

Pour decisions?

The case for reforming alcohol duty

Scott Corfe

SMF

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ABOUT THE AUTHORS

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Scott was voted one of the top three forecasters of UK GDP by Focus Economics in 2016.

1. EXECUTIVE SUMMARY

This report explores the case for reforming alcohol duty in the United Kingdom, and the principles which should underpin a new, improved alcohol duty regime. This includes consideration of alcohol duty reforms that could be implemented following Brexit.

The report notes a number of key issues with the current alcohol duty regime:

- **Significant disparities in duty charged for same strength products.** While a relatively weak 6% ABV bottle of wine faces duty of 50 pence per unit of alcohol, as of the time of writing a 6% ABV cider faces duty of just 7 pence per unit of alcohol.
- **Mixed incentives to produce weaker strength products.** While beer duty increases or holds steady, on a per-unit of alcohol basis, with the strength of the product, this is not true for cider or wine. For these products, incentives to reduce product strength are limited.
- **An inconsistent approach to taxation.** While beer and spirits duty are taxed according to pure alcohol content, wine and cider duty are taxed according to the volume of the final product. This is a reflection of EU regulatory requirements, which require wine and cider to be taxed in this way. Brexit could open up possibilities to rationalise alcohol taxation in the UK.
- **Lack of consideration for the alcohol tax system as a whole.** Alcohol duty has become highly politicised and often driven by spurious arguments, rather than what evidence suggests would be most optimal – whether that be in terms of raising revenue, supporting jobs or improving public health outcomes.
- **Arguments often used to justify duty freezes and favourable treatment for certain beverages are deeply flawed.** For example, jobs-based arguments used to justify cider and spirits duty freezes ignore the fact that cider accounts for a very small number of jobs in the economy, and the fact that about 90% of whisky is exported from the UK – meaning duty changes and domestic consumption patterns have little bearing on jobs. Jobs-based arguments also ignore work lost through excessive alcohol consumption. Analysis by Public Health England found that, in 2015, there were 167,000 working years of life lost due to alcohol consumption – 16% of all working years lost in that year.

Arguments used to call for a more favourable tax treatment for spirits tend to focus on the need to support the Scotch whisky industry, yet UK-produced whisky accounts for just 17% of spirits consumed in the UK. Whisky's dominance in the political discourse around spirits, with its evocation of images of charming rural distilleries, thus seems highly misguided. Vodka is in fact the most widely consumed spirit in the UK, accounting for about 30% of total consumption.

Arguments related to the regressive nature of excise duties are also flawed. Firstly, alcohol taxation does not appear to be particularly regressive, given relatively high rates of non-drinking among lower income households. Secondly, regressivity alone is not a strong argument against alcohol duty. Inequalities in the economy are better addressed through broader tax and welfare policy, rather than through alcohol duty which should largely be concerned with addressing the health and social harms caused by alcohol consumption.

The report notes the substantial health and social problems in the UK that are caused by excessive alcohol consumption:

- **Studies suggest that the total costs of alcohol to UK society could stand at between 1.3% and 2.5% of GDP.** This includes higher healthcare, policing and social care costs, as well as costs associated with lost productivity and lower employment.
- **While in the 1960s the UK had a much lower rate of liver disease and cirrhosis deaths than other European countries such as France, Spain and Italy – the UK now has a higher rate of deaths than these countries.**
- **Alcohol-related deaths are more common in the most deprived areas of the United Kingdom.** Alcohol-specific death rates among men in the most deprived quintile of the population are 4.3 times higher than for men in the least deprived quintile. For women, age-standardised death rates are 3.4 times higher.

The report notes that, while the evidence around the health impacts of mild-to-moderate drinking is mixed, the adverse impacts of heavy drinking on individual health and society are indisputable. Hazardous and harmful drinkers account for a staggering 78% of alcohol consumed in England. This is despite the fact that these heavier drinkers account for just a quarter (25%) of the total population.

There is also growing evidence suggesting that even moderate rates of alcohol consumption are associated with higher risks of cancer.

We argue that alcohol duty should be reformed to focus taxation where health and other harms are greatest. This will ensure that lower risk drinkers are not overly penalised for their consumption of alcohol. It also increases the chance of duty reform reducing alcohol consumption among heavier drinkers, or at least ensuring that such drinkers are paying for the costs associated with their consumption.

Analysis presented in this report provides insights into the types of drinker, and types of alcohol product, most associated with heavy drinking:

- Heavy drinkers are more likely to consume higher strength products such as spirits and high strength beers and ciders.
- Heavy drinkers are also more likely to consume alcohol in the off-trade (that is, drinking “at home” or “on the street”, rather than in a pub, bar or restaurant).
- Heavy drinkers are more likely to consume cheaper alcoholic beverages.

To better focus alcohol taxation on where health and other social harms are greatest, this report sets out five recommendations for a revised alcohol duty system:

1. **Introducing a duty strength escalator**, to focus alcohol duty on the higher strength products disproportionately consumed by heavy drinkers, and create stronger incentives to produce lower strength products.

There is at least tentative evidence that alcohol producers respond to duty changes, by reformulating products. Carlsberg reduced the strength of its low strength lager, Skol, from 3% to 2.8% ABV, in response to the introduction of a new lower-rate duty band for low strength beers. AB InBev has also reduced the strength of more mainstream brands

of beer – including Stella Artois, Budweiser and Becks – as a means of reducing costs associated with alcohol duty.

2. **Levelling the playing field across same-strength products.** Products of the same strength should face the same rate of duty and duty should be a function of the pure alcohol content of drinks, rather than the volume of the final product. This would help simplify the alcohol duty system.
3. **Allowing pubs to claim back a proportion of alcohol duty through a new “Pub Relief”.** This would focus alcohol duty on the off-trade, which is particularly reliant on sales to hazardous and harmful drinkers.

Conceivably, this could work in a similar way to Alcoholic Ingredients Relief, which already exists. With Alcohol Ingredients Relief, businesses can claim relief on alcohol excise duty when they use alcohol as an ingredient in drinks less than 1.2% ABV, chocolates, vinegar and other foods for human consumption (below a certain alcohol content).

4. **Explicitly linking alcohol duty to the social costs of alcohol, rather than treating it as a cash cow.** At the very least, alcohol duty should cover the health, crime and welfare costs to government and wider society (the “externalities” associated with alcohol consumption). Paternalistic arguments, which consider the ability of individuals to make “bad” and regrettable lifestyle choices (such as those that undermine their job prospects), could justify a higher tax take.

Alcohol duty should not be treated as a cash cow for government. The UK public finances are already overly reliant on niche taxes, rather than broad taxes such as income tax and VAT. Reliance on niche taxes makes the public finances inherently more volatile and at risk from factors such as changing consumer preferences. Linking alcohol duty to social harms, rather than as a general tool for revenue raising, could help to improve dialogue between drinks manufacturers, government and health experts.

5. **Regularising the uprating of alcohol duty, with inflation or earnings uprating being the “norm”.** This would help depoliticise the setting of alcohol duty.

While we believe inflation or earnings should be the “status quo” form of uprating duty, this should be complemented with review periods, held perhaps on a five or 10 yearly basis. The purpose of the review period would be to explore the latest evidence base on alcohol-related costs to society, and ensure that alcohol duty tax take is broadly in line with these costs – as we proposed in Recommendation 4 above. This review should be informed by expert insights from government, the healthcare sector, academics, charities and industry, taking into account the latest evidence and structural trends. As we discussed in this report, some of the evidence base, for example on the health impacts of mild-to-moderate drinking, remain debatable; conceivably estimates of the social cost of alcohol could change significantly as our knowledge-base improves.

The review period would provide further incentives for drinks manufacturers to reduce alcohol-related harms - for example by withdrawing “worst offender” products from the market (such as high strength, low quality, low cost drinks) and advertising the risks of

excessive consumption of alcoholic products. Manufacturers would be incentivised to do this in order to reduce structural duty increases following the review period.

Some of the recommendations we outline above can only be realised in the event of European-wide regulatory reform, or the UK pursuing a different approach to regulation following Brexit. As discussed earlier, European directives bind the UK to taxing wine and cider according to the volume rather than the alcohol content of the final product. In addition to the possibility that the UK remains in the EU, or returns to the EU following departure, the UK might still be bound by EU regulations following a permanent Brexit. This might be a requirement for a successful trade deal with the EU following Brexit, for example.

Even if European regulations constrain the possibility for duty reform, there is still scope to have a more optimal regime than we have at present – one that better focuses taxation where harms are being most generated. This includes:

1. Regular updating and evidence-based duty reviews.
2. Introducing more duty bands for cider (as Ireland has done) to better incentivise the production of lower strength products.
3. Bringing beer, cider, spirits and wine duty more closely into line in the sub-8.5% ABV category, for similar strength products.
4. Introducing a new duty band for beer, between 2.8% and 3.9% ABV. It was brought up in our discussions with industry that there is likely to be a broader market for beverages in this kind of strength category, as opposed to the sub 2.8% ABV category which is relatively niche. However, the current duty system does not incentivise production of such beverages. Alternatively, there may be a case for increasing the upper limit of the “< 2.8%” beer duty band, to cover low strength beers which are more likely to gain mainstream demand.
5. Narrowing the main duty band for wine. In the UK the main duty rate for still wine runs from 5.5% ABV to 15% ABV. EU law requires that there has to be a single band for wine between 8.5% and 15% ABV. As the UK’s main still wine and made-wine band is currently 5.5% to 15% ABV, it would be possible to split the main still wine and made-wine band into two, and introduce stronger incentives via duty to produce low strength wines between 5.5% ABV and 8.5% ABV.

2. INTRODUCTION

Alcohol duty is one of the most dysfunctional parts of the UK tax system. Duty varies dramatically across beverages, products are taxed on different bases and incentives to produce lower strength products are mixed. Indeed, for some drinks categories, the duty system acts to encourage the production of higher strength products – even though evidence suggests that the heaviest drinkers tend to consume stronger products.

Critically, alcohol taxation has been shaped heavily by politics, rather than economics, data and analysis. For example, alcohol duty freezes and cuts in recent years have often been motivated by a desire among politicians to protect jobs tied to the production of alcoholic beverages. Yet, as we discuss in this report, the link between alcohol duty and jobs in these industries is often much weaker than the political discourse seems to assume. Further, the political discourse largely ignores the job and productivity losses caused by excessive alcohol consumption.

Given the political nature of duty changes, the UK has been lumbered with a system of alcohol taxation ill-suited for meeting key objectives of government: raising tax revenue, protecting jobs or improving public health and other social outcomes. Rather than examining the evidence base and reflecting on the alcohol duty regime as a whole, the system has been tweaked according to political whims over time.

This needs to change – not least for public health reasons. Although per capita alcohol consumption in the UK peaked in 2004 and has declined since then, liver cirrhosis death rates in the UK remain higher than in the 1970s. As we discuss in this report, alcohol contributes to substantial and widening health inequalities which exist in the UK. Excessive alcohol consumption among some segments of the population is also contributing to the UK's relatively poor performance on public health outcomes compared with our European neighbours. For example, while rates of liver disease and cirrhosis deaths have declined dramatically in France, Italy and Spain since the 1970s, they have increased in the UK – leaving Britain with the highest rate of liver disease and cirrhosis deaths among these countries.

The focus on this report is on setting out the principles which should underpin a reformed, and improved, system of alcohol duty in the UK – one that can deliver better health, social and economic outcomes than the current regime. We believe that the reforms proposed in this report would ensure that alcohol duty is more focused on products associated with the greatest health and social problems – and less focused on lower risk drinkers consuming low-to-moderate amounts of alcohol.

In addition to ensuring the alcohol duty is better targeted, we also consider the role that duty can play in creating stronger incentives for alcoholic drinks manufacturers to produce less harmful beverages – through for example reducing product strength or removing “problem” brands (such as white cider and other low cost, low quality, high strength products).

We emphasise that the report is principally concerned with the *system* of alcohol duty rather than the *overall level* of alcohol taxation. This reflects the fact that the overall level of taxation from alcohol depends strongly on the preferences of politicians and the electorate. Attitudes towards what is widely referred to as “paternalism” vary markedly – with implications for views on the extent to which policymakers should seek to steer the public's decision-making through tools

such as taxation. We take no views on the extent to which policymakers should be paternalistic in this report – merely noting that opinions are divided on the issue.

One rationale for publishing this report now is Brexit. Depending on the nature of the UK's departure from the European Union (if, indeed, the UK departs), there may be scope to reform significantly the way alcoholic beverages are taxed in the UK. At present, some of the irregularities in the alcohol duty system are a reflection of EU-wide regulation – in particular Directive 92/83/EEC which sets out the basis on which excise duty is calculated¹. Following Brexit, policymakers will probably be keen to explore the regulatory and tax reforms that have been “unlocked” by leaving the European Union – and alcohol duty might be an area where positive changes could be realised.

The structure of this report is as follows:

- **Chapter 3** elaborates on the case for reforming alcohol duty in the UK, highlighting the recent history of duty changes and the inconsistencies within the current duty system.
- **Chapter 4** compares the UK alcohol duty regime with other countries.
- **Chapter 5** examines the profile of UK drinkers – how much they consume, their demographic characteristics and where the burden of alcohol duty falls across the population. It also considers the evidence base around the link between alcohol taxation, alcohol prices and levels of consumption among different types of drinker
- **Chapter 6** explores the linkages between alcohol duty, alcohol consumption, health and other social outcomes.
- **Chapter 7** explores the linkages between alcohol duty, alcohol consumption and jobs.
- **Chapter 8** sets out a series of principles which should underpin a reformed alcohol duty system, informed by the preceding analysis.
- **Chapter 9** provides a high-level assessment of what the impact of shifting to a revised alcohol duty system would be – on prices and levels of alcohol consumption.
- **Chapter 10** draws conclusions from the preceding analysis.

3. THE CASE FOR REFORMING ALCOHOL DUTY

This chapter provides a brief overview of the alcohol duty system in the UK, highlighting the apparent inconsistencies within the current regime. It thus provides a motivation for the rest of the report.

How are alcoholic beverages taxed?

In addition to VAT, alcoholic beverages are subject to *excise duties*. As with other excise taxes, such as fuel and tobacco duty, alcohol duty falls due at the time when the goods leave any *duty suspension arrangements*. This includes when they are released for consumption from warehouses or if goods imported for personal use are then sold or put to commercial use².

As with VAT, excise duty is technically paid for by business, though ultimately the consumer bears most of the cost of the tax as this is passed on in the form of higher prices. The extent to which the burden of a business tax is ultimately borne by the end consumer is commonly referred to as the “passthrough rate”.

A frequent point made in the discourse around alcohol duty, and indeed other excise duties, is the existence of “double taxation”. VAT is applied after duty, so the impact of duty rates on consumer prices is in fact 1.2 times the stated rate of duty (assuming passthrough rates are close to 100%).

Through passthrough to consumers, alcohol duty thus has an impact on prices faced by individuals. We emphasise that alcohol duty differs from minimum unit pricing (MUP) – another potential policy lever for influencing alcohol prices – in several important ways. Firstly, alcohol duty is a form of taxation, yielding direct revenue for government. In contrast, MUP sets a minimum price that a unit of alcohol (defined as 10ml of pure alcohol) can be sold at; it is not therefore a form of taxation and affects government revenues more indirectly – through for example changes in VAT receipts reflecting price increases and changes in levels of consumption. Further, alcohol duty impacts the end price of all beverages, whereas MUP impacts the price of relatively low-cost alcoholic beverages (at least directly – conceivably producers might alter the prices of relatively more expensive drinks in response to MUP).

A MUP of 50p per unit of alcohol was implemented in Scotland in 2018 and the Welsh Government is “committed” to introducing a minimum price for alcohol³. The UK Government does not, currently, have plans to introduce MUP in England.

Another policy tool that has been implemented to influence alcohol prices, beyond MUP and duty, is bans on below-cost sales of alcohol. Since May 2014, shops and bars in England & Wales have been unable to sell drinks for less than the tax (duty plus VAT) paid on them. However, in contrast to MUP and alcohol duty, such a measure impacts a very small proportion of alcohol sold in the UK; the Institute of Fiscal Studies found that only 0.9% of products in the off-trade would be affected by the policy⁴.

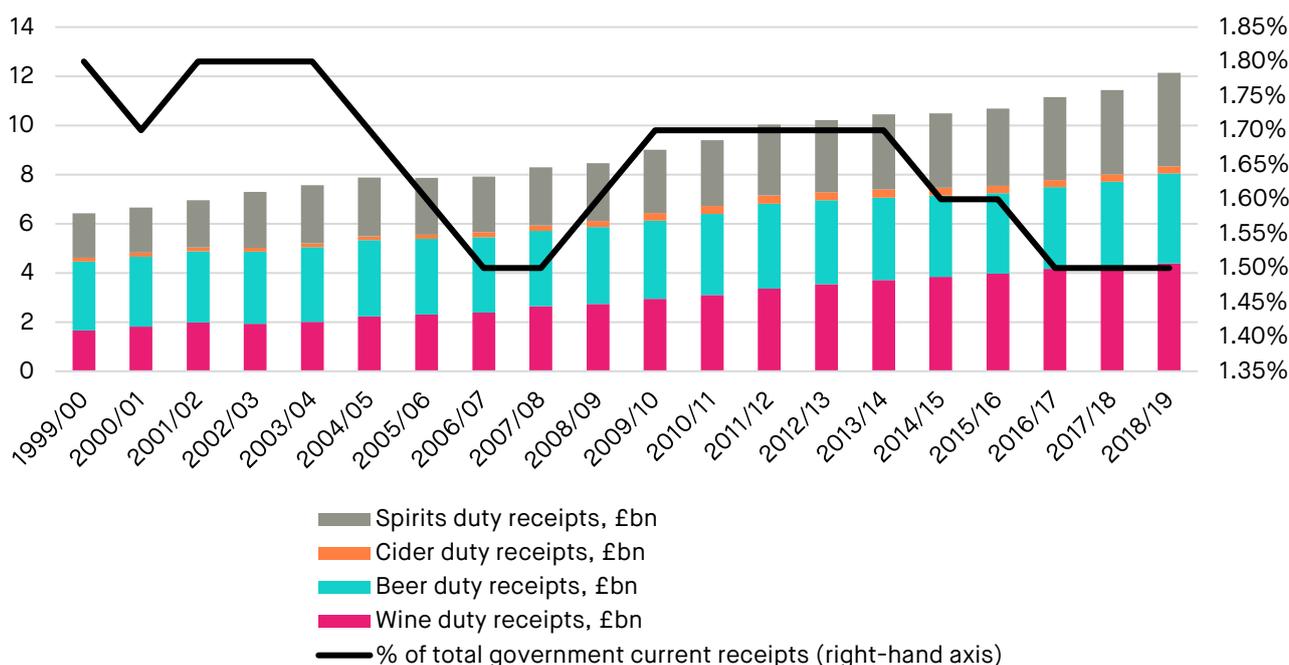
In summary, alcohol duty in the UK sits alongside other policy levers which aim to increase the price of alcohol above where it would stand in an unregulated, free market. As we discuss later, a key rationale for increasing the price of alcohol above market rates is to ensure the price reflects the social harms associated with alcohol consumption.

How much revenue does alcohol duty raise?

In the fiscal year 2018/19, alcohol duty raised £12bn for the government – 1.5% of total current revenues in that year. Including VAT applied to alcohol duty, revenue raised increases to £14bn.

Split by product category, wine accounted for 36% of duty receipts in 2018/19, spirits accounted for 31%, beer accounted for 30% and cider accounted for 2%. As Figure 1 below shows, while alcohol duty receipts have increased since the year 2000, they have declined as a share of total government current income – from 1.8% in 1999/00 to 1.5% in 2018/19.

Figure 1 Alcohol duty receipts, £ billion and as a share of total government current receipts



Source: HMRC alcohol duty bulletin, ONS public finances statistics

How are alcohol duty rates determined?

Alcohol duty rates are set by the Chancellor of the Exchequer and as such are determined by the preferences of the prevailing government. Duty is, therefore, a highly *politicised* policy instrument.

Over the years, alcohol duty changes have been motivated on several grounds. This includes:

- **The need to raise revenue for the Exchequer** – and help address fiscal deficits.
- **The need to curb “problem” drinking** – using alcohol duty to increase the consumer price of beverages, and curb excessive drinking. As well as the uprating of duty rates over time, we have also seen the introduction of new tax bands aimed at targeting products perceived to be particularly harmful, as well as promoting products perceived to be “healthier”. Examples of this include the introduction of higher duty bands for high strength cider, and a lower duty band for low strength beer.
- **The need to preserve jobs in the economy** – justifying freezes and cuts to duty, and preferential rates for some products, on the grounds of the need to preserve jobs in

industries such as beer, cider and whisky production. With respect to cider and whisky production, the concentration of employment in these industries in particular parts of the UK is a key part of the policy debate – with some arguing that excessive rates of duty risk having a significant adverse economic impact on particular regions of the country.

Although the government has a great deal of control over the prevailing rates of taxation and their uprating over time, the hands of UK policymakers are somewhat tied by EU regulation – as we noted in the preceding chapter.

EU Directive 92/83/EEC sets out a range of requirements around alcohol duty, effectively harmonising structures across the EU. While beer and spirits duty rates can be applied to the *pure alcohol* content of each beverage, wine and cider duty rates must be applied to the *total volume* of the beverage – meaning duty rates cannot vary by product strength within the bands in which products are defined.

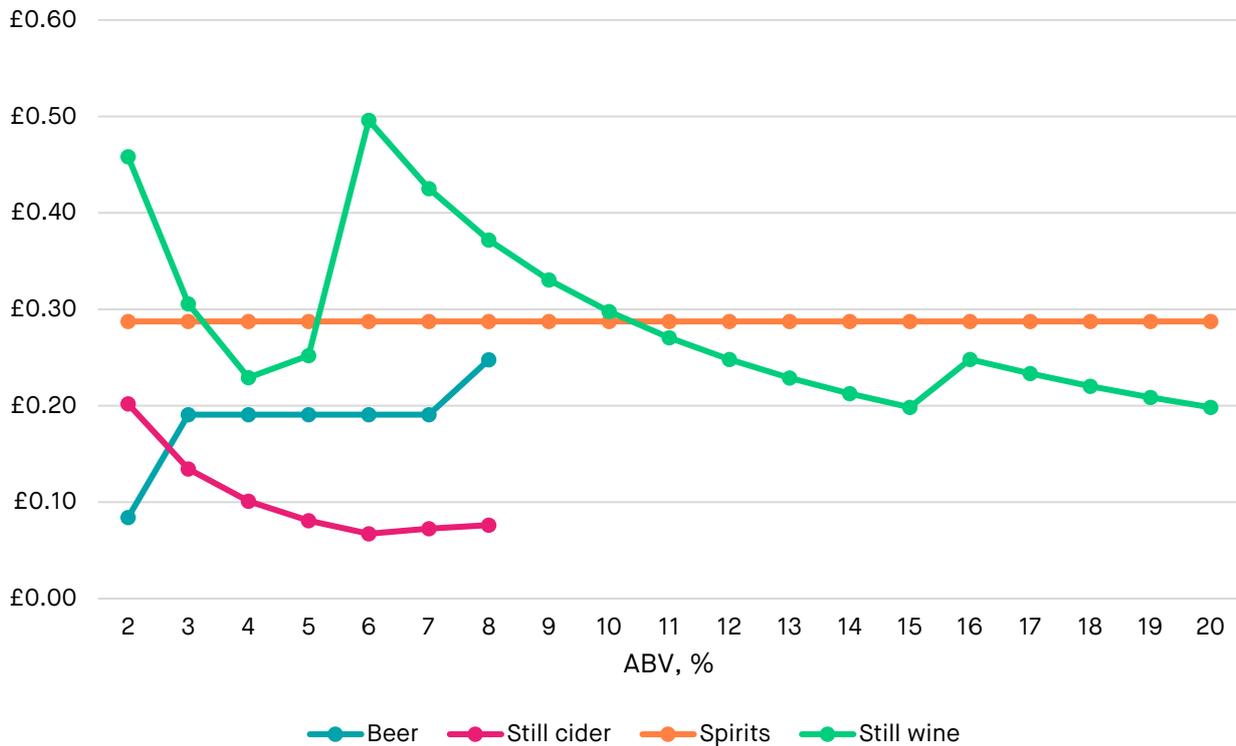
What are the current duty rates and how has this changed over time?

Reflecting the domestic political motivations and EU regulations described, the UK has ended up with an alcohol duty system where rates of duty differ markedly across different categories of alcoholic beverage.

This is most apparent when examining the amount of duty charged *per unit of alcohol* across beverages. The reason for looking at duty per unit of alcohol, is that it is the alcohol content of beverages which generates health and other social harms – as such this should be the prime target of the tax at least from the perspective of using duty as a tool to address the harms caused by the consumption of alcoholic beverages.

As Figure 2 shows, duty per unit of alcohol varies substantially across products, and across different strength drinks. While a relatively weak 6% ABV bottle of wine faces duty of 50 pence per unit of alcohol, as of the time of writing a 6% ABV cider faces duty of just 7 pence per unit of alcohol. While beer duty increases or holds steady, on a per-unit of alcohol basis, with the strength of the product, this is not true for cider (except for the strongest varieties). Wine duty is even less coherent, as the graph shows, reflecting the requirement that, within specific bands, wine duty must be applied to the volume of the final product rather than the pure alcohol content.

Figure 2 Alcohol duty per unit of alcohol, by product type

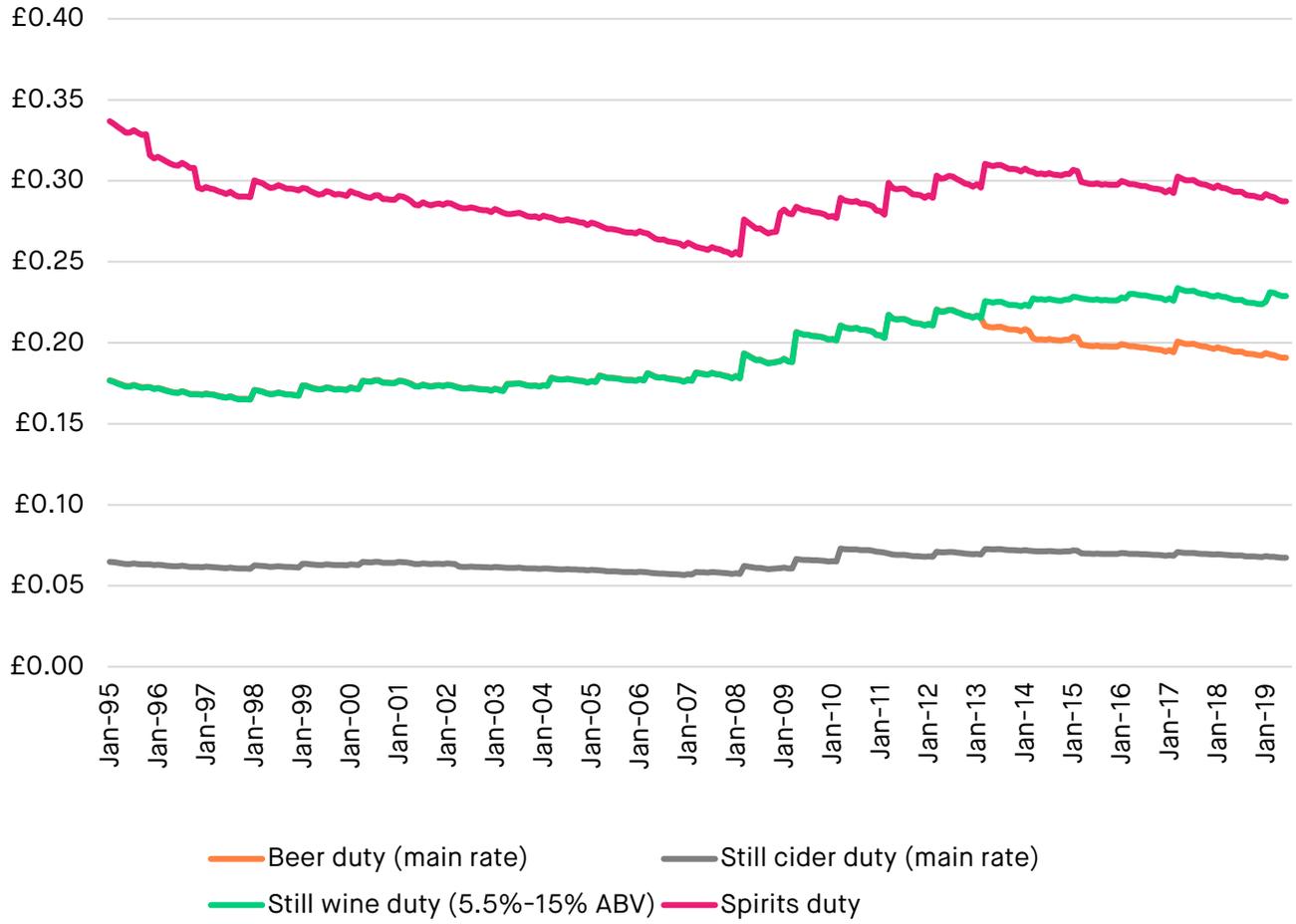


Source: SMF calculations based on HMRC alcohol duty statistics

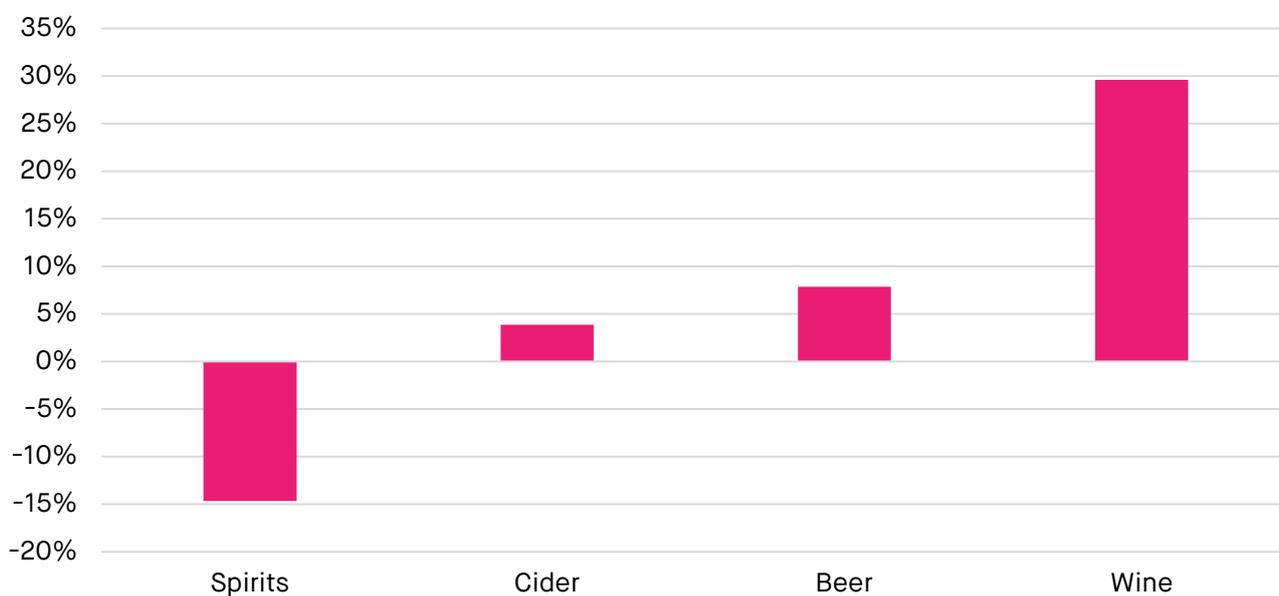
In the UK, alcohol duty has been updated on an inconsistent basis over time. Rather than being updated regularly by inflation or some other statistic such as employee earnings, political intervention has resulted in a situation where duty has grown at different rates for different products. In part, this reflects changing policy objectives. For example, the prolonged period of spirits duty freezes in the 1990s and early 2000s was in part motivated by a desire among policymakers at the time to support the Scotch whisky industry to lobby other countries to reduce spirits taxation (by requesting that they follow the UK in reducing or freezing duty)⁵. Generally, since then, the policy regime has shifted away from one that would gradually remove the duty gap between spirits and other beverages, given that it would leave spirits cheaper, per unit of alcohol, than beer or cider (reflecting the lower average production costs of spirits⁶).

Figure 3 below shows alcohol duty rates, per unit of alcohol, for typical strength products over time, adjusted for inflation. Compared with 1995, spirits duty is lower in real terms – meaning that it has become cheaper relative to the price of other goods and services. Cider duty increased in real terms over this time period, though at a lower rate than for beer or wine.

Figure 3 Duty per unit of alcohol, over time, January 1995 = 100. Expressed in June 2019 prices, deflated using the Consumer Price Index



Source: SMF calculations based on HMRC alcohol duty statistics

Figure 4 % change in real alcohol duty rates, January 1995 – June 2019

Source: SMF calculations based on HMRC alcohol duty statistics. Consumer Price Index used as price deflator for creating a real time series

The problems with the current duty system

The analysis above has shown that alcohol duty is, at first glance, highly irregular – given the variations in rates across products, and inconsistencies in how these have been updated over time. But why does this matter?

The simple answer is that the alcohol duty system, as it stands, is likely to be a highly inefficient way of meeting the goals of government – protecting jobs, raising revenue and improving health outcomes. From an optimal tax perspective, duty rates should be concentrated where *externalities* are generated – such as health and other social harms. By “externalities”, we mean costs to society which are not reflected in the pre-tax price of a good. Examples of externalities, in this sense, are pollution and congestion. In the case of alcohol, externalities include costs to the police and National Health Service, as well as damage inflicted on other individuals through violence, crime and family breakdown.

Focusing duty on where externalities are being generated ensures that mild-to-moderate drinkers are less likely to be impacted adversely by duty, while heavy drinkers are more likely to face higher rates of duty – leading to either lower rates of consumption, or at least ensuring that they are “paying” for the costs their actions are placing on wider society. In economic terms, ensuring that lower risk drinkers are not excessively penalised is good for *social welfare*.

As the following chapters of this report show, arguments in defence of the current duty system – such as the need to protect jobs – often do not stand up to scrutiny. Critically, policymakers have failed to adopt a “systems approach” to alcohol taxation. Rather than reviewing the duty

regime as a whole and structuring it in a way that best meets the objectives of government, duty for specific products has been tweaked over time, without consideration for impact on the range of objectives of government.

Given the lack of joined up thinking on alcohol duty, there is likely to be significant scope to do better than the current regime. This report explores the evidence around alcohol consumption, jobs, health, the economy and tax revenues – using this to inform some principles for an alcohol duty regime better placed to meet the objectives of government.

4. HOW DOES ALCOHOL TAXATION IN THE UK COMPARE WITH OTHER COUNTRIES?

The previous chapter showed that the UK's alcohol duty system contains numerous irregularities. But is the UK an anomaly in having a dysfunctional duty regime? This is the question to which we now turn.

Alcohol taxation in Europe

Approaches to alcohol taxation across much of Europe suffer similar issues to the UK, with a general lack of a “systems approach” which optimises duty rates to best address government objectives. Similar to Figure 2 in this report, “spaghetti charts” of alcohol duty per unit of alcohol can be seen in other European countries, such as Denmark, Finland and Ireland. In part this reflects these countries facing the same regulatory constraints as the UK, with European directives binding them to taxing wine by volume of final product rather than alcohol content. This is charted overleaf.

Numerous countries avoid having a “spaghetti chart” by zero-rating wine duty. Wine is zero-rated in multiple European countries, including major wine producers such as France, Italy and Spain. No country treats “alcohol as alcohol”, with either a fixed duty rate per unit of alcohol, or a rate that is at least fixed for products of the same strength in terms of alcohol content. In part this reflects European directives which influence how different products can be taxed. But it also reflects the fact that there are compelling justifications for taxing spirits at a higher rate to other alcoholic beverages – for example, due to the lower average production costs for spirits, which make their pre-tax prices, per unit of alcohol, lower than for drinks such as beer and cider.

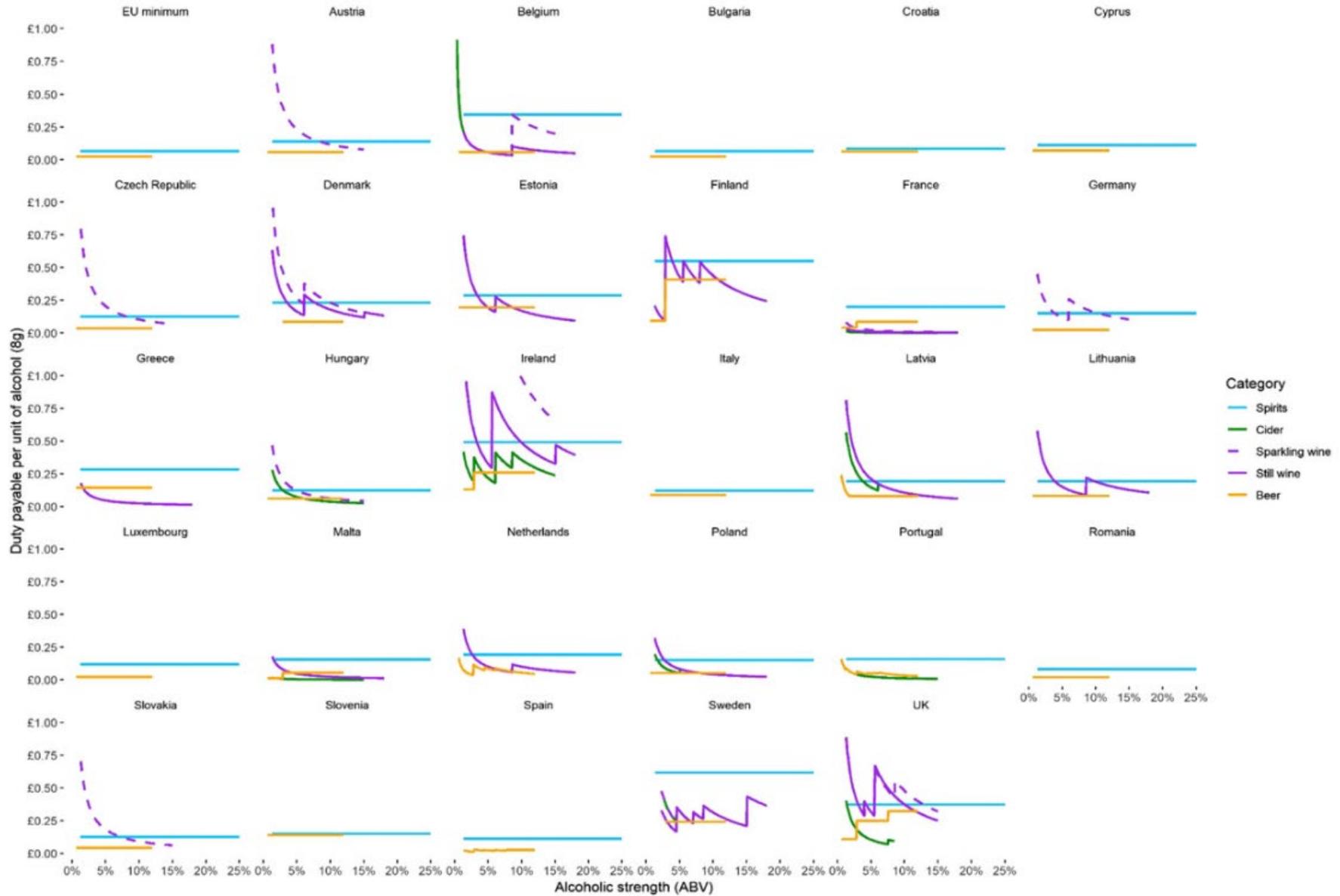
As with the UK, jobs-related arguments provide a political rationale for favourable tax treatment of some products. As Angus, Holmes and Meier noted in their recent review of alcohol duty systems across Europe⁷:

“There is only limited evidence that alcohol duties are designed to minimize public health harms by ensuring that drinks containing more alcohol are taxed at higher rates. Instead, tax rates appear to reflect national alcohol production and consumption patterns.”

That is to say, alcohol duty appears to be a highly politicised, rather than evidence-informed, form of taxation across Europe.

Having said that, there are lessons that the UK could possibly learn from other European countries. We note, for example, that other countries have fewer perverse incentives embedded in their alcohol duty systems than the UK. Ireland, for example, has introduced more cider duty strength bands than the UK; creating a situation where duty per unit of alcohol is not too dissimilar to beer, and less inclined to fall as product strength increases (a key issue with cider duty in the UK).

Figure 5 Alcohol duty per unit for common products across Europe. Source: Angus, Holmes and Meier (2019) "Comparing alcohol taxation throughout the European Union"



Alcohol taxation in the United States

In the United States, there are federal and state excise taxes on alcohol – allowing some degree of regional variation within the country.

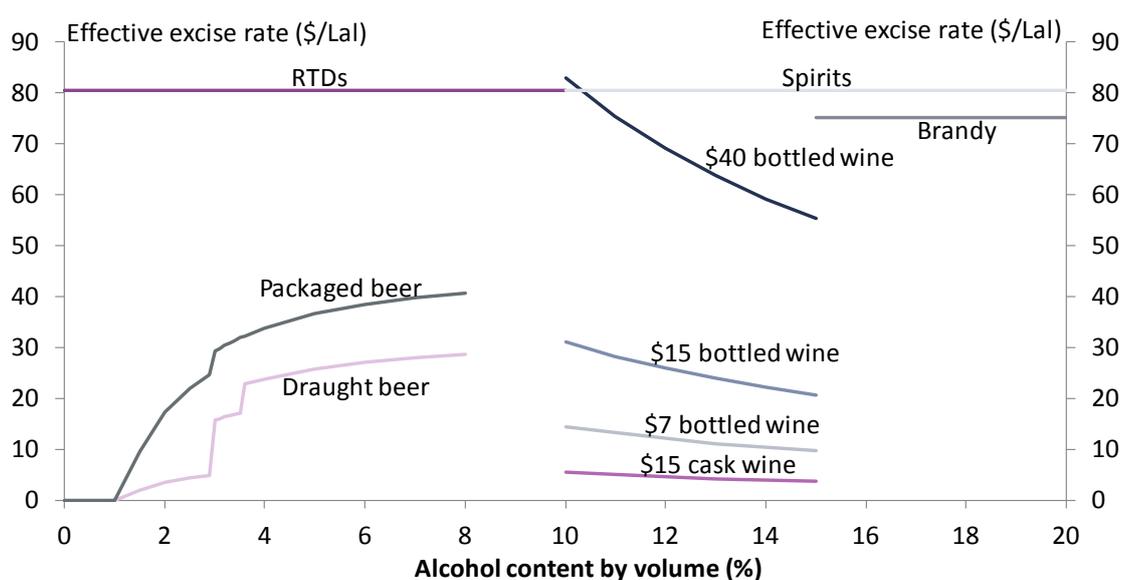
Federal tax rates for wine and beer are calculated according to the final volume of the product, meaning duty per unit of alcohol falls with product strength within given tax bands.

At a state level, alcohol taxes vary significantly, both in terms of structure and overall level of taxation. For example, while state beer excise duty in Wyoming was just \$0.02 per gallon in January 2019, this was \$1.29 per gallon in Tennessee. Some states, including Florida, Texas and Hawaii, have additional complexities in their approach to beer taxation. This includes varying taxation according to alcohol content, place of production, size of container, or place purchased (on or off-trade). Several states, such as Arkansas have a specific sales tax for alcoholic beverages in addition to excise duty – meaning that alcohol is taxed on an *ad valorem* basis according to price, as well as a \$ per gallon basis⁸.

Alcohol taxation in Australia – favouring on-trade consumption

Australia provides an interesting point of comparison to the UK, in terms of alcohol taxation. While it shares several of the inconsistencies seen in the UK duty system, such as substantial differences in duty rates across products of similar strength, it differs in two notable ways. Firstly, beer duty in Australia explicitly favours on-trade alcohol consumption (that is, alcohol consumed in licensed premises such as pubs, bars and restaurants) – with a lower rate of duty for draught rather than packaged beer. Secondly, wine duty in Australia is an *ad-valorem* tax – varying according to the price of the bottle of wine on sale. This means that, for wine, duty per unit of alcohol increases with product price.

Figure 6 Effective excise taxes in Australia (2015)



Source: Parliament of Australia Budget Office, "Alcohol taxation in Australia", March 2015

Alcohol taxation in Singapore – attempts to “rationalise” the duty regime

The one country we identified with a significantly “rationalised” alcohol duty system is Singapore. In the Singapore Budget 2007, the government announced that:

“We will progressively move towards taxing liquors on the basis of alcoholic content. From 1st January 2008, [we] will tax beer and stout on this new basis. This is a rationalisation of duties and is not aimed at generating additional revenues”.

Since 2008, Singapore has retained a simple excise duty system, with just two rates – an excise duty rate for beer, cider & perry and an excise duty rate for wines and spirits. Both of these rates are calculated according to the pure alcohol content of the beverage – in contrast to the duty regime prior to 2008 which taxed according to volume of the final product. The duty rate for beer and cider is lower than the duty rate for wine and spirits, meaning duty per unit of alcohol is higher for stronger (on average, in terms of alcohol content) products⁹.

Summary

Across most of the countries we have examined, alcohol taxation has significant inconsistencies and appears to be largely a reflection of politics rather than attempts to provide an optimal form of taxation from an economic, social and public health perspective.

Having said that, there may be lessons that the UK could learn from other countries. This includes the Republic of Ireland’s attempts to rationalise duty within the constraints of EU regulation, with more duty bands for cider. Singapore’s approach to alcohol taxation shows the potential to simplify duty regimes significantly. And the distinction between on-trade and off-trade alcohol taxation in Australia and some US states provides examples of how alcohol duty could be more targeted on specific types of consumption. As we discuss in the following chapter, certain types of drinker are more likely to drink in the off-trade than the on-trade.

One challenge with cross-country comparisons of alcohol taxation is understanding the *impact* of the alcohol duty regime on drinking patterns and the extent to which drinking patterns in one country would mimic those in another if they were to adopt similar tax regimes. Variations in “drinking culture” and other health outcomes create difficulties in drawing cross-country comparisons on the outcomes of tax reforms.

5. WHO DRINKS IN THE UK AND HOW MUCH ARE WE DRINKING?

The preceding chapters explored the structure of the duty regime in the UK, and how it compares with other countries. We argued that the current alcohol duty regime is ill-equipped to meet the goals of policymakers and there is scope to improve upon the current system from a social welfare perspective.

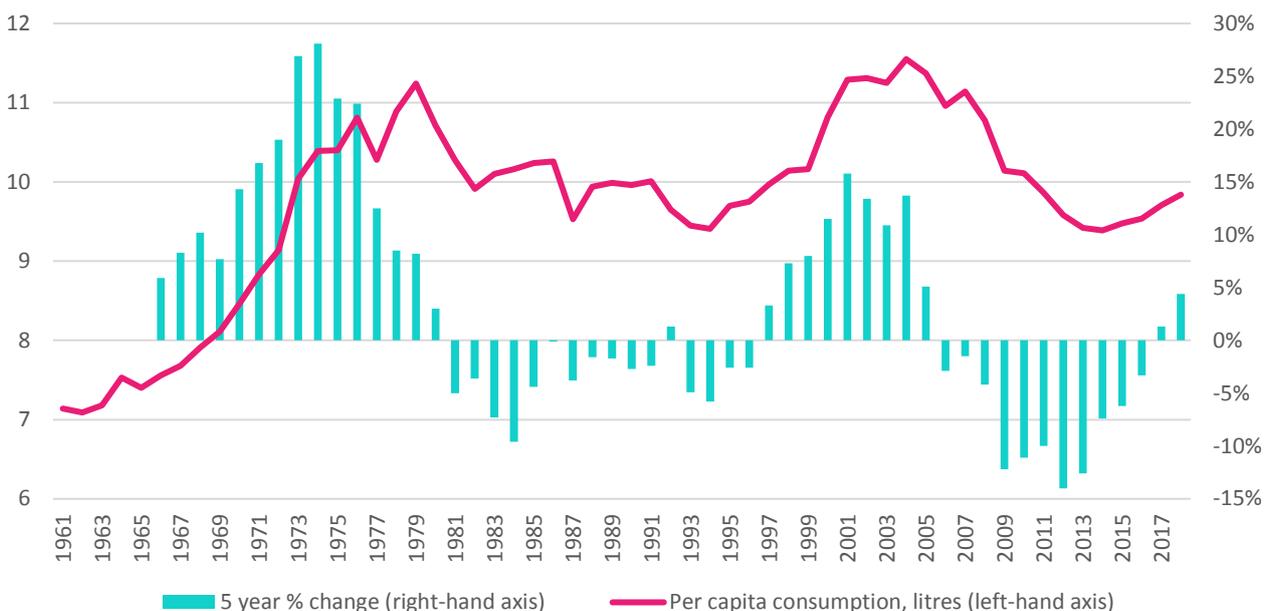
To understand how the alcohol duty regime should be improved, it is crucial to have a firm understanding of drinking patterns in the UK – who is drinking, how much they are drinking, as well as what and where they are drinking. Understanding who the heaviest drinkers in society are, and what they are drinking, can inform us as to where alcohol taxation should be targeted – whether that be to incentivise people to drink less, or to ensure that heavy drinkers are “paying” for the health and other social costs of their actions.

As we show in this chapter, drinking patterns in the UK vary markedly across different segments of the population, with rates of non-drinking and heavy drinking varying across income groups, age groups and regions of the country. Further, as we show in this chapter, heavy drinkers account for a substantial proportion of all alcohol consumed in the UK.

Headline drinking trends

In 2018, per capita pure alcohol consumption in the United Kingdom stood at 9.8 litres, among those aged 15 and over. While this is 15% below the peak of 11.6 litres seen in 2004, per capita consumption remains 30% higher than in the early 1960s. Further, the trajectory since 2015 has been one of rising alcohol consumption following a period of decline – as the figure below shows. The most notable periods of growth in per capita alcohol consumption are from the mid-1960s to the end of the 1970s, and another period of growth in the late 1990s and early 2000s.

Figure 7 Per capita pure alcohol consumption among population aged 15 and over, litres, 1961-2018

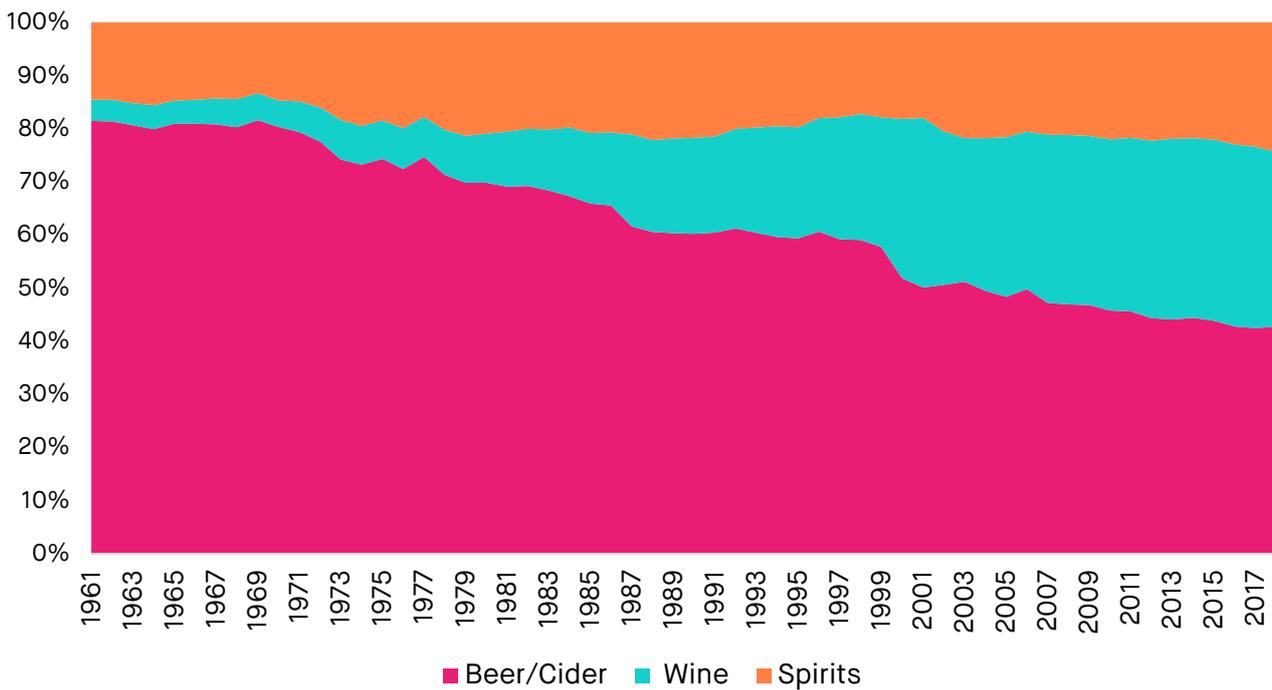


Source: World Health Organisation Global Health Observatory data repository (1961-2009). SMF calculations based on HMRC alcohol clearance statistics and ONS population estimates for 2010-2018.

What are people drinking?

The "drinking profile" of the UK, in terms of products consumed, has changed significantly since the 1960s. While in the early 1960s about 80% of alcohol was consumed through beer or cider, by 2018 these beverages accounted for just 43% of alcohol consumption. Wine has risen from just 4% of UK alcohol consumption in 1961 to about a third (33%) of consumption in 2018. Spirits now account for about a quarter of alcohol consumed in the UK (24% in 2018), up from 15% in 1961. This is shown in the graph below.

Figure 8 Pure alcohol consumption, by beverage category, 1961-2018



Source: World Health Organisation Global Health Observatory data repository (1961-2009). SMF calculations based on HMRC alcohol clearance statistics and ONS population estimates for 2010-2018.

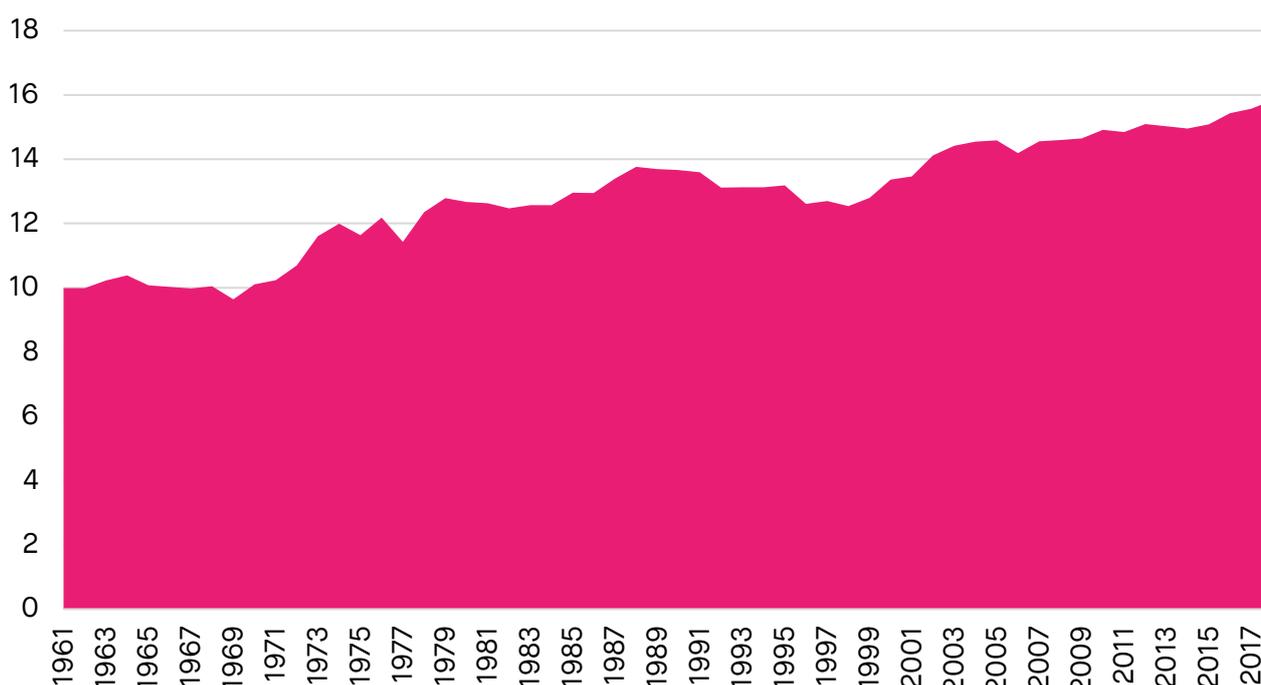
One implication of the shift away from beer and cider consumption, and towards spirits and wine consumption, is that the British are, on average, drinking much stronger alcoholic beverages than in the past. Our estimates of average product strength, graphed below, suggest a 58% increase in average strength of alcoholic product consumed between 1961 and 2018, from 10.0% to 15.8% ABV. This is based on the strength of the alcoholic beverage itself; some drinks, in particular spirits, will be mixed with other products such as juice, soda and tonic water prior to consumption. We do not have enough data to account for such mixing in our calculation of average strength, though it is unlikely to change the key conclusion that average product strength has increased significantly in recent years¹.

¹ The conclusion would only change if spirits are considerably more diluted (mixed with other drinkers) now than had been the case in the past. We also note the difficulty of measuring the extent to which spirits are diluted, particularly when consumed on the off-trade, given the tendency of individuals to "overpour" alcohol when preparing drinks at home.

We assume that the strength of products has held steady over this time period, due to data limitations. There is some evidence that the average strength of wine has increased over time, reflecting increased consumption of wines from parts of the world which tend to produce higher strength varieties¹⁰.

As we discuss in the chapter on alcohol consumption and health outcomes, the strength of product consumed potentially has a bearing on the scale of alcohol-related harms. Further, as we discuss in this chapter, higher strength products are more likely to be favoured by the heaviest drinkers in the country.

Figure 9 Estimated average ABV of alcoholic beverages consumed in the UK, %



Source: World Health Organisation Global Health Observatory data repository (1961-2009). SMF calculations based on HMRC alcohol clearance statistics and ONS population estimates for 2010-2018. Average ABV of 4.5% assumed for beer/cider, 12.6% for wine and 40% for spirits

Where do people drink?

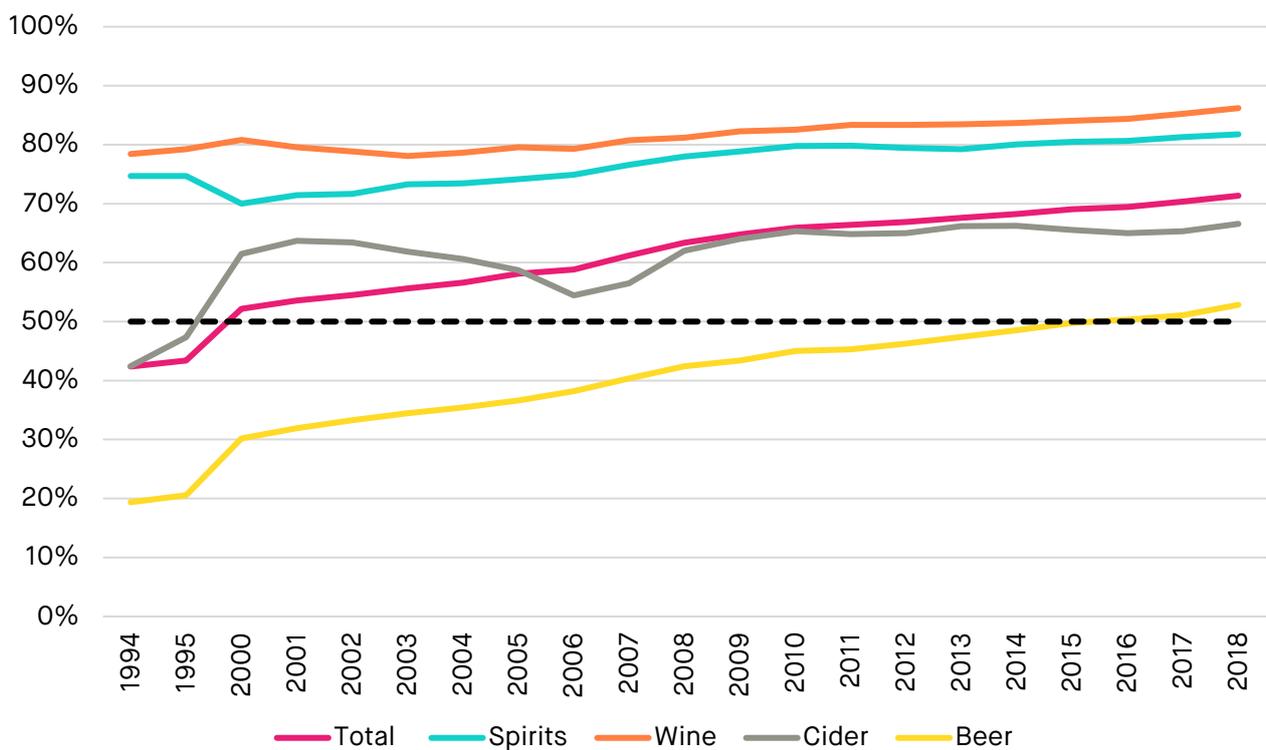
One of the most notable trends in alcohol consumption in recent decades has been the shift from on-trade consumption to off-trade consumption. While in the early 1990s most alcohol was consumed in pubs, bars and restaurants, by the turn of the new millennium most alcohol was being consumed in the off-trade. Beer and cider went from being drinks mainly consumed in the on-trade, to drinks mainly consumed in the off-trade (such as at home or on the street).

Having said that, we note that off-trade and on-trade consumption are not mutually exclusive experiences; there has been a significant amount of discussion in the media and political discourse on “pre-loading” – individuals consuming alcohol at home before consuming more at a bar and pub later in the day. A motivation for this is likely to be financial reasons. Pre-loading has been discussed, in particular, in relation to binge drinking culture and a potential contributor to high binge drinking rates among some groups. A Local Government Association report in 2016

showed 62% of local authority respondents to a survey highlighting pre-loading as something that occurs in their area to a great or moderate extent. Two in five (39%) felt there was a correlation between the pre-loading of alcohol and alcohol-related crime and disorder¹¹.

The shift from on-trade on off-trade consumption has a range of implications as far as alcohol duty policy is concerned. Firstly, it has a bearing on some of the jobs-related arguments used to justify alcohol duty changes – given that alcohol consumption is decreasingly tied to jobs in pubs, bars and restaurants. Secondly, where people drink has implications on the types of social and health externalities generated by alcohol consumption – for example binge drinking, street violence and domestic violence.

Figure 10 % of units of alcohol consumed through the off-trade, England and Wales



Source: MESAS monitoring report 2019. Note that years covered are discontinuous in the 1990s, with data only for 1994 and 1995

How does alcohol consumption vary across the population?

Levels of alcohol consumption vary significantly across demographic groups. Here we highlight some of the most notable trends.

Alcohol consumption across the income distribution

There is a link between alcohol consumption and income. Those in the highest income groups in the UK tend to drink more alcohol, on average, than those in the lower income groups. They are less likely to abstain from alcohol consumption; while close to three in 10 (28%) of those with a

personal gross income of less than £10,000 were non-drinkers in 2017, this falls to just 6% among those with a personal income of £40,000 or more.

Those on higher incomes drink more frequently than those on lower incomes. According to Opinions and Lifestyle Survey data from 2017, some 7% of those earning less than £10,000 per year drank on at least five days in the week before they were surveyed. This proportion doubles to 14% when considering those earning £40,000 or more.

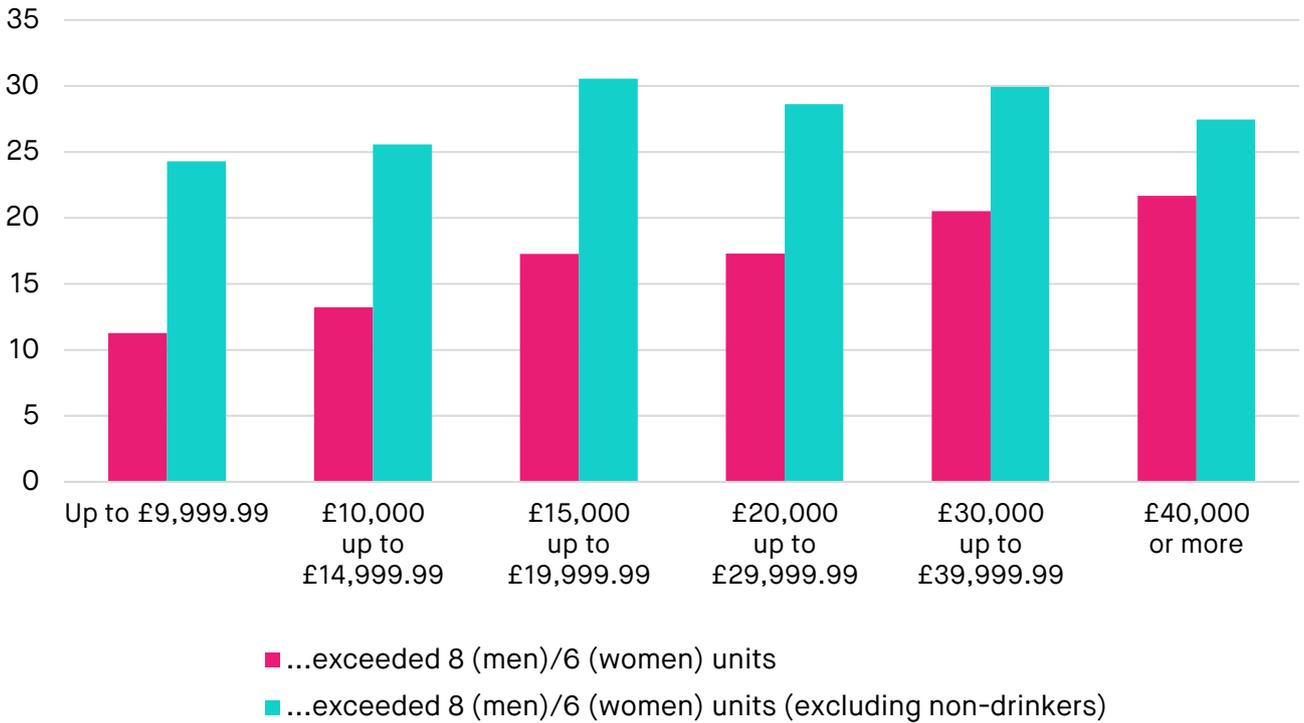
Further, those on higher incomes are more likely to binge drink on their heaviest drinking day – defined here as a man exceeding 8 units of alcohol and a woman exceeding 6 units of alcohol. Over a fifth (22%) of those earning £40,000 or more binge drank on their heaviest drinking day, twice as high at the 11% seen for those earning less than £10,000 per year. The varying prevalence in binge drinking rates largely reflects the greater proportion of non-drinkers in the lower income groups – when just considering drinkers, binge drinking rates peak among those earning between £15,000 and £20,000.

Figure 11 Drinking patterns, by gross annual personal income, proportion of population, 2017, %



Source: ONS Opinions and Lifestyle Survey

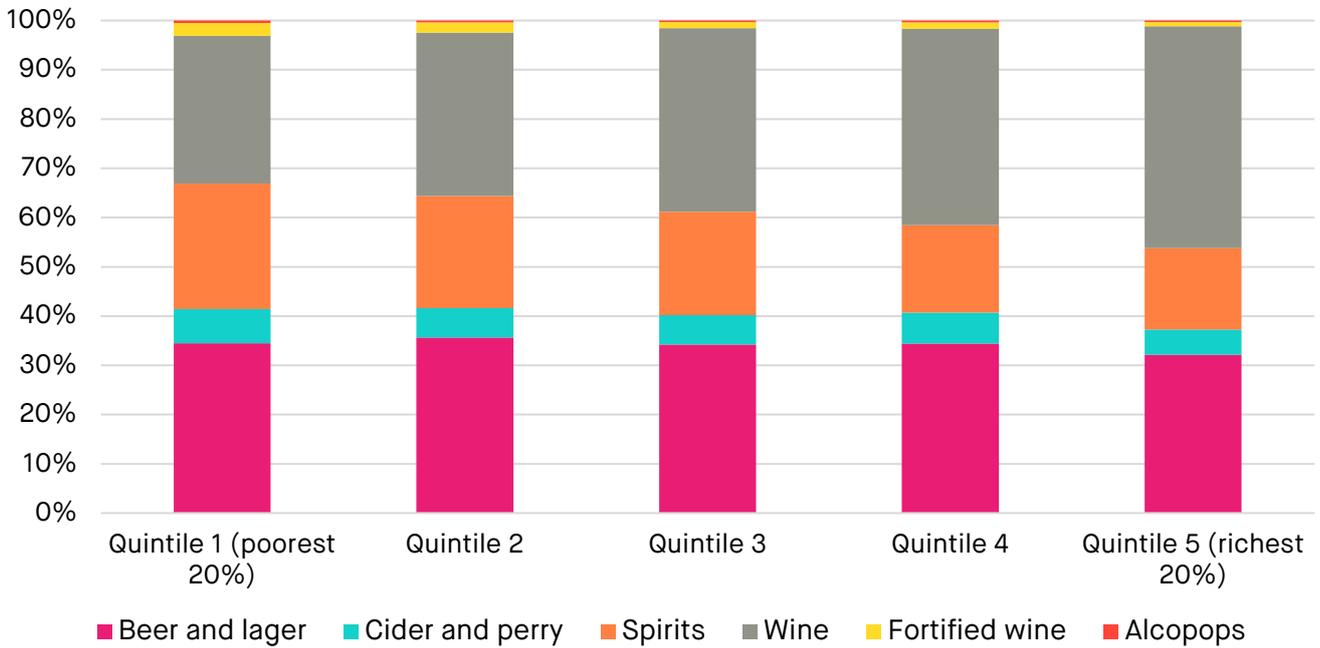
Figure 12 Amount of alcohol consumed on heaviest drinking day, by gross annual personal income, 2017, proportion of population, %



Source: ONS Opinions and Lifestyle Survey

In terms of the type of product consumed, SMF analysis of the Defra Family Food dataset suggests that spirits represent a greater proportion of alcohol purchases (combined on and off-trade purchases) among those in the lowest income quintile. Fortified wine and cider purchases also account for a greater proportion of alcohol consumed by those on lower incomes. Beer and lager consumption accounts for a similar proportion of alcohol consumption across income quintiles, while non-fortified wine consumption increases as a proportion of alcohol purchases with income quintile.

Figure 13 Distribution of pure alcohol consumption by household income quintile, 2015-2016/17



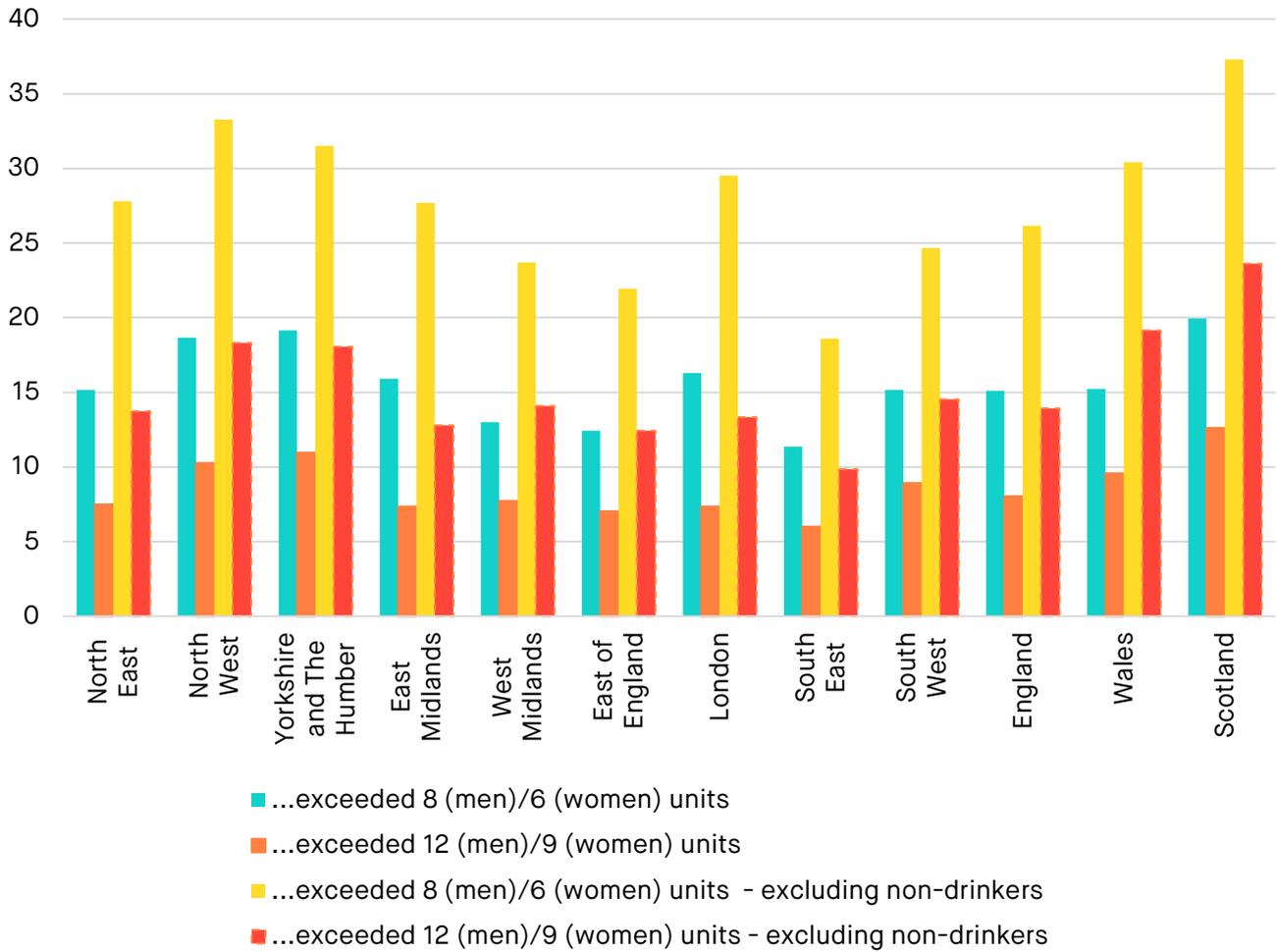
Source: SMF analysis of Defra Family Food dataset

Alcohol consumption by region

There is significant regional variation in levels of alcohol consumption and drinking patterns.

Binge drinking rates are particularly high in Scotland. According to the 2017 Opinions and Lifestyle Survey, 37% of Scottish people aged over 16 or over binge drank in the last week, excluding the 21% of Scots that do not drink at all. Concerningly, about a quarter (24%) drank even more heavily than the standard binge drinking threshold – consuming more than 12 units (men) or 9 units (women) of alcohol on their heaviest drinking day.

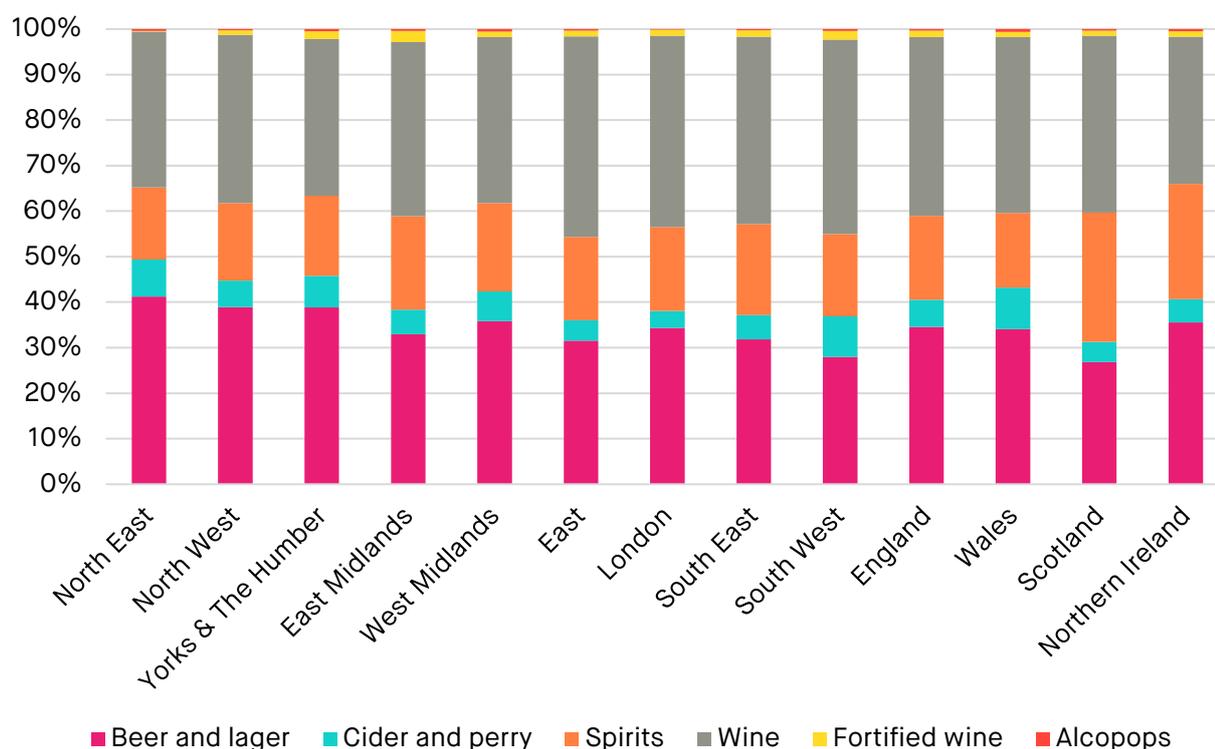
Figure 14 Amount of alcohol consumed on heaviest drinking day, by region, proportion of population, %, 2017



Source: ONS Opinions and Lifestyle Survey

While beer consumption accounts for a relatively high proportion of alcohol consumed in the North East of England, spirits consumption accounts for a relatively high proportion of drinks purchased in Scotland, according to our analysis of the Defra Family Food dataset.

Figure 15 Distribution of pure alcohol consumption by region, 2015-2016/17



Source: SMF analysis of Defra Family Food dataset

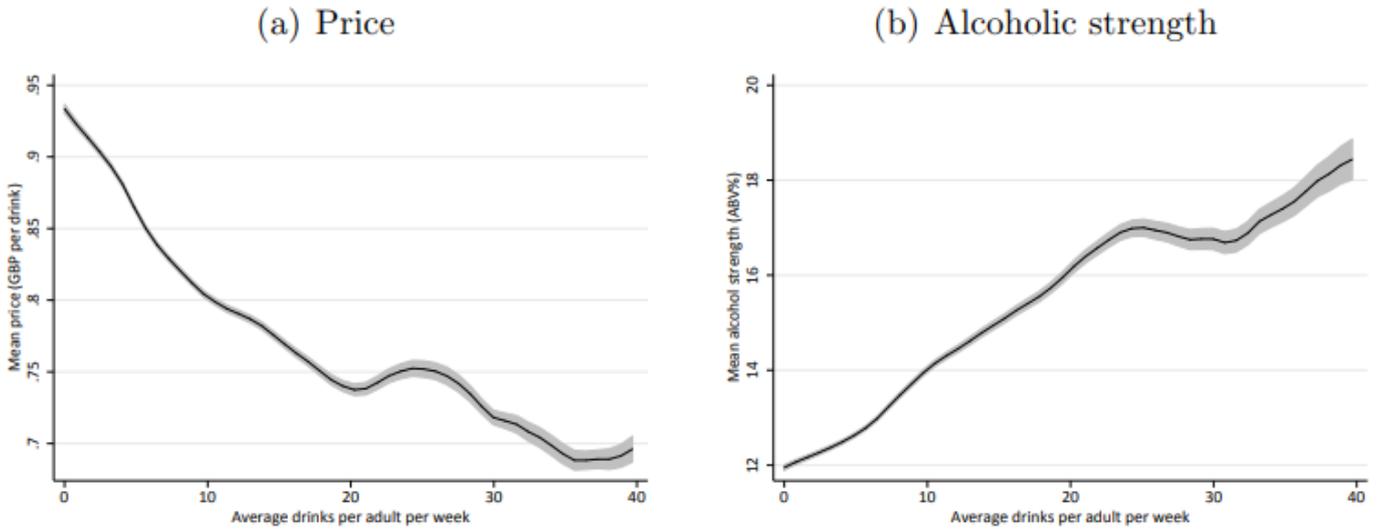
Alcohol consumption by type of drinker

Stating the obvious, levels of alcohol consumption differ across mild, moderate and heavy drinkers. But the extent to which this is the case is, perhaps, underappreciated: analysis by Bhattacharya, Angus et al found that hazardous and harmful drinkers account for a staggering 78% of alcohol consumed in England². This is even though these heavier drinkers account for just a quarter (25%) of the total population¹².

Notably, recent research by the Institute for Fiscal Studies has found the heavier drinkers tend to consume alcohol products that are both cheaper and stronger on average, compared with lighter drinkers¹³. The higher average strength of products consumed reflects differences in type of beverage consumed, with the heaviest drinkers more likely to consume a higher proportion of spirits. It also reflects choice of products within beverage categories – with heavier drinkers more likely to consume higher strength beers and ciders, for example.

² Hazardous drinking defined as 15-35 units of alcohol per week for women, or 15-50 units per week for men. Harmful drinking defined as 36+ units per week for women, or 51+ units per week for men.

Figure 16 Average alcoholic strength and price of products purchased, across the distribution of drinkers

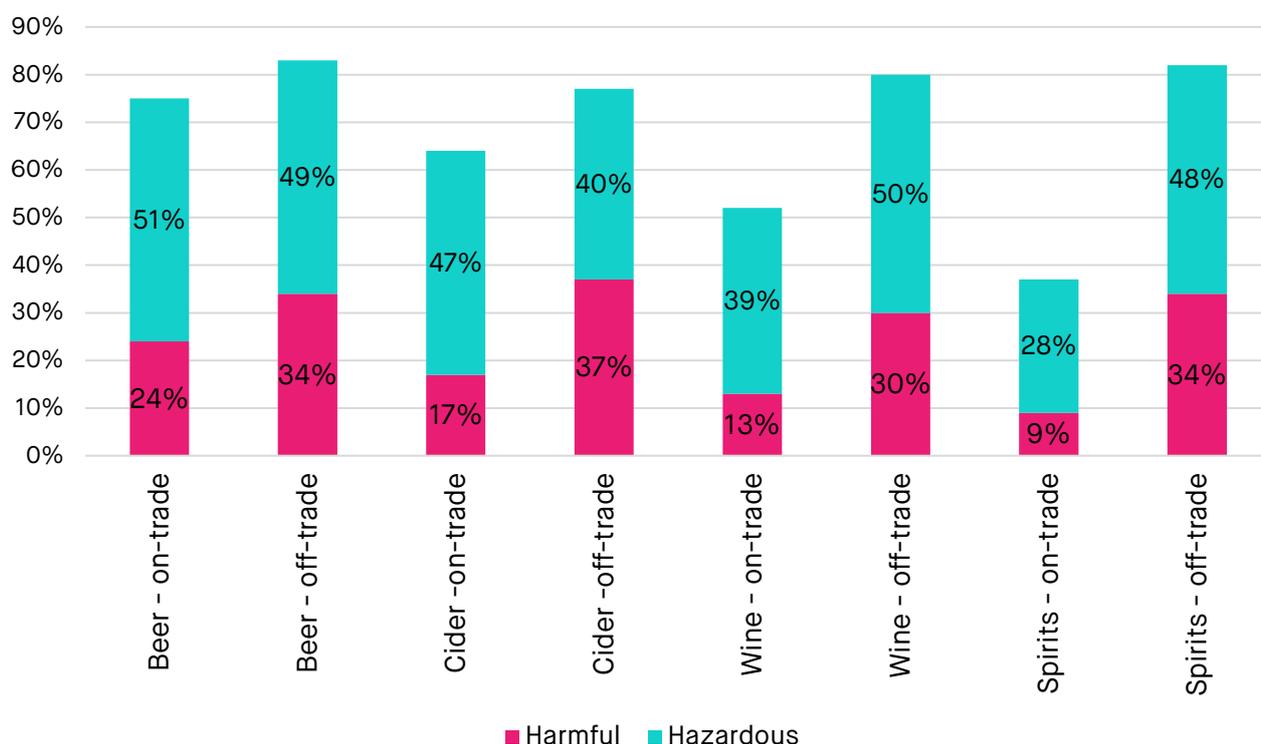


Source: IFS (2017), “Tax Design in the Alcohol Market”

Analysis also suggests that heavy drinking is more concentrated in the off-trade rather than the on-trade. The study by Bhattacharya, Angus et al found that harmful drinkers - the most detrimental level of drinker after “hazardous drinkers”³ - account for 32% of alcohol-related revenue in the off-trade, compared with 17% of revenue in the on-trade. Across all beverage categories, but especially for wine, cider and spirits, harmful and hazardous alcohol consumption is more heavily concentrated in the off-trade.

³ “Hazardous drinking” is defined as 15-35 units of alcohol per week for women, or 15-50 unit of alcohol per week for men. “Harmful drinking” defined as 36+ units per week for women or 51+ units per week for men.

Figure 17 Proportion of revenue from harmful, hazardous and moderate drinkers by beverage types and retailer, 2013/14



Source: Bhattacharya, Angus et al (2018), “How dependent is the alcohol industry on heavy drinking in England?”

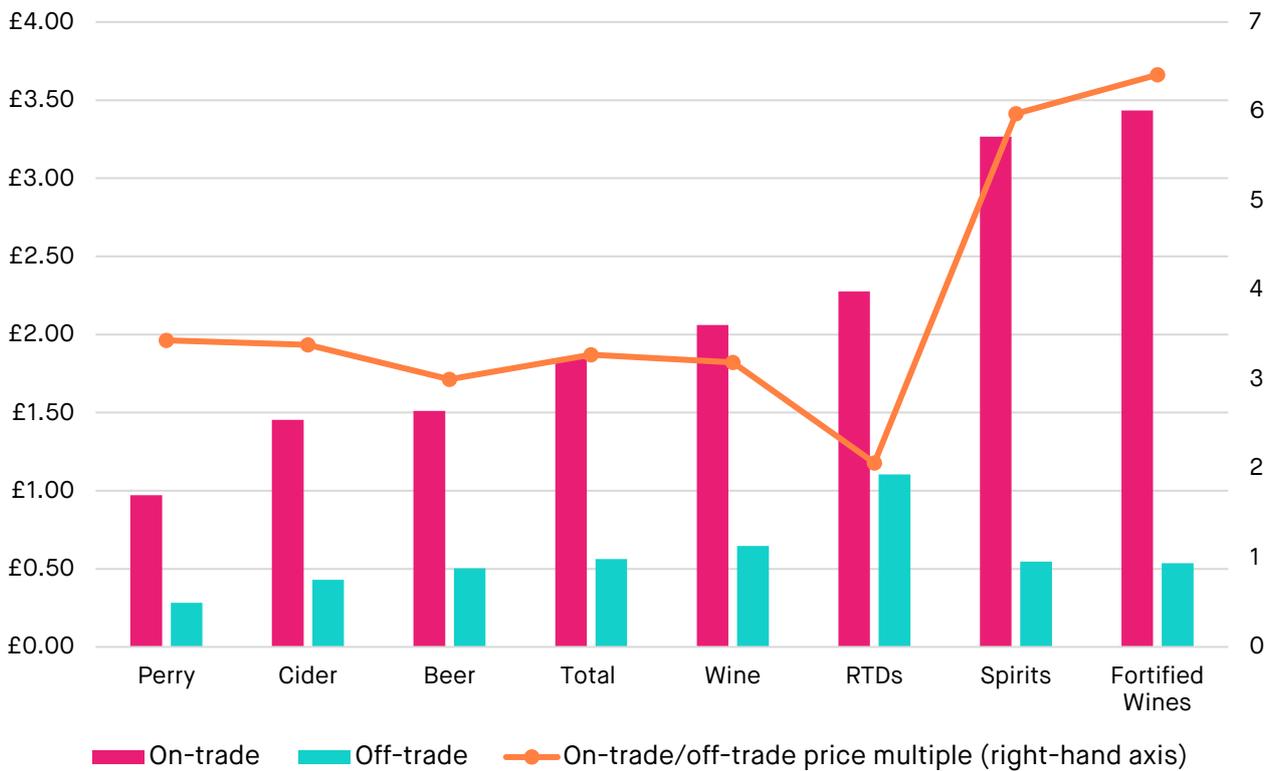
How much do Brits spend on drink and how much does alcohol duty affect prices?

Prices of alcohol vary significantly across product categories and whether consumption is taking place in the on-trade versus the off-trade.

Prices tend to be much higher in the on-trade than the off-trade, though the extent to which this is the case varies across products, as Figure 18 shows. The “on-trade average price premium” is particularly high for spirits and fortified wine, per unit of alcohol. This suggests that spirits and fortified wine consumption in bars, pubs and restaurants is likely to be very different to spirits and fortified wine consumption taking place at home.

A plausible hypothesis here is that on-trade spirits consumption tends to be much more focused on premium products, while off-trade consumption tends to be more focused on lower price, lower quality products. This would also explain the data of Bhattacharya, Angus et al – which showed off-trade spirits consumption being markedly more dependent on heavy drinkers than on-trade spirits consumption; they appear to be very different markets catering to very different types of drinker.

Figure 18 Average price per unit of alcohol in England and Wales, 2018



Source: MESAS monitoring report 2019.

For some products, alcohol duty makes up a significant component of the end-price of alcohol.

In the off-trade, duty accounts for a higher proportion of the consumer price of spirits than for other beverages, at about 60%. One often-cited rationale for taxing spirits at a higher rate than other beverages, mentioned earlier, is that production costs tend to be lower than for beer and cider. In the absence of higher alcohol duty, spirits would be significantly cheaper than beer or cider, per unit of alcohol, in the off-trade.

In the on-trade, we estimate that spirits duty accounts for a lower proportion of the average sale price than is the case for wine and beer – again reflecting the substantially different nature of on-trade versus off-trade spirits consumption – with on-trade consumption tending to be more premium products where production costs are likely to be higher. In addition, “brand price premiums” and marketing are likely to play a role here.

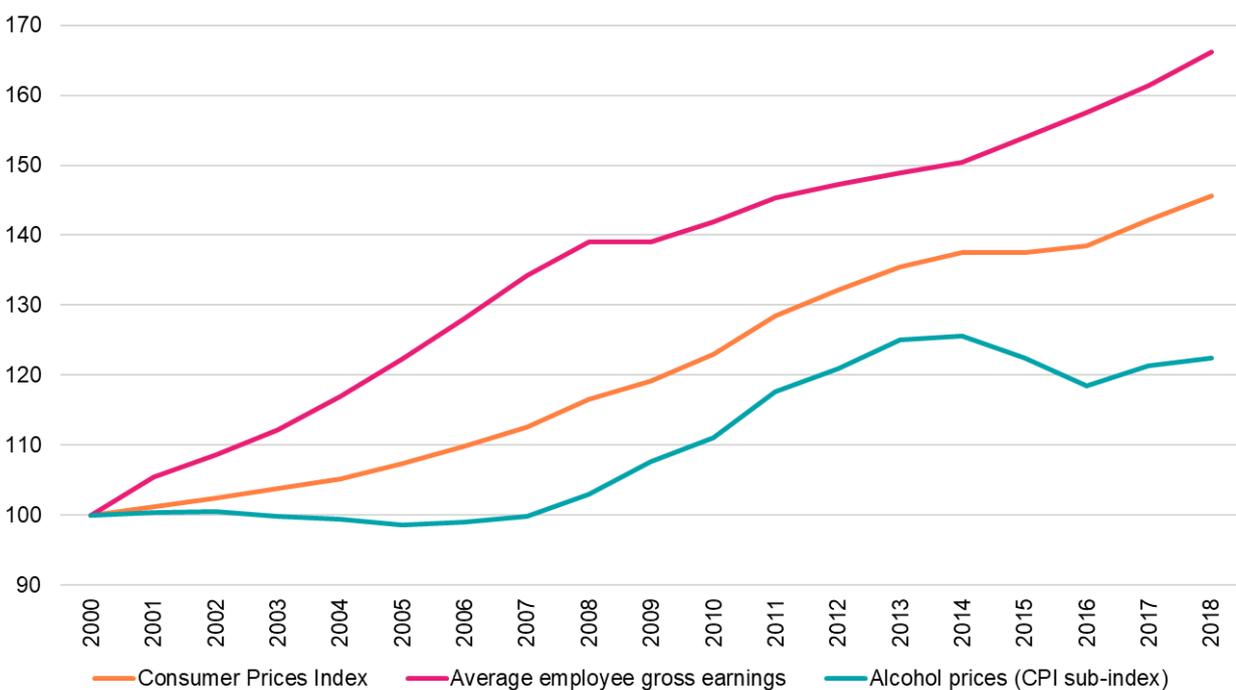
Figure 19 Average price per unit of alcohol in England and Wales, 2018. “Duty” figures include VAT on duty



Source: SMF analysis of MESAS monitoring report 2019.

Compared with the price of other goods in the economy (as measured by headline inflation indices), alcohol has become relatively more affordable over time, as the chart below shows. Furthermore, compared with household incomes, alcohol has become relatively more affordable. This reflects a combination of factors: namely duty rates not being uprated consistently over time, as well as pre-tax drinks prices not increasing as rapidly as other goods in the economy.

Figure 20 Indices of earnings and prices, 2000 = 100



Source: ONS consumer price indices and labour market statistics

Alcohol duty, prices and consumer behaviour

Consumer demand for specific alcoholic beverages is a function of:

1. The price of specific products
2. The price of substitute products
3. Incomes
4. Consumer tastes and preferences

The price and income sensitivity of products are called, in economic terms, the price and income *elasticities* of demand. *Own-price* elasticities of demand relate to how sensitive demand is to changes in the own price of the product, while *cross-price* elasticities of demand relate to how sensitive demand for a product is to changes in the price of other products. For example, the cross-price elasticity of cider with respect to beer refers to how sensitive cider demand is to changes in the price of beer.

A wide range of studies have been produced exploring the price sensitivity of alcohol demand. While, as intuitively expected, such studies tend to show alcohol demand declining in response to price rises, estimates of the extent to which demand falls in response to price changes vary significantly. A literature review by HM Revenue and Customs, for example, showed that estimated own-price elasticities of demand for beer varied from -0.09 (very insensitive to price) to -3.20 (highly sensitive to price). There are also wide variations in estimated demand elasticities for wine and spirits.

Table 1 Range of own price elasticity estimates from UK alcohol studies

Alcohol type	Literature median	Literature mean	Literature range
Beer	-0.44	-0.60	-0.09 to -3.20
Wine	-0.78	-0.86	-0.14 to -2.42
Spirits	-0.72	-0.75	-0.08 to -1.60

Source: HMRC Working Paper 16

We note, from our roundtable discussions with both industry and health experts, that the issue of price sensitivity of alcohol demand is a significant source of contention. Several experts we spoke to within the alcohol industry, and alcohol trade bodies, felt that government analysis often *understated* the extent to which demand for alcohol is price sensitive. Disputation over the veracity of elasticities assumed by policymakers is thus a key part of the debate around alcohol taxation.

One issue in the debate around elasticities of demand is widespread misunderstanding of how to interpret elasticities. Critically, price elasticities of demand refer to the expected demand response to *marginal* price changes, rather than substantial price changes. They might not tell us much about how demand will respond to significant changes to the duty system. There is no reason why the elasticity of demand should be constant for a product, at every price level.

Another consideration is that elasticities also vary significantly across different types of drinker. Evidence suggests that heavy drinkers and those with alcohol-dependence issues tend to be less price sensitive than other types of drinker¹⁴ - at least in terms of overall alcohol consumption.

For a particular type of beverage, they might be more price sensitive, switching to other types of alcoholic drink in the event of price rises.

A range of studies suggest that, overall, alcohol taxation can curb excessive consumption and generate improved health and other social outcomes. The Alcohol Policy Model developed by academics at the University of Sheffield has estimated, for example, that a 10% increase in all alcohol taxes would reduce annual alcohol-attributable deaths by 2.9%¹⁵. The World Health Organisation argues that “an increase in excise taxes on alcoholic beverages is a proven measure to reduce harmful use of alcohol and it provides governments with revenue to offset the economic costs of harmful use of alcohol”¹⁶.

Evidence from countries that have drastically altered alcohol taxation also provide “natural experiments” into the links between excise duty, alcohol consumption and alcohol-related harms. In 2004, Finland reduced spirits, beer and wine taxation by 44%, 32% and 10% respectively. Alcohol consumption increased 10% in 2004. With few exceptions, alcohol-related harms increased. Alcohol-induced liver disease deaths increased the most, by 46% in 2004-06 compared to 2001-03, which indicates a strong effect on pre-2004 heavy drinkers. Consumption and harms increased most among middle-aged and older segments of the population, and harms in the worst-off parts of the population in particular¹⁷.

Is alcohol duty “regressive”?

One common feature of the debate around alcohol duty (and indeed other “sin taxes” such as tobacco duty), are arguments around the distributional consequences of such taxes. Those calling for lower or frozen rates of duty often argue that taxes such as alcohol duty are regressive – disproportionately affecting those on lower incomes. This is a position advanced by the free market think tank the Institute of Economic Affairs, for example¹⁸.

Yet the notion that alcohol duty is regressive is questionable. A 2011 report by the Institute for Fiscal Studies argued that, “if anything, [alcohol price rises are] broadly progressive [in response to a 5% increase in prices]: the worse-off households lose around 0.1% of their budget on average compared to almost 0.2% for those further up the expenditure distribution”¹⁹.

Even if alcohol duty is regressive, it might be justifiable (to some) on public health grounds. Some might point to the substantial health inequalities which exist in the UK and argue that higher rates of alcohol duty are a price worth paying to address this, if they lead to lower rates of consumption and improved health outcomes. As we discuss in the health chapter of this report, evidence suggests that alcohol consumption might be more damaging, on average, to low income consumers. This is in part because alcohol-related harms appear to be *multiplicative*, having even greater impact when combined with other lifestyle factors such as smoking and poor diet – which tend to be more prevalent among lower income households. As we touch on later, there is growing discussion among policymakers around the extent to which lifestyle choices – such as smoking or drinking excessively – are “freely” made. Evidence suggests that the stress of being on a low income and under financial pressure can drive irrational choices which individuals would not countenance under more fortuitous circumstances.

Another point worth noting – which is often left out of public discussions around policy – is that even if one cares strongly about distributional outcomes, a regressive policy measure might still be desirable if it leads to other benefits, such as a more efficient tax system or improved health

and social outcomes. Financial inequalities are probably better dealt with through benefits or general taxation reforms rather than through “sin taxes”. In that sense, the distributional arguments around sin taxes, and indeed many other policies, are something of a red herring. As the Institute for Fiscal Studies has argued:

“A common objection to the use of excise duties as corrective taxes is that they are regressive. However, this does not provide a strong argument against setting rates to fully correct externalities and internalities. What matters for meeting distributive goals is the distributional impact of the tax and benefit system as a whole, not the progressivity or regressivity of any single tax. In general, policymakers should seek to meet distributive goals through adjustments to the income tax and benefit system, and should primarily focus excise taxes on targeting market failures. Of course, understanding the distributional impact of excise taxes can be important in determining how to adjust other aspects of the tax and benefit system to offset excise tax reforms that on their own would be regressive.”²⁰

Summary

This chapter has examined, in detail, trends in alcohol consumption across the UK. It identifies several important trends:

- Alcohol consumption, per capita, remains much higher than in the 1960s, despite declining from a peak in 2004. Recent years have shown alcohol consumption starting to rise again.
- There has been a trend over time towards consuming higher strength products, with consumers shifting away from beer and towards wine and spirits.
- Higher income groups tend to consume more alcohol.
- There are significant regional variations in alcohol consumption, with spirits accounting for a higher proportion of all alcohol consumed in Scotland. Scots are also more likely to binge drink.
- Heavy drinkers account for the overwhelming majority of all alcohol consumed in the United Kingdom.
- Heavy drinkers are more likely to consume high strength products and consume relatively more alcohol in the off-trade.
- Alcohol demand tends to decline as prices rise, though estimates of the degree of price sensitivity vary significantly.
- Alcohol duty accounts for a substantial portion of the price consumers face in the off-trade.
- Spirits consumption in the on-trade appears to be markedly different than consumption in the off-trade, with the on-trade market more geared towards premium products.

6. ALCOHOL DUTY, HEALTH AND SOCIETY

As we have discussed, beyond being a source of additional revenue for the Exchequer, a key motivation for alcohol taxation is the need to address the *externalities* generated by alcohol consumption. In economic terms, an externality refers to a cost that is not properly reflected in the market price of a good or a service. This occurs when an individual's consumption of a product has wider social implications – the cost of the product reflects the value the individual places on it, and manufacturing costs but not the costs that wider society bears as a result of its consumption.

The taxation of motor fuel, for example, reflects the need to better ensure that costs associated with pollution and congestion are reflected in the prices that motorists pay for petrol and diesel. In the case of alcohol consumption, taxation should, in theory, cover alcohol-related externalities, such as:

- Alcohol-related crime
- Costs to the National Health Service associated with alcohol consumption
- Other social costs such as family breakdown.

This chapter of the report provides an overview of the externalities associated with alcohol consumption.

Health impacts

A mixed evidence base on mild-to-moderate alcohol consumption...

Understanding the health outcomes associated with alcohol consumption presents several statistical challenges. One is the fact that non-drinkers often have very different characteristics to drinkers; for example, many suffer a health condition which is at least part of the reason for them not drinking. Given this, it makes it difficult to make an “apples with apples” comparison between drinkers and non-drinkers.

Another challenge in understanding the health impacts of alcohol consumption is the quality of the data – including potential under or overreporting in survey datasets. Furthermore, data on alcohol expenditure over a time period might not be fully indicative of personal levels of alcohol consumption over the same time period. Someone might buy a bottle of whisky as a gift for someone else, for example. Consumption of a bottle of whisky might be spread over the course of a year or several years, rather than shortly after purchase. The extent to which individuals binge drink or spread their alcohol consumption across the week is also likely to have an impact on health outcomes, as are other behaviours that individuals engage in. As we discuss in this chapter, there is evidence suggesting that alcohol-related harms multiply when combined with other behaviours such as smoking or having a poor diet – further complicating the relationship between consumption and health outcomes.

There are also likely to be challenges in identifying, with certainty, alcohol-related deaths. While some diseases such as liver cirrhosis might be easily attributable to alcohol consumption, others (such as breast cancer) might be more difficult to link to an individual's drinking patterns.

A reasonable summary of the health impacts of alcohol consumption is that the evidence base is mixed for mild-to-moderate consumption, while there is clear, indisputable evidence that heavy drinking is injurious to health.

On mild-to-moderate consumption, some of the most widely publicised studies in recent decades on alcohol and health have pointed to benefits – including lower rates of heart disease from drinking red wine. However, the British Heart Foundation notes that the relationship between wine and health is a complicated one:

“There is some evidence that a moderate intake of alcohol brings a small reduction in heart disease risk. But this is not the case for other conditions, such as stroke and vascular dementia, and alcohol is linked to some cancers.” – British Heart Foundation website

A widely publicised 2018 study, published in the Lancet, argued that there was “no safe level” of alcohol consumption, stating that “the level of consumption that minimises health loss is zero”²¹ However, this conclusion is debatable. For example, David Spiegelhalter, a statistician at the University of Cambridge, noted that this conclusion exaggerates the risks to mild drinkers, which he describes as “very low risk”²². Further, Spiegelhalter noted that another article published in the Lancet earlier in 2018 showed worse health outcomes for those that do not drink at all, compared to those that drink modest amounts of alcohol²³. This is likely to reflect differences in data and modelling used between the two studies, in addition to the different health outcome measures adopted.

Although mixed, there appears to be a general trend in the evidence base on alcohol consumption – away from studies pointing to potential benefits from consumption towards studies suggesting limited benefits and potential harms from even moderate consumption. In the Chief Medical Officers’ (CMOs’) 2016 Alcohol Guidelines Review, it was noted that the “evidence supporting protective effects today is now weaker than it was at the time of the [Department for Health] 1995 [Sensible Drinking] report and there are substantial uncertainties around direct attribution to alcohol of the level of protection still observed”²⁴.

In examining how the evidence on regular drinking has changed since 1995, the CMOs’ guidelines noted that “there is much more evidence on the link between alcohol and cancer – alcohol is now recognised as a cause of certain cancers by the International Agency for Research on Cancer”. Given this, the CMOs’ guidelines argue for a more cautious approach to even mild and moderate levels of alcohol consumption:

“A consequence of [the evidence on alcohol and cancer] is that drinking any amount of alcohol regularly can cause harm; the risks of cancer for most people are present even at a low level of consumption, but are lower if drinking is within the proposed weekly guidelines levels”.

... but clear health-related harms among heavy drinkers

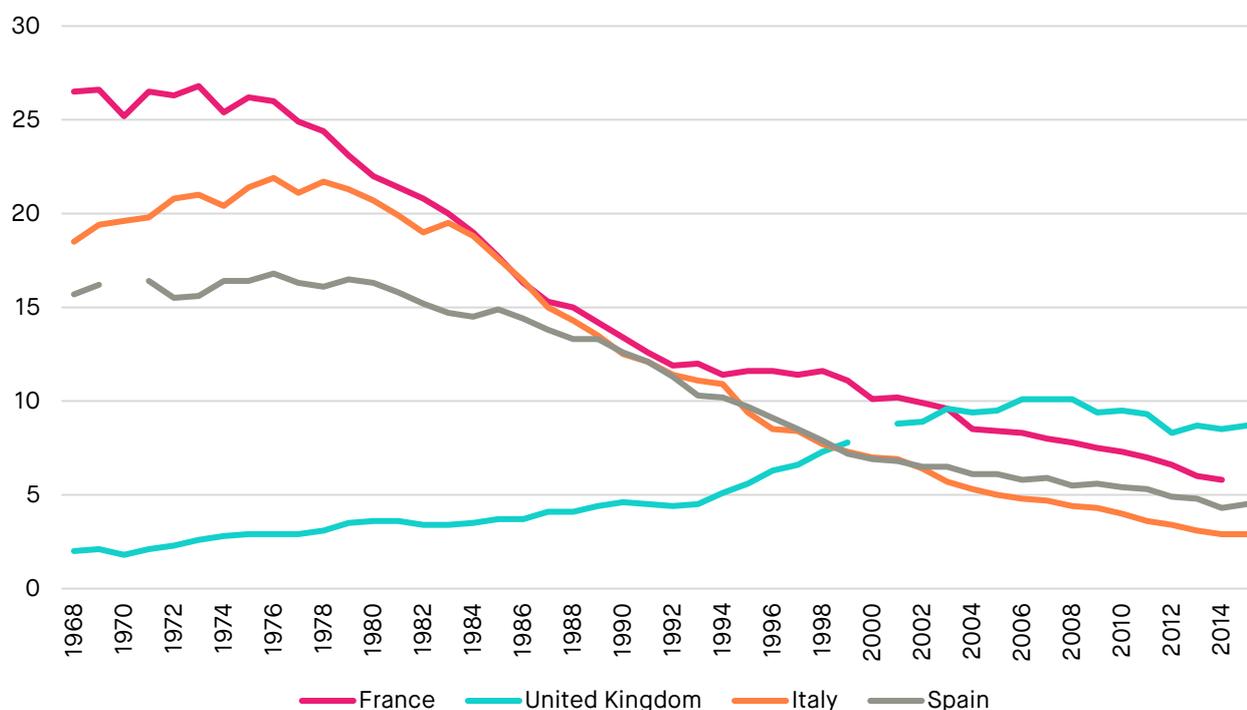
While the evidence on mild-to-moderate alcohol consumption and health is relatively mixed, it is clear the heavy drinking is associated with a range of health problems – including heart disease, cancer and liver disease. Any benefits from alcohol consumption are negated beyond a certain level of consumption; the CMOs’ Alcohol Guidelines Review noted that any cardio-protective effects of moderate alcohol consumption are cancelled out by irregular heavy drinking occasions mixed with low-to-moderate consumption, for example²⁵.

According to NHS data, there were 5,843 alcohol-specific deaths in England in 2017, 16% higher than a decade earlier. This is despite a decline in per capita alcohol consumption over this period, highlighting some of the complexities in linking aggregate alcohol consumption data to health and mortality data²⁶. Ultimately, the distribution of drinking across the population matters.

Alcoholic liver disease accounted for 80% of the 5,843 alcohol-specific deaths. A further 9% were from mental and behavioural disorders due to the use of alcohol.

Long-term time series data from the World Health Organisation highlights the dramatic increase in liver disease in the UK in recent decades, reflecting higher rates of alcohol consumption. While in the 1960s the UK had a much lower rate of liver disease and cirrhosis deaths than other European countries such as France, Spain and Italy – the UK now has a higher rate of deaths. While these countries have seen death rates decline dramatically since the 1960s, they have increased sharply in the UK.

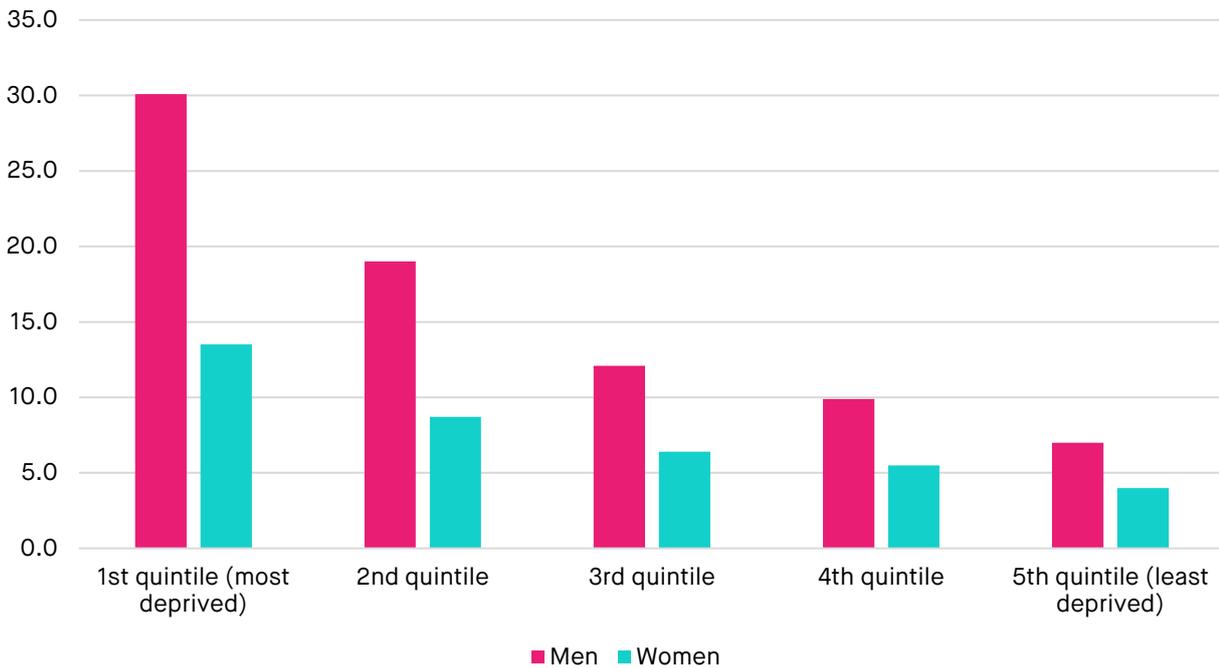
Figure 21 Age-standardised liver disease and cirrhosis death rates, per 100,000, aged 0-64, 1968-2015



Source: WHO European HPA Database

Alcohol and health inequalities

Alcohol-related deaths are concentrated heavily in deprived areas of the United Kingdom. According to ONS data, alcohol-specific death rates among men in the most deprived quintile of the population (as measured by the Index of Multiple Deprivation), are 4.3 times higher than for men in the least deprived quintile. For women, age-standardised death rates are 3.4 times higher. There is a growing public debate around the substantial and widening health inequalities that exist in the UK – and alcohol-related harms appear to be contributing to these health inequalities.

Figure 22 Age-standardised alcohol-specific death rates, per 100,000, by deprivation quintile, 2017

Source: ONS

The concentration of alcohol-specific deaths in deprived areas presents something of a paradox, given that (as we discussed in the previous chapter) alcohol consumption tends to increase with personal incomes. Indeed, this disparity is referred to as the “Alcohol Harm Paradox”²⁷. Potential explanations for the Paradox include:

1. High income earners being more likely to offset the negative impact of alcohol with better lifestyle choices in other areas in terms of health outcomes – for example by exercising and eating a relatively healthy diet.²⁸
2. Low-income earners making worse lifestyle decisions that exacerbate alcohol-related problems such as smoking and poor diet²⁹. Such lifestyle decisions might reflect the stress and other negative effects associated with being on a low income and under financial pressure.
3. Data quality issues – high income earners could have issues exacerbated or caused by alcohol consumption, but negative outcomes not registered as alcohol-related³⁰
4. High income earners are more likely to be receiving more regular, better quality healthcare.
5. Heterogeneity in type/strength of alcohol consumed (as shown in SMF analysis in the preceding chapter).
6. Experiencing poverty may impact on health, not only through leading an unhealthy lifestyle but also as a direct consequence of poor material circumstances and psychosocial stresses.³¹ Poverty may therefore reduce resilience to disease, predisposing people to greater health harms of alcohol.
7. Regional variations in drinking culture (as shown in SMF analysis in the preceding chapter).
8. A weaker social support network among people of in deprived areas (lack of “social capital”).

9. Extremely heavy drinking, at the tail end of the distribution of alcohol consumption, being more concentrated among lower income households. For example, data for Scotland show that average alcohol consumption among those exceeding weekly guidelines is higher among those on lower incomes³². That is to say, while a smaller proportion of low income households exceed weekly alcohol consumption guidelines, those that do on average consume more compared to higher income heavy drinkers.

Recent attempts to explain the causes of the Alcohol Harm Paradox suggest that interactions with other health challenging behaviours such as smoking, excess weight and poor diet/exercise have an important role to play. However, to date there is no comprehensive explanation – highlighting the need for further research on this topic.

Other impacts

Beyond health-related externalities, excessive alcohol consumption generates a range of other social externalities. This includes crime and family breakdown, and accidents causing deaths to other people.

For example, in 2016/17 in England and Wales, 12.4% of theft offences, 20.6% of criminal damage and 21.5% of hate crimes were alcohol-related. This rises to 35.8% for sexual assault cases. Offenders were believed to be under the influence of alcohol in 39% of all violent incidents. Across Great Britain, there were 9,040 drink-drive casualties and 6,070 drink-drive accidents³³.

A recent Public Health England report, drawing on a wide range of survey evidence from across the globe, drew attention to the link between alcohol consumption and family breakdown. This includes intimate partners having to leave home due to a person's drinking or having to end the relationship with the drinker due to their alcohol consumption³⁴.

Monetising the social costs of alcohol

A small number of studies have attempted to quantify, in monetary terms, the total social externalities generated by excessive alcohol consumption. In addition to the financial costs to government from increased demand on NHS and police resources, these studies sometimes attempt to monetise less tangible costs – such as reduced health quality, grief and informal care costs for families.

A recent Public Health England report, summarising the evidence base on alcohol-related harm, set out three major categories for harm³⁵:

1. **The direct economic costs of alcohol consumption**, such as health and social care, the police and criminal justice, and unemployment and welfare systems.
2. **The indirect costs of alcohol consumption**, such as lost productivity, unemployment, reduced earnings potential and lost working years due to premature pension or death.
3. **The intangible costs of alcohol consumption**, such as pain, suffering, poor quality of life and costs from money spent on alcohol in families where money should be spent on other things.

Direct costs of alcohol abuse are typically borne by government, whereas indirect costs tend to be borne by society at large and intangible costs by drinkers, their families and their associates. The distribution of the burden of alcohol-related costs has important implications for how alcohol should be taxed, as we discuss later in this report.

A cross country study by Rehm et al estimated the total costs of alcohol to be 2.5% of GDP in 2007, equivalent to £47 billion in 2016. 72% of these costs were indirect costs. 13% were health costs and 12% were other direct costs³⁶.

A widely-quoted study by the Cabinet Office estimated the economic costs of alcohol in England at £21bn in 2012 – equivalent to 1.3% of GDP. This estimate took account of alcohol-related health disorders and disease, crime and antisocial behaviour, loss of productivity in the workplace and problems for those who misuse alcohol and their families, including domestic violence.

As Public Health England, in their summary of the evidence base, note, few studies in the existing research report costs on the magnitude of harm to people other than the drinker, such as crime, violence and to the developing foetus in the case of pregnant women. Given this, published estimates might underestimate the scale of alcohol-related harms.

Overall, there are limited estimates to the total costs of alcohol consumption to society. Many of the figures used in the public debate on this are dated, as well as being sensitive to assumptions. There is a need for more up to date and accurate data on the costs of alcohol consumption, particularly given the scale of these costs should have a bearing on the overall rate of alcohol taxation, as we discuss below.

Implications for alcohol taxation

From a health perspective, alcohol policy should aim, particularly, to curb heavy consumption of alcohol (or at least ensure that heavy drinkers pay for the externalities they generate) – as this is where the evidence, indisputably, shows strong negative health and other social outcomes. Evidence on the health impacts of low-to-moderate consumption compared with total abstinence from alcohol are more mixed - though of course this might change in the future as evidence bases continue to develop. There has been a general trend in the evidence base on alcohol consumption towards studies casting doubt on health benefits of moderate consumption, and increased evidence of risks from moderate consumption such as higher rates of cancer.

Given that, as we showed earlier, heavy drinkers are more likely to consume cheaper and higher strength products, there is a case, from a public health perspective, for focusing taxation and other policy tools on these types of drink. Further, we note that heavy drinking is more concentrated in off-trade rather than on-trade consumption, suggesting duty should be more focused on off-trade consumption too.

A particular concern with spirits, given their strength, is that it is relatively easy to consume excessive amounts of alcohol rapidly. This might explain some of the links between product strength, levels of consumption and alcohol related harms. However, the evidence base on the extent to which spirits are or are not inherently more harmful than other drinks appears limited – there is scope for more research on this topic.

Given that alcohol consumption generates externalities – impacting government, families and other individuals as well as the direct consumers of alcohol – the overall rate of alcohol taxation should be reflective of the size of these externalities.

7. ALCOHOL DUTY, JOBS AND THE ECONOMY

One of the most widely-used justifications for changes in alcohol duty policy – particularly freezes and cuts to duty – is the need to support jobs in alcohol related industries. This includes direct employment in alcoholic beverage production, as well as employment in pubs, bars and the hospitality sector more broadly. Others point to jobs along the supply chain, which are supported by the production of alcoholic beverages.

One issue with the political discourse around jobs and alcohol production is the tendency of the debate to focus on employment in a particular industry rather than consider an economy-wide perspective. Given the health costs of excessive alcohol consumption, jobs are lost, as well as created, through production of alcoholic drinks. Further, productivity losses associated with excessive consumption – from hangovers to more serious health conditions – have a negative impact of economic outcomes, including jobs.

We need a more nuanced public debate on alcohol consumption and jobs which acknowledges this relatively complicated picture and considers the economy-wide impact on employment – both at a country and regional level. We also need to acknowledge the dynamic nature of the economy; job losses at a point in time are often replaced with jobs created elsewhere or within the same industry. A tax policy that leads to job losses in the production of “high harm” beverages might have a negative impact on jobs in the short run, but a positive impact on jobs in the medium-to-long run – as those that lose their jobs find work elsewhere, and as health benefits lead to improved rates of employment among heavy drinkers. Further, we would expect some producers of “high harm” beverages such as strong white ciders, to perhaps move into other, less harmful product markets (such as lower strength cider) rather than sack workers following a tax rise.

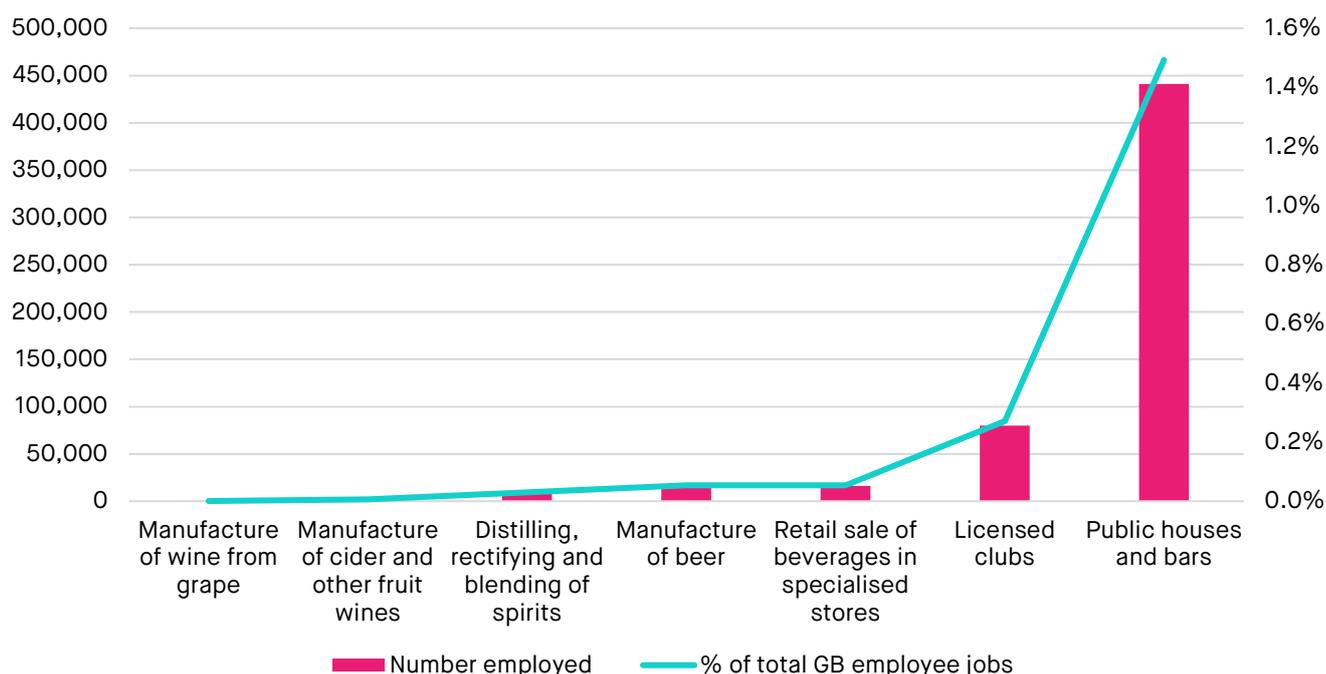
This chapter explores the link between alcohol consumption, jobs and the economy in more detail – testing the extent to which common jobs-related arguments stand up to scrutiny.

How many jobs are directly supported by the alcohol industry?

According to the Business Register and Employment Survey, there were 27,000 workers directly employed in the manufacture of spirits, wine, cider and beer in Great Britain in 2017 – 0.1% of total employee jobs. Of this, over half (16,000) was employment in the manufacture of beer. Spirits was the next largest employer, with 9,000 directly employed in production. Despite having a great deal of prominence in the public debate around alcohol duty, and having by far the most favourable duty status of all beverages, cider production directly employs just 2,000 workers in Britain.

A greater number of people are employed in public houses, clubs and bars – 521,000 people in 2017 and 1.8% of all employee jobs in Great Britain. 16,000 were employed in retail outlets where the sale of beverages dominates (such as off-licences) and 441,000 were employed in licensed restaurants. It would be incorrect to say that employment in pubs, bars and restaurants is entirely dependent on alcohol consumption, given that revenue is also generated from food and non-alcoholic drinks. Indeed, pubs have become increasingly dependent on food as a source of revenue in recent decades.

Figure 23 Number of individuals employed in industry, and % of total GB employee jobs, 2017



Source: Business Register and Employment Survey

Industry figures often report on the “wider economic impact” of alcohol production. This includes jobs supported along supply chains, and also jobs supported by the spending power of employees in the alcohol industry – what economists refer to, respectively, as “indirect” and “induced” economic impacts. The Wine and Spirits Trade Association 2017 Market Overview states that wine and spirits directly and indirectly support 554,000 jobs³⁷. A study by Oxford Economics for the British Beer and Pub Association found that, in 2009/10, beer and pub activity supported just under a million jobs, including indirect and induced employment impacts³⁸.

With respect to cider, close links to apple farming are noted; about half of all apples produced in Great Britain go into the manufacture of cider³⁹. According to the National Association of Cider Makers, the industry supports 11,000 jobs⁴⁰.

What is the regional distribution of this employment?

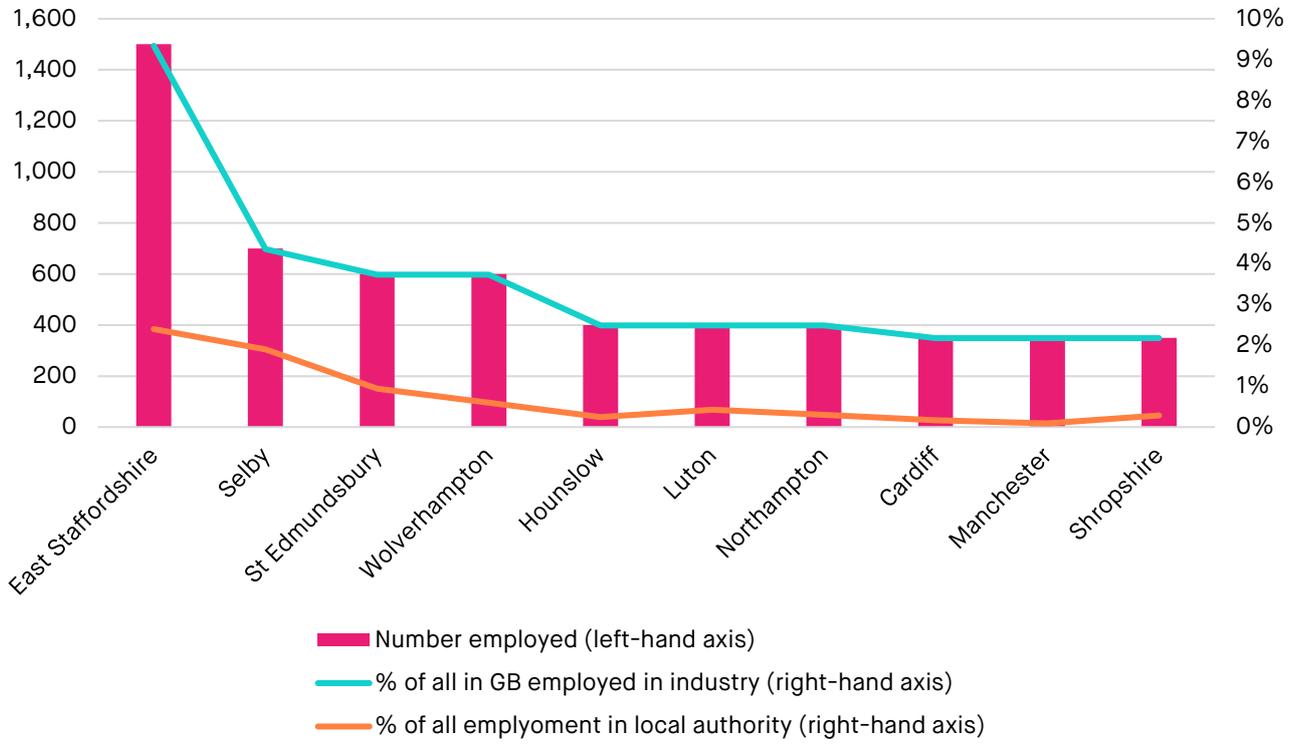
The current alcohol duty regime is often defended on the grounds of the need to protect jobs in parts of the country where other sources of employment are scarce. Such arguments are particularly strongly used with respect to cider and spirits duty.

It is indeed true that employment in these industries has a strong regional focus, as the graphs below examining employee jobs by local authority show. About 40% of direct employment in cider & perry production in Great Britain is in Herefordshire. Employment in spirits production is also concentrated in Scottish local authorities.

Yet, despite this regional concentration of employment in alcohol production, it is important to put this into perspective – looking at alcoholic beverage production as a share of *total* employment in an area. In Herefordshire, just 1.0% of jobs were in cider & perry production in

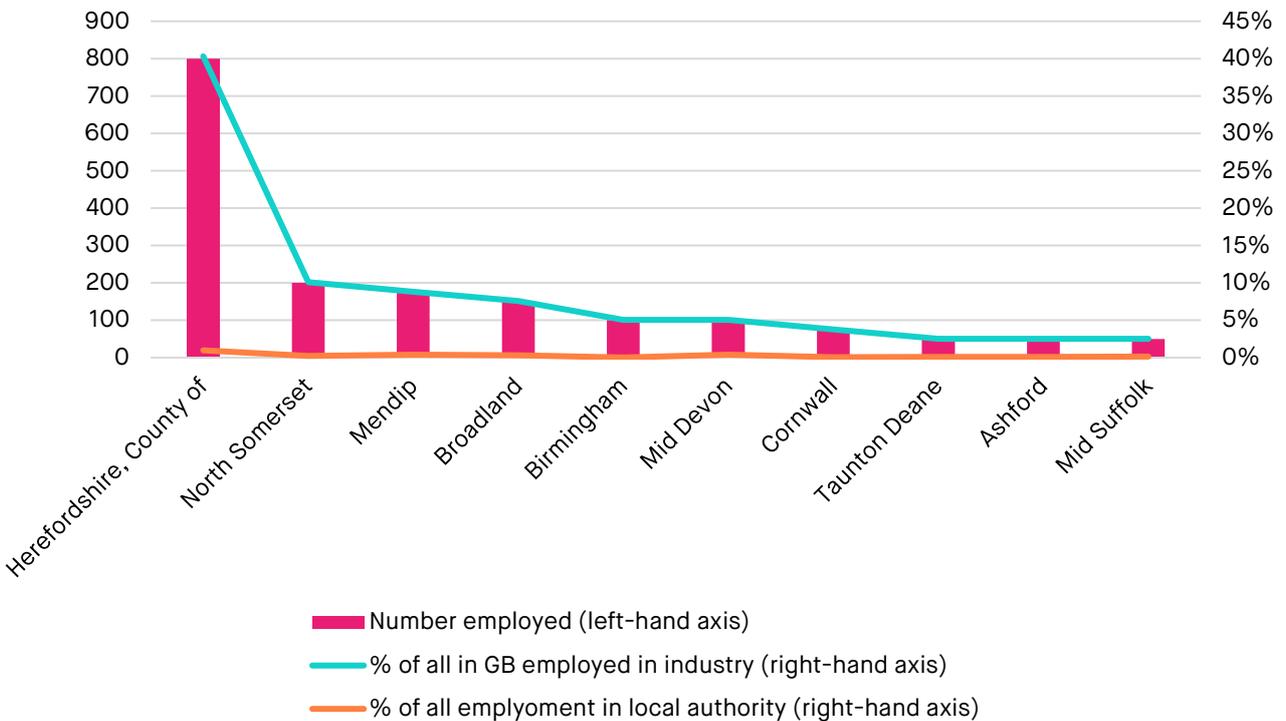
2017 – hardly suggestive of an economy that would be devastated if some jobs were lost in cider employment (for example, following a tax move which forces low quality, low cost, high strength ciders out of the market).

Figure 24 Employment in beer production – top 10 local authorities



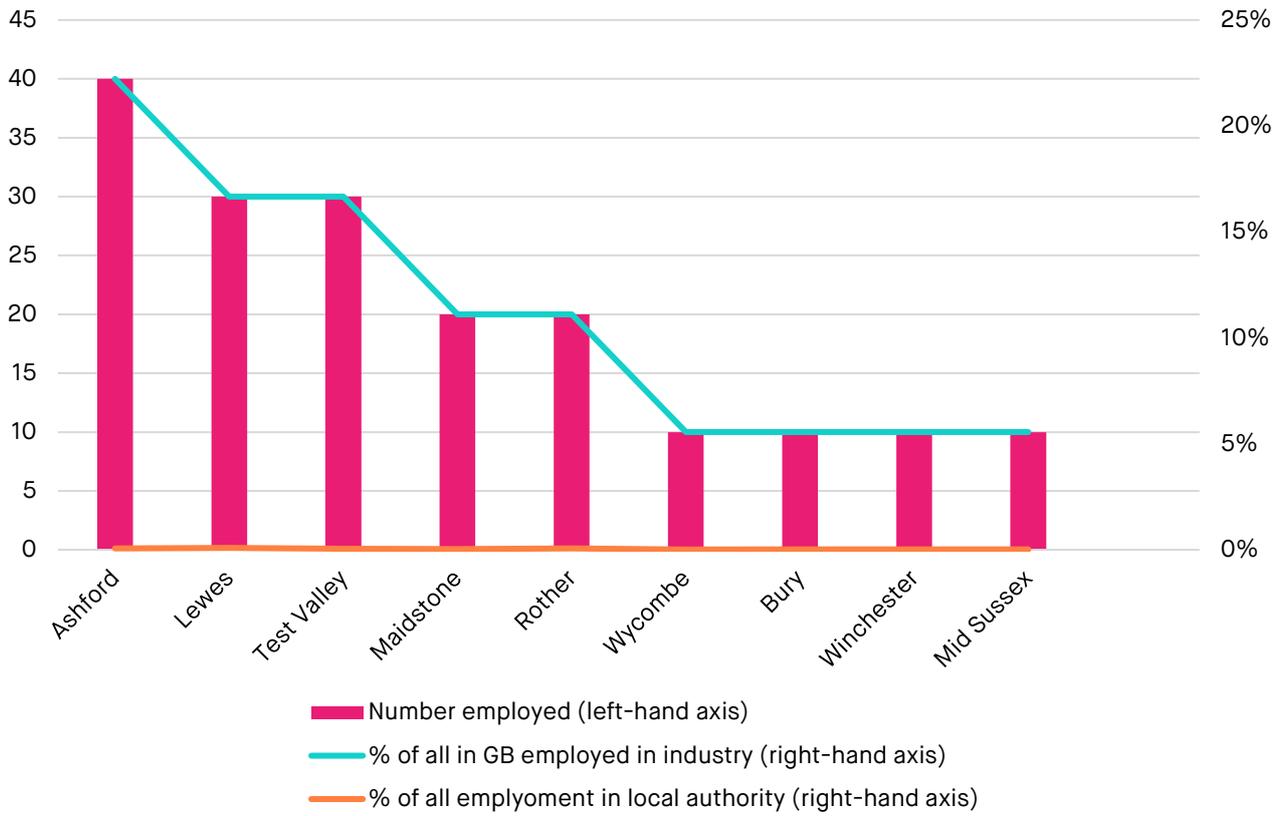
Source: Business Register and Employment Survey

Figure 25 Employment in cider and perry production – top 10 local authorities



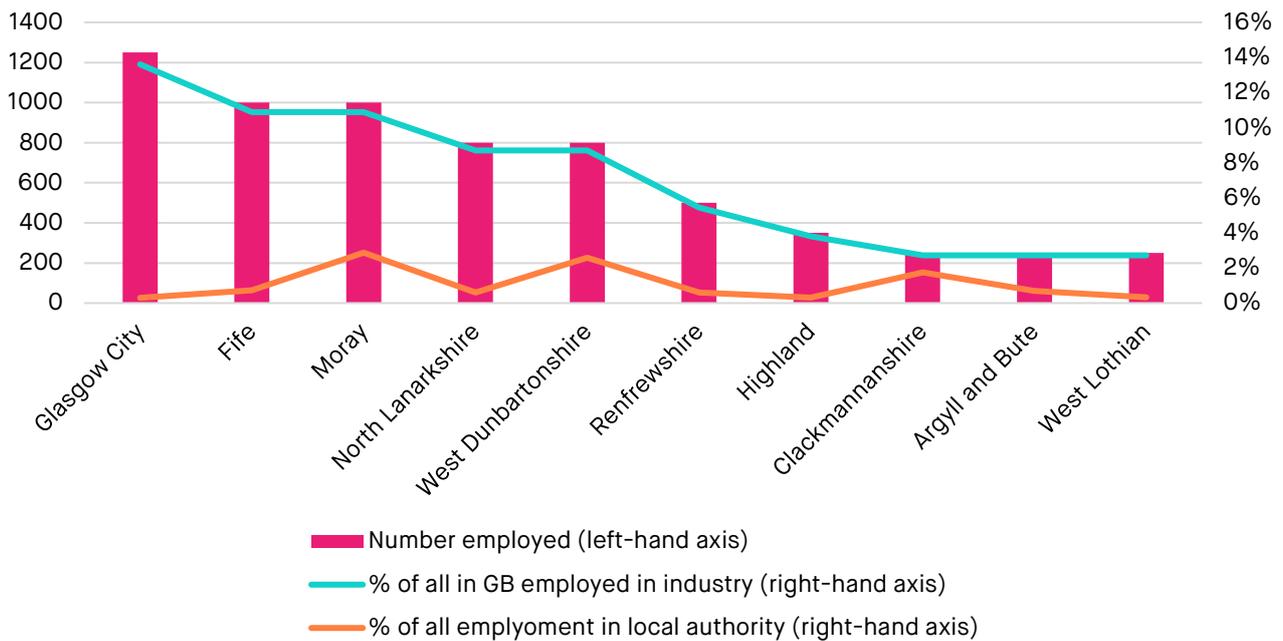
Source: Business Register and Employment Survey

Figure 26 Employment in wine production – top 9 local authorities



Source: Business Register and Employment Survey

Figure 27 Employment in spirits production – top 10 local authorities



Source: Business Register and Employment Survey

In terms of economies being reliant on alcohol production for employment, the argument for this is perhaps stronger at face value in Scotland. In the local authorities of Moray and West Dunbartonshire, for example, spirits production directly accounted for 2.9% and 2.6% of employment respectively. Yet, as we discuss below, the links between spirits consumption and jobs in the UK are notably weak, reflecting the fact that the vast majority of spirits are exported rather than consumed in the UK.

What is the link between alcohol consumption and employment in alcohol-related industries?

The analysis above has shown that, while employment in some types of alcohol production is regionally concentrated, it would be a distortion of truth to claim that regional economies are heavily reliant on these industries for work – even in the most extreme cases. Yet, much of the public and political rhetoric continues to overstate the relative importance of industries such as cider and spirits production to local jobs markets.

Another matter often overlooked in the political discourse is the link between domestic alcohol production and employment in these industries. Given that consumers drink imported as well as domestically-produced alcoholic beverages, the link between alcohol consumption and jobs is not straightforward. Further, the UK exports alcoholic beverages; meaning employment might be more closely tied to consumption elsewhere in the world.

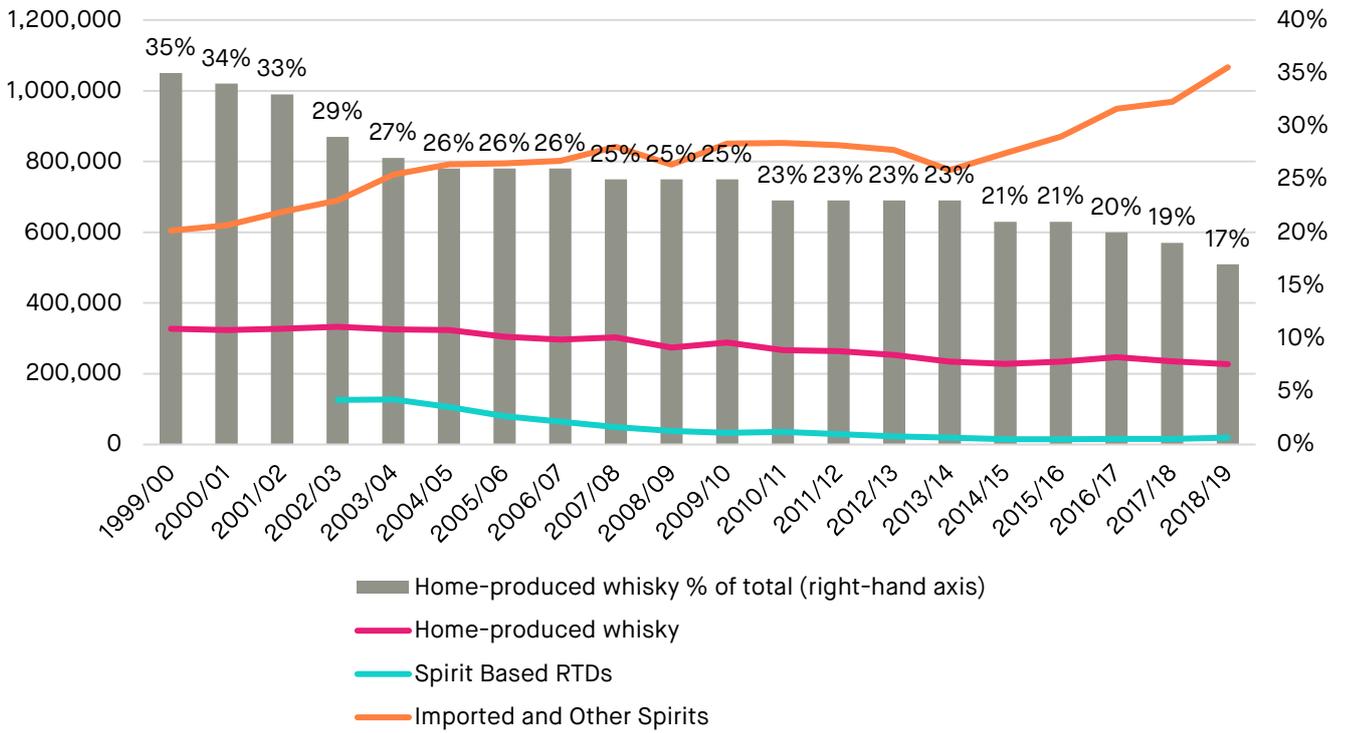
This is indeed borne out in the data graphed in Figure 30 – which shows scatter plots of employment in alcohol-related industries, against levels of domestic consumption over time. Beer employment is most closely tied to domestic alcohol consumption levels – around half of the variation in jobs growth over the time period charted is explained by changing levels of domestic consumption⁴. In contrast, domestic consumption of spirits explains less than 20% of the variation in employment in spirits production since the year 2000.

This is not surprising, given that a high share of spirits are exported from the UK. In the case of the Scotch whisky industry, about 90% of production is exported⁴¹. Given this, trends in domestic alcohol consumption are likely to have a limited impact on employment in the whisky industry. Indeed, analysis of HMRC alcohol statistics, graphed below, show that most of the growth in domestic spirits consumption has been from other spirits (such as vodka), rather than whisky. UK-produced whisky accounted for just 17% of spirits consumption in 2018/19, down from 35% in 1999/00, with the absolute volume of whisky consumed in the UK down by over 30% over this time period. UK-produced whisky consumption fell by 9% between 1999/00 and 2006/07 – a time period over which spirits duty was frozen – while consumption of imported and other spirits such as vodka increased by a third (33%). It was thus these drinks, rather than whisky, that were the prime beneficiaries of the duty freeze over this time period.

Whisky's dominance in the political discourse around spirits, with its evocation of images of charming rural distilleries in remote locations, thus seems highly misguided. Data from the Wine and Spirits Trade Association show that vodka is the most widely consumed spirit in the UK, accounting for about 30% of total consumption.

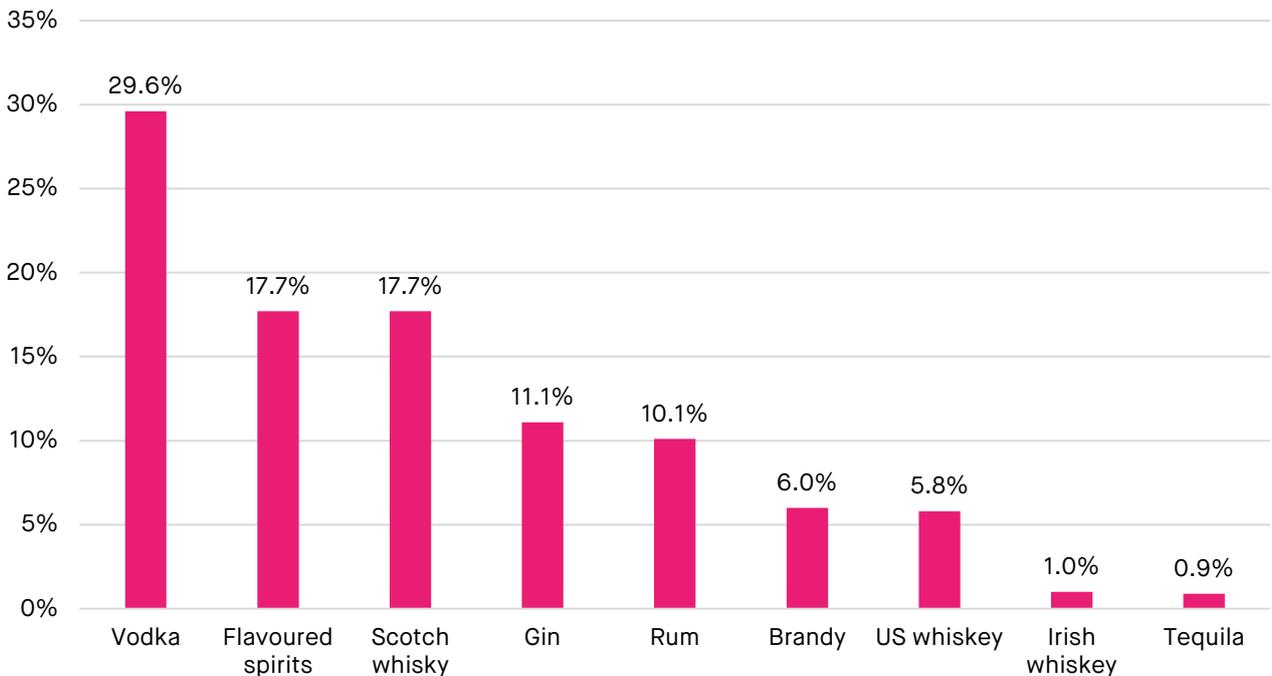
⁴ Based on the R-square value from a simple univariate regression.

Figure 28 Net quantities of spirits charged with duty, hectolitres of pure alcohol



Source: HMRC alcohol duty bulletin

Figure 29 UK spirits sales, breakdown by product category, 2016



Source: Wine and Spirits Trade Association Market Overview 2017

Figure 31 explores the correlation between employment in pubs, bars & clubs, and consumption of different types of alcoholic beverage in the UK. UK-wide beer consumption accounts for about 54% of the variation in employment in pubs, bars and clubs since 2000. In contrast, levels of spirits and wine consumption show less correlation, while cider consumption is negatively correlated with employment in pubs, bars and clubs.

Figure 30 Correlation between alcohol consumption and employment in manufacture of alcoholic beverages 2000-2017

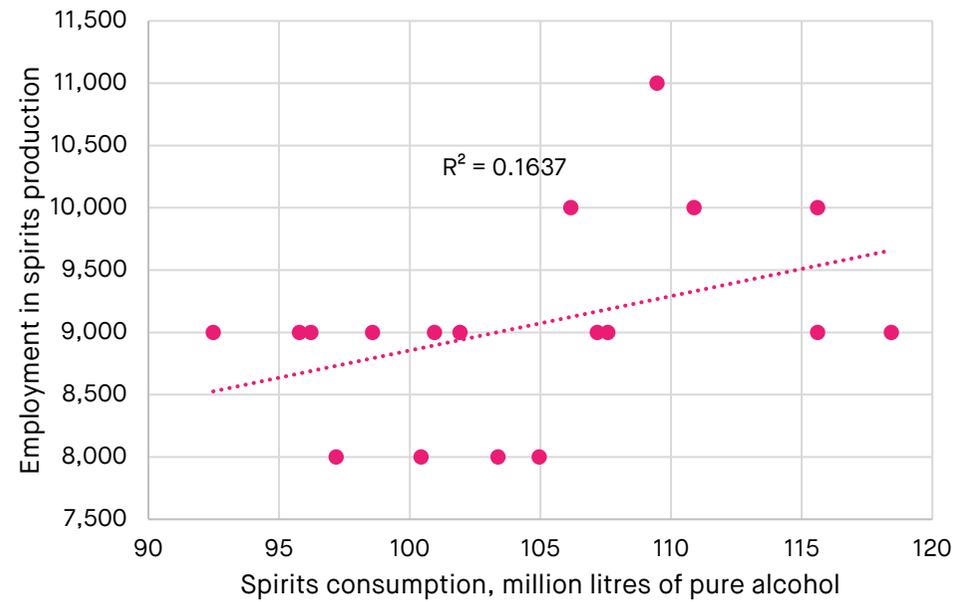
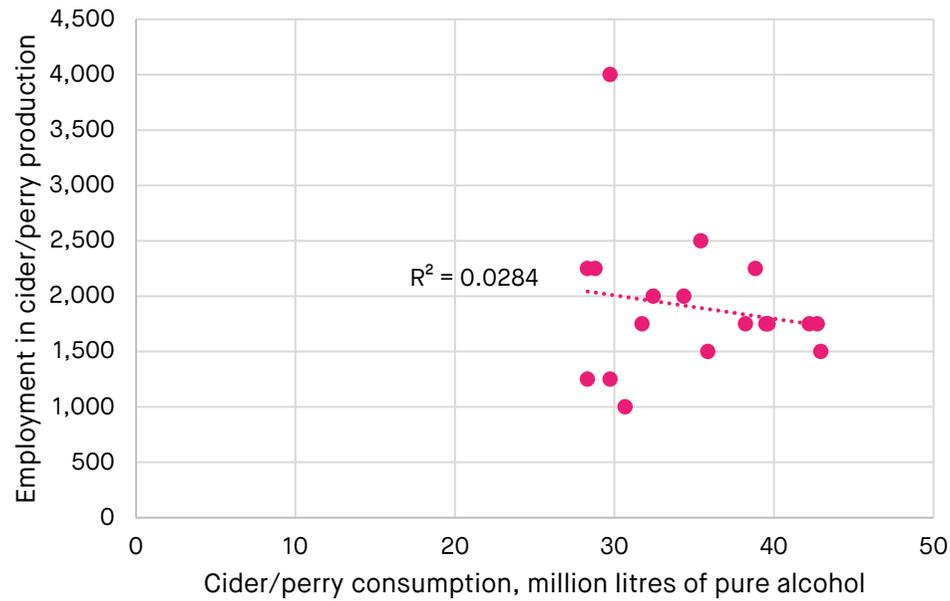
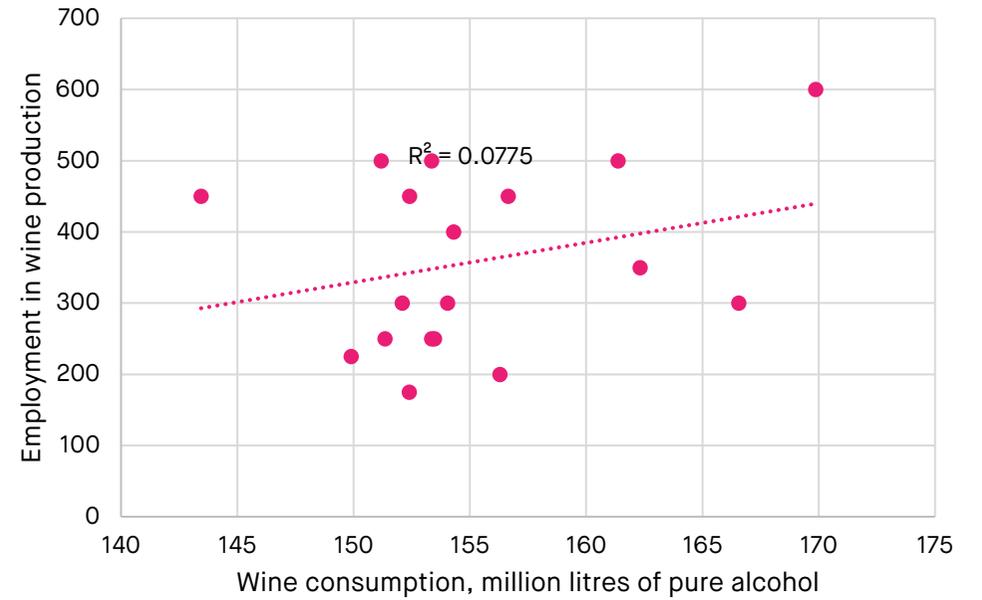
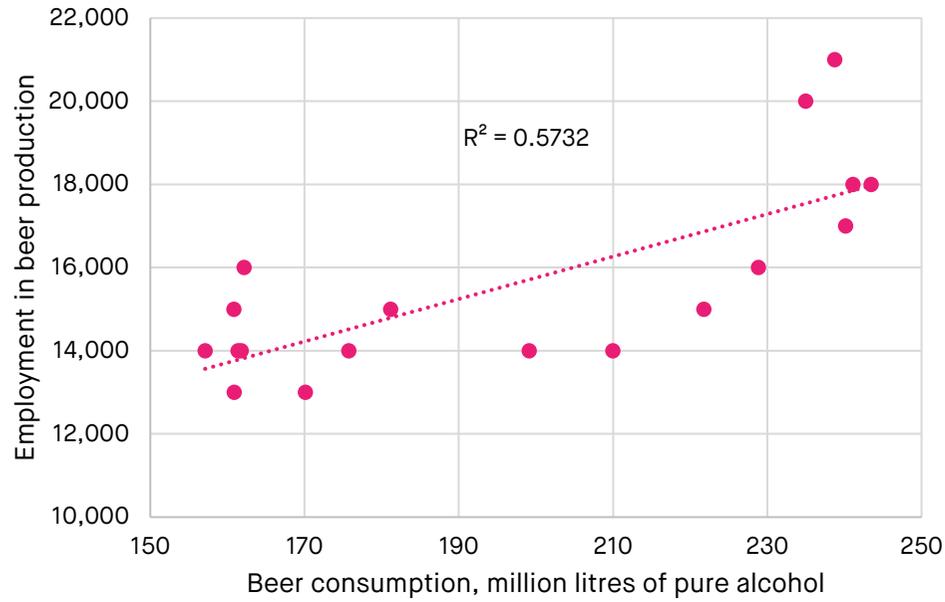
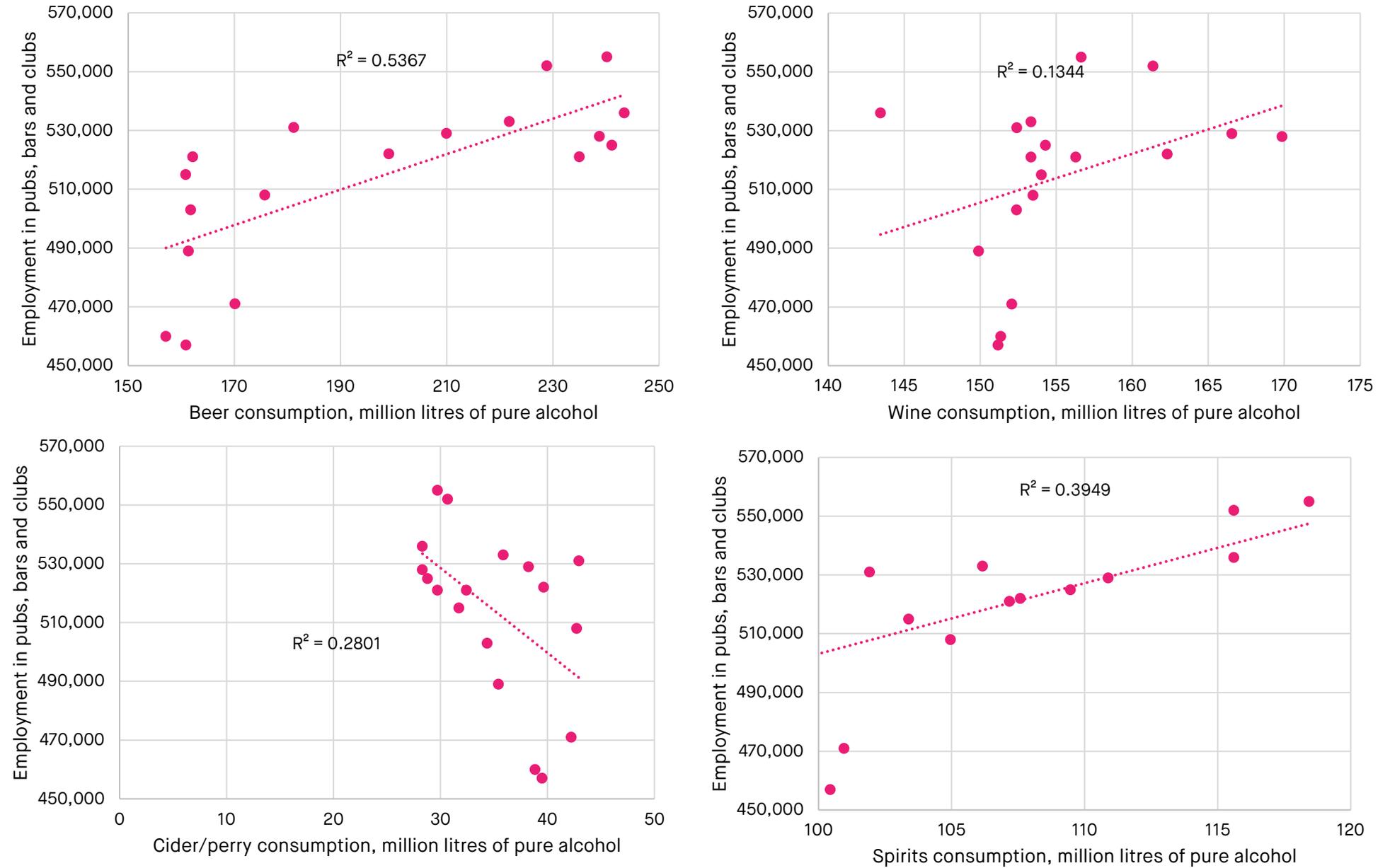


Figure 31 Correlation between alcohol consumption and employment in pubs, bars and clubs 2000-2017



Are jobs lost elsewhere in the economy as a result of alcohol consumption?

Much of the policy debate around alcohol taxation is focused on employment in alcohol-related industries. Relatively little is focused on the jobs that are lost in the economy as a result of alcohol-related harms, yet these are likely to be significant. As well as unemployment, alcohol-related harms can result in increased sick days, and reduced rates of productivity at work (often referred to as “presenteeism”) – leading to lower rates of economic output. A proper analysis of the economic impact of alcohol consumption should consider such factors as well.

Analysis by Public Health England found that, in 2015, there were 167,000 working years of life lost due to alcohol consumption – 16% of all working years lost in that year. Premature deaths from liver disease as a result of alcohol consumption led to 50,000 working years of life lost, and more working years were lost to alcohol than the ten leading causes of cancer death combined⁴². Working years of life lost are calculated as the number of years between a death in those aged 16-64 years and the age of 65 years.

A study by MacDonald and Shields found that problem drinking – drinking over 45 units of alcohol per week, or reporting things like guilt, loss of control and feeling the need to cut down on drinking in the morning – reduces the likelihood of working between 7% and 31%⁴³. A 2011 literature review of eight studies showed all eight indicating a link between heavy drinking and increased risk of unemployment⁴⁴.

Implications for alcohol taxation

This chapter argues that some of the common jobs-related arguments used to justify alcohol duty freezes or “favourable treatment” do not stand up to scrutiny. Even in the local authorities where cider production is heavily concentrated, it does not account for a significant share of total employment. With 90% of Scotch whisky exported from the United Kingdom, domestic duty policy and domestic levels of consumption have relatively little bearing on levels of employment. Further, vodka, not whisky, is the most popular spirit consumed in the UK.

Only for beer does there appear to be a strong link between domestic consumption and employment in production – as well as in pubs, bars and clubs. This suggests that, if alcohol duty policy were to be used in a way to support jobs in the economy, beer would be a more logical candidate for favourable treatment than spirits or cider. Even then, it remains unclear why alcohol duty should be the “go to” instrument for supporting jobs in the economy – as opposed to other tools such as business rates, employment laws and corporation tax.

8. PRINCIPLES OF A NEW ALCOHOL DUTY REGIME

The preceding chapters of the report have explored the “drinking landscape” in the UK – trends in alcohol consumption, the health and social implications, and the linkages between alcohol, the economy and jobs. We also explored the structure of the current alcohol duty regime in the UK and the inconsistencies within it.

As we have discussed, the current duty regime is not fit for purpose. We have shown in this report that alcohol-related harm is concentrated heavily on particular beverages – higher strength, lower cost products, relatively concentrated in the off-trade. Yet, the prevailing duty regime does a poor job at focusing taxation on where harms are being generated. Rather than encouraging the consumption and production of lower strength wine and cider, for example, the current duty regime incentivises the production of higher strength products – given that duty per unit of alcohol tends to fall with product strength.

We also showed, in the preceding chapter, the dubious nature of many of the jobs-related arguments used to defend alcohol duty freezes and cuts. Beyond beer, linkages between alcohol consumption and jobs in their manufacturing seem relatively weak.

Given this, this chapter sets out five principles which we think should underpin a reformed alcohol duty system in the UK. The focus of these principles is on ensuring that alcohol duty is higher for the products which generate the most social and economic harms, and lower for products which are less harmful. As well as generating improved health outcomes – for example through incentivising the production of lower strength products – our proposed reforms to the alcohol duty system would also be better from a consumer welfare point of view, given that they would reduce the relative focus of taxation on mild-to-moderate drinkers that do not generate substantial harms to themselves or society at large.

Recommendation 1: Introducing a duty strength escalator, to focus alcohol taxation on higher strength product

We noted in Chapter 4 that the heaviest drinkers in the UK are more likely to consume higher strength products. They are more likely to consume spirits, as well as higher strength beers and ciders. Given this, we believe that a **duty strength escalator** should form a key component of a revised alcohol duty system.

A strength escalator would work by applying a multiplier to alcohol duty, according to the strength of the product. For a multiplier of “1”, for example, the alcohol duty, per unit of alcohol, on a 4% ABV cider would be half as much as the duty on an 8% ABV cider. A multiplier greater than 1 would penalise higher strength products even more heavily. The strength multiplier need not be linear.

In addition to helping to focus alcohol taxes where the social costs are greatest, a strength escalator brings with it other benefits in the form of dynamic effects and incentives. By ensuring that, unlike the current regime, duty per unit of alcohol increases with product strength, drinks manufacturers would have stronger and clearer incentives to produce lower strength products.

There is at least tentative evidence that alcohol producers respond to duty changes, by reformulating products. Carlsberg reduced the strength of its low strength lager, Skol, from 3%

to 2.8% ABV, in response to the introduction of a new lower-rate duty band for low strength beers⁴⁵. AB InBev has also reduced the strength of more mainstream brands of beer – including Stella Artois, Budweiser and Becks – as a means of reducing costs associated with alcohol duty⁴⁶. Notably, as we discussed earlier, beer is the only alcoholic beverage category where duty per unit of alcohol holds steady and increases with product strength⁵– creating incentives towards lower strength products. Extending similar principles to wine, spirits and cider would yield similar benefits.

Recommendation 2: Levelling the playing field across same-strength products

For products of the same alcohol strength, we recommend equalising duty rates. This would simplify the duty regime, helping the government meet its goal of simplifying the UK tax regime⁴⁷. Under our proposed approach, a 6% ABV wine and a 6% ABV beer would face the same duty per unit of alcohol. Only if products are a different strength would duty rates differ.

Equalisation of duty rates for same-strength products would probably still generate differences in the end-price per unit of alcohol faced by consumers, given variations in pre-tax prices and production costs. However, it is unclear that this should be reflected in the tax treatment of products, especially if pre-tax price differences reflect relative economic efficiencies and inefficiencies in industries.

We recommend taxing alcohol on a consistent basis, according to the pure alcohol content of the beverage. With wine and cider at present taxed according to the volume of the end product, rather than the alcohol content, it is difficult to create strong and consistent incentives to produce lower strength products.

Recommendation 3: Focusing taxation on the off-trade. Allowing pubs, bars and restaurants to claim back a proportion of the duty costs they face with a new “Pub Relief”.

As we have discussed, as well as consuming stronger products, heavier drinkers are more likely to consume alcohol on the off-trade. Therefore, in line with our proposed framework of focusing alcohol duty where harms are most generated, we suggest explicitly favouring on-trade consumption of alcohol in the tax system. Beyond health outcomes, there are jobs-related justifications for such an approach; as we showed in the previous chapter, the majority of alcohol-related employment is in pubs, bars and clubs, rather than in production.

One way of doing this for beer and cider would be, like Australia, to have favourable rates of duty for kegs rather than bottles and cans. However, we note that this does not address spirits, cider and wine, where alcohol-related harms are concentrated heavily in off-trade consumption. As we noted earlier, the on-trade market for spirits appears notably more “premium” than the off-trade market.

In Ireland, some have proposed a “lid levy” for alcohol purchased in the off-trade⁴⁸, applied as an *ad valorem* tax (similar to VAT). This would penalise more expensive products more heavily. Given

⁵ Spirits duty holds steady, but does not increase, with product strength

that the evidence base suggests that the heaviest drinkers tend to consume cheaper products, this is unlikely to be a well-focused tax.

A better, and more politically appealing, approach would be to allow pubs, bars and other licensed premises to claim back a percentage of the duty costs that they face – a clear policy in favour of on-trade consumption.

Conceivably, this could work in a similar way to Alcoholic Ingredients Relief, which already exists. With Alcohol Ingredients Relief, businesses can claim relief on alcohol excise duty when they use alcohol as an ingredient in drinks less than 1.2% ABV, chocolates, vinegar and other foods for human consumption (below a certain alcohol content). A “Pub Relief” could work in the same way, though relief would be a proportion of duty rather than all duty, given that a proportion of health and other social harms related to alcohol consumption are generated in the on-trade.

Beyond Alcohol Ingredients Relief, we note the existence of other reliefs in the alcohol duty regime. Small brewers face lower rates of duty than larger ones⁴⁹. The existence of other reliefs means that a Pub Relief is not without precedent.

However, despite duty reliefs not being unprecedented, one barrier to a Pub Relief at present are the EU directives on alcohol taxation. In discussions about a “lid levy” in the Republic of Ireland, it was argued that such a measure would breach the relevant EU directive on alcohol taxation, which requires that such taxes are applied by reference to the nature and strength of the product rather than the means of packaging or the location in which the product is sold⁵⁰. Brexit could, potentially, eliminate this barrier to a Pub Relief being introduced.

Couched in a more positive framing than a “lid levy”, we believe that “Pub Relief” is a more politically palatable policy option. From a public health perspective, focusing alcohol taxation on the off-trade might be more successful in curbing alcohol consumption. Price in the off-trade is easier to influence through duty (and indeed other policy tools such as MUP), given that duty accounts for a higher proportion of the final consumer price, as we discussed earlier.

Recommendation 4: Linking alcohol duty to the social costs of alcohol, rather than as a cash cow

There has been a great deal of debate in the UK around the case for or against hypothecating certain taxes – ensuring that funds raised from a tax are dedicated to a particular purpose. In the case of alcohol taxation, some have argued for duty and other revenues to be hypothecated for healthcare spending.

We believe that the amount of revenue raised from alcohol duty should be closely tied to a measure of the total social costs of alcohol in the United Kingdom – including health and crime-related costs to government, as well as costs faced by wider society such as family breakdown. This is somewhat different from hypothecation, as we are not suggesting that revenues should be dedicated to a particular resource such as healthcare or policing. Hypothecation in that way carries with it the risk of funds being used inefficiently rather than where most needed.

We caution against using niche taxes, such as alcohol duty, as a general form of revenue-raising for the Exchequer, particularly given that structural changes in consumer behaviour which could

end up leaving a hole in the public finances in the long-term. As the Institute for Fiscal Studies has noted, the UK public finances already suffer from increased reliance on relatively small taxes, with “insufficient consideration of how they might operate within a well-designed tax system”⁵¹

We emphasise that our suggestion of linking tax take to the costs of alcohol does **not** reduce its setting to a purely empirical exercise around the measuring the health and social costs. Ultimately, decisions on overall tax take will depend on the wishes of politicians and the public more broadly – specifically around the degree of “paternalism” embedded in the UK tax system. At the very least, alcohol duty should cover the health, crime and welfare costs to government and wider society (the “externalities” associated with alcohol consumption). As we have discussed, there are currently limited and dated estimates of the value of these externalities; there is a need for updated analysis if we are to ensure that alcohol taxation is set at an appropriate level.

More debatable than the need for alcohol duty to cover the externalities of alcohol consumption, is the extent to which the private costs to the drinker, such as reduced earnings potential and wellbeing, should be reflected in the overall rate of taxation.

Social libertarians will argue that private costs should not be reflected in alcohol duty regime, given that they might reflect an individual’s lifestyle choices and preferences. Conceivably, some believe worse health outcomes are a price worth paying for enjoying activities such as smoking and heavy drinking.

More paternalistic individuals argue that individuals often make ill-informed choices which they end up regretting once they face the consequences. Indeed, there appears to be growing support for some degree of paternalism in the economy, particularly in light of the emerging evidence base around the links between mental health, poverty and decision-making. Financial stress, mental health problems and a host of other issues are associated with a constrained ability of individuals to make “rational” decisions⁵². In addition, lack of access to advice, information and support can also hinder decision-making.

We do not take a strong position on the degree of paternalism that should be embedded in the alcohol duty system in this report – ultimately, we believe this is a matter for politicians and the electorate. Our key argument is that tax take from alcohol duty should be focused on alcohol-related costs, whether that be the externalities of alcohol consumption or a broader measure covering private costs drinkers. Alcohol duty should not be used as a cash cow for government beyond this, given the risk of exacerbating the UK’s already problematic reliance on niche taxes.

Beyond some measurement issues associated with alcohol-related harms, is the intertemporal dimension of harm. Alcohol consumption today might not translate into health problems until years into the future. Given this, the measure used for calculating alcohol-related harms should take into account expected future costs given current consumption levels.

Recommendation 5: Regular updating and review periods

As discussed earlier in this report, one of the features of the alcohol duty system in recent years has been that it has been subject to a great deal of tinkering – meaning beverages go through

periods of duty rises, freezes and cuts with little consideration of the system-wide implications – for tax revenues, the economy or health outcomes.

While we are reasonably agnostic on whether alcohol duty should be uprated by earnings or inflation, we believe that a key principle underpinning a reformed alcohol duty regime should be an increased element of certainty in how duty is likely to change over time. Rather than being a highly politicised policy instrument, the general assumption should be that alcohol duty will rise in line with a metric such as inflation or earnings.

Consistency in uprating is particularly important given our suggestion that the alcohol duty system should provide compelling incentives to produce lower strength products. Given that product reformulation will require investment and innovation by drinks manufacturers, it is important that they operate in an environment of relative certainty around alcohol taxation, at least in the medium-term – so they can invest with some degree of certainty around future tax policy.

While we believe inflation or earnings should be the “status quo” form of uprating duty, we think this should be complemented with review periods, held perhaps on a five or 10 yearly basis. The purpose of the review period would be to explore the latest evidence base on alcohol-related costs to society, and ensure that alcohol duty tax take is broadly in line with these costs – as we proposed in Recommendation 4 above. This review should be informed by expert insights from government, the healthcare sector, academics, charities and industry, taking into account the latest evidence and structural trends. As we discussed in this report, some of the evidence base, for example on the health impacts of mild-to-moderate drinking, remain debatable; conceivably estimates of the social cost of alcohol could change significantly as our knowledge-base improves. We envision this review being conducted by an independent commission, tasked with recommending an overall level of alcohol taxation for government (much as, say, the Low Pay Commission is tasked with advising government on the setting of the National Minimum Wage and National Living Wage).

The review period would provide further incentives for drinks manufacturers to reduce alcohol-related harms – for example by withdrawing “worst offender” products from the market (such as high strength, low quality, low cost drinks) and advertising the risks of excessive consumption of alcoholic products. Manufacturers would be incentivised to do this in order to reduce structural duty increases following the review period.

In short, regular uprating of alcohol duty, combined with a holistic review period taking account of all the relevant evidence, would help depoliticise alcohol duty and ensure that it is a well-focused tax with strong incentives for improved economic, social and health outcomes.

European regulations and a “second best” duty regime

Some of the recommendations we outline above can only be realised in the event of European-wide regulatory reform, or the UK pursuing a different approach to regulation following Brexit. As discussed earlier, European directives bind the UK to taxing wine and cider according to the volume rather than the alcohol content of the final product. They also limit the ability to differentiate on-trade and off-trade taxation.

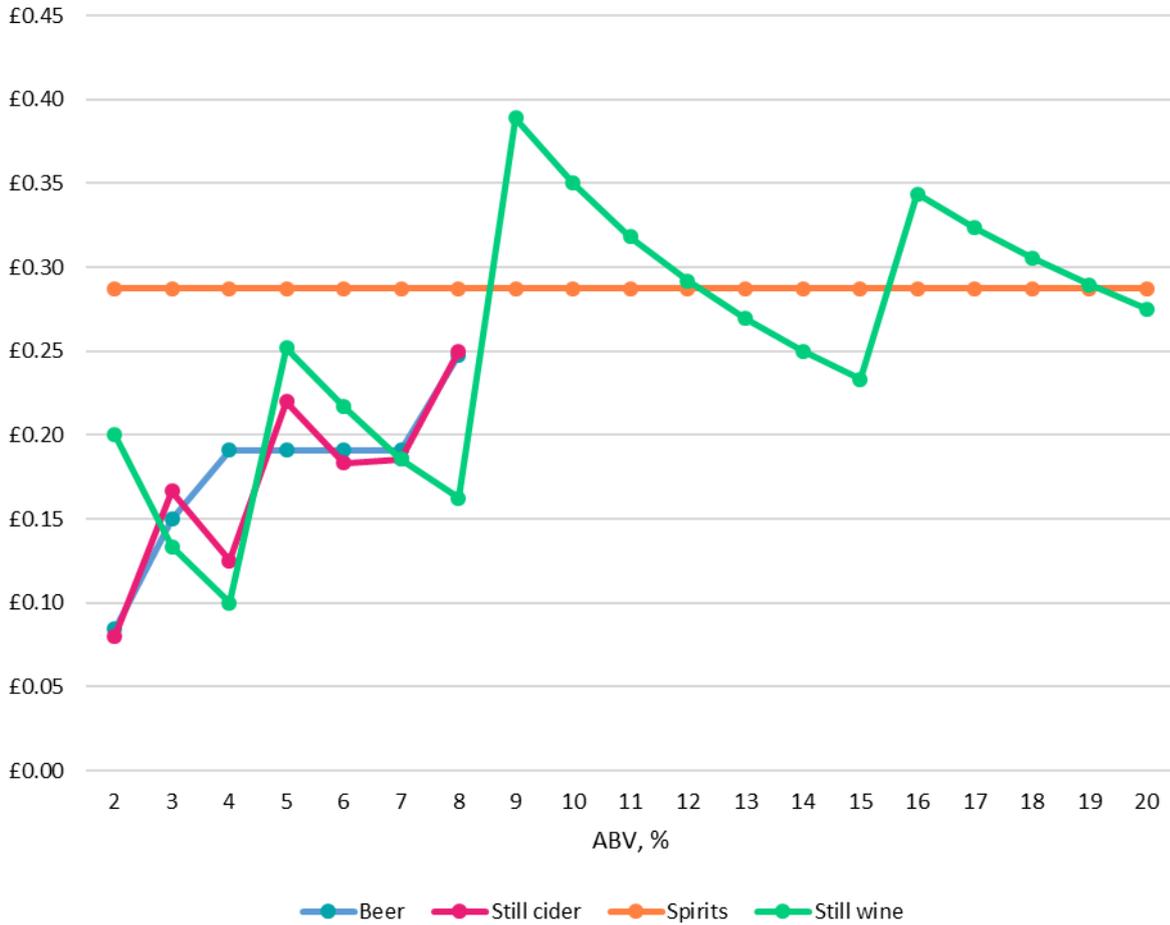
In addition to the possibility that the UK remains in the EU, or returns to the EU following departure, the UK might still be bound by EU regulations following a permanent Brexit. This might be a requirement for a successful trade deal with the EU following Brexit, for example.

Yet, even if European regulations constrain the possibility for duty reform, there is still scope to have a more optimal regime than we have at present – one that better focuses taxation where harms are being most generated. This includes:

- Regular updating and evidence-based duty reviews (as proposed above).
- Introducing more duty bands for cider (as Ireland has done) to better incentivise the production of lower strength products.
- Bringing beer, cider and wine duty more closely into line in the sub-10% ABV category, for similar strength products.
- Introducing a new duty band for beer, between 2.8% and 3.9% ABV. It was brought up in our discussions with industry that there is likely to be a broader market for beverages in this kind of strength category, as opposed to the sub 2.8% ABV category which is relatively niche. However, the current duty system does not incentivise production of such beverages. Alternatively, there may be a case for increasing the upper limit of the “< 2.8%” beer duty band, to cover low strength beers which are more likely to gain mainstream demand.
- Narrowing the main duty band for wine. In the UK the main duty rate for still wine runs from 5.5% ABV to 15% ABV. EU law requires that there has to be a single band for wine between 8.5% and 15% ABV. As the UK’s main still wine and made-wine band is currently 5.5% to 15% ABV, it would be possible to split the main still wine and made-wine band into two, and introduce stronger incentives via duty to produce low strength wines between 5.5% ABV and 8.5% ABV.

As the figure below shows, there is scope, even within current regulatory requirements, to structure duty bands and levels in a way that creates stronger incentives to produce lower strength products.

Figure 32 Illustration of a reformed duty regime within the constraints of EU regulation – more cider duty bands and a greater deal of equivalence between similar strength products



Source: SMF analysis

9. WHAT WOULD BE THE IMPACT OF DUTY REFORM ON ALCOHOL CONSUMPTION AND PRICES?

The previous chapter of the report set out five principles which should underpin a revised alcohol duty system in the UK. This chapter explores, using economic modelling, the potential impact that duty reform could have on levels of alcohol consumption and prices for specific products.

In this chapter, we take no view on what the overall level of alcohol duty revenue should be – as we have discussed, we believe this is a somewhat subjective matter dependent on one’s views regarding “paternalism”. Given this, we consider revenue-neutral reforms to alcohol duty – reforms which would raise the same amount of duty revenue as the current system.

Assumptions of the model

Our model of alcohol demand and revenue generated draws on a number of datasets:

- HMRC estimates of the elasticity of demand for alcohol (tabled below)
- Data on current alcohol duty rates from the HMRC alcohol duty statistical bulletin
- Data on on-trade and off-trade prices and sales volumes from the NHS Scotland “MESAS” dataset (which includes data for England & Wales as well as Scotland).

Table 2 Price elasticities of demand for alcohol

Price	Quantity	Beer		Spirits		RTDs		Cider		Wine	
		On	Off	On	Off	On	Off	On	Off	On	Off
Beer	On	-0.34***	0.03	0.26***	0.08	0.08	0.11	0.05	0.11	0.10*	-0.04
	Off	-0.08	-0.74***	-0.10	-0.11**	0.02	-0.01	-0.02	0.07	-0.02	-0.08*
Spirits	On	-0.10***	-0.01	-1.25***	0.01	0.04	0.00	0.00	0.03	0.01	0.05*
	Off	0.00	0.04	-0.16**	-0.45***	-0.22	-0.09	-0.06	0.13	-0.01	-0.02
RTDs	On	0.00	0.09	0.17*	0.05	-0.24*	-0.03	-0.02	0.00	-0.04	0.00
	Off	0.00	-0.03	-0.03	-0.02	-0.03	-0.52***	0.03	-0.04	0.04	-0.03
Cider	On	-0.06	0.05	0.04	0.10	-0.04	0.24	-0.49***	-0.13	0.02	-0.06
	Off	-0.06	-0.01	0.02	0.05	0.30*	0.13	-0.25**	-0.74***	-0.04	-0.09**
Wine	On	0.02	0.02	0.12***	0.00	-0.07	0.01	0.07	-0.04	-0.24***	0.02
	Off	0.01	0.00	-0.02	-0.07*	0.14*	0.10	0.15*	0.05	0.03	-0.08***

* p<0.05, ** p<0.01, *** p<0.001

Source: HMRC estimates

We assume in our model that the passthrough rate for alcohol duty, across all products, is 100%. That is to say, duty is fully passed on to consumers.

Based on this data, we can then model the impact of alcohol duty changes through the following process:

1. Consumer prices for alcohol are updated in light of the duty changes.
2. The demand for products is then updated, using the estimated price elasticities of demand from HMRC. We estimate, separately, demand for beer, spirits, wine, cider & perry and ready-to-drink (RTD) products. Further, we estimate, separately, demand for on-trade and off-trade consumption.
3. Total duty revenue can then be updated to reflect the estimated changes to alcohol demand, in addition to the new rates of duty.

4. We use the “goal seek” function in Excel in calibrate the model to give revenue-neutral duty rates compared with the current duty regime.

One notable limitation of the model is that it does not take into account the response of producers to changes in alcohol duty. As discussed in the previous chapter, we would expect some of our proposals to trigger product reformulations (such as reducing strength) as well as the removal of some brands from the market.

For cider, we would expect the removal of its substantial tax advantage under a reformed system to lead to a range of innovations in the industry, rather than terminal decline. Presumably, cider manufacturers would respond to the removal of tax advantages through, for example, premiumisation of the product offer to encourage consumers to spend more money on drinks. We would also expect the average strength of cider products to decline.

The scale of such producer responses is difficult to establish with the current evidence base, though as discussed in the preceding chapter, there are recent examples of firms at least claiming to have reformulated their products in response to alcohol duty changes.

An example alcohol duty regime

Below, we give an example on the potential impact that alcohol duty reform could have on consumer prices and levels of alcohol consumption. We emphasise that, while this example is based on the principles we discussed earlier, we are not endorsing the precise rates of duty here, or assumed rates of on-trade duty relief.

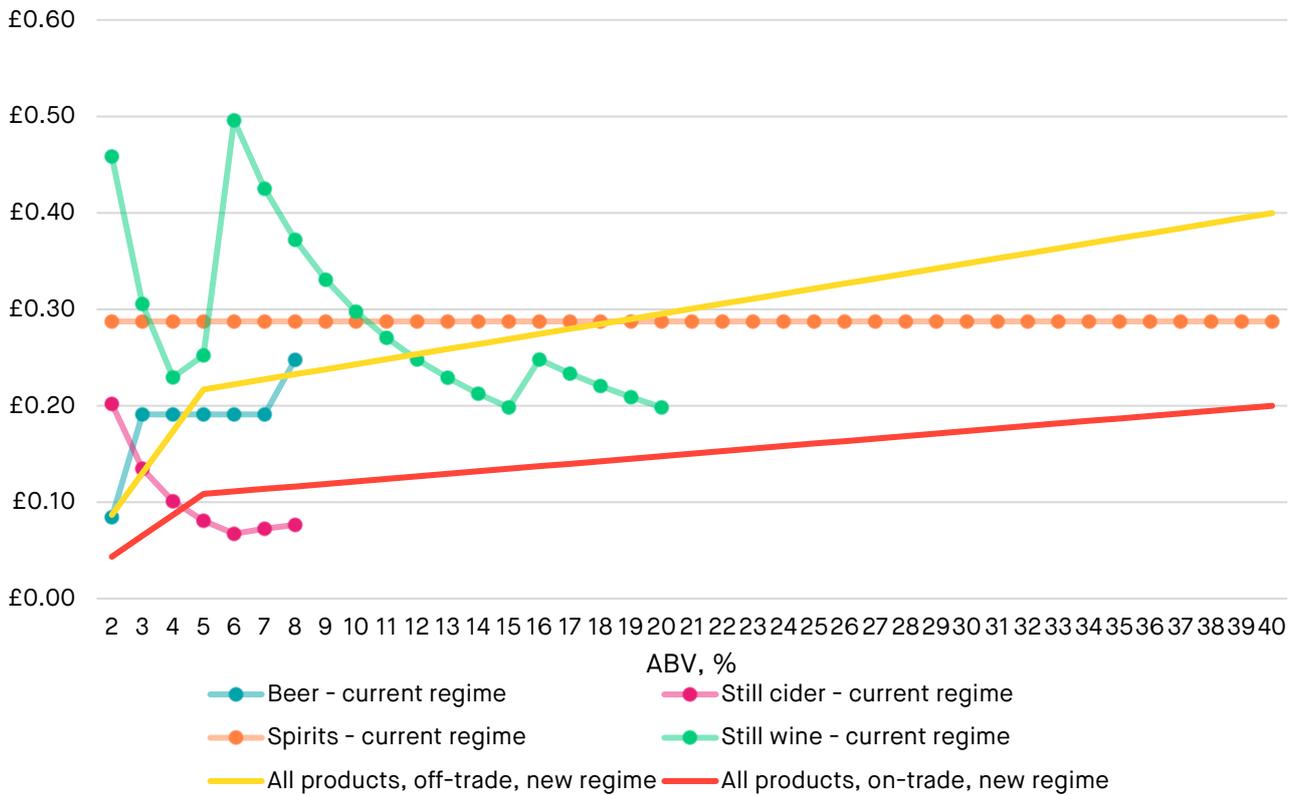
We assume that our proposed “Pub Duty Relief” rate is set at 50% - meaning that duty rates in the on-trade are half as much, per unit of alcohol, than on the off-trade – for every product category. In theory one could have different rates of on-trade duty relief for different products. Though this would complicate the duty system, it might be justified from an “optimal tax” perspective. We showed earlier that the extent which on-trade and off-trade consumption differs varies across product categories. Spirits consumption in the on-trade is much more “premium” than in the off-trade, whereas beer is more similarly dependent on harmful/hazardous drinkers in the off-trade and the on-trade. This could be used to justify a higher rate of on-trade duty relief for spirits than for beer. Defra Food Survey data also suggest that spirits tend to be diluted (mixed) when consumed in the on-trade – providing a further justification for a greater rate of on-trade relief.

We assume in our example that the average off-trade beer duty rate remains unchanged compared with the current system.

There is a fixed duty per unit of alcohol. This is multiplied by a strength multiplier.

This gives the duty regime graphed in Figure 33. The strength multiplier is steeper at the bottom end of the alcohol strength distribution. This creates stronger incentives to produce very low strength products. It also helps ensure that duty does not rise to “excessive” levels for the highest strength products. The chart also shows the current duty regime for the purpose of comparison.

Figure 33 Revised alcohol duty per unit, modelled new regime vs current regime



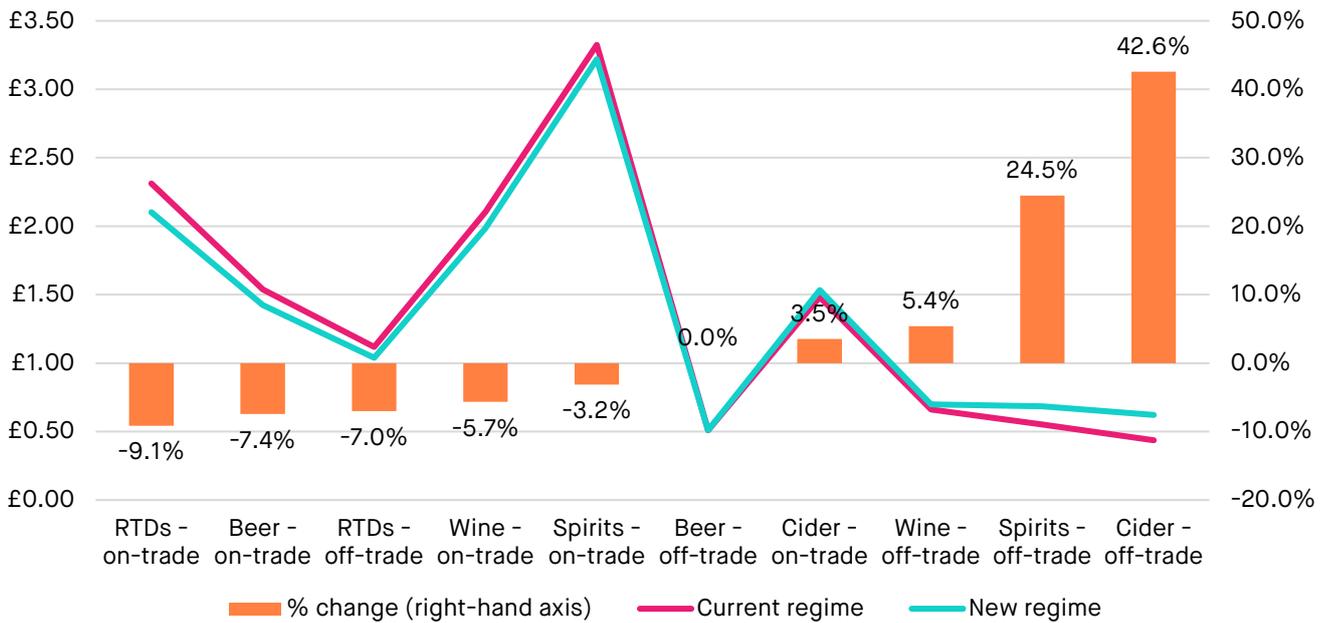
Source: SMF analysis

Impact on prices

The impact of switching to the regime described above would be to reduce prices of all on-trade products except cider. On the off-trade, average end consumer prices would rise on average by 24% for spirits, 5% for wine and 43% for cider. Per unit of alcohol, this would still leave cider cheaper than spirits or wine in the off-trade, despite a significant increase in average price. However, cider would become more expensive than beer on average, reflecting the higher typical strength of the product.

Price rises would be much greater, in percentage terms for cheaper products – given that duty is a greater proportion of the final price. This is shown in the table below which compares the price rise of a single malt Scotch whisky with the price rise for a relatively cheap vodka. From a tackling social harm perspective, this is desirable, as we know that the heaviest drinkers tend to consume cheaper products.

Figure 34 Consumer prices per unit of alcohol, current versus new regime



Source: SMF analysis

Table 3 Example price changes under new duty regime

Product	Price - current regime	Units of alcohol	Price - new regime	£ change	% change
Pint in a pub - 4.5% lager	£3.70	2.6	£3.44	-£0.26	-7.1%
175ml glass of still wine in a bar - 13% ABV	£4.50	2.3	£4.23	-£0.27	-6.1%
Single measure of spirit - 40% ABV	£3.50	1	£3.39	-£0.11	-3.0%
Stella Artois, 4 x 440ml cans, 4.8% ABV	£5.50	8.4	£5.75	£0.25	4.6%
Pint in a pub - 6% cider	£3.70	3.4	£3.88	£0.18	4.8%
750ml bottle of wine bought in a supermarket - 13% ABV	£6.00	9.8	£6.35	£0.35	5.8%
Glenmorangie single malt whisky - 70cl bottle in Tesco	£36.00	28	£39.77	£3.77	10.5%
Sainsbury's Basics Vodka - 70cl bottle	£10.00	26.3	£13.13	£3.13	31.3%
Frosty' Jack's Orginal Cider - 2.5 litre bottle sold in Iceland, 7.5% ABV	£3.70	18.8	£7.37	£3.67	99.2%

Source: SMF analysis

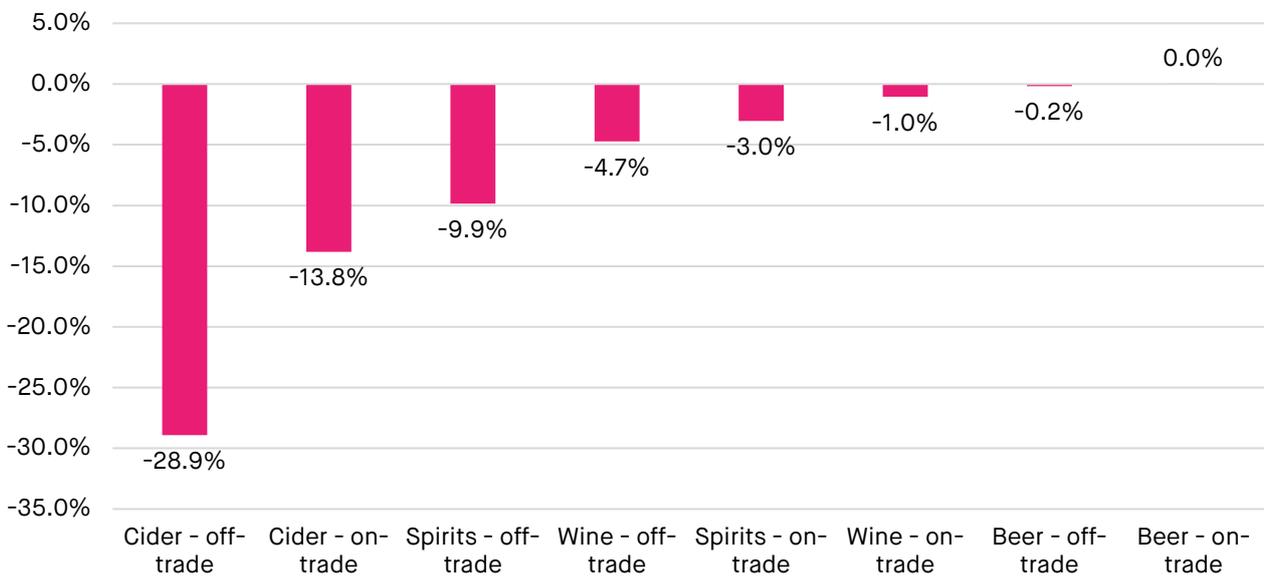
Impact on alcohol consumption

The impact of switching to the duty regime described above would be to cut overall alcohol consumption by 5.4%, compared to the current regime. This would come from a 1.9% decline in on-trade alcohol consumption and a 6.8% decline in off-trade consumption.

On-trade consumption of alcohol falls, in the model, despite declines in on-trade prices. This reflects cross elasticities of demand for alcohol products. Increased prices in the off-trade can reduce demand in the on-trade as well.

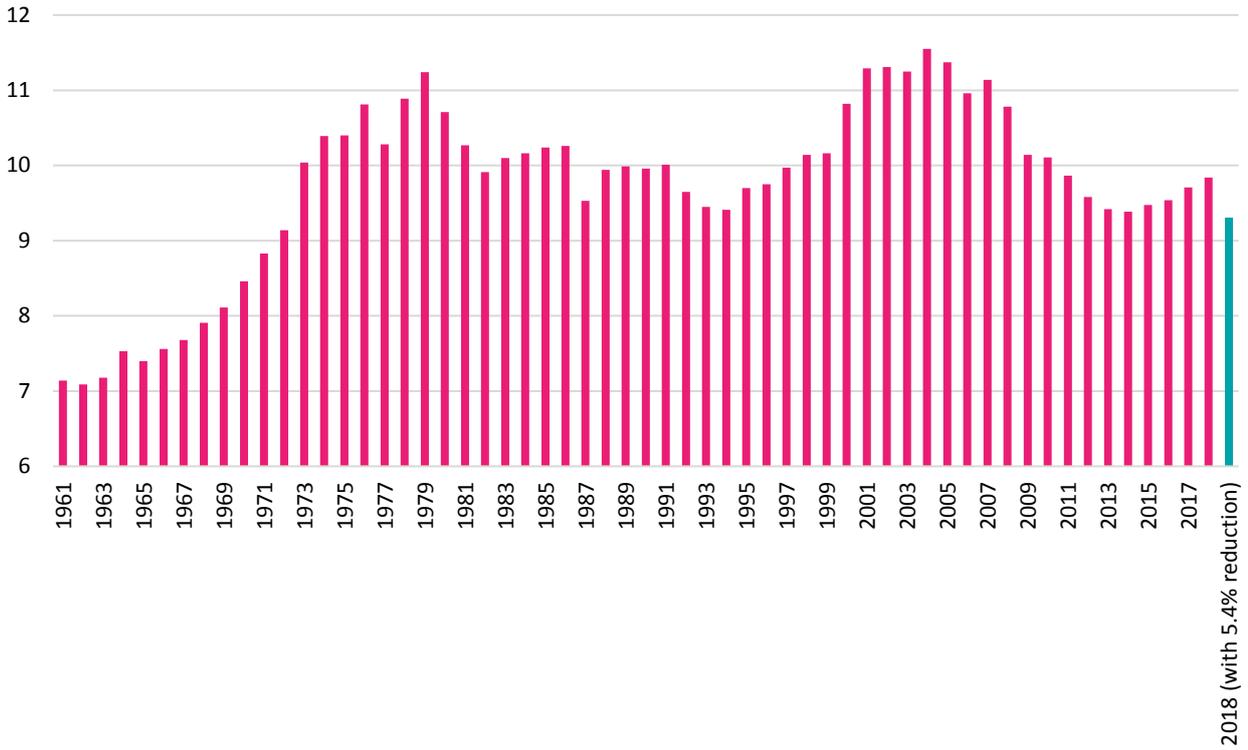
A 5.4% reduction in alcohol consumption would reduce per capita consumption to its lowest level since the early 1970s.

Figure 35 Change in alcohol consumption – new regime versus current regime



Source: SMF analysis

Figure 36 Per capita pure alcohol consumption among population aged 15 and over, litres, 1961-2018



Source: World Health Organisation Global Health Observatory data repository (1961-2009). SMF calculations based on HMRC alcohol clearance statistics and ONS population estimates for 2010-2018.

10. CONCLUSIONS

This report has analysed, in detail, alcohol taxation in the UK and the potential benefits that could be realised from reforming it. There is scope for producing a more efficient alcohol duty regime – which focuses tax on the most harmful products on the market.

We emphasise that alcohol duty is just one policy instrument with which government can tackle the health and other social harms associated with excessive drinking. Other policy measures that have been discussed include minimum unit pricing, advertising restrictions, labelling requirements (such as health warnings on drinks) and raising awareness of the harms associated with alcohol (via, for example, education). We do not assess the relative benefits and drawbacks of these policies within this report. However, we would expect a reformed alcohol duty regime to be complemented with a range of other policy options if government is to effectively address the harms caused by excessive alcohol consumption.

Duty alone cannot be expected to address all the issues associated with excessive alcohol consumption though, as the World Health Organisation notes, it is a proven tool for tackling harms and ensuring that social harms are reflected in the price of drinks. It thus has a role to play alongside the range of other policy options. This report has set out ways of ensuring that duty is a more effective policy instrument than it is at present.

Critically, we emphasise the importance of looking at the alcohol duty system as a whole, rather than maintaining the current, heavily politicised approach to alcohol duty which has led to a very distorted tax system. There is clearly much more of a role for experts and evidence in the setting of alcohol taxation than at present and steps to “depoliticise” the duty setting process should be welcomed.

In this report, we emphasise the importance of incentives and innovation in the drinks industry. A reformed alcohol duty system should provide better incentives for drinks manufacturers to produce less harmful products, and reforms to beer duty to favour lower strength products suggest that producers respond to such incentives. As well as favouring lower strength products in the tax system, linking the overall level of alcohol duty revenue to the social harms of alcohol, as we propose in this report, creates further incentives for drinks manufacturers, pubs and other licensed premises “to get their house in order” (if they are not already doing so). If industry wants to limit the size of future tax rises, it can do so through encouraging more responsible alcohol consumption and removing “worst offender” products such as high-strength, low-quality, low-price drinks.

Brexit could open up opportunities for significant reform of the UK’s alcohol duty system, allowing the creation of a more rationalised and effective tax regime. This includes enabling on-trade and off-trade alcohol consumption to be taxed at different rates and allowing wine and cider to be taxed according to their alcohol content, rather than the volume of the final product as is the case at present. European directives mean that these reforms are not possible at the moment, and we urge policymakers looking for tax and regulatory reforms “unlocked” by Brexit to consider the case for rethinking alcohol duty.

Even if the UK remains bound by EU regulation in the future, for example following a trade agreement, there is still scope to significantly improve upon the current duty regime. This

includes the creation of more incentives to produce lower strength products, as well as bringing duty rates for same strength products more into line with each other.

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