Tobacco industry response to taxes – what do we know and what can we anticipate?

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Manufacturing tobacco products is inordinately profitable

- In 2015 the world's 6 largest cigarette manufacturers made a profit of more than $62 billion
- That is more than Coca-Cola, Walt Disney, FedEx, Google, Starbucks, and McDonalds combined ($55bn)

They earn profit margins like no other

- In 2018: Imperial Brands made an net operating profit margin of 46%; BAT was 39.9%; PMI it was 39% (inc 43.1% in the EU).
- Imperial made net operating profit margin of 68% in the UK in 2013

Avoid paying profit based taxation on these huge profits

- E.g. BAT is UK based but paid £11m in total in the last 6 years when earning £10s billion in profit.

Such profits give these firms significant resources and the incentive to maintain their positions
• Tobacco taxation is widely regarded as being one of the most effective ways to address tobacco use
  – Industry looks to undermine the impact of tax increases

• The industry suggests that illicit will rise if taxes increase
  – But their actions shows they don’t believe this themselves!
  – Evidence suggests no direct link with robust customs and excise systems
• The industry has been found to be involved in the Illicit market
  – Over-supplying some markets to facilitate illicit
  – Suspicions that companies are not declaring all production for duty in some locations.
  – Pushing their weak track and trace system.
• Illicit Tobacco is really an enforcement issue
  – Introduction of robust Track and Trace systems should help
  – Revenue from higher taxes can pay for more enforcement measures
Lobby for **predictable tax** increases

- Regular, limited and predicted tax changes are easier for the industry to **anticipate and undermine**

**Price Smoothing**

- Avoid quit inducing jump in prices via smaller, **incremental** but more **frequent adjustments** to prices
- Start to increase prices in **anticipation** of tax changes
• Over- and under-shift tax increases
  – Tax increase are not passed on uniformly to different brand segments
  – Mix profit-seeking with cushioning those sensitive to price.

• Increase segmentation
  – Increased brand variants to mix profit maximisation with retaining price sensitive smokers.
  – Widening of the price gaps
  – Factory Made (FM) and Roll-Your-Own (RYO)
• Create further routes for smokers to **downtrade** instead of quitting
  – Create Ultra-Cheap FM brands / brand variants
  – New RYO versions of FM brands
  – **RYO Combi-Packs** (& details of these)

• **Shrinkflation**
  – **Disguise price increases** by reducing the size of a standard pack
  – Minimum pack sizes of the EU TPD makes this **a lot harder**
• Tax is fundamentally a price based public health measure so the wider pricing strategies of the industry also matter
  – Price marked packaging to limit retailer profit margins and also advertise the ‘value’ of certain brands / brand variants
  – Increase tobacco prices in line with consumer incomes to ensure affordability
  – Sell tobacco related products not subject to the same taxation regime.
  – Emerging picture of New Generation Products
• Need **regular tax increases** to offset increasing consumer income that makes tobacco more affordable
  – **Duty escalators** a good thing as they commit to yearly increases, but...

• **Large and unexpected tax changes** help minimise industry attempts to undermine tobacco taxes

• **Lump sum taxes** are better than ad-valorem taxes as they help to minimise the **price range** of tobacco products
  – A regularly increased **Minimum Excise Tax** helps address the availability of cheapest products
• Taxes need to recognise how tobacco products are used
  – RYO cigarettes typically contain less tobacco than Factory Made cigarettes, but create the same harm.

• Tax in relation to harm
  – Tax should discourage the use of all products with meaningful risk
  – Tax should be structured to push consumers away from the most risky products
OTHER SUGGESTIONS

- Limit the **number of price changes** per year
- **Limit** the number of brands / **brand variants**
- Cut FM / RYO **brand cross-overs**
- Promote standardised **packaging** (or least ban price advertising)

- **Regulate tobacco prices** to reflect the lack of competition and the harm being created.
  - Take away the industry **weapon of price**
  - **Price caps** not minimum prices
  - Government would benefit from a **greater proportion of** the selling price