

THE ECONOMICS OF TOBACCO AND TOBACCO CONTROL, A
DEVELOPMENT ISSUE.

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The facts and figures clearly show the enormous and increasing health impact of tobacco use in development countries. This is especially an issue in Europe and the Former Soviet Union, and in Asia. It should be more than clear that in many countries, reducing tobacco use will make an important contribution in the medium and long term to improving health outcomes.

I will talk about some key economics issues related to tobacco, and explain why we in the World Bank believe that tobacco control is an important part of the development agenda, and some of the things that development agencies and donors can do to make a difference.

No one disputes any more that tobacco use causes disease and death. However, many countries hesitate to implement strong tobacco control measures, in part because they fear that Tobacco Control measures (especially tax increases) may hurt poor people, reduce government revenues, lose jobs, and cause smuggling. Is any of this true? In 1998/99 we recruited a large group of economists and other experts, to look at the facts, and carefully analyze the economic impact of tobacco control. Just how economically important is tobacco? Will tobacco control harm the economy?

The results of this work are published in summary in “Curbing the Epidemic”¹, and in detail in “Tobacco Control in Developing Countries”.²

Lets look at some of the key findings.

Certainly tobacco farming, processing and tobacco product manufacturing create jobs and generate government revenues. There are a handful of countries and regions within other countries where tobacco makes an important contribution to the economy. But in most countries, the economic contribution of tobacco is small. Only a small percentage of farmers grow tobacco, and for many, it no longer provides much of a living. Only a tiny fraction of the labor force relies on tobacco for employment, and mechanization in the cigarette industry is reducing those jobs. For the many countries with net foreign trade deficits in tobacco leaf and products, tobacco damages, rather than helps, their trade balance.

So while the economic benefits are large in some cases, a lot of the benefit is in the form of corporate profits, that don’t do much for economic development. The broad economic benefits of tobacco to developing nations are often overstated.

Set against the economic benefits from tobacco, there are also substantial economic costs -

Annual health care costs are higher for smokers, and the burden of these costs falls on families, the public purse, and employers/insurers.

Earnings and productivity losses because of tobacco-related illness and premature death can be huge, and are borne by employers and employees.

¹ World Bank, 1999. “Curbing the Epidemic: governments and the economics of tobacco control. World Bank, Washington DC, USA.

² P. Jha and F Chaloupka (editors). 2000. “Tobacco Control in Developing Countries”. OUP for the World Bank and World Health Organisation, New York, USA

Illness is a major precipitating cause of poverty – “Voices of the Poor”³ documents this for many countries.

Lit cigarettes are a major cause of fires in many countries, and environmental damage to the soil from tobacco which leaches nutrients, uses pesticides and fertilizer, and uses quantities of firewood to cure tobacco, can impose high economic losses.

And an insidious, often overlooked cost arises from the impact on the well being of poor families in which scarce income is used for cigarettes and other tobacco products.

It is not unusual for households that include one or more smokers to spend between 2 and 10% of the family income on tobacco products. For a poor family, that has a very high opportunity cost. It can mean that a child goes hungry, or is kept out of school, or that a sick family member does not see a health care worker or get medicines when necessary.

The more we look at these expenditure figures, and also take account of the impact of health care costs and lost income as a result of tobacco-related illness among poor families, the clearer it becomes that helping poor families not to smoke or use other tobacco products can contribute – perhaps significantly – to our efforts to reduce poverty.

While we are talking specifically about poverty and tobacco, lets look at another concern that we hear often – Won’t cigarette tax increases hurt poor smokers? Clearly, if tobacco product prices rise, poor people who continue smoking the same amount will pay more, which diverts more family income and raises the tax burden that they bear. But economic theory and a growing body of empirical evidence (eg recent research in Poland, South Africa, Bulgaria,) shows that people with low incomes are more likely to cut back

³ D. Narayan, R. Chambers, M. Shah and P. Petesch, 2000. *Voices of the Poor Crying Out for Change*. World Bank, Washington DC, USA.

their tobacco consumption or quit when prices rise. These people benefit twice over- they have more money to spend on other things, and they reduce their risk for developing tobacco-related diseases.

This underlines the importance of advice, support and help for smokers to quit, and particularly efforts targeted to poor smokers.

Finally, tobacco tax increases will result in higher government tax revenues, and the additional revenues could, in principle, be used in ways to benefit poor people – whether to improve health services, water and sanitation, education and training, build roads in rural areas, etc.

Now I'd like to turn to some macroeconomic issues related to tobacco control. World Bank and World Health Organization analysis clearly shows that tax increases are the single most effective and cost effective measure to reduce tobacco consumption. Practically every country that has raised tobacco taxes has enjoyed a rise in total tax revenues as a result. One example, Norway, shows that even at very high levels of tax and price, and with many other measures all trying to reduce consumption, tax increases keep generating more revenues, even though higher prices reduce consumption. It's an unusual win-win situation for health and finance – higher taxes mean more revenues and better health outcomes.

Now the question that always arises is about smuggling – will tax increases cause more smuggling?

High taxes and prices and large differentials are only part of the smuggling story. They may provide an incentive to smuggle, and an opportunity for criminals to make large profits. But they are only part of the explanation for smuggling. Our analysis shows

that general levels of corruption play a big role. And supply issues are often disregarded, but they are absolutely key. So long as it is possible for smugglers to buy cigarettes cheaply from manufacturers (or middle men) and sell them for a profit, with little risk of being caught, there will be an incentive to smuggle. Even if taxes were half their present level, there would still be an incentive to smuggle, and big illegal profits to be made. So reducing taxes or foregoing tax increases is NOT the solution. There are effective actions that can be taken, and are starting to be taken and to show an effect.

If tobacco consumption falls, there may indeed be some job losses. But the money that used to be spent on cigarettes does NOT disappear from the economy. When people cut back their smoking or quit, they spend the money on other things. This generates new jobs in other sectors. And in almost all countries where this expenditure switching has been carefully studied, there are more new jobs created than there are jobs lost.

Of course, there are winners and losers. Some people will lose jobs and income, others will gain, and I don't want to pretend that this isn't a major concern. But it is not something unique to tobacco – we have to deal with changes in consumption patterns and other economic adjustments all the time.

Since farmers are a special concern in several countries, let me make two points. (1st) The FAO projections suggest that farmers will be able to sell their tobacco for many years to come. Even if tobacco control is very successful, the global tobacco market will only gradually decline – population and income growth (and advertising if it is allowed to continue) are pushing consumption up. (2nd) Tobacco control isn't the only factor that affects the incomes of tobacco farmers in developing countries. The subsidies that the EU, USA and other countries pay to their tobacco farmers hurts tobacco farmers in

developing countries – probably much more than tobacco control does or will in the near future.

So on that rather contentious point, but one on which our senior economist Nick Stern and other colleagues in the World Bank have been speaking out quite passionately about recently, let me conclude.

I hope that I have made the point that tobacco control is – and should be – part of our development agendas. If done well, it can contribute to reaching several of the Millennium Development Goals that many of our organizations are strongly committed to, notably poverty reduction, and better health and nutrition outcomes. It makes good fiscal and economic sense (even if it threatens company profits), and may require gradual economic adjustments.

Finally, I'd like to suggest 5 things that we in the development community can do – or do more of.

We should give greater priority to tobacco control, especially in Europe and the Former Soviet Union, and in Asia. Specifically and practically, this priority should be reflected in more resources for country-specific policy dialogue and analytic work to support it, and for other proven tobacco control measures. There is much more to be done to combat cigarette smuggling, and here regional and global partnerships are especially important. And finally, if we really care about the livelihoods and incomes of tobacco farmers in developing countries, let's take a broader perspective on how we can help, while pursuing proven and sound policies with the potential to make real health gains for

1.2 billion smokers in the world and their families and others who are exposed to second hand tobacco smoke.