Taxation, traceability, and levers in the fight against the parallel trade in tobacco

EU Tobacco Taxation, Tax Related Challenges, and Extreme Industry Profitability

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Conflict of interest declaration

- I/We have **no financial COI**
- TCRG does not accept funding from tobacco companies or other commercial organisations whose interests are not aligned with improved public health and ensures each research contract gives us freedom to publish.
- TCRG is part of STOP, a global tobacco industry watchdog; and part of the SPECTRUM (Shaping Public Health Policies to Reduce Inequalities and Harm) research consortium.
- I received the gift of **10 shares in Imperial Brands** for research purposes. Any money received is/will be donated to health related charities.

Funding policy
https://www.bath.ac.uk/corporate-information/tobacco-control-research-group-statement-on-funding-sources/

List of projects and funders
https://www.bath.ac.uk/corporate-information/tobacco-control-research-group-research-projects/

TAX INDUCED SUBSTITUTION

- The whole point of tobacco taxation is to **increase retail prices** to discourage tobacco consumption
  - Cigarettes are estimated to have an **elasticity** in the region of -0.4 to -0.6
  - Higher taxes can be expected to **increase tax revenue**
- But, if tax is not applied in a **consistent** manner, it encourages smokers to **switch to cheaper products** rather than **quit**
  - But the health consequences (and wider impacts) of **combustion products** are broadly the same
  - This can **reduce government revenue**

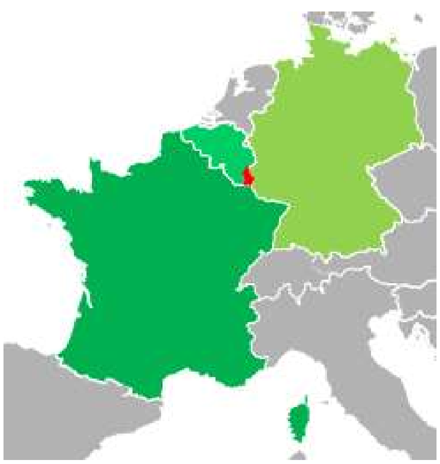
RYO PRICE DIFFERENTIALS

- **RYO is cheaper** than factory made (FM) cigarettes in all EU countries
- In **2021** using Weighed Average Prices (WAP) and 0.7g of tobacco per RYO cigarette:
  - Difference between 20 cigarettes was **€5.22 in Ireland** (€13.43 for FM vs €8.21 for RYO)
  - Greater than €2 in **15 EU countries**
  - Smokers in Estonia can **save up to 80% of the cost** of FM cigarettes (€4.47 vs €0.87)
  - Greater than 40% saving in **14 EU countries**
- EU releases for **consumption** 2002 vs 2019 show the cost of the **tax inconsistency**
  - Cigarettes go from 778bn to 458bn (sticks)
  - But RYO goes from 56m to 79m (KG)
  - **Germany** goes from 145bn to 75bn FM, but 14m to 24m RYO
  - **Spain** goes from 89bn to 45bn FM, but 1.3m to 6m RYO
- We need to **equivalise taxes** (on products as used)!

CROSS-BORDER PRICE DIFFERENTIALS

- The EU **Tobacco Tax Directive** sets **minimum tax levels** that must be respected by member states
  - But member states can set their domestic taxes **above the EU minima** if they wish so
- This creates another challenge for the preventative power of tobacco taxes when low tax induced **cheaper prices** are available in **neighbouring member states**
  - This problem is particularly acute in a series of '**regional hotspots**'

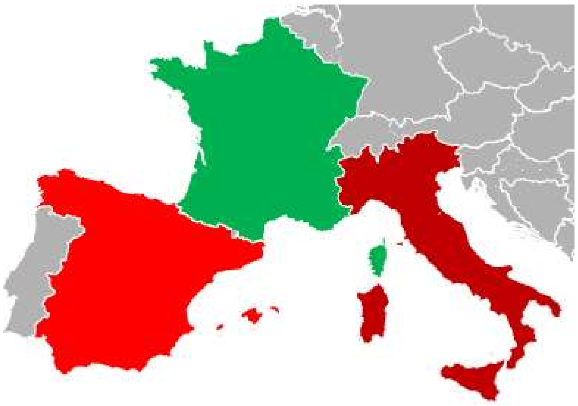
France, Belgium, Luxembourg and Germany



Average price for 20 cigarettes (€)
Source: European Commission

BE	6.9
DE	6.3
FR	10.2
LU	4.8

Spain, France, Italy



Average price for 20 cigarettes (€)
Source: European Commission

ES	4.6
FR	10.2
IT	5.2

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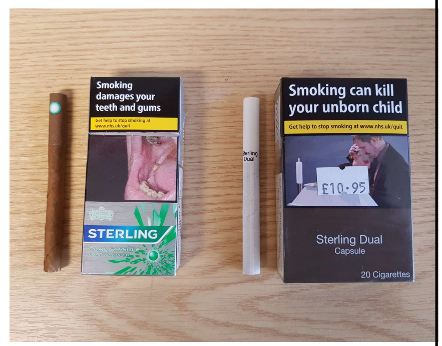
- A revised Tobacco Tax Directive needs to **increase minimum tax rates** to address cheap tobacco prices in tax laggard member states (and other things like income growth)
  - Other measures can help too!

INDUSTRY RESPONSES

- When setting taxes we need to be mindful of how the **industry** directly **responds** to taxes
  - Price **Smoothing**
  - **Over-** and **under-shift** tax increases
  - Pathways for **downtrading**
  - Increase **segmentation**
  - **Shrinkflation**
  - Change **product attributes/characteristics**
- They also have other **tax avoiding strategies** too!
- Undermining/Avoiding Taxes **costs governments in lost tax revenue** and creates further costs through the **health harms** created



PROFITS LIKE NO OTHER

- Manufacturing tobacco products is **inordinately profitable**
  - In 2018 the world's **6 largest** cigarette manufacturers made a profit of more than **$55 billion**
  - That is more than Coca-Cola, Pepsico, Nestle, Mondelez, Fedex, General Mills, Starbucks, Heineken, and Carlsberg combined ($51bn)
- They earn incredible **profit margins**
  - In 2021 BAT adjusted operating margin was 43.4%; for PMI it was 42.6% (**inc 49.8% in the EU**).
  - Imperial made net operating profit margin of **70.5%** in the UK in 2021
- The **comparator companies** had operating profit margins of **around 15–16%** ranging from a low of 6.5% (Fedex) and a high of 26.7% (Coca-Cola)
- Still mainly **combustion tobacco** producing profits

INDUSTRY NARRATIVES

- Such profits give these firms significant **resources and the incentive** to maintain the status quo
- The Industry (false) tactic of promoting concerns around **illicit tobacco** are a great example
  - Industry often **increases their prices** beyond tax increases
  - Country examples of illicit going **down as tax rates go up** (e.g. Ireland, Belgium, the UK)
  - Primarily an **enforcement issue**
- Illustrates the importance of **Article 5.3** of the FCTC

Thank you