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THE FEDERAL TOBACCO SUIT: THE ADMINISTRATION CARRIES OUT ITS THREAT OF TAXATION THROUGH LITIGATION

The Justice Department has filed a civil lawsuit against the tobacco industry to recover some or all of the $20 billion yearly that the Administration claims smoking adds to government health care expenditures for Medicare recipients, veterans, and federal employees. President Clinton had included the suit among many Administration proposals in his January 1999 State of the Union Address.

The lawsuit is simply a tax imposed by litigation instead of legislation. The burden ... will fall on smokers, tobacco growers, and tobacco company employees and shareholders in some proportion either way.

The President also wants a tobacco tax increase for the same purpose; his Fiscal Year 2000 Budget sought an additional cigarette excise tax of $0.55 cents a pack. This proposed tax hike would be 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. It would also be on top of the tobacco industry's massive $248 billion settlement last year with the states. Despite little support in Congress for the tax hike, the Administration continues to push for the revenues. In early September, White House spokesman Barry Toiv said that the added taxes could help finance appropriations bills and predicted that "politically, the Republicans will see that this makes sense."

Nevertheless, the tax hike is unlikely to get very far. Last year, Congress rejected proposals to boost the cigarette tax by another $1.10 to $1.50 a pack. With the federal budget surpluses that were being projected last year, 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. This year, the projected budget surpluses are even larger and federal revenues as a share of people's incomes have reached a record level. (And now the Administration announces that the surplus for fiscal year 1999 will be $115 billion, $16 billion higher than it predicted in July.) The $792 billion tax cut that the President just vetoed expresses the majority view in Congress that taxes are too high, too anti-growth, and too complicated, and that they should be reduced rather than increased.

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 this expensive probably 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. Although Congress denied the money request over the summer, a Justice Department official speculated that Congress might agree now that the suit has been filed. A Clinton Administration official claimed that if Congress still refuses, the Justice Department could locate funds elsewhere in the budget to pursue the lawsuit.

Whether the government takes money from the tobacco companies through an increase in the cigarette excise tax or through a lawsuit, the result

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will be an increase in the cost of cigarettes. The 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 suit has the potential to open much wider a method of imposing *de facto* taxes that circumvents the normal requirement for Congress to vote on tax increases. The method is to take poorly worded regulatory legislation, twist its meaning, and then claim—presto—that it imposes a multi-billion dollar liability on a particular product or industry. One recent example is the so-called Gore Tax; the Federal Communications Commission asserts that an ambiguous provision of the 1996 Telecommunications Act enables it to force long-distance phone companies (really, the companies' customers, owners, and employees) to pay billions of dollars towards government spending programs. In the tobacco case, the Administration postulates new legal theories to claim tort damages under the Medical Care Recovery Act, the Medicare Secondary Payor provisions of the Medicare program, and the Racketeer Influenced and Corrupt Organizations Act (RICO).

Such *de facto* taxation is troubling because the "taxes" it imposes may be hidden, complicated, burdensome, and retroactive. Moreover, this method of taxation drastically reduces the government's accountability to the people—it is taxation without representation. Part of the problem lies with Congress for allowing the Executive Branch to usurp its taxing authority through sloppy legislation, delegation of power, and lack of attention to the consequences. The tobacco case raises the stakes both because the amount being sought is bigger and because the Administration's argument (i.e., the producer of a lawfully sold product is liable for damages if a federal program can be found whose costs would be lower if the product disappeared) could be applied to so many products. As one example, heart disease and the costs it places on Medicare could probably be reduced if people drastically cut their fat intake. By the Administration's logic in the tobacco case, the government might target as revenue sources at some future time producers and consumers of chocolate, ice cream, meat products, and an array of other popular foods.

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 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.

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 and facilitate more federal spending elsewhere.

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Endnote

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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