

# TOBACCO SUIT

## Order firms to reduce rate

Stephen D. Sugarman

The federal government is currently prosecuting a racketeering lawsuit against the major cigarette manufacturers. What if it wins? The U.S. Department of Justice talks about a financial penalty of nearly \$300 billion plus limits on future tobacco company behavior.

Here is a better idea. Order the cigarette makers to reduce the rate of smoking to what it would have been absent their decades of misconduct. In other words, rather than having government dictate tobacco company behavior, let's try "performance-based" regulation instead.

Today, approximately 20% of American adults smoke. Yet most smokers begin as children and most current smokers say they want to quit but are hooked. It is not unreasonable to assume that Judge Gladys Kessler would conclude that, absent industry wrongdoing, smoking rates in the United States would be less than 10%.

On that assumption, Kessler could tell the tobacco companies to do whatever it takes to bring the smoking rate down to single-digit levels and keep it there. This would mean cutting smoking rates for each company's brands by more than 50%-phased in over, say, seven years.

### *One precedent for the scheme*

Notice how this parallels the performance-based regulatory approach of the Bush administration's No Child Left Behind scheme, in which schools are required, over time, to close the gap in attainment between high- and low-performing student groups.

If Kessler issued this order, the key point is that the tobacco companies-not government-would have to figure out how to attain the reduced-smoking goal. Some tobacco firms might reduce or eliminate their print ads, in-store materials, direct mail campaigns and/or other promotional activities. Others might cut off retailers who are found to sell to children. Still others might fund smoking-cessation programs.

Most likely, many firms would sharply raise the price of cigarettes. This would not only increase firm profits per pack, but it also could well be the most reliable way to reduce the smoking rate.

The actual design of the performance-based remedy must assure that, instead of making more money when more people smoke, tobacco firms would financially benefit if fewer people smoke. In short, the financial incentives of the companies need to be turned upside down. This would happen if Kessler ordered tobacco companies that failed to meet their performance targets to pay stiff financial penalties.

### *A 'look back' provision*

This performance-based approach borrows a feature contained in the so-called global settlement, tentatively reached in 1997 between the tobacco companies and the state attorneys general—a deal ultimately scuttled when Congress failed to pass the required legislation.

The "look back" provision would have required the tobacco companies to achieve reduced smoking rates among youths, and the idea proposed here extends the look-back strategy to smoking rates for all Americans.

If Kessler were to implement this approach, she would have to give careful attention to the precise penalty for failure. But the original look-back provision was clearly on the right track when it envisioned penalizing firms by a multiple of their future profits from youth smokers in excess of their target. That way, more youth smokers would be financially worse for the companies, rather than fewer.

### *Evening out the impact*

To deal with the possibility that smokers might shift away from the products of the defendants in the current litigation to those of other tobacco companies, the sensible solution would be to impose similarly steep charges on those other firms if more people began to smoke their brands than do today. This would probably require congressional action timed to coincide with Kessler's order.

Kessler might permit tobacco firms to buy and sell their reduction quotas, just as power plants are allowed to buy and sell pollution permits as part of performance-based power plant emission control schemes under federal environmental laws.

This would mean, for example, that if R.J. Reynolds were especially effective in figuring out how to diminish the number of smokers of its brands, it could sell gains beyond its target, say, to Philip Morris, if the latter was slower in reaching its target.

When the state attorneys general reached the Master Settlement Agreement with the tobacco companies in 1998, in addition to winning large payments to the states, the government lawyers also insisted on a series of "command and control" measures traditionally favored by the public health community. Yet the impact of that settlement on smoking rates appears modest. By contrast, the legal remedy proposed here dramatically increases the chance that a government victory would actually be converted into substantial public health gains.

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