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TECHNICAL  
REPORT

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# Preliminary assessment of economic impacts of alcohol pricing policy options in the UK

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## Executive summary

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### Introduction

Alcohol has an important economic and socio-cultural place in the UK. It creates jobs, generates fiscal revenues in the form of alcohol taxes, and contributed around £2.7 billion<sup>2</sup> in 2007 to the economy through trade (ONS, 2007b). Alcohol is shared in social interactions, and is drunk as an accompaniment to meals. While alcohol has been, and continues to be, consumed in an unproblematic way by many people, a proportion of alcohol consumption is problematic and generates harms for individuals and society.

Alcohol misuse is high in the UK policy agenda. According to data from the World Health Organization (WHO), alcohol consumption in the UK increased by approximately 4 percent between 1985 and 2003, whereas it decreased over the same period for most other European Union countries (Rabinovich *et al.*, 2009). At the same time, some alcohol-related harms have grown over this period; for example, there were 8,758 deaths from alcohol-related causes in the UK in 2006, twice as many as there were 15 years before (National Audit Office, 2008).

While there is a large body of literature focusing on the variety and extent of the public health and criminal justice impacts of alcohol use, its *economic* impact has received relatively less attention. In order to help Government assess the full range of implications from proposed alcohol pricing policies, RAND Europe has undertaken this study to provide evidence in the area of potential economic impacts of the following three pricing policy options: minimum pricing, ban on below-cost sales, and taxation.

### Approach

Through qualitative and quantitative methods, this report provides a preliminary assessment of the potential economic impacts of three pricing policy options to increase the price of alcohol. These are minimum pricing, increases in taxation, and a ban on below-cost sales. In order to conduct this preliminary assessment, we:

- review existing literature on the three policy options
- present statistics and relevant economic literature on the UK market for alcohol, and

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<sup>2</sup> In terms of gross value added (GVA), which is the difference between the value of goods and services produced and the cost of raw materials and other inputs used in production.

- conduct interviews with representatives of the alcohol industry and business and economic academics to understand the industrial relations and product development aspects in the UK alcohol market.

Based on the above, this report discusses the potential impacts that the three pricing options may have on consumers, producers, the on- and off-trade retail sectors, and government.

## **Main findings**

The main findings from this study are presented for each pricing policy below. The literature on the pricing policies has grown substantially over the past decades, particularly for taxation policy. There is a great deal of available data to describe the UK market for alcohol and interviews provided interesting insights into the actual operations in alcohol market.

On the other hand, there are some limitations to our findings. Literature on the economic impacts of the different alcohol pricing policies remains surprisingly scarce, despite the passionate debate about the potential winners and losers from these measures. Furthermore, the complexity of the alcohol supply-chain and the long-run implications of the pricing policies are inadequately researched and there are therefore many uncertainties regarding effects in the longer-term. Consequently, the main findings presented in this report should be interpreted with caution.

### **Economic implications of minimum pricing**

Unlike taxation, minimum pricing circumvents retailers' ability to absorb price increases, so all alcohol currently sold below the minimum price per unit would become more expensive with the introduction of this policy. The full effect of the policy of course depends on the minimum pricing introduced; for instance, a minimum price of £0.30 per unit of alcohol is unlikely to change much as most alcoholic beverages (other than cider) are already priced above £0.30 per unit.

Since the price effect of this policy is especially strong for low-cost alcohol, minimum pricing has important implications for young and hazardous/harmful drinkers and low-income groups, who are more likely to purchase cheaper drinks.

Due to the already higher prices charged, minimum pricing is likely to affect prices in the on-trade less than other retailers. In fact, on-licence may benefit from increased trade as the relative prices of on- to off-trade premises are reduced, and some consumption switches from the off- to the on-trade. Nevertheless, minimum pricing could have a positive impact on other off-trade retailers' revenues as well. The direct costs to producers and retailers of implementing this regulation are likely to be relatively small.

Lastly, government generates no revenue from a minimum price policy.

### **Economic implications of a ban on sales below cost**

The size of the impact of a ban on sales below cost depends on the extent to which retailers engage in this pricing strategy. There is evidence that sales below cost are particularly common in the UK in the supermarket sector, and specifically during times of high demand (such as Christmas and the hotter month of July). It is also possible that retailers (especially large supermarket chains) would lower alcohol prices further in order to

circumvent a ban on below cost sales. The effect on consumption of a ban on sales below cost, therefore, may be relatively small compared with broader restrictions on discounts and promotions, and also with the introduction of certain minimum prices or tax hikes. Nevertheless, even if the effect is small, where it increases the price of the cheapest drinks, the ban could potentially lead to some reduction in hazardous/harmful drinking.

An important issue regarding sales below cost bans is the definition of cost adopted for this policy. If cost is defined as VAT + excise duty, the implementation and compliance costs of the policy are relatively small as VAT + excise duty are a transparent and easily identifiable cost. Another definition of costs (such as the true cost of production of the product) would make this policy much more difficult to implement due to the fact that many of these costs vary significantly across products, producers and even times of the year.

As in the case of minimum pricing, the ban would not generate revenue for government.

### **Economic implications of increases in alcohol excise duty rates**

For the most part, the on-trade sector in the UK appears to pass tax increases on to consumers at least at the level of the tax increase, whereas the off-trade (in particular larger retailers such as supermarkets) appears to be more able to absorb these increases, leading to little or no change in the price faced by consumers.

When they are passed on, taxes affect all drinkers, who either pay more to consume the same amount, reduce the amount they drink, or substitute for cheaper beverages or other products. This is why taxation has been considered a 'blunt instrument' that does not target those drinkers who cause harms, instead affecting all consumers to some extent.

An important aspect of taxation is that, unlike with the two other pricing policies examined here, the government obtains additional revenues from tax increases.

### **Future research directions**

A key element of the economic assessment is to understand what will be the actual, final prices to consumers in each of the policies. This means taking into account the inter-dependent, dynamic relationships between actors in the alcohol market and, thus, an important avenue of research would be to estimate the long-run prices of alcohol.

The way in which alcohol reaches retailer shelves and on-trade menus deserves further scrutiny. There may be constraints and incentives in the system that will be important to consider for the long-run, economic sustainability of all actors, such as wholesalers.

A significant research gap exists in the UK on the substitutes and complements to alcohol. This is an important element of an economic impact assessment, as price increases in alcohol may have the unintended consequence of leading to growth or decline in other commodity markets, such as cannabis or tobacco.