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. 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) 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, 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 grows 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 whereby 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-
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 develop-
ment 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 im-
plementation 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 con-
sumption-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
2 Barnum H. The economic costs and benefits of investing in tobacco (internal
3 Chapman S, Richardson J. Tobacco excise and declining tobacco
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, en-
vironmental, 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.