proceeds of the levy will be used to help fund a comprehensive strategy to reduce the extensive harm and burden of economic cost caused by tobacco. We believe such a strategy should include effective and cost effective plans with appropriate funding at national, regional and local level. This should ideally include vital measures such as; funding mass media and social marketing campaigns which add value to other tobacco control activities, support for tobacco control programmes at regional and local level, funded partnership programmes to tackle illicit tobacco to supplement those lead by HMRC, and steps to ensure the ongoing provision of high quality Stop smoking Services across the country.

## 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.

In our opinion this definition would be relatively simple to administer in comparison to any other realistic alternative. It would serve to optimise 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?**

We would support the levy being introduced on the basis of a calculation based on previous year clearances. However, we are concerned that there would appear to be would note that there is evidence that the level of clearances has previously been manipulated by the tobacco industry through the process known as forestalling.

We understand that the term ‘forestalling’ in this context is taken to mean 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 can be followed by lower than average release of products in the month of so after the Budget. The practice of 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 and the impact that could have in prompting smokers to quit as a result.

The recent extent of forestalling is demonstrated 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 is notable that a very similar pattern is evident for tax receipts from, imported cigarettes, cigars, hand rolling tobacco, home produced cigarettes and other tobacco products.

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

By making use of previous year clearance data there could be an opportunity to minimise the effect of forestalling.

A more robust potential basis on which to raise a tobacco levy would be to use tobacco sales volumes and prices by brands, disclosed at a local, regional and national level. This would have the advantage of minimising any possible industry manipulation of the figures and would also facilitate the disbursement of proceeds of the levy to fund tobacco control work in a way that better reflects local or regional consumption and prevalence levels and the consequent harm caused.

We would anticipate that the tobacco industry would already hold more sales data than it currently discloses. If the industry were to be required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive (3 April 2014), and the Illicit Trade Protocol to Eliminate Trade in Tobacco Products: (World

Health Organisation 2013). For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a “*unique identifier*” that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.

## 2.45 Dr Rob Branston and Prof Anna Gilmore of the Tobacco Control Research Group



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10<sup>th</sup> February 2015

Dear Sir/Madam

### Re: Tobacco Levy Consultation

This response has been prepared by Dr Rob Branston and Professor Anna Gilmore of the Tobacco Control Research Group at the University of Bath. We are a multidisciplinary group producing high quality academic research that evaluates the impact of public health policy on health, and the influence of major corporations on health behaviours, health outcomes, and policy. The TCRG is a member of the UK Centre of Tobacco and Alcohol Studies (UKCTAS) which has made a separate submission.

As general comments we would make the following observations before we proceed to consider the particular questions within the consultation.

- We welcome 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."*<sup>1</sup>
- Tobacco Manufacturers and importers in the UK are immensely profitable, such that they could certainly afford to make a greater contribution. Recent research by our group (report attached) 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, despite declining sales, and that the profitability is likely to be in the region of £1.5bn in the most 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.

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<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

- Whilst a levy is to be welcomed, the effects of this on the tobacco market are likely to be limited. As such the main benefit to be derived from such a measure is how the money is to be spent.
- 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 utility style price regulation. Placing a cap on tobacco prices would enable the excess profit to be transferred from the manufacturer to government, so fulfilling the objective of ensuring that the industry pays a greater contribution to the costs it imposes on society. See enclosed papers by Gilmore, Branston and Sweanor (2010)<sup>2</sup> and Branston and Gilmore (2014, 2015).<sup>3,4</sup>

**1. *Is it appropriate to define the tobacco market as products on which tobacco excise duty is paid.***

Yes, that would seem like a sensible definition since all smoked products carry major health risks.

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

Volumes cleared doesn't necessarily equate perfectly to product sold, as stock can be held. In an ideal world exact sales data from the previous year will be used to calculate such a levy. However, if this isn't or can't be made available then cleared volumes seems a reasonable measure.

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

Sales data would be the ideal metric. See answer to question 2 above.

**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?*

Products like cigarettes and cigars are sold in distinct units (e.g. packets of 20 sticks) whereas HRT and similar are sold by weight. The market should be split along these lines so that a levy can be applied to each in a way that doesn't result in the consumption of one or other product

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<sup>2</sup> 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

<sup>3</sup> Branston JR and Gilmore A. 'The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK', *Tobacco Control* 2014 23(1):45-50

<sup>4</sup> Branston, JR and Gilmore A. 2015 *The extreme profitability of the UK tobacco market and the rationale for a new tobacco levy*, University of Bath, <http://opus.bath.ac.uk/43061/>

being favoured. Recent research on the average weight of a hand-rolled cigarette may be useful in this respect.<sup>5</sup>

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

We would suggest option (i) is preferable as information for the current year must inevitably be partial data and hence is more option to manipulation by the industry.

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

This goes to the very heart of the type of levy being proposed. The attached paper by Branston and Gilmore (2015) sets out the two main types of levy that are possible. If a profit based levy were introduced then the corporate tax system would be an obvious means of collecting it.

**7. What are the alternative approaches?**

If a sales based levy were to be introduced then the excise and/or VAT tax system would be an obvious mechanism for collecting it.

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

This again goes to the very heart of the type of levy being proposed. The attached paper sets out the two main types of levy that are possible. If a sales based levy is introduced then it is likely that the full amount of the levy would be passed on to consumers although, as with the way the industry differentially transfers tobacco taxes to consumers, it is possible that different companies could spread the cost of the levy differently across the brands that exist within their portfolios.<sup>6</sup> If a profit based levy were to be introduced then the consumer would not be affected since this would by definition come from the shareholders currently enjoying massive profits, rather than consumers. The government would still be free to increase excise rates in order to influence the final price the consumer pays.

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

This again goes to the very heart of the type of levy being proposed. The attached paper sets out the two main types of levy that are possible and discusses their likely impact.

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<sup>5</sup> Gallus S, Lugo A, Ghisland S, La Vecchia C, [Gilmore A](#). Roll-your-own cigarettes in Europe: Use, weight and implications for fiscal policies. *European Journal of Cancer Prevention*. 2014 May;23(3):186-92.

<sup>6</sup> Gilmore A, Tavakoly B, Taylor G, Reed H. Understanding tobacco industry pricing strategy and whether it undermines tobacco tax policy: the example of the British cigarette market. *Addiction* 2013;108(7):1317-26. doi: 10.1111/add.12159. Epub 2013 Apr 16.

**10. *Would the levy have any other market impacts?***

This again goes to the very heart of the type of levy being proposed. The attached paper sets out the two main types of levy that are possible and discusses their likely impact. It is unlikely that either type of levy would generate significant changes in the current tobacco market.

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

As per the attached report and papers, the government should consider introducing utility style price caps. This would not only generate more tax revenue for the government but would also lead to better public health outcomes. Public health benefits occur both because of the reduction in profits and the changed incentives this engenders, and because a regulatory agency charged with capping tobacco manufacturers' prices would be required to investigate all aspects of the tobacco industry, thus exposing it to greater scrutiny than ever before. Most obviously, price-cap regulation prevents the tobacco industry from using price to market its products or undermine the impact of tobacco excise policies because maximum prices would now be set by the regulator and reduced industry profits would significantly impair its ability to cut any prices below these. Price differences between brands/products would, therefore, be mainly based on the costs of production rather than attempts to segment the market by price, which should significantly reduce the problem of down-trading to cheaper brands/products. Indeed, the suppression of pricing strategy from the arsenal of the transnational tobacco companies would be a complementary policy to other tobacco control measures, as it would essentially prevent the companies from using price changes as a defence in response to public health measures, such as plain packaging, and might even reduce their future resistance to such measures as their profitability becomes partially insulated from them, as the price caps set would take account of the impact of such measures. Furthermore, price-cap regulation could offer a means of controlling other unwanted industry practices, such as price fixing, cigarette smuggling and marketing to the young, as the regulator would be able to identify such activity and then take it into account when setting the price caps. For example, by forbidding, or tightly restricting the marketing budget if the companies are marketing to children. Companies could be regulated based only on their legal activities (so that they do not benefit from illegal activities, such as smuggling) and potentially even penalised for any undesirable activity in order to provide a strong incentive to act responsibly. There is also significant potential to generate indirect public health benefits through the reduction in the money the industry has available to spend on lobbying or fighting public health measures

Yours sincerely

Dr Rob Branston  
(Email) \_\_\_\_\_

Prof Anna Gilmore  
(Email) \_\_\_\_\_

### Supplementary documents:

Branston, JR and Gilmore A. 2015 *The extreme profitability of the UK tobacco market and the rationale for a new tobacco levy*, University of Bath, <http://opus.bath.ac.uk/43061/>

Branston JR and Gilmore A. 'The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK', *Tobacco Control* 2014 23(1):45-50

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

## 2.46 Public Health Agency Northern Ireland

### HM Treasury Consultation

#### Tobacco Tax Levy (closing date 18<sup>th</sup> February 2015, 11.45pm)

##### Response from Public Health Agency Northern Ireland

The Public Health Agency (PHA) is a NHS organisation working towards improvement in public health. The PHA have been tasked by the Department of Health Social Services and Public Safety Northern Ireland (DHSSPSNI) to implement the Ten Year Tobacco Strategy for Northern Ireland (Feb 2012). The ultimate aim is 'to create a tobacco free society'. A Tobacco Strategy Implementation Plan has been developed to achieve the aims and objectives set out in the Ten Year Tobacco Strategy<sup>1</sup>.

##### General Observations

###### Summary

6. The PHA 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."*<sup>2</sup>
7. Tobacco manufacturers and importers in the UK are immensely profitable, such that it could certainly afford to make a greater contribution. Recent research by Branston and Gilmore at the University of Bath suggests that in the UK 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.
8. 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.<sup>3</sup> 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.
9. 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.

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<sup>1</sup> Department of Health, Social Services and Public Safety. 2012. Ten Year Tobacco Control Strategy for Northern Ireland: Belfast: DHSSPS. [http://www.dhsspsni.gov.uk/tobacco\\_strategy\\_-\\_final.pdf](http://www.dhsspsni.gov.uk/tobacco_strategy_-_final.pdf)

<sup>2</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

<sup>3</sup> EU Tobacco Tax Directive Article 15.

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.

10. The EU Tobacco Tax Directive is due for review shortly. We recommend that the UK government advocate for revisions which would enable the introduction of a price capping mechanism. Placing a cap on industry profit, without allowing a scenario for the tobacco industry to reduce the cost of tobacco to make it more affordable and escape reaching the cap, 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.<sup>4</sup>

## Background

11. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year.<sup>5</sup> This is likely to be an under-estimate as only costs where data is attributable have been included. For example it did not include the cost of collecting smoking-related litter. The following costs are included:
  - £2 billion cost to the NHS of treating diseases caused by smoking
  - £3 billion loss in productivity due to premature death
  - £5 billion cost to businesses of smoking breaks
  - £1 billion cost of smoking-related sick days
  - £1.1 billion of social care costs of older smokers
  - £391 million cost of fires caused by smokers' materials
12. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
13. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated Fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>6</sup>
14. The tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution.<sup>3</sup> <sup>7</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but in 2002 the World Bank estimated that in rich countries such as

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<sup>4</sup> 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

<sup>5</sup> [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

<sup>6</sup> *ibid*

<sup>7</sup> Branston JR and Gilmore A. The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tobacco Control* 2014; 23(1): 45-50

the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>8</sup> A comprehensive review of the literature published since this date by IARC in 2011 concludes that based on aggregate demand studies, price elasticity remains around -0.4 in high income countries including the UK.<sup>9</sup>

15. There is widespread support in England for the idea of putting the equivalent in today's prices of 25 pence on a packet of cigarettes with the funds being used to fund tobacco control; 78% of the adult population is in favour of the idea including 54% of those in Social Grade E ('unemployed, on state benefit and lowest grade workers') who had smoked in the past year and 52% of these who were smoking at the time of the survey.<sup>10</sup> This could raise around £500 million (see table 1 below). Similar support is found in surveys across Europe.<sup>11</sup>
16. Just over one in four adults (22%) in Northern Ireland now smoke, but smoking prevalence rates are much higher among poorer people. In 2013/14, 12% of adults in the least deprived areas smoked compared with 34% in the most deprived areas. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes.<sup>12</sup>
17. Poorer smokers are more sensitive to price increases than better off smokers. So, increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>13</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
18. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to increase the rate of quitting tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers and popular both with smokers and the general public, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
19. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:  
*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*

*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*

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<sup>8</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

<sup>9</sup> International Agency for Research on Cancer. IARC Handbooks of Cancer Prevention. Tobacco Control Volume 14. Effectiveness of Tax and Price Policies for Tobacco Control. Lyons: IARC, 2011

<sup>10</sup> West R. Public support for a tobacco levy. Smoking Toolkit Study. 2006

<sup>11</sup> [Policy Recommendations for Tobacco Taxation in the European Union. Integrated research findings from the PPACTE project. 2012](#)

<sup>12</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>13</sup> The World Bank. Curbing the epidemic: governments and the economics of tobacco control. May, 1999.

*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation...”<sup>14</sup>*

20. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
21. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short-term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products. However, in line with our obligations as a party to the WHO FCTC and in particular Article 5.3, the tobacco industry could have no control over this money, or how it should be allocated.<sup>15</sup>
22. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual ‘user fee’ to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity.<sup>16</sup> This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
23. International evidence shows that public investment in policies designed to reduce smoking prevalence is likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, “The Health Consequences of Smoking – 50 Years of Progress”, reports that “States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased.” The Report also finds that long term investment is critical. It states, “Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact.”<sup>17</sup>
24. In reducing smoking prevalence rates in Northern Ireland and the UK, an essential role is played by tobacco control measures, for example the specialist stop smoking services. The Department of Health document “Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12” stated that: “Stop smoking services are a key part of

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<sup>14</sup> [NHS: Five Year Forward View](#) NHS England, October 2014

<sup>15</sup> WHO FCTC. Article 5.3 guidelines.

<sup>16</sup> [Family Smoking Prevention and Tobacco Control and Federal Retirement Reform](#). 123 Stat. 1776 Public Law 111–31—June 22, 2009. Section 919 user fees.

<sup>17</sup> U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

*tobacco control and health inequalities ... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers.”*<sup>18</sup>

25. However, these services are vulnerable because of the exceptionally tight public spending regime. There are already grounds for concern about how many people are being reached by stop smoking services. The DHSSPSNI reports that, from the beginning of April 2013 to the end of March 2014, 26,870 people set a quit date through the PHA Stop Smoking Services, but that this figure was down 18 per cent (n=5,844) on those for 2012/13. 15,813 people successfully quit giving a quit rate of 59%, 3% higher than 2012/13<sup>19</sup>.
26. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs, much of the direct savings they deliver accrue mainly to the NHS and not to those who pay for the services. This point also applies to local action by trading standards officers and others to reduce the scale of the illicit tobacco trade. The Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local government do not.
27. Although the level of illicit trade has fallen sharply since 2000, it remains unacceptably high and the latest figures from HM Revenue and Customs suggest that it has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>20</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>21</sup> and the House of Commons Home Affairs Select Committee.<sup>22</sup> The PHA strongly supports these recommendations which include specific recommendations on increasing local and regional action against illicit trade.
28. Mass media and social marketing campaigns can also be highly effective in stimulating quitting behaviour but require significant investment in order to be most effective.<sup>23 24 25</sup>
29. **We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help fund a comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost no more than £500 million a year, and would include key measures such as:**

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<sup>18</sup> [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

<sup>19</sup> Health Survey Northern Ireland: First Results 2013/14: Public Health Information & Research Branch, Information Analysis Directorate, November 2014.

<sup>20</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

<sup>21</sup> [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

<sup>22</sup> [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

<sup>23</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>24</sup> Langley T, McNeill A, Lewis S, Szatkowski L, Quinn C. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction* 2012;107(11): 2043-2050

<sup>25</sup> Sims M, Salway R, Langley T, Lewis S, McNeill A, Szatkowski L, Gilmore A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014; 109(6): 986-94.

- supporting tobacco control measures at regional and local level, for example to fund action against the illicit tobacco trade outside of HMRC;
  - ensuring the provision of high quality Stop Smoking Services across the country; and
  - financing mass media and social marketing campaigns, which add value to other tobacco control initiatives.
30. We would also strongly suggest that this portion of the levy be established along similar lines to the US “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence, completely independent from any influence by the tobacco industry. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control”.
31. It should be noted that as of 31<sup>st</sup> March 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education and \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>26</sup>

## Answers to Consultation Questions

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

32. 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?

33. 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.

34. “*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

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<sup>26</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

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.<sup>27</sup>

35. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes and prices by brands, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult, and, crucially, would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local consumption and prevalence levels and the consequent harm caused. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>28 29</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a "unique identifier" that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.
36. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

**Table 1: Suggested allocation of revenue from tobacco levy across the countries of the UK**

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from 2013 Integrated Household Survey. Adult population totals in each country: mid-2013 estimates.

37. In summary, we recommend that:

<sup>27</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

<sup>28</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>29</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

38. 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.
39. 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)
40. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>30</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 43 below.

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

41. For the reasons stated in paragraphs 28 to 30 above, 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?

42. 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 control of tobacco industry* could not be used to reduce liability for corporation tax. Should corporation tax rates be devolved it will be important that this doesn't allow the tobacco industry to reduce its contribution in any of the devolved regions or countries.

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<sup>30</sup> Joossens L, Lugo A, La Vecchia C, Gilmore A, Clancy, L and Gallus S. 2012 [Illicit cigarettes and hand-rolled tobacco in 18 European countries: a cross-sectional survey Tobacco Control, Online First.](#)

43. 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?

44. 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.

45. According to the Department of Health Impact Assessment on standardised packaging <sup>31</sup> (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.”*

46. 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.

47. The research paper written by Howard Reed, Landman Economics, 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).

48. 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.

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<sup>31</sup> [Impact assessment: standardised packaging of tobacco products](#): Department of Health June 2014

**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
<b>Scenario (a): No pass through</b>					
<b>Adult smoking prevalence (%)</b>	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
<b>Scenario (b): Full pass through</b>					
<b>Adult smoking prevalence (%)</b>	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

49. 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):<sup>32</sup>

#### **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

50. 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

<sup>32</sup> Communication with Action on Smoking and Health, 14 January 2015

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.

51. Two companies: Imperial Tobacco and JTI account for around 80% of sales of tobacco in the UK. Both make large profits and have very large profit margins on their products.<sup>6</sup> Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits in the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>33</sup> It is therefore clear that the tobacco industry could well afford to pay the proposed levy.

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

52. 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.

53. 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.<sup>34</sup>

54. 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 attached paper by Gilmore et al.<sup>3</sup> 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.

55. 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.

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<sup>33</sup> BAT Annual Report 2013

<sup>34</sup> Gilmore A, Tavakoly B, Taylor G, Reed H. Understanding tobacco industry pricing strategy and whether it undermines tobacco tax policy. The example of the UK cigarette market. *Addiction* 108; (7): 1317-1326.

## 2.47 Confederation of British Industry

### CBI's response to the tobacco levy consultation

*The CBI is the UK's leading business organisation, speaking for some 190,000 businesses that together employ around a third of the private sector workforce. With offices across the UK as well as representation in Brussels, Washington, Beijing and Delhi the CBI communicates the British business voice around the world.* Upon reviewing the consultation and literature the CBI has the following headline points in response to the tobacco levy consultation:

- Imposing new forms of corporate taxation on particular industries has a chilling effect on business investment and the UK's international reputation. This undermines the welcome progress made by this Government in improving the UK's international competitiveness.
- The consultation lacks detail and a credible evidence base. For example, the consultation provides no detail on how much the Government intends to raise from this levy.
- Estimates of the cost smoking imposes on society seem misplaced. For example, the business cost of smoking breaks is likely to be significantly less than £5 billion per annum.
- **The existing tax system raises more than £10 billion directly from tobacco taxes** and already fully corrects the full negative externality imposed by smoking (£10 billion<sup>1</sup>). Additional taxation to correct the negative externality imposed by smoking is therefore unnecessary.
- A new tobacco tax will have a similar effect on the tobacco market and consumption as if the same revenue is raised by an increase in excise duty. It will therefore fail to deliver any new policy goals while increasing administrative burden for both business and government.
- Tobacco smuggling impose a negative externality on law abiding businesses and consumers. The government needs to focus on enforcing the taxes it already imposes to limit this negative side-effect before considering new taxes.

### Why the CBI is responding to this consultation?

The tobacco levy consultation requests that "Tobacco Manufacturers and Importers and others interested in the tobacco industry" read and respond to the consultation. The CBI membership does include some businesses in this group. However, tobacco companies represent a small proportion of our membership. More importantly this levy consultation raises a number of issues of common concern to the business community. These include:

- Ensuring that policy is formulated with a firm evidence base, and that consultations are conducted impartially with robust data;
- That business tax policy provides certainty for business to make long term decisions with a high bar set for new sector specific taxes, and
- That the rule of law is upheld, and the Government is careful not to indirectly increase the incentive for illegal activity that can damage society (including businesses).

Our response will therefore focus on our principals for efficient taxation and the true cost to business from smoking, rather than attempting to answer the consultation in full.

### The consultation lacks detail, impartiality and a credible evidence base

Without more detail, such as the anticipated cost of the levy, interested stakeholders cannot provide a full response that models the likely impact on the tobacco market and government

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<sup>1</sup> The CBI disputes the Levy Consultation estimate that smoking breaks cost business £5 billion. Even if we were to accept the remaining costs quoted by the consultation but replace the overestimate for smoking breaks, the negative costs that smoking imposes upon society falls to £10 billion –less than the amount already raised by the current tax system.

revenues. It would therefore be improper for the Government to make a policy decision to impose a levy on the basis of this consultation exercise.

The consultation is not impartial. It lacks any reference to the significant fiscal contribution that tobacco makes to society. Instead, it cites only an estimate of the costs smoking imposes on society produced by ASH, an anti-tobacco campaign group.

Also questionable are the component costs of smoking that according to ASH total £12.9bn. The largest component is the estimate of £5 billion in work breaks. However, a survey of previous academic research finds an average estimate of only £2.1 billion<sup>2</sup> lost through smoking breaks. The research estimate quoted by this consultation is therefore an outlier and overestimates the true cost to business by £2.9 billion.

The £5 billion estimate in the ASH report is based on smokers taking 3.9 average breaks lasting each lasting 9.8 minutes and therefore amounting to 37 minutes lost per work day. This analysis is simplistic and flawed, the estimated cost of smoking breaks in the ASH report biases the cost of smoking in an upward direction for a number of reasons:

- There is an assumption that the hourly productivity of smokers excluding smoking breaks is equal to the average UK productivity. In practice it is well known that smoking is concentrated amongst less educated and therefore less productive groups. A failure to correct for this will on its own overestimate the cost to business by over 20%.
- The research assumes that all smokers who work will take smoking breaks. This is an incorrect generalisation, only workers in enclosed workplaces will need to take smoking breaks.
- This research assumes that smoking breaks automatically result on a cost upon the employer. This is another incorrect generalisation, in many occupations (particularly higher productivity employment), the employee has a certain amount of work rather than just working their hours. In these cases smoking employees will tend to work longer hours to offset time lost through smoking breaks.

Tobacco smuggling impose a negative externality on law abiding businesses and consumers, the government needs to focus on enforcing the taxes it already imposes before considering new taxes

Tobacco smugglers impose a negative externality on society both directly through lost tax revenue but also indirectly as individuals and groups involved in smuggling are often involved in other criminal activity. There is a clear correlation between the real value of tobacco taxes and tobacco smuggling in the UK. Without improvements in the enforcement regime, higher UK taxes increase the differential between UK and European tobacco taxes and therefore the incentive to smuggle tobacco. Between 1993-2000, when the Tobacco escalator was in place, there was an 85% increase in tobacco smuggling. In contrast in the 2000's after the tobacco escalator was scrapped, reducing the real incentive to smuggle cigarettes, the proportion of cigarettes smuggled was halved<sup>3</sup>. In this parliament the tobacco escalator has been reintroduced, the latest HMRC data suggests that tobacco smuggling<sup>4</sup> relative to the legal market has increased from 12.0% in 2011/12 to 14.2% in 2012/13. In 2013/14 uncollected tobacco duties cost Britain £2.1 billion. The government should focus on better enforcement

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<sup>2</sup> Excluding the British Heart Foundation (BHF) commissioned research that has been selectively quoted by the consultation, the range business costs from work breaks due to smoking is estimated to be between £950 million to £3.2 billion by various studies.

<sup>3</sup> Chapter 3; [http://www.ash.org.uk/files/documents/ASH\\_814.pdf](http://www.ash.org.uk/files/documents/ASH_814.pdf)

<sup>4</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/364009/4382\\_Measuring\\_Tax\\_Gaps\\_2014\\_IW\\_v4B\\_accessible\\_20141014.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/364009/4382_Measuring_Tax_Gaps_2014_IW_v4B_accessible_20141014.pdf)

strategies to collecting tobacco duties due before it considers either levying a new tax or increasing rate of existing tobacco taxes.

Additional taxation to correct the negative externality imposed by smoking is unnecessary

If the true cost to business is in fact the £2.1 billion estimated by an average of consensus estimates then the total cost of smoking in England is £10 billion per year rather than the £12.9 billion per year claimed by the consultation document. Tobacco taxes for the UK were £12.3 billion in 2012-13 according to the latest available HMRC data. A per capita apportionment to England would imply that tobacco taxes already exceed £10 billion, therefore the existing tax system already fully corrects the full negative social externality imposed by smoking.

A new tobacco tax will add complexity and administrative burden and fail to deliver any new policy goals

The consultation suggests that a new tobacco tax targeted at tobacco firms rather than smokers is needed to correct the negative effects that tobacco manufacturers and importers impose on society. Economic analysis suggests that the levy will in fact have the same effect tobacco excise duty. The price elasticity of tobacco is estimated to be around -0.5 by a variety of academic research<sup>5</sup>. Microeconomic theory shows that where goods are price inelastic (demand is not sensitive to price) additional business costs including taxes will be passed on from business upon the consumer. The proposed tobacco levy will therefore have an effect similar to increasing excise duty, both taxes increase the cost of tobacco to the consumer. Introducing a new tobacco tax therefore adds unnecessary complexity and administrative burden –both for business and government, at a time when the resources of HMRC are already stretched, while failing to deliver any additional policy goal.

Imposing new forms of corporate taxation on particular industries has a chilling effect on business investment and the UK's international reputation

The coalition agreement pledged to give the UK the most competitive business tax regime in the G20. The CBI welcomes that this pledge will be met this year through reducing the headline rate of Corporation Tax to the joint lowest in the G20. This improvement in the overall business environment has driven a strong recovery in business investment. The government risks undermining the good work of the last four year through the proliferation of sector specific levies such as the "Google tax", bank restriction on losses and a possible tobacco levy. There should be a high bar for the introduction of sector specific taxation, imposing new forms of taxation has a chilling effect on business investment as a result of speculation regarding which sector will be next. The UK's international reputation is harmed and a political risk premium will be attached to the UK which erodes the attractiveness of the UK as a location for international investment directly undermining the benefits of a lower headline rate of Corporation Tax. Furthermore, examples such as the North Sea supplementary charge and Bank levy illustrate that a fraction of the additional revenue expected by HM Treasury in fact materialises in reality.

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<sup>5</sup> Jha P. Avoidable global cancer deaths and total deaths from smoking. *Nature Reviews. Cancer* 2009;9(9):655–64

Gallet C and List J. Cigarette demand: a meta-analysis of elasticities. *Health Economics* 2003;12(10):821–35

International Agency for Research on Cancer. Chapter 4. Tax, price and aggregate demand for tobacco products. Effectiveness of tax and price policies for tobacco control. Lyon, France: IARC, 2011.

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Tobacco levy consultation  
VAT and Excise  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

20 February 2015

Ref:  
Your ref: CS/DS  
Direct line: \_\_\_\_\_  
Email: \_\_\_\_\_

Dear Ms \_\_\_\_\_

### Consultation a tobacco levy – EY response

Please find our comments on the proposals set out in the consultation document on a tobacco levy, published on 10 December 2014 (the “Consultation Document”). We are grateful for the opportunity to provide our comments on the consultation. Our comments cover the high-level policy issues regarding the introduction of a levy in the UK, namely:

1. The rationale for the introduction of a levy
2. Does the levy offers anything over excise?
3. Pass through
4. Deductibility of levy payments for corporation tax

#### 1. Rationale for Introducing a tobacco levy

The tobacco industry is subject not only to the taxes that apply across all sectors, such as corporation tax and VAT, but also to specific and ad valorem excise duties. Together, these fiscal instruments would seem to provide the tools needed to impose the burden the Government considers appropriate and to do so in a way that influences behaviour in the way desired.

Given this, and the desire for the tax system to be as simple as possible in a way that is consistent with delivering on the Government’s needs, it would seem that there needs to be a compelling reason before a new fiscal instrument is created.

#### 2. Does a levy offer anything over excise?

The allocation mechanism could distribute the burden of the levy differently amongst the market participants, depending on the option chosen. Some options would produce a similar outcome to existing mechanisms, for example an allocation based on volumes would be similar to an increase in specific excise, while an allocation based on value would be similar to ad valorem excise. If such options were chosen, then the differential impact of a levy may not justify the burden of developing, imposing and collecting a whole new tax.

It could be argued that a levy would allow each tobacco company to choose how to distribute the cost of the levy amongst its products, since the levy is not directly attributable to the product itself. In practice, however, this option remains available to the tobacco company under excise as well, since the tobacco company can vary the margin on each product.

### **3. Pass through**

A further consideration would be whether the imposition of the levy would have a different pass through effect than excise. This might be expected to be the case in a non-competitive market. However, no evidence has been presented to support an argument that the sector is anything but competitive.

### **4. Deductibility of proposed levy payments for corporation tax**

Given that any levy would be a cost incurred to participate in the tobacco market, it can be seen to wholly and exclusively for the purposes of the trade. On this basis, the levy would naturally appear to be deductible for corporation tax purposes, based on first principles. This treatment would be consistent with similar taxes such as Value Added Tax (VAT), Fuel Duty, Non-Domestic Rates and Petroleum Revenue Tax (PRT). Furthermore, denying a tax deduction for this expense would require an adjustment to the profits before tax and hence would be an additional, though small, administrative burden.

We thank you once again for the opportunity to comment and if you require any further information, please do not hesitate to contact me.

Yours sincerely

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Partner, Head of Tax Policy  
Ernst & Young LLP  
United Kingdom



Protecting and improving the nation's health

### HM Treasury tobacco levy consultation Public Health England Submission February 2015

#### Resourcing "a radical upgrade in prevention and public health"

The *NHS Five Year Forward View* calls for a "radical upgrade in prevention and public health".<sup>i</sup> The proposed tobacco levy provides a unique and timely opportunity to resource such an upgrade.

Public Health England (PHE) strongly supports the introduction in the United Kingdom (UK) of a levy on tobacco manufacturers and importers. PHE would want to see significant funding raised and the money channelled directly into addressing the harm at source, via further population-wide and targeted action to prevent uptake and support smokers to quit. Comprehensive tobacco control brings an excellent return on investment, saving both lives and money. It benefits from a robust and extensive evidence base, enabling government and partner agencies to focus efforts on high-impact, cost-effective interventions. Investing in local and regional action to tackle illicit tobacco has the dual benefits of reducing the supply of the cheap tobacco that keeps the poorest smokers addicted, while also protecting government revenue.

In *Healthy Lives, Healthy People: our strategy for public health in England* (2010),<sup>ii</sup> the government made a commitment to "helping people live longer, healthier and more fulfilling lives; and improving the health of the poorest, fastest". This priority is echoed in PHE's *From evidence into action: opportunities to protect and improve the nation's health*<sup>iii</sup> and also in the 2014 *NHS Five Year Forward View*, which states: "the future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a **radical upgrade in prevention and public health**". Harnessing a portion of tobacco industry profits to sustain and boost investment in tobacco control would be a powerful demonstration of translating this national commitment into action.

#### Building on 15 years of progress

In England and across the UK, strong sustained commitment has seen the introduction of powerful tobacco control measures including a ban on advertising, restriction on age of sale and smokefree public places. This momentum was maintained by successive governments starting with *Smoking Kills*<sup>iv</sup> and followed up by *Healthy Lives, Healthy People: A Tobacco Control Plan for England*<sup>v</sup>. Together with tough and effective action at regional and local levels, this has helped to drive down rates of smoking among adults and children to the lowest levels since

records began. The Tobacco Control Plan for England concludes in 2015. The successor to this plan will be drafted in a more financially challenging context.

### **Smoking drives inequalities**

The progress made in reducing the burden of smoking related disease has been uneven. Smoking remains concentrated in our most disadvantaged communities as the single biggest contributor to health inequalities, accounting for half the difference in life expectancy between the richest and poorest in society. Sustained ambition, and continued evidence-based action at all levels, is needed if we are to arrest and reverse this heavy and regressive burden of harm.

### **A product and an industry like no other**

Tobacco is uniquely dangerous among legal consumer products, killing half of all long-term users as well as damaging the health of bystanders. Apart from the resulting misery for many thousands of individuals and families, the wider costs to society are huge – almost £13bn a year in England alone.<sup>vi</sup> The costs of tackling the harm at local level fall disproportionately on those areas already facing the greatest pressures on their resources. The profits made by the tobacco industry are also exceptional. Tobacco manufacturers have exploited market failure to extract enormously high profits. Two companies, Imperial Tobacco and Japan Tobacco International (JTI), hold 75% of the UK market. Imperial has consistently achieved a margin of over 65% over recent years and in 2013 reported an adjusted operating profit of £623m on net revenue of £915m.<sup>vii</sup>

### **The polluter pays**

Given the extent of the individual and societal damage caused by the products of the tobacco industry, it is hard to imagine a stronger case for the application of the ‘polluter pays’ principle. Given the extent of the profits from its activities, the industry can well afford to make a greater contribution to tackling the health inequalities it is largely responsible for creating.

### **Learning from the United States (US): target revenue on reducing demand**

The US introduced a federal ‘user fee’ on tobacco companies in 2009, calculated on market share and with the money used to fund the tobacco control activities of the Food and Drug Administration (FDA).<sup>viii</sup> According to the United States Government Accountability Office, as at 31 March 2014 \$1.48bn of the \$1.88bn total user fees collected had been spent on public education, regulatory science, and compliance and enforcement.<sup>ix</sup>

By contrast the US state-level tobacco settlement of 1998 did not ring-fence allocation of the money received from the industry. States have fallen far short of recommended funding levels for tobacco control set by the US Centers for Disease Control and Prevention (CDC)<sup>x</sup>, spending on average just 2.3% of their tobacco-generated revenue (settlement and taxes) on fighting tobacco use over the last 15 years.<sup>xi</sup> Those states that have chosen to invest have achieved impressive ‘bang for their buck’: for example Florida, which among its efforts to tackle tobacco use has a long-running and well-funded tobacco prevention programme, has cut high school smoking by 73% since 1998.<sup>xii</sup>

The US experience is salutary and serves to strengthen the case for the allocation of the proceeds from a tobacco levy to fund a new era of comprehensive tobacco control incorporating prevention, regulation and enforcement activity at national, regional and local levels. This is the only way to ensure that such a levy can realise its full potential to help reduce inequalities and bring real and measurable improvements to public health.

### **Impacts of a tobacco levy**

Secretary of State for Health Jeremy Hunt has said we should “aspire to a smokefree Britain”<sup>xiii</sup>, a

country where nobody chooses to smoke. A growing body of research on the commercial determinants of health suggests that “tobacco has remained such an intractable problem only because our economic system allows free ranging corporations to market it”.<sup>xiv</sup>

The Tobacco Manufacturers’ Association estimates that cigarette sales by volume in the UK have fallen by 50% since 1990<sup>xv</sup>. In a declining market, a fixed-revenue target for the tobacco levy should reduce the appeal of market dominance, acting as a disincentive for an individual company to seek to increase its share through discounting. A tobacco levy therefore could also help maximise the public health benefits of standardised packaging of tobacco products. The tobacco industry has argued that “plain packaging legislation would remove the last differentiating factor at the point of sale, ECMA [European Cigar Manufacturers Association] also believes that plain packaging will inevitably lead to increased price competition and therefore to reduced consumer prices, making tobacco products more affordable”.<sup>xvi</sup>

Should tobacco companies choose to pass part, or all, of the levy on to consumers via higher prices, the greatest impact on smoking rates would be seen among poorer smokers who are more price-sensitive. This would have a direct impact on reducing health inequalities.

Increasing numbers of smokers are using nicotine vapourisers (e-cigarettes) to help them to cut down or to quit for good.<sup>xvii</sup> On the available evidence these products, while not harmless, are very much safer than smoked tobacco<sup>xviii</sup> and a study by Nutt et al estimated the relative harm to be just 4% of that from cigarettes.<sup>xix</sup> Higher prices for tobacco would tilt the balance in favour of nicotine vapourisers, increasing the incentive for smokers to switch to these far lower-risk alternatives.

With the money ring-fenced and allocated to fund a new era of comprehensive tobacco control, a tobacco levy would realise its full potential to help reduce inequalities and bring real and measurable improvements to public health.

### **Responses to consultation questions**

PHE has responded to those consultation questions with direct relevance to the potential public health impacts of the introduction of a tobacco levy. PHE has not provided responses to questions 4, 5, 6 and 7 dealing with matters of operational design and administration.

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

PHE agrees with this approach. The inclusion of herbal cigarettes in the definition of the tobacco market is justified in our view, given that there is no evidence that herbal smoking products are less harmful than tobacco products.

#### **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?**

PHE agrees that the tobacco levy should reflect market share by volume, not by value. Steep price differentials provide an incentive for manufacturers to cross-subsidise from premium to discount brands.<sup>xx</sup> Encouraging a flatter price structure reduces this incentive and discourages smokers from ‘trading down’.

To ensure accurate calculation of the total market and market shares, tobacco companies should be required to publish audited sales data. The data should be provided at national, regional and

local levels as a useful addition to current information sources for understanding smoking prevalence and identifying evidence of illicit trade, and targeting action accordingly.

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

Consumption of hand rolling tobacco has increased considerably over recent years. In 1990, 18% of male smokers and 2% of female smokers said they smoked mainly hand-rolled cigarettes but by 2013 this had risen to 40% for men and 23% for women.<sup>xxi</sup> If the total market is to be split into two distinct parts for the purposes of the tobacco levy, it will be important to design a system which avoids the creation of an incentive for tobacco manufacturers to move production from cigarettes into hand rolling tobacco and other cheaper products. This would serve to undermine the impact of a levy on reducing the affordability of tobacco.

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

Depending on the amount of money raised and how it is used, a tobacco levy has the potential to bring major benefits beyond reductions in the affordability of tobacco. Around 200,000 children take up smoking every year in England. Two thirds of smokers want to quit – they do not want to be continuing consumers of tobacco. The money from a tobacco levy should be used to fund a comprehensive programme of tobacco control at national, regional and local levels. In England, this should encompass all the elements in the government’s new Tobacco Control Plan, based on the six internationally recognised strands:

- stopping the promotion of tobacco
- making tobacco less affordable
- effective regulation of tobacco products
- helping tobacco users to quit
- reducing exposure to secondhand smoke
- effective communications for tobacco control

Half of all long-term smokers die prematurely as a result of their tobacco use. All suffer to a greater or lesser degree from compromised health. Smoking is the single greatest contributor to health inequalities in England. Using the money from a tobacco levy to prevent uptake and help smokers to quit would have a direct impact on this heavy burden of harm, with the greatest benefit felt by the most disadvantaged people and communities.

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

**Tobacco promotions**

Even with the so called ‘dark market’ created by the Tobacco Advertising and Promotion Act, the tobacco industry engages in extensive promotion of its brands. The industry claims this is designed to increase market share rather than to attract new smokers. Imperial Tobacco has presented “some examples of how we have increased our market shares by developing brands in the premium, mid-price and value (but not rock-bottom) segments”. Imperial focused its efforts on Lambert & Butler’s packaging: “Already the N<sup>o</sup> 1 brand, our share grew by over 0.4% during this period – that may not sound a lot but it was worth over £60 million in additional turnover and a significant profit improvement...And today, the brand is in a much stronger position. It is the UK’s biggest FMCG [Fast-moving consumer goods] brand with over £2bn in turnover. It has a 16.2% share of the UK cigarette market, and most importantly, proved that we can add value to a brand even in a very dark environment.”<sup>xxii</sup>

As long as tobacco continues to provide £2 of profit for £3 of net revenue, the UK will remain an attractive target for industry marketing. By contrast, a fixed levy based on market share,

particularly in a declining market, would reduce the incentive to increase market share by discounting. A tobacco levy therefore could also help maximise the public health benefits of standardised packaging of tobacco products. Over time, it could have the indirect impact of exerting downward pressure on demand as well as supply.

### Price elasticity of demand

Most work on price elasticity of demand for tobacco products comes from the period before the wide availability of nicotine vapourisers. The emergence of this popular substitute for smoking could be expected to greatly increase elasticity so that a relatively small increase in price might yield greater benefits in terms of smoking reduction and cessation. PHE recommends that assumptions on elasticity are reviewed in the context of the new market for nicotine vapourisers.

- I. [NHS Five Year Forward View](#), NHS England, Oct 2014
- II. [Healthy Lives, Healthy People: our strategy for public health in England](#), Department of Health, Nov 2010
- III. [From Evidence into action: opportunities to protect and improve the nation's health](#), Public Health England, Oct 2014
- IV. [Smoking Kills – A White Paper on Tobacco](#), Cm 4177, The Stationery Office, Dec 1998
- V. [Healthy Lives, Healthy People: A Tobacco Control Plan for England](#), Department of Health, Mar 2011
- VI. [ASH Ready Reckoner](#), ASH, Sep 2014
- VII. [The extreme profitability of the UK tobacco market and the rationale for a new tobacco levy](#). Branston, J. R. and Gilmore, A. Bath 2015
- VIII. [Family Smoking Prevention and Tobacco Control Act](#), Sec 919 User Fees
- IX. [United States Government Accountability Office Report to Congressional Committees, GAO-14-561, June 2014](#)
- X. [Best Practices for Comprehensive Tobacco Control Programs — 2014](#). Atlanta: U.S. Department of Health and Human Services, Centers for Disease Control and Prevention, National Center for Chronic Disease Prevention and Health Promotion, Office on Smoking and Health, 2014
- XI. [Broken Promises to Our Children: The 1998 State Tobacco Settlement Fifteen Years Later](#), Campaign for Tobacco-Free Kids et al, Dec 2013
- XII. Florida Department of Health. Chronic Disease Epidemiology, Surveillance and Evaluation Section. Florida Youth Tobacco Survey, 2014
- XIII. [House of Commons Daily Hansard – Debate 23 Oct 2014: Column 1052](#)
- XIV. Hastings G. Why corporate power is a public health priority. *British Medical Journal* 2012; 345:e5124
- XV. [Tobacco Manufacturers' Association, UK cigarette consumption](#)
- XVI. McEwen, W. From Riches to Rags? *Tobacco Journal International* 2011; 1:p89
- XVII. [Use of electronic cigarettes in Great Britain](#), ASH, Oct 2014
- XVIII. Britton J, Bogdanovica I. [Electronic cigarettes, A report commissioned by Public Health England](#). May 2014
- XIX. Nutt D, J, et al, [Estimating the Harms of Nicotine-Containing Products Using the MCDA Approach](#). *Eur Addict Res* 2014; 20:218-225
- XX. Gilmore, A, Tavakoly, B, Taylor, G and Reed, H. [Understanding tobacco industry pricing strategy and whether it undermines tobacco tax policy: the example of the UK cigarette market](#). *Addiction* Jul 2013; 108(7):1317–1326.
- XXI. [2013 Opinions & Lifestyle Survey](#), Office for National Statistics, Nov 2014
- XXII. [Presentation by Global Brand Director, Imperial Tobacco Group plc at the UBS Tobacco Conference, 1 December 2006](#)

### HM Treasury Consultation: Tobacco Tax Levy (closing date 18<sup>th</sup> February 2015)

#### Response from Tobacco Free Futures

Tobacco Free Futures is a social enterprise, whose mission is to Make Smoking History for Children. We are leading experts in tackling tobacco harm and our mission is to change the way children, young people and adults think about tobacco and help future generations to be tobacco free. Our community of interest is the North West. Tobacco Free Futures does not have any direct or indirect links to, or receive funding from, the tobacco industry.

**Please note:** This response is based upon the Action on Smoking and Health (ASH) consultation response which is informed by a research report for ASH by Howard Reed, Landman Economics, "A UK Tobacco Levy: The options for raising £500 million per year" (January 2015), and a report on "The Extreme Profitability of the UK Tobacco Market" by Branston and Gilmore, which was submitted alongside the ASH consultation response document.

#### General Observations

##### Summary

1. Tobacco Free Futures welcomed the Chancellor's announcement in the Autumn Statement that the Government is considering introducing 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.*"<sup>1</sup>
2. Tobacco Manufacturers remain amongst the most profitable businesses in the UK in spite of declining smoking rates, 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. 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. Tobacco Free Futures believes that to implement a modest levy on such profit margins would be an equitable recompense for the burden that smoking costs society.
3. Preventing the industry from passing on the cost of any levy would require price controls. ASH has noted that it is not clear that this would be technically feasible in the light of the current EU Tobacco Tax Directive.<sup>2</sup> 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. Speaking as an organisation whose community of interest lies in the North West of England where smoking rates remain at 21% in spite of recent falls, it is abundantly clear to us that smokers themselves cannot be made to pay any additional price for what is largely recognised to be a childhood addiction to tobacco.

<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

<sup>2</sup> EU Tobacco Tax Directive Article 15

4. We strongly believe that a levy to raise this amount of money must 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. This is something which Tobacco Free Futures has noted in previous Government tobacco control consultations as this data would be enormously beneficial to local Directors of Public Health and all those working to tackle tobacco harm at community level.
5. The EU Tobacco Tax Directive is due for review shortly. We recommend that the UK government advocate for revisions to this 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.<sup>3,4</sup>

### Background

6. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year.<sup>5</sup> This is likely to be an under-estimate as only costs where data is attributable have been included. For example it did not include the cost of collecting smoking-related litter. The following costs are included:
  - £2 billion cost to the NHS of treating diseases caused by smoking
  - £3 billion loss in productivity due to premature death
  - £5 billion cost to businesses of smoking breaks
  - £1 billion cost of smoking-related sick days
  - £1.1 billion of social care costs of older smokers
  - £391 million cost of fires caused by smokers' materials
7. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
8. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated Fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>6</sup>

<sup>3</sup> 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

<sup>4</sup> Branston R, Gilmore A. The case for OFSMOKE: the potential for price cap regulation of tobacco to raise £500 million per year in the UK. Tobacco Control January 2013.

<sup>5</sup> ASH Ready Reckoner. ASH and LeLan Solutions, Sept. 2014

<sup>6</sup> *ibid*

9. Tobacco manufacturers and importers enjoy massive profit margins in the UK and would be very well able to make more of a contribution.<sup>3</sup> And of course, they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>7</sup>
10. There is widespread support in England for the idea of putting the equivalent in today's prices of 30 pence on a packet of cigarettes with the funds being used to fund tobacco control; 78% of the adult population is in favour of the idea including 54% of those in Social Grade E ('unemployed, on state benefit and lowest grade workers') who had smoked in the past year and 52% of these who were smoking at the time of the survey.<sup>8</sup> This would raise around £500 million (see table 1 below).
11. Fewer than one in five adults now smoke, but smoking prevalence rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes.<sup>9</sup> Smoking exacerbates poverty as tobacco consumption accounts for a disproportionately higher level of poorer families' incomes. A low-income family earning £21,000 a year, where both parents smoke 20 cigarettes a day will spend a quarter of their total net income on tobacco or around £5,600 a year assuming that they are not smoking premium brands.

 income (net)	% of household income spent on cigarettes (net)	
	 Both parents smoke: 20 cigs a day	 One parent smoker: 20 cigs a day
£10,000	51%	26%
£15,000	34%	17%
£20,000	26%	13%
£21,000	24%	12%
£25,000	20%	10%
£30,000	17%	9%
£40,000	13%	6%
£50,000	10%	5%
£60,000	9%	4%

From Tobacco Free Futures

<sup>7</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

<sup>8</sup> West R. Public support for a tobacco levy. Smoking Toolkit Study. 2006

<sup>9</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

12. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>10</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
13. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to increase the rate of quitting tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. In Tobacco Free Futures' view investment in measures to fund tobacco control action at regional and local level should be in direct proportion to smoking prevalence. Use of the proceeds of the levy to fund tobacco control is not only fair and equitable to smokers and popular both with smokers and the general public, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
14. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:
- "The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*
- While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing..."*
- For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation..."<sup>11</sup>*
15. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
16. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short-term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.

<sup>10</sup> The World Bank. Curbing the epidemic: governments and the economics of tobacco control. May, 1999

<sup>11</sup> NHS: Five Year Forward View NHS England, October 2014

However, in line with our obligations as a party to the WHO FCTC and in particular Article 5.3, the tobacco industry could have no control over this money, or how it should be allocated.<sup>12</sup>

17. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention & Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
18. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, *"The Health Consequences of Smoking – 50 Years of Progress"*, reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."* The Report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."*<sup>13</sup>
19. In reducing smoking prevalence rates in the UK, an essential role is played by tobacco control measures carried out by local authorities, for example the stop smoking services. The Department of Health document *"Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12"* stated that: *"Stop smoking services are a key part of tobacco control and health inequalities ... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers."*<sup>14</sup>
20. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about how many people are being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13.
21. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs, much of the direct savings they deliver accrue mainly to the NHS and not by the increasingly cash-strapped local authorities that have to pay for the services. This point also applies to local action, by trading standards officers and others, to reduce the scale of the illicit tobacco trade. The Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.

<sup>12</sup> WHO FCTC. Article 5.3 guidelines

<sup>13</sup> U.S. Department of Health and Human Services. *The Health Consequences of Smoking: 50 Years of Progress: A Report of the Surgeon General*, Atlanta, GA: U.S. Department of Health and Human Services

<sup>14</sup> *Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012*: Executive Summary page 5 Department of Health 2011

22. Although the level of illicit trade has fallen sharply since 2000, it remains unacceptably high and the latest figures from HM Revenue & Customs suggest that it has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>15</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>16</sup> and the House of Commons Home Affairs Select Committee.<sup>17</sup>
23. Tobacco Free Futures strongly supports these recommendations, which include specific recommendations on increasing local and regional action against illicit trade.
24. Pan-regional working to tackle illicit tobacco, as part of broader tobacco denormalisation strategies and within the World Health Organisation Framework Convention on Tobacco Control, has been in place since 2007 in three regions (although local authority financial contributions to these programmes have reduced substantially in the North West and South West in recent years); Fresh and Tobacco Free Futures established the world-first 'North of England Tackling Illicit Tobacco for Better Health programme',<sup>18</sup> a comprehensive model to reduce the demand for and the supply of illicit tobacco. In 2011, Smokefree South West launched a similar model and since 2013 the two programmes have collaborated through the Tackling Illicit Tobacco for Better Health Partnership.
25. Effective approaches to tackle illicit tobacco are co-ordinated across local boundaries where health partners – e.g. local authority public health teams and the NHS – collaborate with enforcement partners – Trading Standards, HM Revenue & Customs and the Police amongst others.
26. Social marketing, through campaigns and sustained public relations activity<sup>19</sup>, harnesses the role of the public in reducing demand for illicit tobacco. The public often know where illicit tobacco is being sold and, as a result of increased awareness and a clear call-to-action, enforcement agencies can use this intelligence to target their activity. Supra-local enforcement activity to reduce supply is also a very cost-effective way of dealing with the issue of illicit tobacco, enabling capacity to be built at a local level, intelligence to be effectively used to target resources at the right place and connections to be made across law enforcement agencies.
27. Mass media and social marketing campaigns can also be highly effective in stimulate quitting behaviour, but require significant investment in order to be most effective.<sup>20 21 22</sup>

<sup>15</sup> HMRC Tobacco Tax Gaps Estimates 2013/14

<sup>16</sup> National Audit Office: Progress in tackling tobacco smuggling. Report published 6 June 2013, and Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling Report published 4th September 2013.

<sup>17</sup> Home Affairs Select Committee: First Report, Tobacco Smuggling. 11th June 2014

<sup>18</sup> [www.illicittobacconorth.org](http://www.illicittobacconorth.org)

<sup>19</sup> [www.keep-it-out.co.uk](http://www.keep-it-out.co.uk), [www.stop-illegal-tobacco.co.uk](http://www.stop-illegal-tobacco.co.uk)

<sup>20</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>21</sup> Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction*, 107(11), 2043-2050

<sup>22</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun;109(6):986-94

28. We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help fund a comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost no more than £500 million a year, and would include key measures such as:
- supporting tobacco control measures at regional and local level, for example to fund action against the illicit tobacco trade outside of HMRC;
  - ensuring the provision of high quality Stop Smoking Services across the country; and
  - financing mass media and social marketing campaigns, which add value to other tobacco control initiatives.
29. We would also strongly suggest that this portion of the levy be established along similar lines to the US “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence, completely independent from any influence by the tobacco industry. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “*establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control*”.
30. It should be noted that as of March 31, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education, \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>23</sup>

#### **Answers to Consultation Questions**

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

31. 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?

#### **Response to Questions 2 and 3 below:**

32. 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.
33. “*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

<sup>23</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

the lower pre-Budget rate. This is of course generally followed by lower than average release of products in the month or 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.<sup>24</sup>

34. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult, and, crucially, would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local consumption and prevalence levels and the consequent harm caused. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>25</sup>  
<sup>26</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a "unique identifier" that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.
35. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

**Table 1: Suggested allocation of revenue from tobacco levy across the countries of the UK**

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a). Adult population totals in each country taken from ONS (2014b).

<sup>24</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

<sup>25</sup> [EU Revised Tobacco Products Directive 3 April 2014](#)

<sup>26</sup> [Protocol to Eliminate Trade in Tobacco Products: World Health Organisation 2013](#)

36. In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

37. 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.

38. 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)

39. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>27</sup> This is the basis on which we have calculated the levy on HRT over five years in Table 2 below at paragraph 47.

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

40. For the reasons stated in paragraphs 32 to 0 above, 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?

**Response to Questions 6 and 7 below:**

41. 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.

42. 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.

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<sup>27</sup> 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

**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?

**Response to Questions 8, 9 and 10 below:**

43. 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.

44. According to the Department of Health Impact Assessment on standardised packaging<sup>28</sup> (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.”*

45. 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.

46. The research paper attached to this consultation response written by Howard Reed, Landman Economics, 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).

47. 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
<b>Scenario (a): No pass through</b>					
<b>Adult smoking prevalence (%)</b>	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
<b>Scenario (b): Full pass through</b>					
<b>Adult smoking prevalence (%)</b>	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

<sup>28</sup> [Impact assessment: standardised packaging of tobacco products](#): Department of Health June 2014

48. 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):<sup>29</sup>

**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

49. 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.
50. 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<sup>30</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>31</sup> In subsequent years with new policy measures regularly being introduced and the government’s tobacco control strategy having been updated and improved<sup>32 33</sup>, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.
51. 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

<sup>29</sup> Communication with Action on Smoking and Health, 14 January 2015

<sup>30</sup> Office for National Statistics. General Lifestyle Survey Overview: A report on the 2011 General Lifestyle Survey. 2013

<sup>31</sup> Smoking drinking and drug use among young people in England in 2013. The Information Centre for Health and Social Care, 2014

<sup>32</sup> DH. *A smokefree future: a comprehensive tobacco control strategy for England*. HM Government. February 2010

<sup>33</sup> DH *Healthy Lives, Healthy People: a tobacco control plan for England*. HM Government. March 2011

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.

52. 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.
53. 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.<sup>34</sup>
54. 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 attached paper by Gilmore et al.<sup>3</sup> ASH has advised 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.
55. Tobacco remains a unique consumer product, because it is highly addictive. The majority of smokers become addicted as children and one in two of those lifetime smokers will die from smoking-related disease, including respiratory diseases, circulatory diseases and cancer. So 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.
56. Marmot's focus on the social determinants of health needs to be matched with an equal focus on the commercial determinants<sup>35\*</sup> of health and how the two interact. Tobacco companies have a fiduciary duty to stakeholders to generate as much profit as possible and it has been noted above just how successful they are. In Tobacco Free Futures' view a levy on tobacco manufacturers is a fair way to mitigate the tobacco industry's impact on commercial determinants of health if utilised nationally and distributed locally and regionally to address the patterns of smoking present across the UK.

<sup>34</sup> Gilmore A, Tavakoly B, Taylor G, Reed H. Understanding tobacco industry pricing strategy and whether it undermines tobacco tax policy: the example of the British cigarette market. *Addiction*

<sup>35</sup> Health promotion research in the United Nations' Post-2015 agenda *HEALTH PROMOT INT* (2015) 30 (1): 1-4

# The Newcastle upon Tyne Hospitals

NHS Foundation Trust

## HM Treasury Consultation on a Tobacco Levy;

### Response from The Newcastle upon Tyne Hospitals NHS Foundation Trust

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1. The Newcastle upon Tyne Hospitals NHS Foundation Trust is one of the largest NHS trusts in the UK, offering a wider range of specialist services than any other. We offer the second highest number of specialist services than any other group of hospitals in the UK and are one of the most successful teaching NHS Trusts in the country. The hospitals within the Trust have over 1,800 beds and over 1.3 million patient 'contacts' every year are managed. The Newcastle upon Tyne Hospitals Trust provide innovative, high standard healthcare, including community services and primary care. Yet despite our size, complexity and national position we remain committed to the healthcare needs of local people. We are committed to tackling smoking as the most preventable cause of ill health and disease and a major contributor to health inequalities.
2. The Newcastle upon Tyne Hospitals Trust is an active member of the Smoke Free Newcastle tobacco control alliance and provides the commissioned NHS Stop Smoking Service in Newcastle. The Health Improvement Team within the Trust lead the coordination of the Smoke Free Newcastle alliance. We contribute to the evidence based comprehensive eight strand approach to plan and carry out tobacco control activity in the city. The Trust supports Newcastle's vision that adult smoking prevalence in the city will be 5% or lower by 2030. In 2013 smoking rates among adult smokers over the age of 18 years, in Newcastle were 23.7% (over 18's, <http://www.tobaccoprofiles.info/>) with higher rates seen among routine and manual groups (32.7%). Such rates remain above England and North East averages. This emphasises the need to continue to invest in a comprehensive programme of tobacco control to support smokers to quit, prevent young people from starting to smoke and to protect people from tobacco related harm.
3. The Newcastle upon Tyne Hospitals Trust works in partnership with Fresh; Smoke

Free North East. Fresh is the North East of England's comprehensive tobacco control programme, commissioned by all 12 local authorities in the region, including Newcastle City Council. Fresh was the UK's first dedicated tobacco control office, set up to tackle the worst smoking rates in England which, in 2005, dropped from 29% in 2005 to 22% in 2013. Additionally The Hospitals Trust is one of the first NHS organisations to sign the NHS Statement of Support for Tobacco Control. The Newcastle Hospitals Trust is not in any way linked to the tobacco industry. We are grateful to ASH and Fresh for their support in developing this response.

## General Observations

4. The Newcastle upon Tyne Hospitals Trust welcomes the opportunity to respond to this consultation on introducing 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."*<sup>1</sup>
5. There is widespread public appetite for more policies to reduce the harm of smoking in society with appetite for these measures having increased over the past few years. In 2014 a survey by YouGov commissioned by Action on Smoking and Health found nearly half of North East adults (43%) believing that not enough is being done to cut the harm of smoking, and another 33% saying the Government is doing about right (this was compared to 2011 when 36% said not enough is being done and another 36% thought the government was doing about right). Only 12% of adults in the North East thought "the Government is doing too much" compared to 22% in 2011 and even amongst smokers in England fewer than half (35%) believed that the government is doing too much.
6. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year<sup>2</sup>. This is likely to be an under-estimate as only costs where data is attributable have been included.
7. In Newcastle, the conservative cost of smoking is avoidably high at £68.3 million per year (ref as footnote 1), which includes the cost to business through lost productivity, the costs to the NHS of treating smokers and those exposed to secondhand smoke, the costs of smoking related fire deaths, the cost of smoking related social care but not those costs borne by other agencies e.g. Newcastle City Council who commission stop smoking services, provide regulatory services to support compliance with tobacco-related legislation and street cleaning services to remove litter such as cigarette butts and tobacco packs. Overall, the main smoking related diseases are conservatively estimated to cost the NHS across the Newcastle £14.11 million per year. The cost of smoking-related hospital admissions in the Newcastle alone is calculated to be nearly £8.82 million per year<sup>3</sup>. The impact of smoking on NHS Trusts is marked. There are an estimated 3,143 hospital appointments each year from Newcastle residents over the age of 35, as a consequence of the main smoking-related diseases. (Ref as footnote 3) This is significantly higher than the average across England. In 2013/14 The Newcastle upon Tyne Hospitals Trust had approximately 109,165 inpatient

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<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

<sup>2</sup> [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

<sup>3</sup> NICE Return on Investment Tool for Tobacco Control <http://www.nice.org.uk/ROI/tobacco>

episodes (elective and none elective admissions, excludes those admitted to children's services, day cases and outpatients)<sup>4</sup>.

8. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
9. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>5</sup>
10. The tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution.<sup>6</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>7</sup>
11. Fewer than one in five adults in England now smoke, but smoking rates are higher in Newcastle and particularly among poorer people. In 2013 in England, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. The smoking rate for routine and manual workers in Newcastle is 32.7%. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes<sup>8</sup>, killing one in two of all long-term smokers<sup>9</sup>. The Newcastle Hospitals Trust are aware that if the smoking prevalence in our inpatient population of 109,165 inpatient episodes in 2013/14 (elective and none elective admissions, excluding those admitted to children's services, day cases and outpatients)<sup>10</sup> is similar to the wider community at 23.7%, it is estimated that in around 25,500 of these episodes, the patient was a smoker. This is likely to be a conservative estimate given the strong correlation between smoking and illness, and the likelihood that smoking prevalence amongst inpatients in the city is higher than that of the general population.

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<sup>4</sup> Newcastle upon Tyne Hospitals NHS Foundation Trust data extraction - Inpatient episodes by admission method, directorate and smoking diagnosis April 2013-2014. Created 14/4/14

<sup>5</sup> ibid

<sup>6</sup> Branston JR and Gilmore A (2014) The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tob control* 23(1):45-50

<sup>7</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

<sup>8</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>9</sup> Doll R, Peto R, Wheatley K, Gray R, Sutherland I. Mortality in relation to smoking: 40 years observations on male British doctors. *British Medical Journal* 1994; 309:901-911

<sup>10</sup> Newcastle upon Tyne Hospitals NHS Foundation Trust data extraction - Inpatient episodes by admission method, directorate and smoking diagnosis April 2013-2014. Created 14/4/14

12. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>11</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
13. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to reduce tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
14. The Newcastle upon Tyne Hospitals Trust welcome the latest NHS Five Year Forward View for England, published in October 2014, which includes a section called "Getting serious about prevention". This states that:
- "The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*
- While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*
- For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation..."*<sup>12</sup>
15. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
16. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the shortterm, entirely substituted by renewable technologies. So, just as the considerable profits of the

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<sup>11</sup> The World Bank. Curbing the epidemic: governments and the economics of tobacco control. May, 1999.

<sup>12</sup> [NHS: Five Year Forward View](#) NHS England, October 2014

energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.

17. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
18. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, *"The Health Consequences of Smoking – 50 Years of Progress"*, reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."*
19. Similar declines have been seen in the North East, North West and South West of England where there is investment at a regional level in comprehensive tobacco control programmes which add value and substantially enhance and amplify efforts and outcomes nationally and locally. Investment at this level ensures that national policies and evidence-based practice are implemented effectively and allows local commissioners to benefit from economies of scale and to reach much greater population numbers<sup>13</sup>. The NICE Tobacco Return on Investment Tool provides evidence that tobacco control delivery is most cost-effective when it is delivered across a bigger geographical footprint at the sub-national level<sup>14</sup>.
20. Much more can be achieved if this regional investment is sustained, increased and widened: the report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."*<sup>15</sup>
21. In reducing the harm from smoking in the UK, an essential role is played by tobacco control measures carried out and/or commissioned by local authorities. For example Newcastle City Council commission local stop smoking services, with the specialist NHS Stop Smoking Service provided by The Newcastle upon Tyne Hospitals Trust. The Department of Health document "Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12" stated that: *"Stop smoking services are a key part of tobacco control and health inequalities... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers."*<sup>16</sup>

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<sup>13</sup> Royal College of Physicians and the UK Centre for Tobacco Control Studies: Fifty years since Smoking and health: Progress, lessons and priorities for a smoke-free UK, March 2012

<sup>14</sup> NICE [Tobacco return on investment tool](#) v3.03

<sup>15</sup> U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A

Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

<sup>16</sup> [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

22. In many areas of the country, Stop Smoking Services are thought to have suffered following their transfer to local authorities under the Health and Social Care Act, given that they are non-mandatory and that many councils face an exceptionally tight public spending regime. In Newcastle, the City Council and Newcastle Hospitals continue to regard these services as essential. However City wide there has been a reduction over the last two years in the number of smokers accessing Stop Smoking Services. From the beginning of April 2013 to the end of March 2014, 1388 people set a quit date through the Specialist NHS Stop Smoking Service, a figure that was down 3% on those for 2012/13. A total of 947 people successfully quit with the Service (up 7%), with a quit rate of 68%, an increase of 6% compared to 2012/13. As a consequence of a national and regional decline in footfall, the City Council have decided to redesign stop smoking services in the city.
23. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs most of the savings in the short and long term accrue mainly to the NHS and not by the local authority which provides their funding. This point also applies to local action, by trading standards officers and others, to regulate the tobacco market and support compliance with legislation. In respect of illicit tobacco, the Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not. A levy on the tobacco industry provides an opportunity to divert a far more appropriate sum to those bodies concerned with prevention.
24. The level of illicit trade nationally has declined by half since 2000. Regions in England have also seen reductions in the illicit market particularly in the North East, North West and South West, where the three regional comprehensive tobacco control programmes lead the Tackling Illicit Tobacco for Better Health Partnership<sup>17</sup> to reduce the demand for and supply of illegal tobacco. The Trust supports such a partnership approach. For example in the North East, 15% of tobacco products in 2009 were estimated to be illicit; by 2013 this had dropped to 9%<sup>18</sup>. However, the latest figures from HM Revenue and Customs suggest that nationally the illicit tobacco market has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>19</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>20</sup> and the House of Commons Home Affairs Select Committee.<sup>21</sup> We strongly support these recommendations, which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.

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<sup>17</sup> [www.illegal-tobacco.co.uk](http://www.illegal-tobacco.co.uk)

<sup>18</sup> NEMS illicit tobacco survey 2013

<sup>19</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

<sup>20</sup> [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

<sup>21</sup> [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

25. Mass media and social marketing campaigns can also be highly effective in stimulate quitting behaviour, but require significant investment in order to be most effective.<sup>22 2324</sup>

<sup>24</sup> Higher mass media campaign exposure also appears to confer greater benefit on socioeconomically disadvantaged population subgroups. Studies comparing different media message types have found messages concerning negative health effects most effective at generating increased knowledge, beliefs, higher perceived effectiveness ratings, or quitting behaviour. Evidence for other message types is more mixed. They do, also, perform very well among young people. In contrast, ads dealing with the cosmetic effects of smoking, addiction and athletic performance, have been found to be less effective. However, with funding for national campaigns having reduced substantially over the past five years, it is vital that campaigns as a vital component of effective tobacco control are able to run at national and regional level.

26. The Newcastle upon Tyne Hospitals Trust therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help supplement existing investment in tobacco control, and ensure that the UK can deliver a genuinely comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost an additional £500 million a year, and would include key measures such as:

- supporting comprehensive tobacco control measures at national, regional and local levels based on the best available evidence
- financing sustained mass media and social marketing campaigns, complemented by other tobacco control initiatives; and
- ensuring and improving the provision of high quality Stop Smoking Services across the country as part of broader tobacco control strategies.

27. We would also strongly suggest that this portion of the levy be established along similar lines to the US manufacturer “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control”.

28. It should be noted that as of 31<sup>st</sup> March, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education, \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>25</sup>

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<sup>22</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>23</sup> Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction*, 107(11), 2043-2050

<sup>24</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun;109(6):986-94.

<sup>25</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

## Answers to Consultation Questions

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

29. The Newcastle upon Tyne Hospitals Trust 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?**

30. The Newcastle upon Tyne Hospitals Trust 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.

31. Forestalling in this context means a temporary increase in the clearance rate of cigarettes and other tobacco products 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 or 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.<sup>26</sup>

32. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult. Crucially it would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local and regional consumption and prevalence levels and the consequent harm caused whilst ensuring cost effectiveness through delivery across a wider footprint. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>27,28</sup> For example, an effective

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<sup>26</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

<sup>27</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>28</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a 'unique identifier' that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.

33. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

**Suggested allocation of revenue from tobacco levy across the countries of the UK**

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

34. In summary, The Newcastle upon Tyne Hospitals Trust recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- Proceeds of the levy to be spent on tobacco control and enforcement, are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?**

35. 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.

36. 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)

37. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>29</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 37 below.

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

38. For the reasons stated in paragraphs 16 to 19 above, The Newcastle upon Tyne Hospitals Trust 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?**

39. The Newcastle upon Tyne Hospitals Trust support the use of the corporation tax system to collect the levy, as the system that would pose the least 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.

40. We are unaware of a plausible alternative means for collecting the levy.

**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?**

41. 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.

42. According to the Department of Health Impact Assessment on standardised packaging<sup>30</sup> (paragraph 90), *“On the assumption that all cigarette packets cost broadly the same to*

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<sup>29</sup> 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.](#)

<sup>30</sup> [Impact assessment: standardised packaging of tobacco products](#): Department of Health June 2014

*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.”*

43. 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.
44. The response from ASH 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, and is based on the research paper written by Howard Reed, Landman Economics. It will be noted that 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 (1.26 pence per stick compared to 1.27 pence per stick). 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.

#### Size of tobacco levy required to raise £500 million per year

Results, assuming impact of introducing standardised packaging (all figures in pence)

Year	15/16	16/17	17/18	18/19	19/20
Smoking prevalence (%) (Adults)	17.3	16.4	16.7	16.2	15.7

#### Scenario (a): No pass through of levy to consumers

Cigarette levy (pence per stick)	1.26	1.31	1.35	1.39	1.43
Cigarette levy (per packet of 20)	25.2	26.2	26.9	27.7	28.5
HRT levy (per gram of tobacco)	1.68	1.75	1.80	1.85	1.90
HRT levy (per 25g packet)	42.0	43.7	44.9	46.2	47.5

#### Scenario (b): Full pass through

Cigarette levy (pence per stick)	1.27	1.33	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.5	26.5	27.3	28.0	28.9
HRT levy (per gram of tobacco)	1.70	1.77	1.82	1.87	1.92
HRT levy (per 25g packet)	42.4	44.2	45.4	46.7	48.1

45. 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):<sup>31</sup>

46. 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.

#### Affordability Index: Tobacco Products

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

47. 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<sup>32</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>33</sup> In subsequent years with new policy measures regularly being introduced and the government’s tobacco control strategy having been updated and improved<sup>34 35</sup>, smoking rates across the UK have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds. We note that smoking prevalence in the city stands at 23.7% for 18 years and over and in 2013, 10% of Year 10 students (age 14-15 years) reported smoking occasionally

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<sup>31</sup> Communication with Action on Smoking and Health, 14 January 2015

<sup>32</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey.

<sup>33</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>34</sup> DH. [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

<sup>35</sup> DH [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

or regularly in a survey coordinated by the Trust's Health Improvement Team<sup>36</sup>. Nevertheless good progress has been made in reducing prevalence across all age groups since 1999.

48. Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products.<sup>6</sup> Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits of the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>37</sup> **Tobacco is unlike any other product on the market in that it kills half of all long-term users unless they quit. It is therefore clear that the tobacco industry should, and could well afford to, pay the proposed levy.**

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

49. We anticipate that tobacco multinationals may suggest alternatives to a levy but we would be highly wary of any suggestion that they make a 'contribution' to society other than death and disease on an industrial scale. We would recommend vigilance against any attempts by the tobacco industry to reposition the levy as part of a separate 'corporate social responsibility deal' to enable it to exert influence on government public health policy, in violation of the WHO FCTC Article 5.3. We would also recommend government vigilance against the tobacco industry attempting to influence how this money is spent. Historically, the tobacco industry has sponsored youth prevention programmes to forestall legislation such as smokefree spaces and restrictions on marketing in the US. The 2012 Surgeon General's Report, *Preventing Tobacco Use Among Youth and Young Adults*, concluded "*the tobacco companies' activities and programs for the prevention of youth smoking have not demonstrated an impact on the initiation or prevalence of smoking among young people*<sup>38</sup>." There is evidence these programmes have been ineffective at best and harmful at worst.
50. The Newcastle upon Tyne Hospitals Trust consider that a levy on tobacco products, with a revenue target per year fixed over five years, is by far the most desirable policy option. 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 a sufficient proportion of such funds are used to support comprehensive tobacco control delivery which includes evidence-based policy initiatives designed to reduce smoking prevalence. We therefore do not offer any alternative to a levy in this consultation response.

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<sup>36</sup> Newcastle City Council. *The Health Related Behaviour of Secondary School Children in Newcastle*. 2013

<sup>37</sup> BAT Annual Report 2013

<sup>38</sup> 2012 US Surgeon General Report



HM Treasury Consultation on a Tobacco Levy;

Response from Smoke Free Newcastle

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1. Smoke Free Newcastle is a multi disciplinary and multi-agency alliance, coordinated by The Newcastle upon Tyne Hospitals Foundation NHS Trust (Community Directorate) and chaired by Newcastle City Council, which oversees tobacco control across the city. It uses a comprehensive eight strand evidence based approach to plan and carry out tobacco control activity in the city. Smoke Free Newcastle has a vision that adult smoking prevalence in the city will be 5% or lower by 2030. In 2013 smoking rates among adult smokers over the age of 18 years, in Newcastle were 23.7% (over 18's, <http://www.tobaccoprofiles.info/>) with higher rates seen among routine and manual groups(32.7%). Such rates are remain above England and North East averages. This emphasises the need to continue to invest in a comprehensive programme of tobacco control to support smokers to quit, prevent young people from starting to smoke and to protect people from tobacco related harm.
2. Smoke Free Newcastle is one of the key partners in Fresh; Smoke Free North East. Fresh is the North East of England's comprehensive tobacco control programme, commissioned by all 12 local authorities in the region, including Newcastle City Council. Fresh was the UK's first dedicated tobacco control office, set up to tackle the worst smoking rates in England which, in 2005, dropped from 29% in 2005 to 22% in 2013. Additionally Smoke Free Newcastle is a member of the Smokefree Action Coalition, which is an alliance of over 250 organisations involved in action to address smoking. Smoke Free Newcastle is not in any way linked to the tobacco industry.
3. We are grateful to ASH and Fresh for their support in developing this response.

## General Observations

4. Smoke Free Newcastle welcomes the opportunity to respond to this consultation on introducing 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."*<sup>1</sup>
5. There is widespread public appetite for more policies to reduce the harm of smoking in society with appetite for these measures having increased over the past few years. In 2014 a survey by YouGov commissioned by Action on Smoking and Health found nearly half of North East adults (43%) believing that not enough is being done to cut the harm of smoking, and another 33% saying the Government is doing about right (this was compared to 2011 when 36% said not enough is being done and another 36% thought the government was doing about right). Only 12% of adults in the North East thought "the Government is doing too much" compared to 22% in 2011 and even amongst smokers in England fewer than half (35%) believed that the government is doing too much.
6. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year<sup>2</sup>. This is likely to be an under-estimate as only costs where data is attributable have been included.
7. In Newcastle, the conservative cost of smoking is avoidably high at £68.3 million per year (ref as above), which includes the cost to business through lost productivity, the costs to the NHS of treating smokers and those exposed to secondhand smoke, the costs of smoking related fire deaths, the cost of smoking related social care but not those costs borne by other agencies e.g. Newcastle City Council who commission stop smoking services, provide regulatory services to support compliance with tobacco-related legislation and street cleaning services to remove litter such as cigarette butts and tobacco packs.
8. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.
9. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>3</sup>
10. The tobacco industry enjoy massive profit margins in the UK and would be very well able to make more of a contribution.<sup>4</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in

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<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

<sup>2</sup> [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

<sup>3</sup> *ibid*

<sup>4</sup> Branston JR and Gilmore A (2014) The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500m per year in the UK. *Tob control* 23(1):45-50

reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>5</sup>

11. Fewer than one in five adults in England now smoke, but smoking rates are higher in Newcastle and particularly among poorer people. In 2013 in England, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. The smoking rate for routine and manual workers in Newcastle is 32.7%. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes<sup>6</sup>, killing one in two of all long-term smokers<sup>7</sup>.
12. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>8</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
13. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to reduce tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
14. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:

*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*

*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*

*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation..."<sup>9</sup>*

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<sup>5</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

<sup>6</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>7</sup> Doll R, Peto R, Wheatley K, Gray R, Sutherland I. Mortality in relation to smoking: 40 years observations on male

British doctors. British Medical Journal 1994; 309:901-911

<sup>8</sup> The World Bank. Curbing the epidemic: governments and the economics of tobacco control. May, 1999.

<sup>9</sup> [NHS: Five Year Forward View](#) NHS England, October 2014

15. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
16. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products.
17. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
18. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, "*The Health Consequences of Smoking – 50 Years of Progress*", reports that "*States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased.*"
19. Similar declines have been seen in the North East, North West and South West of England where there is investment at a regional level in comprehensive tobacco control programmes which add value and substantially enhance and amplify efforts and outcomes nationally and locally. Investment at this level ensures that national policies and evidence-based practice are implemented effectively and allows local commissioners to benefit from economies of scale and to reach much greater population numbers<sup>10</sup>. The NICE Tobacco Return on Investment Tool provides evidence that tobacco control delivery is most cost-effective when it is delivered across a bigger geographical footprint at the sub-national level<sup>11</sup>.
20. Much more can be achieved if this regional investment is sustained, increased and widened: the report also finds that long term investment is critical. It states, "*Experience also shows*

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<sup>10</sup> Royal College of Physicians and the UK Centre for Tobacco Control Studies: Fifty years since Smoking and health:

Progress, lessons and priorities for a smoke-free UK, March 2012

<sup>11</sup> NICE [Tobacco return on investment tool](#) v3.03

*that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact.”*<sup>12</sup>

21. In reducing the harm from smoking in the UK, an essential role is played by the delivery of tobacco control measures carried out and/or commissioned by local authorities. For example, Newcastle City Council commission local stop smoking services, with the specialist NHS Stop Smoking Service provided by Newcastle’s Hospitals Trust which is represented on the Smoke Free Newcastle alliance. The Department of Health document “Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12” stated that: *“Stop smoking services are a key part of tobacco control and health inequalities... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers.”*<sup>13</sup>
22. In many areas of the country, Stop Smoking Services are thought to have suffered following their transfer to local authorities under the Health and Social Care Act, given that they are non-mandatory and that many councils face an exceptionally tight public spending regime. In Newcastle, we continue to regard these services as essential, but also consider that they have under-delivered in comparison to other such services in recent years. As a consequence, the Newcastle Stop Smoking Service will be subject to tender during 2015 with a view to securing a more productive and cost-effective service, with a stronger community orientation, and which will be responsive to changing patterns of quit-related behaviour in the population (e.g. the trend towards use of e-cigarettes in quit attempts). The aim will be subsequently to build upon the new service in addressing one of our major health issues.
23. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs most of the savings in the short and long term accrue to bodies other than the local authority which provides their funding. This point also applies to local action, by trading standards officers and others, to regulate the tobacco market and support compliance with legislation. In respect of illicit tobacco, the Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not. Historically the NHS was very poor at directing funding towards smoking prevention, despite the enormous toll of death with which it is associated. A levy on the tobacco industry provides an opportunity to correct this by diverting a far more appropriate sum to those bodies concerned with prevention.
24. The level of illicit trade nationally has declined by half since 2000. Regions in England have also seen reductions in the illicit market particularly in the North East, North West and South West, where the three regional comprehensive tobacco control programmes lead the Tackling Illicit Tobacco for Better Health Partnership<sup>14</sup> to reduce the demand for and supply of illegal tobacco. For example in the North East, 15% of tobacco products in 2009 were estimated to be illicit; by 2013 this had dropped to 9%<sup>15</sup>. Smoke Free Newcastle is active in this partnership approach. However, the latest figures from HM Revenue and Customs

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<sup>12</sup> U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A

Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

<sup>13</sup> [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

<sup>14</sup> [www.illegal-tobacco.co.uk](http://www.illegal-tobacco.co.uk)

<sup>15</sup> NEMS illicit tobacco survey 2013

suggest that nationally the illicit tobacco market has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures midrange estimates).<sup>16</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>17</sup> and the House of Commons Home Affairs Select Committee.<sup>18</sup> Smoke Free Newcastle strongly supports these recommendations, which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.

**25.** Mass media and social marketing campaigns can also be highly effective in stimulate quitting behaviour, but require significant investment in order to be most effective.<sup>19 2021</sup> Higher mass media campaign exposure also appears to confer greater benefit on socioeconomically disadvantaged population subgroups. Studies comparing different media message types have found messages concerning negative health effects most effective at generating increased knowledge, beliefs, higher perceived effectiveness ratings, or quitting behaviour. Evidence for other message types is more mixed. They do, also, perform very well among young people. In contrast, adverts dealing with the cosmetic effects of smoking, addiction and athletic performance, have been found to be less effective. However, with funding for national campaigns having reduced substantially over the past five years, it is vital that campaigns as a vital component of effective tobacco control are able to run at national and regional level.

**26.** Smoke Free Newcastle therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be used to help supplement existing investment in tobacco control, and ensure that the UK can deliver a genuinely comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost an additional £500 million a year, and would include key measures such as:

- supporting comprehensive tobacco control measures at national, regional and local levels based on the best available evidence
- financing sustained mass media and social marketing campaigns, complemented by other tobacco control initiatives; and
- ensuring and improving the provision of high quality Stop Smoking Services across the country as part of broader tobacco control strategies.

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<sup>16</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

<sup>17</sup> [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

<sup>18</sup> [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

<sup>19</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>20</sup> Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction*, 107(11), 2043-2050

<sup>21</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun;109(6):986-94.

27. We would also strongly suggest that this portion of the levy be established along similar lines to the US manufacturer “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control”.

28. It should be noted that as of 31<sup>st</sup> March, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education, \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>22</sup>

### Answers to Consultation Questions

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

29. Smoke Free Newcastle 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?**

30. Smoke Free Newcastle 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.

31. Forestalling in this context means a temporary increase in the clearance rate of cigarettes and other tobacco products 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 or 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

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<sup>22</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

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.<sup>23</sup>

32. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult. Crucially it would also enable the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local and regional consumption and prevalence levels and the consequent harm caused, whilst ensuring cost-effectiveness through delivery across a wider geographical footprint. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>24 25</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a 'unique identifier' that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.
33. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

#### Suggested allocation of revenue from tobacco levy across the countries of the UK

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

34. In summary, Smoke Free Newcastle recommend that:

<sup>23</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

<sup>24</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>25</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- Proceeds of the levy to be spent on tobacco control and enforcement, are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?**

35. 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.

36. 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)

37. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>26</sup> This is the basis on which we have calculated the levy on HRT over five years in the table in paragraph 37 below.

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

38. For the reasons stated in paragraphs 16 to 19 above, Smoke Free Newcastle 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?**

39. Smoke Free Newcastle support the use of the corporation tax system to collect the levy, as the system that would pose the least administrative burden. We assume that the Treasury

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<sup>26</sup> 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.](#)

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.

40. We are unaware of a plausible alternative means for collecting the levy.

**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?**

41. 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.

42. According to the Department of Health Impact Assessment on standardised packaging<sup>27</sup> (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.”*

43. 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.

44. The response from ASH 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, and is based on the research paper written by Howard Reed, Landman Economics. It will be noted that 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 (1.26 pence per stick compared to 1.27 pence per stick). 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.

**Size of tobacco levy required to raise £500 million per year**

Results, assuming impact of introducing standardised packaging (all figures in pence)

Year	15/16	16/17	17/18	18/19	19/20
Smoking prevalence (%) (Adults)	17.3	16.4	16.7	16.2	15.7

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<sup>27</sup> Communication with Action on Smoking and Health, 14 January 2015

### Scenario (a): No pass through of levy to consumers

Cigarette levy (pence per stick)	1.26	1.31	1.35	1.39	1.43
Cigarette levy (per packet of 20)	25.2	26.2	26.9	27.7	28.5
HRT levy (per gram of tobacco)	1.68	1.75	1.80	1.85	1.90
HRT levy (per 25g packet)	42.0	43.7	44.9	46.2	47.5

### Scenario (b): Full pass through

Cigarette levy (pence per stick)	1.27	1.33	1.36	1.40	1.44
Cigarette levy (per packet of 20)	25.5	26.5	27.3	28.0	28.9
HRT levy (per gram of tobacco)	1.70	1.77	1.82	1.87	1.92
HRT levy (per 25g packet)	42.4	44.2	45.4	46.7	48.1

45. 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):<sup>28</sup>
46. 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.

### Affordability Index: Tobacco Products

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

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<sup>28</sup> Communication with Action on Smoking and Health, 14 January 2015

47. 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<sup>29</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>30</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved<sup>31 32</sup>, smoking rates across the UK have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds. Smoke Free Newcastle notes that smoking prevalence in the city stands at 23.7% for 18 years and over and in 2013, 10% of Year 10 students (age 14-15 years) reported smoking occasionally or regularly<sup>33</sup>. Nevertheless good progress has been made in reducing prevalence across all age groups since 1999.

48. Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products. Imperial's UK profits in 2010 were £614m, with a profit margin of more than 67%. JTI's (Gallaher) UK profits for the same year were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>34</sup> **Tobacco is unlike any other product on the market in that it kills half of all long-term users unless they quit. It is therefore clear that the tobacco industry should, and could well afford to, pay the proposed levy.**

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

49. We anticipate that tobacco multinationals may suggest alternatives to a levy but we would be highly wary of any suggestion that they make a 'contribution' to society other than death and disease on an industrial scale. We would recommend vigilance against any attempts by the tobacco industry to reposition the levy as part of a separate 'corporate social responsibility deal' to enable it to exert influence on government public health policy, in violation of the WHO FCTC Article 5.3. We would also recommend government vigilance against the tobacco industry attempting to influence how this money is spent. Historically, the tobacco industry has sponsored youth prevention programmes to forestall legislation such as smokefree spaces and restrictions on marketing in the US. The 2012 Surgeon General's Report, Preventing Tobacco Use Among Youth and Young Adults, concluded "the

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<sup>29</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey.

<sup>30</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>31</sup> DH. [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

<sup>32</sup> DH [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

<sup>33</sup> Newcastle City Council. The Health Related Behaviour of Secondary School Children in Newcastle. 2013

<sup>34</sup> BAT Annual Report 2013

*tobacco companies' activities and programs for the prevention of youth smoking have not demonstrated an impact on the initiation or prevalence of smoking among young people<sup>35</sup>.*" There is evidence these programmes have been ineffective at best and harmful at worst.

50. Smoke Free Newcastle consider that a levy on tobacco products, with a revenue target per year fixed over five years, is by far the most desirable policy option. 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 a sufficient proportion of such funds are used to support comprehensive tobacco control delivery which includes evidence-based policy initiatives designed to reduce smoking prevalence. We therefore do not offer any alternative to a levy in this consultation response.

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<sup>35</sup> 2012 US Surgeon General Report



## Swindon Trading Standards response to HM Treasury Consultation: Tobacco Tax Levy (closing date 18th February 2015)

### General

Swindon Smokefree Alliance is a partnership of organisations who work together to drive down smoking prevalence and the associated harm and inequalities in health it causes in Swindon. Partners include Swindon Borough Council, (Trading Standards, Community Safety Partnership, Public Health, licensing, Healthy Schools), Great Western Hospital NHS Foundation Trust, Wiltshire and Swindon Fire Service, Swindon Stop Smoking Service and community representatives. Swindon Trading Standards have reviewed this consultation and as members of the Swindon Smokefree Alliance would like to submit the following response.

**Please note:** This response is in support of the ASH response which has been informed by a research report produced for ASH by Howard Reed, Landman Economics, "A UK Tobacco Levy: The options for raising £500 million per year" (January 2015), and a report on "The Extreme Profitability of the UK Tobacco Market", by Branston and Gilmore.

### General Observations

#### Summary

1. Swindon Trading Standards 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."*<sup>1</sup>
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. 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.

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<sup>1</sup> [HM Treasury Autumn Statement](#) December 2014, paragraph 2.252

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.<sup>2</sup> 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.<sup>3 4</sup>

## Background

6. As quoted in the consultation document, Action on Smoking and Health estimate that the total cost of smoking to society in England alone is approximately £12.9 billion a year.<sup>5</sup> This is likely to be an under-estimate as only costs where data is attributable have been included. For example it did not include the cost of collecting smoking-related litter. The following costs are included:
  - £2 billion cost to the NHS of treating diseases caused by smoking
  - £3 billion loss in productivity due to premature death
  - £5 billion cost to businesses of smoking breaks
  - £1 billion cost of smoking-related sick days
  - £1.1 billion of social care costs of older smokers
  - £391 million cost of fires caused by smokers' materials
7. The costs to society are expressed in financial terms but underlying this are the severe financial and personal costs both to the smoker and their loved ones due to the death and disease caused by tobacco.

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<sup>2</sup> EU Tobacco Tax Directive Article 15.

<sup>3</sup> 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

<sup>4</sup> Branston R. Gilmore A. The case for OFSMOKE: the potential for price cap regulation of tobacco to raise £500 million per year in the UK. Tobacco Control January 2013.

<sup>5</sup> [ASH Ready Reckoner](#). ASH and LeLan Solutions, Sept. 2014

8. Tobacco taxation already raises around £9.5 billion in excise tax for the Consolidated Fund, money which comes from the pockets of smokers, plus a further £2.5 billion in VAT. The Office for National Statistics estimates that the total UK household expenditure on tobacco in 2013 was £18.7 billion. For 2014, a 20-a-day smoker of a premium cigarette brand will spend about £2,900 over the year on cigarettes.<sup>6</sup>
9. Tobacco Manufacturers and importers enjoy massive profit margins in the UK and would be very well able to make more of a contribution.<sup>3</sup> And, of course they may well decide to pass on to consumers some or all of the cost. If any of the levy is passed on in the form of higher prices, this will have some public health benefits, since price increases are an effective policy lever in reducing smoking prevalence. Estimates of the price elasticity of cigarettes and tobacco products vary, but the World Bank estimates that in rich countries such as the UK, a 10% increase in the price of cigarettes will reduce tobacco consumption by 4%.<sup>7</sup>
10. There is widespread support in England for the idea of putting the equivalent in today's prices of 30 pence on a packet of cigarettes with the funds being used to fund tobacco control; 78% of the adult population is in favour of the idea including 54% of those in Social Grade E ('unemployed, on state benefit and lowest grade workers') who had smoked in the past year and 52% of these who were smoking at the time of the survey.<sup>8</sup> This would raise around £500 million (see table 1 below).
11. Fewer than one in five adults now smoke, but smoking prevalence rates are much higher among poorer people. In 2013, 14% of adults in managerial and professional occupations smoked compared with 29% in routine and manual occupations. Tobacco use is by far the greatest single factor in health inequality, accounting for about half the difference in life expectancy between social classes.<sup>9</sup>
12. Poorer smokers are more likely to quit as they are more sensitive to price increases, so increasing price through taxation is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.<sup>10</sup> However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
13. Therefore the benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to increase the rate of quitting tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers and popular both with smokers and the general public, but vital if the societal harm caused by tobacco is to be eliminated. Indeed comprehensive measures to reduce smoking prevalence are essential to reducing inequality and improving the nation's health.
14. It should be noted that the latest NHS Five Year Forward View for England, published in October 2014, includes a section called "Getting serious about prevention", which states that:  
*"The future health of millions of children, the sustainability of the NHS, and the economic prosperity of Britain all now depend on a radical upgrade in prevention and public health... We do not have to accept this rising burden of ill health driven by our lifestyles, patterned by deprivation and other social and economic influences..."*

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<sup>6</sup> *ibid*

<sup>7</sup> [Economics of Tobacco Toolkit](#) World Bank 2002

<sup>8</sup> West R. Public support for a tobacco levy. Smoking Toolkit Study. 2006

<sup>9</sup> [Smoking and Health Inequalities](#) Action on Smoking and Health

<sup>10</sup> The World Bank. Curbing the epidemic: governments and the economics of tobacco control. May, 1999.

*While the health service certainly can't do everything that's needed by itself, it can and should now become a more activist agent of health-related social change. That's why we will lead where possible, or advocate when appropriate, a range of new approaches to improving health and wellbeing...*

*For all of these major health risks – including tobacco, alcohol, junk food and excess sugar – we will actively support comprehensive, hard-hitting and broad-based national action to include clear information and labelling, targeted personal support and wider changes to distribution, marketing, pricing, and product formulation...”<sup>11</sup>*

15. Tobacco smoke is a legal pollutant. But this does not exempt the polluter from paying the costs of the pollution it causes. There is already a major industry in the UK that pays to reduce the legal pollution caused by its everyday business: the energy industry. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
16. A Tobacco Company Obligation would follow the same logic. The pollution and harm caused by smoking cannot be eliminated overnight by prohibition or technological innovation, just as carbon-intensive energy sources cannot be banned or, in the short-term, entirely substituted by renewable technologies. So, just as the considerable profits of the energy companies allow for investment in interventions to reduce demand for energy, it is right and proper for government to draw on the excessive profits of the tobacco industry to reduce demand for tobacco products. However, in line with our obligations to the WHO FCTC and in particular Article 5.3, the tobacco industry could have no control over how this money, or how it should be allocated.<sup>12</sup>
17. This is not a new idea in tobacco control. In the United States, the Family Smoking Prevention and Tobacco Control Act 2009 requires the tobacco industry to pay an annual 'user fee' to the Food and Drug Administration (FDA) to fund tobacco regulation and wider tobacco control activity. This levy is independent of the wider US fiscal regime and its proceeds are controlled directly by the FDA. The total value of the levy is based on a calculation of the costs of tobacco regulation, which is then apportioned to tobacco companies according to their market share in the US.
18. International evidence shows that public investment in policies designed to reduce smoking prevalence are likely to prove highly cost-effective in the long run. For example the 2014 US Surgeon General Report, *"The Health Consequences of Smoking – 50 Years of Progress"*, reports that *"States that have made larger investments in comprehensive tobacco control programs have seen larger declines in cigarettes sales than the nation as a whole, and the prevalence of smoking among adults and youth has declined faster, as spending for tobacco control programs has increased."* The Report also finds that long term investment is critical. It states, *"Experience also shows that the longer the states invest in comprehensive tobacco control programs, the greater and faster the impact."*<sup>13</sup>

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<sup>11</sup> [NHS: Five Year Forward View](#) NHS England, October 2014

<sup>12</sup> WHO FCTC. Article 5.3 guidelines.

<sup>13</sup> U.S. Department of Health and Human Services: [The Health Consequences of Smoking: 50 Years of Progress](#): A Report of the Surgeon General, Atlanta, GA: U.S. Department of Health and Human Services

19. In reducing smoking prevalence rates in the UK, an essential role is played by tobacco control measures carried out by local authorities, for example the stop smoking services. The Department of Health document “Local Stop Smoking Services: service delivery and monitoring guidelines 2011-12” stated that: *“Stop smoking services are a key part of tobacco control and health inequalities ... Evidence-based stop smoking support is highly effective both in cost and clinical terms. It should therefore be seen in the same way as any other clinical service and offered to all smokers.”*<sup>14</sup>
20. However, these services are vulnerable, following the transfer of the public health function to local authorities under the Health and Social Care Act 2012, because of the exceptionally tight public spending regime that local authorities now face. There are already grounds for concern about how many people are being reached by stop smoking services. The Health and Social Care Information Centre reports that, from the beginning of April 2013 to the end of March 2014, 586,337 people set a quit date through the NHS Stop Smoking Services, but that this figure was down 19 per cent on those for 2012/13. 300,539 people successfully quit (down 20 per cent) giving a quit rate of just over half, similar to 2012/13
21. It should be noted that, although stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs, much of the direct savings they deliver accrue mainly to the NHS and not by the increasingly cash-strapped local authorities that have to pay for the services. This point also applies to local action, by trading standards officers and others, to reduce the scale of the illicit tobacco trade. The Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.
22. Although the level of illicit trade has fallen sharply since 2000, it remains unacceptably high and the latest figures from HM Revenue and Customs suggest that it has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13. The figures for hand-rolled tobacco (HRT) were 39% in 2013/14 compared to 36% in 2012/13 (all figures mid-range estimates).<sup>15</sup> Detailed recommendations on how to improve action against illicit trade have been made by both the National Audit Office<sup>16</sup> and the House of Commons Home Affairs Select Committee.<sup>17</sup> Swindon Trading Standards strongly supports these recommendations, which include specific recommendations on increasing local and regional action against illicit trade that would require financial contributions from local authorities to be implemented.
23. Mass media and social marketing campaigns can also be highly effective in stimulate quitting behaviour, but require significant investment in order to be most effective.<sup>18 19 20</sup>
- 24. We therefore consider it essential that the imposition of the tobacco levy be accompanied by a specific spending announcement on how a proportion of the proceeds of the levy will be**

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<sup>14</sup> [Local Stop Smoking Services: service delivery and monitoring guidance 2011-2012](#): Executive Summary page 5 Department of Health 2011

<sup>15</sup> [HMRC Tobacco Tax Gaps Estimates 2013/14](#)

<sup>16</sup> [National Audit Office: Progress in tackling tobacco smuggling](#). Report published 6 June 2013, and [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#) Report published 4th September 2013.

<sup>17</sup> [Home Affairs Select Committee: First Report, Tobacco Smuggling](#). 11th June 2014

<sup>18</sup> Wakefield M et al. Impact of Tobacco Control Policies and Mass Media Campaigns on Monthly Adult Smoking Prevalence. *Am J Public Health*. 2008 August; 98(8): 1443–1450.

<sup>19</sup> Langley, T., McNeill, A., Lewis, S., Szatkowski, L., Quinn, C., 2012. The impact of media campaigns on smoking cessation activity: a structural vector autoregression analysis. *Addiction*, 107(11), 2043-2050

<sup>20</sup> Sims, M., Salway, R., Langley, T., Lewis, S., McNeill, A., Szatkowski, L., Gilmore, A. Effectiveness of mass media campaigns to change tobacco use in England: a population-based cross-sectional study. *Addiction* 2014 Jun;109(6):986-94.

used to help fund a comprehensive strategy to reduce the harm caused by tobacco. Such a strategy, at a rough estimate, would cost no more than £500 million a year, and would include key measures such as:

- supporting tobacco control measures at regional and local level, for example to fund action against the illicit tobacco trade outside of HMRC;
- ensuring the provision of high quality Stop Smoking Services across the country; and
- financing mass media and social marketing campaigns, which add value to other tobacco control initiatives.

25. We would also strongly suggest that this portion of the levy be established along similar lines to the US “user fee”, so that it is effectively made independent of the wider fiscal regime and so that appropriate means can be found to ensure that disbursement of the proceeds on tobacco control can be informed by the best available evidence, completely independent from any influence by the tobacco industry. We believe that such an arrangement would impose minimal bureaucratic costs and would also be consistent with the UK’s obligation under Article 5.2 of the Framework Convention on Tobacco Control to “establish or reinforce and finance a national coordinating mechanism or focal points for tobacco control”.

26. It should be noted that as of March 31, 2014, the US Food and Drug Administration had collected \$1.88 billion in manufacturer user fees since 2009 and has spent \$1.48 billion of that amount over the past five years. Of the \$1.48 billion spent so far, \$508 million, or just over half a billion dollars, has been spent on public education, \$449 million has been spent on scientific research projects that will form the foundation for additional FDA regulations on tobacco products.<sup>21</sup>

## Answers to Consultation Questions

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

27. 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?

Response to Questions 2 and 3 below

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<sup>21</sup> [General Accounting Office reports FDA tobacco user fee spending](#). Accessed 16 January 2015

28. 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.
29. “*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 or 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.<sup>22</sup>
30. Use of previous year clearance data would help to minimise the effect of forestalling. However, we believe that the best possible basis on which to raise a tobacco levy would be sales volumes, disclosed at a local, regional and national level. This would make industry manipulation of the figures much more difficult, and, crucially, would also the disbursement of proceeds of the levy to fund tobacco control work in a way that was sensitive to local consumption and prevalence levels and the consequent harm caused. We believe that the tobacco industry already has much more sales data than it currently discloses. In addition, the industry will be progressively required to collect, hold and disclose such data as part of the tougher supply chain controls envisaged in the revised EU Tobacco Products Directive and the Illicit Trade Protocol.<sup>23 24</sup> For example, an effective tracing system for tobacco products, mandated under Article 15 of the Directive and Article 8 of the Protocol, would require that cigarette packs and other tobacco packaging carry a “*unique identifier*” that would allow enforcement authorities to access detailed information about the manufacturing process and intended market.
31. Assuming that the tobacco levy would be a reserved matter for the Westminster Parliament (at least in the first year), revenue should be distributed to the UK administrations in accordance with the proportion of the total number of UK smokers in each jurisdiction. If the levy were set at a level to raise £500 million, as we suggest, we estimate that the distribution would be as shown in the table below. We see this resource being distributed according to the evidence at national, regional and local level.

**Table 1: Suggested allocation of revenue from tobacco levy across the countries of the UK**

Country	Proportion of smokers in the UK (%)	Funding allocation (£m)
England	82.5	412.6
Wales	5.1	25.7
Scotland	9.6	47.9
Northern Ireland	2.8	13.8
TOTAL	100.0	500.0

<sup>22</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

<sup>23</sup> [EU Revised Tobacco Products Directive](#) 3 April 2014

<sup>24</sup> [Protocol to Eliminate Trade in Tobacco Products](#): World Health Organisation 2013

**Notes:** Statistics for adult smoking prevalence in each country in the UK taken from ONS (2014a), Adult population totals in each country taken from ONS (2014b).

32. In summary, we recommend that:

- Previous year clearance data be used as the basis on which to raise the levy in year one.
- The Chancellor takes powers in primary legislation to change the basis on which the levy is raised in future years by Order, with a view to shifting towards sales data in parallel with the introduction of mandated supply chain controls under the EU Directive and WHO Protocol.
- That proceeds of the levy to be spent on tobacco control and enforcement are distributed in a way that reflects local prevalence rates, to ensure that money is focussed on areas of greatest need.
- That the proceeds of the levy be distributed to the devolved administrations in a ratio determined by the proportion of the total number of UK smokers in each jurisdiction.

**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?

33. 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.

34. 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)

35. A recent study of HRT consumption in 18 European countries gives a tobacco content of a typical hand-rolled cigarette as 0.75 grams.<sup>25</sup> 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?

36. For the reasons stated in paragraphs 16 to 19 above, 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?

**Response to Questions 6 and 7 below**

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<sup>25</sup> 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.](#)

37. 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.

38. 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?

**Response to Questions 8,9 and 10 below.**

39. 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.

40. According to the Department of Health Impact Assessment on standardised packaging <sup>26</sup> (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.”*

41. 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.

42. The research paper referred to in this consultation response written by Howard Reed, Landman Economics, 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).

43. 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.

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<sup>26</sup> [Impact assessment: standardised packaging of tobacco products](#): Department of Health June 2014

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
<b>Scenario (a): No pass through</b>					
<b>Adult smoking prevalence (%)</b>	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
<b>Scenario (b): Full pass through</b>					
<b>Adult smoking prevalence (%)</b>	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

44. 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):<sup>27</sup>

**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

45. 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

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<sup>27</sup> Communication with Action on Smoking and Health, 14 January 2015

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.

46. 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<sup>28</sup> and smoking rates among young people 11-15 years old declined much faster, falling by nearly a half from 11% to 6%.<sup>29</sup> In subsequent years with new policy measures regularly being introduced and the government's tobacco control strategy having been updated and improved<sup>30 31</sup>, smoking rates have continued to decline so that fewer than one in five adults now smoke, and only 3% of 11-15 year olds.
47. 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.

48. 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.
49. 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.<sup>32</sup>
50. 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

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<sup>28</sup> Office for National Statistics. [General Lifestyle Survey Overview](#): A report on the 2011 General Lifestyle Survey. 2013.

<sup>29</sup> [Smoking drinking and drug use among young people in England in 2013](#). The Information Centre for Health and Social Care, 2014.

<sup>30</sup> DH. [A smokefree future: a comprehensive tobacco control strategy for England](#). HM Government. February 2010.

<sup>31</sup> DH [Healthy Lives, Healthy People: a tobacco control plan for England](#). HM Government. March 2011.

<sup>32</sup> Gilmore A, Tavakoly B, Taylor G, Reed H. Understanding tobacco industry pricing strategy and whether it undermines tobacco tax policy: the example of the British cigarette market. *Addiction*

undermining government tax policy. The means by which this could be achieved is set out in a paper by Gilmore et al.<sup>3</sup> 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.

51. 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.



### Local Government Association Submission to Tobacco Levy Consultation - 17 February 2015

#### About the LGA

The Local Government Association (LGA) is here to support, promote and improve local government. We will fight local government's corner and support councils through challenging times, focusing our efforts where we can have real impact. We will be bold, ambitious, and support councils to make a difference, deliver and be trusted.

The LGA is an organisation that is run by its members. We are a political organisation because it is our elected representatives from all different political parties that direct the organisation through our boards and panels. However, we always strive to agree a common cross-party position on issues and to speak with one voice on behalf of local government.

The LGA covers every part of England and Wales and includes county and district councils, metropolitan and unitary councils, London boroughs, Welsh unitary councils, fire, police, national park and passenger transport authorities. Visit [www.local.gov.uk](http://www.local.gov.uk)

#### General Points

1. The Local Government Association (LGA) welcome the Chancellor's announcement in the Autumn Statement that the Government is minded to introduce a levy on tobacco manufacturers and importers. We 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."*<sup>1</sup>
2. Smoking is the primary cause of premature and preventable death, accounting for more than 80,000 lives a year in England.<sup>2</sup> The toll is greater than the next six most common causes of preventable death combined – drug use, road accidents, falls, preventable diabetes, suicide and alcohol abuse. It comes despite the fact the smoking rate has fallen considerably since the 1950s when the link with lung cancer was established beyond all doubt.
3. Today about one in four men (24 per cent) and one in six women (17 per cent) are smokers.<sup>3</sup> However, the figure masks the gap seen between different income groups – for example smoking prevalence is twice as high among people in routine and manual occupations as those in managerial or professional jobs.
4. Cigarette Litter is the most common type of litter found in England - present on 79% of streets. 122 tonnes of cigarette related litter dropped every day. 23 billion cigarette ends

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<sup>1</sup> Rt Hon George Osborne, Chancellor of the Exchequer, Autumn Statement 3 December 2014

<sup>2</sup> Health and Social Care Information Centre, 2014, Statistics on Smoking 2014: [www.hscic.gov.uk/catalogue/PUB14988/smokeng-2014-rep.pdf](http://www.hscic.gov.uk/catalogue/PUB14988/smokeng-2014-rep.pdf)

<sup>3</sup> Health Survey England 2013 statistics on smoking: [www.hscic.gov.uk/catalogue/PUB16076/HSE2013-Ch8-adult-cig-smo.pdf](http://www.hscic.gov.uk/catalogue/PUB16076/HSE2013-Ch8-adult-cig-smo.pdf)

discarded every year. The latest report commissioned by INCPEN from Keep Britain Tidy found that the most frequently littered items in England this year are cigarette butts (30 percent).

5. Although the level of illicit trade has fallen sharply since 2000, it remains unacceptably high and the latest figures from HM Revenue and Customs suggest that it has risen slightly from a low point in 2012/13. In 2013/14 an estimated 10% of cigarettes consumed in the UK were illicit compared to 9% in 2012/13.
6. Businesses are losing over 11 million days of productivity each year due to smoking-related sick days.<sup>4</sup>
7. The most common tobacco control activity conducted by local authorities is tackling the supply illicit tobacco. 91% of councils have taken action in relation to illicit tobacco and 88% in relation to preventing under age sales of tobacco products.<sup>5</sup>

### **Financial Burden on Local Government**

8. The cost to the NHS of treating smoking-related illness is estimated to be between £2.7 billion and £5.2 billion a year. The costs to local councils are also considerable.
9. Local authorities across England are spending an additional £600 million on social care as a result of smoking-related illness.<sup>6</sup>
10. The cost of clearing cigarette litter is estimated to cost councils at least £342 million each year. A conservative estimate of the cost of smoking-related fire is £507 million annually.<sup>7</sup>
11. Total identified expenditure on tobacco control by local councils is in the region of £250 million each year.<sup>8</sup> Stop smoking services and interventions funded by council public health teams are estimated to cost £140 million each year.<sup>9</sup>

### **Tobacco Profits**

12. 35,414 million cigarette sticks and 7,077,000 kg of other forms of tobacco were sold in the UK last year.<sup>10</sup>
13. Tobacco manufacturers and importers in the UK are immensely profitable, such that we believe it could certainly afford to make a greater contribution. Imperial Tobacco for example, is the biggest seller of cigarettes in the UK. The company made £3bn in global operating profits last year. In 2010, it made operating profits in the UK of £614m.<sup>11</sup> 14. Two companies account for around 80% of sales of tobacco in the UK, Imperial Tobacco and JTI. Both make large profits and have very large profit margins on their products.<sup>6</sup> JTI's (Gallaher) UK profits in 2010 were £345m, with a profit margin of over 38%. British American Tobacco, the world's second largest tobacco company is based in Britain although virtually all of its products are now manufactured outside the UK. In 2013, BAT

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<sup>4</sup> <https://www.gov.uk/government/news/employers-get-behind-stoptober-quit-smoking-campaign>

<sup>5</sup> TSI Tobacco control Surevy. <http://www.tradingstandards.gov.uk/extra/news-item.cfm/newsid/1657>

<sup>6</sup> LocalGov, 'The care costs of smoking', 15 October 2014: [www.localgov.co.uk/The-care-costs-of-smoking/37422](http://www.localgov.co.uk/The-care-costs-of-smoking/37422)

<sup>7</sup> Policy Exchange Think Tank report Cough Up: Balancing Tobacco Income and Costs to Society.

<sup>8</sup> Inquiry into the effectiveness and cost-effectiveness of tobacco control: Submission to the 2010 Spending Review and Public Health White Paper Consultation process.

<sup>9</sup> Local Authority Revenue Expenditure and Financing: 2014-15 Budget, England (revised) Oct 2014.

<sup>10</sup> HMRC Tobacco Bulletin July 2014

<sup>11</sup> Imperial tobacco Annual report 2010 <http://www.imperial-tobacco.co.uk/files/financial/reports/ar2010/index.asp?pageid=39>

produced 676 billion cigarettes worldwide and reported an operating profit of £5,526 million, an increase of 3% on 2012.<sup>12</sup>

15. Recent research by Branston and Gilmore at the University of Bath suggests that in the UK 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.<sup>13</sup> It is therefore clear that the tobacco industry could well afford to pay the proposed levy.

### In support of a Tobacco Levy

16. We strongly support a levy. We believe the money raised could be spent on measures that prevent youth uptake, tackle smoking in pregnancy, encourage smokers to quit, tackle counterfeit and illicit tobacco and help councils clean up the streets of cigarette litter that blight our neighbourhoods.
17. However, if money raised through the levy went into the Consolidated Fund this wouldn't deliver the preventative and regulatory action needed in terms of escalating trading standards, environmental health and public health activity.
18. We believe that the levy should be distributed to reflect local prevalence rates, to ensure that money is focussed on areas of greatest need.
19. Kris Hopkins MP, Minister at the Department for Communities and Local Government is reported to have brought the specific issue of smoking-related littering to Treasury Ministers' attention and would like to understand how, if a levy is introduced, the tobacco industry could contribute to the cost to local government of dealing with smokers' litter.<sup>14</sup>
20. The benefits to public health will only be fully realised if a proportionate amount of the proceeds of the levy are used to fund tobacco control action designed to increase the rate of quitting tobacco use, and prevent uptake among young people, over and above what might be expected as a result of any price rises. This is not only fair and equitable to smokers and popular both with smokers and the general public, but vital if the societal harm caused by tobacco is to be eliminated.
21. The recent debate on spending pressures has catalysed renewed interest in hypothecating taxation for the NHS. There are a number of examples where hypothecated taxes or levies have been used. The Energy Company Obligation (ECO) places a legal requirement on energy companies to invest in energy efficiency measures, especially for poor and vulnerable households. The principal component of the ECO, the Carbon Emissions Reduction Obligation, makes explicit the statutory obligation on the industry to reduce environmental pollution by reducing demand for its core product.
22. Hypothecated taxation is not a new idea, the TV licence is a current example of hypothecation, as the revenue raised is earmarked for the BBC. Gordon Brown's decision in 1999 to allocate additional revenue raised from real increases in tobacco duties to health expenditure is an example of hypothecation. Similarly, Gordon Brown stated in his November 1999 Pre-Budget statement that 'revenues from any real terms increases in fuel

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<sup>12</sup> BAT Annual Report 2013

<sup>13</sup> The case for OFSMOKE: The potential for price cap regulation of Tobacco to raise £500m per year in the UK <http://www.ncbi.nlm.nih.gov/pmc/articles/PMC3812939/>

<sup>14</sup> Cigarette and chewing gum companies urged to help with national spring clean, Daily Telegraph, Jan 2015

duties will, in future, go straight into a ring-fenced fund for improving public transport and modernising the road network'.<sup>15</sup>

23. More recently in December 2012, the Chancellor transferred £35 million from fines levied on the banks for attempting to manipulate LIBOR to the MOD for use in supporting the armed forces community.<sup>16</sup>
24. Earmarking taxes for particular services makes the link between taxation and government spending more transparent, which can help to reconnect voters with the purpose of taxation.
25. As the public health authority for the area, the local council has the expertise and experience to ensure that services are in place to help smokers to quit. Council elected members and officers know the communities they serve and how they are made up. This makes it easier for them to target the groups in the population who are known to smoke the most and who find it most difficult to give up.
26. Stop smoking services are demonstrably cost-effective and benefit the local economy, apart from social care costs, much of the direct savings they deliver accrue mainly to the NHS and not by the increasingly cash-strapped local authorities that have to pay for the services.
27. Local authority trading standards' teams have powers to stop the supply of counterfeit cigarettes and to tackle sales from pubs, mobile traders and people's homes. They can also tackle underage sales and illegal advertising. They work with Her Majesty's Revenue and Customs and with the police through local Community Safety Partnerships. Trading standards officers and others help reduce the scale of the illicit tobacco trade. The Exchequer gains financially from its investment in measures by HMRC to tackle tobacco smuggling through revenue loss prevention, but local authorities do not.
28. 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.

### Answers to Consultation Questions

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

29. We support this definition of the tobacco market. It would be relatively simple to administer.

**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?**

30. 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 could be manipulated by the tobacco industry through the process known as forestalling.

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<sup>15</sup> Hypothecated taxation – Parliament briefing Nov 2011

<sup>16</sup> Libor Funds, BBC News, 5 Dec 2013 <http://www.bbc.co.uk/news/business-25237844>

31. “*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. 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.<sup>17</sup>

32. Revenue should be distributed to local authorities in accordance with the proportion of the total number of smokers in each local authority area.

**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?**

33. 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.

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

34. For the reasons stated in paragraphs 29 to 31 above, 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?**

35. Use of the corporation tax system to collect the levy is a good idea, as the system would not impose an additional administrative burden.

**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?**

36. We believe the Levy would impact the proportion of the levy that manufacturers decide to pass on in the retail price of cigarettes and other tobacco products.

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

37. 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, refuse collection and enforcement work.

38. Additional resources would enable local councils to respond to the specific health and social care needs of their communities in ways that they know will be effective.

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<sup>17</sup> [HM Revenue and Customs: Tobacco Bulletin, August 2014](#)

- 39. We believe the money raised could be spent on measures that prevent youth uptake, tackle smoking in pregnancy, encourage smokers to quit, tackle counterfeit and illicit tobacco and help councils clean up the streets of cigarette litter that blight our neighbourhoods.
- 40. If money raised through the levy went into the Consolidated Fund this wouldn't deliver the preventative and regulatory action needed in terms of escalating trading standards, environmental health and public health activity.

**Contact:**

\_\_\_\_\_, Senior Adviser

(Tel) \_\_\_\_\_

## 2.55 TOR Imports Limited



Tobacco Levy Consultation  
VAT and Excise  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

### Response to Tobacco Levy Consultation

4<sup>th</sup> February 2015.

Tor Imports Limited is a small family run tobacco importer and distributor business based in Devon, employing seven staff. Over 80% of our turnover is specialist niche hand made cigars, pipe tobacco and smoking accessories. Our market place is the Specialist Tobacconist stores located across the United Kingdom, making Tor a Tobacco Specialist Importer.

In total, Tor Imports Limited distribute over 10% of all the individual tobacco products available in the UK, **however due to unique and niche nature of these products**, we have an estimated share of the overall estimated tobacco revenue (2102/13 £15.4bn) of **0.01%**.

The name and address of the respondent is:

\_\_\_\_\_, TOR Imports Limited, The Old Quarry, Caton Cross, Ashburton Devon TQ13 7LH

Contact email address: \_\_\_\_\_

Contact Phone Number: \_\_\_\_\_

### STATEMENT OF PRINCIPLE

We are fundamentally opposed to the principle of a Levy on tobacco companies as we consider it to be an unreasonable and discriminatory measure.

**I will therefore respond to the principle of such a Levy, rather than comment on the individual questions in the Consultation which relate primarily to implementation issues in the event that the introduction of a levy goes ahead.**

### TOR IMPORTS LIMITED TAX CONTRIBUTION

It is relevant to emphasise that Tor Imports Limited contributed £1.4 million in tax revenue (Excise and VAT) during our last financial year on a turnover of £2.1 million, so it is impossible and unreasonable to see how we can contribute any further.

As a small business, we have been significantly and disproportionately affected by the level of regulation in recent years, and an additional tax (Levy) would put us under severe economic pressure.

### **DIMINISHING RETURNS**

There is a strong likelihood that a Levy would have a similar market effect as an excise duty increase. In spite of the implication made in the Consultation document, we would have no option but to pass on any additional costs onto the end consumer. The result of this would be a decline in volumes and a corresponding diminished return in tobacco tax receipts to HM Treasury, thereby undermining any contribution resulting from the Levy.

### **MINIMUM MARKET SHARE THRESHOLD**

Tor Imports have a miniscule share of the total tobacco market in the UK. The calculation of a Levy payment based on this, whilst relatively limited in the overall context of the intended receipts, would still represent an unacceptable financial commitment. It is therefore our recommendation that, in the event of a levy being imposed, a minimum threshold should be established below which no contribution would be expected.

### **MINIMUM MONETARY PAYMENT REGARDLESS OF MARKET SHARE**

Based on the logic outlined in the previous paragraphs, any minimum Levy payment regardless of market share would represent a disproportionate imposition for our business.

### **CONCLUSION**

A significant level of tobacco regulation has been introduced over the past 10 years, in addition to relentless annual excise increases.

A full tobacco display ban will be in effect from April 2013 and an extensive range of complex and costly measures, including 65% health warnings, will be implemented from May 2016 as a result of the revision of the EU Tobacco Products Directive along with potential Standardized Packaging on Tobacco products planned also for 2016.

We have been significantly and disproportionately affected by this level of regulation because of our size and the very specialist nature of our trade. I am therefore extremely concerned that, if a Levy were to be applied to Tor that it would have devastating consequences.

Under these circumstances it is our view at Tor Imports that the introduction of a Levy is a step too far, and the Government should give serious consideration to resisting the ideological temptation to take forward a policy which is (i) unlikely to deliver its stated objectives, and (ii) likely to cause significant damage to a number of small and vulnerable UK businesses like us.

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4<sup>th</sup> February 2015

## 2.56 Trading Standards Institute



Information Officer  
Trading Standards Institute  
1 Sylvan Court, Sylvan Way  
Southfields Business Park  
Basildon, Essex, SS15 6TH

Telephone: \_\_\_\_\_  
E-Mail: \_\_\_\_\_

### By Email

Tobacco Levy Consultation  
VAT and Excise  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

18 February 2015

Dear Sirs

### Tobacco Levy Consultation

The Trading Standards Institute welcomes the opportunity to comment on this consultation. Please see the following pages for our views.

The Institute is the UK national professional body for the trading standards community working in both the private and public sectors. Local authority trading standards services have for some years promoted public health through, for example, tobacco control activities and this role gained in importance recently when, as part of its health reforms, the government repositioned public health back into English local government.

Further brief information about TSI is provided on the final page of this letter.

In compiling this response, TSI has canvassed the views of its Members and Advisers. The response has been composed by TSI joint lead officer for health \_\_\_\_\_ and TSI director of policy \_\_\_\_\_. If you would like to discuss the response with us, please do not hesitate to contact \_\_\_\_\_ or \_\_\_\_\_ at \_\_\_\_\_ or \_\_\_\_\_ respectively.

TSI does not regard this response to be confidential and is happy for it to be published.

Yours faithfully

\_\_\_\_\_  
Information Officer

## Introduction

TSI welcomes the opportunity to comment on this consultation. The Chancellor's announcement in the Autumn Statement that the Government is minded to introduce a levy on tobacco manufacturers and importers is welcomed and 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"*.

In making this response the Institute wishes to highlight the important role that local authority trading standards play in regulatory tobacco control and to bring to the attention of Government the dangers facing future activity in the face of further cuts to services.

## Context

The Department of Health and Public Health England set out the approach to be taken for comprehensive tobacco control. "Healthy Lives, Healthy People: A Tobacco Control Plan for England", published in March 2011, states that Government will:

- Encourage and support the **effective local enforcement of tobacco legislation**, particularly on the age of sale of tobacco products;
- Support the continuing provision of **guidance, education and best practice for the local enforcement** of tobacco legislation; and
- **Promote local action to identify niche products** on sale in communities to ensure that these products meet the requirements of tobacco legislation.

"Our Priorities 2013:14 Public Health England", published in 2013, states that the organisation will:

'Accelerate efforts to promote tobacco control and reduce the prevalence of smoking. We will identify, support and champion national and local efforts to accelerate smoking cessation, promoting the use and implementation of evidence based-interventions, and addressing variations in smoking'.

Internationally, the WHO Framework Convention on Tobacco Control describes the essential elements of comprehensive tobacco control policy. This includes a strong focus on regulatory matters.

Local authority trading standards have a leading role to play in delivering the regulatory strands of comprehensive tobacco control, working in collaboration with a range of colleagues locally, regionally and nationally.

Specifically, trading standards is engaged in the prevention and detection of illegal underage sales, tackling the supply of illicit tobacco products, the control of tobacco advertising and display, and the identification of niche products.

The Institute collects data on an annual basis from trading standards services in England to measure the level of activity undertaken in this vitally important area of work. The Tobacco

Control survey report for 2013-14<sup>1</sup> noted that there had been “a significant decrease since 2012/13 in the number of authorities undertaking the following “:

- Conducting activities in relation to under-age sales (decreasing from 95 per cent to 88 per cent of councils);
- Undertaking collaborative working (decreasing from 86 per cent to 79 per cent of councils);
- Conducting activities in relation to advertising and display of tobacco products (decreasing from 70 per cent to 34 per cent of councils).

### **The case for a levy to fund future tobacco control activities undertaken by trading standards**

While we recognise that no service has been protected from cuts, local authority trading standards services have suffered particularly severe reductions in resources over the period of financial austerity. Over the lifetime of this parliament, the average service has seen its budget fall by 40%, with reductions of up to 80% in some areas. Services spend around 80% of their budget on staff, and therefore staff numbers have fallen by almost half since 2009. Some services are now left with only a single part time trading standards officer to cover over 250 statutory duties in areas as diverse as combating doorstep crime and scams through to controlling animal movements to prevent disease outbreaks.

The Trading Standards Institute is concerned that the levels of cuts to the service, which look set to continue for the foreseeable future, are unsustainable. We are concerned that new legislation is often added to the statute book without adequate consideration of how enforcement will be resourced – in this parliament alone there have been over 50 statutory instruments and 8 Acts which have created new duties for trading standards. New legislation in the area of tobacco control which gives trading standards an additional enforcement role includes:

- The Tobacco Advertising and Promotion (Display) (England) Regulations 2010 (coming into force in small business premises in April 2015 );
- The Tobacco Advertising and Promotion (Display of Prices) (England) Regulations 2010 (as above);
- New legislation to prohibit proxy purchasing of tobacco products (from 01 October 2015);
  - New legislation to implement the standardised packaging of tobacco products (May 2016);
- A range of regulatory matters still to be confirmed via the EU Tobacco Products Directive (May 2016).

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<sup>1</sup> Tobacco Control survey report 2013-14 published by TSI (2014) – available online at: <http://www.tradingstandards.gov.uk/policy/improvingthehealthofsociety.cfm> [accessed 18 February 2015]

Many of the areas of trading standards activity are preventative in nature, and a small investment in these services will lead to savings for the public purse. This is particularly true in the area of tobacco control, as illustrated by the preventative work undertaken in relation to sales of tobacco to young people.

The statistics in this area are alarming – with 567 children starting smoking in the UK every day, and 80% of heavy smokers starting before the age of 20.

On average, a lifelong smoker will lose 10 years of their life and will live many of their remaining years in poor health, leading to enormous costs to the NHS. It is our view that investing in trading standards' tobacco control work has the potential to bring huge savings to the NHS and the public purse in future.

TSI is concerned that falling resources are forcing services to refocus their activity away from these preventative activities and concentrate on fire-fighting, reacting to complaints and crises as they occur. This is not the most effective way to deliver comprehensive tobacco control at a local level; it does not, for example, allow for the economies of scale that can be achieved with coordination of resources.

It is estimated that the delivery of tobacco control regulatory activities costs each local authority on average £44,000 per annum inclusive of on-costs. In taking advice from trading standards services on this matter, the range of estimated costs was found to extend from £10k in a small borough to £80k in an urban unitary where there are two officers employed full time to work on tobacco control activities. This estimate does not, however, take account of any new additional responsibilities that may be assigned to trading standards.

The Trading Standards Institute believes that distributing funding intended to support trading standards work on tobacco control through the Revenue Support Grant would not be effective. In a background of shrinking resources for local government, there is no guarantee that this funding will reach trading standards and it could readily be diverted to other services.

Examples of existing alternative funding mechanisms that are successful include the Food Standards Agency grant for animal feed work distributed through the National Trading Standards Board (NTSB) and the Department of Health contract with the Trading Standards Institute for tobacco control work.

Given that the NTSB has no current role in the area of public health, we recommend that any portion of the tobacco levy intended for trading standards is distributed through the existing TSI tobacco control contract to ensure that resources will go directly to local trading standards services for the purposes of tobacco control work.

A recent example of how this works in practice is provided by Operation Henry<sup>2</sup>, a project delivered and managed by TSI to tackle illicit tobacco across England. With 81 local authority trading standards services participating, a small amount of financial support from the Department of Health enabled a coordinated approach to be undertaken across the

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<sup>2</sup> Operation Henry report published by TSI (2015) – available online at: <http://www.tradingstandards.gov.uk/extra/news-item.cfm/newsid/1705> [accessed 18 February 2015]

country, removing illicit tobacco with a value of over £749,000 and providing future intelligence for both trading standards services and HMRC .

The Trading Standards Institute therefore supports the imposition of the tobacco levy and looks forward to an announcement detailing how a proportion of the proceeds of the levy will be used to help support local authority trading standards tobacco control regulatory activity.

The role undertaken by trading standards in a comprehensive strategy to reduce the harm caused by tobacco is currently, and for the foreseeable future, at great risk without such additional support.

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## **The Trading Standards Institute**

The Trading Standards Institute (TSI) is a professional membership association formed in 1881. It represents trading standards professionals working in the UK and overseas - in local authorities, the business and consumer sectors, and central government.

The Institute aims to promote and protect the success of a modern vibrant economy and to safeguard the health, safety and wellbeing of citizens by empowering consumers, encouraging honest business, and targeting rogue traders. We provide information, evidence and policy advice to support national and local stakeholders.

We are taking on greater responsibilities as the result of the government's announcement in October 2010 that trading standards is one of the two central pillars of the new consumer landscape (the other being Citizens Advice).

We have taken over responsibility for business advice and education, developing the Business Companion website ([www.businesscompanion.info](http://www.businesscompanion.info)) which provides information for businesses and individuals needing to know about trading standards and consumer protection legislation.

The TSI Consumer Codes Approval Scheme, established at the request of the government to take over from the OFT scheme, was launched in 2013.

TSI is a member of the Consumer Protection Partnership which was set up by the government to bring about better coordination, intelligence sharing, and identification of future consumer issues within the consumer protection arena.

We run events for both the trading standards profession and a growing number of external organisations. We also provide accredited courses on regulations and enforcement.

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***A key concern for TSI is that of resources. UK local authority trading standards services enforce over 250 pieces of legislation in a wide variety of areas. They have suffered an average reduction of 40% in their budgets since 2010 and staff numbers have fallen by 50%.***

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## 2.57 John Britton of the UK Centre for Tobacco and Alcohol Studies



UNITED KINGDOM • CHINA • MALAYSIA

Tobacco levy consultation  
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4<sup>th</sup> February 2015

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(Email) \_\_\_\_\_

Dear Madam/Sir

### Re: Tobacco Levy Consultation

This submission is made on behalf of the UK Centre for Tobacco and Alcohol Studies, a UKCRC Public Health Research Centre of Excellence established in 2008 and comprising a network of leading tobacco and alcohol researchers from 13 universities in the UK and overseas. A full listing of the researchers involved, and background information on the objectives and activity of the Centre, are available at [www.ukctas.ac.uk](http://www.ukctas.ac.uk).

We welcome the opportunity to respond to this consultation. Tobacco smoking is a highly addictive and lethal behaviour which, since the early 20<sup>th</sup> century, has become the largest avoidable cause of premature death and disability in our society. Despite marked reductions in smoking prevalence over recent decades smoking still causes around 100,000 or one in six deaths in UK adults [1], around 5000 fetal deaths, 40 cot deaths and over 160,000 new cases of childhood illness in the UK each year [2]. Being particularly prevalent among the most disadvantaged in society [3;4], smoking is also the largest avoidable cause of social inequalities in health [5]. For these reasons alone, preventing smoking should be the highest health priority in the UK.

The consultation document summarises estimated annual costs of smoking to society, produced by Action on Smoking and Health, of £12.9 billion. Whilst robust, this figure is almost certainly an underestimate of the true costs: earlier estimates of NHS and societal costs have been higher [6-8], and none of these figures includes the costs of exacerbation of mental health problems by smoking, which are likely to be substantial [3].

In our view it is right to expect the tobacco industry to meet the full costs of smoking to society, and for government to adopt all measures likely to help to reduce the death and disability caused by smoking. The proposed levy will help to achieve both of these objectives. Increasing the cost of tobacco is one of the most effective ways to prevent smoking [9] and as it is likely that much, if not all, of the cost of the levy will be passed on to consumers, the levy will prevent smoking to a degree proportional to its effect on prices. We therefore support the principle of the levy and applaud the Treasury for this proposal. Our responses to the questions posed are as follow:

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

Yes.

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

Use of the previous year's clearances would appear to provide a reliable estimate of the licit market

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

No

**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?**

Hand-rolling tobacco (and loose pipe tobacco) provide smokers with much less expensive alternatives to manufactured cigarettes, and hence undermine the effects of tobacco price rises on smoking prevalence. We support splitting the market if it allows a differential levy to reduce the cost discrepancies between these two product categories.

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

We have no preference.

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

Yes.

**Question 7: What are the alternative approaches?**

We are not expert in the collection of tax or other financial levy and hence make no comment

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

We would expect that the cost of the levy to be passed, in substantial part if not completely, on to consumers. If relatively small, the cost is likely to be allocated disproportionately to premium brands, in line with the longstanding industry policy of overshifting tax increases onto more profitable brands and hence maintaining low floor prices for the budget brands used mostly by poor smokers [10]. If the levy is large enough, it may force substantial price rises in the least expensive cigarettes and hence encourage smokers to quit. This effect on smoking prevalence will be enhanced if the levy is also used to reduce the price differential between manufactured and hand-rolled cigarettes.

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

Price rises will encourage existing smokers to quit, and discourage young people from starting to smoke.

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

Price rises caused by the levy would make alternative nicotine sources, including licensed over-the-counter medicines and electronic cigarettes, relatively more affordable, and hence promote switching to these less hazardous products among smokers who are unable or unwilling to stop using nicotine. This will enhance the public health gains achieved by the levy.

**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 think it highly unlikely that the costs of the levy will be passed to consumers to the extent that the market will bear. We see no advantage in this respect from adopting alternative levy or tax structures.

We therefore support the levy, and add another consideration. Tobacco smoking is powerfully addictive, and many smokers find it extremely difficult to quit smoking. Raising the cost of smoking encourages smokers, and particularly the most price-conscious smokers to quit. However price rises also exacerbate poverty and deprivation among smokers, and the dependents of smokers, who find themselves unable to quit. For moral as well as health and wellbeing reasons it is therefore essential that income raised from the tobacco levy is used directly to improve the support available for all smokers, and particularly those on low incomes, to help them to stop smoking.

Yours sincerely

John Britton  
UK Centre for Tobacco and Alcohol Studies

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## 2.58 Worcestershire Tobacco Control Alliance

**From:** \_\_\_\_\_  
**Sent:** 18 February 2015 15:34  
**To:** TobaccoLevy  
**Cc:** \_\_\_\_\_  
**Subject:** Tobacco Levy consultation

Hello

Please find attached the Worcestershire Tobacco Control Alliance response to the Tobacco Levy consultation.

We support the ASH submission attached.

Kind regards

\_\_\_\_\_  
Health and Well-being Strategy Development Officer  
Adult Services and Health Directorate  
Worcestershire County Council  
Tel: \_\_\_\_\_  
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(Email) \_\_\_\_\_



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