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# The economics of tobacco

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## Introduction

Smoking is a health problem, the costs of which include sickness, pain, grief and misery. It is impossible to value such impacts in monetary terms. However, smoking also plays a significant economic role in society. While cigarette tax is a significant source of revenue to the Treasury, the costs of smoking to the economy include not only the expense of treating diseases caused by smoking but also other costs such as working days lost and social security payments.

## Cost to smokers

Currently, a 20-a-day smoker will spend about £2,000 a year on cigarettes. People on low income spend proportionally more of their income on tobacco than wealthier people. In 2008, households in the lowest income bracket spent £3.40 per week on cigarettes whilst those in the highest group spent £3.70 per week.<sup>1</sup> This equates to 1.6 percent and 0.4 percent respectively of total weekly household expenditure. Smokers also pay with their health: the results from a 50 year study shows that half to two thirds of all lifelong cigarette smokers will be eventually killed by their habit.<sup>2</sup> Death is usually due to one of the three major diseases caused by smoking - lung cancer, chronic obstructive lung disease and coronary heart disease. Many who suffer from these diseases experience years of ill-health and subsequent loss of productivity. A Danish study concluded that smokers face a significantly higher chance of early retirement due to chronic disease.<sup>3</sup>

## Cost to the Government

Research commissioned by ASH has shown that the cost to the NHS of treating diseases caused by smoking is approximately £2.7 billion a year.<sup>4</sup> Another study put the estimated cost as high as £5.2 billion.<sup>5</sup> Other costs include the payment of sickness or invalidity benefits to those suffering from diseases caused by smoking and the payment of pensions and other family social security benefits to the dependants of those who die as a result of their smoking. However, it is also estimated that about £380 million a year is being saved by the NHS as a result of public health strategies such as the ban on tobacco advertising and the creation of the stop smoking services which have resulted in fewer people smoking.<sup>4</sup>

In the 2009-10 financial year the Government spent £83.9 million on the stop smoking services in England plus an additional £61.8m on medicinal aids (eg nicotine replacement therapy). Expenditure on mass media health campaigns on smoking was £14.79 million.<sup>6</sup>

**Fires** Cigarettes and other smoking materials are the primary cause of fatal accidental fires in the home and have claimed the lives of 1200 people in the UK over the past ten years. In 2008, smokers' materials accounted for 113 deaths - over a third of all accidental dwelling fire deaths. Since 1997, such deaths were becoming increasingly less common and there was a downward trend in the figures. In 2007 however, the number of these deaths rose for the first time in a decade. Smokers' materials are also the second biggest cause of non-fatal casualties in dwelling fires (after cooking materials). In 2008, there were 932 casualties. The injury rate was highest for fires caused by cigarette lighters – 443 per 1,000 fires, a total of 139 injuries in 2008 (down from 251 injuries in 2007).<sup>7</sup>

**The costs of smoking to industry** Prior to the implementation of the law banning smoking in the workplace, smoking caused significant costs to industry. These included lost productivity caused by smoking breaks and increased absenteeism amongst smokers due to ill-health. It was estimated that each year about 34 million days were lost in England and Wales through sickness absence caused by smoking.<sup>8</sup> In Scotland, the cost of this productivity loss was estimated to be £400 million per annum.<sup>9</sup> Other costs to industry include cleaning and building maintenance costs. A review of the costs and benefits of making workplaces smokefree in England concluded that there would be a total net benefit of between £2.3 billion and £2.7 billion.<sup>10</sup>

**International studies** A study commissioned by the US tobacco company Philip Morris examined the economic impact of smoking on the Czech Republic. It concluded that tobacco smoking provided a net benefit to the economy, largely because of “reduced health care costs” and “savings on pensions and housing costs for the elderly” that would not have to be paid since smokers die earlier than non-smokers. In fact, the smoking costs were shown to be 13 times greater than the ‘benefits’.<sup>11</sup> A Danish study has shown that tobacco imposes a net cost to society even when taking life expectancy into consideration both in direct and indirect costs<sup>12</sup> while a study of the economic effects of a decline in smoking prevalence in New South Wales, Australia, found that the only sector that would be seriously affected would be the tobacco industry.<sup>13</sup>

**Tobacco taxation** The Treasury earned £8,813 million in revenue from tobacco duties in the financial year 2009-2010 (excluding VAT).<sup>14</sup> The price of a pack of 20 premium brand cigarettes currently costs around £6.50, of which £5 (77%) is tax. In July 1997, the Government announced its intention to raise cigarette taxes by at least 5% above the rate of inflation each year, following the previous government's policy of raising tobacco duty by at least 3% above inflation. This commitment was carried through in the 1998 and 1999 Budgets but in November 1999 the Chancellor abandoned this policy. Instead, he announced that any extra revenue raised from future tobacco tax rises would be spent on improved health care.<sup>15</sup> From 2001 until 2008 tobacco taxes rose only in line with inflation. In 2009, tobacco duties were increased by 2% on the basis of a deflationary forecast in the Retail Price Index of -3%, thus representing a 5% increase in real terms. In 2010, the Chancellor announced that tobacco duty would rise by 1% above inflation for the current year and made a commitment to raising tobacco duty by 2% above inflation from 2011 to 2014.<sup>16</sup>

A cost benefit analysis of the effects of increasing tobacco taxation commissioned by ASH found that a tobacco price rise of 5% would result in net benefits to the economy as a whole of around £10.2 billion over 50 years.

The economic benefits in the first five years would be around £270m per year on average.<sup>17</sup>

## VAT on stop smoking aids

In the 2007 Budget, the Chancellor reduced the VAT on nicotine replacement products to the minimum level of 5%, initially for one year.<sup>18</sup> In 2008 this lower rate was extended indefinitely.<sup>19</sup>

## Tobacco smuggling

The price of tobacco is one of the most important factors affecting tobacco consumption. Increasing levels of tax on cigarettes reduces consumption because people respond to the price signal by giving up, cutting down or never starting. However, this policy can be undermined by the illegal importation of tobacco which is sold at reduced rates on the black market.

A study published in 2008 estimated that about 22% of all tobacco smoked in the UK was smuggled – equivalent to 18 billion cigarettes out of a total market of 82 billion.<sup>20</sup> As a result, the Government was losing more than £2 billion a year in revenue.<sup>21</sup> However, the latest report from HM Revenue & Customs suggests that recently there has been a fall in smuggling with the illicit trade in cigarettes now accounting for about 11% of the market (mid-point of range of estimates) while the illicit trade in hand-rolled tobacco is estimated to account for about 49% of the total market.<sup>22</sup> In 2008 the Government announced that the UK Border Agency and HM Revenue & Customs would work together on a new strategy to tackle smuggling.<sup>23</sup> For further information on tobacco smuggling see [ASH Fact Sheet: Tobacco Smuggling](#).

## The tobacco industry

British American Tobacco, the world's second largest tobacco company is based in Britain although the vast majority of its products are exported or manufactured outside the UK. In 2010, the company reported group operating profits of £4,101 million.<sup>24</sup> The two principal UK tobacco companies - Imperial Tobacco and Gallaher (the latter now owned by JTI) - control around 85% of the UK market. In 2009, approximately 2,800 people were employed in tobacco manufacturing in Great Britain.<sup>25</sup> According to tobacco industry estimates in 1998 9,620 people were employed in tobacco manufacturing, accounting for 0.2% of employment in all manufacturing activities in the UK.<sup>26</sup> For further information see [ASH Fact Sheet: The UK Tobacco Industry](#) and the [ASH Report on Job losses in the tobacco industry](#).

## Advertising and sponsorship

Since the implementation of the 2002 Tobacco Advertising and Promotion Act, tobacco advertising is now illegal except at the point of sale. Tobacco companies have exploited this loophole and since 2003 displays of tobacco products have become increasingly elaborate to stimulate sales, thus undermining the effectiveness of the law.<sup>27</sup> Following a public consultation<sup>28</sup> the previous Government announced plans to ban the display of tobacco products at the point of sale. This was passed into law as part of the Health Act 2009 and is due to take effect from October 2011, pending confirmation by the Health Secretary. In addition, sales of tobacco from vending machines will be prohibited.

Studies have shown that tobacco advertising increases consumption and that advertising bans can lead to a drop in consumption of between 5% and 9%.<sup>29</sup> The Government estimated that the tobacco advertising ban in the UK would lead to a drop in tobacco consumption of around 3%, saving approximately 3000 lives in the long term. For more information see [ASH Fact Sheet: Tobacco Advertising and Promotion](#).

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