Cato Handbook for Policymakers

CATO INSTITUTE

7TH EDITION

32. Tobacco and the Rule of Law

Congress should

- enact legislation to abrogate the multistate tobacco settlement, and
- reject proposed legislation to regulate cigarette manufacturing and advertising.

Enact Legislation to Abrogate the Multistate Tobacco Settlement

The Master Settlement Agreement, signed in November 1998 by the major tobacco companies and 46 state attorneys general, transforms a competitive industry into a cartel, then guards against destabilization of the cartel by erecting barriers to entry that preserve the dominant market share of the tobacco giants. Far from being victims, the big four tobacco companies are at the very center of the plot. They managed to carve out a protected market for themselves—all at the expense of smokers and tobacco companies that did not sign the agreement.

To be sure, the industry would have preferred that the settlement had not been necessary. But given the perverse legal rules under which the state Medicaid recovery suits were unfolding, the major tobacco companies were effectively bludgeoned into negotiating with the states and the trial lawyers. Finding itself in that perilous position, the industry shrewdly bargained for something pretty close to a sweetheart deal.

The MSA forces all tobacco companies—even new companies and companies that were not part of the settlement—to pay ''damages,'' thus foreclosing meaningful price competition. Essentially, the tobacco giants have purchased (at virtually no cost to themselves) the ability to exclude competitors. The deal works like this: Philip Morris, Reynolds, Lorillard, and Brown & Williamson knew they would have to raise prices substan-

tially to cover their MSA obligations. Accordingly, they were concerned that smaller domestic manufacturers, importers, and new tobacco companies that didn't sign the agreement would gain share of market by underpricing cigarettes. To guard against that likelihood, the big four and their state collaborators added three provisions to the MSA.

First, if the aggregate market share of the four majors declined by more than two percentage points, then their ''damages'' payments would decline by three times the excess over the two-percentage-point threshold. Any reduction would be charged against only those states that did not adopt a ''Qualifying Statute,'' attached as an exhibit to the MSA. Naturally, because of the risk of losing enormous sums of money, all the states have enacted the statute.

Second, the Qualifying Statute requires all tobacco companies that did not sign the MSA to post pro rata damages—based on cigarette sales—in escrow for 25 years to offset any liability that might hereafter be assessed! That's right—no evidence, no trial, no verdict, and no injury, just damages. That was the stick. Then came the carrot.

Third, if a nonsettling tobacco company agreed to participate in the MSA, the new participant would be allowed to increase its market share by 25 percent of its 1997 level without paying damages. Bear in mind that no nonsettling company in 1997 had more than 1.0 percent of the market, which, under the MSA, could grow to a whopping 1.25 percent. Essentially, the dominant companies guaranteed themselves a commanding market share in perpetuity.

Perhaps as troubling, the settlement has led to massive and continuing shifts of wealth from millions of smokers to concentrated pockets of the bar. Predictably, part of that multibillion-dollar booty has started its round-trip back into the political process. With all that money in hand, trial lawyers have seen their influence grow exponentially. Every day that passes more firmly entrenches the MSA as a fait accompli, and more tightly cements the insidious relationship between trial attorneys and their allies in the public sector. The billion-dollar spigot must be turned off before its corrupting effect on the rule of law is irreversible.

An obvious way to turn off the spigot is to abrogate the MSA. If it is allowed to stand, the MSA will create and finance a rich and powerful industry of lawyers who know how to manipulate the system and are not averse to violating the antitrust laws. At root, the MSA is a cunning and deceitful bargain among the industry, private attorneys, and the states, allowing giant companies to monopolize cigarette sales and foist the cost

onto luckless smokers. Indeed, the MSA is the most egregious antitrust violation of our generation—a collusive tobacco settlement that is bilking millions of smokers out of a quarter of a trillion dollars.

Congress should dismantle the MSA to restore competition. That's a tall order, but the stakes are immense.

Reject Proposed Legislation to Regulate Cigarette Manufacturing and Advertising

Under legislation periodically reintroduced in Congress, the Food and Drug Administration would be authorized to regulate cigarette ads and ingredients, including nicotine; set product standards; require new health warnings; and curb marketing to kids. True to form, Philip Morris—the industry leader with the most to gain from restrictions on would-be competitors—quickly chimed in to support many of the proposals. Yet if tobacco is to be regulated as a drug, Congress will simply be guaranteeing a pervasive black market in tobacco products. FDA regulation that makes cigarettes unpalatable, coupled with higher prices, will inevitably foment illegal dealings dominated by criminals and terrorists hooking underage smokers on an adulterated product freed of all constraints on quality that competitive markets usually afford.

The war on cigarettes, like other crusades, may be well-intentioned at the beginning, but as zealotry takes hold, the regulations become foolish and ultimately destructive. Consider the provisions in the current bill that would grant FDA control over tobacco advertising. Not only are the public policy implications harmful, but there are obvious First Amendment violations that should concern every American who values free expression.

Here are the constitutional ground rules: In *Central Hudson Gas & Electric Corp. v. Public Service Comm'n* (1980), the Supreme Court concluded that nonmisleading commercial speech about a lawful activity cannot be regulated unless (a) the government has a substantial interest in doing so, (b) the regulation directly and materially serves that interest, and (c) the regulation is reasonable and no more extensive than necessary to achieve the desired objective. Sixteen years later, the Court affirmed that even vice products like alcoholic beverages are entitled to commercial speech protection. More recently, the Court threw out Massachusetts regulations banning selected cigar and smokeless tobacco ads.

Even if hard facts proved that the demise of specified ads might dissuade some children from smoking, prohibiting generic forms of advertisements—such as those containing cartoon characters—would not meet the

final directive of the *Central Hudson* test. When a prohibition is overbroad and unreasonably inhibiting, it is more extensive than necessary to achieve the desired objective. As the Court has stated, the government must not ''reduce the adult population . . . to reading only what is fit for children''; alternative and less intrusive means are surely available.

For example, the sale of cigarettes to underage smokers is illegal in every state. Those laws should be vigorously enforced. Retailers found to have violated the law should be prosecuted. A proof-of-age requirement for the purchase of tobacco products is acceptable as long as it is reasonably drafted and objectively administered; and a prohibition on vending machines is not excessively invasive if limited to areas frequented primarily by children (e.g., schools, arcades, and perhaps recreation centers).

However unpopular the tobacco industry, and however repugnant the thought that children may become addicted to smoking, there are countervailing values that sustain a free society. We need not sacrifice our fundamental liberties in order to reduce tobacco consumption by minors. ''If there is a bedrock principle underlying the First Amendment,'' cautions Justice William J. Brennan, ''it is that government may not prohibit the expression of an idea simply because society finds the idea itself offensive or disagreeable.''

Moreover, if advertising were deregulated, newer and smaller tobacco companies would vigorously seek to carve out a bigger market share by emphasizing health claims that might bolster brand preference. Regrettably, in 1950 the Federal Trade Commission foreclosed health claims—like ''less smoker's cough''—as well as tar and nicotine comparisons for existing brands. To get around that prohibition, aggressive companies created *new* brands, which they supported with an avalanche of health claims. Filter cigarettes grew from roughly 1 percent to 10 percent of domestic sales within four years.

Then in 1954, the FTC tightened its restrictions by requiring scientific proof of health claims, even for new brands. The industry returned to promoting taste and pleasure; aggregate sales expanded. By 1957, scientists had confirmed the benefit of low-tar cigarettes. A new campaign of ''Tar Derby'' ads quickly emerged with tar and nicotine levels collapsing 40 percent in two years. To shut down the flow of health claims, the FTC next demanded that they be accompanied by epidemiological evidence, of which none existed. The commission then negotiated a ''voluntary'' ban on tar and nicotine comparisons.

Not surprisingly, the steep decline in tar and nicotine ended in 1959. Seven years later, apparently alerted to the bad news, the FTC reauthorized

tar and nicotine data but continued to proscribe associated health claims. Finally, in 1970 Congress banned all radio and television ads. Fast-forward more than three decades. In a lawsuit filed against the tobacco industry by the Justice Department, the government argued that ads promoting ''light'' or low-tar cigarettes as a healthier alternative to regular smokes were fraudulent. Yet Congress is now considering a bill that would authorize the FDA to mandate less nicotine and tar—the same practices condemned as worse than useless because smokers would compensate by puffing harder, consuming more cigarettes, and smoking them closer to the filter.

Today, the potential gains from health-related ads are undoubtedly greater than ever—for both aggressive companies and health-conscious consumers. If, however, government regulation expands, those gains will not be realized. Instead of ''healthy'' competition for market share, we will be treated to more imagery and personal endorsements—the very ads that anti-tobacco partisans decry.

Mired in regulations, laws, taxes, and litigation, we look to Congress to extricate us from the mess it helped create. Yet if Congress authorizes the FDA to regulate cigarette ads and control the content of tobacco products, it will exacerbate the problem. Equally important, Congress will have delegated excessive and ill-advised legislative authority to an unelected administrative agency.

Of course, the machinery of regulation, once set in motion, will not stop with ameliorative changes. As former Commissioner David A. Kessler stated, outlining his concept of FDA oversight: ''Only those tobacco products from which the nicotine had been removed or, possibly, tobacco products approved by FDA for nicotine-replacement therapy would then remain on the market.'' In other words, cigarettes as we know them would cease to exist.

In 1919, Americans understood that Congress could not prohibit the sale of alcoholic beverages, so Prohibition was effectuated by constitutional amendment. Today, when it comes to tobacco, our lifestyle police argue that we require neither a constitutional amendment nor even an intelligible statute—just an amorphous delegation to an unelected administrative agency, which can ban ingredients it doesn't think ''uninformed'' citizens should consume. So much for limited government. We are left with the executive state—return of the king.

Just as bad, assigning quasi-legislative authority to the FDA will drive another nail into the coffin of personal responsibility. A federal agency

will be empowered to dictate the form and composition of a legal product about which consumers have exhaustive knowledge. Throughout the past century, incessant warnings about the risks of tobacco have come from doctors, public health sources, and thousands of scientific and medical publications. By the 1920s, 14 states had prohibited the sale of cigarettes. A warning has appeared on every pack of cigarettes lawfully sold in the United States for almost four decades. Nicotine content by brand has been printed in every cigarette ad since 1970.

That isn't enough for the anti-tobacco crowd, for whom cigarettes are only the first in a long list of products that the nanny state will monitor. If we know anything at all about government, it is that bureaucrats are likely to have an expansive view of their mission. So what comes next—coffee, soft drinks, red meat, dairy products, sugar, fast foods, automobiles, and sporting goods? The list is endless—all in pursuit of so-called public health.

But smoking is a private, not a public, health question. The term ''public,'' if it is to have any substantive content, cannot be used to describe all health problems that affect numerous people. Instead, ''public'' should refer only to those cases requiring collective action, when individual harms cannot be redressed without a general societal solution. Smoking, for example, would be a public health problem if it were contagious. But it isn't. Similarly, cigarettes do not infect us as they cross state borders. Nor has nicotine shown up in biological or chemical weapons.

An adult's decision to smoke is a voluntary, private matter. It's time to rein in the administrative state and restore a modicum of individual liberty.

Suggested Readings

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