

“Taxation and Illicit Trade of Tobacco Products“

Leuven

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Developing a health perspective on
taxation of tobacco products

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Carmen Álvarez Sánchez. Madrid.

Letter to editor of El País (Published 02-10-2005)



I am a heavy smoker. I am 41 and I smoke two packs per day. I started early, at 13. You could buy cigarettes everywhere. Now there seems to be a war against tobacco...

When I stop and think that a pack of cigarettes can be cheaper than a *coke*, I realise that this is aimed at “hooking” youngsters. ..This is like the first “shot” of heroin given away by dealers: they know they’ll come back for more.

It seems that it’s enough printing a label saying “*Tobacco can kill*” to be able to sell tobacco at any price. I, frankly, call this hypocrisy.

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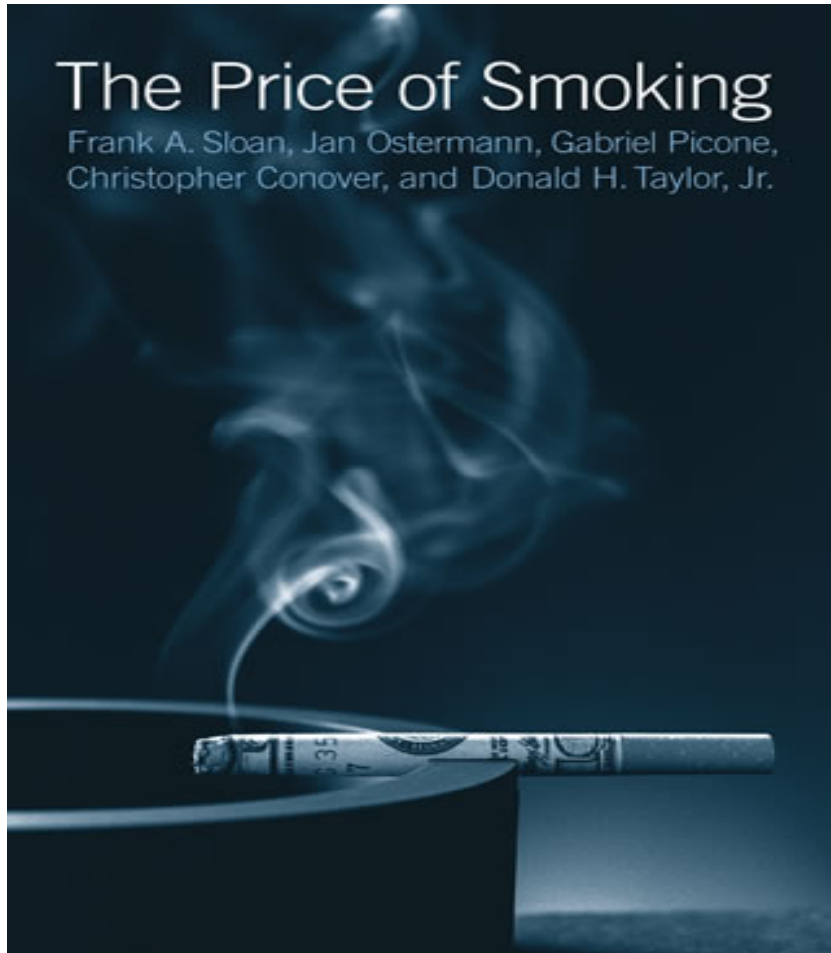


- The letter points at a divorce between public health objectives and fiscal policy
- Why is there such a divorce?
 - ▣ Standard economic rationale for tobacco taxation
- New perspectives from economics
 - ▣ *Libertarian paternalism* and tobacco tax policy

Standard economic rationale for (special) tobacco taxes

- External costs
 - ▣ Passive smoking and other costs
- Taxes should be used to incorporate these *social* costs into the price of tobacco
- How far does this argument take us?
 - ▣ Need to obtain estimates of these social costs and compare them with level of taxation

A rigorous study of costs



Sloan et al. (2004)
MIT Press "The Price of
Smoking"

External costs

| External | \$ year 2000 |
|---|---------------------|
| Sickness leave from work | 3277 |
| Medical costs (public network) | 2064 |
| Net payments to Social Security and pension plans | -9048 |
| Income tax | 4440 |
| Net payments to life insurance policies | 7702 |
| Productivity losses | 1007 |
| Total external costs | 9442 |
| Cigarette taxes paid | -3241 |
| Net external costs | 6201 |

Sloan et al. (2004) MIT Press "The Price of Smoking"

Semi-external costs

| Costs borne by household members other than the smoker | \$ year 2000 |
|---|---------------------|
| Loss of life years by spouse | 22399 |
| Years of disability by spouse | 1045 |
| Widowhood pensions | -1253 |
| Child deaths | 611 |
| Private medical costs by spouse | 604 |
| <i>Total semi-external costs</i> | 23406 |

Sloan et al. (2004) MIT Press "The Price of Smoking"

Social networks and contagion



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The importance of peer effects, cigarette prices and tobacco control policies for youth smoking behavior

Lisa M. Powell^{a,*}, John A. Tauras^b, Hana Ross^c

dependent variable and implement a series of diagnostic tests. The key finding is that peer effects play a significant role in youth smoking decisions: moving a high-school student from a school where no children smoke to a school where one quarter of the youths smoke is found to increase the probability that the youth smokes by about 14.5 percentage points. The results suggest that there is a potential for social multiplier effects with respect to any exogenous change in cigarette taxes or tobacco control policies.

Do taxes cover external costs?

- No, even if a narrow view of what are external costs is assumed
 - ▣ If semi-external costs are added to the bill, the gap is further increased
 - ▣ If external costs borne by other members of society were added, the gap would be even bigger
- For these reasons, standard economics would suggest increasing the tax burden
- **BUT THIS IS NOT THE MOST IMPORTANT ARGUMENT**

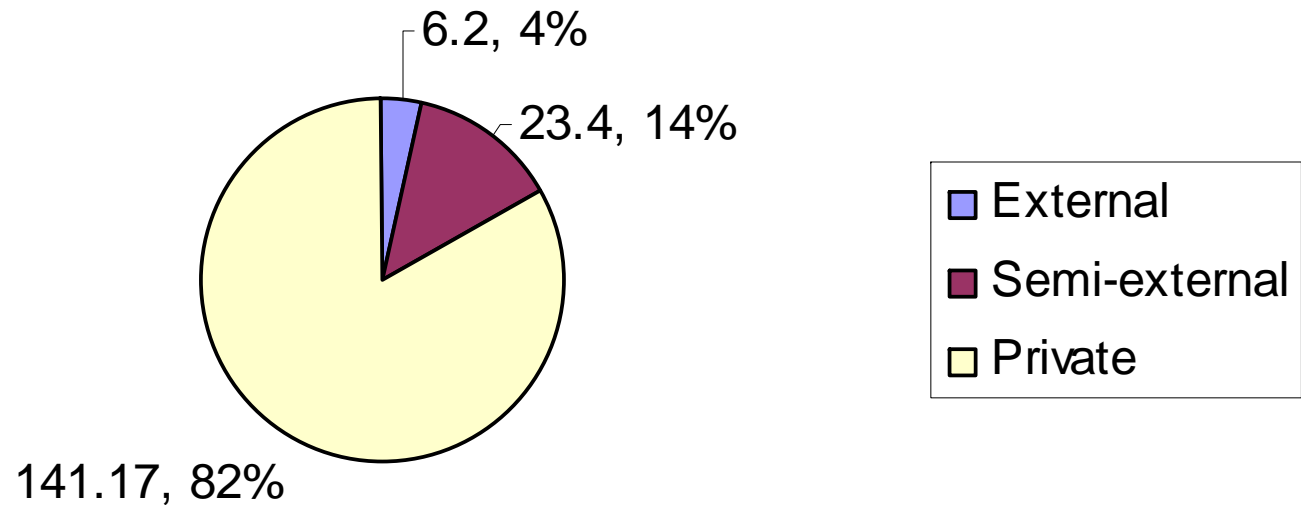
Internal (private) costs

| Costs borne by smoker | \$ year 2000 |
|---|---------------------|
| Cigarettes | 13338 |
| Loss of life years | 87378 |
| Life years with discapacity | 14621 |
| Private medical costs | 1041 |
| Net payments to Social Security and pension plans | 10301 |
| Loss of income | 22202 |
| Net payments to life insurance | -7702 |
| <i>Total private costs</i> | 141179 |

Sloan et al. (2004) MIT Press "The Price of Smoking"

The main cost is borne by the smoker

The costs of smoking ('000 dollars of 2000)



Standard economics



- A common view among economists is that these private costs are not a cause for concern
- View embodied in “happy addicts” concept emerging from theories of “rational addiction”
 - ▣ Smokers compare the private costs with the private benefits of smoking and do not smoke if the latter are smaller than the former

Standard economics

- **Motorcycling is about 16 times more dangerous than driving a car; but a motorcyclist will tell you that the pleasure of wind in the hair and a powerful engine between the thighs is worth the risk. Smoking, which can both soothe and stimulate, entails just the same sort of risk-for-pleasure trade.**
- **Blowing smoke** (Dec 18th 1997
The Economist)



New insights from (behavioral) economics



- The economics of procrastination
 - ▣ Conflicts between short term and long term objectives
 - I will start a diet next month
 - I will wake up early and study just before my maths test
 - I will stop smoking next January
 - ▣ But I do neither start a diet, nor wake up nor stop smoking when these deadlines arrive



Cigarette smoking and self-control

Kamhon Kan*

Institute of Economics, Academia Sinica, Taipei, Taiwan

Abstract

This paper empirically studies time inconsistent preferences in the context of cigarette smoking behavior. With hyperbolic discounting, an individual has time inconsistent preferences, which give rise to a lack of self-control, i.e., she may perpetually postpone the execution of a plan. This implies that a smoker who wants to quit has a demand for control devices, e.g., a smoking ban in public areas or a hike in cigarette excise taxes. This paper empirically tests this implication, using a sample that is based on survey data from Taiwan. The estimation results indicate that a smoker's intention to quit has a positive effect on the smoker's support for smoking bans and a cigarette excise tax increase. These results lend support to the validity of the time inconsistent preferences in the context of cigarette smoking behavior. This casts doubt on the validity of the assumption that individuals have time consistent preferences in Becker and Murphy's [Becker, G.S., Murphy, K.M., 1988. A theory of rational addiction. *Journal of Political Economy* 96 (4), 675–700] rational addiction model.

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Article 4

Do Cigarette Taxes Make Smokers Happier

Jonathan H. Gruber*

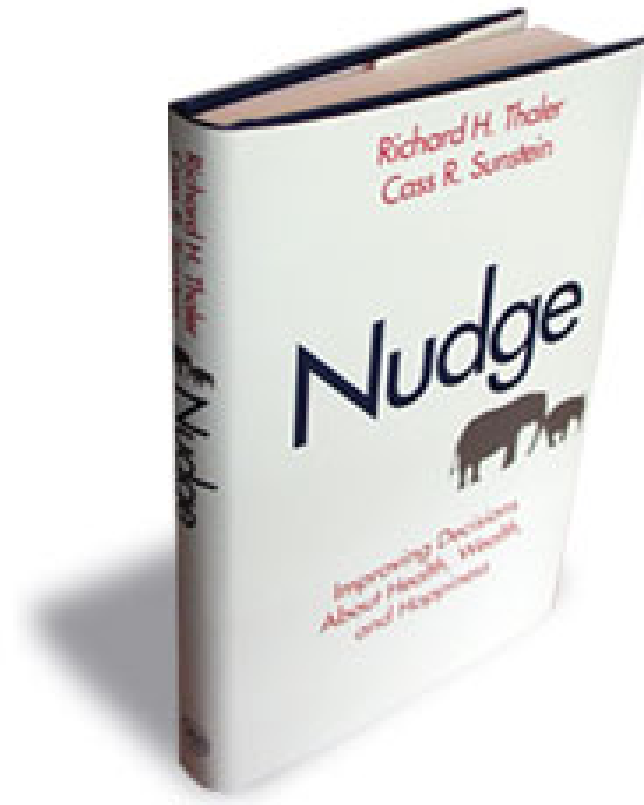
Sendhil Mullainathan†

Our results are striking: those with a propensity to smoke are significantly happier when excise taxes rise. To corroborate this finding, we use parallel data from

This result is inconsistent with rational views of smoking that would view such a tax as a pure hindrance on smokers, and more consistent with alternatives such as behavioral time-inconsistent models in which these taxes may serve as self-control devices.

Taxes as “nudges”

- These new insights support the use of taxation as self-control mechanisms
- They “nudge” individuals to behave in their own long run interest without limiting their freedom of choice (libertarian paternalism)
- They can be viewed as instruments that correct “internalities”
 - ▣ Present self vs. future self viewed as two different persons



Richard H. Thaler and Cass R. Sunstein (2008)
Caravan Books

Libertarian paternalism and smoking licences

- Some (among them Julian Le Grand in the UK) have proposed the use of smoking licences as self-control mechanisms
 - ▣ Individuals would face a situation where, by default, they cannot buy cigarettes
 - ▣ But they could easily sign out of this default by buying the licence



Julian Le Grand (LSE)

Some obstacles



- But apart from possible unpopularity with median voter...
- It might exacerbate illicit sales and smuggling
- Yet, the idea is worth exploring and it need not require public sector intervention

Put Your Money Where Your Butt Is:
A Commitment Savings Account for Smoking Cessation*

Xavier Giné
World Bank

Dean Karlan
Innovations for Poverty Action

Jonathan Zinman
Innovations for Poverty Action

August 2008

Abstract

We designed and tested a voluntary commitment product to help smokers quit smoking. The product (CARES) offered individuals a savings account in which they deposit funds for six months, after which they take a urine test for nicotine and cotinine. If they pass, their money is returned; otherwise, their money is forfeited to a charity of the bank's choosing. Smokers randomly offered CARES were approximately 3 percentage points more likely to pass the 6-month test than the control group. Surprise tests at 12 months, 6 months after the account was closed, indicate an effect on lasting cessation: those offered CARES were still at least 3 percentage points more likely to pass the surprise test than the control group. Treatment-on-the-treated estimates suggest that CARES usage increased the likelihood of smoking cessation by 30 percentage points or more.

Conclusions

- Standard economics limit the application of tobacco taxes to the correction of external effects
 - ▣ Even so, this sole reason would probably suggest raising taxes in many countries
- But the main costs are borne by smokers and many economists now agree that this can hardly be justified in terms of rational consumer sovereignty
- Taxes can then be seen as a self-control mechanism
- Some form of smoking licence could act as a self-control mechanism and respect libertarian paternalistic principles
- Other forms of self-control mechanisms complying with these principles are worth investigating