



**UKCTAS**  
UK Centre for Tobacco & Alcohol Studies

**ash.**  
action on smoking and health

## **HM Treasury Autumn Statement 2016**

### **Representation from ASH and the UK Centre for Tobacco and Alcohol Studies to the Chancellor of the Exchequer**

**7 October 2016**

#### **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. ASH receives funding for its full programme of work from the British Heart Foundation and Cancer Research UK. It has also received project funding from the Department of Health to support tobacco control. The UK Centre for Tobacco & Alcohol Studies (UKCTAS) was created in 2008 and includes research teams in twelve UK universities. It is one of six 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 Autumn Statement.

#### **Summary and Recommendations**

3. The Prime Minister in her inaugural speech committed to *“fighting against the burning injustice that, if you’re born poor, you will die on average 9 years earlier than others”*<sup>1</sup>
4. To achieve this will require a continued focus on reducing smoking prevalence, since, as the Government itself acknowledges, half the difference in life expectancy between the richest and the poorest is due to smoking prevalence. In responding to a Parliamentary Question on the issue, the Government quoted Sir Michael Marmot’s independent review into health inequalities recommendation that *“Tobacco control is central to any strategy to tackle health inequalities as smoking accounts for approximately half of the difference in life expectancy between the lowest and highest income groups. Smoking-related death rates are two to three times higher in low-income groups than in wealthier social groups.”*<sup>2</sup>
5. Since 1998 the UK government has successfully reduced smoking prevalence through implementation of a sustained and comprehensive tobacco control

<sup>1</sup> [Statement from the new Prime Minister Theresa May](#), 13 July 2016.

<sup>2</sup> [Smoking: Written question - HL1194](#), 26 July 2016

programme, including successive tobacco control strategies, sustained tax increases above inflation to reduce affordability and very successful anti-smuggling strategies. Indeed, tax increases have been shown to be most effective in reducing health inequalities as they have a greater effect on more disadvantaged smokers than the general population. However, more needs to be done, particularly to reduce inequalities and the last tobacco strategy expired in December 2015, over nine months ago.

## Recommendations

6. We recommend that the Government should:
  - Publish the new tobacco control strategy at the earliest opportunity.
  - Increase the tobacco tax escalator to 5% above inflation and take further action to reduce the tax differential between different market segments and between manufactured cigarettes and HRT.
  - Require the tobacco industry to fund measures to reduce smoking prevalence through a levy or user fee, in line with the principle established by the soft drinks industry levy.
  - Fund partnership working at regional level to support coordinated enforcement against the illicit trade in tobacco.
  - Implement a tobacco retail licencing system funded by the tobacco manufacturers.

## Requirement for a new Tobacco Control Plan

7. The UK is rightly regarded as a global leader in tobacco control, and there has been a steady fall in smoking rates over several decades. Smoking prevalence has declined rapidly in England amongst adults and children since the Government first implemented comprehensive tobacco strategies from 1998 onwards. The latest figures show adult smoking prevalence in England has declined by more than a third from 27% in 1998 to 16.9% in 2015. The proportion of 15 year olds in England who are regular smokers fell by two thirds from 24% in 1998 to 8% in 2014, while the proportion of 11-15 year olds who have ever smoked fell from 47% to 18% over the same period. These are the lowest figures, both for adults and children, ever recorded.
8. However, smoking remains the leading cause of preventable premature death, and the major reason for differences in life expectancy between the richest and poorest in society. Experience elsewhere shows what can happen if we do not review and renew our tobacco control strategy, and ensure that it is properly funded. Since 2007 the UK has scored highest for tobacco control policy implementation in Europe.<sup>3</sup> While we've seen significant declines in smoking due to our comprehensive approach, smoking prevalence in France and Germany, which have not had such strategies in place, has barely shifted over the last twenty years.<sup>4</sup> It cannot therefore be assumed that the long-term decline in smoking prevalence will continue unless we renew and review our strategy.
9. In New York, for example, sustained investment in tobacco control led to a sharp fall in prevalence between 2002 and 2010. But when funding was cut in 2010 this decline ceased. Following new investment from 2014, smoking rates began to decline again.<sup>5</sup> To be effective, tobacco control policy and activity has to be both sustained

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3 Nguyen L, Rosenqvist G, Pekurinen M. Demand for Tobacco in Europe. An Econometric Analysis of 11 countries for the PPACTE project. PPACTE 2012 p.30

4 ASH. [Smoking Still Kills](#). London. June 2015.

5 Politico New York, [NYC smoking rate drops to lowest on record](#), September 2015

and progressive, one reason being that people who continue to smoke when a particular policy or control action is introduced can be said to have “discounted” it and therefore will require new incentives to quit. To plan sustained and progressive action of this kind requires a considerable degree of certainty about future funding.

10. Reducing smoking prevalence is also central to the future of the NHS. The NHS England Five Year Forward View (FYFV) forecast a £30 billion shortfall in funding for the NHS by 2020.<sup>6</sup> Even after the £8 billion in additional funding committed by the Government, there remains a predicted shortfall of £22 billion.<sup>6</sup> This funding gap is highly unlikely to be closed through increased efficiency alone, since this would require efficiency savings of about 3% per year, a higher level of efficiency saving annually than the NHS has achieved since its foundation.
11. This is why the FYFV stated 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.”* The report notes that this has been long called for: *“Twelve years ago, Derek Wanless’ health review warned that unless the country took prevention seriously we would be faced with a sharply rising burden of avoidable illness. That warning has not been heeded - and the NHS is on the hook for the consequences.”*<sup>7</sup>
12. The Government committed in parliament in December 2015<sup>8</sup> to publish a new strategy in summer 2016, to replace the Tobacco Control Plan for England published in 2011.<sup>9</sup> However, a parliamentary question seeking clarification of the date in July 2016 was met with the response that, *“Ministers will decide on an appropriate publication date in due course.”*

### **Recommendation**

13. The Government proceed with publication of the new tobacco control strategy without further delay.

### **Making the tobacco industry pay**

14. Tax increases have been shown to be most effective in reducing health inequalities as they have a greater effect on more disadvantaged smokers than the general population.<sup>10 11</sup> However, poorer smokers who don't quit are disproportionately disadvantaged in economic terms because of the negative impact of tobacco tax increases on their already small incomes. This poses a dilemma which can be resolved by ensuring that all efforts are made to motivate and support smokers in quitting. In addition the positive health impact of taxes is greater when some of the revenues generated are used to support comprehensive tobacco control strategies.<sup>12</sup>
15. Estimates for the UK government seem to show that elasticity of demand has increased in recent years, making tax, and consequent price changes, an even more effective tool for reducing smoking prevalence. In 2010 the short-run elasticity was

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<sup>6</sup> [NHS England Five Year Forward View](#) . NHS October 2014.

<sup>7</sup> Ibid page 9

<sup>8</sup> Hansard <http://www.publications.parliament.uk/pa/cm201516/cmhansrd/cm151217/halltext/151217h0001.htm> December 2015

<sup>9</sup> Department of Health: [Healthy Lives Healthy People](#): A tobacco control plan for England. DH 2011

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

<sup>11</sup> Amos A, Bauld L, Clifford D, et al. *Tobacco control, inequalities in health and action at a local level*. York, Public Health Research Consortium, 2011.

<sup>12</sup> Chaloupka F, Yurekli A, Fong G. [Tobacco taxes as a tobacco control strategy](#). *Tobacco Control* 2012; 21:172-180

estimated by HMRC to be -0.57 and the long-run elasticity -1.05.<sup>13</sup> In 2015 the short-run elasticity had remained the same at -0.57 while the long-run had increased to -1.19.<sup>14</sup>

16. At the current time public health budgets which support tobacco control have been cut at national and local level<sup>15</sup> and the funding needs to be found to sustain a properly funded tobacco control strategy. In the 2014 Autumn Statement HM Treasury announced that it would consult on the introduction of a levy on the tobacco industry, stating 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>16</sup>
17. The estimated costs to society of smoking quoted in the Tobacco Levy consultation, taken from an analysis by ASH, were £12.9 billion a year in NHS costs<sup>17</sup>, social care costs, and lost productivity, costs which have subsequently risen to £13.9 billion in the most recent estimate. 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 per annum in recent years.<sup>18</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.
18. However, HMT decided not to proceed with a levy on the basis 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.”*<sup>19</sup> The review of the evidence by DEFRA stated that, *“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.”* However, this review also went on to say that, *“Over the longer term firms will also look to reduce costs to maintain profitability and returns.”*
19. The implication of the DEFRA analysis is that in the short-run revenues would increase not decrease, and in the long-run as stated the tobacco industry would reduce costs so as to absorb the levy and ensure that its profitability and returns were maintained. DEFRA’s analysis does not therefore support HMT’s conclusion that such a levy would be unsuccessful.
20. Furthermore it should be noted that long-run elasticities tend to be greater than short-run elasticities. For example in Europe they are estimated to be between -0.2 and -1.5 with a typical value close to -1.0. However, they are also considered to be much

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13 Czubak M. Johal S. [Econometric Analysis of Cigarette Consumption in the UK](#). HMRC Working Paper Number 9. December 2010.

14 HMRC. [Update to HMRC Working Paper Number 9: Econometric Analysis of Cigarette Consumption in the UK](#). 30 September 2015.

15 Johnstone R. [Public health grants to be cut by £160m over next two years](#). Public Finance 12 February 2016.

16 HM Treasury. [Autumn Statement 2014](#). CM 8961. December 2014

17 HM Treasury. [Tobacco levy: Consultation](#). December 2014

18 [Branston, J. R.](#) and [Gilmore, A.](#), 2015. The extreme profitability of the UK tobacco market and the rationale for a new tobacco levy. University of Bath.

19 HM Treasury. [Tobacco levy: response to the consultation](#). September 2015.

more variable and less reliable than short-run elasticities and “*thus one should be very cautious about using the long-run price elasticity estimates*”.<sup>20</sup>

21. Other mechanisms than a tobacco levy as consulted on could be introduced, for example an increase in corporation tax or a “*user fee*” as is in place in the United States<sup>21</sup> to fund regulation of the tobacco industry. A Legal Opinion for ASH concluded that such a “*user fee*” would be lawful, pointing out that such a mechanism is already utilised in the UK for the purpose of funding, in part or in whole, other regulatory functions for example the Prudential Regulatory Authority, Ofgem, Ofwat and the Human Fertilisation and Embryology Authority. And that it would be legal for the money raised to be used to fund recurring costs of tobacco control such as mass media campaigns, stop smoking services and local authority enforcement functions.

### **Recommendation**

22. Introduce a mechanism such as a “*user fee*” or increased corporation tax to ensure that the industry makes a greater contribution to the damage it causes society. This would be used to ensure that funding was available to meet the cost of mass media campaigns, and local and regional tobacco control measures such as enforcement and stop smoking services.

## **Improving the effectiveness of tobacco tax policy as a revenue, and public health, policy**

23. Tobacco taxation has been at the heart of UK government policy to improve the health of the nation by driving down smoking prevalence for over 20 years. A tobacco tax escalator to reduce the affordability of tobacco was first introduced under a Conservative government in 1993, on the understanding that this “*is the most effective way to reduce smoking*”.<sup>22</sup> An escalator of 2% above inflation is in force for the duration of the current parliament.
24. However, while successive Chancellors have used the rhetoric of progressive tobacco tax policies, in practice the UK has been overtaken by other countries in recent years, particularly Australia.<sup>23</sup> The Australian Treasury not only indexes tobacco tax increases to inflation twice a year, but in 2010 it increased tobacco excise taxes by 25% with the intention of producing a 15% increase in revenues.<sup>24</sup> Despite Budgetary pressures stemming from the global economic crisis, 2010-11 revenues increased by 13% compared with the previous financial year.<sup>25</sup>
25. Australia also committed to introducing staged 12.5 per cent increases in tobacco excise over the subsequent four years “*to battle smoking-related cancer and help return the Federal Budget to surplus in 2016-17*”. The most recent commitment in the 2016 Australian budget was for four further annual increases of 12.5 per cent per year from 1 September 2017 until 2020. There was also an additional AU\$7.7 million a year for the Tobacco Strike Team to combat illicit tobacco activity, provision for stronger penalties and more support for the Border Force team responsible for

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20 Nguyen L. Rosenqvist G. Pekurinen M. Demand for Tobacco in Europe. An Econometric Analysis of 11 countries for the PPACTE project. PPACTE 2012 p.89

21 [Family Smoking Prevention and Tobacco Control Act](#) 2009. Section 919 User fees.

22 Chancellor's Budget statement. House of Commons Hansard debates. 30 November 1993

23 Jha, P and Peto, R. [Global effects of smoking, of quitting, and of taxing tobacco](#). New England Journal of Medicine 2014; 370:65.

24 Treasury, Australia, [Issues in tobacco taxation](#). Accessed January 2016.

25 Australian Government Budget Outcomes [2009-10](#) and [2010-11](#). Accessed January 2016.

enforcing tobacco importation restrictions, plus a reduction in duty free allowance to only 25 cigarettes per person.<sup>26</sup>

26. In comparison while in the UK the government has committed to tackling the health impacts of smoking by increasing taxation, and has increased funding for action to tackle the illicit trade in tobacco, the current annual tobacco duty escalator is only 2% above inflation until the end of this Parliament. While this ensures tobacco duties rise by more than inflation each year, Australia now outstrips the UK and tobacco prices are much higher both in absolute terms and in relation to income. As early as 2010, cigarettes in Australia became less affordable in relation to per capita GDP than the UK, and indeed than in all high-income countries other than Norway.<sup>27</sup> Tobacco is still more affordable in the UK today than it was in the 1960s.

27. In Australia, which has a comprehensive tobacco control strategy which has led to declines in smoking prevalence, due to tax increases and other measures including mass media campaigns and plain standardised packaging, tobacco tax revenues have continued to increase following the tax increases, to a greater extent than expected. In 2013-14 the budget estimate was AU\$7.8 billion, the outturn was AU\$8.5 billion, and in 2014-15 the budget estimate was AU\$8.280 billion while the outturn was AU\$8.848 billion, respectively 8% and 7% higher than the budget estimate.<sup>28</sup>

28. In contrast over the last five financial years overall receipts in the UK have remained fairly stable and over the five years are 0.7% down (£66 million). This masks differences in the pattern for manufactured cigarettes and handrolled tobacco. The revenue on manufactured cigarettes has fallen by 3.6% (£310 million) while revenues on handrolled tobacco have increased by 28% (£250 million). In terms of the amount of tobacco consumed the change is greater, with the quantity of manufactured cigarettes falling by 28% while that of HRT has only fallen by 1.9%.

HMRC revenue receipts for all tobacco products – changes over the last five financial years 2011/12 to 2015/16			
Financial Year	£ million	Change in £ million	% change year on year
2011/12	9,551		
2012/13	9,681	+130	+1.4%
2013/14	9,531	-150	-1.6%
2014/15	9,548	-17	-0.2%
2015/16	9,485	-63	-0.7%

29. The reasons for this are likely to be multi-factorial. In the UK we have seen significant downtrading by smokers both to cheaper brands of cigarettes and to handrolled tobacco, which has been encouraged by the tobacco industry pricing strategy.

30. Following consultation, the government has committed to the introduction of a Minimum Excise Tax on cigarettes in the Finance Bill 2017, which will set a floor below which tax on cigarettes cannot fall. This is crucial as the MET consultation document noted that while real average cigarette prices have been increasing across the market as a whole in recent years, the difference between retail prices of the most expensive and cheapest cigarettes has widened by more than two thirds over

26 Budget 2016-17. [Making our tax system more sustainable so we can cover the Government's responsibilities for the next generation](#). Commonwealth of Australia 3 May 2016

27 Tobacco in Australia- Facts and Issues: A comprehensive online resource [13.4 The affordability of tobacco products](#), downloaded 22 August 2016.

28 Australian Government Budget Outcomes [2013-4](#) and [2014-15](#). Accessed January 2016.

the last 10 years. The research cited in the consultation document on tobacco industry pricing was carried out by Professor Gilmore and colleagues at the UKCTAS and demonstrates that this is because the tobacco industry has been absorbing tax increases on the cheapest brands rather than passing them on to consumers.<sup>29</sup> 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 at the time of the budget in spring each year.<sup>29</sup>

31. Cheaper brands are targeted at the young, the poor, women and those living in areas of the country with high smoking rates who are most in need of protection from tobacco industry marketing tactics. 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 brands<sup>30</sup> 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.<sup>30 29</sup>
32. Further downtrading is encouraged by the significant differential in taxation and price per cigarette between manufactured and hand-rolled tobacco (HRT). We were pleased to see that in the March 2016 Budget the UK government acknowledged the health impacts of this differential, and narrowed the gap in tax levels between manufactured cigarettes and hand-rolled tobacco by increasing HRT taxes by an additional 3% above inflation.<sup>31</sup>
33. There is evidence from the Netherlands that consumption of hand-rolled tobacco increases as the price differential between manufactured and hand-rolled tobacco increases<sup>32</sup>, and certainly this is the pattern we've seen in the UK. The proportion of smokers mainly using HRT has increased from 25% of men and 8% of women in 1998 to 40% of men and 23% of women in 2013.<sup>33</sup>
34. The equivalent tax rate for HRT can be accurately calculated using recent research on the average weight of tobacco per hand-rolled cigarette. This would increase the tax take and reduce the likelihood of smokers downtrading to HRT rather than quitting. While recent work, based on a 2010 survey, shows the median weight of a RYO cigarette across 18 countries in Europe was approximately 0.75g, England had the lowest mean weight of 0.48g.<sup>34</sup> More recent analysis of six waves (2006 to 2014) of the ITC study data showed the average grams of tobacco per RYO cigarette for the UK sample to be between 0.45 - 0.55 grams.<sup>35</sup> We therefore suggest 0.5 g be used as the average weight of a RYO cigarette.

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29 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): 1317-1326

30 Gilmore A, Tavakoly B, Hiscock R, Taylor G. Smoking patterns in Great Britain: the rise of cheap cigarette brands and roll your own (RYO) tobacco. *J Public Health* (2014) doi:10.1093/pubmed/ftu048. Published online: August 11, 2014

31 HMT. [Budget 2016](#). HC901. March 2016.

32 Mindell JS, Whyne DK. [Cigarette consumption in the Netherlands 1970 – 1995: does tax policy encourage the use of hand-rolling tobacco?](#) *Eur J Public Health* 2000;10:214-9.

33 [Opinions and Lifestyle Survey. Smoking habits amongst adults, 2013](#) Office for National Statistics, November 2014

34 Gallusa S, Lugoa A, Ghislandic 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; 23:186–192

35 Partos, et al. Availability and use of cheap tobacco in the UK 2002 - 2014: Findings from the International Tobacco Control Project. *Nicotine and Tobacco Research* (submitted).

35. 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.<sup>36</sup> For this reason we suggest keeping taxes on pipe tobacco in line with those on HRT.

### Recommendation

36. HMT needs to continue to increase tobacco taxes by:
- Increasing the tobacco tax escalator to 5% above inflation
  - Applying a tax escalator on HRT in this and subsequent years of 15% above inflation, until, using an average conversion rate of 0.5 grammes per handrolled cigarette, the tax on manufactured cigarettes and handrolled cigarettes is equivalent. At this point the escalator on HRT should become the same as that for manufactured cigarettes
  - Substituting a Minimum Consumption Tax for the proposed Minimum Excise Tax. This includes VAT as well as excise tax and therefore impacts not just on tax levels for manufactured cigarettes but also on hand-rolled tobacco. Raising the tax levels at the lower priced end of the HRT market could help reduce the likelihood of downtrading within HRT.

### Illicit Trade

37. The UK has had a very effective anti-smuggling strategy since 2000<sup>37</sup>, when the market share for illicit tobacco was over 20% for manufactured cigarettes and over 60% for handrolled tobacco. In 2006-7 the market share of illicit handrolled tobacco was still 55%, by 2014-15 it had fallen to 35%. For manufactured cigarettes the illicit market share in 2006-7 was 15% by 2014-15 this had fallen to 10%. This has resulted in significant benefits to government revenues, the tax gap has fallen over the same time period from £2.5 billion to £2.1 billion.<sup>38</sup>
38. Yet the tobacco industry has misrepresented HMRC figures, and produced their own, misleading, estimates on the size of the illicit market to exaggerate both the scale of the illicit tobacco trade. In turn they have used these data to promote their misleading messaging on illicit to the media and have distorted the public discourse on illicit by so doing.<sup>39 40 41</sup>
39. This is despite the fact that the tobacco manufacturers' own reports for Europe show that the size of the illicit market is in decline, and that only a small proportion, less than 10%, comprises counterfeit product and the majority of the illicit market, 56%, comprises tobacco company product.<sup>42</sup> What is self-evident is that better control of the legitimate supply chain, as required by the WHO FCTC Illicit Trade Protocol

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36 Clifford D, Cierciernski C, Silver, K, Gilmore A. PPACTE Work Package 5 – Milestone 5.2. Tobacco industry influence over tobacco taxation in Poland. Dublin. PPACTE, 2012

37 HMRC and Border Force. [Tackling illicit tobacco: From Leaf to Light](#) The HMRC and Border Force Strategy to tackle tobacco smuggling. HMRC March 2015

38 HMRC. Tobacco Tax Gap estimates 2014-15. 22 October 2015

39 Rowell A, Evans-Reeves K, Gilmore A. [Tobacco industry manipulation of data on and press coverage of the illicit tobacco trade in the UK](#). Tob Control Published Online First 10 March 2014 doi:10.1136/tobaccocontrol-2013-051397.

40 Gilmore A, Rowell A, Gallus S, et al. [Towards a greater understanding of the illicit tobacco trade in Europe: a review of the PMI funded, KPMG authored "project star" report](#) Tob Control 2014;23:e51–61.

41 Evans-Reeves K A, Hatchard JL, Gilmore AB. ["It will harm business and increase illicit trade": an evaluation of the relevance, quality and transparency of evidence submitted by transnational tobacco companies to the UK consultation on standardised packaging 2012](#) Tob Control. doi:10.1136/tobaccocontrol-2014-051930 December 10, 2014

42 Project SUN. [A study of the illicit cigarette market in the European Union, Norway and Switzerland](#). 2015 Results. June 2016. Prepared by KPMG for BAT, Imperial Tobacco, JTI and PMI.

which the UK has signed and committed to ratify, is essential if we are to continue to reduce the size of the illicit market.

40. Successfully containing the illicit trade requires continued vigilance, which is why we were pleased to note the announcement in the March 2016 Budget that the Home Office would receive £31 million of funding *“to form a dedicated group of border officers and intelligence officials to tighten the government’s grip on the most prolific smuggling routes and intercept smugglers as they try to adapt their tactics.”*<sup>43</sup> This was alongside the additional intelligence and investigative resources provided in the Summer 2015 Budget.
41. We strongly agree with the statement in the 2016 Budget that *“Coordinated enforcement, will work to further increase the seizure of illicit shipments and increase prosecutions for tobacco fraud.”* In a 2013 report the National Audit Office pointed to the *“promising results”* from regional partnerships in the north of England between HMRC and other agencies such as the police, trading standards and health organisations, which helped provide the coordinated enforcement that is required. The NAO also encouraged HMRC to roll out such partnerships nationally.
42. The success of such partnerships is shown by the impact in the northeast, which have had concerted multi-agency enforcement activity and evidence-based effective demand reduction measures in place since 2007, supported by the work of the regional Illicit Tobacco Partnership. The result of this has been a significantly greater fall in the illicit trade in the region than has been seen at national level. Between 2009 and 2015 the illicit market had declined by more than a third in the northeast from 15% to 9%, while the decline at national level was less than a fifth, from 12% to 10%.
43. Unfortunately not only has there not been a further roll out of such partnerships nationally since the NAO report, but the only partnership outside the north of England, in the southwest, has had its funding cut. To date none of the funding for such partnership working has come from HMRC, it has come either from localities or from the Department of Health.
44. The trading standards staff who are crucial to effective collaborative working, are increasingly under threat. During the last six years, total spend nationally on trading standards has fallen from £213m in 2010 to £124m today. Teams have been cut to the bone, with a 12% drop in staff working in trading standards since 2014. This came on top of the 45% drop identified over the previous five years by an earlier survey.<sup>44</sup> The financial benefit from enhanced enforcement accrues to HM Government not to local authorities, so it would seem appropriate for funding to be found by HMRC, unless and until measures are put in place to require the tobacco manufacturers to pay for these costs.
45. Earlier this year HMRC consulted on the introduction of licensing of the tobacco industry supply chain. In our response we supported the introduction of a positive licensing scheme, with an adequate licence fee, which could provide valuable financial resources for enforcement authorities, including those at local level (e.g. Trading Standards departments) as well as regional partnerships. In a period of tight public spending constraints this could provide funds to ensure that enforcement of all legislation relating to tobacco control can continue at an appropriate level.

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43 HM Revenue & Customs. [Progress in tackling tobacco smuggling](#). Report by the Comptroller and Auditor General. HC 226 SESSION 2013-14. June 2013

44 CTSI. [Chartered Trading Standards Institute Workforce Survey](#). June 2016

46. In our response we also pointed out that an effective positive licensing scheme could offer the following benefits:
- The permanent removal of a large proportion of the final sellers of illicit tobacco, once a widespread system of detection and enforcement is in place.
  - Significant reductions in the leakage of tobacco from the licenced distribution system into grey and black markets in the UK.
  - Increased turnover for legitimate local retailers who obey tobacco control legislation. Although these businesses make very low profit margins from selling tobacco itself, it does draw customers into their shops regularly, and the resulting collateral sales are very important to these businesses.
  - A decline in the illicit tobacco trade should also result in fewer children obtaining cigarettes and becoming addicted in their teens.
47. In our consultation response we favoured recovering the cost of licences through a levy on manufacturers and importers, with the proceeds distributed to national and local enforcement authorities, the local element being distributed in proportion to sales in each local authority area. (A possible but less desirable alternative could be distribution on the basis of local measures smoking prevalence rates.) While retailers make low profit margins on tobacco, the four major tobacco companies are some of the most profitable in the world, and could easily meet the costs of a licensing scheme.
48. The distribution of part or all of the fees from a licensing system to local government would help overcome two problems with local enforcement work against illicit trade: first, that Council budgets are being sharply reduced; and secondly that, unlike for central government, which benefits from increased tax revenues, there is no direct financial gain to Councils from enforcement action leading to reductions in the level of illicit trade.
49. The consultation closed in May 2016, nearly six months ago. We urge the government to proceed to the introduction of a licensing system for the tobacco supply chain, funded by the manufacturers, without further delay.

### **Recommendation**

50. HMRC should:
- fund partnership working at regional level to support coordinated enforcement against the illicit trade in tobacco; and
  - implement a tobacco retail licencing system funded by the tobacco manufacturers.