



Report on Tobacco Taxation in the United Kingdom

Excise Social Policy Group

HM Customs and Excise



World Health Organization



Tobacco Free Initiative Headquarters would like to thank the Regional Offices for their contribution to this project.

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Introduction¹

Taxation levels

The United Kingdom has among the highest levels of tobacco tax in the world¹. Table 1 shows the current duty rates for tobacco products while Table 2 presents taxation levels. The latter is based on a typical pack of each product and on the most popular price category for cigarettes.

Table 1

Current United Kingdom tobacco duty rates

Product	Duty rate
Cigarettes	22% <i>ad valorem</i> and £94.24 (130.24 Euro) per 1 000
Cigars	£137.26 (189.69 Euro) per kilogram
Hand-rolling tobacco	£98.66 (136.35 Euro) per kilogram
Other tobacco (e.g. pipe tobacco)	£60.34 (83.39 Euro) per kilogram

Source: HM Customs and Excise (HMCE)

Note: VAT at 17.5% is also charged on the total cost of tobacco products, that is, their value plus the duty charged on them.

Table 2

Comparison of selling price and tobacco tax

Product	Typical selling price	Total tax (Excise duty and value added tax)	Total tax as a % of selling price
Cigarettes (pack of 20)	£4.51	£3.55	78.7%
Small cigars (pack of 5)	£3.05	£1.37	45.0%
Hand-rolling tobacco (25g)	£4.60	£3.15	68.5%
Pipe tobacco (25g)	£3.55	£2.04	57.5%

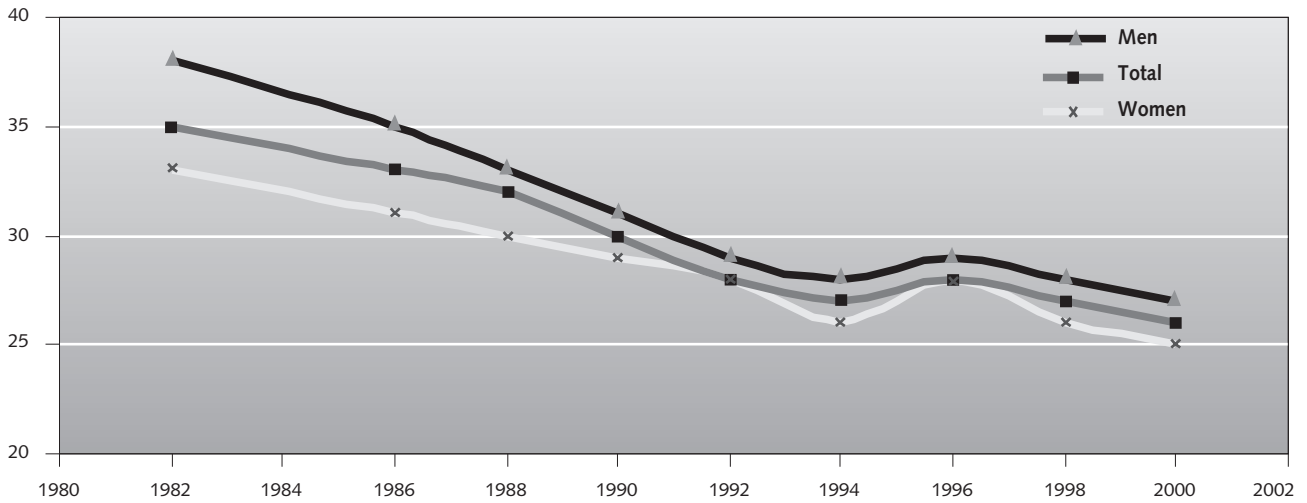
Source: HM Customs and Excise

¹ *Tobacco Journal International Yearbook*, Fact Sheet Number 18, 2002.



Figure 1

Smoking prevalence (percentage of adult population who smoke cigarettes and hand-rolling tobacco in the United Kingdom)



Source: Office of National Statistics, General Household Survey, 2000-2001

Smoking prevalence

Smoking prevalence (the proportion of the adult population over 16 who admits to smoking) in the United Kingdom declined steadily throughout the 1970s and 1980s. Since then the rate of decline has slowed but it remains on an overall slight downward trend².

Product trends

The majority of smokers in the United Kingdom smoke cigarettes³. Since 1997 there has been a trend for smoking cheaper brand cigarettes⁴ and also for increased use of hand-rolling tobacco⁵. Although the percentage of the population who smoke has been decreasing since 1996–1997, the percentage smoking hand-rolling tobacco has been increasing slightly since then.⁶

Prevalence of cigar smoking has declined substantially since 1974⁷. Although cigars are smoked mostly by men, use by women is increasing slightly due to their consumption of miniature cigars.⁸ Prevalence of pipe tobacco smoking is now very low. Nearly all pipe smokers are men.⁹

Health

Smoking is the greatest single cause of premature death and avoidable mortality in the United Kingdom, killing some 120 000 people in the United Kingdom every year. It is responsible for one death out of every five and causes 84% of deaths from lung cancer as well as 83% of deaths from chronic obstructive lung disease, including bronchitis.

Treating smoking-related illnesses costs the National Health Service in excess of £1.5 thousand million a year.

Taxation and tobacco policy

Brief historical facts about tobacco taxes

The United Kingdom has a very long history of taxing tobacco. Excise duty on tobacco was first introduced in 1660. The present structure of specific and *ad valorem*

² Office of National Statistics, General Household Survey 2000-2001

³ Office of National Statistics, General Household Survey 2000-2001

⁴ HM Customs and Excise

⁵ Office of National Statistics, General Household Survey 2000-2001

⁶ Office of National Statistics, General Household Survey 2000-2001

⁷ Office of National Statistics – General Household Survey 2000-2001

⁸ Gallaher Group, Gallaher Tobacco Category Review, 2002

⁹ Office of National Statistics – General Household Survey 2000–2001.

Table 3

United Kingdom tobacco duty rates 1992 to date*

Date of Change	Cigarettes		Cigars	Hand-rolling tobacco	Other tobacco
	Ad valorem %	Specific £ per 1000	£ per kg	£ per kg	£ per kg
10.03.92	21	44.32	67.89	71.63	29.98
16.03.93	20	48.75	72.30	76.29	31.93
30.11.93	20	52.33	77.58	81.86	34.26
29.11.94	20	55.58	82.56	85.94	36.30
01.01.95	20	57.64	85.61	85.94	37.64
28.11.95	20	62.52	91.52	85.94	40.24
26.11.96	21	65.97	98.02	87.74	43.10
01.12.97	21	72.06	105.86	87.74	46.55
01.12.98	22	77.09	114.79	87.74	50.47
09.03.99	22	82.59	122.06	87.74	53.66
21.03.00	22	90.43	132.33	95.12	58.17
07.03.01	22	92.25	134.69	96.81	59.21
17.04.02	22	94.24	137.26	98.66	60.34

* nominal terms

Source: HM Customs and Excise

excise duty on cigarettes was introduced in 1976 to ease tax harmonization within the European Economic Community (EEC).

United Kingdom tobacco duty rates

Since evidence shows that price increases have a major effect on reducing both smoking prevalence and consumption,¹⁰ raising the price of tobacco products through duty increases

has been a vital element in the strategy of successive United Kingdom Governments to reduce smoking. Cigarettes, which form the majority of the tobacco market in the United Kingdom, are now sold at historically high prices. Table 3 shows the current duty rates for tobacco products.

Tax rises from 1992

From November 1993 to November 1999 there was a commitment to increase tobacco duties in real terms annually, initially by at least 3% on average and from July 1997 by at least 5% on average.

In November 1999 the commitment to real increases was replaced by Budget-by-Budget decisions on the level of tobacco duty, although the Government made it clear that there was still a strong ongoing health case for real increases.

¹⁰ Research includes: *Curbing the Epidemic: Governments and the Economics of Tobacco Control*. Washington, D.C., The World Bank, 1999. At web site: www.worldbank.org/tobacco; and Jha P, de Beyer J and Heller PS. *Death and Taxes, Economics of Tobacco Control*. Washington, D.C. International Monetary Fund, December 1999.



In 2000 tobacco duty was raised by 5% in real terms and in 2001 and 2002 it was increased in line with inflation to maintain the high price of cigarettes in real terms. Table 3 shows the tax rates on all tobacco products from March 1992 to date and Table 4 shows the percentage increase in both real and nominal terms in tobacco duty over that period. Figure 2 shows the duty (in nominal terms) on the various tobacco products from March 1992 to the latest increase in April 2002. It is based on a typical pack of each product, i.e. 20 premium-price category cigarettes (the most popular price category), 5 small cigars and a 25-gram pack of hand-rolling tobacco or other tobacco.

Use of tobacco taxes

Tobacco taxation brings in over £9 thousand million a year in duty and VAT.¹¹ This is an essential source of government funding for investment in public services such as schools and hospitals. Furthermore, in 1999 the Government of the United Kingdom announced that any additional revenue raised from future real increases in tobacco duty would be spent on improved health care. Proceeds from the 5% real terms increase in 2000 contributed to additional funding for the United Kingdom National Health Service (NHS).

Health initiatives

In 1998 the Government of the United Kingdom published a White Paper *Smoking Kills*, which sets out a comprehensive strategy designed to reduce smoking. It includes measures specifically targeted at those in lower income groups. The initiatives include:

- a comprehensive ban on advertising, which begins to come into effect in early 2003;
- a £76 million smoking cessation initiative from 1999–2000 to 2002–2003, including a targeted programme to address smoking during pregnancy, with a further £138 million made available for 2003–2004 to 2005–2006;
- a large-scale health education campaign designed to persuade smokers to quit and non-smokers not to start; and

¹¹ VAT on tobacco products is estimated from the Office for National Statistics figures for household consumption of tobacco.

Figure 2
Duty on tobacco products (in real terms at November 2002 prices) since March 1992

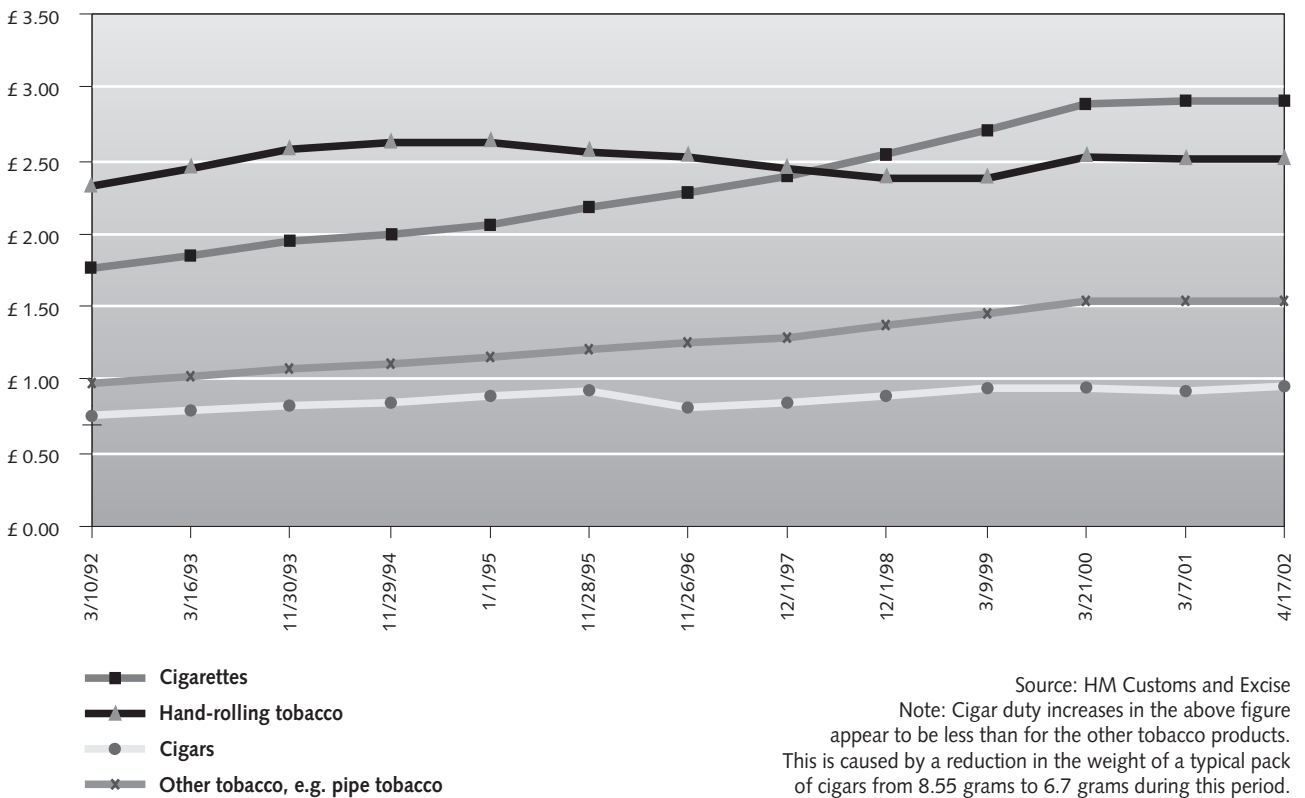


Table 4

Percentage increase* in tobacco duty per product from 1992 to date**

Product	Nominal % increase	Real % increase
Cigarettes	113.1%	84.2%
Cigars	102.2%	73.3%
Hand-rolling tobacco	37.7%	8.8%
Other tobacco (e.g. pipe tobacco)	101.5%	72.6%

* Based on duty on a pack of 20 premium priced cigarettes and duty per kilogram for the other products

** From 11/3/92 Budget

Source: HMCE

Note. Duty on hand-rolling tobacco was frozen on several occasions due to concerns about the effect of smuggling on its small domestic market.

— making smoking cessation aids available on NHS prescription: Zyban (Bupropion) since 2000 and Nicotine Replacement Therapy since 2001.

The Government of the United Kingdom¹² believes that the United Kingdom now has one of the most comprehensive smoking cessation services in the world.

In November 2002 details of a further accelerated drive to combat smoking were announced. This includes an increase in hard-hitting public awareness campaigns and new health warnings of significantly increased size on the front and back of cigarette packs. A partnership is being developed between the Government and the pharmaceutical industry to assess how they can work better together to reduce smoking. The Government of the United Kingdom's Department of Health is seeking to develop a rebate system whereby pharmaceutical companies compensate the National Health Service (NHS) part of the additional money they receive from seeing cessation grow and prescriptions rise.

Policy implementation

Sequence of tax changes

In 1992 targets to reduce adult smoking by 40% by 2000 were published.¹³ These targets, related to consumption of cigarettes, were set against a background of steadily decreasing prevalence, a trend that stalled in the mid-1990s when there was an increase in tobacco smuggling. The Conservative Government committed to "at least

maintain the real level of taxation on tobacco" and in 1992 increased tobacco taxes by 5% above the inflation rate.

In March 1993 tobacco taxes were again raised by more than inflation. In the autumn of 1993 a joint pre-Budget submission by several health organizations called for unique treatment for tobacco because of its health consequences. This included a request for a real increase in the forthcoming Budget and a commitment to real increases in future. The Health Minister asked the Finance Minister to establish "future real increases". The 'tobacco escalator' was introduced, which promised rises in tobacco duty of at least 3% in real terms in future Budgets. The reasons given for this were:

- to raise revenue;
- to encourage further reductions in the levels of smoking; and
- to demonstrate the Government's commitment to the *Saving Lives: Our Healthier Nation* White Paper.

In 1994 tax on cigarettes was raised by 4.2% above inflation while tax on hand-rolling tobacco was raised by 3% above inflation. A second increase in tax was announced in December 1994 that added an extra 3.7% tax to cigarettes from January 1995.

¹² Department of Health

¹³ *Saving Lives: Our Healthier Nation* White Paper. Presented to Parliament by the Secretary of State for Health, the Stationery Office, July 1999.



By 1995 tobacco smuggling had begun to take root, in particular hand-rolling tobacco smuggling. Tax on cigarettes was raised by 4.6% above inflation, but tax on hand-rolling tobacco was frozen because of concerns about the impact of smuggling on its small domestic market.

Although cigarette smuggling was being contained in 1996, there was concern that it was switching from amateur gangs to organized crime. Customs were allocated additional staff to deal with smuggling. Tax on cigarettes was raised by 5% above inflation while tax on hand-rolling tobacco was raised in line with inflation.

In 1997 the new Labour Government announced an increase in the 'tobacco escalator' from 3% to 5% because of its concern about the rates of death and disease attributable to active and passive smoking. The increased escalator was one of the measures intended to reduce tobacco consumption and dissuade young people from taking up the habit. Tax on cigarettes was increased by 5% above inflation while tax on hand-rolling tobacco was frozen again because of the impact of smuggling on its small domestic market.

In 1998 and 1999 tax increases were the same as in 1997. Tobacco smuggling continued to grow, and in 1999 the Government commissioned an independent review by a senior businessman of tobacco smuggling. In 2000 the Government, acting on recommendations made in this review, announced their strategy *Tackling Tobacco Smuggling* to address the growing tobacco smuggling problem. This included a new Government investment of £209 million over three years to reduce smuggling. The strategy provided additional customs staff and a network of x-ray scanners, funded a major publicity campaign, introduced fiscal marking of cigarettes and hand-rolling tobacco along with related new criminal offences, and introduced a tough vehicle seizure policy.

In November 1999, the Government announced that it was abandoning the 'tobacco escalator' in favour of Budget-by-Budget decisions. It also said that future real increases in tobacco taxes would be spent on improved health care. Taxes were increased by 5% above inflation in 2000 and with inflation in 2001 and 2002 to maintain the real cost of cigarettes. At the same time the Government sought to increase the average price of cigarettes for the consumer by clamping down on the supply of cheap smuggled products through the successful *Tackling Tobacco Smuggling* strategy.

Lobby for and against policy

As already mention in paragraph 3.2, several health organizations submitted a joint paper in 1993 calling for unique treatment of tobacco because of its health consequences. They considered that the general affordability of tobacco products had been unaffected by the previous tax rises and they noted that the market was changing with the introduction of cheaper cigarette brands. They also considered that the introduction of tax stamps and law enforcement were the appropriate way to tackle smuggling and that it should not be addressed by a reduction in duty rates.

Health and anti-smoking groups have been supportive of tobacco policy, including *Tackling Tobacco Smuggling*, since that time. Prior to the 2002 Budget these groups said they believed that "greater emphasis should now be placed on raising prices through addressing the trends that tend to drive prices down rather than on increasing headline tax rates for cigarettes." The trends include the supply of cheap, unregulated tobacco through the smuggling market.

Tobacco manufacturers, retailers and tobacco workers groups have continually blamed the tobacco smuggling situation on the level of tobacco taxation in the United Kingdom and have called for significant reductions in duty to tackle smuggling. However over the last year manufacturers have publicly acknowledged an increase in legitimate trade due to the success of the *Tackling Tobacco Smuggling* strategy. Despite this, both manufacturers and retail trade groups lobby at every opportunity for a decrease in tax levels to reduce the differential between the tax level in the United Kingdom and in other nearby European Union (EU) countries.

Effect of the taxation policy

Tobacco prices

Cigarette prices in the United Kingdom are now at historically high levels. Although high tax levels are the major factor in these high prices, manufacturers' pre-tax prices are also significantly higher in the United Kingdom than elsewhere in the world for the same product. For example, in 2001 the pre-tax price of 20 Benson & Hedges Special Filter cigarettes was 93p in the United Kingdom, 48p in France and 39p in Greece.¹⁴

¹⁴ Gallaher, Ltd.

Table 5

Prevalence of cigarette smoking by sex and socioeconomic group

Socioeconomic group	Men	Women
Professional	15%	13%
Employers & managers	22%	21%
Intermediate & junior non-manual	26%	25%
Skilled manual & own account non-professional	34%	27%
Semi-skilled manual and personal service	36%	34%
Unskilled manual	39%	34%
Total non-manual	23%	22%
Total manual	35%	30%
All aged 16 and over	29%	25%

Source: Office of National Statistics, General Household Survey 2000-2001

Smoking prevalence

Smoking prevalence (the proportion of the adult population who admit to smoking) has been declining but at a slow rate recently. In 1992 it was 29% and in 2000 it was 27%.¹⁵ Figure 1 shows the decline in a longer time scale.

Although taxation plays an important role in reducing smoking, it is not possible to isolate the effect of taxation. Smoking is affected by an entire range of measures such as health campaigns and targeted cessation programmes. It is also affected by social trends, e.g. the acceptability of smoking or peer pressure for young people.

Social groups

Table 5 illustrates that smoking prevalence increases down the socioeconomic groups. Manual workers are also likely to consume more cigarettes than those in non-manual professions. Households with children are more likely to have smokers and smoking is increasingly linked with poverty. Tobacco duties are regressive: lower-income households are more affected by duty increases than richer ones.¹⁶ This is why the Government balances high tobacco taxes with real support for people to quit (see “Health initiatives”).

Impact of tobacco taxation policy

Revenue

From 1992 to approximately 1997 revenue from tobacco taxes was increasing. There followed a period of decreasing revenue until early 2000 due to the revenue loss caused by tobacco smuggling. Since then tobacco duty revenue has started to increase again because of the success of the United Kingdom *Tackling Tobacco Smuggling* strategy. The latest estimate of tobacco revenue being evaded or avoided is £4.3 thousand million for 2001–2002. However, this includes about £1 thousand million from legitimate cross-border shopping (duty-free and EU duty-paid goods). Table 6 shows tobacco duty revenue

¹⁵ Office of National Statistics – General Household Survey 2000-2001

¹⁶ Even if tobacco duties are regressive this does not mean that increases in tobacco duties are. A paper by Townsend et al., Cigarette smoking by socioeconomic group, sex, and age: effects of price, income, and health publicity, *British Medical Journal* 1994, 309:923-927, shows that when the price of cigarettes increases, lower-income groups decrease their consumption more than do higher-income groups.



from 1992–1993 to 2001–2002, although the latter is a provisional figure.

Table 6

United Kingdom tobacco duty revenue in £million
(in real terms at November 2002 prices)

Year	Revenue £million
1992–1993	7,551.3
1993–1994	8,007.2
1994–1995	8,837.6
1995–1996	8,448.0
1996–1997	9,093.7
1997–1998	9,152.4
1998–1999	8,712.4
1999–2000	5,939.0
2000–2001	7,764.5
2001–2002*	7,754.5

* Provisional

Source: HM Customs and Excise

Tobacco manufacturers

We cannot provide detailed information on the United Kingdom tobacco manufacturers' profits, but Imperial Tobacco, the United Kingdom's largest manufacturer, recently announced a 27% increase in operating profit. Despite the high levels of tobacco taxation and smuggling, tobacco manufacturers continue to make large profits. As already mentioned in paragraph 4.1, pre-tax prices in the United Kingdom are much higher than in other countries. During 2002–2003 manufacturers publicly acknowledged the success of the *Tackling Tobacco Smuggling* strategy, which has increased legitimate sales and begun to restore a more orderly market.

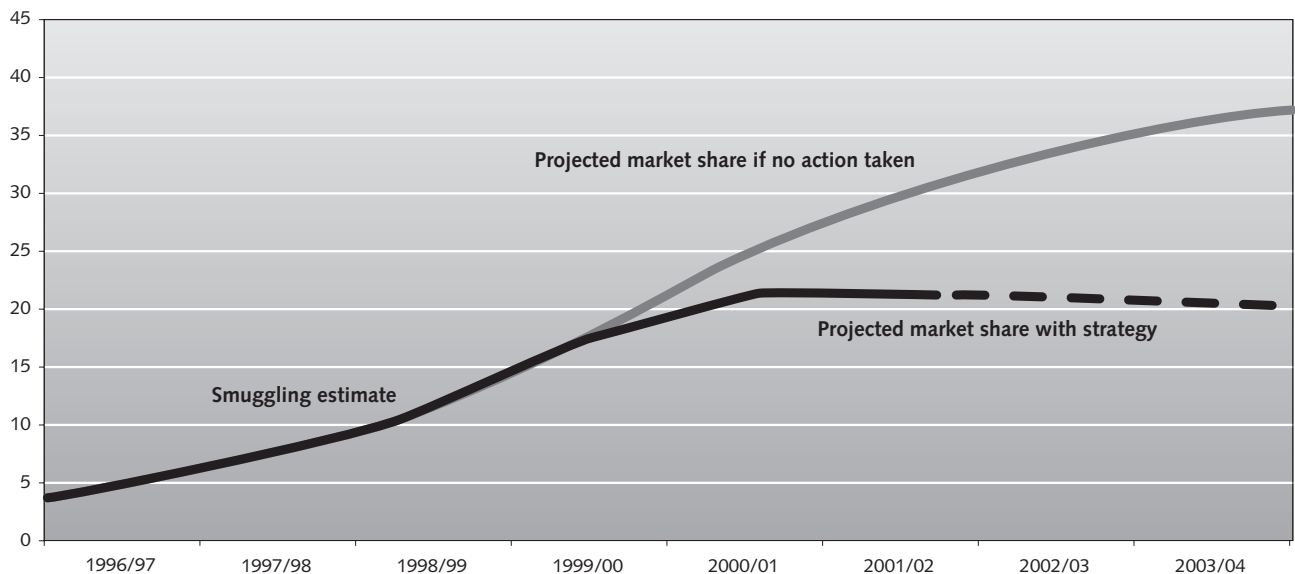
Tobacco smuggling

The introduction of the single market in 1993 and ease of travel to neighbouring EU countries where tobacco products were priced lower than those in the United Kingdom both led to increased tobacco cross-border shopping and smuggling as United Kingdom prices rose. Initially the smuggling was confined to cross-Channel smuggling of hand-rolling tobacco but it soon increased to both cross-Channel and freight smuggling of cigarettes.

By 1999 the revenue lost through tobacco smuggling was an estimated £2.5 thousand million, which was about 25% of all tobacco revenue; smuggling was on a strong upward trend. Customs estimated in 2000 that without

Figure 3

Percent market share of smuggled cigarettes



Source: Tackling Tobacco Smuggling. HM Customs and Excise, HM Treasury, March 2000.



intervention the smuggled share of the cigarette market would have reached over a third by 2002–2003. Figure 3 shows the trend in cigarette smuggling and the projected trend with and without the *Tackling Tobacco Smuggling* strategy.

In March 2000 the Government announced its strategy to tackle the tobacco smuggling problem, investing £209 million over three years toward this end. The *Tackling Tobacco Smuggling* strategy provided additional resources and technology (x-ray scanners) for customs, funded a publicity campaign and led to the introduction of fiscal marks on tobacco and hand-rolling tobacco in 2001, with new criminal offences related to their use. The strategy set challenging targets for customs to slow, stabilize and reverse the growth in tobacco smuggling by the end of 2002–2003.

Customs achieved its first year target and held the illicit share of the cigarette market to 21% in 2000–2001. In 2001–2002 customs continued to restrict the illicit share to 21% (when its key target was 22%) thereby stopping the growth in tobacco smuggling for the first time in a decade.¹⁷

In the first two years of the *Tackling Tobacco Smuggling* strategy customs:

- broke up 103 gangs involved in large-scale cigarette smuggling; and
- seized in excess of 5 thousand million illicit cigarettes.

In 2001–2002 the network of x-ray scanners detected 13 tonnes of hand-rolling tobacco and 325 million cigarettes. Revenue lost from tobacco smuggling is now estimated to be some £3.3 thousand million, a slight decrease from the previous year.

The strategy has also had a significant impact on cross-Channel smuggling of hand-rolling tobacco. The estimated revenue lost from this is now £95 million compared to approximately £785 million two years ago.

Cross-Channel shopping

The introduction of the single market in 1993 led to an increase in cross-border shopping as well as smuggling.

As a result of the success of the *Tackling Tobacco Smuggling* strategy, cross-Channel smugglers have increasingly sought to pose as honest shoppers in an attempt to evade customs controls. In October 2002 the Government announced a new package of measures designed to be

fair to honest shoppers, tough on criminal smugglers and clear about the distinction between the two. This package includes an increase in the guidelines, which are an indicator that a traveller has brought a significant quantity of tobacco goods into the United Kingdom, to about six months' use for an average smoker.

Conclusion

Smoking is the single greatest cause of preventable illness and premature death in the United Kingdom, killing over 120 000 people a year. Research shows that the demand for cigarettes is affected by price¹⁸ so high tax levels have played a significant role in reducing overall consumption. In particular, high tobacco prices are a valuable deterrent to children who are tempted to take up smoking. Various other benefits occur for individuals, society and the economy through a reduction in smoking:

- non-smokers enjoy healthier and longer lives than smokers and smokers who quit can eventually achieve almost the same levels of health as those who have never smoked;
- there is an economic benefit particularly for low-income families for whom money spent on tobacco can be a large proportion of income;
- the risk of fire is reduced;
- industry benefits from reducing lost time due to smoking breaks at work and the higher absence rates of smokers¹⁹; and
- there are savings to the NHS.²⁰

¹⁷ The methodology for calculating the illicit market share was published in *Measuring Indirect Tax Fraud as part of the Pre-Budget Report*, November 2001 (available on the United Kingdom Government web site: www.hmce.gov.uk)

¹⁸ Research includes *Curbing the Epidemic: Governments and the Economics of Tobacco Control*, The World Bank, 1999 and Jha P, de Beyer J and Heller PS. Death and Taxes, *Economics of Tobacco Control*, International Monetary Fund, 1999.

¹⁹ See for example: Parrot et al. Costs of employee smoking in the workplace in Scotland. *Tobacco Control*, 2000, 9 pp.187-192.

²⁰ Department of Health



Over the last ten years tax on tobacco products in the United Kingdom has risen significantly, mostly well in excess of inflation.

Unfortunately, the effect of these increases has been undermined by tobacco smuggling, which increases the availability of cheap smuggled products. Not only does this make cigarettes more affordable, it also decreases revenue required for investment in public services such as health and education.

The Government of the United Kingdom believes that the way to tackle tobacco smuggling is through enforcement and it will not allow criminal activity to dictate its policies to improve the nation's health. Health and anti-smoking groups have supported that approach. The successful *Tackling Tobacco Smuggling* strategy is currently addressing this problem and restricting the illicit share of the total cigarette market.

Tobacco manufacturers frequently call for the United Kingdom duty rates to be reduced to rates that are closer to those of the neighbouring EU countries. However at the same time those same manufacturers contribute to the current historically high cigarette prices in the United Kingdom by setting their pre-tax prices in the country at levels significantly above those for the same product in other countries, including those belonging to the EU.

The United Kingdom believes that focusing on differentials between the United Kingdom and EU countries is misleading and misses the key issue, which is that the vast majority of illicit goods have borne no tax in any country. Cutting duty levels to those prevalent in countries from which smuggling occurs would cost thousands of millions of pounds in revenue. The shortfall in revenue would either mean less investment in essential public services or increases in other forms of taxation to fund them. Lower cigarette prices would increase consumption, lead to more premature deaths and smoking-related illnesses and incur further costs for the National Health Service.

The United Kingdom has therefore tackled tobacco use by a multi-pronged approach. It has used a package of health measures along with taxation to bring about a reduction in smoking. Where this has been undermined by tobacco smuggling, the United Kingdom is tackling this criminal activity and has sought to increase the effective price of cigarettes by reducing the supply of cheap smuggled products and so raising the share of the market taken by more expensive legitimate products.