

2012 Budget submission to HM Treasury and HMRC

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Introduction

1. ASH is a public health charity set up by the Royal College of Physicians in 1971 to advocate for policy measures to reduce the harm caused by tobacco, which receives funding from the British Heart Foundation and Cancer Research UK for this work. The UK Centre for Tobacco Control Studies (UKCTCS) was created in 2008 and includes research teams in nine UK universities. It is one of five Public Health Research Centres of Excellence, funded by the UK Clinical Research Collaboration.

2. This paper sets out our joint recommendations on tobacco policy in tax and related areas in advance of the forthcoming Budget. This submission is endorsed by 91 health organisations (see annex for full list).

Summary and Recommendations

Summary

3. We support the government's objective – consistent with its wider fiscal objectives - of reducing the affordability of tobacco through increasing taxation, widely acknowledged as the most effective means of reducing smoking prevalence while increasing government revenues.
4. We congratulate the government on the measures introduced in the 2011 budget to sustain the tobacco escalator and to restructure tobacco taxation to reduce down trading to cheaper brands and handrolled tobacco (HRT).
5. We also support the provision of additional funding for the refreshed tobacco smuggling strategy. This strategy has been highly successful for over a decade in reducing the illicit market in tobacco while taxes continue to rise. This is in stark contrast to the arguments put forward by the tobacco industry that tax increases inevitably lead to increases in the illicit trade. Set out below are detailed rebuttals of tobacco industry arguments on tax, smuggling and plain packaging of tobacco products (due to be consulted on shortly).
6. However, we believe that there are some additional measures which would strengthen government policy still further. Our key recommendations on tobacco taxation and anti-smuggling measures are set out below followed by a more detailed background and analysis.

Key Recommendations:

Taxation

- 1) Increase the tobacco tax escalator from 2% to 5% above inflation from 2012 onwards.
- 2) Ensure that the specific tax element for cigarettes is the maximum allowed under the revised EU tax directive.
- 3) Further reduce the differential between tax levels on HRT and that on cigarettes.
- 4) Set a minimum excise tax for cigarettes to ensure that tax on all below average price cigarettes is set at the same level as that of average price cigarettes.
- 5) Improve the collection of data on the price of tobacco products.
- 6) Investigate the feasibility of introducing a price cap on tobacco product profits.

Smuggling

- 7) Set national ambitions to reduce the illicit market share of cigarettes from 10% in 2009/10 to 3% by 2015-16 and of HRT from 46% in 2009/10 to 25% by 2015-16.
- 8) Introduce legislation to require registration of tobacco retailers to make it easier to penalise sellers of illicit tobacco and protect the rights of legitimate retailers.
- 9) Support the inclusion of a pack-level tracking and tracing system administered independently of industry in the illicit trade protocol to the WHO FCTC;
- 10) Ensure that any engagement with the tobacco industry is in line with the UK's obligations as a Party to the WHO FCTC to protect public health policy from the vested interests of the tobacco industry.
- 11) Sustain investment in working with partner agencies in the UK, for example local authorities and the police, as exemplified in the North of England Programme.

- 12) Improve market surveillance and data collection in support of more effective enforcement and publish on the HMRC website an annual tobacco report.

Tobacco Taxation

7. We were pleased to see the commitment in the last budget to levy increased excise duties on tobacco which contribute to deficit reduction whilst supporting health objectives. Reducing affordability through increasing taxation is acknowledged to be very effective in encouraging smokers to quit and in discouraging young people, who are particularly price sensitive, from taking up smoking.^{1 2 3} Reducing youth uptake is a major concern as smoking is an addiction of youth with two thirds of smokers starting before they reach adulthood and very few taking up the habit after the age of 20.⁴
8. To this end we believe that the government could and should go further. Currently cigarettes still remain around 50% more affordable than they were in 1965, when our understanding of the harm from smoking was in its infancy. Therefore taxes need to be increased significantly above the rate of inflation if affordability is to be brought back to the level of the 1960s. The reintroduction of the tax escalator of 2% above inflation in 2010 did not lead to a significant decline in smoking prevalence, showing that an escalator of this size is insufficient to encourage smokers to quit.⁵
9. Given the need to meet the Government's fiscal objectives, it is clear that sources of further tax revenues – especially in areas that do not damage economic performance – are needed. Tobacco duty is, we believe, one such source. The revenue collection data published by HMRC showed that when tobacco taxes went up above inflation in 2009, tax revenues held up and have continued to do so since the escalator was introduced in 2010.⁶
10. There is historical and international evidence that larger increases can yield greater revenues while reducing the number of smokers. A 50% increase in UK tobacco duty in 1947 reduced the number of smokers by hundreds of thousands while revenues increased sharply.⁷ The Australian Treasury expected its 2010 increase of 25% in tobacco taxation to produce a 15% increase in revenues.⁸ Despite budgetary pressures stemming from the global economic crisis, 2010-11 revenues increased by 12.5% compared with the previous financial year. A further 7% increase is forecast for the current financial year, 2011-12.⁹
11. Raising tobacco taxes significantly is popular with the public as well as an effective public health intervention. A poll for the Daily Mail in June 2010 in advance of the emergency budget found that 81% of those sampled supported increasing tobacco

¹ WHO Framework Convention on Tobacco Control. Article 6.

² The World Bank. Curbing the epidemic: governments and the economics of tobacco control. May, 1999.

³ IARC Handbook of Cancer Prevention Volume 14. Lyon: IARC, 2011

⁴ Smoking and drinking among adults, 2009. A report on the 2009 [General Lifestyle Survey](#). Office for National Statistics, Jan 2011.

⁵ West R, Fidler J. (2011) Smoking and smoking cessation in England 2010. London: Vasco-Graphics. Available from www.smokinginengland.info.

⁶ Tobacco Bulletin HMRC. October 2011.

⁷ Unpublished research by Dr C Pickering (ex-HM Treasury)

⁸ Treasury, Australia. [Issues in tobacco taxation](#). Treasury, Australia. 2012-01-03.

URL:http://www.treasury.gov.au/documents/2086/PDF/Document_57.pdf. Accessed: 2012-01-03.

⁹ Australian Treasury reports at http://www.budget.gov.au/2009-10/content/fbo/html/part_1.htm;
http://www.budget.gov.au/2011-12/content/myefo/html/03_part_3-01.htm

taxes by 50% to help tackle the budget deficit.¹⁰ Surveys have also shown that the majority of smokers would support price increases above inflation if they were used to help stop young people take up smoking and help smokers quit.¹¹ Indeed there is evidence to show that smokers value higher taxes as devices to increase their own commitment to give up.¹²

Tax escalator

12. The tax escalator for tobacco put in place in 2011 is only 2% above inflation per annum. Relatively small increases like these appear to have less impact on consumption than higher increases, as smokers find them easier to adjust to. In order to continue to reduce smoking prevalence, a key government objective, while sustaining tax revenues, we would recommend introducing a higher escalator of at least **5% above inflation in the 2012 budget**.
13. Such a policy is supported by emerging evidence from financial analyst reports,^{13 14} tobacco industry documents¹⁵ and research on industry lobbying.¹⁶ All these sources suggest that regular, moderate tax increases can benefit industry while large intermittent tax increases have a greater impact on demand. Analysts, for example, note that “steady, small tax increases can be helpful for the industry”¹⁴ while “large unforeseen increases are one of the most effective means of reducing smoking prevalence.”¹³ As BAT noted back in 1992:

“The psychology of smoker demand is such that they are more likely to absorb smaller and more frequent price increases than larger and less frequent price increases . During negotiations with Government therefore it is preferable to seek the former excise environment.”¹⁷
14. As noted above there are precedents for significantly higher tax increases than the current escalator in the UK as well as in other jurisdictions.

Tax structure

15. While real average cigarette prices have been increasing across the market as a whole in recent years, the prices of the cheapest cigarettes have remained unchanged in real terms. This is because the tobacco industry has been absorbing tax increases on the cheapest brands rather than passing them on to consumers.¹⁸ It can afford to do this by increasing prices and thus profits on its more expensive brands. The timing of industry initiated price changes appears timed to accentuate price differences between brand segments when tobacco duties increase in April each year.¹⁸

¹⁰ BPIX survey for The Mail on Sunday. Published 10th June 2010. <http://www.dailymail.co.uk/news/article-1286199/David-Cameron-told-Heres-37bn-cuts-started.html>

¹¹ Gardner B, West R. (2010) Public support in England for raising the price of cigarettes to fund tobacco control activities. *Tobacco Control*, 19(4), 331-333.

¹² Gruber, J and Mullainathan, S. (2005). Do Cigarette Taxes Make Smokers Happier? *Advances in Economic Analysis and Policy* Vol. 5: No. 1, Article 4 Available at <http://www.bepress.com/bejeap/advances/vol5/iss1/art4>

¹³ Morgan Stanley. Tobacco - Late to the Party. Morgan Stanley Research Europe. London. 30 January 2007.

¹⁴ Spielman A. *European Tobacco. The startling business of tobacco*. Citigroup 2008.

¹⁵ Bingham P. [Note from Paul Bingham to B Ryan regarding area paper on excise taxation] In: *Tobacco BA*, ed. 1990:501572229-501572243. <http://legacy.library.ucsf.edu/tid/gam34a99>.

¹⁶ Shirane R, Smith K, Ross H, et al. Tobacco industry influence in the Czech Republic: manipulating tobacco excise tax and tobacco control policies in times of major political change. *PLoS Med* 2011 (under review).

¹⁷ Bingham P. Key Area Paper: Excise Taxation of Tobacco Products. 1992:503923191-503923215. <http://legacy.library.ucsf.edu/tid/mkn70a99>.

¹⁸ 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* (under review).

16. Related evidence shows that the increase in the use of cheap cigarettes is most marked in the youngest (16-24 year old) smokers, 71.4% of whom now use cheap brands¹⁹ and that the young, the poor, women and those living in areas of the country with high smoking rates are more likely to use cheap (ultra-low price and economy) cigarette brands. This highlights the impact of the availability of cheap cigarettes on inequalities in smoking.^{18 19} A recent (as yet unpublished) study by the UKCTCS found that the most popular brands by far amongst underage smokers were Mayfair and Richmond (economy brands).
17. The consequence of the industry pricing its cigarettes in this way has been to undermine the effectiveness of the UK's tobacco tax strategy, by leaving the affordability of the cheapest cigarettes unchanged, so encouraging downtrading. We therefore recommend, in addition to increasing taxes above inflation, that the government maximise specific taxes and introduce a minimum excise tax to help ensure that the cost of the cheapest cigarette brands increases in real terms.

Specific taxation on cigarettes

18. To minimise as far as possible the tax differential between different price categories and so help prevent the downtrading outlined above, we recommend that the UK ensure that specific tax is set at the maximum allowed under the new regulations.
19. The EU tax directive allows for specific tax to be up to 76.5% of the total tax burden on the weighted average retail selling price (WAP) from 1 Jan 2011 onwards.²⁰ In the UK after the budget in March 2011 specific tax was estimated to be only 62.3% of the total tax of a typical pack of cigarettes in the ultra low price category cigarettes allowing significant room for further rebalancing, as it will be an even lower proportion of the total tax burden of the weighted average price.²¹

Minimum Excise Tax (MET)

20. The revised directive also allows for a minimum excise tax for all products.²⁰ We urge the government to introduce the highest possible minimum excise tax in order to help reduce the tax differential between different price categories.
21. To maximize taxation on lower than average priced cigarettes and set an effective floor below which the total tax burden can't fall, the MET should be set equivalent to the maximum total tax burden allowable based on the Weighted Average Price (WAP).

Tax on Hand Rolled Tobacco (HRT)

22. There has also been a significant increase in the use of HRT in recent years. This is due to the lower price of HRT particularly as a result of large imports of tax paid cheap HRT smuggled into the UK from Europe. This in turn discouraged the government from increasing taxation on HRT in line with cigarettes, so increasing the price differential between cigarettes and legal HRT. The proportion of smokers mainly using HRT has increased from 25% of men and 8% of women in 1998 to 37% of men and 21% of women in 2009⁴¹ and increases in the use of HRT have again been most marked in the youngest age group (16 to 24 year olds).¹⁸

¹⁹ Tavakoly G, Taylor G, Hiscock R, Gilmore A. Smoking patterns in Great Britain: the rise of cheap cigarette brands and hand rolled tobacco. *Addiction* (under review).

²⁰ Council Directive 2010/12/EU of 16 February 2010 amending Directives 92/79/EEC, 92/80/EEC and 95/59/EC on the structure and rates of excise duty applied on manufactured tobacco and Directive 2008/118/EC

²¹ HMRC Tobacco Factsheet. Table 3.3 Taxation on Cigarettes. November 2011.

23. The government is to be congratulated for increasing taxes on HRT by an additional 10% above cigarettes in the 2010 budget, which does not appear to have led to an increase in the market share of smuggled HRT.²² However, tax on HRT in the UK is still only 68.8% of total price and there is room for further increases in taxation. In the past it has been as high as 74.3%.²³ We recommend tax on HRT should be increased again this year above that of cigarettes to further reduce the differential.
24. In the past there have been concerns that increasing taxation on HRT would lead to an increase in the already substantial illicit market. However, increasing control of smuggled HRT and a reduction in smuggled market share from 61% in 2004-5 to 46% in 2009-10 shows that the illicit market for HRT is in decline.²⁴ The quantities released for consumption increased by 16% year on year in the seven months after the last budget.²⁵ It is too soon to see the impact of reduced minimum indicative limits for both cigarettes and HRT, introduced in October 2011, but this is likely to further reduce smuggling of HRT from Europe.
25. Furthermore, tax on HRT will be going up in other jurisdictions as a result of the revised directive. The minimum tax at EU level will rise from 36% of weighted average selling price previously to 40% on 1 Jan 2011, 43% in 2013, 46% in 2015, 48% in 2018 and 50% in 2020.²⁰
26. Evidence from overseas indicates that the tobacco industry will try to exploit loopholes in tax legislation by selling HRT as pipe tobacco if lower taxes are applied to pipe tobacco.²⁶ For this reason we suggest keeping taxes on pipe tobacco in line with those on HRT.

WHO Framework Convention on Tobacco Control Article 6

27. Guidelines to the WHO FCTC on tobacco taxation are currently under development, with the European Commission as one of the Key Facilitators. Member States are being consulted on the draft guidelines by the Commission. The UK has been in the forefront of tobacco tax policy development for many years and has considerable expertise to bring to bear, which will be very valuable in the development of effective guidelines.

Price capping

28. The tobacco industry is the most profitable consumer business in the world. In the UK, just two companies dominate the market, each having approximately a 40% market share.²⁷ Imperial Tobacco, the market leader, enjoys margins in the UK of some 67%.²⁸ These excess profits are, in turn, used in marketing and lobbying, thereby undermining government policies to reduce smoking prevalence.
29. This is because while tobacco regulation by government has been extremely effective in driving down smoking prevalence it has also had unintended consequences. The

²² HMRC Tobacco Factsheet. Table 1.1 Tobacco receipts by type. November 2011.

²³ HMRC Tobacco Factsheet. Table 3.8 Taxation on HRT. November 2011.

²⁴ HMRC. Measuring tax gaps 2011. An official statistics release. 21st September, 2011.

²⁵ HMRC. Tobacco Bulletin. October 2011.

²⁶ Clifford, D. Ciecierski, C. Silver, K. Gilmore, A. PPACTE Work Package 5 - Milestone 5.2. Tobacco industry influence over tobacco taxation in Poland. Dublin: PPACTE, 2012.

²⁷ 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

²⁸ 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 (*under review*).

tobacco industry is heavily concentrated globally, with four companies accounting for the vast majority of tobacco sold worldwide, two of which, British American Tobacco and Imperial Tobacco, are British. This concentration has been enhanced by the significant barriers to entry caused by regulatory measures in particular bans on advertising, promotion and sponsorship, leading to market failure.²⁷

30. 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 (outlined above), 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.¹⁸
31. Placing a cap on industry profit 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. 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.²⁷ A related paper, currently under review, estimates that price capping could raise in the region of £500 million per year in additional government revenue in the UK without changing the price the consumer faces.²⁸

Tobacco tax and health inequalities

32. Measures to reduce smoking prevalence, including through making tobacco less affordable by increasing tobacco taxes above inflation and reducing the illicit market in tobacco, are not only essential to improving the nation's health and reducing health inequalities but also increase government tax revenues.²⁹ Tobacco tax increases are also popular with the general public.¹⁰
33. However, tobacco is a commodity disproportionately consumed by poorer people and because tobacco taxes are sales taxes they are potentially regressive. Nonetheless, genuine price increases above inflation do lead some smokers to quit and lead to very substantial health and welfare gains for those that do.
34. Indeed poorer smokers are more likely to quit as they are more sensitive to price increases, so putting tobacco taxes up is potentially a progressive rather than regressive measure which can help reduce health inequalities at population level.³⁰ However, poorer smokers who don't quit are disproportionately disadvantaged because of the negative impact of tobacco tax increases on their already small incomes.
35. This poses a dilemma, which can be resolved by ensuring that all efforts are made to motivate and support smokers in quitting. The health organisations which endorse the ASH budget submission support increasing the tobacco tax escalator to 5% above inflation to continue to reduce the affordability of tobacco as long as at the same time government continues to provide adequate funding for measures to reduce smoking prevalence. These should include funding effective stop smoking services targeted at low income smokers and further measures to tackle the illicit trade in tobacco.

²⁹ Reed, H. The Effects of Increasing Tobacco Taxation. A Cost Benefit and Public Finances Analysis. London, ASH, 2010.

³⁰ The World Bank. Curbing the epidemic: governments and the economics of tobacco control. May, 1999.

Rebuttals of Tobacco Industry arguments

36. Every year the tobacco industry argues that increasing taxes would increase the illegal trade in tobacco, that the UK's taxes are amongst the highest in the world and that government should not increase taxes in the forthcoming budget. The argument that tobacco control measures will increase smuggling is used to argue against any tobacco control measure as it allows the industry to both argue that the measure will be ineffective, while at the same time arguing that it will harm the economy by reducing legal sales.

Rebuttals of arguments on tax and smuggling

37. The argument that tax increases and enhanced regulation inevitably lead to increases in smuggling are not borne out by UK evidence.⁴⁰ In the UK smuggling has been significantly reduced over the last decade by strong enforcement measures.²⁴

38. Reintroduction of the tax escalator, increasing taxation above the rate of inflation while sustaining a tough anti-smuggling strategy has been successful. It has not led to increasing levels of illicit tobacco, as predicted by the tobacco industry.

39. These arguments have been reinforced this year following an erroneous assertion that evidence from a recent study shows that tax increases are ineffective in reducing smoking prevalence.³¹ This assertion is not borne out by the study being cited by the Tobacco Manufacturers' Association (TMA).³² Indeed one of the conclusions of the research was that *"price and affordability are not being utilised to their full potential in smoking prevention"* even in the EU-15 member states.

40. The paper used Most Popular Price Category (MPPC) as a measure of price rather than WAP, so is not necessarily a good measure of the average price being paid by consumers. Importantly, the MPPC is interpreted differently in different EU member states and may represent the price of premium brands in one country and economy brands in another. This makes it harder for the study to detect an impact of tax. In the UK the MPPC represents the price of premium brands only and the market share of premium brands has declined over time. As such the MPPC is increasingly unrepresentative of prices here.¹⁸

41. Using the MPPC also doesn't account for downtrading to alternative cheaper tobacco products for example lower price cigarettes or HRT. The UK data show that the industry has a differentiated pricing strategy and has increased prices of MPPC premium brands while keeping prices of cheaper brands static in real terms in recent years.¹⁸ This also undermines the impact of tax policies. This is why it is essential to put a Minimum Excise Tax in place in the UK and to investigate the feasibility of price capping.

42. Furthermore, the paper does not claim that affordability increased massively in new EU member states. It claims that prices increased *"progressively"* in all EU member states and there was no significant difference between old and new members. It also states that affordability was lower in new compared to old EU countries but that the increase was not significantly different. Indeed, this GRADUAL increase in

³¹ Holehouse, M. Tobacco Sector wants freeze on cigarette duty. Daily Telegraph. 14 November 2011.

³² Bogdanovica, I. Murray R., McNeill A., Britton, J. Cigarette price, affordability and smoking prevalence in the European Union. Addiction 2011.

taxes/prices may explain the lack of impact of tax increases on prevalence seen in the study.

43. There were also other pressures to consume tobacco (for example tobacco marketing and the illicit market) which had more impact in some EU member states in the period examined, than others.
44. Lastly prevalence measures used in the study were from Eurobarometer. While this is the only pan-European survey available and thus the best data to use, the sample size in each country is small and the confidence intervals large. Other work done by the same authors highlights weaknesses in these data that make it harder to detect an impact of the tax increases.³³
45. It is true that using tax to reduce affordability in the 1990s was undermined by the growth of smuggling which gave smokers access to cheap illicit tobacco. During that decade the illicit market in tobacco ballooned, making smoking more affordable and reducing the incentive to quit. The tobacco industry argued that this increase was due to tax increases and that taxes should be cut.³⁴
46. In fact, the increase in smuggling was strongly associated with a dramatic growth in UK manufacturers' exports of cigarettes.^{35 36} Products smoked in significant quantities only in Britain, such as Regals and Superkings, were being exported to jurisdictions where there was no end market and smuggled back to the UK. To quote the current Chancellor, then a member of the Public Accounts Committee questioning the Imperial Tobacco CEO, and members of his senior management team about this:
"One comes to the conclusion that you are either crooks or you are stupid, and you do not look very stupid. "
*"How can you possibly have sold cigarettes to Latvia, Kaliningrad, Afghanistan and Moldova in the expectation that those were just going to be used by the indigenous population ... and not in the expectation they would be smuggled? You must know - you only have to read a newspaper every day, a member of the public could tell you - these are places which are linked to organised crime."*³⁷
47. From 2000 onwards an anti-smuggling strategy including tough measures to force the tobacco manufacturers to control their supply chains was introduced by the Government. Subsequently the illicit market has slowly but surely declined without taxes being cut.
48. The tobacco industry continues to assert that tax increases above inflation will lead to an increase in smuggling again.^{38 39} However, this is not borne out by the revenue

³³ Bogdanovica, Godfrey, F., McNeill A., Britton, J. Smoking prevalence in the European Union: a comparison of national and transnational prevalence survey methods and results. Tobacco Control. 2011.

³⁴ See various TMA briefings and press releases for example. 'Cut and Freeze' tobacco tax policy could win war on smuggling. <http://www.prnewswire.co.uk/cgi/news/release?id=83061>
http://web1.wisetigerhosting.co.uk/~thetma/wp-content/uploads/2010/06/TMA_Briefing_02.pdf accessed 6th March 2011

³⁵ Public Accounts Committee. Third Report. Tobacco Smuggling. HC 143. 2002-3 Session.

³⁶ BBC Money Programme. <http://news.bbc.co.uk/1/hi/business/210260.stm> accessed 28 February 2011.

³⁷ Public Accounts Committee minutes of evidence Wednesday 19th June, 2002.
<http://www.publications.parliament.uk/pa/cm200203/cmselect/cmpubacc/143/2061915.htm> (accessed 21st January 2011).

³⁸ Clark N, Thompson J. VAT and duty: Cigarettes and alcohol hit by 'hidden' excise charge. Independent 10 December 2009.

<http://www.independent.co.uk/news/uk/politics/vat-and-duty-cigarettes-and-alcohol-hit-by-hidden-excise-charge-1837302.html> accessed 7 March 2011.

³⁹ Bowers, S. Tobacco taxes set to boost smuggling. Guardian Monday 6th February 2011.
<http://www.guardian.co.uk/business/2011/feb/06/tobacco-vat-duty-smuggling> accessed 7 March 2011.

collection data published by HMRC which shows that when tobacco taxes went up above inflation in 2009, tax revenues held up and have continued to do so since the escalator was re-introduced in 2010.⁴⁰

49. Smoking prevalence, which had declined significantly from 45% of the adult population in 1974 to 30% in 1990, stopped declining in the 1990s.⁴¹ It was only after smuggling began to be brought under control as part of a comprehensive tobacco control strategy that smoking rates started to fall again. By 2008, the illicit trade in cigarettes had reduced significantly as had smoking prevalence.⁴¹ This illustrates the importance of controlling the illicit trade as part of a comprehensive strategy to reduce smoking prevalence.
50. One further piece of evidence against the industry's argument that price increases lead to smuggling is also important: that the industry does not even believe its own rhetoric on the issue and despite publicly making these claims continues to increase prices. In Ireland, a recently published paper shows that over the last ten years, despite heavy industry lobbying that price/tax increases would lead to smuggling, over a third of the price increases over that period were initiated by the industry.⁴² Similarly, in the UK, the industry has been increasing the price of all but its so called "ultra-low-price" brands over and above the tax increases.¹⁸

Rebuttals of arguments on plain, standardised packaging

51. The tobacco industry argues strongly against plain, standardised packaging using a range of arguments. Those most relevant to HM Treasury and HMRC are that it will lead to increased smuggling and a reduction in price, thereby reducing tax revenue and increasing smoking prevalence.
52. There is no evidence that plain packaging will lead to an increase in the illicit trade in tobacco. Tobacco packs are already easily counterfeited which is why the industry is required to put covert markings on all tobacco packs to distinguish between authentic and counterfeit packs.⁴³ Plain packs may not have tobacco branding but they will have all the health warnings and other markings required on current packs.
53. ASH commissioned a review of the Padilla analysis⁴⁴ - which claimed that price would drop significantly - which we have shared with the Treasury. The key conclusion is that the model of the cigarette market which Padilla⁴⁵ uses overstates the extent to which prices will fall because:
 - The emphasis on branding as the sole determinant of cigarette pricing and of the oligopolistic structure of the current cigarette market is misplaced, and ignores other equally if not more important determinants of market structure (for example, economies of scale in production and distribution).
 - There are also a number of misspecifications in the econometric model which Padilla uses to estimate the price and demand effects of plain packaging, which mean that the predicted effects are almost certainly too large.

⁴⁰ Tobacco Bulletin HMRC. October 2011.

⁴¹ Robinson S. & Bugler C. Smoking and drinking among adults, 2009. General Lifestyle Survey 2009, Office for National Statistics, Jan 2011.

⁴²
⁴³ Tackling Tobacco Smuggling Together: An integrated strategy for HM Revenue & Customs and the UK Border Agency. HMRC November 2008.

⁴⁴ Reed, H. Analysis and review of J. Padilla, "The impact of plain packaging of cigarettes in the UK: a simulation exercise" A report for Action on Smoking and Health. London. September 2011

⁴⁵ Padilla, J. The impact of plain packaging of cigarettes in the UK: a simulation exercise. A report for Philip Morris International, November 2010.

54. Last but not least, even if it were the case that the introduction of plain packaging did result in a fall in cigarette prices to the extent Padilla suggests, tobacco duties can be adjusted to compensate for any fall in the prices charged by retailers, leaving the average post-reform price unchanged from the pre-reform price. This would have the additional effect of reducing excess profits in the tobacco industry, with a corresponding increase in tax receipts.⁴⁴
55. According to Philip Morris International the world's major manufacturers have agreed to fight the introduction of plain packaging stating that they "*do not want to see plain packaging introduced anywhere regardless of the size and importance of the market.*"⁴⁶ The real reason behind this united front against plain, standardised packaging is because the packet remains their last key means of marketing and thus recruiting new smokers and the measure will therefore impact on uptake and, longer-term, on the profitability of the industry, by reducing its ability to charge premium prices for its product.

Tobacco Smuggling

56. The UK Government's anti-tobacco smuggling strategy first launched in 2000 and regularly reviewed and updated since then, has been very successful. We welcome the commitment to increased funding for the strategy between now and 2015 and are particularly pleased that the support given to HMRC by ASH and the UK Centre for Tobacco Control Studies is acknowledged in the document.⁴⁷ We do, however, have some suggestions for how the strategy can be further improved which are set out below.

Outcome measures

57. The UK government set outcome measures for a quantified reduction in the market share of illicit cigarettes and tobacco between 2000 and 2007-8. These were achieved in advance of the deadline and proved very effective in helping maintain the incentive to put resources into this area, while helping ensure consistency and transparency. This is particularly salient as responsibility is now divided between HMRC and the UKBA, and securing the UK border and controlling migration in the UK is the key objective of UKBA, not reducing the illicit trade in tobacco.
58. The current strategy includes a commitment "*to achieve further sustainable downwards pressure on the illicit market in cigarettes and HRT through to 2015*".⁴⁷ We believe this objective should be quantified or it is meaningless. The average rate of decline from a peak of 21% in 2000-01 to 10% in 2009-10 in the illicit market share of cigarettes has been 1.2 percentage points per annum. 24 In line with this trend, and given the effectiveness of HM Government's anti-smuggling strategy, we recommend that HMRC and the UKBA agree and publish an objective to reduce the market share of illicit cigarettes from 10% in 2009-10 to 3% by 2015-16. This would take the market share of illicit cigarettes back to the levels of the early 1990s.
59. The illicit trade in HRT, after many years during which it flatlined, has recently begun to decline significantly at an average rate of 3 percentage points per annum from 2004-5 to 2009-10.²⁴ Therefore we recommend that there also be a published objective to reduce the market share of illicit HRT from 46% in 2009-10 to 28% by 2015-16.

⁴⁶ Dangoor D. PMI corporate affairs meeting, Rye Brook 950215 & 950216. In: Pim P. I. M., editor. Philip Morris; 1995: 2048207342/7346

⁴⁷ Tackling Tobacco Smuggling – building on our success. A renewed strategy for HM Revenue & Customs and the UK Border Agency. April 2011.

Registration of retailers and penalties for trading while unregistered

60. In Scotland there is now a new offence of selling tobacco while unregistered which came into force in October 2011. By that date all legitimate tobacco retailers were required to be registered with the Scottish Government, and any unregistered seller now faces a maximum penalty of £20,000 and/or up to six months in prison.⁴⁸
61. This creates an additional mechanism to deal with illicit tobacco sellers at local level which is low cost to retailers and will largely be enforced by council trading standards. We strongly recommend that HMRC work together with DH to introduce similar legislation for England as it will protect the rights of legitimate tobacco retailers, many of which are small businesses, and make it much easier to force sellers of illicit tobacco out of business. The implementation of such legislation by local councils should be funded by the Government in the same way as the implementation of smokefree legislation.

Illicit Trade Protocol

62. We welcome the commitment to “*press for, and support, the successful conclusion to the World Health Organisation (WHO) negotiations to develop a new international protocol to fight illicit trade in tobacco products in 2012*”.⁴⁷ However we would also like to see the UK support the inclusion of tracking and tracing of cigarettes at pack level as an integral part of the protocol and to help ensure that any such system is administered independently of industry.

Minimum Indicative Limits

63. We support the reduction of the Minimum Indicative Limits (MIL) from 3,200 to 800 cigarettes and 3kgs to 1 kg of HRT from October 2011. However, we would like to see the government go further.
64. The MILs in Finland are the same as that for legitimate imports of duty free tobacco from outside the EU. The Finnish law states that “*The maximum amounts of tobacco products whose labelling differs from that laid down in section 7 (3) that may be imported to Finland for own use are 200 cigarettes, 50 cigars, 100 cigarillos and 250 grams of pipe or cigarette tobacco.*” The UK should also impose these limits.
65. In addition the UK should request that Minimum Indicative Limits be put on the agenda of the EU Customs Working Group and Finland asked to present on its policy. This would encourage other Member States to consider implementing the same policy and provide them with the information necessary so to do.

EU partnership working

66. The UK is to be congratulated on becoming a signatory to the EU’s legally binding Agreements with the top four multinational tobacco companies requiring them to control their supply chains and subjecting them to seizure payments if any of their products are smuggled into the EU. However, concerns are coming to light about a number of aspects of these deals and the ongoing conduct of the tobacco industry in relation to cigarette smuggling.
67. Despite these agreements, evidence is starting to emerge that the major tobacco companies’ involvement in the illicit tobacco trade has continued. In November 2011, internal JTI correspondence obtained via whistleblowers shows that JTI involvement in

⁴⁸ Tobacco and Primary Medical Services (Scotland) Act 2010.
<http://www.legislation.gov.uk/asp/2010/3/introduction>
<http://www.scotland.gov.uk/Topics/Health/health/Tobacco/tobacco-bill>

“rampant smuggling” has continued through to 2010.⁴⁹ In 2008 the TTCs were shown to be manufacturing or importing into Ukraine nearly 130 billion cigarettes, 30% in excess of what the local market can consume. These “extra” cigarettes fuel the black market in the rest of Europe.⁵⁰ In Bulgaria, it appears that TTC involvement in the illicit trade continued after the deals with PMI and JTI until Bulgaria lowered its import duties on joining the European Union in 2007.⁵¹

68. Furthermore, the tobacco manufacturers should not be involved in any training of customs officials, which should be the responsibility of HMRC and equivalent international agencies. Given that controlling the illicit tobacco trade requires international collaboration, it is important that HMRC help clarify this message among its international collaborators
69. Stronger supply chain controls are also needed on a number of tobacco companies producing cigarettes which have appeared in the illicit market throughout Europe including the UK, for example the Baltic Tobacco Company, Karelia and Raquel.⁵² The European anti-fraud office OLAF should be given a mandate by the UK and other Member States to negotiate with these companies as well and to take appropriate action against them if they are not willing to become signatories to Agreements to control the illicit trade in their products.
70. Partnership working on the international stage has further potential which has not yet been realised. Smuggling is a global and complex problem and smuggling in the EU commonly involves more than one member state. Like the UK, the European anti-fraud office, OLAF, has a dedicated unit working to tackle the illicit trade in tobacco internationally. HMRC/UKBA and OLAF should work together more closely to take advantage of each others complementary expertise and resources while avoiding duplication. This could enhance their effectiveness and improve cost-effectiveness in tackling the illicit trade to the benefit of taxpayers in the UK as well as the rest of Europe. For example, we understand that HMRC has not yet provided data on seizure breakdown to OLAF for 2010, data which would be helpful in developing a better understanding of the illicit market at EU level.

WHO FCTC Article 5.3

71. We recognise the need for HMRC to work with the tobacco industry to ensure that it controls its supply chain effectively as this is core to an effective anti-smuggling strategy. However, the UK has legal obligations as a partner to the WHO FCTC to protect its tobacco control policies, which include taxation and smuggling, from the commercial and vested interests of the tobacco industry. The interests of the industry and government are not aligned in many respects and in particular in respect of smuggling as the tobacco industry profits from illicit sales of its product. Tobacco industry collusion in the illicit trade is well documented³⁵ and while the industry protests that this is historical, recent reports indicate at least one major UK manufacturer is still allowing its products to be diverted to the illicit market as outlined above.⁴⁹
72. We were, therefore, very disappointed that the strategy did not make explicit reference to Article 5.3 in the section on working with industry and commit that any engagement with the tobacco industry is in line with the UK’s obligations as a party to the WHO

⁴⁹ Holland J, Jovanovic B, and Dojcinovic S. Organized Crime and Corruption Reporting Project (OCCRP) report: Big trouble at Big Tobacco is available at: <http://www.reportingproject.net/>

⁵⁰ Lavrov V, *Ukraine's 'Lost' Cigarettes Flood Europe*. The Center for Public Integrity, 2009.

⁵¹ Skafida V, Gilmore A. *Tobacco industry influence on tobacco excise policy in Bulgaria: a story of lobbying, smuggling and failed privatisations*. Dublin: PPACTE, 2011

⁵² ASH Press Release. Imperial toes the Line. 27th September, 2010. <http://www.ash.org.uk/media-room/press-releases/imperial-tobacco-toes-the-line>

FCTC (Article 5.3) and that minutes of any meetings would be published. There should also be a reference to the role of the tobacco industry as a driver for smuggling and the consequent need for the strategy to require the industry to control its supply chain. Furthermore, government should not collaborate with the industry on education, as set out in 4.46, as this is not in line with our obligations under Article 5.3 of the WHO FCTC and on past experience the industry will misuse any such opportunity to forward its commercial interests.

Working with partner agencies in the UK

73. We welcome the references in the updated strategy to the value of working with partner agencies in the UK and in particular to the template set by the *“North of England Tackling Illicit Tobacco for Better Health programme”*. This programme provides a useful model not just for England as a whole, but also for the devolved administrations.
74. The evaluation of the North of England strategy carried out by the UKCTCS demonstrates that the programme has been effective in increasing awareness of illicit tobacco, increasing intelligence and improving cross agency engagement in tackling illicit tobacco. There are also indications of a promising reduction in demand for illicit tobacco.⁵³ However, it also concludes that the sustainability of the programme relies on continued investment, including by HMRC.

Market analysis and Intelligence gathering

75. We are pleased that HMRC recognises the need to continue *“to publish annual estimates of the illicit market share and key information (for example, seizure and prosecution statistics) that we use to monitor and scrutinise the performance and impact of the strategy.”*⁴⁷ However, since the Departmental report and Autumn report have been combined into one document, some of the data previously included, such as information on the numbers of prosecutions and confiscation orders, numbers of seizures and breakdown by mode and type of product, is no longer included so that this commitment is not currently being fulfilled.
76. We recommend that data relating to the tobacco market and the illicit trade should be published on HMRC’s website as part of an annual tobacco report which includes all the relevant information on tobacco in one place. This report should include information both on the make up of the licit and the illicit market, including seizures broken down by mode and type of product, prosecution statistics, data on confiscation and fines, and so on. In addition there is additional information that would provide useful intelligence to HMRC and to partner agencies, as set out below.

Local level information about the illicit market

77. All local authorities should be encouraged to continue to complete and return the annual Tobacco Control Survey currently managed by the LGA. This survey gathers data on a range of different indicators including data relating to under age sales and other enforcement activity. Local authorities already provide such information to the Department of Health, and can track their performance via benchmarking from information which is provided post publication of the survey. Such data should also be made available to HMRC.

⁵³ UK Centre for Tobacco Control Studies. Tackling Illicit Tobacco for Better Health Final Evaluation Report. January 2012.

Available at: <http://www.ukctcs.org/ukctcs/research/featuredprojects/illicittobacco.aspx>

78. Similarly, for the purposes of monitoring all enforcement activity aimed at tackling the supply of illicit tobacco, it would be beneficial if HMRC could routinely share data with trading standards services about levels of seizures, enforcement outcomes and levels of duty recovered. This does not currently happen in all areas and can act as a barrier to effective partnership working.

Price data

79. Data on the price paid for tobacco by smokers has not been collected on a consistent and long-term basis and needs to be included on a regular basis in HMRC surveys of smokers' attitudes and behaviour.

Sales Data

80. The tobacco manufacturers gather detailed data on sales patterns of their products by retailers. By comparing sales with demographic data it should be possible to identify smuggling hotspots. Trend data can also be helpful. For example, where sales dip suddenly it can be a useful indicator of a growing smuggling problem, or vice versa where sales suddenly increase when smuggling is being effectively tackled.

81. It is our understanding that in the 1990s, when the illicit market in the UK was growing rapidly, Gallaher approached HM Customs and Excise offering such information because it was concerned about growing smuggling into the UK of non-duty paid Benson & Hedges, one of their brands for which the overseas rights were owned by BAT. It may already be the case that the tobacco manufacturers provide HMRC with such data, if not they should be approached and asked so to do.

Sentencing

82. The figures on average sentence included in HMRC's statistical tables⁵⁴ are not very helpful as they provide no indication of the seriousness of the offences in question, which may vary significantly from year to year. One way of providing an indicator of how seriously smuggling is being taken by the courts might be to publish the average size of seizures in cases that come to court as well as the average sentence, so the two can be compared.

Confiscation orders

83. Similarly the success of confiscation orders should be reported. It is useful to know how many millions of Confiscation Orders have been issued, but it is just as important to know how much money has successfully been collected as a result. This should be an additional piece of information included in HMRC statistical tables on tobacco.

⁵⁴ HMRC. Meeting our challenges. Departmental Autumn Performance Report 2009. pp41-42.

Annex: List of endorsing organisations

Arrhythmia Alliance
Action on Smoking and Health (ASH)
ASH Northern Ireland
ASH Scotland
ASH Wales
Association of Directors of Public Health
Atrial Fibrillation Association
Bedfordshire Tobacco Control Alliance
Breast Cancer Care
British Association for Nursing in
Cardiovascular Care (BANCC)
British Cardiovascular Society
British Dental Health Foundation
British Heart Foundation
British Lung Foundation
British Society for Heart Failure
British Thoracic Society
Buckinghamshire Tobacco Free Alliance
Cancer Research UK
Central Lancashire Tobacco Alliance
Chartered Institute of Environmental
Health
Cheshire and Merseyside Public Health
Network (ChAMPs)
Cheshire and Merseyside Tobacco
Alliance
Director of Public Health for NHS
Lancashire
Director of Public Health for Sandwell
Director of Public Health for Swindon
Faculty of Public Health
Foundation for the Study of Infant
Deaths
Fresh Smoke Free North East
Greater Manchester Tobacco Alliance
Heart Care Partnership UK
Heart of Mersey
Heart UK
Lancashire Public Health Network
Leader of the Council, the Royal
Borough of Kingston upon Thames
Leicester City Clinical Commissioning
Group
Leicester City Tobacco Control
Coordination Group
Leicestershire Local Pharmaceutical
Committee
Leicestershire Partnership Trust
Liverpool PCT
Medical Women's Federation
Mental Health Foundation
Mouth Cancer Foundation
National Heart Forum
NCSCT Community Interest Company
Newcastle City Council
NHS Alliance
NHS Blackburn with Darwen
NHS Brent
NHS Bury
NHS Harrow
NHS Leeds
NHS Leicester City, Leicestershire County
& Rutland
NHS Portsmouth
NHS Sheffield
NHS Wirral
North Lancashire PCT
Plymouth NHS Stop Smoking Service
Portsmouth City Council
QUIT
Royal College of General Practitioners
Royal College of Physicians
Royal College of Radiologists
Royal Pharmaceutical Society
RNIB
Smoke Free East of England
Smoke Free East Lancashire Alliance
Smoke Free Essex Tobacco Control
Alliance
Smokefree Lincs Alliance
SmokeFree Liverpool
Smoke Free Newcastle
Smokefree Somerset Alliance
Smokefree South West
Smokefree Yorkshire and the Humber
Solihull Smoke Free Alliance
South Asian Health Foundation
Suffolk Tobacco Alliance
Syncope Trust And Reflex anoxic
Seizures (STARS)
The Deborah Hutton Campaign
The Roy Castle Lung Cancer Foundation
Tobacco Control Collaborating Centre
Tobacco Free Futures
Tobacco Free Hertfordshire
Tobacco Free Lancashire
Tobacco Free Leicestershire and Rutland
Tobacco Free Norfolk Alliance
Trading Standards Institute
UK Centre for Tobacco Control Studies
Ulster Cancer Foundation
University Hospitals of Leicester NHS
Trust
Wolverhampton Coronary Aftercare
Support Group
Worcestershire Tobacco Control Alliance