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Report Highlights:

The ongoing decline in UK production of cigarettes continues to reduce import demand for unmanufactured tobacco. That said, the UK is expected to produce 150 billion cigarettes in 2000, around two thirds of which will be exported. Around 30 percent of the UK's adult population, or 15 million people, smoke with a total annual expenditure of around USD18 billion. As well as causing a switch away from cigarettes towards other tobacco brands, the high taxes on tobacco in the UK fuel a tobacco black market meaning that taxes are not paid on an estimated 20-25 percent of all cigarettes smoked in the UK.

Includes PSD changes: Yes
Includes Trade Matrix: Yes
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Explanatory Notes

Stocks

The format of the production, supply and demand (PSD) tables for cigarettes featured in this report makes no allowances for stocks. The trade information is, therefore, distorted when it is reported in the PSD and in turn affects the supply and distribution totals. To remedy this problem the actual market conditions are described in separate tables within the body of the text. References to market data therefore relate to these tables and not the traditional PSD tables which for cigarettes can be found in the statistical appendix.

Exchange Rates

This report refers to sterling's competitiveness against other currencies. The following table provides yearly average exchange rates for sterling against the U.S. Dollar and the European Currency Unit (ECU) which was replaced by the Euro on 1 January, 1999.

Since late 1996, sterling has appreciated in value relative to the ECU/Euro and against the dollar, reducing somewhat the competitiveness of UK tobacco products in export markets.

Year	ECU per BPS	USD per BPS
	(Euro per BPS	
	for 1999 and 2000)	
1991	1.4265	1.7694
1992	1.3607	1.7655
1993	1.2822	1.5020
1994	1.2897	1.5316
1995	1.2070	1.5785
1996	1.2286	1.5610
1997	1.4431	1.6393
1998	1.4789	1.6570
1999	1.519 (1)	1.6279
2000	1.623 (2)	1.6467 (3)
(1) Euro superceded ECU from January 1, 1999		
(2) Jan-Feb 2000 average		
(3) Jan-March 2000 average		
Source: Bank of England		

Note: Throughout this report the rate of exchange used is BPS 1 = USD 1.65

Executive Summary

The structure of the UK tobacco industry is dominated by two national companies – Gallaher and Imperial Tobacco for sales of cigarettes, roll your own (RYO) and pipe tobacco. A third player – British American Tobacco has traditionally operated in the UK solely as an exporter of tobacco products. However, BAT has become more significant in the UK market after its 1999 purchase of Rothmans.

This report focuses on unmanufactured tobacco and cigarettes, the two most important elements in the UK tobacco market. Imports of unmanufactured tobacco continue to fall in line with the 5 year decline in cigarette production. The UK is expected to produce 150 billion cigarettes in 2000. While the strength of sterling has slowed the increase in UK cigarette exports somewhat, the export market still remains strong at 95-100 billion. A turnaround in the Asian economies, important markets for UK produced cigarettes, will likely keep export markets firm.

There are currently about 15 million adult smokers representing about 30 percent of the adult population in the UK. The percentage of smokers in the UK declined steadily from 40-50 percent in the mid 1970's to 30 percent in the early 1990's and has remained steady ever since. Overall consumer expenditure on cigarettes has been between BPS 10-11 (USD 16.5-18) billion annually for the past 5 years.

Officially reported UK cigarette sales to the trade have declined since 1993 when annual increases in cigarette taxes provoked a greater incidence in cigarette smuggling into the UK. It is now estimated that approximately 20-25 percent of all cigarettes smoked in the UK are non-duty paid. Given this situation, the consumption of duty-paid and non-duty paid cigarettes has stayed in the range of 80-90 billion over the last 5 years. The availability of cheaper non-duty paid cigarettes has stopped consumption from falling more rapidly.

In the UK tax policy, which keeps cigarettes in the UK well above prices in most of the rest of the EU, has had the most significant impact on the tobacco industry. Government initiatives to stop smuggling may curb the illegal imports somewhat but most in the industry do not expect dramatic changes until tax policy is modified. Government anti-smoking initiatives may eventually reduce domestic consumption but these figures are not expected to decline by much. The UK government will support the EU drive for stricter labeling and advertising of cigarettes.

Unmanufactured Tobacco

PSD Table

Country	United Kingdom					
Commodity	Tobacco, Unmfg., Total				(HA)(MT)	
	Revised	1998	Preliminary	1999	Forecast	2000
	Old	New	Old	New	Old	New
Market Year Begin		01/1998		01/1999		01/2000
Area Planted	0	0	0	0	0	0
Beginning Stocks	38134	38134	34814	34814	34514	25352
Farm Sales Weight Prod	0	0	0	0	0	0
Dry Weight Production	0	0	0	0	0	0
U.S. Leaf Imports	7093	7093	7000	4339	0	4500
Other Foreign Imports	142663	142663	140000	132844	0	131000
TOTAL Imports	149756	149756	147000	137183	0	135500
TOTAL SUPPLY	187890	187890	181814	171997	34514	160852
Exports	16326	16326	15000	33745	0	30000
Dom. Leaf Consumption	0	0	0	0	0	0
U.S. Leaf Dom. Consum.	6800	6800	6800	4000	0	3750
Other Foreign Consump.	129950	129950	125500	108900	0	92102
TOTAL Dom. Consumption	136750	136750	132300	112900	0	95852
TOTAL Disappearance	153076	153076	147300	146645	0	125852
Ending Stocks	34814	34814	34514	25352	0	35000
TOTAL DISTRIBUTION	187890	187890	181814	171997	0	160852

UK imports of unmanufactured tobacco fell 8 percent in 1999 due to a continued reduction in UK cigarette production. The high cost of cigarettes in the UK due to tax policy has somewhat slowed domestic demand for tobacco products. Brazil, Zimbabwe and Italy remain the UK's greatest suppliers with most of Italy's leaf being transhipped product from Sri Lanka and India. Leaf imports from the U.S. fell nearly 40 percent in 1999 to 4,339 tonnes and are expected to remain about the same in CY2000.

UK exports of unmanufactured tobacco doubled in 1999 to nearly 34,000 MT. Most of the increase was to Germany, where tobacco product sales to Central and Eastern European countries have increased. While exports doubled from 1998, they only make up a small proportion of the total use.

UK consumption of tobacco leaf fell just over 15 percent in 1999 to reflect the general downturn in cigarette production in the UK. Stocks are expected to be drawn down somewhat in 2000 as leaf exports remain at 1999's higher levels and UK cigarette production only falls by 3 percent.

Trade Matrices

IMPORTS - 1999		
COUNTRY	QUANTITY (MT)	VALUE ('000 USD)
ITALY	13865	51322
BELGIUM	7447	31402
GREECE	5250	17774
SPAIN	4499	10748
FRANCE	1561	3015
GERMANY	1213	5726
OTHERS	1159	5804
TOTAL EU	34994	125791
BRAZIL	35728	105582
ZIMBABWE	24735	69458
INDIA	11296	29152
CANADA	5904	22542
CHINA	4395	8123
USA	4339	44006
THAILAND	2478	5116
KENYA	2300	6315
TANZANIA	2190	6653
ARGENTINA	2121	6308
MALAWI	2058	7103
OTHERS	4645	21611
TOTAL NON-EU	102189	331969
GRAND TOTAL	137183	457761

EXPORTS - 1999		
GERMANY	21918	3829
FRANCE	4764	772
IRISH REPUBLIC	3477	17017
SPAIN	515	474
OTHERS	631	2025
TOTAL EU	31305	24117
RUSSIA	987	2614
POLAND	614	715
OTHER	839	2778
TOTAL NON-EU	2440	6107
GRAND TOTAL	33745	30224

Cigarettes

(Million pieces)	1998	1999	2000 (f)
Opening stocks	160774	204046	199418
Production	163547	155000	150000
Imports	44847	23872	25500
Exports	82182	100000	95000
Consumption	75190	63500	60000
Private Imports	7750	20000	22000
Consumption	82940	83500	82000
Closing stocks	204046	199418	197918

Production

UK cigarette production totaled 155 billion in 1999, down 5 percent from the previous year and continuing the downward spiral which started in 1997. This can be attributed to reduced domestic demand due to high tax policy and anti-smoking campaigns and to limits on export demand due to the appreciation of the pound relative to the ECU/Euro and to the dollar.

The cigarette market is dominated by three major companies who command more than 90 percent of the total market.

UK Company Market Share (1999)

Gallaher	39.50
Imperial	38.00
BAT/Rothmans	13.75
R.J. Reynolds	2.25
Other	6.50

In the UK, there has been increased activity at the low-price end of the cigarette market. The major companies have reacted to consumer demand for cheaper cigarettes by launching their own economy brands which have proved very successful. According to industry estimates, the lower priced sector accounts for 23 percent of the total market and is likely to keep growing.

As an example of this, Lambert and Butler, a mid-priced cigarette, took over from the more expensive Benson and Hedges as the leading brand in 1999. Gallaher's economy brands Mayfair and Sovereign have been some of the fastest growing brands on the market. UK supermarkets and cash and carry stores have also responded to

the demand for lower priced cigarettes by introducing their own label cigarettes to compete with these discount brands. Ironically, the incidence of tax is actually the greatest on the lower priced economy brands (see price table below).

The majority of cigarettes in the UK are sold in grocery stores (more than 50 percent) with a further 22 percent sold in newsagents and 10 percent in pubs and off-licenses (package stores).

Top 10 Brands in the UK

Lambert & Butler KS
Benson & Hedges KS
Mayfair KS
Superkings
Silk Cut KS
Regal KS
Rothmans Royals KS
Sovereign KS
Embassy No 1
Marlboro Lights

Trade

The UK has for the past five years enjoyed a positive trade balance in the cigarette market, exporting more than half of all production despite the problems associated with unfavorable exchange rates. The value of overall cigarette exports fell only 5 percent in 1999 while volume exported actually increased slightly.

The most important export markets for the UK in value terms are Belgium and the Netherlands in the EU, Singapore, Hong Kong and Taiwan in the Far East and Saudi Arabia in the Middle East. The financial difficulties in the Far East translated into a nearly 25 percent reduction in the value of cigarette exports into this region in 1999. This is expected to improve in 2000 as many of the Asian economies pick up. While UK manufacturers are not enjoying the same advantages they had in the early 1990's, due to the appreciation of the pound in more recent years, they continue to value the UK as a good base for exports.

Nearly all of the UK's cigarette imports come from other EU countries. Overall UK imports in 1999 are reported to be down by 16 percent in value with imports from the U.S. down 15 percent to USD700,000 (BPS 425,000). Errors discovered in the official UK import figures have made it impossible to further analyze these import statistics. In any case, official import figures only account for a portion of actual cigarettes entering the UK; unofficial imports due to personal and smuggled imports must also be estimated.

Trade Matrices

IMPORTS - 1999		
COUNTRY	QUANTITY (000'S)	VALUE (000 USD)
GERMANY	7306284	78579
OTHERS	13183594	46155
TOTAL EU	20489878	124734
JAPAN	1200000	24
SWITZERLAND	1194654	208
CANADA	861620	76
USA	92996	700
OTHERS	32677	1072
TOTAL NON EU	3381947	2080
GRAND TOTAL	23871825	126814

EXPORTS - 1999	QUANTITY (000'S)	VALUE (000 USD)
SPAIN	11009924	54000
NETHERLANDS	5647711	88000
BELGIUM	5175282	181000
GREECE	1715991	24000
GERMANY	1311833	116000
FRANCE	570769	10000
OTHERS	815072	42000
TOTAL EU	26246582	515000
SINGAPORE	13740292	120000
HONG KONG	7140647	91000
CYPRUS	6229709	36000
SAUDI ARABIA	3672037	72000
SOUTH KOREA	3604401	38000
TAIWAN	3290264	64000
BENIN	3254389	57000
KUWAIT	2439998	19000
SOUTH AFRICA	2193015	32000
DUBAI	2086435	31000
TURKEY	1532664	23000
JAPAN	1518313	23000
EGYPT	1177455	2000
DJIBOUTI	1157382	19000
RUSSIA	1098535	17000
USA	779780	9000
OTHERS	19187200	189000
TOTAL NON EU	74102516	842000
GRAND TOTAL	100349098	1357000

Policy Issues

Tax Policy and Prices

In an effort to curb the high costs to the National Health Service of smoking-related illnesses and to increase revenues to the government, the Conservative party in the early 1990's introduced an escalator policy on cigarette taxes. Increases of 3 percent in real terms annually were imposed. The Labour party continued this policy with tax increases closer to 5 percent annually from 1997. Since taking office, the Labour party has increased the tax on cigarettes by 84 pence (USD1.39) per packet in 4 steps.

As a result of this policy, UK cigarette prices are among the highest in the EU, with taxes ranging from 78-90 percent of the price. With prices approximately double those in nearby France or the Netherlands, smuggling is a major problem.

Range of Prices of Typical Brands Sold in UK (March 2000)
(Package of 20)

Brand	RRP (BPS)	Tax	Tax Incidence
Capstan (Plain)	4.41	3.44	77.9%
Dunhill International	4.33	3.41	78.7%
Benson & Hedges Special Filter	4.17	3.35	80.3 %
Embassy Number 1	4.14	3.34	80.6%
Lambert & Butler King Size	3.71	3.18	85.6%
Sovereign King Size	3.61	3.14	87.0%
Richmond King Size	3.54	3.11	88.0%
Dorchester King Size	3.45	3.08	89.3%

The Tobacco Manufacturers Association (TMA) in its budget submission in early 2000, opposed this tax policy and suggested that, in fact, the incidence of smoking is on the rise in the UK as a result of the availability of lower-priced black market cigarettes. They have lobbied heavily for a decrease in UK taxes down to approximately BPS1.00 (USD1.65) per pack of 20, closer to the level of taxes levied in many other EU countries.

Smuggling – Anti Smuggling Initiatives

The UK government estimates 1999 revenue losses of BPS2.5 (USD4.125) billion up from BPS1.7 (USD2.8) the previous year) due to smuggling activities. Of this, BPS1.7 (USD2.8) billion is attributed to smuggled cigarettes, BPS800 (USD1320) million to smuggled RYO products, and BPD85 (USD140) million to legitimate cross border shopping. These figures take into account the value of excise duty and Value Added Tax (VAT) on

the smuggled products. Unofficial sources claim that approximately 20-25 percent of all cigarettes sold in the UK in 1999 were non-duty paid. Much has been made of the losses to the retail trade as a result of smuggling.

According to industry sources, without a change in UK tax policy, the trend toward an increase in cigarette smuggling will continue and could rise from 1 in 5 cigarettes currently smuggled to 1 in 3 within a few years. The industry's position is that the high incidence of smuggling has made low priced cigarettes widely available (black market prices range from BPS2.00-2.50 per pack) and therefore reduced the effectiveness of UK tax policy in curbing smoking.

There are a number of initiatives being discussed in the UK to combat smuggling including a March 2000 report by UK Customs and Excise called "Tackling Tobacco Smuggling". New initiatives would include installing more scanners in UK ports, pack marks stating UK DUTY PAID on legitimate imports, increasing punishment for smugglers, increasing the number of customs officers and increasing the publicity of the problem. An additional BPS30 (USD50) million in 2000 will supplement the budget for anti-smuggling activities.

Anti-smoking initiatives

The UK government has made reducing the incidence of smoking a key health objective. In addition to its policy of high taxes, it has supported wholeheartedly various EU directives to curb smoking.

EU advertising directive – The EU has proposed a ban on the advertising of tobacco products. This initiative would ban poster advertisements by July 2001, media advertising by July 2002, and tobacco company sponsorship of events by July 2003. A decision on the EU directive is expected to be made by the European Court in October 2000. The UK government, as part of its anti-smoking initiative, attempted to bring forward the date for these bans on tobacco advertising to December 1999. However, the UK industry were successful in thwarting the government's attempt and are also lobbying against the EU directive.

EU Labelling Directive – The EU has proposed a directive to change labelling requirements on tobacco products. Aspects of the directive include requirements to increase the size of the health warning on the packets, more stringent rules on tar and nicotine levels, and banning the use of words like mild and light for cigarettes. A common EU position on this directive is expected in June 2000. While the UK government will support this, the UK tobacco industry is lobbying against.

Change in "duty free" trade laws – As part of completing the single market initiative, duty-free trade between the EU and the UK was discontinued at the end of June 1999. Cross border movement of cigarettes did not diminish as a result of this action as the "duty paid" price of imports still remains much lower than UK duty paid prices. While this change has negatively affected some retailers, especially in the southeast, manufacturers have not seen a drop in sales.

Other Products

Roll Your Own (RYO)

The RYO market is the second most important tobacco market in the UK growing in popularity as duty-paid cigarette prices have skyrocketed. The same manufacturers are producing this product with Gallaher's Samson and Imperial's Drum among the most popular brands. It is estimated that up to 80 percent of the RYO products on the UK market are non-duty paid, having been smuggled into the country. Official estimates of just over 2 million MT sold in the UK in 1999 do not account for non-duty paid products and must be heavily inflated to adequately represent the true size of the market. The RYO market is expected to continue increasing in popularity as long as UK cigarette taxes remain high.

Cigars

The UK cigar market is worth approximately £500 million, with consumption in 1999 totalling approximately 960 million cigars. Overall cigar consumption has been declining for the past 4 years in the UK. However within the sector, small cigars have become particularly popular with approximately 25 percent of all sales. Gallaher's Hamlet brand commands 50 percent of the market here competing with Imperial's Classic and King Edward Coronets and with Henri Winterman's Slim Panatellas.

Pipe Tobacco

There are an estimated 500,000 pipe smokers in the UK who consumed between 700-800 MT of tobacco in 1999. This market was estimated to be worth £90 million in 1999. Pipe smoking is a niche market and is not expected to grow.

Appendix

Cigarettes PSD

Commodity	Tobacco, Mfg., Cigarettes			(MIL PCS)		
	Revised	1998	Preliminary	1999	Forecast	2000
	Old	New	Old	New	Old	New
Market Year Begin		01/1998		01/1999		01/2000
Filter Production	159750	163297	154750	154750	0	149750
Non-Filter Production	250	250	250	250	0	250
TOTAL Production	160000	163547	155000	155000	0	150000
Imports	28000	44847	30000	43872	0	47500
TOTAL SUPPLY	188000	208394	185000	198872	0	197500
Exports	101000	125454	105500	115372	0	115500
Domestic Consumption	87000	82940	79500	83500	0	82000
TOTAL DISTRIBUTION	188000	208394	185000	198872	0	197500