The illicit trade protocol: a cost benefit analysis

FACTSHEET

A new research report commissioned by Action on Smoking and Health in the UK shows the potential financial and health benefits to the UK of a strong illicit trade protocol. It also provides a methodology that other researchers can use to measure the possible impact of the protocol in their own country. It provides powerful evidence in favour of a strong protocol, suggesting once again that it could lead to major advances in public health.

The report, *"Cost Benefit Analysis of the FCTC Protocol on Illicit Trade in Tobacco Products"* by Paul Johnson, assesses the impact of the protocol on the UK, including identifying and quantifying all benefits and costs associated with the protocol and calculating the net benefits. A successful protocol should help to curb tobacco smuggling and limit the availability of cheap smuggled and counterfeit tobacco products. As illicit tobacco products become less available, smokers, facing higher prices, should reduce their consumption or stop smoking altogether. That would improve their health and longevity resulting in a range of benefits, such as savings to the healthcare system, improved productivity and higher output, and lives saved (or premature deaths averted).

The cost-benefit framework used in the report is a general approach to evaluating government interventions. Such analyses help governments to understand whether an intervention is likely to represent 'value for money' and to choose the most cost-effective intervention from several alternatives.

The report finds that under almost all plausible scenarios the benefits of the protocol are likely to exceed the costs, even when only considering benefits accruing to the UK. Our central estimate of the monetary net benefits to the UK (assuming very wide international take up of the protocol) is £5.7 billion (in Net Present Value terms) plus 760 premature deaths averted annually Even on the most pessimistic assumptions benefits are likely to outweigh costs.

The calculations for other countries will differ. Employment costs form a large proportion of the total, and these will vary significantly country by country, so UK costs should not be assumed to be directly transferable to other countries. The UK is characterised by quite a significant illicit market, most legal consumption being of domestically produced cigarettes and already significant action by government and manufacturers. Where there is currently less action by government and manufacturers, additional costs may be higher than will be the case in the UK. Conversely benefits are also likely to be higher.

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In fact, of course, this is an international protocol. Costs, and particularly benefits, will depend upon the actions of other countries. Benefits to the UK increase as more other countries implement the protocol. Equally, if the UK implements the protocol, that will create benefits for other countries, not estimated in the report.

The effectiveness of the protocol is likely to depend on its geographic scope:

- If the protocol is ratified by the EU member states only, it would help to curb smuggling of genuine UK brands, but might have limited impact on counterfeit and 'cheap whites'[1]. The report estimates the possible reduction in illicit trade in the UK under this scenario at between five and 15 per cent;
- If, on the other hand, most countries in the world party to the FCTC ratify and implement the protocol, it is expected to be highly effective with possible reductions in UK illicit trade between 60 and 80 per cent;
- Finally, if the protocol is ratified by the EU and a few other countries, where counterfeit and cheap whites are currently being produced, the impact initially is likely to be significant. However, over time the effectiveness of the protocol may go down because producers of counterfeit may 'relocate' to areas not covered by the protocol. Under this scenario, the report estimates possible reductions in UK illicit trade to be between 25 and 50 per cent.

As cheap illicit cigarettes and hand-rolled tobacco (HRT) become less available, those who currently buy these products would face higher prices and consequently reduce their consumption or stop smoking altogether.

Lower smoking prevalence would generate a number of benefits:

- Reduced healthcare costs
- Output gains due to reduced mortality
- Reduced absenteeism
- Years of life gained

The report puts monetary values on the first three of these. Overall, the benefits of the protocol outweigh its costs for all three scenarios of the protocol's effectiveness:

- The 'EU only' scenario leads to small positive net benefits, with the central estimates varying between £0.1 billion (for five per cent reduction) and £0.9 billion (for 15 per cent reduction in the size of the illicit market);

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[1] Foreign brands that do not have a legal market in the UK or in other EU countries.

- For the ‘EU and other countries’ scenario the central estimates of the net benefits vary between £1.6 billion and £3.4 billion (for 25per cent and 50 per cent reduction in the size of illicit market respectively); and
- The ‘worldwide’ scenario always produces large net benefits (the central estimate is between £4.1 billion and £5.7 billion).

The report also estimates the impact of the protocol on the number of deaths because of smoking-related diseases and finds that if the illicit market is reduced substantially (by 60 per cent – 80 per cent), between 596 and 759 deaths would be averted annually (based on our central estimate).

Finally, although the report’s estimates are specific to the UK, the analysis could be easily replicated for other countries. The following table show the steps that the report suggests should be taken for an assessment of the impact of the protocol on any party ratifying the protocol.

A full copy of the report can be downloaded from the ASH website at www.ash.org.uk/illicittradeprotocol/CBA

Steps in an analysis of the costs and benefits of the illicit trade protocol

	Steps
A: Costs	A1. Identify ‘additional’ elements of the protocol. For example, if all participants in the supply chain are already licensed, do not need to consider this further. A2. For all additional elements, assess costs for: - Manufacturers and primary processors; - Wholesalers and brokers; - Importers, exporters, warehousers and distributors - Retailers; - Government
B: Benefits	B1. Collect information on current size of illicit market, the number of people buying illicit products and prices of licit and illicit products. Calculate the average price paid by those who buy illicit products.

	B2. Review assumptions on demand elasticities, relative risks for ex-smokers and mortality rates by age and smoking status as these may vary by country. B3. For any reduction in the size of illicit market (from 0 per cent to 100 per cent), assess the impact on: - average price paid; and - smoking prevalence (using smoking prevalence elasticity). B4. Using smoking prevalence data over time, split the population into smokers, non-smokers and ex-smokers (the latter groups should be also split by duration of smoking cessation). B5. Assess the 'starting point', i.e. current smoking-related healthcare costs, number of smoking related deaths and absenteeism rates by smoking status. B6. For any reduction in the size of illicit market, model population 'movements' from smokers to ex-smokers and non-smokers over time. B7. Assess the impact of the population movements on healthcare costs, number of smoking related deaths (by age) and absenteeism. Express these impacts in monetary terms (by applying relevant wage rates where applicable).
C: Net benefits	C1. Calculate the net benefits as total benefits minus total costs C2. Analyse sensitivity of the results, i.e. assess the differences in net benefits under most conservative and most optimistic assumptions (if applicable). C3. Conclusions and recommendations