

REVIEW

Tobacco Regulation or Litigation?

Eric A. Posner[†]

Smoke-Filled Rooms: A Postmortem on the Tobacco Deal,
W. Kip Viscusi. Chicago, 2002. Pp vii, 263.

INTRODUCTION

Cigarettes kill hundreds of thousands of people every year, yet until recently litigation against the tobacco industry constantly failed. In case after case judges and juries found that smokers understood the risks of smoking and thus could not hold the tobacco industry legally responsible for the consequences. When states brought suits claiming that the tobacco industry owed them reimbursement for Medicaid expenses attributable to care for tobacco-related illnesses, observers expected the suits to go nowhere. The state suits appeared to be parasitic on the individual tort suits that had failed, for the states would not appear to have a claim unless the tobacco industry wronged the smokers who benefited from Medicaid. Yet the tobacco industry agreed to a settlement worth hundreds of billions of dollars, and to curb advertising and marketing practices.

This Master Settlement Agreement (MSA) is just one brick in the regulatory edifice that houses the smoking policy of the United States. The federal government imposes an excise tax on cigarettes; regulates warning labels, advertising, and product characteristics; and forbids sales to minors. The state governments have their own excise taxes on cigarettes; they also regulate advertising and sales practices in ways that go beyond the requirements of the MSA, and restrict smoking in workplaces, restaurants, and other public spaces. Municipalities impose yet another layer of regulation.

[†] Kirkland & Ellis Professor of Law, University of Chicago. Thanks to Scott Hemphill, Saul Levmore, Richard Posner, Lior Strahilevitz, Cass Sunstein, Adrian Vermeule, and David Weisbach for helpful comments and discussions, and J.T. Bloch for research assistance. Thanks also to The Sarah Scaife Foundation Fund and The Lynde and Harry Bradley Foundation Fund for generous financial support.

In *Smoke-Filled Rooms*, Kip Viscusi lobbs grenades at this byzantine structure. He is not its only critic; many legal scholars and public health experts have weighed in against the MSA as well as against many of the tobacco laws and regulations.¹ But Viscusi's arguments deserve special attention. He is one of the most prominent authorities on government regulation, and has written a great deal about tobacco regulation in particular.² He has played a role in the tobacco litigation on the side of the industry. And he is one of the few reputable scholars who could be characterized as a defender of the tobacco industry, or at least as an anti-antismoking advocate,³ though he does not criticize all tobacco regulation.

The book consists mostly of previously published work and is a bit of a hodgepodge as a result, but two main themes emerge. The first theme is that cigarettes are not different from other hazardous products that are widely tolerated, and should be regulated with similar moderation. Smokers have a good though not perfect understanding of the risks of smoking, and smoking does not cause a significant level of harm to nonsmokers. Cigarettes are like knives, chainsaws, snowmobiles, and other risky but useful or enjoyable products, and should be regulated no more severely. Traditional and recently proposed tools of tobacco regulation—including excise taxes, extreme and alarmist warning labels, and advertising restrictions—have significant flaws and should be eliminated or cut back (p 7). Viscusi does not, however, object to all regulation. He supports restrictions on youth smoking and moderate labeling requirements (pp 191–92). Although he seems skeptical about the dangers of second-hand smoking, he acknowledges that they might justify limited regulation (pp 101–02). He proposes that the government develop a rating system that would help consumers understand the risks of smoking different kinds of cigarettes; and that the government encourage cigarette companies to design safer cigarettes (pp 13, 213–14).

The second theme is a critique of the MSA, the litigation that led up to it, and other recent tobacco-related litigation efforts. The MSA is a special object of scorn for Viscusi not only because it involved de facto excise taxes⁴ and other restrictions that Viscusi deplores, but also

¹ See, for example, Robert L. Rabin, *The Third Wave of Tobacco Tort Litigation*, in Robert L. Rabin and Stephen Sugarman, eds, *Regulating Tobacco* 176, 192–93 (Oxford 2001). Other essays in this book also criticize the MSA.

² See, for example, W. Kip Viscusi, *Smoking: Making the Risky Decision* (Oxford 1992).

³ For another example, see Robert D. Tollison and Richard E. Wagner, *The Economics of Smoking* (Kluwer 1992).

⁴ The MSA did not explicitly mention excise taxes, but the payment provisions are functionally equivalent. See Jeremy Bulow and Paul Klemperer, *The Tobacco Deal*, Brookings Papers on Economic Activity: Microeconomics 323 (1998) (discussing an earlier settlement proposal that functioned like a per pack excise tax). It should also be mentioned that a few states are not

because, he claims, it was based on an indefensible legal theory, and it served mainly to cartelize the tobacco industry (pp 16, 38). Part of the critique is Viscusi's famous "financial costs" argument that even if the states had a valid legal claim against the tobacco industry, damages should have been zero because the states gained more from the early mortality of smokers than the states lost in the form of medical expenses. His larger point is that when tort lawyers bring class actions against manufacturers of hazardous products, there is a danger of secretive, irresponsible, lawyer-enriching "regulation by litigation," of which the MSA is just one example among many (pp 5-7).

In this Review, I focus on three of Viscusi's claims. First, I argue that Viscusi's "financial costs" argument rests on a misunderstanding of the law. Second, I express some doubts about his normative proposals. Third, I comment on his concerns about regulation by litigation.

I. THE MSA

A. The States' Legal Claims and the MSA

The states sued the tobacco companies for reimbursement of the Medicaid costs attributable to treatment of smoking-related illnesses. The states pressed diverse legal theories, but because of the settlement none of the theories was evaluated by an appellate court. This presents a quandary for scholars who want to understand why the tobacco industry settled. Many of the states' theories were implausible; and even if accepted, normal calculations of damages would not have produced the sums that the tobacco industry agreed to pay. For this reason, some scholars have argued that the settlement was in fact a conspiracy between the states and the tobacco companies to cartelize the industry (p 38). But before we examine this argument, let us look more closely at the law.

The simplest and most plausible legal argument was that the tobacco companies committed a tort against smokers, and the states, because they acted as insurers for the smokers, are subrogated to their claims. The states did not actually make this argument, because the subrogation theory would have invited litigation from the Medicaid recipients who would have had a right, under subrogation principles, to collect from the states to the extent that the states recovered damages in excess of the cost of care.⁵ But many courts probably would

formally parties to the MSA but settled with the tobacco industry separately, although the settlements were for the most part quite similar.

⁵ See Hanoch Dagan and James J. White, *Governments, Citizens, and Injurious Industries*, 75 NYU L Rev 354, 384-85 (2000).

not have accepted any other theory, giving states the choice to amend their complaints or drop them.

Subrogation claims are vulnerable to defenses to the underlying claims; thus, the tobacco industry would have been able to assert the same assumption of risk arguments against the states that had proven so powerful in litigation brought by individuals. For Viscusi, this point is enough to dismiss the MSA as an error or fraud (pp 16–17). But tobacco litigation in the late 1990s was different from the earlier litigation. Information discovered in succeeding lawsuits painted a bleaker and bleaker picture of the actions of tobacco executives, enough to persuade some of the more recent juries that the industry wrongfully misrepresented the dangers of the product.⁶ In addition, tort standards are not static: what is reasonable conduct at one time will no longer seem reasonable a few years or decades later.

The only other theory of recovery that seems plausible is a *parens patriae* claim that states have a quasi-sovereign interest in the well-being of their citizens, a claim that was accepted by one trial court but that has been criticized by commentators.⁷ On this theory, the states are harmed by the injuries suffered by all smokers, not just those who received Medicaid benefits, and are entitled to a remedy from the tobacco industry. The states asserted other theories as well, including theories based on older statutes and recently enacted statutes designed to give them standing to sue the tobacco companies.⁸

One reason the tobacco industry might have settled, then, is that it believed that it would become more vulnerable as tort standards evolved, as further information about the tobacco executives' behavior came to light, and as states reached for or created legal instruments that were not available to individual plaintiffs. If so, the decision to settle was prescient rather than foolish: individuals have started winning lawsuits against tobacco companies since the MSA was implemented. Viscusi blames the MSA for this development, but he provides no evidence that it affected attitudes in such a profound way. Attitudes toward smoking had been changing for many years before the MSA was negotiated, and the MSA was as likely a reflection of these changes as a cause. The MSA had no precedential effect in a court of

⁶ Compare *Pritchard v Liggett & Meyers Tobacco Co*, 350 F2d 479 (3d Cir 1965), with *Henley v Philip Morris*, 1999 WL 221076 (Cal Super).

⁷ See *Texas v American Tobacco Co*, 14 F Supp 2d 956, 962 (ED Tex 1997) (allowing Texas to pursue a common law theory of recovery based on its quasi-sovereign interest in the health of its citizens). For criticism, see Dagan and White, 75 NYU L Rev at 375 n 90 (cited in note 5) (arguing that state claims based on the "quasi-sovereign" interest theory would constitute a new cause of action requiring legislative approval).

⁸ See Dagan and White, 75 NYU L Rev at 375 n 90 (cited in note 5) (discussing various claims advanced by the states including violations of consumer statutes and state and federal antitrust provisions).

law, and it is doubtful that the jurors who have since awarded damages in tobacco cases have even heard of it.

Viscusi believes that the MSA was a device for cartelizing the tobacco industry at the expense of smokers.⁹ One of the striking features of the MSA is its provision for (de facto) excise taxes rather than a lump sum damages payment from the tobacco industry to the states. States have the power to impose excise taxes on tobacco, and they had exercised that power prior to the MSA. But a state's power to raise excise taxes is limited by the political power of those who are hurt by the taxes, including the tobacco industry, retailers, and consumers. In the MSA, the tobacco industry consented to make payments out of future revenues in return for protection against liability for Medicaid costs, past and future. Thus, the payments would come from future sales rather than from the cash and other assets that the industry held at the time of the settlement. Prices would rise to cover the liability, but states agreed to pass laws binding future entrants to the cigarette industry to the regulatory provisions of the MSA. This prevented competition from driving down the price (and driving the MSA signatories out of business). Studies show that a 10 percent increase in the price of a pack of cigarettes will result in a 4 to 7 percent reduction in demand. The remaining smokers will simply pay more for their cigarettes, and have less money for other things. Thus, it is inaccurate to say that under the MSA the tobacco industry will pay (to use one figure) \$206 billion to the states. If the demand for cigarettes is relatively inelastic, most of the money will be paid by smokers—on average, people with lower incomes than the national median—through higher cigarette prices, and not by the shareholders of tobacco companies.

For these and other reasons—including the enormous fees earned by the plaintiffs' lawyers—few scholars are happy with the MSA. If this account is correct, however, Viscusi should not accuse the tobacco industry of making a "catastrophic error in judgment" (p 5). The industry was clever, not dumb.

B. What Were the "Financial Costs" Incurred by the States?

Most of the arguments discussed above are familiar, and Viscusi's take on them is workmanlike but not novel. The heart of Viscusi's book is his famous argument that the states enjoyed financial benefits rather than costs as a result of smoking. Viscusi did not originate the argument,¹⁰ as he acknowledges, but he has pressed it tirelessly over many years, and he is now closely identified with it.

⁹ The case was originally made by Bulow and Klemperer, *The Tobacco Deal* at 323 (cited in note 4), and Viscusi repeats it.

¹⁰ See Willard G. Manning, et al, *The Costs of Poor Health Habits* 62 (Harvard 1991)

Viscusi argues that the state and federal governments¹¹ enjoy benefits as well as incurring costs from the early mortality of smokers. On the cost side of the ledger the major items are medical care (\$0.75 per pack), group life insurance (\$0.25 per pack), and lost payroll taxes (\$0.93 per pack). On the benefit side is the avoidance of nursing home care (\$0.63 per pack) and retirement payments (\$3.05 per pack) (p 73).¹² Because smokers are sicker than other people, they require more medical care; and because smokers die earlier than other people, they cost more in life insurance and foregone payroll taxes. But because smokers die earlier, they also don't need significant nursing home or pension benefits. They don't pay as much in payroll taxes as other people, but they also don't take back those they do pay in the form of a pension. Smokers are a "financial profit center" for society, in Viscusi's phrase (p 75), to the tune of \$1.72 per pack, or tens of billions of dollars per year, plus another \$0.56 per pack, on average, from excise taxes. And the basic conclusion remains true for a range of reasonable discount rates.

Viscusi's argument is simple, and many scholars have accepted it at face value,¹³ or have argued about the numbers but not the logic.¹⁴ But it depends on legal premises of questionable validity.

We first need to understand the purpose of Viscusi's inquiry. He does not claim to be doing a "social welfare calculation" (p 62), an exercise that he conducts later in the book and that I will discuss in Part II of this Review. According to Viscusi, the social welfare calculation has

nothing whatsoever to do with the damages claims by the states or the ongoing federal claim. These cases were about one thing only—money. How much do smokers cost these government entities financially? Health losses to smokers themselves were not the subject of the litigation in any of the governmental lawsuits. The litigation consisted of little more than a sophisticated ac-

(summarizing economic analysis demonstrating that smoker's early mortality more than offsets the costs of their increased morbidity).

¹¹ In the part of the book I am discussing, Viscusi combines the states and the federal government into a single entity, which is a useful simplification; in a subsequent chapter he separates out their burdens and benefits. For ease of exposition, I will refer to the states only.

¹² The retirement payments are made mainly by the federal government in the form of Social Security; but, as I noted above, Viscusi collapses the governments for purposes of his financial costs argument.

¹³ See, for example, Gary T. Schwartz, *Tobacco, Liability, and Viscusi*, 29 *Cumb L Rev* 555, 557 (1999).

¹⁴ See, for example, Jon D. Hanson and Kyle D. Logue, *The Costs of Cigarettes: The Economic Case for Ex Post Incentive-Based Regulation*, 107 *Yale L J* 1163, 1262 (1998). They do express some doubts about whether Viscusi's approach makes sense, see *id* at 1259–60, but do not seem convinced of their own criticisms.

counting exercise to determine if smokers impose financial costs (p 62).

This argument goes too fast, however. “Accounting exercise” is not self-defining; what counts as a cost or benefit in this exercise depends on the law. Do property taxes paid by tobacco farmers count as “benefits” in the accounting? Do the subsidies they receive count as “costs”? What about the cost of providing cigarette manufacturers with police protection and enforceable property rights?¹⁵ To determine what items count as “costs” and “benefits” in the accounting, one must examine the states’ legal theories.

We have already seen that the states’ most plausible legal claim is based on subrogation of the tort claims of the Medicaid recipients. There are other possible claims, including the *parens patriae* claim mentioned earlier, but what I say below will apply *mutatis mutandi* to these claims as well.

If subrogation is the right model, we must think of Medicaid as a kind of insurance policy given by the state to people who have a low income. When a smoker contracts lung cancer, the state pays his medical expenses, and then obtains a subrogation claim against the tobacco companies. If Medicaid were an ordinary insurance policy, it would not make sense to subject the subrogation claim to an offset for, say, avoided nursing home costs even if we thought of Medicaid and other programs as a package that covers nursing home as well as medical care. The reason is that the implicit premium—the *ex ante* value of the insurance—equals the insurer’s expected costs. If damage offsets prevented the insurer from recovering from tortfeasors its expenses for low-cost insureds like smokers, then people would have trouble selling their contingent legal claims (via subrogation) to insurers in return for a reduction in the premium. That would make insurance more costly and less effective at pooling risks, and, by interfering with the insurance companies’ exploitation of economies of scale in tort litigation, blunt the deterrent effect of the tort system.

Medicaid, however, is not the same thing as private insurance. Preventing a private insurer from taking advantage of subrogation can only make private insurance more expensive and less effective at pooling risks. The result would be that fewer people would obtain medical insurance, and thus medical care. Preventing a state from taking advantage of subrogation also increases expenses for the state, but if, as Viscusi argues, smoking saves the state more money in avoided nursing care and pension costs, the ultimate result of the tobacco in-

¹⁵ See Daryl Levinson, *Framing Transactions in Constitutional Law*, 111 Yale L J 1311, 1135–36 (2002) (discussing line-drawing problems involved in the accounting of the costs and benefits associated with the long-term relationship between tobacco companies and the states).

dustry's torts is that the state can provide more medical care than it could otherwise. Unlike private insurers, the states make the initial transfer of the insurance policy to poor people, and if some of these people die sooner because they smoke, then the states' pension and nursing home savings, in effect, make these transfers cheaper. In other words, a state with a population of smokers can afford to make more generous Medicaid, nursing home, and pension payments than a state without a population of smokers—because the latter state has additional heavy financial obligations that take from the tax revenues that might otherwise go to beneficiaries of transfer programs.

But it seems odd to say that in the financial accounting of the relationship between the state and the tobacco industry, the avoided old-age transfers *intended by the state* should count as benefits. In an ordinary accounting of a firm, assets are assets, and we would not expect to run into a situation where the firm's financial position is improved because a third party frustrates its efforts to spend money on a project. The question, then, is whether the avoided transfer should be counted as a benefit, like the receipt of excise taxes, or not counted at all, like the receipt of taxes on the real estate on which cigarette factories stand. This question cannot be answered using general principles of financial accounting; its answer depends on how the law defines costs and benefits in the context of a lawsuit seeking reimbursement. The precise legal question is whether a government's subrogation-like claim stemming from illness and wrongful death could be reduced because the victim of the tort, if he had not died, would likely have been a net recipient of transfers from the government rather than a net payer of transfers to the government.

A negative answer is suggested by *United States v House*,¹⁶ a case in which a prison inmate named House was ordered to pay restitution to the federal government for the cost of providing a funeral for a fellow prisoner whom House had murdered.¹⁷ House argued that he owed the government no damages because the \$1,303 cost of burying the victim was less than the cost of keeping the victim locked up in prison. Because House saved the government money, he should not have to pay damages.¹⁸

Judge Easterbrook of the Seventh Circuit Court of Appeals rejected his argument:

The computation should not be complicated by possible offsets. The murderer might as well say that because his victim would have died of natural causes if not by violence, he did not "cause"

¹⁶ 808 F2d 508 (7th Cir 1986).

¹⁷ *Id.* at 509.

¹⁸ See *id.*

funeral expenses to be incurred. Death by stabbing is murder notwithstanding the inevitable mortality of the victim; so too the funeral expenses caused by murder are current losses notwithstanding offsets. The policy of the United States was that Callison [the victim] should live; the expenses of keeping him alive served a public purpose (as well as Callison's own purposes). House accelerated Callison's death and may be taxed the ensuing expenses.¹⁹

House did not benefit the government by killing Callison, because the government did not want Callison to die. The federal government has adopted a policy of keeping prisoners alive, and the fact that this is expensive is irrelevant to the question of whether a prisoner should pay restitution for funeral expenses when he frustrates the government's policy.

Viscusi's view is the same as House's defense and thus, in this context, would deprive the government of restitution for no purpose whatsoever. The government is not a firm and does not have to pay people to respect its interests. Once it decides—for whatever reason—that prison murderers should reimburse the government for funeral expenses, the net effect of the murder on the government's budget is of no relevance. If, for example, the purpose of restitution is to deter crimes by people who have nothing to lose but their prison wages, Viscusi's argument would simply deprive the government of a valuable tool. In response, the government would either have to tolerate more murder in prisons, or else switch to a more expensive method such as isolation of prisoners or hiring more guards.

Now let's transport this reasoning back to the Medicaid litigation. The conventional view is that tortfeasors should be made to pay damages equal to the social cost of the tort: that includes the cost of illness and premature death. If individuals cannot bring successful suits against tobacco companies, but states can, then the damages should be paid to the states. If, because of Viscusi's argument, avoided transfers are subtracted from the damages, then the tobacco companies will pay less than the social cost of their behavior, and underdeterrence will result. States seeking to deter socially costly tobacco use would have to switch to more expensive and less effective tools such as advertising, use restrictions, addiction programs, and education.

Viscusi's argument implicitly appeals to the offsetting benefits rule, which holds that the victim of a tort can recover damages equal to only the net costs of the tort. If, to use the standard example, a person incurs a \$100 reputational harm from libel that enables him to

¹⁹ *Id.* at 510.

earn speaking fees of \$20, his loss is only \$80 and his damages should be limited to that amount.²⁰ The rule has a simple justification: to ensure that the award of damages equals the actual harm. When the government is the plaintiff, however, the offsetting benefits rule is easily misused. If the social cost of a tobacco-caused death is \$100, and the government avoids \$20 in transfers, the proper award remains \$100 and does not fall to \$80. The social cost of the death is, by assumption, \$100. The fact that the government would have given lots of money to the victim if he had lived is irrelevant—an avoided transfer, not an avoided social cost. The contrary view would imply that if the government today abolished pensions and other old-age transfers, the tobacco industry would henceforth be liable to the states for Medicaid costs under the states' original tort theories—an exceedingly odd result.

The principle, as reflected in the *House* case, is that monetary savings for the government cannot count as an offsetting benefit when the savings come at the expense of its own policy goals. This is perfectly sensible: One cannot know whether an apparent benefit is a real benefit without knowing the underlying goals of the supposed beneficiary.²¹ We normally assume that the goal of a private firm is to make money, and therefore any monetary savings that it enjoys as a result of a tort should be used to reduce the damages to which it is entitled. But we can easily imagine a contrary situation. Think of an insurance company that for philanthropic or public relations reasons plans to give some of its wealth to a group of poor people who have purchased its medical insurance. The poor people die prematurely because of a tort committed by the tobacco industry. The insurance company pays for their medical care and then sues the tobacco industry for reimbursement pursuant to a right of subrogation. Could the industry argue that the damages should be offset by the amount that the insurer had anticipated giving to the victims as a gratuity? Clearly no. The social cost of the tobacco industry's tort is the medical costs, and the in-

²⁰ See Restatement (Second) of Torts § 920 and comments (1979).

²¹ See *Handicapped Children's Education Board of Sheboygan County v Lukaszewski*, 112 Wis 2d 197, 332 NW2d 774 (1983). In this case, an employee quit, breaching the employment contract, and was replaced with a substitute who was both more expensive and more skilled. Damages were the difference in salaries, with no offset for the added benefit for the employer provided by the more experienced replacement. The court noted that "[a]ny additional value the [employer] may have received from the replacement's greater experience was imposed upon it and thus cannot be characterized as a benefit." *Id.* at 779. The employer could have made less money on the new employee than on the old employee: we know the cost of the new employee but not his or her value. In the absence of evidence of the value, the court will not assume that it was high enough to produce the same gain. Similarly, the states gained from early mortality only to the extent that the benefits (the cost savings) exceed the costs (shorter life expectancy). Not knowing the magnitude of the costs to the states, the courts would not assume that it was low or (as Viscusi assumes) zero.

dustry should be forced to pay it for deterrence reasons; since the insurer desired to give the gratuity to the insureds, its monetary savings cannot be said to be an offsetting benefit. This is in essence the position of the states.

Others have pointed out that if Viscusi's argument were correct, the state would benefit if elderly people were killed.²² They are right to point out this implication, and Viscusi does not have a convincing response to it,²³ but they have not explained exactly what the problem is. The problem is that Viscusi's argument is neither a social welfare argument nor a well thought-out legal argument. A social welfare argument would take account of the cost of premature mortality. A well thought-out legal argument would acknowledge that tort law is supposed to deter people from harming others, and this purpose would be frustrated if damages were reduced because of avoided transfers. When Viscusi assumes for the sake of the financial cost argument that the tobacco industry committed a tort, he has already undermined that argument by implicitly assuming that the industry created a social cost.

Where does Viscusi go awry? One clue is his brief discussion of the political controversy about the use of state funds to subsidize risky activity (p 60). Not just smokers, but motorcycle riders, mountain climbers, snowmobilers, heavy eaters, swimmers, and everyone else who takes above average risks, put a disproportionate burden on a public health system that is partially financed by taxpayers. To many commentators, this seems unfair, and they argue that the risk takers should pay more to the public treasury. This argument provides a political justification for excise taxes on cigarettes. Viscusi responds that smokers (and the same is true for other risk takers) actually subsidize nonsmokers—not the other way around—because they die before receiving old-age transfers that dwarf their risk-adjusted medical expenses.²⁴ They already pay an implicit excise tax in the form of Social Security taxes for which they never receive the corresponding pension benefit. Thus, excise taxes are not necessary for evening out the balance.

Some people might be persuaded by Viscusi's response, but his response is a political argument that has nothing to do with the Medicaid litigation. The states did not sue the tobacco industry on the ground that it was unfair that smokers received more medical benefits than nonsmokers did. There was no such legal basis for a suit: After

²² See, for example, Hanson and Logue, 107 Yale L J at 1259–60 (cited in note 14).

²³ Viscusi does have a response (p 69), but it is incomprehensible.

²⁴ This argument is discussed and rejected as well in Tollison and Wagner, *The Economics of Smoking* at 89–105 (cited in note 3) (citing the complex nature of government transfers as an impediment to determining if mortality confers benefits to individuals funding the transfer).

all, if the states thought that the current distribution of burdens and benefits was unfair, they could have (with the help of the federal government) changed the Medicaid program, or—on their own—increased excise taxes. The states sued the tobacco industry on the theory that the industry had harmed smokers and therefore the states themselves. If one accepts this theory, we are in the realm of tort, and under standard tort principles the tobacco industry should pay damages equal to social costs rather than social costs minus avoided transfers.

II. ADDICTION, BELIEFS, AND TOBACCO REGULATION

To determine whether and how cigarettes should be regulated, the first thing to do is to identify any externalities from cigarette smoking. Because Medicaid payments and other transfers are not externalities, they are irrelevant to the efficiency analysis. The states' financial burden of caring for the elderly would be relevant to an efficiency analysis of cigarettes only if the mere existence of old people created costs for others—costs that are reflected in the transfers. Suppose people consent to transfer programs because they feel sorry for old people who are not taken care of, but would be happier if these old people simply did not exist. If this supposition were correct, then products that kill people before they become old would confer positive externalities on other young people. Perhaps, there are curmudgeons and misanthropists who take this position. But Viscusi never does explicitly, and it seems to me insufficiently plausible to warrant further discussion.²⁵

Viscusi focuses on more conventional externalities. He acknowledges the risks posed by second-hand smoke but argues that they are relatively small and can be addressed with moderate regulations like ventilation requirements in public spaces (pp 13–35).

Viscusi also considers the problem of misinformation. If people do not understand the risks of smoking when they take it up, then the government can help them make informed decisions by requiring warning labels and engaging in educational efforts (p 221). Viscusi believes that this function is appropriate, and suggests ways that the government might improve people's understanding of the risks of smoking or encourage tobacco companies to design safer cigarettes (pp 194–214). All of this is sensible enough, but one cannot help but notice the tension between these reforms and Viscusi's view that tobacco

²⁵ If it were plausible, then we would see some public thought about, or movement toward, legal suicide pacts, where individuals accept an early death in return for generous payments from the government to beneficiaries. See Hanson and Logue, 107 *Yale L J* at 1259–60 (cited in note 14).

companies cannot be liable for failing to inform people about the risks of smoking because people already have sufficient information, indeed usually overestimating the risks. If he is right about this latter point, then one would expect his reforms to *increase* the amount of smoking as people learn that smoking is less risky than they had believed.

But Viscusi fails to grapple with the public health community's fundamental concern with smoking: that it is addictive. Many people start smoking when they are still children, and others who start as adults do not have adequate information about the dangers of smoking. They might know that smoking causes a high risk of lung cancer and other diseases, but they do not understand the power of nicotine addiction, and they believe that they will quit before they do significant damage to their bodies. They also have trouble resisting peer pressure and the glamorous image of smoking fed by highly effective tobacco advertising. These individuals try to quit later in life, but are unable to, and high numbers succumb to smoking-related illnesses.

Viscusi's view about addiction is not clear. On the one hand, he says that cigarettes are addictive. On the other hand, he stresses that smoking is a matter of choice. He cites the -0.4 to -0.7 elasticity of demand for cigarettes as evidence that they are not addictive (pp 171–72), but the elasticity just tells us that some people will stop or reduce smoking when the price rises, not that everyone will, and the evidence suggests that for a core group even large price increases will not affect their behavior. The two views can be reconciled with the rational addiction model, which Viscusi cites.²⁶ This model assumes that when a person begins to smoke he takes account of the cost of being able to stop. By contrast to the public health model, which assumes that a person starts smoking without thinking about addiction, and then finds himself trapped by the addiction when further information about the risks persuades him that it is time to stop, the rational addiction model assumes that a person chooses the whole package of cigarette-related benefits and afflictions—the pleasure of the smoke, the glamorous image, the approval of friends, the possibility of addiction, and the remote but devastating health consequences.

The rational addiction view has been criticized in ways that go beyond the scope of this Review.²⁷ It is sufficient, however, to point out that even if one accepts its behavioral assumptions, it does not have strong normative implications. Usually, when a person makes a choice

²⁶ See Gary S. Becker and Kevin M. Murphy, *A Theory of Rational Addiction*, 96 J Polit Econ 675 (1988).

²⁷ See Ole-Jorgen Skog, *Rationality, Irrationality, and Addiction—Notes on Becker's and Murphy's Theory of Addiction*, in Jon Elster and Ole-Jorgen Skog, eds, *Getting Hooked* (Cambridge 1999).

at time 1 that he regrets at time 2, we do not allow him to escape the consequences of his decision. Otherwise, it would be difficult for people to commit themselves, and the power to commit oneself is extremely valuable in a range of social and economic relationships. But there is a philosophical objection to holding the welfare of the person at time 2 hostage to the preferences of the person at time 1: There is no obvious reason for thinking that welfare at time 1 is more important than welfare at time 2, while it is clear that individuals discount benefits flowing to their future selves. These concerns are relatively minor for most transactions, but they loom large when the early choice has significant negative consequences in the distant future, as is the case for smoking and the consumption of other dangerous and addictive drugs.

Viscusi is more persuasive when he criticizes the regulatory package established by the MSA, and in particular the high de facto excise taxes that it establishes.²⁸ High excise taxes are troublesome regardless of whether one takes Viscusi's choice view, or the public health community's addiction view. If smoking is a matter of choice, then excise taxes should be used to deter harms to others; however, these harms appear to be relatively small, justifying only low excise taxes. If smoking is a matter of addiction, then excise taxes will deter some people from smoking but leave unaffected a large group of people who will pay more for smoking, and carry a larger part of the tax burden than nonsmokers.²⁹ (In theory, these distributive burdens could be eliminated by adjusting the income tax but the politics of such adjustments are complex.) A moderate excise tax might be justified, but at a time when the drug war is under intense criticism, a prohibitively high tax or an outright ban hardly seems appropriate.

Other policy instruments also have moderate value. Educational efforts, advertising limitations, and regulation of public spaces show promise but have clear limits.³⁰ One problem with these strategies, which is frequently overlooked, is that their quasi-intended effect of stigmatizing smoking may do more harm than good. Stigma is an inefficient way of helping addicts; stigma harms the addicts just like excise taxes, but unlike excise taxes does not raise revenues. In addition, self-conscious efforts by authorities to create and reinforce stigma can

²⁸ This is a point made by many other authors. See, for example, Frank J. Chaloupka, et al, *Taxing Tobacco: The Impact of Tobacco Taxes on Cigarette Smoking and Other Tobacco Use*, in Rabin and Sugarman, eds, *Regulating Tobacco* at 63–64 (cited in note 1) (describing the disproportionate impact of tobacco excise taxes on low-income smokers). But there are complications, as noted in this Review.

²⁹ See *id.*

³⁰ For discussions of these proposals, see the essays in Rabin and Sugarman, eds, *Regulating Tobacco* (cited in note 1).

backfire and make the forbidden activity all the more alluring to young people and others who regard themselves as nonconformists not easily cowed by officially endorsed public sentiment.

III. REGULATION BY LITIGATION

Viscusi sees the MSA as but one element in a class of cases that reflect a disturbing new trend that he calls “regulation by litigation” (p 217). The vast fees earned by tort lawyers in the Medicaid litigation have stimulated similar lawsuits against gun manufacturers, the paint and fast food industries, and HMOs. Viscusi argues that litigation generates bad regulation that favors lawyers and interest groups, and that legislation and agency regulation (he does not distinguish the two) are the more appropriate vehicles for reining in industry, if such reining-in is needed (p 217). He faults the MSA for its role in encouraging this new litigation (p 4).

This claim that there is a special class of troubling “regulation by litigation” cases³¹ will strike lawyers as odd. Tort law is a form of regulation, and always has been. Manufacturers know that when they design products they will be held liable under tort law if they choose an unreasonably dangerous design. Judicial decisions *ex post* will often have the effect of creating regulation-like commands—for instance, do not design a car that explodes if rear-ended at low speeds—but the policy here is to give manufacturers an *ex ante* incentive to invest in safety. There is nothing new about regulation by litigation, and one suspects that Viscusi does not understand this basic point.³²

Viscusi argues that regulation is superior to litigation because of the traditional values of transparency and accountability. Affected parties have the opportunity to lobby legislators and regulators prior to the creation of rules. If the public does not like the rules, they can vote the politicians out of office. Viscusi thinks that the tort system, by contrast, has been corrupted by well-financed tort lawyers, pusillanimous judges, and populist juries.

This view turns traditional public-choice thinking on its head. If there is any interest group with dominant influence, one would think it the tobacco industry—rich, highly concentrated, very sophisticated—and not so much the tort lawyers, who are much more numerous and varying in their goals and, for all their new wealth, not nearly as rich. The public health community—another one of Viscusi’s *bêtes*

³¹ See W. Kip Viscusi, ed, *Regulation through Litigation* v (Brookings 2002) (contending that large-scale lawsuits over tobacco, guns, and other products represent a new genre of litigation that confront broad policy problems better left to legislatures).

³² See also Randall Lutter and Elizabeth Mader, *Litigating Lead-Based Paint Hazards*, in Viscusi, ed, *Regulation through Litigation* at 125–26 (cited in note 31) (calling the tort system’s normal retroactive determination of liability “Kafkaesque”).

noires—is a loose conglomeration of different interests, including doctors, hospitals, insurance companies, universities, and health advocates. The fact is that all these groups influence legislative and regulatory outcomes, transparency and accountability notwithstanding. The tobacco industry subverted the effort to incorporate a predecessor to the MSA in federal legislation when the proposed bills went beyond the restrictions to which the industry had initially agreed. The tort lawyers persuaded state legislatures to enact statutes that would facilitate their Medicaid litigation. And the public health community has influenced countless smoking-related laws and regulations. Indeed, all the things that Viscusi deplores in the MSA, like the excise taxes and the advertising restrictions, can be found in countless laws and regulations that existed long before the MSA was negotiated. “Regulation by regulation” has produced outcomes every bit as bad from Viscusi’s perspective as those produced by “regulation by litigation.”³³

By contrast, the tort system has long been thought to be relatively immune to public choice pressures. Although this view has come under increasing scrutiny, the evidence provides little support for Viscusi’s negative view about tobacco litigation. If Viscusi is right about the weakness of the smokers’ cases, the tort system has performed admirably until recently, resulting in few awards against the tobacco industry. Although the tort lawyers won some important early victories in the Medicaid litigation, they also lost some important cases, and never obtained a final judgment against a tobacco company. Viscusi’s own theory—that the cartel arrangement benefited the tobacco industry and hurt smokers—suggests that the MSA can’t be blamed on the tort system. On Viscusi’s theory, the tobacco industry would have agreed to the MSA, or some similar version of it, even if the industry had thought it would do well in court.

One of Viscusi’s strongest grounds for complaint is the extraordinary legal fees won by the tort lawyers, but the blame for these fees lies on the shoulders of the states and the tobacco industry. When the tort lawyers offered to represent states in the Medicaid litigation, many states turned them down and relied on the staffs of their attorneys general. Other states preferred to use outside counsel and agreed to pay a percentage of any damages recovered, or what in other contexts would be called a normal contingency fee arrangement. The MSA contained a vague “reasonable” fees provision, to be determined by arbitration, and the arbitrators used the contracts between the states and the lawyers as a guide. Because the states won hundreds of billions of dollars, the contingency percentages yielded very high dol-

³³ For a detailed discussion of the politics of tobacco litigation and legislation, see Martha A. Derthick, *Up in Smoke* (Congressional Quarterly 2002).

lar values. The political outcry was muted because under the MSA the tobacco industry had to pay the fees, though of course the payment could only come from money that would otherwise be available for the states. However, the outcry was still significant enough to create resistance in some legislatures and stimulate concessions by some tobacco lawyers. So if the fees were unreasonable, the responsibility can be traced to the voluntary arrangements between attorneys general, legislatures, tobacco executives, and the tort lawyers. Judges, the guardians of the tort system, could not be expected to interfere with these arrangements. Nor could juries.

The significant role of state legislatures and attorneys general in the Medicaid litigation suggests that this litigation should not be the prime exhibit for the case against "regulation by litigation," which is probably best used to refer to class actions involving private individuals, not governments, as the plaintiffs. Because the states were the plaintiffs in the Medicaid litigation, it is hard to draw a clean distinction between a virtuous political process and a corrupt legal process. Viscusi complains that the de facto excise taxes in the MSA are perverse because they are regressive, and as a result of them states benefit when tobacco sales rise. States' reluctance to finance antismoking advertisements with their tobacco money, as they had promised, is taken as evidence that they regard tobacco sales as a money pump. But if legislatures are politically responsible, why did they consent to the excise taxes in the first place? And if they were presented with them as a *fait accompli*, why didn't the legislatures fix the regressive impact by adjusting income taxes, and why would they put revenues over their concern for public health? No one argues that the excise tax on gasoline should be repealed because it gives the government an incentive to encourage people to drive.

What is most noteworthy about the tobacco litigation is not its exposure of a new form of ex post regulation; the tort system is far older than the regulatory system that Viscusi champions. What is noteworthy is the significant role in the litigation of a group of wealthy and successful tort lawyer-entrepreneurs. Viscusi thinks that these people are bad guys (pp 5, 53-54, 134, 219-20), and perhaps they are, but like the tobacco industry executives their sin was their exploitation of a permissive legal environment in order to make money. So that this legal environment may be changed, understanding the emergence and incentives of the tort lawyers is an important task, for which the crude opposition between litigation and regulation is not helpful. There are smoke-filled rooms in state capitols, just as there are in the pricey hotels where the MSA was hammered out.

