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Editorials

The economics of tobacco trade: enabling the transition

This issue of *Tobacco Control* features an address to the 9th World Conference on Tobacco and Health by Howard Barnum, a senior economist at the World Bank.[1] In his address, Barnum makes three points. First, tobacco consumption (and therefore, the associated mortality and morbidity rates) is destined to rise worldwide, particularly in developing regions. Second, the costs to society, narrowly defined as direct health-related expenses and loss in productivity, far outweigh the benefits of the existence of the tobacco industry as an economic activity. Finally, this imbalance calls for policy action on the part of governments to curtail the consumption of tobacco.

The logic of the Barnum and similar arguments is impeccable. The aim of this editorial is not to question Barnum's conclusion, but rather, to briefly discuss the matter of costs and benefits, and to probe in a bit more detail *transition* costs and institutional arrangements, so as to suggest further research and policy directions.

It is not clear which way the bias contained in estimates of the net costs of tobacco consumption operates. Clearly, costs associated with increased morbidity and mortality differ across countries, and indeed within countries. Even using national averages on figures like health care costs and lost income, (or global averages, as Barnum does in his background paper[2]) can be problematic in light of skewed income/wealth distribution or differing access to health care for different groups in a particular country. On the other hand, it is also the case that morbidity rates due to tobacco use are typically under-reported in developing countries.

What this really points to is the need to conduct region-specific or country-specific assessments of the costs associated with tobacco-related morbidity and mortality. At the very least, we need to differentiate between net tobacco users and producers, as this distinction has serious balance of payments, public finance, and regional development implications, addressed below in more detail.

The Barnum argument for higher taxes on the use of tobacco would be buttressed if the case were made not only on optimal tax grounds (as factoring in costs at developing country levels significantly lowers the required optimal tax rate), but rather, on demand elasticity ("sin taxes") grounds as well.* This goes against a fundamental tenet of economic efficiency (and Bank-Fund adjustment programmes), which is to minimise distortions, and simplify tax regimes, but nonetheless merits our attention. This leads to the second theme of this editorial.

Although globally tobacco reduces social welfare, there are individual countries and regions within them, and individual governments or levels of government, which have come to rely heavily on tobacco production and processing as an economic activity. While Malawi and Zimbabwe come readily to mind, the fact is that almost every country in the world has regions or sectors within it which rely on the tobacco industry as an economic activity.

Even though the sale of tobacco is likely to be more price-sensitive in developing countries than in industrialised countries,[3] it will be possible to tax its consumption, alter (slightly) its pattern of use, and yet maintain it as an industry in tobacco-producing areas. However, if serious and pro-active efforts are made to curtail its consumption, then the budgetary and livelihood implications of moving away from tobacco need to be examined.

The issue is complicated by the fact that whatever commodity-oriented industry growers are persuaded to enter, it is unlikely that the commodity price will be as buoyant and stable as that of tobacco has been. Besides, tobacco companies have a reputation for paying cash, and on time, something that cannot be said of many public-sector enterprises, often encumbered with severe cash flow problems.

In the short run, tobacco-exporting countries will face significant reductions in their foreign exchange earnings (Malawi, for example, derives approximately two-thirds of its export earnings from tobacco). Governments, too, will face the prospect of lower revenues from export and processing taxes related to tobacco. Individual regions will face structural issues that any "one-industry town" must eventually face.

If the current situation is undesirable, and a tobacco-free future is clearly superior, then it is time to think of enabling the transition from one state to the other. It is here that the potential of the Barnum paper, and indeed that of organisations such as his and ours, remains largely untapped.

If net gains – tangible financial savings – are to be made from reducing tobacco consumption, then consideration must be given to mechanisms or institutional arrangements wherein at least a part of these gains are transferred to support the adjusting regions during the transition. This is a particularly tricky issue if the gains will only be realised many years after an anti-tobacco policy is instituted, or if the calculation of the gains depends on the value of certain parameters. Secure in the knowledge that tobacco control policies will result in tangible future gains, the inter-

* Simply defined, an optimal tax is one that equalizes the benefits of lower tobacco consumption (principally financial estimates of reduced morbidity and mortality) with the costs of lower tobacco consumption (ie, lost income for the tobacco industry and a measure of foregone "satisfaction" for consumers). The point being made here is that there is no reason why tobacco could not be taxed even beyond this point. Of course, the argument for this depends heavily on what alternative use the revenues thus raised are put to by governments.

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national community should, at the very least, be willing to put up money today to fund transitions away from tobacco.

From a development or political economy point of view, the situation is not unlike the issue of the European Union's Common Agricultural Policy. Tobacco lobbies in the US, Europe, and Canada have maintained their existence in the face of strong market and environmental pressures to do otherwise, through skilful manipulation of the political process. There is no reason why African farmers should pay the price for the self-interested (what economists call "rent-seeking") behaviour of tobacco interests (cultivators and manufacturers) in rich countries. Someone, somewhere needs to articulate this to policy makers in developed countries, and it is not unreasonable to expect multilateral organisations and national development constituencies within their own countries to principally take on this task. They have done so with great effect, for example, in articulating the benefits of global free trade over parochial national interests and policies.

Finally, Barnum outlines the Bank's policy vis-à-vis tobacco. It is clear and to the point. The next step would be to think through the implications for growing and processing regions of decreased world consumption of tobacco, and to support transition initiatives in pilot areas. In fact, the Bank is ideally suited to be the broker for any mechanism to administer a transition fund based on global savings from decreased tobacco use. There are lessons to be learnt, both positive and negative, from experience with the Global Environmental Facility, the fund established to finance environmental projects that carry national implementation costs, but global net benefits.**

** An externality is a positive or negative by-product of the consumption or production of a good which is not reflected in its market price. We recognise that the analogy of tobacco as a global externality is imperfect. In the case of a true global externality, such as protection of the ozone layer, in which a country (such as Brazil) is asked to curtail deforestation in the interests of saving the world's (not just Brazil's) atmosphere, a case may be made for having a mechanism like the Global Environmental Fraternity to "tax" the world and compensate individual countries that bear most of the costs of implementing the environmentally friendly policy. In the case of tobacco, the analogy is not perfect because the costs and benefits of curtailing the tobacco industry are often centered in the same country but among different groups, certainly more so than in the case of many environmental initiatives. The general point being made here is this: to the extent that already poor countries or groups within them will be affected disproportionately by tobacco consumption-reducing policies, there is scope for a mechanism that eases their transition from tobacco-related activities to other less socially harmful ones.

Barnum ends with a "simple message". The message in this editorial is equally direct. Tobacco is a losing economic and social proposition. That shown, we must start work on the task of designing and enabling an appropriate adjustment path from a clearly undesirable state to one that is superior.

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1 Barnum H. The economic burden of the global trade in tobacco. *Tobacco Control* 1994; 3: 358–61.
2 Barnum H. *The economic costs and benefits of investing in tobacco* (internal working document). Washington, DC: World Bank, March 1993.
3 Chapman S, Richardson J. Tobacco excise and declining tobacco consumption: the case of Papua New Guinea. *Am J Public Health* 1990; 80: 537–40.

Editor's note

In response to the costs and benefits of tobacco production and consumption in the developing world, the International Development Research Centre has launched the **International Initiative for Tobacco Policy Research**. This multi-donor consortium will fund economic, agricultural, environmental, health, social, and legislative research in support of effective public policy and in support of the development of feasible transition initiatives for tobacco producers. The Initiative will also fund capacity-building and information dissemination activities.

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