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THE FEDERAL TOBACCO SUIT: TAXATION THROUGH LITIGATION INSTEAD OF LEGISLATION

The Clinton Administration is proposing to sue tobacco companies to "recover the costs" that smoking supposedly imposes on the federal government for the Medicare and Medicaid programs. The President still wants a tobacco tax increase for the same purpose; his Fiscal Year 2000 Budget promises to seek an additional \$0.55 cents a pack. (This is on top of the \$0.15 a pack increase being phased in between 2000 and 2002 under the so-called Taxpayer Relief Act of 1997).

The tax hike might not get very far. Last year, Congress retreated from proposals to boost the tax by another \$1.10 to \$1.50 a pack. At a time of projected budget surpluses, it was hard to justify the proposals as anything other than what they were, an "easy money" grab that would have fallen mainly on low and middle income smokers, and that was stirring unexpectedly strong resentment among its potential victims. Another round this year would not be any more popular.

The Administration may be hoping that a lawsuit against the tobacco companies will not encounter as much Congressional opposition as a tax hike, since any adverse price effect on smokers would be indirect, and, if noticed, could be blamed on the courts. Nonetheless, a lawsuit does require some action by Congress. The Administration has asked it to approve an appropriation of \$20 million for the Justice Department to start work on the case.

Whether the government takes money from the tobacco companies through an increase in the cigarette excise tax or through a lawsuit, the result will be an increase in the cost of cigarettes. A lawsuit is simply a tax imposed by litigation instead of legislation. The burden of any damage award or tax hike will fall on smokers, tobacco growers, and tobacco company employees and shareholders in some proportion either way.

The Administration's contention that smoking imposes additional costs on the Medicare and Medicaid systems, and that smokers should pay more for cigarettes as a result, is as wrongheaded an excuse for a lawsuit as it is for a tobacco tax hike. Study after study has found that current tobacco excise taxes raise government revenues by substantially more than smoking-related illnesses raise government outlays.¹

Smoking may increase outlays somewhat in government funded health programs, but not by the full cost of treating these disorders. The chief effect of smoking-related illness is to change the

timing and type of illness, but not necessarily the lifetime cost of treatment, of a Medicare or Medicaid enrollee. People who die at age 65 from a smoking-related ailment do not die at age 75 from

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some other disease, which may be even more expensive. Medicare's outlays are shifted, not necessarily increased. In fact, people who die before age 65 never receive any Medicare benefits, and do not linger in nursing homes on the states' Medicaid rolls.

Furthermore, insofar as smoking reduces life expectancy, smokers receive less from Social Security and federal and state employee pensions, on average, than non-smokers. (The Social Security Trustees Reports project the System's outlook under "low cost", "intermediate cost", and "high cost" assumptions about various economic and demographic variables. These cost projections used to be labeled the "optimistic", "intermediate", and "pessimistic" outlooks. It was a standard joke among Social Security discussants to

note that the "optimistic" projection assumed the highest death rates and lowest life expectancies of the three, and the "pessimistic" case assumed the lowest death rates and longest lifespans.)

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All things considered, currently scheduled tobacco taxes are about twice as high as necessary to compensate the state and federal governments for any net program expenses due to smoking, and the 1998 state tobacco settlement will increase the margin. There is no economic justification for the federal government to raise tobacco taxes, sue the tobacco companies, or otherwise

extract money from smokers to bail out Medicare.

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Endnotes

1. For a broad overview of the economic argument and a review of the literature, see: Stephen J. Entin, "There's No Economic Argument for a Higher Cigarette Tax," *IRET Policy Bulletin No. 72*, April 30, 1998. Specific studies of note:

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Robert E. McCormick, Robert Tollison, and Richard E. Wagner, "Smoking, Insurance, and Social Cost," *Regulation*, Summer 1997, pp. 33-37.

Lorraine Mooney, "Smoking Out Bad Science", *The Wall Street Journal*, March 19, 1998, p. A18.

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