

What has happened to UK duty-paid FCT consumption over time?

London Economics' analysis for ESTA
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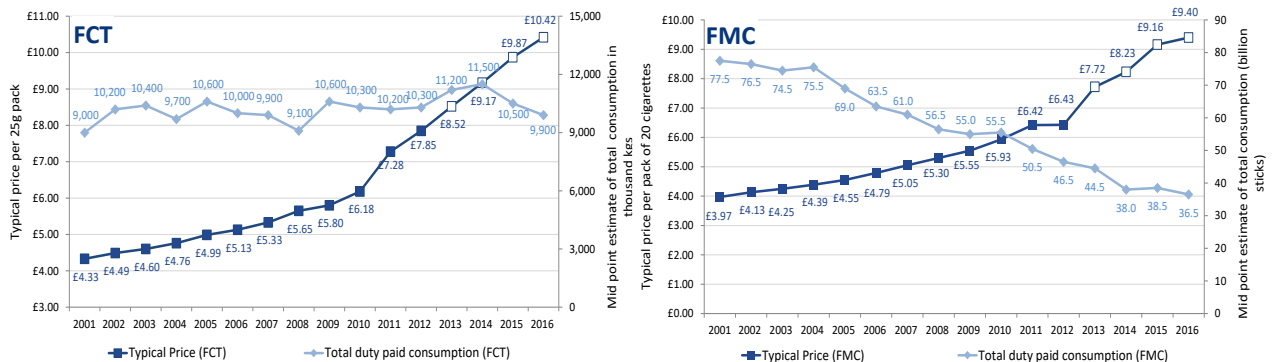
What has happened to UK duty-paid FCT consumption over time?

UK has some of the highest tobacco taxes in the world with huge profits to be made: a 40ft container of cigarettes has a revenue value of approx. £2.5m. [...] Evasion of tobacco duty is rated the highest risk in HMRC's Tax Compliance Risk Overview
Judith Kelly, HMRC Head of Tobacco Strategy

Since 2001, the high level of UK tobacco taxation has resulted in a significant increase in the retail price of FCT (by approximately **174%** in nominal terms between 2000 and 2017). Normally, from an economic perspective, holding all other factors constant, any increase in the price should result in a reduction in the quantity of duty-paid FCT purchased.

However, the information presented in Figure 23 (left hand panel) shows that the total duty paid consumption of FCT has *increased* over time (and stabilised at these higher levels), predominantly as a result of both the relative affordability of FCT following sharp increases in the FMC taxation (and subsequent price increases), as well as the very noticeable declines in the level of illicit and cross-border trade.

Figure 23: Nominal retail price and total consumption of FCT and FMC (2001-2016)



Notes: FCT presented in left panel; FMC presented in right panel. Prices of typical mid-price brand.

Source: Prices from Tobacco Fact Sheet 2012 (HMRC). In the case of FCT, beyond 2012, we have applied the index of tobacco taxation prices (derived from the Consumer price index) to the latest available year. Note that this index applies to all tobacco products, but has been applied solely to FCT (represented by the unshaded markers). In relation to FMC, beyond 2012, the information presented refers to a 'typical' pack of 20 cigarettes. Tax-paid consumption from Measuring tax gaps tables 2017 (HMRC). Consumption estimates refer to previous tax year. Note that price information is not available in 2013 as the series was discontinued. The estimate of total FMC consumption in 2013 is based on a mid-point estimate of illicit consumption equating to 4bn sticks equivalent to 10% of total consumption

Over the same period, in contrast, purchases of FMC have declined by **53%**. It is likely that tax increases have to some extent encouraged cessation or a reduction in consumption (alongside the full range of other anti-smoking policies); however, part of the decline is attributable to individuals substituting to cheaper **products (including FCT)**, as well as non-UK tax paid cross-border and **illicit** produce.

Total FCT consumption demonstrated a small increase in demand between 2001 and 2016 despite an increase of 174% in the price of duty-paid FCT. However, since 2014, demand has declined by 16%

The increased enforcement activity implemented by the UK government since 2000, combined with the **buffer function** of FCT between the legal and the illicit tobacco market, explains in part why total consumption of duty-paid FCT **increased** between 2001 and 2016 despite the substantial price increases over the same period. However, although the level of illicit trade in FCT has fallen significantly over the period, the revenue losses to the government have remained stubbornly high (standing at approximately **£4.4 billion** in aggregate over the last 5 years).