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The truth about cigarette price increases in Britain

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Tobacco tax increases are one of the most effective means of reducing tobacco use¹ and consequently the tobacco industry has historically lobbied heavily against tax increases.² With standardised packaging of cigarettes now under consideration in the UK, industry lobbying on the illicit tobacco trade has intensified.³ In November 2012 Japan Tobacco International (JTI), which has approximately a 40% share in the UK market⁴, published a report, the Billion Pound Drop, on tobacco smuggling in the UK⁵ which claims, *inter alia*, that tobacco tax increases fuel the illicit tobacco trade. Statements such as “the tax on a pack of Premium brand cigarettes... has risen by more than £1..... As a result, we have seen levels of non-UK duty paid consumption increase by almost 20% so far this year” litter the report. These claims are made despite evidence of the far more complex, supply-side drivers of the illicit tobacco trade (including tobacco industry involvement),^{6,7} recent survey evidence showing that price was unrelated to levels of illicit tobacco use across Europe,⁸ and data from Her Majesty’s Revenue and Customs showing that levels of illicit cigarettes in the UK have declined steadily to reach an estimated 9% by 2010/11.⁹ JTI has reiterated these claims in its response to the last two budgets; its press releases on this issue in both 2012 and 2011 being entitled “JTI Response to the UK Budget...An open invitation to crooks, criminals and counterfeiters.”¹⁰

The essence of JTI’s claims is that tax increases, by substantially increasing the price of cigarettes, lead to an increase in the illicit tobacco trade. This letter addresses this issue by examining the extent to which cigarette price increases in Britain are attributable to tax increases or tobacco industry price increases.

In line with European Union (EU) legislation requiring Member States to have a mixed tobacco excise structure,¹¹ the UK tobacco excise comprises both proportional (ad valorem) and fixed (specific) elements, with VAT added on top.¹² Until January 2011 excise taxes were based on the retail selling price of the price category most in demand, commonly known as the Most Popular Price Category (MPPC).

We took brand specific cigarette price and sales data from Nielsen covering the period November 2006 to November 2009 in Britain. Nielsen began to publish cigarette sales data in November 2006; such data are obtained via Scantrack software which Nielsen claim picks up 87p in every £1 spent.¹³ The brands were categorised into four price segments (premium, mid, economy and ultra-low price brands), based on a review of the industry literature on brand segmentation. Weighted real average prices by brand segment were calculated using

the data on price and market share for each brand from Nielsen and deflating the resulting price series using the Consumer Price Index, the UK government's preferred measure of inflation, obtained from the Office of National Statistics(<http://www.statistics.gov.uk/statbase/tsdtables1.asp?vlnk=mm23>) and using 2010 as the baseline year. We then calculated the total price increase over this period, and subdivided this into the portion attributable to tax and the rest.

Table 1 shows that across this 3-year period approximately half (48%) of the total price increase across all brands combined was due to the tobacco industry increasing prices, the other half (52%) being attributable to tax increases. On all but the cheapest brands, these proportions were approximately 55% (industry price increase) and 45% (tax) respectively. Without data on the costs of inputs (manufacturing, distribution and marketing) over this period, we are unable to ascertain whether the increase in industry pricing was driven by increased input costs although we have no reason to believe this was the case and note the high profit margins the industry enjoys in the UK.¹⁴

In short, therefore, industry claims about tax increases being responsible for massive price increases are misleading as they fail to acknowledge that approximately half of the price increase is directly attributable to industry pricing. Moreover, should the industry be genuinely concerned that price increases fuel illicit it would surely not increase prices to this extent, particularly given its very large profit margins which significantly outstrip those of consumer staple companies.³

Our findings are entirely consistent with evidence from Ireland which showed that between 2000 and 2010 36% of the price increase in cigarettes was imposed by the industry despite its claims at every budget that tax (and thus price) increases would lead to smuggling.¹⁵

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Table 1

Real cigarette price increases from November 2006 to November 2009 by price segment

Brand segment	Total price increase	Tax increase	Non-tax increase	% price increase attributable to tax	% price increase attributable to industry price increases
Premium	0.227	0.103	0.124	45%	55%
Mid-range	0.249	0.110	0.139	44%	56%
Economy	0.261	0.114	0.147	44%	56%
Ultra	0.090	0.050	0.040	56%	44%
All combined	0.121	0.063	0.059	52%	48%