

Letter from America: Crime, Punishment and Tobacco

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In another of his stimulating commentaries on life in the USA, Angus Deaton takes issue with the widespread view that the tobacco industry and its clients deserve all the financial punishment that they get.

The American tobacco industry, after many years of invulnerability to legal challenges, now seems keen to find a way of avoiding a prolonged war of attrition in the courts that it will eventually lose. The parties have so far failed to reach agreement on a national settlement, whereby companies would pay the federal government in exchange for limits on future liability. However, individual states pursued their own suits against the tobacco companies to recover Medicaid expenses attributable to smoking. (Medicaid is a joint Federal-state health insurance program for low-income people, currently covering about 36 million individuals.) The states' suits were settled by an agreement in November 1998, in which the tobacco manufacturers agreed to pay, over time, more than \$200 billion (less than half of that in present value) to 46 states, the other four states having received separate, earlier settlements.

Support for a regressive tax

As far as one can judge, there is widespread support for the settlement. Non-economist friends argue that the manufacturers have behaved in a way that merits severe punishment, and think that, if anything, they have escaped lightly. This view is typically not much affected by pointing out that the settlements are coming, not out of the pockets of tobacco executives, nor even in large part from their shareholders, but from future smokers. The general view is that smokers too deserve what they get, and indeed should be grateful for the incentive to quit provided by the settlement-induced increase of about 45 cents a pack. Tobacco consumers have been demonized along with tobacco manufacturers. And some state governments seem to agree; for example, in March this year New York state increased its own state tax on cigarettes by a further 55 cents, raising the current price of a pack to nearly \$4. Several economists have argued that the tobacco settlements should be seen as a deal between government, the tobacco companies, anti-tobacco campaigners and (especially) lawyers at the expense of consumers. It is not yet clear how much the lawyers will get in the end, perhaps a quarter of the value of the settlement. If so, and depending on how the states spend their receipts, the settlements represent an extraordinarily regressive transfer, from smokers, a group of taxpayers who are poorer and less-educated than the population at large, to lawyers and taxpayers in general. Yet one of the most remarkable features of the settlement is that it is supported both by those who are opposed to taxes (it's not a tax, but a penalty) as well as those who are opposed to taxing the poor (it's for their own good).

Spending the windfall

The National Governors' Association provides details on how states are spending or planning to spend the money. Almost all plans have a substantial health component (one of the stated goals of the settlement), sometimes aimed at reducing tobacco consumption, but often less specific, for example the provision of health insurance coverage for children, or prescription drug benefits for the elderly. The tobacco growing states of Indiana, Maryland, North and South Carolina, Virginia, and West Virginia are using much or all of their funds to compensate tobacco farmers. Others are more imaginative: Georgia is funding rural economic development, Michigan and Nevada are funding college scholarship programs, North Dakota is spending 45 percent of its funds on its water needs, while South Dakota's settlement will help fund the conversion of South Dakota Public Television to digital broadcast technology. In many states, there are large provisions for education (e.g. teachers' salaries) while in others, the money finds its way into the 'budget stabilization fund' or general reserves or even, in the case of Connecticut, for 'tax relief to towns,' presumably a reduction in property taxes. There is no evidence that any state has considered that, while it might be a good idea to increase the price of tobacco to discourage its use, some part of the receipts might be used to offset the decline in smokers' real incomes.

But is it efficient?

A group of distinguished health economists, including three of the four editors of the Journal of Health

Economics, David Cutler and Joe Newhouse of Harvard and Jon Gruber of MIT, have recently argued that the public perception is right, that the states' tobacco settlement is efficient because the benefits to smokers far outweigh the costs to smokers. Although their calculations involve much more, the main point is that, at \$150,000 per year of life saved, the increase in price makes smokers better off. The authors recognize and defend their rejection of consumer sovereignty and explicitly dismiss the theory of rational choice, at least as applied to the decision to smoke. One might argue that this represents a good case of economists belatedly recognizing that lay (not to mention psychologists') views may have more to be said for them than is traditionally recognized by the profession. Yet non-economists are not so likely to approve of the valuing of life (from the same kind of optimal choice between risky alternatives that is assumed not to apply to tobacco consumption) nor of the fearless use of the monetary arithmetic to subtract deaths avoided from taxes paid.

In all this debate, only the tobacco lobby seems interested in defending smokers, a defence that is easily discounted. Yet surely there is much to be said for economists' once standard belief, that people know what is good for them, that health and life-expectancy are not the only determinants of welfare, and that smoking brings benefits to many. But if you live in the US, if you are poor, poorly-educated, and enjoy smoking, you must pay better-educated and more fortunate people for the privilege, and be grateful, to boot. And the process seems far from over. The industry still bears a legal liability to be decided by future court cases and the (partial) defeat of the tobacco industry has effectively declared open season on tobacco users for any state governor short of money to fix his state's digital television.

Angus Deaton's Letter from America appears every six months in the Royal Economic Society's Newsletter. For more information, visit <http://www.res.org.uk/society/newsletters.asp>.

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