

A Response to the Alcohol Taxation Review, August 2010

Commentary by the UK's National Association of Cider Makers – NACM

All references in this paper to cider should be understood to include perry (pear cider)

Note:

This paper is NACM's response to the questions posed at the public Workshop held at HM Treasury on 23 August 2010.

Introduction:

In the Budget papers of 22 June 2010 it was announced that:

"The Government will review the taxation and pricing of alcohol to ensure it tackles binge drinking without unfairly penalising responsible drinkers, pubs and important local industries."

The review is understood to be considering a wide range of topics under three headings:

Licensing – a Home Office consultation on reforms to the Licensing Act.

Pricing – a government commitment to a ban on below-cost sales of alcohol. Pricing forms part of the Home Office consultation.

Taxation – an HM Treasury review to consider tax-based measures to address problem drinking.

Earlier in 2010, NACM was consulted by HM Treasury in the cider review announced in the Pre-Budget Report of November 2009. NACM provided much detail in its confidential submission of February 2010 (the '2010 Review' referred to in the Note above) and this has now been updated where necessary and is quoted from here.

In this current paper, NACM summarises its view of the questions raised in the Workshop of 23 August last.

Workshop Topics discussed:

Excise Duties

- ***the rates and structure of duty on different products:***

UK cider duty has been charged in modern times since September 1976 only. Before that time cider was unique among alcoholic drinks in being charged Purchase Tax. The imposition of duty followed shortly after the UK's conversion to VAT. Since the reintroduction of duty on cider, the structure has seen two significant changes: the introduction of a higher strength duty band on 01/10/96 and a Sparkling Cider classification and band on 01/01/97.

By virtue of the EU Structures Directive (92/83/EEC, of 19 October 1992), cider duty must be charged in bands of strength (ABV). The definition of cider for duty purposes has recently been clarified with new rules coming into force on 01/09/10.

In the UK, still cider (ie: <3 bar pressure at 20°C, due to carbon dioxide gas) is now charged in two bands according to strength, 'mainstream' from >1.2% ABV to not exceeding 7.5% ABV, and 'higher strength' from >7.5% ABV to 'less than' 8.5% ABV. Sparkling cider duty (when bottled with >3bar pressure or with a mushroom-shaped stopper) applies to qualifying product above 5.5% ABV:

The current rates of cider duty are:

Still & Sparkling, >1.2% - ≤5.5% ABV:	£33.46 per hl
Still, >5.5% - ≤7.5% ABV:	£33.46 per hl
>7.5% - <8.5% ABV:	£50.22 per hl
Sparkling, >5.5% - 8.5% ABV:	£217.83 per hl

Apart from the higher rate on sparkling cider >5.5% ABV, these rates are among the lowest on UK alcoholic drinks but this differential reflects cider's particular circumstances, the relatively late imposition of duty on cider and its importance to the UK rural economy and particularly apple growing. It should also be noted that the UK is not alone in applying lower rates of duty to cider – this approach is shared by other EU member states and, in particular, Germany, Spain, France and Belgium.

Cider makers producing up to 70 hectolitres (hl) in any 12 months may register an exemption from duty payment with HMRC. As known to NACM, their total numbers are 386 but they are estimated to produce only about 0.3% in total of national volume. All other cider makers (ca. 92) pay duty at the full national rate. NACM estimates that 79 of these make less than 30,000 hl p.a. They distribute locally and are therefore in competition with small brewers who enjoy an individually calculated duty rate which might be at 50% of the national beer duty rate (for output ≤5,000 hl of beer p.a.).

- ***the differential between duty rates on low- and high-strength products:***

Higher strength cider duty was introduced on 1 October 1996 and is charged at a rate 50% greater than mainstream cider duty. Before 1996, higher strength cider represented about 20% of total volume and over the next 3 or 4 years this shrank to the current level of less than 2% of total volume. To NACM’s knowledge, this category is now entirely made up of artisan or craft-scale products.

Sparkling cider duty is aligned with lower strength sparkling wine duty following an agreement between the UK, Italy and the EU Commission in 1996. As the direct result, the amount of sparkling cider made in the UK is now negligible since more generally it is the preserve of duty-exempt (≤ 70 hl p.a.) cider makers.

- ***the interaction between tax and price:***

The impact of VAT must be taken into account as well as excise duty. Excise duty is the single highest cost in making cider for sale but is followed closely in significance by the high cost of the key raw material, apples, compared to other alcoholic drinks – except perhaps wine where the costs are understood to be comparable.

Recently completed econometric research by HMRC has shown that cider has the highest overall response to price change of all alcoholic drinks:

CURRENT own-price elasticities					
	beer	wine	cider	spirits	RTD
on trade	-0.69	-0.40	-0.97	-1.00	-0.79
off trade	-0.97	-0.28	-1.39	-0.74	-0.95

PREVIOUS own-price elasticities					
	beer on	beer off	wine & cider	spirits	RTD
	-0.48	-1.03	-0.75	-1.31	-0.3

Source: HMRC Indirect Taxes – Excise Team – July 2010

This and the generally slower rate of sale of cider and its lack of economies of scale result in higher margin expectation by wholesalers and retailers and leads, overall, to a higher unit retail price, in On Trade. Owing in the main to the different packaging styles historically used by cider, when compared say to beer in Off trade, the pricing is comparable.

Distribution of products

- ***Where is the market concentrated? (for ciders?)***

The UK cider market is almost entirely divided evenly between On trade (now ca. 40% of volume) and Off trade (now ca. 60%). Artisan and craft-scale cider makers claiming the 70 hl exemption from duty may sell locally in independent On & Off trade outlets or direct to the public.

- ***What products are there outside of the mainstream (i.e. at high- and low-strengths)?***

Cider is effectively limited to a ceiling of 'less than 8.5% ABV' since at or above 8.5% it is classed for duty purposes as made wine. Owing to the natural sugar content of apple juice, which ranges in specific gravity (SG) from just above 1.030 to as much as 1.070, or even more on occasions, cider is naturally somewhat stronger than beer for which it acts as an alternative (but cider is recognised as seldom if ever being the first choice of drinkers). The SG of most apple juice lies between 1.040 and 1.055 (and at these levels will give 5.2% and 7.2% ABV respectively); historically this has set the strength range. Modern premium ciders such as Magners have led the movement to lower ABVs and the recent recognition of a minimum gravity of 1033 may allow more development at lower strength in future.

Mainstream cider currently lies between about 4.0% and 5.5% ABV with some being found at 3.0% - 3.5% ABV; the overall average in 2009 was 5.0% owing to a quantity of cider at 7.0% - 7.5%.

Low-alcohol ciders are found at below 1.2% ABV and are therefore free of duty but, owing mainly to the technical difficulties of making cider (rather than apple juice) at that level of strength and the limited demand, the output is small.

Artisan and craft-scale ciders often lie close below and generally above 7.5% ABV in recognition of the selection of higher gravity juices as representing higher overall quality.

- ***What proportion of the market are these products?***

For the year 2009, NACM reports its members' output (estimated as ca. 85% of the total of cider & perry sold in the UK) as:

Low ABV	0 – 3.5% ABV:	>1% of total volume
Mainstream	>3.5% - 5.5% ABV:	84%
Higher ABV	>5.5% - 7.5% ABV:	14%
High ABV	>7.5% - ≤8.5% ABV:	<2%

- ***What drives demand for these products?***

Low alcohol ciders are considered to be very acceptable products and are represented in the market but their share of what is itself a small sector at <8% of UK drink servings in 2009 does not allow the drivers of demand to be assessed. It is assumed that only a small minority exists of consumers that wish to enjoy a cider with the absolute minimum of alcohol.

Most consumers are content to enjoy cider of the order of strength common in the UK and elsewhere in the world (3.5% - 5.5% ABV) for long alcoholic drinks.

Higher strength ciders may be sought out for two reasons: a) that they represent the highest quality expression of the finest apple juice raw material, or b) that they offer higher strength alone and regardless of quality. NACM members have made great efforts in recent years to rebalance the cider market so that a) is overtaking b). In 2009, Premium and Niche (artisan type) products together gained almost 17% of share while White cider and Value Strong cider together lost real volume and 8% of share.

- ***What are the barriers to their development and production?***

As indicated above, the key barriers to the development of lower strength ciders are a) general consumer indifference to low alcohol ciders, and b) consumer expectation that cider should be at least in the standard strength range if not stronger. It should be recognised as a major achievement that cider at 4.5% ABV has developed to a very significant extent.

Production, duty and price

- ***What are the major influences on production?***

The key influence is availability of apples (and pears) suitable for making cider in the UK style. While a significant tonnage of UK-grown surplus table fruit is absorbed each year and some concentrated apple juice is bought in, generally from European suppliers, the UK industry has had to invest heavily in the planting of cider apple orchards – either itself or by subsidising others to do so. Unlike other raw materials, an orchard is for life and has a long period of dependence in that breakeven can take between 6 and 9 years – a ridiculously long time by other's business standards. Dependence on such a relatively narrow supply base means also that, by drinks industry standards, stocks of juice and cider are carried as a strategic buffer. These costs are essential to cider making and cannot be avoided.

The industry's commitment to self-reliance is shown by NACM estimates that, in 2009, cider apple orchards already accounted for more than 45% of total UK orchard area and will be the majority by the end of 2010. This significant need brings real risk to rural economies should the cider industry suffer reverses.

Owing to its small relative size, the cider industry lacks economies of scale. Stemming from this are demands from distributors and retailers for higher margins on cider than on the larger volume and value sectors of the UK drinks market. The rural base of the industry compounds this effect.

- ***What are the strongest drivers of price?***

Duty, followed by raw materials, is the single most significant cost and, with regular increases in rates above inflation, these are the first trigger of rises in ex-cider mill prices. VAT is also of course significant but changes there occur automatically. Duty and VAT changes are wholly outside the cider maker's control.

- ***To what extent are duty changes passed through?***

As with any drink sector, cider makers seek to pass on duty increases in full to their customers. The customer's natural resistance to this can delay pass-through and the resulting cost differential must be borne by the drink producer.

Eventually, duty increases, like any cost, will result in depressed profitability and all drinks producers must then, to protect shareholder value, raise prices further to restore percentage margins.

- ***How does this differ between the on- and off-trades?***

There is little difference nowadays – if there ever was before. The growth of pub operating companies' influence means that the negotiating experience nowadays is much the same.

- ***How does duty affect the final consumer offering?***

In 2008, NACM carried out a detailed analysis, on a comparative basis, of the cost structure of cider to retail price. This is reviewed from time to time and is reported in some detail in the 2010 Review.

As a general rule, while the drinks maker may increase his price by the amount of a duty increase, the distribution chain, working on fixed percentage margins, will automatically apply a margin expectation to the new, higher duty price. This and the effect of VAT on final price means that the influence on retail price of any duty increase becomes multiplied. Cider might expect to see duty pass-through to retail of 3 to 4 times in On trade and 1 to 2 times in Offs.

Consumer demographics – 'Harm-related' questions

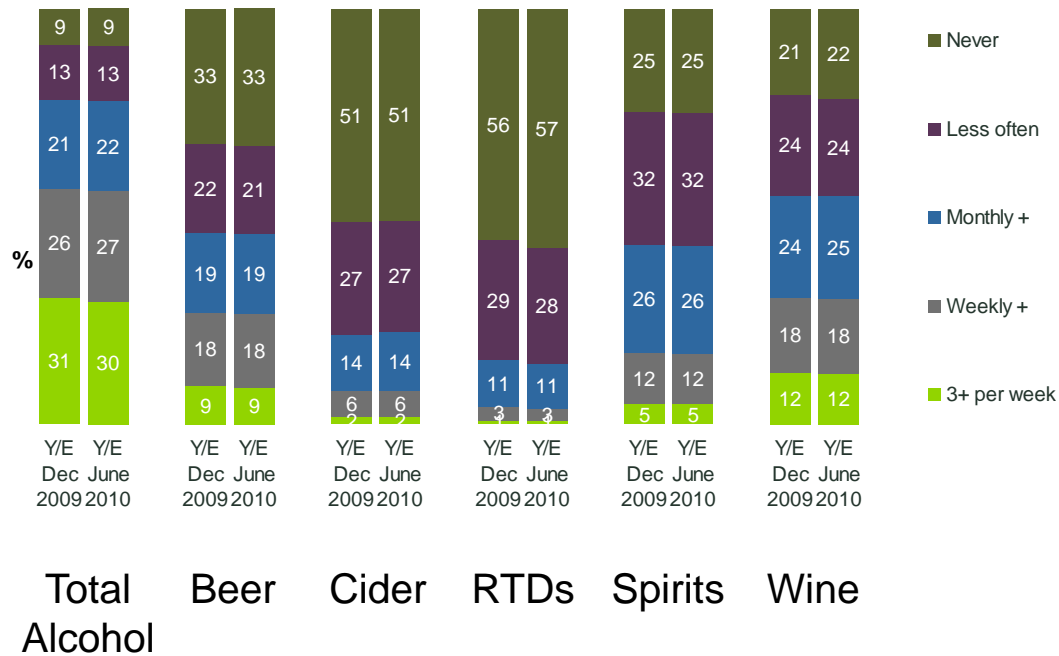
In response to the specific questions asked under this heading and the others that follow, NACM is unable to offer more than a few specific answers. While relativities to other alcoholic drinks are researched, the cider sector is too small – see chart on claimed frequency of drinking alcohol categories, below - to be able to research specific cider consumer behaviour with any reliability - and it might not be proper or indeed possible for members of the alcoholic drinks sector to carry out such research in many consumer classifications.

NACM sets out its agreed position on alcohol abuse and abusers after the chart which follows.

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Claimed frequency of Drinking Alcohol Categories - Total Trade

Y/E Dec 2009 v Y/E June 2010



Source: Alcovision

NACM Position on alcohol abuse and abusers

We are of the opinion that public order and public health require their own policy instruments to tackle issues in these areas. The specific problems have to be identified and the remedial measures targeted. Taxation and other price measures are broad policy instruments that, if used to deal with specific policy concerns, will have repercussions elsewhere that could be unintentionally detrimental to the majority of socially responsible drinkers and to responsible alcoholic drinks producers.

We are aware of reported concerns over the way prices for alcoholic beverages are reduced for promotional activity. However, this is a directly legitimate and effective way to introduce consumers generally to new products and product variants as well as securing brand market shares. The unintended consequence of, for example, blanket bans or restrictions on price promotions will be to inhibit new product introductions: before any product is put on sale more widely it is usually trialed and promoted in a limited number of on and off-retail outlets. Without the ability to promote such new products, producers will not be able to introduce them to the public at large. Inevitably the market will stagnate and will become characterized by lower quality and cheaper products.

There is evidence to demonstrate that the type of consumers that purchase alcohol on promotion has reasonably low weekly spend on alcohol and that as a result of their purchase they reduce their alcohol spend in subsequent weeks. Furthermore there is no evidence to suggest promotions encourage excessive drinking.

NACM fully subscribes to the Portman Group Code of Practice which is successful in ensuring that products are marketed in a socially responsible way and only to an adult audience.

Penalising the general population by using the tax system to drive up the price of alcohol does not seem to be the most appropriate way forward in either seeking to bring about cultural change in people's relationship with alcohol or dealing with alcohol misuse (the problem drinkers).

NACM has taken the position, shared also by other alcoholic drinks organisations, that there are no problem drinks, only problem drinkers and therefore measures need to be targeted at these mis-users. Furthermore NACM believes that the panoply of powers available to the police and local authorities should be used much more effectively both against individuals who misuse alcohol and those who wilfully seek to break the law in obtaining alcohol underage, as well as against those retailers who sell alcohol irresponsibly.

It has become apparent that no effort has been made by those wishing to introduce further legislative controls on the availability and the price of alcohol to identify and deal with the real causes of alcohol misuse (*and indeed substance abuse in general*). It is short-sighted to focus on the availability and affordability of alcohol as the sole and root cause of misuse and this means that the real causes of such behaviour remain in operation and are therefore ignored and not acted on. The real drivers behind harmful drinking, binge drinking behaviour and under 18's alcohol misuse are overlooked as a consequence. Failure to get this right means that behaviour does not change, misuse and harmful drinking continues but the general public are penalised as a result of failed policies built on false premises.

Specific questions posed by the review

- ***What types of consumer are associated with alcohol-related harms?***
- ***Can we characterise 'problem drinkers'***
 - ***by age, gender, income?***
 - ***by drinking location, occasion?***
- ***What drives problem consumption?***
- ***How price-sensitive are problem drinkers?***

Products and harm

NACM is not aware of any medical or other scientific evidence that might indicate that any alcoholic drink has of itself more connection with problem behaviour than any other.

- ***Is there evidence that certain drinks are associated with problem behaviour?***
 - ***Types of drink***
 - ***Strength of products***
- ***Are different types of drink associated with different types of harm?***

Ban on below-cost sales

- ***Government is committed to a ban on the sale of alcohol products below cost price.***
- ***Duty forms a part of costs, alongside inputs, production costs, rents, marketing, etc.***
- ***Government considering definition of cost, options include a net invoice cost or form of "average cost".***

If such a broader 'cost' definition than duty and VAT is sought, then, given the wide range of products available within not only the cider industry but all other alcohol sectors, it will be a challenge to set a satisfactory definition – or level – of minimum cost. Failure to do so could inadvertently expose premium and artisan producers, whose products will naturally have a higher cost base when compared to mainstream producers, during any customer negotiations.

- ***Home Office consultation: "Rebalancing the Licensing Act".***

NACM members are not directly concerned in retailing – apart from any on-site shops run usually by smaller-scale cider makers. However, the experience reported by artisan or craft-scale members, to whom special public events are an important channel of trade, is of increased bureaucracy and cost under the 2003 Licensing Act and to little purpose since such events are generally well-run and do not lead to excessive or inappropriate consumption.

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