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Price cap regulations for UK tobacco would raise 500 million every year

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If tobacco products sold in the UK were subject to price cap regulation, the system would generate around £500 million (US$750 million) for the government every year, without affecting the price consumers pay, reveals a feasibility study published online in *Tobacco Control*.

That amount of cash, which takes account of the costs of running an "Ofsmoke" regulator, would be enough to fund smoking cessation services in England and anti-smuggling activities UK wide, twice over, say the authors.

The most recent market data available for tobacco companies currently selling their products in the UK shows that the tobacco industry is very profitable.

The largest player, Imperial, accounted for just over 44% of the UK tobacco market in 2010, with a profit margin of 67% (net revenue of £911 million; operating profits of £614 million)—equivalent to £0.67 profit for every £1 the company receives after paying tobacco duties.

The other major players—Japan Tobacco International, represented by its Gallagher Limited subsidiary; Phillip Morris International (PMI); and British American Tobacco (BAT)—also enjoy healthy profits.

Taking the RPI-X price cap regulation system, which is widely used in the utilities sector, as a model, companies would be able to charge a price high enough for them to make enough profit to cover their legitimate costs and still make a small return.

To come up with an appropriate level of profitability for tobacco companies, the authors used the profit margins of European firms operating internationally in highly competitive consumer staples markets. These were between 12% (best case) and 20% (worst case scenario) before deduction of taxes, interest, etc.

They then looked at the operating costs of UK regulators for services, such as water supply and the rail network, to calculate the equivalent costs for the tobacco regulator—"OfSmoke"—and came up with estimates of between £15 million (best case) and £45 million (worst case scenario) for both 2009 and 2010.

Lastly, they took account of deductions for corporation tax—28% of profits in 2009/10—to cover the costs of regulation.

In the final analysis, their calculations indicated a total fall in industry profits of £664.7 million and £617 million, respectively, in 2009 and 2010, for the worst case scenario, and of £834.2 million and £782.5 million, respectively, for the best case.

After taking account of regulatory costs, this would leave scope to raise the proportion of revenue the government receives in taxes from tobacco sales by between £433.6 million (worst case) and £585.7 million (best case scenario) every year—without affecting the price consumers pay, say the authors.

"This would be approximately enough to fund twice over, UK-wide anti-tobacco smuggling measures, and smoking cessation services in England," they write.

Industry regulation would have numerous benefits, they argue. It would expose companies to much tighter scrutiny than ever before, and so curb activities, such as smuggling and marketing to the young.

Price caps would stop industry using price to market its products and undermine the impact of tobacco duties. And price differentials between brands/products would have to be based on production costs, and not deliberate attempts to segment the market, so curbing the switch to cheaper products by smokers, they add.

And if industry has less money, it would have less to spend on lobbying or fighting public health measures, such as plain packaging, they suggest.

"Given the wider health benefits that would also be generated, and also the political benefits inherent to not changing the price that consumers pay, this policy should be given serious consideration," they conclude, adding that although they have used the UK as an example, such a policy could work equally well elsewhere.

More information: The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500 million per year in the UK Online First, doi:10.1136/tobaccocontrol-2012-050385

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