PRE-BUDGET SUBMISSION 2013

Overview

Smoking is the single biggest cause of preventable death in Ireland. At least 5,200 people die prematurely as a result of smoking every year. It is also the biggest contributor to health inequalities and accounts for up to half the difference in life expectancy between the richest and the poorest groups in our society. The burden that tobacco places on our society needs to be reduced through a long-term, comprehensive, multi-component approach.

Ireland needs to commit to a comprehensive national tobacco control strategy (high taxation, smuggling controls, cessation services and effective legislation) that will not only save lives on a substantial scale, but will also rebalance the burden of smoking on the Exchequer so that the tobacco industry contributes more towards the harm it causes. Implementing the measures proposed in this submission would have positive economic and public health effects.

In previous submissions to Government, the Irish Cancer Society and Irish Heart Foundation have consistently called for price to be a tool to encourage people to quit smoking. Ireland now has one of the highest prices in Europe – but this is not only due to Government tax, it is also due to the large profit margin enjoyed by the tobacco industry. Our pricing policy has been subtly and effectively undermined by an industry that reinvests its profits to attract new smokers, weaken our tobacco control strategies and capitalise on the belief in some Government Departments that keeping people smoking is revenue positive.

In Budget 2013 we call for a new approach from Government so that the Exchequer benefits from the high price of cigarettes, not the tobacco industry. Our proposals seek to correct a string of market failures that are exhibited by the tobacco market.

We should never perceive tobacco products as a valid revenue stream for Government – it places a massive societal and financial burden in terms of both chronic and fatal illnesses and any revenue raised from it needs to be reinvested to encourage people to quit, with the aim of eventually ending smoking in Ireland.

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SECTION 1: Introduction

Tobacco products in Ireland and other countries are subject to high levels of taxation and with good reason: tobacco is the only legal consumer product that kills when used as intended and is highly addictive, with half of all long term users dying from their addiction. The use of tobacco imposes significant costs on the Irish economy through increased public health service expenditure on smoking-related health conditions and increased mortality rates for smokers of working age.

Upwards of a quarter of the Irish population still smoke. Other countries show us that large reductions in smoking rates are possible – in 2010, just 11.9% of people smoked in California, 17% in Canada, less than 17% in Australia and just 21% in England. Yet, as a result of our continued high smoking rates, 5,200 people in Ireland every year – or 14 people every day – die of smoking-related illnesses.

That’s the human cost. But the economic price is also high when you consider the burden of smoking-related illness to the health service, lost productivity, absenteeism, increased welfare costs and

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1 Evidence from three national surveys (SLÁN, the Office for Tobacco Control (OTC), and the Living in Ireland survey) covers the period between 1998 and 2010. Combining the results from all three surveys, smoking prevalence for Irish adults fell from around 31% to 24% between 1998 and 2010. The last SLÁN survey was in 2007, showing an overall smoking prevalence rate smoking rate of 29%. The most recent survey (with a smaller sample size) by the OTC in June 2010 found a rate of 24%.


4 Australian Government, Department of Health and Ageing.

environmental damage. A Spanish survey in 2010 found the real cost of a pack of cigarettes to be €107 for men and €75 for women, when medical dependency is taken into account.

1.1 The tobacco industry lobbies for favourable taxation policies

The tobacco industry has a vested interest in stopping, weakening, or delaying tobacco control measures – the most effective form of which are taxation increases. The lobbying positions taken by the tobacco industry in Ireland include:

- high price causes tobacco smuggling;
- the point-of-sale legislation is having a detrimental impact on retailers’ income and is increasing smuggling and;
- counterfeit tobacco contains ‘unregulated’ product and is much more dangerous to smokers.

Tobacco industry tactics in Ireland

The industry’s use of disingenuous economic arguments in Ireland can be seen in the way it lobbied against tobacco tax increases in Ireland, while simultaneously increasing its own prices. The impact of tobacco industry lobbying in relation to tobacco taxation in Ireland during the period 2000-2010 has been examined in recent research. The research identifies three themes used in tobacco industry pre-Budget submissions to Government:

- increasing taxes would increase the illegal trade,
- Ireland’s taxes on tobacco are amongst the highest in the world and;
- that government should not increase taxes in the forthcoming budget.

Of note was the ‘complete absence of any reference to the price increases that it imposed on tobacco products’. The study shows that the industry consistently lobbied the Government for no tax increases, yet the industry increased its own prices every year. As a result of the industry’s activities, the Government was deprived of tax revenue which it could have collected. The research concludes that: ‘one could argue that they [the tobacco industry] lobbied government from increasing taxes so that they could in turn increase price even further to maximise its own profits’.

Between 2000 and 2010 tobacco industry revenue per pack of 20 cigarettes has also grown at a higher rate than tobacco tax. Trade content rose from 100.2 cent to 183.7 cent – an increase of 83.33%. In the same period tobacco tax increased from 377.2 cent to 671.3 cent – up by 78.02%.

1.2 Tobacco industry profitability in Ireland

The tobacco industry is one of the most profitable industries in the world. In 2010, the combined profits of the six leading tobacco companies was $35 billion, equal to the combined profits of Coca-Cola, Microsoft and McDonald’s.

In the UK, the tobacco industry enjoys profits of up to 67%, despite a tax structure where Government takes almost 90% of the retail price of tobacco. In Ireland, Government takes just 79% of the price of cigarettes which indicates that the tobacco industry enjoys profits that are even more substantial than in the UK.

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8 Howell, F (2011) ‘The Irish tobacco industry position on price increases on tobacco products’. Tobacco Control
9 Ibid, p.2.
10 Ibid, p.3.
11 P.3, Howell, F (2011) ‘The Irish tobacco industry position on price increases on tobacco products’. Tobacco Control
12 Based on information in Written Parliamentary Question to Minister for Finance re tobacco prices, 22nd June 2011. Available at: http://debates.oireachtas.ie/dail/2011/06/22/00070.asp
Evidence has also emerged that the tobacco industry in Ireland has been increasing its own revenues from cigarette sales at exactly the same rate as taxes have been increasing. Research indicates that tobacco companies’ pricing policies in Ireland involve ‘overshifting’ of tax increases to consumers.\textsuperscript{14} Prices exclusive of tax are much higher in Ireland than in any other EU country. Furthermore, in the decade between 2000 and 2010, although cigarette prices in Ireland increased markedly in real terms, the percentage of the average price accounted for by tax was exactly the same in 2010 as in 2000 (79% using the Revenue Commissioners’ preferred measure of average retail price).\textsuperscript{15}

**Figure 1: Price of a packet of 20 cigarettes net of tax in 27 EU countries, July 2011\textsuperscript{16}**

How can it be that regular tax increases do not alter the profitability of the tobacco industry? The answer is that a well-established market failure exists in the tobacco market – market power.

This means that the tobacco industry can increase the pre-tax price of tobacco, virtually unnoticed by the consumer.

\textsuperscript{14} Reed. H. (Oct. 2011) Tobacco taxation, smuggling and smoking in Ireland, Irish Heart Foundation: Dublin.

\textsuperscript{15} P.20-1, Reed. H. (Oct. 2011) Tobacco taxation, smuggling and smoking in Ireland, Irish Heart Foundation: Dublin.

\textsuperscript{16} Ibid, P.21
Figure 2: Government and tobacco industry price increases (cent) 2000 - 2010

Figure 3: Price / tax increases on tobacco products in cent, 2000-2009

Table : Price/tax increases on tobacco products in cent, 2000-2009

<table>
<thead>
<tr>
<th>Year</th>
<th>Pre budget price</th>
<th>Govt Tax increase</th>
<th>Tobacco Industry price increase</th>
<th>Final retail price</th>
<th>Trade content</th>
<th>Trade content percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>477</td>
<td>0</td>
<td>10</td>
<td>487</td>
<td>107</td>
<td>22%</td>
</tr>
<tr>
<td>2001</td>
<td>487</td>
<td>13</td>
<td>21</td>
<td>521</td>
<td>117</td>
<td>22%</td>
</tr>
<tr>
<td>2002</td>
<td>521</td>
<td>50</td>
<td>16</td>
<td>587</td>
<td>127</td>
<td>22%</td>
</tr>
<tr>
<td>2003</td>
<td>597</td>
<td>25</td>
<td>13</td>
<td>625</td>
<td>135</td>
<td>22%</td>
</tr>
<tr>
<td>2004</td>
<td>625</td>
<td>0</td>
<td>10</td>
<td>635</td>
<td>142</td>
<td>22%</td>
</tr>
<tr>
<td>2005</td>
<td>635</td>
<td>0</td>
<td>20</td>
<td>655</td>
<td>155</td>
<td>24%</td>
</tr>
<tr>
<td>2006</td>
<td>655</td>
<td>50</td>
<td>10</td>
<td>715</td>
<td>161</td>
<td>23%</td>
</tr>
<tr>
<td>2007</td>
<td>715</td>
<td>80</td>
<td>10</td>
<td>805</td>
<td>168</td>
<td>21%</td>
</tr>
<tr>
<td>2008</td>
<td>805</td>
<td>2.7</td>
<td>2.3</td>
<td>810</td>
<td>168</td>
<td>21%</td>
</tr>
<tr>
<td>2009</td>
<td>810</td>
<td>21.5</td>
<td>23.5</td>
<td>855</td>
<td>184</td>
<td>21%</td>
</tr>
</tbody>
</table>

18 http://www.hse.ie/eng/services/healthpromotion/quit/budgetsubtobacco.pdf
Controls need to be put in place so that the industry cannot continue to earn such extraordinary profits without regard to the significant health burden on smokers and the economic burden imposed on non-smokers. The health effects of tobacco are so serious that its impact ranges from a loss of employee productivity due to tobacco-related illness\(^{19}\) to clogging up 9% of all bed days in the acute hospital services\(^{20}\). There is an onus on the Department of Finance to consider the health implications of tobacco taxation policy on the citizens of the state.

### 1.3 Affordability of tobacco in Ireland

Over the period 2000-2011, the real price of cigarettes (price compared to a basket of goods and services) in Ireland has not kept pace with the nominal price (price as advertised).

*Figure 4: Nominal and real cigarette prices in Ireland (2000-2011)*\(^{21}\)

Ireland has one of the highest tobacco prices in Europe (average approximate €9.10), yet Ireland is in an intermediate position in the EU in terms of affordability of a packet of cigarettes as a percentage of average gross hourly wages. Cigarettes are less affordable in Ireland than in most Western countries (with the exception of Portugal) but are more affordable than in most of the central and eastern European countries which entered the EU in 2004 or later (with the exception of Hungary)\(^{22}\).

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SECTION 2: Recommendations

RECOMMENDATION 1: Introduce a price cap on the pre-tax price of tobacco.

By placing a cap on the tobacco industry’s profit, excess profit would be transferred from the tobacco industry to government, raising significant returns for the Exchequer.

Correcting Market Failure in the Tobacco Industry

We propose a solution to correct the failures that exist in the Irish tobacco market and that allow the industry to earn significant profits. First proposed in the UK to correct market power and some unintended consequences of tobacco control policies, we call on Government to cap the pre-tax price of tobacco. This would allow Government to correct a significant market failure (market power) while expanding its tobacco control initiatives. For tobacco control to be effective we need to ensure the full regulatory landscape is conducive to encouraging smokers to quit and discouraging others to start smoking.

For example – we know that high price is the single most effective way of encouraging people to quit but if tobacco companies are earning a significant proportion of profits from this high price and reinvesting it in product innovation and marketing to attract new smokers, then this undermines tobacco control policy. We need to ensure our regulatory environment isn’t contradictory and that unintended consequences of tobacco control are managed. Our regulatory system should ensure that tobacco price increases benefit the Exchequer rather than provide an opportunity for the tobacco industry to increase profits.

Four tobacco companies dominate the international tobacco market outside China23 with over 90% market share (Philip Morris International, British American Tobacco, Japan Tobacco International and Imperial Tobacco), making this market an oligopoly. The well-known benefits associated with any oligopolistic structure are further enhanced by the significant barriers to entry that have arisen from tobacco control policies such as the ban on advertising and promotion. Furthermore, the highly addictive nature of tobacco products means that there are no real alternatives to cigarettes.

This market failure means that cigarette companies have immense pricing power. Even small increases in the manufacturer’s margin have a significant impact on their profits but do not affect consumption patterns. In fact, this pricing power is actually compounded by tobacco tax policies because when Government increases tax, it enables the tobacco industry to hide their own price increases. Taxes make up a large portion and the manufacturer’s price makes up a small portion of the actual price consumers pay. We believe that the revenue that the tobacco industry is losing as a result of smokers either quitting or dying is replaced by sustained price increases. As the normal competitive forces are absent, the resulting oligopoly can raise prices at will, generating sustained high profits which are significantly higher than those earned on other consumer staples.

Figure 5: Profitability measure using the EBITA (earnings before interest, taxes, depreciation and amortisation) margin (%) for Europe’s two major tobacco companies and comparing against European consumer staple companies.

<table>
<thead>
<tr>
<th>Company</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008*</th>
<th>2009*</th>
<th>2010*</th>
<th>2011*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tobacco companies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>British American Tobacco</td>
<td>24.0</td>
<td>28.1</td>
<td>28.7</td>
<td>30.0</td>
<td>30.7</td>
<td>31.1</td>
<td>32.1</td>
<td>33.7</td>
</tr>
<tr>
<td>Imperial Tobacco Group</td>
<td>40.2</td>
<td>41.5</td>
<td>42.9</td>
<td>45.0</td>
<td>28.2</td>
<td>37.7</td>
<td>39.4</td>
<td>39.5</td>
</tr>
<tr>
<td>Food companies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cadbury</td>
<td>15.6</td>
<td>15.9</td>
<td>14.4</td>
<td>13.5</td>
<td>12.0</td>
<td>13.0</td>
<td>13.8</td>
<td>14.9</td>
</tr>
<tr>
<td>Danone</td>
<td>12.7</td>
<td>13.1</td>
<td>13.3</td>
<td>12.1</td>
<td>14.4</td>
<td>16.9</td>
<td>15.7</td>
<td>15.9</td>
</tr>
<tr>
<td>Nestle</td>
<td>12.7</td>
<td>12.9</td>
<td>13.5</td>
<td>14.0</td>
<td>14.3</td>
<td>13.4</td>
<td>13.6</td>
<td>13.2</td>
</tr>
<tr>
<td>Premier Foods</td>
<td>12.9</td>
<td>13.7</td>
<td>13.8</td>
<td>12.5</td>
<td>11.9</td>
<td>12.0</td>
<td>11.9</td>
<td>11.7</td>
</tr>
<tr>
<td>Consumer products companies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unilever NV</td>
<td>15.5</td>
<td>14.8</td>
<td>14.3</td>
<td>14.5</td>
<td>14.6</td>
<td>14.7</td>
<td>14.9</td>
<td>15.1</td>
</tr>
<tr>
<td>Henkel</td>
<td>9.4</td>
<td>9.7</td>
<td>10.2</td>
<td>10.5</td>
<td>10.3</td>
<td>9.0</td>
<td>10.6</td>
<td>11.6</td>
</tr>
<tr>
<td>L’Oreal</td>
<td>15.3</td>
<td>15.6</td>
<td>16.4</td>
<td>16.6</td>
<td>15.5</td>
<td>14.3</td>
<td>14.9</td>
<td>15.5</td>
</tr>
<tr>
<td>Reckitt Benokiser</td>
<td>19.3</td>
<td>20.1</td>
<td>21.5</td>
<td>22.6</td>
<td>23.4</td>
<td>23.9</td>
<td>23.2</td>
<td>23.6</td>
</tr>
<tr>
<td>Beverage companies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Heineken NV</td>
<td>13.6</td>
<td>13.1</td>
<td>13.0</td>
<td>14.8</td>
<td>13.2</td>
<td>13.5</td>
<td>14.0</td>
<td>14.4</td>
</tr>
<tr>
<td>SABMiller</td>
<td>18.1</td>
<td>20.2</td>
<td>16.9</td>
<td>16.8</td>
<td>16.6</td>
<td>16.8</td>
<td>17.3</td>
<td>18.5</td>
</tr>
<tr>
<td>Carlsberg</td>
<td>8.8</td>
<td>8.7</td>
<td>9.6</td>
<td>11.5</td>
<td>13.2</td>
<td>16.0</td>
<td>16.3</td>
<td>17.1</td>
</tr>
<tr>
<td>Diageo</td>
<td>28.7</td>
<td>29.0</td>
<td>28.2</td>
<td>28.3</td>
<td>28.5</td>
<td>26.9</td>
<td>31.5</td>
<td>31.8</td>
</tr>
</tbody>
</table>

Various Citigroup Consumer Central business analyst investment reports.
*Estimated values

The profits made by tobacco companies in Ireland can be used for marketing and lobbying against the tobacco control policies aimed at reducing the number of smokers. We do not have access to Irish profit margins earned by the tobacco industry but in the UK it is as much as 67% for Imperial Tobacco, 36.5% for Japan Tobacco International, 50% for Philip Morris and 31% for British American Tobacco.

However, tobacco is a legal product and we are not suggesting that the tobacco industry is no longer allowed to make a profit. We propose that like other regulated industries, (Communications Regulator (ComReg), Commission for Energy Regulation (CER), the Commission for Taxi Regulation and the Commission for Aviation Regulation (CAR)) profit is capped. The standard calculation used to assess what profits would be allowed under a regulated industry is CPI-× (where × is the expected efficiency savings). This would allow the tobacco companies to make sufficient profits so that it covers all its legitimate costs and makes a small return which is just enough to cover its cost of capital and therefore keep it involved in the industry.

We believe that by placing a cap on the tobacco industry’s profit, that we could transfer excess profit from the tobacco company to government, raising significant returns for the Exchequer in addition to existing tobacco taxes. This approach would serve a number of purposes:

- Correct the market failure associated with market power;
- Reinforce tobacco control policies;
- Prevent the tobacco industry from absorbing increased taxes on their cheapest brands;
- Increase revenue for the Exchequer;
- Shift the mindset of who should pay for tobacco-related illness from the smoker to the tobacco industry; and
- Highlight that the tobacco industry isn’t like any other.

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RECOMMENDATION 2: Adjust the structure of tobacco taxation.

Adjust the structure of tobacco taxation to ensure tax increases benefit the Exchequer and not the tobacco industry.

Tobacco taxation

Tobacco products tax on cigarettes consists of two separate elements: (i) a specific amount of tax calculated per 1000 cigarettes plus (ii) an ad-valorem element, which is a percentage of the retail selling price.

Taxation is the single most effective and cost-efficient intervention to reduce tobacco consumption, especially amongst younger generations and low income groups. This policy has long been endorsed by the World Health Organization and the World Bank. The Framework Convention for Tobacco Control also emphasises taxation as a major part of a comprehensive tobacco reduction policy.

We can see from the Irish figures that a price increase does actually decrease consumption and that new smokers, probably mostly children and young people, become addicted when price remains constant. This reinforces the fact that price must be kept high in order for people to quit smoking – however, this must go hand-in-hand with increased resources directed at reducing illegal tobacco supply.

Figure 6: Excise increases on cigarettes, (with pro rata increases on other tobacco products) from 2000 - 2010

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount of Duty Increase per pack of 20</th>
<th>Change in Consumption over previous year</th>
<th>(Cigarettes only) Yield €m</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>63 cent</td>
<td>-0.3%</td>
<td>923</td>
</tr>
<tr>
<td>2001</td>
<td>4 cent (compensating increase)</td>
<td>-1.1%</td>
<td>1,102</td>
</tr>
<tr>
<td>2002</td>
<td>13 cent</td>
<td>+3.6%</td>
<td>1,099.5</td>
</tr>
<tr>
<td>2003</td>
<td>50 cent</td>
<td>-10.3%</td>
<td>1,119.5</td>
</tr>
<tr>
<td>2004</td>
<td>25 cent</td>
<td>-15.3%</td>
<td>1,024.6</td>
</tr>
<tr>
<td>2005</td>
<td>No increase</td>
<td>+3.4%</td>
<td>1,053.6</td>
</tr>
<tr>
<td>2006</td>
<td>No increase</td>
<td>+1.6%</td>
<td>1,071.4</td>
</tr>
<tr>
<td>2007</td>
<td>50 cent</td>
<td>-3.6%</td>
<td>1,155.0</td>
</tr>
<tr>
<td>2008</td>
<td>30 cent</td>
<td>-8.5%</td>
<td>1,131.5</td>
</tr>
<tr>
<td>2009</td>
<td>50 cent</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2009 (Supp)</td>
<td>25 cent</td>
<td>-6.7%</td>
<td>1,155.4</td>
</tr>
<tr>
<td>2010</td>
<td>No increase</td>
<td>-9% (to date)</td>
<td>1,052.5</td>
</tr>
</tbody>
</table>

When properly administered, the essence of taxation’s effectiveness lies in its ability to increase the price of tobacco products - which directly decreases tobacco’s affordability to the population at large and groups with lesser purchasing power. For those on lower incomes and for younger generations, who are more likely to smoke or start smoking, making tobacco less affordable decreases its access and attractiveness amongst these groups. The decrease in demand for tobacco is highlighted by increased cessation rates by current smokers and reduced tobacco uptake rates by potential users.


Young people are particularly sensitive to price rises and may reduce their smoking at two to three times the rate of older people. For instance, in 2002, the New York City tobacco control program put in place by Mayor Bloomberg included raising tobacco tax. In the ten years before the programme was implemented, there was no decrease in smoking rates. After the control programme, teenagers’ smoking decreased from 17.6% in 2001 to 8.5% in 2007, a level nearly two-thirds lower than the latest available US national teen smoking rate.

Tobacco taxation has three main purposes:

- To raise revenue
- To promote health by deterring consumption (i.e. as a sumptuary tax)
- To correct for social costs.

Tobacco is unlike most consumer goods, as it is unessential and imposes serious and substantial social costs (called ‘externalities’) when consumed. Externalities include healthcare costs associated with smoking related diseases, and costs related to second hand smoke victims and loss of productivity. These costs justify government intervention in regulating tobacco consumption and constitute an economic rationale for tax on tobacco products. An economically efficient tax should include provision of tax revenue to cover smoking-related external costs, as well as contribute to general revenue.

Economic literature suggests that the existence of some private costs also justify government intervention in the personal decisions about smoking behaviour. The rational is that not all individuals correctly account for the adverse effects of smoking behaviour on their own future health and/or the risk and the costs of nicotine dependency, particularly as typically they start smoking at young ages without realising the addictive nature of nicotine. In this case, the important role of the excise tobacco taxes would be to discourage present and future smoking behaviour.

**What constitutes an optimal tobacco taxation rate?**

There are different perspectives as to what constitutes an optimal taxation rate:

- From a public health perspective → until all smokers quit
- From a governmental perspective → to maximise revenue but also to improve health and reduce health care and other smoking related costs
- From an economics perspective → as an efficient source of tax revenue and to correct for externalities and internalities associated with tobacco consumption

**Structure of Tobacco Tax**

**Figure 7: Current structure of Irish tobacco taxes**

<table>
<thead>
<tr>
<th>Tobacco Products</th>
<th>Cigarettes</th>
<th>Cigars</th>
<th>Fine-cut tobacco for the rolling of cigarettes</th>
<th>Other smoking tobacco</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(a) except where paragraph (b) applies, 233.11 per thousand together with an amount equal to 9.04 per cent of the price at which the cigarettes are sold by retail, or (b) 268.14 per thousand in respect of cigarettes sold by retail where the rate of tax would be less than that rate had the rate been calculated in accordance with paragraph (a)</td>
<td>271.337 per kilogram</td>
<td>228.968 per kilogram</td>
<td>188.243 per kilogram</td>
</tr>
</tbody>
</table>

Manufactured tobacco in the EU is subject to three types of taxation - two types of excise duty and Value Added Tax (VAT):

Specific (or fixed) excise duties are imposed as a set duty per unit of product. The same amount of tax is applied whatever the base price - thereby not increasing price differences between cheaper and more expensive brands (positive effect).

Ad valorem excise duties are a proportion of the retail price of tobacco products (i.e. a set percentage of the manufacturers’ or retail prices). Unlike specific excise tax, ad valorem taxes increase with inflation such as manufacturers’ or other price increases (positive effect).

Current EU tobacco tax law (before 01.01.2014) requires:
- specific tax between 5 – 76.5% of total tax: (specific excise duty + the proportional excise duty and value added tax)
- excise tax at least 57% of the weighted average retail price: (exception countries with tax of at least 101 euros per 1000 cigarettes)
- minimum excise €64 per 1000 irrespective of the weighted average retail price

- Specific tax will be between 7.5% and 76.5%(specific excise duty + the proportional excise duty and value added tax)
- Excise tax at least 60% of the weighted average retail price except countries with tax at least €115 per 1000 cigarettes

Best practice for public health – a combination of Specific and Ad Valorem

To ensure that prices cannot be manipulated and that taxation has the desired effect of making tobacco less affordable and therefore less desirable, a combination of specific and ad valorem rates is often used. For example, the EU combines ad valorem tax with a nominal minimum excise duty, which can be raised by any member state, in order to create a ‘tax floor’ for health and revenue protection. Furthermore, it is important that tax levels are maintained at least to keep up with inflation, otherwise the benefits from the tax rises are eroded.

After taxes are increased, smoking prevalence goes down in three ways:
- more people quit;
- fewer people start smoking, and;
- some smokers will consume fewer cigarettes.

Studies from the US show that a 10% increase in price in the US results in 10% of smokers trying to quit, 2% of which are successful28. There will be major impacts on life expectancy and quality of life, with lives saved, more worked days and savings in medical costs.

Ireland’s tobacco tax structure

Following from Budget 2012, Ireland’s tax structure means that approximately 79% of the total price of cigarettes is Government tax. The combinations of specific and ad valorem taxes are: €192.44 per 1,000 + 18.03% of the selling price. Excise tax increased by 25c in Budget 2012 and it is assumed by the Revenue Commissioners that approximately €40.6 million will be generated from this tax increase.

It must be highlighted again, that long term health benefits must be prioritised over short-term revenue generation and this €40.6 million should be reinvested into encouraging people to quit smoking.

Ireland has one of the highest retail prices in Europe but a correspondingly high profit rate for the tobacco industry. By adopting the pre-tax price-cap discussed earlier in this submission, we can assume that if the retail price remained constant (~€9.10) but the profit margin was reduced Government’s tax-take would increase significantly.

28 Frank J. Chaloupka, University of Illinois at Chicago, ‘Tobacco Taxation’:
http://www.tnstccgov.in/Resources/resource%20materials%20tobacco%20control/tobaccoControl-4.2a.pdf
This opportunity is further enhanced by the tax composition in Ireland. Our specific tax rate is approximately 55% but the maximum EU level is 76.5%. To minimise as far as is possible the tax differential between different price categories and so help prevent downtrading by smokers to cheaper brands, we recommend that Ireland moves towards a tax structure where specific tax is set at the maximum EU level of 76.5%.

We are concerned that while the price of cigarettes has increased across the market as a whole, the prices of the cheapest cigarettes remain the same. How can this be if both tax and profits are increasing? It is because the tobacco industry is absorbing tax increases on the cheapest brands so that smokers of those brands are not affected. It does this by increasing prices on the more expensive brands, usually around the time that Government increases excise duties so that its own increases are not noticed by consumers.

We know that people who smoke cheaper brands of cigarettes are often children or young people and those with low incomes. This makes children and poor people more likely to smoke and further exacerbates an existing health inequality associated with the profile of a smoker.

### Pricing and marketing in Ireland

It is essential that taxation policy or the structure of tobacco taxation do not facilitate the introduction of economy products, encourage price competition, or allow the tobacco industry to absorb tax increases on the cheapest brands, rather than passing them on to the consumer. As illustrated in a recent study in individual markets tobacco companies may ‘increase prices over and above tax increases (ie.,overshift the taxes thus increasing profits), while using these profits to enable them to absorb tax increases (rather than pass them on in full to the consumer) on the cheap brands’.

We are aware of a number of recent marketing / price innovations in the Irish market (see Appendix for advertisements and images):

- In February 2011 *The Irish Times* reported that PJ Carroll was reducing the recommended retail price for Pall Mall by 50 cent from €7.75 to €7.25.
- Pall Mall was advertised in *Retail News* (June 2011, back page) as ‘€7.25 Less money more quality’.
- An example of product innovation is Benson &Hedges ‘B&H Big Box’ in which a 23-cigarette box is being sold for €9.75.
- Benson & Hedges also introduced the Silver Slide brand which is described in *Checkout Magazine* (November 2011, p. 92) as offering ‘a new smoking experience for existing adult smokers with its unique slide pack retailing at €8.00’.
- Malboro Gold Touch was advertised in the *Retail News* (December 2011, p.33) as retailing for €7.80 and is described as ‘an innovative new dimension in smoking: slightly thinner than Malboro Gold Original…’.
- L&M red and blue label was advertised in *Retail News Directory 2011* as ‘Best Value €7.75’.
- In the roll-your-own market marketing practices appear to place roll-your-own prices in direct competition with cigarette prices. For example, as well as the more standard roll-your-own packaging, John Player’s Golden Virginia is sold in cigarette box-type packaging, which highlights that the pack ‘includes 50 papers’ and retails for €4.20 (*Retail News Directory 2011*).

Clearly, the tobacco industry’s strategy has undermined tobacco control efforts by Government because smokers can simply downtrade to cheaper brands rather than quitting smoking. This is why we recommend that the Government increases the specific tax rate to ensure that the cost of the cheapest brand of cigarettes increases in real terms.

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We note that if a pre-tax price cap were to exist, price would increase when taxes increase but industry profits would not. This would be the optimal tobacco control tax policy.

**RECOMMENDATION 3: Introduce a price escalator for tobacco taxes**

Commit to an annual price escalator for tobacco taxes on all tobacco products (including hand-rolled tobacco) of at least 5% per year above the rate of inflation.

Tobacco taxes in Ireland have risen through small, gradual rises in taxation rates. Relatively small increases have less impact on consumption than higher increases, as smokers adjust to them more easily.

*Figure 8: Budget tobacco tax increases*

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In order to achieve a significant decline in the number of smokers and to establish a source of consistent tax revenue, we recommend the introduction of a tax escalator for tobacco of 5% per year above the rate of inflation. The CSO (April 2012) reported an annual inflation rate of 2.2% (2.1% CPI excluding tobacco). For 2013, we therefore recommend a 7.2% increase in tobacco taxes. Such a policy is supported by emerging evidence from financial analyst reports, tobacco industry documents and research on industry lobbying. All these sources suggest that regular, moderate tax increases can benefit industry while large intermittent tax increases have a greater impact on demand.32

Reducing the affordability of tobacco in this way should be accompanied by the provision of adequate resources to assist smokers to quit.

**RECOMMENDATION 4: Standardise the tax on hand-rolled tobacco with the tax on cigarettes.**

Standardise the tax on hand-rolled tobacco to the same level as cigarettes – it is currently only 60% of the retail price.

The taxation system should ensure that all tobacco products become less affordable. Tax on hand-rolled tobacco (HRT) is lower than cigarette duties – tax makes up about 60% of the price of a typical pack of HRT compared with almost 80% of the average price of a packet of cigarettes. In practice, this meant that in 2010, a 12.5g packet of roll your own tobacco (depending on the individual smoker this can be used to make around 25 cigarettes) retails for approximately €4.50, while a packet of 20 cigarettes was €8.5533. Thus, using HRT is significantly cheaper than purchasing the equivalent number of cigarettes.

As cigarette prices increase smokers are turning to HRT as a cheaper alternative. Tax increases on cigarettes in 2009 led to smokers switching from cigarettes to hand rolling tobacco (sales of hand-rolling tobacco rose by over 70 percent in 2009). HRT remains a very small proportion of the overall tobacco market in Ireland.

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31 Figures from Department of Finance’s Budget Information.
RECOMMENDATION 4: Increase spending to tackle the illicit tobacco trade.

Increase spending by €8 million per year to tackle the trade in illicit tobacco. This could bring in €130 million of extra revenue to the Exchequer each year.

Introduce financial penalties in the Finance Bill 2013 directed at tobacco companies whose products are smuggled.\(^{34}\)

Tobacco must be made less desirable, accessible and affordable. Price has been identified as the most effective barrier to smoking. However, the illicit tobacco market is seriously undermining Ireland’s efforts to reduce smoking prevalence further since illicit tobacco is sold at approximately half the price of legal tobacco.

The trade in illicit tobacco has serious consequences for crime and community cohesion. Illicit tobacco trading creates a cheap source of cigarettes for children and young people. Teenage smokers are too often the target for tobacco smugglers and are actively aware of it being sold in their communities, whilst adults are encouraged to continue to smoke. It is also linked to local low level and regional, national and international organised crime, and contributes to a wealthy underground economy.

The dangers of illicit tobacco

- Illicit tobacco discourages smokers from quitting (due to low price incentive) and encourages them to smoke more (due to convenience and availability of multi-packs).
- Illicit tobacco targets the young, vulnerable and those living in poor and disadvantaged communities.
- Illicit tobacco is linked to low-level and large-scale organised crime, nationally and internationally.
- Illicit tobacco goes hand-in-hand with drugs and weapon smuggling, child exploitation, money laundering and even terrorism.

Smuggling in Ireland continues to erode the achievements made in the area of tobacco control. If we can plug the supply of illegal tobacco, the potential for increased revenue is significant. We stress that reducing the price of tobacco products is not the solution. Illicit tobacco use is most common in deprived areas because high price has the biggest impact on this group of users. Illegal tobacco therefore exacerbates existing health inequalities, keeps smokers addicted to tobacco and also encourages young people to start smoking.

The Revenue Commissioners, Irish Customs Service and other agencies including the Naval Service and the Gardaí, play a fundamental role in the seizure and of contraband cigarettes and tobacco in Ireland. Their work is essential in reducing the smuggling of contraband, which has serious implications, not only on public health but also for the exchequer.\(^{35}\) However, these law enforcement bodies are under significant staffing pressures and increasing workloads. For example, the Revenue

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\(^{34}\)In the UK, the Government has made it a legal duty for tobacco manufacturers not to facilitate smuggling and manufacturers who fail to take sufficient steps to prevent their products being smuggled into the UK face fines of up to £5 million. See, UK Finance Act 2006, see [http://www.legislation.gov.uk/ukpga/2006/25/section/2](http://www.legislation.gov.uk/ukpga/2006/25/section/2).

\(^{35}\)In July 2010, the Revenue Commissioners initiated a programme of nationwide blitz-type tobacco operations, which concentrated additional Revenue resources at ports, airports and at various retail points for the purpose of identifying and seizing illicit tobacco products. Three such operations were mounted in 2010, resulting in the seizure of more than 15 million cigarettes and 370kgs of tobacco (Revenue Commissioners’ 2010 Annual Report). The overall value of combined seizure of cigarettes and tobacco for 2010 was €76.4 million.
Commissioners have reduced their staff numbers from 6,581 in January 2009 to 5,962 in January 2012.

Tobacco smuggling results in a loss of revenue which is vital to the Government’s operations and can undercut health policies and the public service. Tobacco smuggling has become one of the most profitable forms of organised crime and is also a critical business for organised criminal gangs. A key issue in relation to the level of tobacco smuggling is the quality of the enforcement and the propensity for criminal activity.

Regarding quality data, the UK HM Revenue and Customs and the World Bank have developed a methodologies for estimating tobacco smuggling rates which we recommend should be mirrored in Ireland.

A 2010 IPSOS MRBI poll combined population estimates with smoking prevalence and consumption rates to provide an estimate of total cigarette consumption in Ireland in 2010. The survey found that total cigarette consumption in Ireland in 2010 was estimated to be 5.5 billion, based on claimed smoking behaviour.

The illicit trading of tobacco products continues to pose real issues for all stakeholders working in the area of tobacco control. The Revenue Commissioners estimate that 20% of tobacco products in Ireland are non-duty paid. While 6% of this figure arises from cross-border shopping, the majority of non-duty paid products are illegal. Using the 14% illegal pack figure, it is estimated that approximately 37,261,136 illegal packs, or 745m cigarettes, were consumed in Ireland in 2010.

The consumption of 745m illegal cigarettes in the course of 2010 represented a loss to Revenue (Excise Duty + VAT) of approximately €249m. Clearly, investment in a comprehensive smuggling strategy is desirable on both health and economic grounds.

A comprehensive National Anti-Smuggling Strategy that hinges on a multi-layered collaborative approach across Government Departments, law enforcement agencies and community partnerships is urgently required. Expenditure on anti-smuggling operations such as enforcement and supply chain control should be increased by around €8 million per year – equivalent to what the UK spends on these activities per head of the population. Achieving the same percentage drop in the size of the illicit tobacco market which the UK achieved – a 9% drop – would reduce the size of the illicit tobacco market here to 5% of the total market, bringing in around €130 million of extra revenue to the Exchequer. Thus, increased investment in anti-smuggling operations would pay for itself many times over.

**RECOMMENDATION 5: Fully implement Article 5.3 of the WHO Framework Convention on Tobacco Control.**

Ensure engagement with the tobacco industry is in line with Ireland’s obligations as a Party to the WHO FCTC to protect public health policy from the vested interests of the tobacco industry.

The tobacco industry is extremely well resourced and uses sophisticated strategies to anticipate and respond to tobacco control policies which have the potential to reduce exposure to tobacco products

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and improve public health. The tobacco industry has a history of subversion and obfuscation in relation to tobacco control measures and a substantial peer reviewed literature exists describing the strategies and tactics the tobacco industry uses to undermine public health.41

The WHO Framework Convention on Tobacco Control (FCTC) is the first international public health treaty. It provides an internationally coordinated response to protect citizens across the world from the dangers of tobacco use and from the influence of the tobacco industry. Under the Article 5.3 FCTC, engagement with the tobacco industry should be limited to only where it is strictly necessary i.e. in order to effectively regulate tobacco products and the tobacco industry itself. This engagement must be transparent – for instance written records, accessible to the public, should be kept of any meetings. In 2009, Guidelines on the implementation of Article 5.3 were adopted by the Conference of the Parties.

Information gathered from parliamentary questions, media reports and Freedom of Information requests indicates that tobacco industry representatives have considerable contact with Irish government officials. This supports the need for a strong Government commitment to incorporating Article 5.3 into Irish policy and practice.

We are disappointed that the Revenue Commissioners’ Strategy on Combating the Illicit Tobacco Trade (2011–2013) did not make an explicit reference to Article 5.3 and commit that any engagement with the tobacco industry is in line with Ireland’s obligations as a Party to the FCTC, including publication of the minutes of any meetings. We recommend the introduction of such a commitment in the next strategy.

The development of a regulatory system for lobbyists by the Department of Public Expenditure and Reform provides the opportunity to protect public health policy across all Government Departments and state agencies from tobacco industry interference. As part of the forthcoming regulations for lobbyists the Government should: make a commitment to guard against tobacco industry interference and institute a code of conduct for Ministers and civil servants; commit to informing the public about all meetings and other contacts with the tobacco industry and its representatives, as well as the discussions and the outcomes of such contacts; and the tobacco industry should be required to publically report activities and practices, including political contributions, payments to lobbyists, scientists, or journalists.

CONCLUSION

We need to change the way we think about tobacco, its price, the way it’s taxed and generally focus on both the supply and demand sides in a complementary and coordinated way, rather than on either exclusively. It is not just the responsibility of the Department of Health to reduce the social, health and economic consequences of smoking. The revenue collected from tobacco taxes is not free money – smoking has significant consequences on fiscal health as well as population health.

The tobacco industry has leveraged the market failures that exist to manipulate Government anti-smoking policies to its own advantage. While the Irish Cancer Society and the Irish Heart Foundation recognise that existing revenue streams have to be protected, we cannot have a situation whereby smoking is seen as a revenue raiser.

International experience shows that sustained reductions in smoking prevalence can only be achieved through co-ordinated action focusing particularly on tax policy, smoking cessation, anti-smuggling measures and legislation.

In Budget 2013 we are calling on the Government to take a new approach to tobacco control so that the tobacco industry begins to contribute to the costs it imposes on the state.

References

- Revenue Commissioners (August 2010), ‘Cross Border Comparison’.
Appendix 1 – Tobacco pricing and marketing

Pall Mall was advertised in *Retail News* (June 2011, back page) as ‘€7.25 Less money more quality’.

![Pall Mall advertisement](image)

L&M red and blue label was advertised in *Retail News Directory 2011* as ‘Best Value €7.75’.

![L&M red and blue label advertisement](image)
An example of product innovation is Benson & Hedges’ ‘B&H Big Box’ in which a 23-cigarette box is being sold for €9.75. Picture taken in Dublin shop, Spring 2012.

In the roll-your-own market marketing practices appear to place roll-your-own prices in direct competition with cigarette prices. For example, as well as the more standard roll-your-own packaging, John Player’s Golden Virginia is sold in cigarette box-type packaging, which highlights that the pack ‘includes 50 papers’ and retails for €4.20 (Retail News Directory 2011).
Benson & Hedges introduced the Silver Slide brand which is described in Checkout Magazine (November 2011, p. 92) as offering ‘a new smoking experience for existing adult smokers with its unique slide pack retailing at €8.00’.

Uniplumo has signed a new agreement with SuperValu, which has been named its national Irish/Scottish wholesaler and one of the world’s largest independent food wholesalers.

The supply of 5 million units of SuperValu’s ‘Traffic Lights’ range has been secured.

SuperValu’s traffic lights range will be available in SuperValu’s stores nationwide from March 2012.

New 3&H in Town - The Start Of A New Movement

Ramon & Hedges Silver Slide is launching its latest flowering cigarette range in five major retail formats: SuperValu, Budgens, Checkpoint, Tennent’s and Marks & Spencer.

The new range of Benson & Hedges Silver Slide is available in four pack sizes: 20s, 50s, 100s and 250s, with prices ranging from €14.99 to €79.99.

The new range of Benson & Hedges Silver Slide is available in four pack sizes: 20s, 50s, 100s and 250s, with prices ranging from €14.99 to €79.99.
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