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TOWARD JUSTICE IN TOBACCO POLICYMAKING: A CRITIQUE OF HANSON AND LOGUE AND AN ALTERNATIVE APPROACH TO THE COSTS OF CIGARETTES

*Paul A. LeBel** and *Richard C. Ausness***

I. INTRODUCTION

No contemporary problem poses more of a challenge to the legal system than dealing with the consequences of smoking. The issues and institutions implicated by the problem cover a vast range of the legal landscape.

- Fundamental questions are posed about compensation for product-related injuries, about regulatory authority over a legal but lethal product and over the anticompetitive practices of the industry that produces and markets it, about the

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accommodation of the competing interests of smokers and those affected by that activity, about the interplay between the exercise of basic constitutional rights and the acknowledgment of even a minimal debt owed to the citizens of the society in which those rights are enjoyed, and about the jurisdictional allocation between federal and state governments.

- The social and public policy ripples that extend outward from the legal system's attempts to alleviate the problem raise complex and interrelated issues relating to the promotion of public and pediatric health, to the economic prosperity of entire regions of our nation and of the workers and businesses that depend in one way or another on the tobacco industry, and to the distribution of the costs of end-of-life care for individuals who are debilitated decades after their initial decisions about whether and how much to smoke.
- A national dialogue about the problem engages the specialized talents and calls for the informed perspectives of politicians, litigators, educators, and social scientists, and it requires a candid recognition of the deeply conflicted opinions that are held among members of the general public who contribute to, who are subjected to, and who bear the burden of the risks associated with tobacco products.
- Recommendations of solutions for a problem this massive and this interwoven with so many strands of the social fabric need to be sensitive to the overlapping and sometimes inconsistent demands of corrective, distributive, retributive, intergenerational and international justice.

It is undoubtedly safe to say that no solution can hope to achieve political viability, economic soundness, moral responsibility, and legal acceptability without the most painstaking consideration of a variety of options. Indeed, it would be surprising if there were a single "magic bullet" solution that attends to all the facets of the problem. A more likely scenario would contemplate patching together the best features of a range of diverse responses, and

employing an incremental trial-and-error process in which the lessons of experience are carefully folded into the insights of theory.

For a brief time, the tobacco industry's decades-long record of successful resistance to governmental attempts to hold it responsible for the harm caused by cigarettes appeared to be in jeopardy. Developments in 1998 indicate, however, that the hurdles confronting regulators,¹ litigators,² and legislators³ may be as formidable as they have historically been. The present political and legal moment may be more in the nature of *entre acte* than *denouement*. If so, the time is ripe for a reassessment of the course to be followed, but the most recent experience suggests a need for a realistic understanding of the pitfalls that lie ahead on that course.

A. THE SIGNIFICANCE OF HANSON AND LOGUE'S *THE COSTS OF CIGARETTES*

The recent article by Jon Hanson⁴ and Kyle Logue,⁵ entitled *The Costs of Cigarettes: The Economic Case for Ex Post Incentive-Based Regulation*,⁶ is a lengthy and often quite compelling exploration of the performance and the promise of the legal system's response to disease and other harms caused by smoking. Following up on earlier articles advocating an enhanced version of tort liability to allocate the costs of product-related injuries,⁷ the authors of *The*

¹ *Brown & Williamson Tobacco Corp. v. FDA*, 153 F.3d 155, 176 (4th Cir. 1998) (2-1 decision) (holding that Food and Drug Administration lacks jurisdiction to regulate tobacco products, invalidating regulations issued by agency in 1996) *cert. granted*, 119 S. Ct. 1495 (1999).

² *Brown & Williamson Tobacco Corp. v. Carter*, 723 So.2d 833 (Fla. Dist. Ct. App. 1998) (reversing plaintiff's judgment on 1996 verdict awarding \$750,000 to ex-smoker, holding that action was barred by statute of limitations).

³ 144 CONG. REC. S6486 (daily ed. June 17, 1998) (recommittal of Tobacco Products Control Act of 1998, S. 1415, following unsuccessful attempts by legislative supporters of the measure to invoke cloture and cut off debate).

⁴ Professor, Harvard Law School.

⁵ Professor, University of Michigan Law School.

⁶ 107 YALE L.J. 1163 (1998) [hereinafter Hanson & Logue, *Costs*].

⁷ See *id.* at 1175 n.40 for citations to the published and unpublished articles by Hanson and Logue, along with others co-authored by Hanson with Steven P. Croley, Professor Logue's colleague at Michigan, and with Michael Zamore. The two articles that are most directly the conceptual predecessors of *Costs* are Steven P. Croley & Jon D. Hanson, *Rescuing the Revolution: The Revived Case for Enterprise Liability*, 91 MICH. L. REV. 683 (1993) [hereinafter Croley & Hanson, *Enterprise Liability*], and Jon D. Hanson & Kyle D.

Costs of Cigarettes present an extended analysis of market failures that justify regulatory intervention in the operation of the tobacco industry. They then offer a series of arguments for overcoming those market failures and attaining economic efficiency by employing a particular kind of legal regulation, which they label "ex post incentive-based regulation."⁸ They had developed in that prior work an "enterprise liability" model of this type of regulation, and explore in this piece and its sequel a "smokers' compensation" version.

Each of us has previously and independently written about tobacco-related harms,⁹ and our work is accurately characterized by Hanson and Logue as calling for the legal system to respond to the problem of tobacco-related harms in ways that differ significantly from the ex post incentive-based liability they champion. We are, for instance, much less confident than Hanson and Logue that an approach that incorporates so many aspects of the tort system is the most appropriate way to resolve the serious loss allocation issues presented by the health-related effects of smoking. Not surprisingly, we find greater promise than Hanson and Logue in the construction of more dramatically different alternatives to tort liability as a responsible method of addressing the concerns raised

Logue, *The First-Party Insurance Externality: An Economic Justification for Enterprise Liability*, 76 CORNELL L. REV. 129 (1990) [hereinafter Hanson & Logue, *Insurance Externality*]. Hanson and Logue, with Mr. Zamore, have also written a follow-up to *The Costs of Cigarettes*, Jon D. Hanson et al., *Smokers' Compensation: Toward a Blueprint for Federal Regulation*, 22 S. ILL. U. L.J. 519 (1998), [hereinafter Hanson et al., *Blueprint*] in which they devote more attention to an administrative compensation system version of ex post incentive-based regulation.

⁸ Hanson & Logue, *Costs*, *supra* note 6, at 1173.

⁹ Richard C. Ausness, *Cigarette Company Liability: Preemption, Public Policy and Alternative Compensation Systems*, 39 SYRACUSE L. REV. 897 (1988) [hereinafter Ausness, *Preemption*]; Richard C. Ausness, *Compensation for Smoking-Related Injuries: An Alternative to Strict Liability in Tort*, 36 WAYNE L. REV. 1085 (1990) [hereinafter Ausness, *Alternative to Strict Liability*]; Richard C. Ausness, *Paying for the Health Costs of Smoking: Loss Shifting and Loss Bearing*, 27 SW. U. L. REV. 537 (1998) [hereinafter Ausness, *Paying*]; Richard C. Ausness, *Product Category Liability: A Critical Analysis*, 24 N. KY. L. REV. 423 (1997) [hereinafter Ausness, *Category Liability*]; Paul A. LeBel, *Beginning the Endgame: The Search for an Injury Compensation System Alternative to Tort Liability for Tobacco-Related Harms*, 24 N. KY. L. REV. 457 (1997) [hereinafter LeBel, *Endgame*]; Paul A. LeBel, *Florida Tobacco Litigation Symposium—Putting the 1997 Settlement Into Context*, 25 FLA. ST. U. L. REV. 731 (1998); Paul A. LeBel, "Of Deaths Put on by Cunning and Forced Cause": *Reality Bites the Tobacco Industry*, 38 WM. & MARY L. REV. 605 (1997).

about smoking and health. While each of us has written about the merits of a compensation system approach to this and other injury problems, our understanding of the potential strengths and demonstrable weaknesses of such an approach leads us to be quite skeptical about the attempt by Hanson and Logue to construct their "smokers' compensation" proposal as an ex post incentive-based system rather than one that is financed by taxes collected ex ante.

Our greatest point of difference with Hanson and Logue, however, is our strong belief that economic efficiency is inadequate as an intellectual construct for thinking and talking about improving the performance of the legal system in dealing with tobacco-related harms. Although Hanson and Logue do refer to considerations other than efficiency as important to a comprehensive analysis of the problem,¹⁰ we believe that the outset of the analysis is the most appropriate place for the introduction of those other concerns—among others, what Guido Calabresi calls "other justice concerns"¹¹ in his pioneering study of the economics of tort law that is the intellectual progenitor of the work by Hanson and Logue.¹² Employing a broader analytical framework will, we believe, produce significantly different conclusions about the advantages and disadvantages of the various responses that a legal system might adopt to the problems associated with tobacco-related harms. In particular, as we will attempt to demonstrate in this Article, the recognition at the outset of the analysis that the appropriate frame of reference should be a value system that includes more than

¹⁰ Hanson and Logue recognize in a number of places that political and practical considerations could lead to the adoption of a scheme that deviates from their optimal approach. See, e.g., Hanson & Logue, *Costs*, *supra* note 6, at 1305 (acknowledging that "political reality may require that . . . some protection must be given to the existing cigarette companies" from retroactive liability); *id.* at 1300 (noting that concern about black market in cigarettes could be alleviated by reducing ex post fine to produce less than optimal deterrence).

¹¹ GUIDO CALABRESI, *THE COSTS OF ACCIDENTS* 24-26 (1970).

¹² For example, the standard that is set out for determining where to place the costs of second-hand smoke, Hanson & Logue, *Costs*, *supra* note 6, at 1314, is a straightforward application of Calabresi's "cheaper cost avoider" notion. The influence of Calabresi's path-breaking scholarship is clear in the earlier work of Professors Hanson, Logue, and Croley. See, e.g., Croley & Hanson, *Enterprise Liability*, *supra* note 7, at 691 n.29; Hanson & Logue, *Insurance Externality*, *supra* note 7, at 131. The major critical focus in these works is, understandably enough, on the more recent contributions to the law and economics literature on tort law.

economic efficiency will lead to a different conclusion about the relative merits of an ex post incentive-based approach to responding to the costs of cigarettes. We will attempt to demonstrate that, as a matter of theory, our alternative approach will eliminate the distortion in Hanson and Logue's evaluation of the various approaches that we think can be traced to their narrower perspective.

Although we ultimately arrive at a position that is considerably more skeptical than Hanson and Logue about reliance on either enterprise liability or their version of smokers' compensation in the cigarette context, we would be remiss if we did not acknowledge the significant contributions that *The Costs of Cigarettes* makes to the economic literature and to the public policy debate about the legal system's treatment of the relationship between smoking and health. Hanson and Logue help to shape that debate by their application to the cigarette setting of some of the more recent refinements in legal concepts and doctrines drawn from economic analysis of law and from political science.

On that score, one could find that a major benefit of Hanson and Logue's article is their application of a taxonomy of regulatory responses as a method of evaluating different responses to a perceived inadequacy of a laissez faire attitude toward the costs created by smoking. Taking that taxonomy seriously, we can sharpen the focus on the essential feature of an approach constructed along the lines we have put forward in our previous writing. Although Hanson and Logue address our work in their discussion of an ex post regulatory response,¹³ the taxonomy set out in their article leads us to conclude that our approach is actually more in the nature of an ex ante attempt to identify and shift to the tobacco industry the costs of the harms that the industry will create in the future.

¹³ Hanson & Logue, *Costs*, *supra* note 6, at 1285-89.

In a number of respects, Hanson and Logue have attempted to establish a new starting point for the analysis of the legal problems associated with smoking. Those who write about tobacco issues and about injury compensation in general have been given a clear challenge to previous ways of thinking and a more precise vocabulary with which to respond to that challenge.

Our concern with their work is not limited to the theoretical construct they set out so impressively. At this political moment, when the course of legislation, regulation, and litigation seems so uncertain, the stage is set for a return to basic principles. Given the demagoguery that has invaded the discourse about tobacco, this is also a risky political moment. The approach advocated by Hanson and Logue is particularly risky because of its susceptibility to being portrayed as a call for a seven-dollar-per-pack increase in cigarette prices. We fear that characterization could diminish the effectiveness of fresh scholarly approaches to the problem. If Hanson and Logue are wrong, in other words, it is particularly important at this time to shift the focus away from their efficiency-centered analysis.

B. OVERVIEW OF TOWARD JUSTICE IN TOBACCO POLICYMAKING

In an article as rich as that of Hanson and Logue, one could easily find a host of topics worthy of extended discussion. Our focus is on the ways in which the insights of *The Costs of Cigarettes* can inform an approach that responds more pragmatically to the cigarette-specific concerns that obtain in devising a legal regime in which allocative efficiency is one of a number of (at least) equally important goals (such as corrective, retributive, and distributive justice concerns) and constraints (such as political feasibility, administrative efficiency, and concern about the unintended legal and economic consequences of the procedural and doctrinal modifications that would have to be adopted for enterprise liability to be an effective method of shifting the losses associated with the use of tobacco products). We ultimately conclude that the most appropriate way to proceed is to center the analysis on the justice concerns that arise in this context and to recognize efficiency concerns as constraints on and as more explicit costs of solutions that proceed from that moral center.

Part II of our Article is a concise presentation of the major points made by Hanson and Logue. In Part III, we first consider in greater detail the market failures identified by Hanson and Logue. While we agree with a good deal of what they say about the performance of the market, particularly with their conclusion that there is a compelling case to be made for legal intervention in that market, we question enough of their analysis that at least some of the prescriptions they draw from that analysis strike us as unwise or unwarranted. Part III then goes on to focus on the central question of *The Costs of Cigarettes*: "Assuming that there are problems with the cigarette market, what regulatory mechanisms should be implemented?"¹⁴ Our disagreement with the choice of an ex post incentive-based system as the virtually exclusive answer to that question stems for the most part from our skepticism that it is a question that is reasonably posed in purely or largely economic terms. Nevertheless, even if one were to step into the analytic framework adopted by Hanson and Logue, we believe that there needs to be a more realistic appraisal of the disparity between the idealized world they describe and the actual setting in which we must grapple with the social and economic effects of smoking.

In Part IV, drawing on the conclusions reached in the preceding two Parts, we articulate the demands we think should be met by the legal system undertaking a responsible approach to the health-related costs of smoking. Part IV sets out the policy considerations that need to be addressed in the cigarette context, and examines the capabilities of different regulatory approaches to address those considerations. Part V ties together the strands of the critique of Hanson and Logue and the policy concerns of our alternative approach by identifying the justice-oriented claims of various constituencies and illustrating how a justice-centered set of solutions might be constructed in response to the complexities of the costs of smoking.

II. A PRÉCIS OF *THE COSTS OF CIGARETTES*

The scope and the complexity of *The Costs of Cigarettes* are difficult to capture in a brief summary of its points. Nevertheless,

¹⁴ *Id.* at 1179.

a condensation can provide a basis for understanding its strengths and weaknesses. Five of the tasks undertaken by Hanson and Logue stand out as likely to be particularly significant in subsequent discussions of how to structure the legal regime for tobacco:¹⁵

(a) an identification of market failures in the cigarette context that call for some form of government intervention in that market;

(b) a powerful critique of some of the more conservative law and economics scholarship that supports the notion that such intervention is unnecessary;

(c) a classification of types of governmental intervention into a useful taxonomy of regulatory responses;

(d) a description of what Hanson and Logue believe to be the serious shortcomings of non-incentive-based and ex ante incentive-based approaches; and

(e) a statement of the benefits that Hanson and Logue attribute to an ex post form of regulation that is both incentive-based and victim-initiated.

In this Part, we set out what we believe to be the most significant points made by Hanson and Logue under each of these five headings. In doing so, we recognize the need to strike a balance between a comprehensive coverage of a 200-page article with more than 800 footnotes and a fair presentation of the essence of what that article

¹⁵ In addition to the five matters described below, Hanson and Logue also critique the elements of the comprehensive national settlement agreement negotiated by the industry and a number of state attorneys general in June 1997. See Hanson & Logue, *Costs*, *supra* note 6, at 1316-49. Hanson and Logue have such a strongly negative reaction to the agreement that they would prefer to remain under the status quo rather than to have had the terms of the agreement implemented. *Id.* at 1181. In their view, a products liability regime that is moving into a "third wave" of liability for smoking-related harms is a more promising vehicle for achieving efficiency in the market for cigarettes than the settlement agreement that they view as such a politically-compromised and conceptually-flawed measure. *Id.* at 1349.

says so that our responses to it will be intelligible. As the remainder of our Article demonstrates, an appreciation of the finer points of particular aspects of our reaction to Hanson and Logue will sometimes require us to expand on the summary presented in this Part.

A. MARKET FAILURES IN THE CIGARETTE INDUSTRY

1. *The Promise of the Perfect Market.* *The Costs of Cigarettes* falls squarely into the body of law and economics scholarship that identifies the divergence of a real world situation from the conditions of a perfect market and then proposes legal solutions to bring the actual situation closer to the efficient allocation of resources that would occur in a perfect market. A perfect market for cigarettes would have producers and consumers (as well as some important classes of third parties) operating in an environment in which the price that the consumer pays for cigarettes will reflect their true costs of production, including the costs of personal injuries and other harm that cigarettes cause.¹⁶

Economists understand that market failures of various types could prevent the efficient allocation of resources. According to Hanson and Logue, conditions of imperfect information and externalities actually do so in the market for cigarettes.¹⁷ Although economic analysis of product injury situations typically concentrates on care levels of producers and activity levels of consumers,¹⁸ Hanson and Logue recognize that the nature of smoking-related harms implicates a larger number of parties whose behavior could affect the efficiency of the cigarette market. Economically efficient conditions in that market could be attained through shifting

¹⁶ See Howard C. Klemme, *The Enterprise Theory of Torts*, 47 U. COLO. L. REV. 153, 159-60 (1976) ("For the pricing mechanism of the market to achieve this goal of the 'best' allocation of the community's total limited resources, a supplier of goods and services must accurately reflect in the price he seeks for his goods or services the 'true' cost of making them available."); Ellen Wertheimer, *Pandora's Humidor: Tobacco Producer Liability in Tort*, 24 N. KY. L. REV. 397, 407 (1997) ("From an economic standpoint, the correct price of a product should reflect all its costs. Only then can one accurately assess the level of demand for that product.").

¹⁷ Hanson & Logue, *Costs*, *supra* note 6, at 1174-75.

¹⁸ *Id.* at 1176-77.

combinations of different variables: (a) when manufacturers reach the optimal level of investment of resources in controlling the risks posed by cigarettes (*manufacturer care levels*);¹⁹ (b) when manufacturers produce the optimal amount of cigarettes (*manufacturer activity levels*);²⁰ (c) when smokers consume the optimal number of cigarettes (*consumer activity levels*);²¹ (d) when smokers make optimal use of the product (*consumer care levels*),²² and (e) when third parties (such as employers and operators of public spaces) make an optimal investment in controlling the adverse health consequences to those who are exposed to smoking by others (*third party care levels*).²³

If the market were to operate so that rational economic actors arrived at the cost-justified level of smoking (and of smoking-related harms), there would be no need or justification for the legal system to intervene in the range of decisions about production and use of cigarettes.²⁴ Such intervention is called for, however, when the market fails in some way to let the parties reach the efficient results by acting free from legal constraints.²⁵

One of the principles that Hanson and Logue articulate—that *the way* the legal system should respond to market failure is contingent on *the particular type* of market failure that occurs²⁶—is a valuable reminder of the need for precision on empirical and normative levels. *The Costs of Cigarettes* builds on that principle to construct

¹⁹ See *id.* at 1296-97 (listing a number of modifications of cigarettes that might follow the imposition of enterprise liability).

²⁰ See *id.* at 1297 (suggesting that manufacturers reducing sales to minors could have long-term positive effect of lowering incidence of addiction).

²¹ See *id.* at 1275-76 (noting that number of packs of cigarettes purchased can be inefficient under market failure conditions).

²² See *id.* at 1340 (acknowledging that *how* cigarettes are smoked can affect risks of smoking); *id.* at 1177 n.45 (expressing view that consumer care levels are only modestly affected by tort law).

²³ See *id.* at 1313 (noting that owners of businesses where exposure to environmental tobacco smoke occurs could be given incentives to take cost-effective measures to restrict smoking in public places).

²⁴ See *id.* at 1181 (stating widely held view among legal economists that regulation of cigarette market is unwarranted if consumers are well aware of risks).

²⁵ See *id.* at 1263 (noting that "cigarette market is characterized by significant market failures and . . . very much in need of regulation").

²⁶ See *id.* at 1180 n.57 ("identify[ing] precise ways in which markets fail . . . [is] a necessary condition for offering worthwhile regulatory proposals").

a sophisticated argument around two important assertions: first, that there is in fact market failure that interferes with efficient outcomes for production and consumption of cigarettes, and second, that the types of market failures that exist in this market call for a particular kind of legal intervention.

2. *The Imperfection of Reality.* The failures in the cigarette market are characterized by what Hanson and Logue label "consumer undeterrability" phenomena, which they describe as situations "where tort law can do very little directly to give consumers incentives to take efficient precautions beyond adjusting their activity levels."²⁷ That undeterrability stems from two types of market failures: (1) imperfect consumer information about the risks of smoking,²⁸ and (2) the ability of smokers to externalize substantial portions of the costs that are created when those risks are realized.²⁹ Because little can be done when the legal system focuses on consumers, according to Hanson and Logue, the appropriate way for the legal system to respond is by imposing liability upon the manufacturers, so that they have a greater incentive to determine what measures are available and whether those measures are cost-justified.³⁰

Considerable attention is devoted to each of the market failures that Hanson and Logue find in the cigarette setting. The informational deficiency allows smokers to ignore or mis-estimate the risks associated with their activity, leading to decisions about whether and how much to smoke³¹ that are suboptimal when compared with

²⁷ *Id.* at 1175. As part of our critique, we hope to demonstrate that this description skews the response to the problem of market failure in the cigarette context. By using as a starting point the monetary incentives of tort damages to injured parties (albeit substantially modified in their approach), Hanson and Logue divert attention too early from other techniques of legal intervention (which we describe below as "direct regulation") that are quite effective at solving some parts of the smoking-related disease problem. At the same time, the description appears to be overly dismissive of reductions in consumer activity levels, which can be a very significant improvement over the status quo.

²⁸ *See id.* at 1181-1223 (examining impact of imperfect information in undeterrability).

²⁹ *See id.* at 1223-63 (offering analysis of externalization of costs by smokers).

³⁰ *Id.* at 1176.

³¹ *Id.* at 1188-92. Some attention is given to what type of cigarette to smoke, but it is difficult for changes in consumer behavior to produce any appreciable difference in the overall safety of cigarettes that would make this variable significant. Similarly, there are occasional references to how to smoke, but Hanson and Logue are skeptical that this

what their behavior would be if they had accurate information about those risks. In a similar fashion, the ability to externalize the costs of smoking leads smokers to make those decisions in a way that is different from what they would do if the full consequences of the decisions were imposed upon them.

a. Imperfectly Informed Consumers of Cigarettes. Consumers of cigarettes are likely to be imperfectly informed of the risks of smoking for any or all of four different reasons, according to Hanson and Logue. One of those reasons, referred to as the "third person effect," involves a cognitive limitation.³² Psychological studies suggest that individuals distinguish between risks to others and risks to themselves.³³ Everyday experience provides evidence as well of people whose attitude toward risk is some form of "it can't happen to me." Thus, even a consumer who is aware of the objective risks of smoking may discount or ignore this information due to a belief that the personal risk from smoking is less than the risk that is posed to others who smoke.³⁴ This theoretical possibility actually occurs within the smoking population. According to Hanson and Logue, survey data indicate that some smokers do believe that the risk to them is substantially lower than the general risks of smoking.³⁵

A second informational imperfection identified by Hanson and Logue is the lack of risk information that is specific to particular brands of cigarettes. According to them, tobacco companies have little incentive to develop safer cigarettes because consumers assume that all cigarettes are equally risky.³⁶ Furthermore, Hanson

makes enough of a difference to matter very much. They do suggest that a concerted marketing effort by manufacturers could produce a "safer smoker," i.e., one who is less likely to begin smoking at an age when there is a high risk of addiction. *Id.* at 1297.

³² In the following Part of this Article, we assert a need to distinguish cognitive limitations from imperfect information. See *infra* Part III.A.1.a. For purposes of this Part's description of the Hanson and Logue article, we adhere to their grouping of both categories of decisionmaking deficiencies under the heading of imperfect information.

³³ Hanson & Logue, *Costs*, *supra* note 6, at 1186 (citing Martin Fishbein, *Social Psychoanalysis of Smoking Behavior*, in *SOCIAL PSYCHOLOGY AND BEHAVIORAL MEDICINE* 179, 183-84 (J. Richard Eiser ed., 1982)).

³⁴ Fishbein, *supra* note 33, at 184.

³⁵ Hanson & Logue, *Costs*, *supra* note 6, at 1187-88 (citing Michael Schoenbaum, *Do Smokers Understand the Mortality Effects of Smoking? Evidence from the Health and Retirement Survey*, 87 *AM. J. PUB. HEALTH* 755, 755-58 (1997)).

³⁶ *Id.* at 1188-89.

and Logue believe that the absence of brand-specific information about risks causes consumers to underestimate the dangers of smoking "high-risk" brands, while overestimating the dangers of smoking "low-risk" brands.³⁷

Yet another inadequacy of information identified by Hanson and Logue is the lack of a basis for making accurate relative risk determinations. Inefficient decisions by smokers are more likely when two relevant comparisons are unreliable. The first is comparing the risk of smoking to the risk associated with engaging in other kinds of activities and using other products.³⁸ The point of this comparison is that the decision to smoke is made within a broader range of risks that are encountered in daily life. Without accurate information about the location of smoking on that risk spectrum, an individual would be unable to put the smoking risks into proper perspective, and thus may smoke more than would be the case if the risk differential between smoking and other activities were properly appreciated.³⁹ The second item of relative risk identified by Hanson and Logue involves the comparison between the risks associated with smoking and those thought to be associated with not smoking. Consumers may decide to smoke or, more plausibly, rationalize their decision to continue smoking by advertizing to the effects that they associate with not smoking, such as weight gain and higher stress levels. The decisions made by the smokers who mis-estimate this type of relative risk will tend to be different from those that would be made by perfectly informed consumers.⁴⁰

³⁷ *Id.* at 1189.

³⁸ *Id.* at 1190-92, 1217-18.

³⁹ *Id.* at 1217-18. Curiously enough, the same sort of phenomenon surfaces when critics of legal action against tobacco companies invoke the slippery slope argument that if tobacco is treated this way today, beef and butter producers can expect similar treatment in the future. Hanson and Logue deal with the slippery slope argument in a convincing fashion. *Id.* at 1352 n.784. What is noteworthy is that the public defenders of the tobacco industry are making the same sort of imperfect relative risk assessment, albeit there it is the risk of having liability imposed for the harm associated with different products, that imperfectly informed smokers are likely to make.

⁴⁰ *Id.* at 1190-91. The factors that Hanson and Logue identify as part of the risks of nonsmoking which consumers tend to exaggerate could appropriately be characterized as the perceived benefits of the use of the product. The point made by Hanson and Logue remains the same: an imperfectly informed smoker will overstate the benefits of smoking to the same degree that he or she will overstate the risks of not smoking. The distinction is worth noting, however, when one encounters the proposition that smoking is an activity

A final and quite significant information inadequacy concerns the effects of the addictive properties of cigarettes. A person who does not understand the nature and the strength of such addiction is likely to make substantially different assessments of the risks associated with decisions about smoking than one who has contemplated addiction.⁴¹ Hanson and Logue offer a multi-layered exploration of the psychological and decisionmaking effects of addiction, concluding that this, too, interferes with the efficient operation of the market for cigarettes.

Hanson and Logue consider two models of decisionmaking. According to one model, consumers who purchase cigarettes weigh the *incremental* benefit of smoking an additional pack of cigarettes against the *incremental* health risks of smoking an additional pack. Because the incremental risk of smoking is quite small, consumers who utilize this model of decisionmaking are likely to underestimate the true risks of smoking.⁴² Professor W. Kip Viscusi, however, suggests a second model of decisionmaking. According to this model, consumers who make the initial decision to smoke compare the lifetime benefits of smoking to the increased lifetime health risks of smoking.⁴³ In Viscusi's view, consumers who utilize this second model will make economically rational decisions about smoking.⁴⁴

Hanson and Logue argue that the particular model of decisionmaking that is employed will depend upon how much the consumer knows about the addictive qualities of nicotine.⁴⁵ According to them, a rational consumer who is fully informed about addiction will conceptualize the decision to smoke as a lifetime choice and will, at least in theory, view risks and benefits of smoking in nonincremental terms.⁴⁶ However, a consumer who believes that cigarettes are not addictive will assume that he or she can easily stop smoking at any time in the future. This type of consumer,

that has no utility.

⁴¹ See *id.* at 1196-1202 (examining different risk assessments among smokers).

⁴² *Id.* at 1197-98.

⁴³ W. KIP VISCUSI, *SMOKING: MAKING THE RISKY DECISION* 34 (1992).

⁴⁴ *Id.*

⁴⁵ Hanson & Logue, *Costs*, *supra* note 6, at 1198.

⁴⁶ *Id.*

therefore, will ignore the high costs of quitting and will seriously underestimate the lifetime health costs of smoking.⁴⁷ Hanson and Logue argue that this second decisionmaking model is more applicable to smoking decisions, particularly because of the fact that most beginning smokers are young persons who tend to underestimate the addictive qualities of cigarettes.⁴⁸

b. Imperfectly Internalized Costs of Smoking. The other type of market failure drawn on by Hanson and Logue to justify legal intervention in the cigarette market involves externalities; which are costs that are attributable to one person's activity but inflicted on another person and not reflected in the cost of the actor's enterprise. When the price of a product reflects its true cost, consumers will be able to make efficient consumption decisions, even if they have no specific information about a product's social costs, because the price they must pay reflects these costs.⁴⁹ If some of a product's social costs are externalized to other persons, the price charged for that product will not provide an accurate signal to consumers, and overconsumption of the product will occur.⁵⁰ This is the problem with cigarettes, according to Hanson and Logue: cigarette prices do not reflect the true social costs of smoking because smokers are able to externalize some of these costs to nonsmokers.⁵¹

⁴⁷ *Id.* at 1200.

⁴⁸ *Id.* at 1201-02.

⁴⁹ See Richard J. Pierce, Jr., *Encouraging Safety: The Limits of Tort Law and Government Regulation*, 33 VAND. L. REV. 1281, 1290 (1980) (noting importance of internalizing accident costs).

⁵⁰ See Raymond E. Gangarosa et al., *Suits by Public Hospitals to Recover Expenditures for the Treatment of Disease, Injury and Disability Caused by Tobacco and Alcohol*, 22 FORDHAM URB. L.J. 81, 104 (1994) (stating that overconsumption will occur if demand for the product is artificially high or if the product's price is artificially low).

⁵¹ See Ausness, *Category Liability*, *supra* note 9, at 442-43 ("[A]t the present time, the price of cigarettes does not reflect the full health costs of smoking because a substantial share of these costs are shifted to nonsmokers."); Donald W. Garner, *Cigarette Dependency and Civil Liability: A Modest Proposal*, 53 S. CAL. L. REV. 1423, 1462 (1980) ("Since welfare and private insurance pay most of a patient's medical bills, a large portion of cigarette smoking costs are borne by the public."); Frank Vandall, *Reallocating the Costs of Smoking: The Application of Absolute Liability to Cigarette Manufacturers*, 52 OHIO ST. L.J. 405, 405 (1991) ("At present non-smokers pay a large portion of the health and welfare costs of smoking-caused cancer through higher taxes and health insurance premiums."); Note, *Plaintiff's Conduct as a Defense to Claims Against Cigarette Manufacturers*, 99 HARV. L. REV. 809, 824 (1986) ("These externalities create a problem of allocative inefficiency: because cigarettes' prices do not reflect their true cost to society,

In analyzing the nature and effect of the externalities of smoking, Hanson and Logue distinguish between insurance and noninsurance externalities, as well as between negative and positive externalities. Within the insurance externality category, Hanson and Logue are concerned primarily with identifying the negative externalities of smoking.⁵² As described in the next Subsection, Hanson and Logue also take issue with the notion that premature death of smokers produces a positive externality, that is, a net social benefit, that more than offsets the effect of any negative externality.⁵³

Insurance externalities occur when a particularly risky segment of the population is included in a ratemaking pool with people who are not exposed to those risks. Most people obtain first-party insurance, either individually or through group insurance programs, to provide protection against the financial consequences of death, disability, medical expenses, property damage, or other losses.⁵⁴ In theory, the premiums charged by first-party insurers can inform consumers about the social costs of some of their lifestyle choices.⁵⁵ For example, in the case of smoking, insurance premiums for coverage related to health could vary according to the smoking habits of the insured. Customers who did not smoke would be offered the best rates; light smokers or those who smoked relatively safer brands of cigarettes would be charged somewhat more; and heavy smokers would have to pay the highest insurance premiums.⁵⁶

consumers misallocate resources by spending money on cigarettes that they would spend on other goods if cigarette prices were higher.”).

⁵² Hanson & Logue, *Costs*, *supra* note 6, at 1224-29.

⁵³ *Id.* at 1233.

⁵⁴ Most Americans are covered by health insurance and many persons also have disability coverage. See George L. Priest, *The Continuing Crisis in Liability*, 1 PROD. LIAB. L.J. 243, 248 (1988) (stating that “the vast majority of the U.S. population possesses medical coverage, and a large number possess general disability coverage”). In addition, about two-thirds of the population have some life insurance. Hanson & Logue, *Costs*, *supra* note 6, at 1226 n.270 (citing AMERICAN COUNCIL OF LIFE INS., 1996 LIFE INSURANCE FACT BOOK 6 (1996)). Finally, almost all commercial and residential structures are protected by fire insurance. *Id.* at 1226 n.271 (citing Guy Halverson, *Insurance Described as a Financial Necessity*, CHRISTIAN SCI. MONITOR, May 8, 1995, at 9).

⁵⁵ Hanson & Logue, *Costs*, *supra* note 6, at 1224-25.

⁵⁶ *Id.* at 1225.

Unfortunately, first-party insurers seldom adjust their rate structure to reflect the health costs of smoking.⁵⁷ The same is true of government-sponsored insurance programs such as Medicare.⁵⁸ According to Hanson and Logue, only life and disability insurers take account of smoking-related risks in the premiums they charge to their customers.⁵⁹ Even those insurers ask only if an applicant is presently smoking, making no attempt to distinguish between heavy smokers and light smokers or between former smokers and those who have never smoked at all.⁶⁰ Furthermore, even when insurance companies do make the effort to inquire about the smoking habits of their customers, there is little the companies can do to verify answers they receive from applicants.⁶¹

The result of this lack of discrimination between smokers and nonsmokers and among smokers is that the higher demand that smokers place on the funds distributed by the insurers does not correspond to a higher price charged to those policyholders. Instead, nonsmokers pay a higher premium than they would if smokers were separately rated and, thus, end up subsidizing a portion of the costs of smoking. If smokers were forced to pay the full cost of insuring against the risks associated with smoking, consumption levels would be based on a more accurate signal about the magnitude of the costs of smoking.

Noninsurance externalities are costs that nonsmokers bear because of the decision that other people make about whether, how much, and where to smoke. The point here, as with imperfect information and insurance externalities, is that suboptimal levels of smoking will tend to occur when decisions about whether and how much to smoke do not reflect those costs.

This type of externality includes two relatively uncontroversial categories of costs imposed on others, harms related to environmen-

⁵⁷ *Id.*

⁵⁸ *Id.* Social "insurance" programs such as Medicaid are also subject to this sort of externality because they are financed by taxes whose rates are determined by income not by smoking habits.

⁵⁹ *Id.* at 1226.

⁶⁰ *Id.* at 1229.

⁶¹ *Id.* at 1227-28.

tal tobacco (also known as "passive" or "second hand") smoke (ETS)⁶² and losses suffered by people with strong ties to smokers who die prematurely. Hanson and Logue observe that the costs of passive or environmental tobacco smoke are largely externalized to non-smokers.⁶³ Estimates of ETS-related deaths vary from 2,500 to about 6,000 per year.⁶⁴ ETS also causes a large number of nonfatal injuries.⁶⁵ Hanson and Logue base their other straightforward category of externalities on the belief that the families and friends of smokers suffer substantial pecuniary and nonpecuniary losses due to smoking.⁶⁶ These costs include deaths and injuries from smoking-related fires, fetal deaths caused by smoking, and increased neonatal intensive care costs for infants born to mothers who smoke during pregnancy.⁶⁷

Hanson and Logue include within the category of noninsurance externalities a cost that may spark more controversy than those just mentioned. According to the authors, it is appropriate to treat some portion of the smoker's own costs as an externality. These costs include uninsured medical expenses and lost wages, as well as the costs of premature death and disability.⁶⁸ This somewhat counterintuitive notion could perhaps be grounded on an understanding of a multiple-self phenomenon touched on in the imperfect information section of *The Costs of Cigarettes*. According to this theory, an individual who experiences present benefits and postponed costs may psychologically externalize those costs to a "future

⁶² The environmental tobacco smoke (ETS) externality would also affect decisions about the circumstances under which one chooses to smoke. This factor is an illustration of the way in which the analysis of the cigarette market is considerably more complex than is captured with a focus that was limited to care levels of manufacturers and activity levels of smokers.

⁶³ Hanson & Logue, *Costs*, *supra* note 6, at 1229.

⁶⁴ David B. Ezra, Note, *Smoker Battery: An Antidote to Second-Hand Smoke*, 63 S. CAL. L. REV. 1061, 1065 (1990).

⁶⁵ See Gregory P. Taxin, *Tobacco Industry Liability for Cigarette-Related Injuries: "Smokers, Give It Up!"*, 16 J. PROD. & TOXICS LIAB. 221, 237 (1994) (concluding that ETS causes nonsmokers to suffer such illnesses as respiratory irritations and nonfatal heart disease).

⁶⁶ Hanson & Logue, *Costs*, *supra* note 6, at 1237-39.

⁶⁷ *Id.* at 1239-40 (citing WILLARD G. MANNING ET AL., *THE COSTS OF POOR HEALTH HABITS* 83-84 (1991)).

⁶⁸ *Id.* at 1240-41.

self,"⁶⁹ resulting in the same sort of market failure that occurs, for example, when a smoker escapes the effect of the costs that are experienced by nonsmokers.

That same point might be made in more conventional terms as another instance of imperfect information rather than as an externality. As such, it would contribute to a distortion in the cost-benefit analysis of the smoker who fails to account fully for the costs that may arise only so far in the future that they have no real meaning today. Characterizing the smoker's own "future self" costs as an externality, as Hanson and Logue do, however, turns out to be an important part of their critique of the law and economics scholarship that disputes the conclusion that smoking is an activity that currently imposes net social costs. That critique is a second significant aspect of *The Costs of Cigarettes*.

B. A CRITIQUE OF THE "CONVENTIONAL WISDOM" IN LAW AND ECONOMICS ANALYSIS OF TOBACCO-RELATED HARMS

A good deal of the analysis that Hanson and Logue perform of the cigarette market is critical of "the numerous scholars [who] have begun to employ efficiency analysis to argue in favor of the status quo and against holding cigarette manufacturers liable."⁷⁰ Two representatives of that scholarship come in for particularly close scrutiny: a Rand study of the external costs of poor health habits conducted by Professor Willard G. Manning and a number of others,⁷¹ and a body of work produced by Professor W. Kip Viscusi.⁷² On a number of fronts, Hanson and Logue take issue with what they describe as the conventional wisdom on the economic analysis of the costs of smoking.⁷³

⁶⁹ *Id.* at 1205-09. Hanson and Logue actually attribute the externality phenomenon of the "future self" much less specifically to the "numerous consumer-information problems" they had earlier described as an imperfect information market failure. *Id.* at 1241.

⁷⁰ Hanson & Logue, *Costs*, *supra* note 6, at 1178 n.49.

⁷¹ MANNING ET AL., *supra* note 67.

⁷² The greatest attention is given to VISCUSI, *supra* note 43. For citations of Viscusi's other work, see Hanson & Logue, *Costs*, *supra* note 6, at 1189 n.102, 1209 n.205, 1211 n.211. For an earlier examination of Viscusi's work, see Croley & Hanson, *Enterprise Liability*, *supra* note 7, at 743-51.

⁷³ Hanson & Logue, *Costs*, *supra* note 6, at 1186.

This exercise is crucial to the policy prescription that Hanson and Logue offer in *The Costs of Cigarettes*. If the conventional wisdom is correct, legal intervention in the affairs of the tobacco industry might still be justified,⁷⁴ but not on the allocative efficiency basis on which Hanson and Logue ground their approach. For their assertion that the cigarette market fails in particular ways that call for the application of an ex post incentive-based liability theory to the industry to be compelling, they need to refute the scholarship that contends that the market either is essentially efficient⁷⁵ or is inefficient in a way that makes smokers pay more than they should.⁷⁶

Hanson and Logue dispute a number of strands of the law and economics scholarship in their work. Three of the specific points they make are likely to be particularly helpful to participants in the public policy discourse. On those points, Hanson and Logue take issue with: (1) the view that "the vast majority of consumers are well aware of" the risks of smoking;⁷⁷ (2) the attempt to explain away on a basis other than addiction the disparity between smokers' behavior and their expressions of a desire to quit;⁷⁸ and (3) the conclusion that "the total social benefits of smoking equal or even exceed the costs,"⁷⁹ a conclusion that they contend is reached both by "grossly underestim[ing] the negative externalities created by smoking"⁸⁰ and by overstating the external benefits of smoking.⁸¹ If the "mainstream" economic analysts are wrong on these points, they argue, a good deal of the efficiency-based support for the status quo of no liability for the tobacco industry collapses.

1. *Consumer Awareness of Risk*. Dealing with the "consumer awareness" contention of the conventional economic wisdom is, of course, the flip side of the considerable effort that Hanson and Logue devote to identifying inadequate information as one of the two

⁷⁴ Hanson and Logue point out that even this notion would appear to be "paternalistic" to many legal economists. *Id.* at 1181.

⁷⁵ *Id.* at 1184.

⁷⁶ *Id.* at 1232-33.

⁷⁷ *Id.* at 1181.

⁷⁸ *Id.* at 1196.

⁷⁹ *Id.* at 1232.

⁸⁰ *Id.* at 1236.

⁸¹ *Id.* at 1247.

chief failures in the market for cigarettes.⁸² In the process of making that argument, they specifically attack reliance on survey results that are alleged to reveal that, if anything, consumers overestimate the risks of smoking. Some of that attack is a fairly technical critique of particular survey methodologies and of the reliability of the inferences drawn from that data.⁸³ Other portions of the attack are more accessible to the nonspecialist,⁸⁴ dealing with the distorting effects of addiction on economic analysis and with the spurious case for a net social benefit to smoking.

2. *The Effects of Addiction on Economic Analysis.* Hanson and Logue bring to the economic analysis a helpful discussion of the way that addiction distorts the consumer's assessment of the costs and benefits of smoking. Those effects of addiction occur principally by increasing the costs of quitting, thus creating an artificially high benefit in continuing to smoke,⁸⁵ and by extending the time frame over which the harmful effects of smoking can accumulate. In this portion of their article, they examine critically the economic arguments that purportedly demonstrate that cigarettes are not addictive. Of particular interest is likely to be their refutation of two industry assertions: first, the interpretation of quitting rates as indicating that cigarettes are non-addictive,⁸⁶ and second, the use of the R.J. Reynolds experimental marketing of the Premier brand of cigarette as dual purpose evidence of the non-addictiveness of cigarettes and of the consumer rejection of safer alternative designs of cigarettes.⁸⁷

Instead of standing for the propositions that conventional scholarship has drawn, the results of these studies and experiences are treated by Hanson and Logue as further proof of the ways in which incorrect and imprecise impressions of the risks of smoking undercut the idea that the current level of government intervention in the cigarette market is adequate, if not excessive. The proposi-

⁸² See *id.* at 1181-1223.

⁸³ See *id.* app. at 1354-61 (examining Viscusi's survey data).

⁸⁴ See *id.* at 1186-1221 (rebutting "conventional" wisdom that cigarette smokers are adequately informed).

⁸⁵ *Id.* at 1200.

⁸⁶ *Id.* at 1194.

⁸⁷ *Id.* at 1209-10.

tion that the existence of so many ex-smokers is evidence of the non-addictiveness of cigarettes is challenged by Hanson and Logue as being based on an overly simplified statement of the data. Instead of accepting the industry assertion that half of smokers are able to quit, for example, Hanson and Logue point out that the industry conclusion is a cumulative figure over twenty-five years of the people who have quit before dying, rather than an annual rate, and that even that figure masks the high number of unsuccessful attempts to quit.⁸⁸

The Premier experiment was a test marketing of a smokeless cigarette that proved to be unattractive to consumers.⁸⁹ Hanson and Logue convincingly dispute the characterization of the experimental cigarette as comparable to the normal product, thus upsetting attempts to draw inferences about consumer reaction to a true substitute.⁹⁰ They also question whether consumers really were informed about the alleged greater safety of the experimental brand, casting doubt on the legitimacy of the experiment's use as evidence that consumers will not purchase a safer cigarette.⁹¹ If any lesson is to be drawn from the marketing of Premier, Hanson and Logue conclude, it is that the failure of the industry to remove nicotine from the experimental product offers additional evidence of addictiveness.⁹²

3. *A Clearer View of Net Externalities.* Challenging the treatment that externalities receive in the conventional economic scholarship is an important part of the incentive-based regulatory approach taken by Hanson and Logue. The essence of that approach is that imposition of liability on cigarette manufacturers is needed to correct the inefficiency in the cigarette market due to the artificially low price of cigarettes caused by the shifting of substantial portions of the social costs of smoking to parties other than the smokers themselves. As Hanson and Logue note, some economists reach the conclusion that the externalities of smoking are relatively

⁸⁸ *Id.* at 1195.

⁸⁹ See RICHARD KLUGER, *ASHES TO ASHES* 603-04 (1996) (describing failure of Premier to satisfy consumers' preferences and characterizing it as a "marketing catastrophe").

⁹⁰ Hanson & Logue, *Costs*, *supra* note 6, at 1211-13.

⁹¹ *Id.* at 1210-11.

⁹² *Id.* at 1213.

minor or that they produce a net positive result. Hanson and Logue challenge that conclusion as based on flawed assumptions and incorrect calculations. According to them, a careful look at that scholarship reveals that "the negative externalities are greater than these economists have estimated and that the positive externalities have been overstated."⁹³

The studies by Manning and Viscusi quantify the externalities at figures that range from a net social benefit of \$0.18 per pack⁹⁴ to an external cost of \$0.52 per pack.⁹⁵ Assuming that the current level of excise taxes represents an internalization of the costs of smoking,⁹⁶ the fact that those taxes are at least \$0.53 a pack would mean that smokers are already more than "paying their way."⁹⁷

Hanson and Logue construct an avenue for reaching the considerably different conclusion that the net external costs of smoking are at least \$7.00 per pack, if one accepts the quantification of the various factors used by Manning and Viscusi, and are probably quite a bit higher than that.⁹⁸ They arrive at their higher figure by including in the calculation some categories of costs that Manning and Viscusi exclude,⁹⁹ by increasing the figure assigned by Manning and Viscusi to particular categories of costs,¹⁰⁰ and by refusing to accept the Manning and Viscusi characterization of a benefit of smoking in the form of the putative savings from the premature deaths of smokers.¹⁰¹

The plausibility of the criticisms that Hanson and Logue make of the conventional wisdom on the economics of cigarette smoking,

⁹³ *Id.* at 1224.

⁹⁴ This is the low end of Viscusi's estimate of the cost-benefit calculation. *Id.* at 1235.

⁹⁵ This is the high end of the Manning range of figures for the external costs of smoking. *Id.* at 1234.

⁹⁶ Hanson and Logue challenge that assumption (we think correctly) on the basis that the payment of current excise taxes is an internalization of costs other than the health-related costs of smoking that their analysis shows to be externalized under the current legal regime. *Id.* at 1254-55.

⁹⁷ *Id.* at 1235.

⁹⁸ *Id.* at 1243, 1262.

⁹⁹ *See id.* at 1236-43 (including the noninsurance externalities of ETS, costs that are imposed on family members and other third parties, and the costs to the smokers' "future selves").

¹⁰⁰ *Id.* at 1243-46.

¹⁰¹ *See id.* at 1247-60 (criticizing treating premature death as a benefit of smoking on economic and moral grounds).

when combined with the more positive assertions they make about failures in the market for cigarettes, leads to a conclusion that some form of government intervention is necessary to counteract the erroneous signal that smokers receive when they make their decisions based on the purchase price of cigarettes.¹⁰² Their examination of exactly how that intervention should occur begins with an exposition of the major options that are available.

C. A TAXONOMY OF REGULATORY RESPONSES

A third important feature of *The Costs of Cigarettes* is its classificatory scheme for evaluating various ways in which a legal system might intervene in a particular product injury context.¹⁰³ The basic categories of regulation are (a) command-and-control, (b) performance-based, and (c) incentive-based, with further subdivisions being made within the incentive-based category.¹⁰⁴ Although the dividing lines between categories are admittedly not always bright,¹⁰⁵ the categories do provide a useful taxonomy for conducting a more focused scrutiny of the options.

1. *The Command-and-Control Approach.* A command-and-control approach is what is understood in common parlance by the term "regulation," in that it "imposes specific requirements on the regulated firm."¹⁰⁶ When employed as a method of responding to product injury problems, this approach could involve regulations

¹⁰² See *id.* at 1232 ("There are large external costs associated with cigarette smoking, costs that will not be taken into account by the relevant decisionmakers, unless there is some form of government intervention.").

¹⁰³ Hanson and Logue use the term "regulatory approaches" in a broad way to describe governmental intervention in the operation of a market for goods. That terminology, which is commonly accepted among economic analysts of law, is unobjectionable as long as one understands that, in this usage, "regulatory" encompasses claims for the recovery of damages for personal injury and property damage. More conventional usage among lawyers might indicate a useful distinction between "direct regulation" as a legislative or administrative agency rule about a product's design, manufacture, or sale, and "liability" as an exposure to an enforceable demand to compensate for the harms caused by a product.

¹⁰⁴ *Id.* at 1263.

¹⁰⁵ See Hanson & Logue, *Costs*, at 1263 n.422 ("[D]istinctions . . . in some instances blur.").

¹⁰⁶ *Id.* at 1264.

that specify a product design that must be implemented.¹⁰⁷ It could also involve specifications of the information that must accompany a product into the marketplace or that must otherwise reach the consumer population.¹⁰⁸ Limitations on sale or use of a product would also fall into the category of command-and-control regulation.¹⁰⁹

2. *The Performance-Based Approach.* A performance-based approach in the product injury setting sets out a goal that must be achieved if sale of the product is to be permitted. Performance standards could be adopted for the level of risk that a product may lawfully create for consumers or others affected by the product.¹¹⁰ Similarly, performance-based regulation could specify a target for the incidence of use of the product in general or by narrower segments of the population who are particularly at risk.¹¹¹ Performance-based approaches differ from command-and-control approaches by relying on the regulated firm or industry to determine the precise method of attaining the required performance.¹¹²

3. *The Incentive-Based Approach.* Incentive-based approaches are yet another step removed from the direct specifications of a command-and-control regulation. This technique operates indirectly to promote efficiency by forcing a firm to bear the full costs of its activity or product and to take those costs into account in its decisionmaking.¹¹³ In the product injury setting, incentive-based approaches would identify the portion of the social cost that the firm is able to externalize and then impose on the firm an obligation to pay that amount.¹¹⁴ The most market-oriented of the approaches, incentive-based regulation leaves to the regulated party the decision of whether it is economically efficient to continue its activity with

¹⁰⁷ *Id.* at 1264, 1338-40.

¹⁰⁸ *Id.* at 1322-24.

¹⁰⁹ *See id.* at 1324-30 (discussing proposed marketing restrictions).

¹¹⁰ *Id.* at 1266, 1340-41.

¹¹¹ *Id.* at 1266, 1331-36.

¹¹² *Id.* at 1268; *see also* John Braithwaite, *The Limits of Economism in Controlling Harmful Corporate Conduct*, 16 LAW & SOC'Y REV. 481, 483-84 (1981-1982) (discussing the advantages of performance-based regulation over command-and-control regulation).

¹¹³ Hanson & Logue, *Costs*, *supra* note 6, at 1273.

¹¹⁴ *Id.* at 1174.

the costs fully internalized.¹¹⁵ If the firm determines that some change in its operation is needed, it leaves the extent and type of that change entirely to the firm.

Hanson and Logue subdivide the incentive-based category into those that are state-initiated and those that are victim-initiated,¹¹⁶ on the self-evident basis that the terminology suggests. Incentive-based approaches are further categorized as *ex ante* or *ex post*,¹¹⁷ according to whether the incentive is applied in the form of a payment that is exacted before the product reaches consumers or in the form of a responsibility to compensate for harm after it has occurred.¹¹⁸ *Ex ante* incentives commonly take the shape of taxes on units of production set at rates that try to capture the costs of the harms.¹¹⁹ *Ex post* incentives are most likely to be awards of damages for harm that has been inflicted by a product.

The three types of approach are seen by Hanson and Logue as ranging along a spectrum from least desirable (command-and-control) to most desirable (victim-initiated *ex post* incentive-based)¹²⁰ ways to correct the inefficiency attributable to the market failures they identify in the cigarette setting.¹²¹ Their location of the approaches on that spectrum requires a brief overview of what they find objectionable in the first two approaches and in all of the incentive-based approaches that are not *ex post* and victim-initiated, as well as the benefits they believe will occur under the approach they advocate.

¹¹⁵ *Id.* at 1273-74.

¹¹⁶ *Id.* at 1263.

¹¹⁷ *Id.* at 1263.

¹¹⁸ *See id.* at 1268-73 (comparing *ex ante* and *ex post* approaches).

¹¹⁹ The best example of an *ex ante* incentive-based approach is the National Childhood Vaccine Injury Act of 1986, which imposes on vaccine manufacturers a tax per dose of vaccine that varies according to the risks associated with the vaccine. 42 U.S.C. §§ 300aa-1 to 300aa-34 (1994).

¹²⁰ Hanson & Logue, *Costs*, *supra* note 6, at 1271.

¹²¹ Hanson and Logue do acknowledge that the approaches that are less effective in promoting efficiency may nevertheless offer advantages in more limited ways. *See, e.g., id.* at 1267-68 (use of performance-based approach to reduce youth smoking); *id.* at 1270 (ex ante tax preferable when monitoring tax compliance is easier than monitoring output or care level compliance).

D. THE INADEQUACIES OF NON-INCENTIVE-BASED AND EX ANTE APPROACHES TO SMOKING COSTS

1. *The Excessive Informational Demands of Efficient Regulation.* Each of the options that might be considered an alternative to ex post incentive-based regulation is found wanting in some significant way by Hanson and Logue. Although there are variations in their specification of the shortcomings of the approaches, the central theme that runs through the criticism is the improbability that the informational requirements of effective regulation could be satisfied.¹²²

According to Hanson and Logue, regulatory approaches that impose requirements, set performance standards, or require the payment of a tax ex ante to internalize injury costs would demand that the regulator acquire the level of knowledge that would be possessed by consumers and producers in a perfect market setting. For command-and-control regulations to demand that the regulated parties reach the optimal level of care, Hanson and Logue see a daunting body of knowledge that the regulator must have. As they succinctly put the matter, "to determine the optimal manufacturer care level for a given product, the regulator must construct supply and demand curves for the product in question—indeed, for all the different designs of the product in question, including substitute products."¹²³ Attempting to regulate with less than that level of understanding creates the likelihood that the regulation will call for either more or less than optimal investment in product safety. Furthermore, they believe that mandating product designs would have the adverse effect of stifling manufacturers' searches for design improvements.¹²⁴

¹²² *Id.* at 1271 ("The main reason [for the preferability of an ex post incentive-based approach] is that ex post regulation requires less information on the part of the regulator. . . .").

¹²³ *Id.* at 1264. Professor James Henderson drew on the work of Lon Fuller to express similar skepticism about the ability of legal decisionmakers in products liability litigation to arrive at appropriate results in the "polycentric" defectiveness issues in design defect cases. See generally James Henderson, Jr., *Judicial Review of Manufacturers' Conscious Design Choices: The Limits of Adjudication*, 73 COLUM. L. REV. 1531 (1973).

¹²⁴ Hanson & Logue, *Costs*, *supra* note 6, at 1265.

Because performance-based approaches do not require the regulator to specify how a standard is to be met, the regulated firm would be able to rely on its own knowledge of technology to choose the most cost-effective way of meeting the standard. The flaw that Hanson and Logue nevertheless find in performance-based standards as an efficiency-maximizing regulatory technique is the same sort of knowledge limitation that hinders the regulator who employs command-and-control approaches. Performance targets could only counteract market failures, they contend, if the regulator could reach the same comprehensive understanding of costs and benefits under different circumstances.¹²⁵ That understanding is no more realistically within the grasp of the performance regulator than it is for the command-and-control regulator. Anything less than perfection in that knowledge would create the risk that the performance standards would require inefficient behavior to meet the standards or even an unjustified removal of a product from the market if the standard proves to be unattainable.

Given the heroic demands that Hanson and Logue place on regulators who attempt to respond to the kinds of market failures they identify in the cigarette context, it is not surprising that their primary objection to *ex ante* versions of incentive-based regulations similarly rests on the inability of the regulator to know the precise rate of taxation to levy if the *ex ante* payment is to force the internalization of precisely the dimension of social costs that would otherwise be avoided by the manufacturer.¹²⁶ In addition to that shortcoming, which is shared with the previously examined approaches, *ex ante* taxation rates are presumed by Hanson and Logue to be set on an industry-wide basis rather than to reflect the precise injury-causing experience of individual brands.¹²⁷ Under those circumstances, they contend that two types of inefficiency can occur: manufacturers' incentives to adopt safety innovations would be lowered,¹²⁸ and in a process they label "unraveling,"¹²⁹ consumers who were only responding to prices reflecting a uniform rate of

¹²⁵ *Id.* at 1267.

¹²⁶ *Id.* at 1268-69.

¹²⁷ *Id.* at 1269.

¹²⁸ *Id.*

¹²⁹ *Id.* at 1271.

taxation would be drawn toward inefficient choices among brands with different risk levels.¹³⁰

2. *Additional Concerns about the Effects of Particular Regulatory Approaches.* Although the main thrust of their criticism of the regulatory approaches that are not ex post incentive-based rests on the information demands placed on the regulators, Hanson and Logue catalog a number of other shortcomings that those approaches display. They assert, for example, that under ex ante systems tobacco companies have an incentive to deceive regulators about the true costs of the harms caused by cigarettes.¹³¹ Because ex ante payments are based on regulators' forecasts of future costs, the regulated party presumably gains an advantage by keeping those forecasts lower than they would be with more accurate information.

Hanson and Logue criticize ex ante approaches as well as ex post schemes that are state-initiated rather than victim-initiated, for raising problems of overdeterrence of smokers. This phenomenon, which they also refer to as errors of "omission,"¹³² occurs when consumers take the risks of smoking into account in their decisions but are also subject to the ex ante tax or do not share directly in the proceeds from the state-initiated incentive process. Under an analysis that strives for optimal levels of smoking, rather than merely lower levels, it is understandable that a regulatory side-effect of too little smoking would be seen as objectionable. While this side-effect may be understandable, it is questionable on public policy grounds, at least in the current state of affairs, as we contend below.

Hanson and Logue contend that there are multiple failures that would occur upon the adoption of the regulatory approaches that could be seen as alternatives to the one they advocate. Their preference is not arrived at simply by a process of elimination that focuses on the shortcomings of the other approaches, however. Throughout *The Costs of Cigarettes*, they elaborate on the positive features of the approach they favor.

¹³⁰ *Id.* at 1272.

¹³¹ *Id.* at 1274.

¹³² *Id.* at 1272.

E. THE BENEFITS OF A VICTIM-INITIATED EX POST INCENTIVE-BASED RESPONSE TO THE COSTS OF CIGARETTES

The economic efficiency goal articulated by Hanson and Logue requires that the price of cigarettes should incorporate their real social costs. In describing how to reach that goal, Hanson and Logue make clear that they are not going to be satisfied with cosmetic repairs of particular market outcomes. Instead, they wish to construct a response that will correct the underlying market failures that they perceive in the current state of affairs.¹³³ That correction will occur, they allege, under a legal system in which victims of smoking-related harms have access to a legal remedy of monetary damages that will be recovered from the manufacturers whose products are responsible for those harms, and that will require the manufacturers (and ultimately the smokers) to internalize the currently externalized and underestimated costs of smoking.¹³⁴

The details of how ex post incentive-based regulatory schemes can accomplish this end occupy a considerable portion of the attention of Hanson and Logue in *The Costs of Cigarettes*. As a prelude to our own critique of their approach, and to counteract any unintended impression that the best case for their approach is how it does *not* suffer from the deficiencies of the other options, we use this Part to collect in one place the principal claims that are made for their regulatory approach. Those claims can be identified under the seven headings that follow.

1. *Countering Consumer Misinformation about the Costs of Smoking.* Adopting a regulatory approach that holds the tobacco industry legally responsible for all the harms caused by cigarettes will require an increase in the price to internalize these additional costs.¹³⁵ That higher price will in turn force the consumer to internalize the injury costs of cigarettes, leading consumers to a behavior that mimics that of a perfectly informed consumer.¹³⁶

¹³³ *Id.* at 1174-75.

¹³⁴ *Id.* at 1176.

¹³⁵ *Id.* at 1221.

¹³⁶ *Id.* at 1222 (“[C]onsumers would . . . respond *as if* they were adding the health costs of smoking to what had been the nominal costs of smoking.” (emphasis added)).

2. *Overcoming the Economic Consequences of the Addictive Nature of Cigarettes.* The basic problem that addiction poses for economic efficiency analysis is that it distorts the present-day calculation of costs and benefits by smokers. That distortion results from a separation of the present benefits from the future costs. The ex post incentive-based liability approach of Hanson and Logue forces the smoker to take those future costs into account, whichever model of addiction is accepted, by incorporating into the present price of cigarettes the total social costs of smoking including those delayed costs.¹³⁷

3. *Creating an Incentive for Product Safety Innovation in Cigarettes.* Ex post incentive-based regulation imposes on manufacturers a legal responsibility to compensate for all of the harms caused by smoking, making those harms one of the costs of cigarettes. A manufacturer marketing a safer cigarette will cause fewer harms, be required to pay less compensation, and be able to charge lower prices for its cigarettes. This regulatory approach therefore creates an incentive for manufacturers to make an optimal investment in the safety of their product,¹³⁸ lowering the risk to a level at which the marginal benefits of the harms that are avoided equal the marginal costs of making the cigarettes safer.

4. *Eliminating the Subsidization of Smoking by Nonsmokers.* Under the current legal regime, nonsmokers bear a significant portion of the costs of smoking. Insurance premiums of nonsmokers are higher because insurers charge smokers and nonsmokers for underwriting the costs of the smoking-related expenses that nonsmokers do not impose upon the insurer. Furthermore, nonsmokers who suffer harm caused by smokers are bearing those costs or spreading them through their own devices, rather than shifting those costs to the smokers who caused them. In addition to the monetary losses that nonsmokers suffer, smoking creates nonpecuniary harm such as emotional loss upon the death of a loved one that cannot be spread through an insurance mechanism. Moreover, this emotional loss is not shifted to the smokers or

¹³⁷ *Id.* at 1222-23.

¹³⁸ *Id.* at 1260-61, 1296-97.

manufacturers on any reliable basis under current tort law. Ex post incentive-based liability eliminates those insurance and noninsurance externalities by requiring manufacturers to compensate for all of those harms and to incorporate those costs into the prices of their cigarettes, so that the costs are ultimately borne by the smokers whose behavior causes them.¹³⁹

5. *Requiring Manageable Levels of Knowledge for System Administrators.* The most significant determination that would need to be made to support the imposition of liability under an ex post incentive-based scheme is a quantification of the harms that have been caused by cigarettes. There is no need for the administrator of the system to calculate whether those costs could be reduced by the adoption of cost-justified safety measures or whether the losses are such that society would be better off from a resource allocation perspective if the product were removed from the market altogether.¹⁴⁰ Under this approach, the decisionmaking responsibility for any action following a determination of the magnitude of the harms caused by smoking shifts to the manufacturers, who are assumed to be the most knowledgeable about the feasibility of various options.¹⁴¹

6. *Producing New Knowledge about Cigarettes, Costs, and Preventive Measures.* Manufacturers who are confronted with legal responsibility to compensate for the harms caused by smoking will have an incentive to be as accurate as possible in predicting what that liability is likely to be, so there is no premium for the industry to continue its practices of discouraging or withholding the results of honest research. Similarly, any marketing advantages attributable to greater safety would accrue directly to the manufacturer, which could translate into a higher market share for a manufacturer that reached a more sophisticated understanding of the science and technology of smoking and health.¹⁴²

¹³⁹ *But see id.* at 1295 (recognizing that in a deterrence-driven economic model, full compensation would be awarded for economic and noneconomic harms, but acknowledging that political and administrative complications could result in modifications to that model).

¹⁴⁰ *Id.* at 1273.

¹⁴¹ *Id.* at 1297.

¹⁴² *Id.* at 1274.

7. *Avoiding the Risk of Overdetering Smokers.* Built into any efficiency-based economic analysis of the tobacco industry is an assumption that there is some level of consumption of cigarettes that is economically efficient. For an efficiency-driven analyst, smoking too little is as much of a market failure as smoking too much. Ex post incentive-based regulation leads to the smoker paying a higher price that reflects the full costs of smoking. The smoker will make decisions about whether and how much to smoke based on that price, rather than on the basis of that price plus whatever knowledge of the risks the smoker has acquired apart from the price. That knowledge does not enter into the economic calculation because the smoker will have the assurance that if those risks are realized for that individual, the compensation that is received under enterprise liability will offset the costs that are incurred.¹⁴³

III. A CRITIQUE OF HANSON AND LOGUE

Hanson and Logue ask two vitally important questions in *The Costs of Cigarettes*: Is government intervention warranted in the market for cigarettes, and if it is, what sort of intervention is best? We believe that Hanson and Logue perform a great service in the careful and thorough answer they give to the first question. After their article, it will be difficult for what they describe as the conventional wisdom among the economic analysts of law to continue to make what Hanson and Logue demonstrate to be extravagant claims on highly questionable evidence. Although we have some points of disagreement or skepticism about some of the details in this part of their article, we believe that the first question should be answered roughly in the way they answer it. Market failure unquestionably exists in this setting, and it occurs along the two major axes that Hanson and Logue describe: smokers making decisions on the basis of imperfect information about the risks and harms of smoking, and smokers being able to externalize significant segments of those costs to third parties.

¹⁴³ *Id.* at 1274-78.

For the second question, however, we are considerably less convinced of the soundness of the conclusion reached by Hanson and Logue giving the highest priority to implementing an ex post victim-initiated incentive-based regulatory scheme. Our alternative contention is that their preferred approach should be used in the tobacco setting in a role that is subordinate to direct regulation and ex ante tax assessments.

Some of our questioning of their conclusion derives from the points on which we disagree with their analysis of the market. That disagreement may be relatively minor in its effect on the conclusion that there is a market failure, but it does turn out to have important consequences for the way one approaches the second question of how the legal system should respond to that failure.

Our disagreement with the conclusion reached by Hanson and Logue is also based on some significantly different assessments of the performance potential of the various regulatory approaches they describe. To be fair to Hanson and Logue, and in particular to avoid the appearance of criticizing them simply for not having written a different article, we also present a critique of their analysis of the strengths and weaknesses of the regulatory approaches if one were to take as given the failures in the market that they identify. Even if market failure exists in the market for cigarettes in roughly the way they describe, we conclude that there are substantial problems with the way in which they arrive at their answer to the question of how one ought to respond to that failure.

Section A indicates how we question Hanson and Logue's market failure analysis, and what we think that difference implies for the way in which the approach to legal intervention in the market is constructed. Section B offers a different perspective on the regulatory approaches to the costs of tobacco-related harms. The ultimate conclusion that we reach in this Part is that sound public policy requires stepping back and making a fresh start from the point at which informational inadequacies and externalities are deemed to occur in the market for cigarettes.

A. TYPES AND MAGNITUDES OF MARKET FAILURES

1. *Informational Imperfections.* Hanson and Logue identify four ways in which a consumer would reach an inefficient decision about smoking because of what they call imperfect information: (1) lack of brand-specific information, (2) imperfect relative-risk information, (3) the effects of addiction, and (4) the third-person effect.¹⁴⁴ In this Section, we first argue that the third-person effect is not best classified as an information imperfection. We then proceed to assess Hanson and Logue's of the other categories of imperfect information they identify.

a. *Mislabeling Cognitive Limitation.* As suggested earlier, one of the points on which we would modify Hanson and Logue's analysis is their inclusion under the label "imperfect information" of two different phenomena that contribute to consumers underestimating the costs of their activity, thus distorting the decisions they make about the appropriate level of that activity. The first three situations described by Hanson and Logue can truly be characterized as imperfect information problems. The third-person effect, however, we would classify as a cognitive limitation problem. We would differentiate between imperfect information and cognitive limitation in deciding how one might counter the effects of these two concepts.¹⁴⁵

Imperfect information is information that is incomplete or inaccurate; a rational consumer who relies on such information may very well make the wrong choice even though the decisionmaking process is sound. This phenomenon is captured by the expression "garbage in, garbage out." For example, assume that a particular consumer would decide to smoke if the risk of a particular adverse health effect of smoking were one in a hundred; however, that same consumer would not smoke if the risk were one in ten. If accurate data would lead the consumer to realize that the risk is one in eight,

¹⁴⁴ *Id.* at 1186.

¹⁴⁵ We do not mean to imply that Hanson and Logue have ignored the cognitive dimension of consumer decisions. They cite to this phenomenon in their description of different models of how addiction affects behavior. *Id.* at 1198 n.153. Our point is that the distinction between these categories of decisionmaking flaws should open the way for recognizing the value of different types of responses.

but inaccurate data lead the consumer to calculate that the risk is one in two hundred, the decision to smoke would be the result of imperfect information distorting a thought process that was otherwise sound.

Cognitive limitation, on the other hand, is an imperfection in the processing of the result of a calculated decision, and prevents individuals from making rational choices even when they have access to perfect information.¹⁴⁶ To continue the illustration in the preceding paragraph, suppose that same consumer has data from which to calculate that the risk of that harm is one in ten, and does actually reach that result. Instead of acting in accordance with that calculation, however, the consumer processes the result through a filter that provides distance between what is expected to happen to that individual and the statistical likelihood. In its extreme form, this cognitive limitation can be seen in the apparent belief in immunity from harm that leads young people to behave in a manner oblivious to patent dangers.

This distinction could be seen as merely of academic interest were it not for differences in the way of reacting to the different categories. Hanson and Logue offer ex post payments as the means of correcting the imperfect information inefficiencies in the cigarette market, drawing on the standard economic understanding that higher prices can be a substitute for perfect information. If the only goal is perfect efficiency, and the only technique for attaining it is imposing liability on the producer to drive up the price the consumer pays, then ex post incentives operate similarly in both of the categories we would distinguish.

If the response to tobacco-related harms broadens to include other techniques, and the goal is changed to a more realistic one of improvement over the current state of affairs, then there may be no

¹⁴⁶ See Howard Latin, "Good" Warnings, Bad Products, and Cognitive Limitations, 41 UCLA L. REV. 1193, 1229-41 (1994) (discussing how cognitive heuristics and biases interfere with rational decisionmaking); see also Melvin A. Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211 (1995) (exploring impact of human cognitive limitations on contract law); Baruch Fischhoff, *Cognitive Liabilities and Products Liability*, 1 J. PROD. LIAB. 207 (1977) (examining cognitive limitations in making decisions regarding risks); Richard G. Noll & James E. Krier, *Some Implications of Cognitive Psychology for Risk Regulation*, 19 J. LEGAL STUD. 747 (1990) (discussing application of cognitive theory to regulatory policies).

need to rely exclusively on an economic effect that *substitutes* for greater information. Steps could be taken to raise the *actual* level of information, so that those with rational decisionmaking processes could reach more accurate results. Educational campaigns of various sorts become useful tools in the attempt to deal with a problem of excessive smoking.

For cognitive limitation, however, the educational process would have to be different. Here, the need is to change how people translate information about risk to a general population group into a perception of the risk to them individually. That alteration would appear on its face to be a more difficult task than simply putting more data into the marketplace. Instead, the only way to address this problem might be to remove the ability to engage in the decisionmaking process in the first place. For example, if the third-person effect were found to be particularly prevalent among young people, who act in some settings as if they believed themselves to be immortal, then some improvement could result from a societal decision to limit exposure to the danger. Bans on sale to and possession by young people could, therefore, be justified in part not as a response to their lack of information but rather as a way of countering their peculiar susceptibility to this cognitive limitation.

b. Overstating the Significance of Imperfect Information. Within the categories that we would agree are appropriately labeled imperfect information, Hanson and Logue appear to overstate the significance of some of the problems they detect in the market for cigarettes. While no single instance of such overstatement undermines their ultimate conclusion that imperfect information constitutes a market failure in this setting, a consideration of two such instances—the absence of brand-specific information and the lack of relative-risk information—will illustrate some of the concerns raised by their analysis.

i. The Role of Brand-Specific Information. Hanson and Logue contend that consumers who had information about the relative risks of specific brands and types of cigarettes would be more likely to make efficient decisions about smoking. One of the more unfortunate consequences they attribute to the lack of such information is a distortion in manufacturers' incentives away from making cigarettes safer and toward creating an appearance of

safety.¹⁴⁷ Holding manufacturers liable *ex post* for the harms associated with their cigarettes is offered as the remedy for this type of market imperfection.¹⁴⁸ However, Hanson and Logue's treatment of brand-specific information is less than persuasive on two levels.

First, it is difficult to conclude that the absence of brand-specific information makes a particularly significant contribution to the overall problem. Brand-specific information would be more useful if smoking-related health risks actually varied significantly among different brands. In fact, however, smoking-related risks appear to be more generic rather than brand-specific. For example, many consumers assume that certain types of cigarettes, such as filter-tipped or "low tar" cigarettes, are safer than ordinary cigarettes, but there is no evidence that one brand of filter-tipped or low tar cigarettes is actually safer than any other, and there is reason for skepticism about the safety differential of even the crude distinctions among categories of cigarettes.¹⁴⁹ Without more reliable evidence that there is currently a demonstrable and quantifiable brand-specific risk differential, it is difficult to attach much significance to this aspect of the imperfect information problem as it exists today. Furthermore, even if the lack of specific information does increase the magnitude of the inefficiency of the current cigarette market, we doubt that the current market sends to the tobacco industry the disincentive to experiment with greater safety that Hanson and Logue assert.¹⁵⁰ Rather than taking the current levels of understanding as frozen, we believe that if tobacco companies were otherwise given an incentive to develop safer cigarettes, they would have no difficulty informing the public about the health benefits of such a product. Indeed, the experience in other segments of the economy suggests that "safety sells," that is,

¹⁴⁷ Hanson & Logue, *Costs*, *supra* note 6, at 1190.

¹⁴⁸ *Id.* at 1278.

¹⁴⁹ Hanson and Logue are skeptical about the relative safety of low-tar cigarettes. *Id.* at 1189. They also suggest that the safety advantages of filter-tipped cigarettes are largely illusory. *Id.* at 1190 n.106.

¹⁵⁰ *See id.* at 1188 (absence of brand-specific risk information leads to smoker assumption that "all cigarettes are equally risky, which would remove any incentive that manufacturers otherwise had to make their particular brands less dangerous").

that risk differentials among brands can be used effectively as a marketing tool.¹⁵¹

The more basic point of disagreement we have with Hanson and Logue's treatment of this category of imperfect information concerns their prescription for curing it. Ex post incentive-based liability could operate in the way they suggest only if manufacturers carefully segregated the price effects of such liability to the brands that caused the harms for which liability was imposed. Leaving aside for the moment the temporal dimension of that process,¹⁵² the plausibility of this solution is undercut by a realistic assessment of the nature of the tobacco industry. Not only do manufacturers offer consumers a variety of brands targeted at specific market niches, they also are increasingly engaged in a range of non-tobacco enterprises, including the sale of food items.¹⁵³ Rational behavior on the part of such conglomerates would likely try to employ cross-subsidies among their own brands and divisions to maximize the return on the total enterprise. To the extent that a commanding market position in light beer, for example, could be used to offset the full reflection of cost internalization in a brand of cigarettes, ex post liability will fall short of the efficiency-generating effect that Hanson and Logue attribute to it.

ii. The Role of Relative Risk Information. Hanson and Logue cite evidence that suggests that consumers *over-estimate* nonsmoking-related risks¹⁵⁴ and that consumers also systematically *under-estimate* smoking risks.¹⁵⁵ In their view, that combination of inaccuracies in risk assessment produces distortions in the decisionmaking process of consumers.

¹⁵¹ One could draw this inference from the safety-conscious marketing campaigns for Volvo automobiles, for example. See generally Note, *Harnessing Madison Avenue: Advertising and Products Liability Theory*, 107 HARV. L. REV. 895 (1994) (exploring "Volvo effect" in which safety advertising helps to achieve accident-reduction goal of tort law).

¹⁵² See *infra* Part III.A.1.c.

¹⁵³ See, e.g., *R.J. Reynolds Asks for Change of Name to RJR Nabisco*, WALL ST. J., Feb. 21, 1986, at 8 (discussing name change and noting food sales surpassing tobacco sales).

¹⁵⁴ See Hanson & Logue, *Costs*, *supra* note 6, at 1191-92 (citing OFFICE ON SMOKING & HEALTH, U.S. DEPT OF HEALTH & HUMAN SERVS., REDUCING THE HEALTH CONSEQUENCES OF SMOKING: 25 YEARS OF PROGRESS 207-12 (1989)).

¹⁵⁵ See *supra* Part I.A.2.a.

It is difficult to gauge the impact of this phenomenon on cigarette consumption levels. In the absence of additional evidence about the different categories of risks that are at issue here, one might believe that the effect of the absence of relative-risk information on smoker activity levels is relatively small. Decisions to begin smoking or to continue smoking could easily be seen as much more dependent on the perceived benefits of smoking itself than on a comparison between smoking and other risky activities.

Even if Hanson and Logue are correct in their description of how this component of imperfect information contributes to market failure, their *ex post* liability remedy omits an important step in arriving at consumer behavior under perfect market conditions. Raising the price of cigarettes only changes half of the comparison; the perception of the risks of other activities and of the risks of ceasing to smoke would be unaffected by that price increase. In this instance, the higher price of cigarettes cannot be seen as a substitute for perfect information, if the perfectly informed consumer would also be aware of the nature and magnitude of other risks.

The decisions that are made after liability is imposed on cigarette manufacturers might be less inefficient than those that are reached without such liability, but they still fall short of the standard of perfect efficiency that Hanson and Logue require. The consistent theoretical response of Hanson and Logue, therefore, should be that *ex post* liability ought to be attached to those other products and activities, but they (correctly, in our view) express considerable skepticism about extending the tobacco analogy too far.¹⁵⁶

In our view, the relative-risk phenomenon offers another and even stronger illustration of the need to extend the search for solutions beyond the economic incentives of *ex post* liability. If a significant part of the risk relationship is unaffected by the approach Hanson and Logue advocate, and if it seems unwise to employ their approach for that part, then the situation calls for a regulatory response that attacks the actual informational deficits of the consuming population. Instead of viewing warnings and educational efforts as peripheral or supplemental to *ex post* incentive-based liability, we would put those techniques at the core

¹⁵⁶ Hanson & Logue, *Costs*, *supra* note 6, at 1352 n.784.

of the program to deal with this part of the problem. While this may appear to be simply a matter of different emphasis, it is nonetheless a potentially significant difference when one considers the politics and public relations dimensions of setting the policy agenda.

c. The Disconnect Between Information Deficiencies and the Payment of Higher Prices. Hanson and Logue identify a number of conditions that prevent consumers from making perfectly rational decisions about smoking. It is important not to be overly dismissive of the fact that most consumers, including young ones, are aware of the health risks of smoking, particularly the risk of lung cancer, even if that awareness falls short of perfect accuracy. We also believe that consumers realize, even if only on the basis of anecdotal evidence, that for many smokers, smoking is a lifetime habit that is difficult or impossible to quit.

It is reasonable to believe that smokers do take these considerations into account when they choose to smoke, so the analytical model that is used should start from a base of a partially informed consumer population, not a "perfectly uninformed" consumer. As described below, we would treat as a positive step a move toward a "better informed" consumer and, thus, would encourage the use of regulatory techniques that admittedly fall short of a goal of perfect information.¹⁵⁷

Suppose that Hanson and Logue are correct in their evaluation of the data about smoker knowledge and behavior. After all, we do agree that imperfect information and cognitive limitation affect the market's ability to function efficiently, even if we are doubtful about the size and precise operation of that effect. A concern that remains with us about the Hanson and Logue analysis relates to its use in supporting the conclusion that the best way to correct this problem is to hold the tobacco industry liable for past harms suffered by smokers. Upon examination, the theoretical foundation of that regulatory approach is not as strong as Hanson and Logue appear to indicate.

A form of liability under which smoking costs will be reflected in the price of cigarettes will produce some marginal decrease in demand. The theoretical underpinnings of Hanson and Logue's

¹⁵⁷ See *infra* Part III.B.1.

approach require a more discriminating inquiry into the temporal dimensions of the occurrence of the harms and the payment of the higher prices, if that price increase is to be justified on the basis that it acts as a substitute for perfect information.

Higher prices that are paid by consumers for cigarettes purchased today will, of course, have had no effect on previous uninformed (or, more accurately, *under-informed*) decisions about smoking. Instead, the compensation that is provided today to people who smoked in the past will be built into the price of cigarettes for people who smoke in the future. That process may work in the way suggested by conventional microeconomic theory, that is, with the price acting as a substitute for perfect information,¹⁵⁸ under circumstances where the price that a consumer pays today reflects the costs associated with *that* purchase, that is, the costs that the product will create in the future.

The cigarette market has a number of features that make this a less likely setting in which that result would occur, however. Some of those features can be traced to the time lag between the use of the product and the onset of harm for which compensation would be available. Much of the harm from cigarettes is significantly delayed from the decision to begin smoking, as Hanson and Logue carefully establish in their consideration of the effects of addiction.¹⁵⁹ The compensation that would be paid under an enterprise liability or smokers' compensation program along the lines that Hanson and Logue advocate¹⁶⁰ reflects the consequences of consumer behavior that occurred as long as three or four decades earlier.¹⁶¹ By the same token, the harms for which ex post liability forces the current consumer to pay a higher price will not occur until decades in the future. In addition, in many if not most cases, the harms will manifest themselves to people who are no longer smoking¹⁶² and,

¹⁵⁸ See A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 97-106 (2d ed. 1989) (discussing consumer and producer decisions regarding products liability).

¹⁵⁹ Hanson & Logue, *Costs*, *supra* note 6, at 1203-09.

¹⁶⁰ *Id.* at 1295.

¹⁶¹ In fact, in their later elaboration of portions of their proposal, the compensation is narrowed to include only a partial award of economic losses. See Hanson et al., *Blueprint*, *supra* note 7, at 553-62 (discussing smokers' compensation scheme).

¹⁶² See Hanson & Logue, *Costs*, *supra* note 6, at 1195 (citing evidence that over the course of 25 years, half of the smoking population will have managed to quit).

thus, no longer paying the price that allegedly includes a component that reflects the risks about which the consumer is otherwise imperfectly informed.

Another part of the problem presented by applying this economic rationale to the cigarette context stems from the dynamic nature of the relevant bodies of information. Public awareness of smoking risks is continually growing, we would suggest. If we are correct in that assumption, then the inaccuracy in risk assessments that were made in the past is different—in kind and in degree, we would suspect—from the inaccuracy that exists among smokers today. Similarly, future potential smokers are likely to make their decisions in a different informational milieu.

The correction of market imperfection in information for current smokers should reflect the kind and the degree of *their* inaccurate risk assessments. Hanson and Logue necessarily must correct that imperfection with damages that are awarded to victims of smoking-related harms who made their decisions on the basis of the risk assessments of *past* smokers. If the goal is the perfect efficiency that Hanson and Logue say it is, the correction of the market's imperfect information needs to be much more finely calibrated than can be accomplished with a solution that is based on compensating for harms that originated in a temporally different market. Even if one accepts Hanson and Logue's conclusions about imperfect information, then we are not persuaded that imperfect information problems, by themselves, would justify the imposition of ex post liability that attempts to compensate for harm that was caused in the past.

To conclude, we concur with Hanson and Logue that information about smoking-related health risks is far from perfect.¹⁶³ We also agree that consumers do not always act rationally when they make decisions about smoking and health. Nevertheless, we doubt that

¹⁶³ One of the most important features of this state of affairs is the extent to which the industry's long campaign of deliberate misinformation and willful ignorance contributed to the inaccurate assessments of risk that many smokers have made over the years. As we will demonstrate below, an optimal solution to the problem of smoking-related costs must be more sensitive to this aspect of the state of information than the ex post liability approach of Hanson and Logue.

it is possible to say with conviction that these problems are of the magnitude that Hanson and Logue suggest.

Even if they are correct in their description of this way in which the market fails, however, we doubt that the approach they advocate can be seen as a solution that is tailored to correcting this particular form of market failure in the context of tobacco-related harms. At this stage in our critique, we would emphasize that we are not objecting to the imposition on the tobacco industry of legal responsibility for current costs of harms attributable to past conduct. Instead, we find the economic rationale Hanson and Logue rely upon for that imposition to be weak enough that liability needs to be supported on other grounds.

2. *Externalized Cost Imperfections.* The other major category of market failure that Hanson and Logue explore is the externalization, both negative and positive, of major portions of the costs of smoking. As indicated above,¹⁶⁴ when they use the basic quantification made by Manning and Viscusi of various elements of the costs of cigarettes, Hanson and Logue estimate that these external costs amount to at least seven dollars a pack.¹⁶⁵ Because of some disagreements with their treatment of one category in particular, we believe that they actually make a case for the proposition that the external costs of smoking, while certainly significant, are substantially lower than their calculation shows them to be.¹⁶⁶

This Section highlights some points on which we disagree with the details of Hanson and Logue's analysis of externalities. As was true of imperfect information, however, we emphasize that our ultimate conclusion is that they have made a compelling case that there *are* significant negative externalities in the market for cigarettes, and that legal intervention in that market is more than justified.

¹⁶⁴ See *supra* Part II.A.2.b.

¹⁶⁵ Hanson & Logue, *Costs*, *supra* note 6, at 1236-43.

¹⁶⁶ We make the same disclaimer here that is offered by Hanson and Logue. *Id.* at 1262. Our analysis is based on the numbers derived from Manning and Viscusi; we neither endorse those numbers nor attempt to produce independent calculations. Our point is similar to that of Hanson and Logue: if those are the numbers, then plugging them into a more appropriate analytical framework produces a substantially different result.

a. *Insurance Externalities.* We agree with Hanson and Logue that a serious insurance externality problem exists. Because most smoking-related risks are covered by some form of private or social insurance, smokers rarely pay directly for the full pecuniary costs of smoking. By itself, however, that is not a particular indictment of the cigarette market. The mechanism of insurance is designed to spread risk over a broad base, to protect those upon whom the economic consequences of a loss might otherwise be concentrated.

The problem that insurance externalities pose in the cigarette context is the inclusion of smokers in the same risk-spreading insurance pool as nonsmokers. When smokers and nonsmokers pay the same rate for their insurance, a substantial portion of the cost of insuring against the consequences of smoking-related risks shifts from smokers to nonsmokers.¹⁶⁷ Manning's study estimates insurance externalities at \$0.15 per pack.¹⁶⁸ Viscusi concludes that insurance externalities amount to \$0.66 per pack.¹⁶⁹ For the most part, Hanson and Logue accept Viscusi's figures.¹⁷⁰

For purposes of analyzing the argument that Hanson and Logue make about externalities, we accept that Viscusi's estimates of the quantification of these categories are essentially correct.¹⁷¹ An objective of legal intervention in the cigarette market therefore

¹⁶⁷ *Id.* at 1229.

¹⁶⁸ See Hanson & Logue, *Costs*, at 1234 (citing MANNING ET AL., *supra* note 67, at 127).

¹⁶⁹ See *id.* at 1235 (citing W. Kip Viscusi, *Cigarette Taxation and the Social Consequences of Smoking*, in 9 TAX POLICY AND THE ECONOMY 51, 74 tbl.4 (James M. Porterba ed., 1995) [hereinafter Viscusi, *Cigarette Taxation*]). This figure includes \$0.50 per pack for medical expenses, \$0.01 per pack for sick leave, \$0.13 per pack for group life insurance, and \$0.02 per pack for fire-related property damage. *Id.* Actually, Viscusi would add another \$0.35 to this figure to reflect lost taxes due to premature disability or death. Hanson and Logue believe, however, that this type of loss should not be included. *Id.* at 1243.

¹⁷⁰ *Id.* at 1240. Hanson and Logue disagree, however, with Manning's decision to focus on group insurance and to exclude individual insurance policies from consideration on the theory that insurers take smoking risks into account when pricing such policies. *Id.* at 1243-44.

¹⁷¹ One commentator recently estimated that the Medicaid program spends the equivalent of \$0.89 per pack to treat smoking-related illnesses. Michael K. Mahoney, Comment, *Coughing Up the Cash: Should Medicaid Provide for Independent State Recovery Against Third-Party Tortfeasors Such as the Tobacco Industry?*, 24 B.C. ENVTL. AFF. L. REV. 233, 238 (1996). However, Hanson and Logue, as well as Manning and Viscusi, are concerned with the costs of smoking over a lifetime *reduced to present value*. Thus, the figures are not really comparable.

ought to be to acknowledge this externality, and then to decide what social policy considerations are brought into play by its existence. The appropriate answer may be to correct this externality through an incentive-driven liability scheme creating deterrence that leads toward economic efficiency.¹⁷² It may also be the case that additional policy concerns lead instead to the conclusion that the costs of these losses are properly distributed widely across the population, either because of justice considerations or because the administrative expense of segregating smokers from nonsmokers would be prohibitive. The point is that the decision about what to do with insurance externalities depends on the goals to be achieved; expanding the range of goals and acknowledging the tension among them can increase the appeal of regulatory responses that differ from the ex post liability advocated by Hanson and Logue.

b. Noninsurance Externalities. Among the noninsurance externalities of smoking, we agree with Hanson and Logue's criticism of some of the "conventional wisdom" about how to characterize categories of harm that smoking causes to others. However, we do have a fundamental difference of opinion about the appropriate way to handle the category that, using the Manning and Viscusi numbers, has the largest figure associated with it. When that difference of opinion is factored into the calculation of the magnitude of noninsurance externalities, we arrive at a significantly lower estimate of the net negative externality.

i. Costs Externalized to Others. As we suggested above,¹⁷³ the least controversial point that Hanson and Logue make about noninsurance externalities is the proposition that smoking creates costs to nonsmokers that are externalized by smokers under the legal regime currently in place. Hanson and Logue are undoubtedly correct that the health costs of environmental tobacco smoke are significant and that smokers externalize most of these costs to nonsmokers.¹⁷⁴

¹⁷² An extensive analysis of this proposition is found in Hanson & Logue, *Insurance Externality*, *supra* note 7.

¹⁷³ See *supra* Part II.A.2.b.

¹⁷⁴ See Hanson & Logue, *Costs*, *supra* note 6, at 1229-30; see also Jendi B. Reiter, *Citizens or Sinners?—The Economic and Political Inequity of "Sin Taxes" on Tobacco and Alcohol Products*, 29 COLUM. J.L. & SOC. PROBS. 443, 466 (1996) ("Smokers impose costs on

The magnitude of that externalization is a matter that is less certain. Hanson and Logue suspect that ETS-related externalized costs may be as high as \$1.00 per pack, but they accept, for the sake of their overall argument about net externalities, Manning's lower estimate of \$0.14 per pack.¹⁷⁵ The present state of knowledge about the costs of ETS makes it difficult to conclude whether Hanson and Logue's estimate of \$1.00 per pack is accurate, or whether the Manning estimate of \$0.14 per pack is closer to the truth.¹⁷⁶ Indeed, a recent federal district court decision questioning the reliability of the Environmental Protection Agency's methodology for calculating the risks posed by ETS suggests that the uncertainty strikes closer to the heart of the matter.¹⁷⁷ Where evidence about smoking-related health costs is uncertain and incomplete, we are inclined to be conservative about estimating such costs. Therefore, we are more comfortable, for the time being, with an estimate that is closer to \$0.14 per pack.

According to Hanson and Logue, Manning and Viscusi underestimate the external costs of smoking because they do not take into account the costs that smokers externalize to family members and friends.¹⁷⁸ Using Manning's figures, Hanson and Logue quantify that category of costs at \$0.25 per pack.¹⁷⁹

Although Manning and Viscusi have calculated the size of the smoking-related costs that are borne by family members, they characterize them as internal rather than external costs because they believe families act as a single economic unit.¹⁸⁰ Manning and Viscusi also omit from their calculations smoking-related costs that are externalized to friends, as distinguished from family mem-

others directly through environmental tobacco smoke ('ETS'), colloquially known as 'second hand smoke'.")

¹⁷⁵ See Hanson & Logue, *Costs*, *supra* note 6, at 1244.

¹⁷⁶ In some of his more recent work, Professor Viscusi has suggested that the external costs associated with ETS may be as high as \$0.41 per pack. See W. Kip Viscusi, *Second-hand Smoke: Facts and Fantasy*, Vol. 18 REGULATION, No. 3, at 42, 46 (1995).

¹⁷⁷ *Flue-Cured Tobacco Co-op. Stabilization Corp. v. EPA*, 4 F. Supp. 2d 435, 465 (M.D.N.C. 1998).

¹⁷⁸ Hanson & Logue, *Costs*, *supra* note 6, at 1230.

¹⁷⁹ *Id.* at 1242 tbl 1. This figure includes \$0.09 per pack for lives lost in fires, \$0.14 per pack for fetal deaths, and \$0.02 per pack for neonatal intensive care. *Id.* at 1242 n.350.

¹⁸⁰ MANNING ET AL., *supra* note 67, at 28-29; Viscusi, *Cigarette Taxation*, *supra* note 169, at 71-72.

bers.¹⁸¹ We agree with Hanson and Logue that sound economic analysis requires that any cost that is borne by someone other than the smoker should be treated as external unless it has already been internalized in some way. As Hanson and Logue point out, the evidence suggests that smokers do not take the costs imposed upon family members and friends into account when they choose to smoke.¹⁸² Therefore, we concur with the conclusion of Hanson and Logue that these costs, along with ETS costs, can legitimately and fairly uncontroversially be characterized as negative externalities.

ii. Costs Externalized to "Future Selves." In their analysis of noninsurance externalities, Hanson and Logue characterize the losses that are shifted by smokers from their current to their future selves as negative externalities.¹⁸³ The Manning study calculates the smoking-related costs of harms that occur to smokers at \$5.00 per pack for premature death and disability, \$0.86 per pack for lost wages, and \$0.07 per pack for out-of-pocket medical expenses.¹⁸⁴ This amounts to a total of \$5.93 per pack for harm to the smoker. Manning and Viscusi do not regard these costs as negative externalities because they represent losses that are borne by the smokers themselves.¹⁸⁵ Manning and Viscusi assume that individuals who choose to smoke take these costs into account and, thus, fully internalize them.¹⁸⁶ Hanson and Logue, on the other hand, argue that smokers are poorly informed about the health risks of smoking¹⁸⁷ and, therefore, do not consider premature death and disability as costs of smoking.¹⁸⁸ In their view, smokers externalize these costs from their "present" to their "future selves."¹⁸⁹

¹⁸¹ Some portion of the costs to friends may be included in the ETS cost calculations of the economists. The more significant component of this category for the criticism that Hanson and Logue level at the economists is the non-pecuniary loss that friends and associates suffer as they perceive the declining health and ultimate death from smoking-related illnesses. Hanson & Logue, *Costs*, *supra* note 6, at 1230, 1239.

¹⁸² *Id.* at 1238-39.

¹⁸³ *Id.* at 1230.

¹⁸⁴ MANNING ET AL., *supra* note 67, at 8, 21.

¹⁸⁵ *Id.* at 82.

¹⁸⁶ Hanson & Logue, *Costs*, *supra* note 6, at 1241.

¹⁸⁷ *Id.* at 1185.

¹⁸⁸ *Id.* at 1241.

¹⁸⁹ *Id.* at 1209.

We find it difficult to accept the notion that costs borne by smokers themselves can be classified as negative externalities. As a preliminary matter, Hanson and Logue's definition of externality is anomalous unless one accepts the bifurcation of a smoker into present and future selves. According to the orthodox definition, a negative externality involves a cost imposed by the actor on *someone else*, rather than upon the actor.¹⁹⁰

More fundamentally, however, Hanson and Logue seem to be converting an imperfect information problem into an externality problem. Earlier, they pointed out that smokers who were fully informed about the health risks of smoking would take these risks into account when choosing whether and how much to smoke. However, because Hanson and Logue believed that smokers were actually poorly informed about such risks, they concluded that smokers would fail to take these costs into account when they choose to smoke. Ignoring those costs would lead to inefficiency in the decisions that are made about smoking. Having identified the inefficiency generated by this phenomenon once, Hanson and Logue are on shakier ground when they return to it under the guise of discussing negative externalities.

All of this makes a huge difference when it comes to calculating the total external costs of smoking. As mentioned earlier, Hanson and Logue begin with the Manning and Viscusi assumptions that the insurance externalities associated with smoking add up to \$0.66 per pack. The decision by Hanson and Logue to characterize losses to future selves as external costs increases the aggregate figure of noninsurance externalities from \$0.39 to \$6.32 per pack, that is, by a factor of more than sixteen. When they calculate total externalities, the figure they reach for negative externalities associated with

¹⁹⁰ See, e.g., HARVEY S. ROSEN, PUBLIC FINANCE 53 (2d ed. 1988) (stating that an externality occurs when "the activity of one person affect[s] the welfare of another in a way that is not outside the market"); Raymond E. Gangarosa et al., *Suits by Public Hospitals to Recover Expenditures for the Treatment of Disease, Injury and Disability Caused by Tobacco and Alcohol*, 22 FORDHAM URB. L.J. 81, 103 (1994) ("An externality can be defined as a cost associated with a market transaction that is absorbed by a party not involved in the market transaction."); see also Hanson & Logue, *Costs*, *supra* note 6, at 1223 n.263 ("Thus, a negative externality occurs when the activity of one entity imposes a cost on another in a way that is not fully reflected in market prices. . . ." (emphasis added)).

smoking is a total of \$6.98 per pack, or more than six-and-a-half times what it would be without the addition of losses to future selves.

There are some aspects of the overall Hanson and Logue contention about externalities that we find persuasive and others about which we have substantial doubts. In this instance, our problem lies in Hanson and Logue's methodology that results in the figure for noninsurance externalities. Again accepting, for the sake of this study, the figures that Hanson and Logue incorporate from Manning and Viscusi, we would include in the negative externality category the \$0.66 per pack for smoking-related insurance externalities, as well as the \$0.14 per pack attributed to ETS and the \$0.25 per pack attributed to costs externalized to family members. Those three categories bring the total external cost of smoking to \$1.05 per pack. We are considerably more skeptical, however, about the appropriateness of characterizing the \$5.93 cost that smokers impose upon themselves as an external cost of smoking¹⁹¹ and would not include those within the externality calculation.

We would emphasize that we are not disputing the contention that the delayed onset of the harms that smokers suffer contributes to the occurrence of market failure in this setting. Our objection is to the reasoning that characterizes those delayed costs as externalities. The effect of this disagreement is significant. If the only technique that is offered to achieve their goal of perfect market efficiency is *ex post* liability, then the payments that would be required under the Hanson and Logue analysis are enormously higher than any remotely acceptable policy proposal could tolerate. Using a more conventional understanding of what constitutes an externality has the benefit of returning the discourse to a focus on a financial impact that is at least within the realm of plausibility. Under this view, the market failure is correctable, at least in part, through measures that educate the consumer about the future costs, rather than exclusively through legal intervention that raises the price of cigarettes to incorporate a very high estimate of what those costs are.

¹⁹¹ See Viscusi, *supra* note 169, at 71 ("Overall, there is little evidence that individuals confer an adverse externality on their future selves through their smoking behavior.").

c. Positive Externalities. One of the strongest parts of Hanson and Logue's article is their taking issue with the contention of the mainstream economic analysts that smoking produces positive externalities as well as negative externalities, and that these external benefits equal or exceed smoking's external costs.¹⁹² Manning and Viscusi acknowledge that smokers are subject to higher medical costs, more work loss days, fewer years of work and life, and more disability retirements than nonsmokers.¹⁹³ Manning and Viscusi observe, however, that smokers receive less than nonsmokers in pensions, in Medicare benefits, and in the coverage of long-term care expenses.¹⁹⁴ Manning and Viscusi also point out that smokers pay substantial amounts of excise taxes and that this tax revenue can be regarded as another external benefit of smoking.¹⁹⁵

Manning's study concludes that the net external costs of smoking lie somewhere between \$0.31 and \$0.52 a pack, a figure that is largely offset by the average combined state and federal excise and sales taxes on cigarettes of \$0.37 per pack.¹⁹⁶ Taking into account both external costs and external benefits, Viscusi concludes that the external benefits of smoking outweigh its external costs when excise and sales tax revenues are taken into account,¹⁹⁷ estimating that smokers provide society with a net external benefit of \$0.32 per pack.¹⁹⁸

Hanson and Logue argue on a number of technical economic grounds that Manning and Viscusi grossly overestimate the external benefits of smoking. For example, Manning and Viscusi argue that smokers' unclaimed pension benefits partially offset the external costs of smoking.¹⁹⁹ Manning estimates that unclaimed pension

¹⁹² See generally Hanson & Logue, *Costs*, *supra* note 6, at 1232-60.

¹⁹³ *Id.* at 1234-35 (citing MANNING ET AL., *supra* note 67, at 127; Viscusi, *supra* note 169, at 72-73).

¹⁹⁴ *Id.* at 1234 (citing MANNING ET AL., *supra* note 67, at 127; Viscusi, *supra* note 169, at 72-73).

¹⁹⁵ MANNING ET AL., *supra* note 67, at 18; Viscusi, *supra* note 169, at 57.

¹⁹⁶ MANNING ET AL., *supra* note 67, at 85.

¹⁹⁷ Viscusi, *supra* note 169, at 57.

¹⁹⁸ *Id.* at 74 tbl.4.

¹⁹⁹ Hanson & Logue, *Costs*, *supra* note 6, at 1248.

benefits amount to \$0.24 per pack,²⁰⁰ while Viscusi's more recent study estimates unclaimed pension benefits at \$1.10 per pack.²⁰¹ Hanson and Logue, on the other hand, conclude that these figures are too high because they cover defined contribution plans as well as defined benefit plans.²⁰² Hanson and Logue argue that defined contribution plans should not be included within the category of unclaimed pension benefits because payments under such plans do not necessarily terminate at the death of the primary beneficiary.²⁰³ In their view, assets that are transferred at death from the smoker to someone else, such as a surviving spouse, should not be treated as an external benefit of smoking.²⁰⁴

Hanson and Logue also contend that foregone benefits, such as unclaimed pension entitlements, cannot be characterized as positive externalities unless their potential loss affects the incentives of the smokers.²⁰⁵ According to them, smokers do not treat foregone future pension benefits or other external benefits as present costs of smoking.²⁰⁶ If they do not take these future potential losses into account, there can be no positive externality.²⁰⁷ Consequently, Hanson and Logue argue, external benefits of this sort cannot be used to offset external costs if economic efficiency is the primary goal.²⁰⁸

²⁰⁰ MANNING ET AL., *supra* note 67, at 79 tbl.4-16.

²⁰¹ Viscusi, *supra* note 169, at 74 tbl.4.

²⁰² Hanson & Logue, *Costs*, *supra* note 6, at 1245-46.

²⁰³ *Id.*

²⁰⁴ *Id.* at 1249.

²⁰⁵ *Id.*

²⁰⁶ *Id.* at 1251.

²⁰⁷ *Id.*

²⁰⁸ *Id.* Hanson and Logue do concede that the external benefits of smoking, if they exist, may be relevant to the distributional issue. From a distributional perspective, it is usually not good public policy for one group to enjoy the benefits of an activity while another group is forced to bear the costs. The distributional concern is alleviated, however, if the group that benefits from an activity transfers sufficient resources to the group that is injured to offset the harm. Thus, if smokers transfer to nonsmokers sufficient resources, such as unclaimed pension benefits, to offset insurance externalities and health costs associated with passive smoke, the balance sheet would be balanced as a distributional matter. Even if distributional concerns were satisfied in this fashion, Hanson and Logue would argue for government intervention on accident-cost reduction grounds. *Id.* at 1253-54.

Finally, Hanson and Logue respond to the argument that federal and state excise taxes already force smokers to internalize the full costs of smoking. First, they point out that existing taxes amount, on average, to \$0.53 per pack, while the external costs of smoking, according to their calculations, exceed \$7.00 per pack.²⁰⁹ Therefore, even if excise taxes do provide some deterrence, Hanson and Logue believe that the rate of taxation is far less than optimal. Furthermore, they are convinced that excise taxes are less efficient than other forms of incentive-based regulation, so they reject the notion that the appropriate way to deal with this disparity between externalities and excise taxes is to raise existing taxes.²¹⁰ Indeed, they would appear to contend that it would be preferable to reduce or eliminate inaccurately assessed redundant excise taxes than to scale back on the use of incentive-based regulation as the means of attaining efficiency.²¹¹ Hanson and Logue further contend that excise taxes are not intended to internalize the tangible costs of smoking, but rather are concerned with internalizing the psychic cost that nonsmokers incur because society allows cigarettes to be marketed and consumed in the first place.²¹²

We agree with Hanson and Logue's claim that Manning and Viscusi overestimate the external benefits of smoking.²¹³ In particular, we accept Hanson and Logue's argument that unclaimed benefits in defined contribution pension plans should not be characterized as external benefits.²¹⁴ On the other hand, it is undeniable that cigarette excise taxes are a cost of smoking that smokers are forced to internalize. Therefore, we believe that it is appropriate to take such taxes into account when calculating the overall costs and benefits of smoking in determining allocative efficiency.

Hanson and Logue's contention that excise taxes should not be allowed to offset external costs because they are intended to be "sin taxes"²¹⁵ misses an important point that needs to be made about the

²⁰⁹ *Id.* at 1254.

²¹⁰ *Id.*

²¹¹ *Id.*

²¹² *Id.* at 1255.

²¹³ *Id.* at 1236.

²¹⁴ *Id.* at 1249.

²¹⁵ *Id.* at 1255.

link between the payment of a tax and the expenditure of the funds raised by that tax. As we will explain below, our position is that the uses to which the revenues generated by current taxes are put must be given considerable weight when characterizing how they affect the economic analysis of smoking. Our position, therefore, is that those taxes are quite relevant to the assessment of the nature and magnitude of the overall market failure problem. Because such taxes affect the price smokers must pay, they must be taken into account when evaluating whether production and activity levels are at optimum levels. When the question asked is instead what costs of smoking are being shifted from third parties to smokers through the imposition of a tax, we believe that a more careful inquiry into the purpose of the tax is needed.

3. *Responding to Market Failures under Conditions of Uncertainty.* Hanson and Logue conclude that the market for cigarettes is inefficient.²¹⁶ For the most part, we find this conclusion to be well supported, though we are concerned that they have overstated the magnitude of the market failure problem, which could lead to a political backlash that dooms at the outset any attempt to draft a sound tobacco policy. That concern leads us to suggest that particular caution is needed when designing such a policy in circumstances in which there is uncertainty about the precise nature and magnitude of the problem and about the unintended consequences of proposed solutions.

First, with respect to imperfectly informed decisionmaking by smokers, Hanson and Logue assume that smokers completely ignore the costs of premature death and disability, estimated to be \$5.93 per pack, when they make a decision to smoke. This leads Hanson and Logue to conclude that the entire costs of premature death and disability, that is, \$5.93 per pack, should be reflected in cigarette prices.²¹⁷ We have more confidence in the ability of smokers to appreciate that there are substantial health risks of smoking and to include the existence of these costs in their mental calculus when making decisions related to smoking. Unlike Manning and Viscusi, we doubt that smokers overestimate the costs of smoking. Rather,

²¹⁶ *Id.* at 1349.

²¹⁷ *Id.* at 1241.

we share the belief of Hanson and Logue that smokers systematically underestimate these costs.²¹⁸ But by how much? In the absence of more reliable data than are available at this time, we are reluctant to place a value on this dimension of the market failure problem, but our underlying premise of partially informed consumers would suggest that any value would be lower than that used by Hanson and Logue.

Second, like Hanson and Logue, we believe that smokers externalize a considerable portion of the cost of smoking to nonsmokers. For example, substantial smoking costs are externalized to private insurers and public social insurance programs. ETS costs are also largely externalized to nonsmokers. Finally, certain costs are shifted to family members and friends of smokers. According to Hanson and Logue, these costs total at least \$1.05 per pack.²¹⁹ At the same time, however, we do not find persuasive Hanson and Logue's claim that one should treat as an externality the \$5.93 in premature death and disability costs that present smokers ignore because they are suffered by their future selves. Furthermore, we believe that the analysis of the allocative efficiency that exists in the market for cigarettes ought to include the excise taxes paid by smokers as part of the purchase price of cigarettes. If our premises are employed, we conclude that the net negative externality costs are considerably closer to the \$0.52 a pack estimated by the conventional economic analysis rather than the \$7.00 per pack figure suggested by Hanson and Logue. Thus, we agree with Hanson and Logue that the market for cigarettes is inefficient, but we would take issue with them about the severity of the problem.

The difference between the figure Hanson and Logue derive and one that we would think more plausible is important for a number of reasons, but none of those reasons is more significant than its effect on the selection of an appropriate method for the legal system to intervene. In the next Section, we shift the focus of our critique to the way in which Hanson and Logue analyze the different regulatory approaches to market failures. As we approach that analysis of possible legal interventions, we believe that the economic

²¹⁸ *Id.* at 1223.

²¹⁹ *Id.* at 1242 tbl.1. This figure includes \$0.66 per pack for insurance externalities, \$0.14 per pack for ETS costs, and \$0.25 per pack for costs imposed on the family and friends of smokers. *Id.*

analysis should be understood as supporting the following working propositions:

- there clearly are market failures in the market for cigarettes;
- the economics-based argument for legal intervention in the cigarette market is very strong; and
- there is considerably more uncertainty about the dimension (if not the direction²²⁰) of that market failure than Hanson and Logue or the economic analyses they rely on seem to acknowledge.

Given that state of affairs, and acknowledging the politically and economically precarious position of tobacco policy proposals at this time, we believe that the construction of a legal regime should be guided by a principle that can be articulated as follows:

When the legal system intervenes under conditions of significant uncertainty about the nature and magnitude of market failure, there is a particular responsibility to design a regime that:

- (i) comes close to an accurate correction of the market failure,*
- or*
- (ii) minimizes the adverse effects of inaccuracy, or*
- (iii) advances some important social interest even at the expense of possible inaccuracy in the correction of the market failure.*

That principle plays an important role in our assessment of the Hanson and Logue analysis of the different responses that the legal system might employ. The most apparent consequence of that

²²⁰ We are assuming, along with Hanson and Logue, that Viscusi's conclusion that smoking creates a net positive externality is unproven.

principle is a considerable skepticism about the wisdom of unidimensional all-or-nothing legal interventions.

B. EVALUATION OF REGULATORY APPROACHES TO MARKET FAILURES

Having concluded that "an idealized regime of enterprise liability"²²¹ satisfactorily addresses the two significant categories of market failure they identify in the cigarette setting, Hanson and Logue go on to explore two additional questions. The first question is whether other techniques of legal intervention are also capable of correcting those market failures. Our disagreement with the way that Hanson and Logue answer this question centers around what we believe to be the unnecessarily restrictive idea of "perfect efficiency" that runs through their discussion of all of the other approaches.

The second question they pose is whether there are "real world factors" that cause their approach to operate less well.²²² In evaluating the ultimate policy proposal that Hanson and Logue offer, that second question proves to be an even more significant inquiry. A thorough critique of their proposal needs to distinguish between two separate aspects of the question. The first aspect calls for a consideration of whether their approach actually has the comparative advantage over the other approaches that they claim. Even apart from the comparison to other approaches, the related but more revealing consideration, we believe, is whether their analysis of the merits of their approach survives the transportation from an idealized setting to something that is as complex and fluid as the socio-economic-political environment in which a responsible policy proposal for dealing with the health effects of smoking will be tested. Our contention is that Hanson and Logue fail to make their case on both aspects: the comparative advantage that they ascribe to their approach diminishes significantly in the real world, and even when considered by itself, attainment of the benefits of their approach is considerably less plausible than Hanson and Logue appear to believe.

²²¹ Hanson & Logue, *Costs*, *supra* note 6, at 1263.

²²² *Id.* at 1263.

It is important to note that we say "appear to believe" in that last sentence. That qualification is necessary because of the ambivalence that intrudes into the discussion of their approach: after setting out the arguments for an ex post incentive-based liability, they then give a good deal of attention to a "smokers' compensation"²²³ approach that deviates from the idealized liability model in fundamental ways that suggest they appreciate the constraints that a real world setting would place on the success of their preferred approach. Our skepticism about their conclusion stems from a belief that their appreciation of those constraints does not go far enough in recognizing the impracticability of their scheme as well as the considerably lower likelihood of its purported benefits being realized.

1. *The Systemic Weakness: Information Demands and the Definition of Efficiency.* Each of the disfavored regulatory approaches to the kinds of market failures that exist in the cigarette setting is found wanting by Hanson and Logue primarily because of the inability of the relevant decisionmaker to acquire the information necessary to achieve the perfect efficiency that they articulate as the goal. Command-and-control requirements will not attain efficiency unless the regulator knows precisely what goes into the market's determination of efficient care and activity levels.²²⁴ Performance standards will fail unless the person setting the standard is able to make a similar determination to support the level of performance that is selected.²²⁵ Ex ante approaches substitute, in their most likely form, a pre-marketing monetary payment for each unit of production, but the amount of that ex ante payment cannot produce efficiency unless the assessor knows the magnitude of the externalities that need to be rectified and the information imperfections that need to be cured.²²⁶ In each instance, then, the efficiency goal being sought cannot be reached because of the impossibility of a regulator making a reliable and accurate

²²³ *Id.* at 1283-84.

²²⁴ *Id.* at 1264-65.

²²⁵ *Id.* at 1267.

²²⁶ *See id.* at 1268-70 (discussing informational needs of regulators).

determination of the factors that mimic the action of a perfect market.

As we will explain in more detail in the next Part of our Article,²²⁷ we think that focusing on economic efficiency as the primary goal leads to an analysis that is so circumscribed as to be unhelpful, if not outright harmful, to a productive consideration of the tobacco problem. The point we make here, though, is that *even if* one were to posit efficiency as the goal, Hanson and Logue use the narrowest possible conception of that goal, ensuring that no approach (including their own, as we will show) could ever hope to reach it. If one were to operate within the confines of their efficiency-centered economic analysis, a modification of the efficiency concept would alter in a positive and realistic way the evaluation of the efficiency-generating potential of the different approaches to legal intervention in the market for cigarettes.

a. The Idealized Target of Perfect Efficiency. In their criticism of alternatives to *ex post* incentive-based regulation, Hanson and Logue evaluate those approaches against a standard of an idealized world in which efficiency is an all-or-nothing proposition: it either exists or it does not. If perfection is what is sought, it is not surprising that heroic measures will be required to achieve it, and that such attributes will rarely be found in the world in which the theories must be implemented.²²⁸

Rejecting regulatory approaches that fail to produce perfect efficiency would exemplify the maxim that the perfect is the enemy of the good. If the concept of efficiency is limited to the conventional definition of marginal costs equaling marginal benefits,²²⁹ arriving at that point requires a precision in measurement and an ability to act that are unlikely to be found anywhere outside of the hypotheti-

²²⁷ See *infra* Part IV.A.

²²⁸ See Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J.L. & ECON. 1, 1 (1969) (characterizing as the "nirvana effect" a choice "between an ideal norm and an existing 'imperfect' institutional arrangement," as opposed to "a comparative institution approach in which the relevant choice is between alternative real institutional arrangements" (emphasis in original)).

²²⁹ SUSAN ROSE-ACKERMAN, *RETHINKING THE PROGRESSIVE AGENDA: THE REFORM OF THE AMERICAN REGULATORY STATE* 18 (1992). Professor Rose-Ackerman notes that "[u]tilitarian and cost-benefit tests are not identical," *id.*, but the conceptions of efficiency we examine in the following paragraphs are adaptable to both.

cal universe of economists' assumptions. One of the lessons of the economic analysis of law, however, has been that we do not need to limit ourselves in that way. Posing the central question in different ways can still permit us to benefit from the insight obtainable from looking at a state of affairs through the prism of efficiency considerations. Two other conceptions of efficiency are particularly useful when addressing the Hanson and Logue question of how one should evaluate different schemes for intervening in the market for cigarettes.²³⁰

b. Pareto Efficiency. The first supplemental conception of efficiency that needs to be considered is derived from the work of Vilfredo Pareto. Attempting to break free from the comparative interpersonal utility dilemma of classical utilitarian thought,²³¹ Pareto criteria offer a less demanding notion of efficiency. A condition is *Pareto optimal* when the situation of no person could be improved except at the expense of some other person.²³² Pareto optimality has much the same all-or-nothing implausibility as the perfect efficiency employed as a goal in the more rigorous aspects of Hanson and Logue's analysis. There is another Pareto condition, however, that makes it possible to view matters against a "more-or-less" rather than an "all-or-nothing" template. A condition is *Pareto superior* when the situation of at least one person is improved and the situation of no person is worsened.²³³

The principal benefit of bringing Pareto analysis into the tobacco policy arena is that it introduces the useful notion that value is added to the analysis when it is possible to identify a state of affairs as better than another, even if not perfect. When evaluating approaches to the tobacco-related health problem, it would be quite helpful to be able to say that an approach is likely to result in an improvement in efficiency rather than simply to dismiss it as unlikely to lead to perfect efficiency, particularly when there is no approach that can plausibly claim to attain that ideal.

²³⁰ See JEFFRIE G. MURPHY & JULES L. COLEMAN, *THE PHILOSOPHY OF LAW: AN INTRODUCTION TO JURISPRUDENCE* 212-218 (1984) (discussing principles of economic efficiency).

²³¹ *Id.* at 212.

²³² *Id.* at 213.

²³³ *Id.*

c. *Kaldor-Hicks Efficiency.* A similar broadening of the efficiency concept occurs in the "new welfare economics"²³⁴ work of Nicholas Kaldor and John Hicks. The Kaldor-Hicks conception of efficiency relaxes the demand that there be no worsening of any person's situation in order for a condition to be efficient in the Pareto optimality sense. Under this test, a condition can be found to be efficient if the gains to those whose situation is improved are greater than the losses of those whose situation is worsened.²³⁵ It is important to note that Kaldor-Hicks efficiency does not require that anything be done in this situation; it merely identifies as efficient a situation in which there is a net social gain.

The most significant consequence of introducing Kaldor-Hicks efficiency into the evaluation of different approaches to dealing with the costs of cigarettes is the opening up of a wider range of action that arises from the determination that winners win more than losers lose. If the losses to the losers could be offset out of the gains to the winners, then there is a potential for attaining a state of affairs that would still be efficient in Kaldor-Hicks terms but could also be Pareto superior if those losses were actually offset.²³⁶

d. *The Effects of a Relaxed Conception of Efficiency in the Development of Tobacco Policy.* While admittedly still falling short of perfect efficiency, this alternative conception of efficiency proves to be extremely useful on at least three dimensions that fit into our critique of Hanson and Logue and that assist us in our development of a different analytical construct.

First, it characterizes as an efficient outcome a result that is an improvement over the prior state of affairs.

²³⁴ JOHN HICKS, WEALTH AND WELFARE: COLLECTED ESSAYS ON ECONOMIC THEORY xi (1981).

²³⁵ MURPHY & COLEMAN, *supra* note 230, at 217.

²³⁶ *Id.* ("If compensation were paid to losers a Kaldor-Hicks efficient move would become a Pareto superior one."). The accuracy of that characterization in practice depends on the amount of the transaction costs needed to provide compensation. If transaction costs are greater than the difference between the gains to the winners and the losses to the losers, requiring compensation would be inefficient. See Jules L. Coleman, *The Economic Analysis of Law*, in NOMOS XXIV: ETHICS, ECONOMICS, & THE LAW 83, 84 (J. Roland Pennock & John W. Chapman eds., 1982) [hereinafter NOMOS XXIV] (explaining Pareto and Kaldor-Hicks efficiency).

The possibility of such a finding is essential in any realistic appraisal of the economic advantages of different ways of intervening in the market for cigarettes.

Second, it opens up the very important opportunity to layer a number of justice concerns on top of the economic analysis. A simultaneous incorporation of justice concerns is one of the most significant demands that should be made of a public policy assessment of the cigarette market.

Third, it strongly suggests a compensatory approach to the central Hanson and Logue question of how to intervene in the imperfect market, and thus offers a theoretical support of what we believe is one of the most important components of a multi-dimensional approach to this complex problem.²³⁷

This modification of efficiency theory has very real significance in the consideration of the merits of the various categories of regulatory approaches. Take, for example, a performance-based regulation in the form of a rule that cigarettes may not be marketed with a nicotine content above a certain level. That rule would likely produce some losses to the tobacco industry; if it did not, then one would have expected the industry to adopt such a move on its own. Smokers themselves may also experience a reduced pleasure from smoking cigarettes that comply with that rule. More importantly, studies of the ways in which a smokers' behavior might change to compensate for the lower nicotine content suggest that at least some smokers will experience adverse health consequences because of the reduction in nicotine levels.²³⁸ It would still be possible to say that

²³⁷ See *infra* Part V.A (discussion of justice claims for compensation of smokers and others adversely affected by smoking).

²³⁸ See, e.g., William N. Evans & Matthew C. Farrelly, *The Compensating Behavior of Smokers: Taxes, Tar, and Nicotine*, 29 RAND J. ECON. 578 (1998) (concluding that higher taxes lead to some smokers shifting to consumption of higher tar and nicotine cigarettes, reducing the health benefits from the lower demand attributable to the higher price). Studies such as this one support Hanson and Logue's contention that *ex ante* incentive-based schemes are not likely to produce an optimal activity level on the part of smokers. Hanson & Logue, *Costs*, *supra* note 6, at 1275-76. Our point, however, is that such a technique is an important component of a multidimensional policy scheme in which the

the rule was an efficiency-promoting step, however. If the positive health and economic consequences of such a requirement²³⁹ were determined to exceed the adverse consequences to the industry and to its customers, then the approach would be efficient under Kaldor-Hicks principles.

The major advantage of changing the template against which the regulatory approaches are measured, in our view, is that doing so alleviates the recurring problem that Hanson and Logue find in the approaches other than the one they advocate. Instead of requiring the precise measurement needed to attain perfect efficiency, this alternative notion of efficiency leaves room for approval of an approach that could be based on admittedly rougher but more practicable judgments about the types and dimensions of gains and losses. It thus enables a policymaker to keep on the table a number of regulatory approaches that Hanson and Logue dismiss on the way to an advocacy of their approach.

2. *The Overly Critical View of Particular Regulatory Approaches.* The other substantial area of our disagreement with the Hanson and Logue treatment of the regulatory approaches relates more to the specific shortcomings they identify in some approaches and the particular advantages of their preferred approach. While the preceding discussion identified what we believe to be a systemic or theoretical weakness in their analysis, this part of our critique is centered more on the assumptions that are made about the operation of the different approaches.

a. *The Responsiveness of Command-and-Control Regulators.* As pointed out above, we believe that one can say that command-and-control regulations are capable of producing greater efficiency if one expands the idea of efficiency to allow room for a positive result that falls short of perfection. Even if one were to be limited to the perfect efficiency goal of Hanson and Logue, we question the assumption

disadvantages of one component could be offset by another component. In this instance, for example, a cap on permissible nicotine and tar levels could minimize the adverse health effects of this compensating behavior.

²³⁹ One could assume that those positive consequences could include such benefits as a reduction in the likelihood of addiction or the diversion of disposable income from cigarette purchases to other uses that do not carry the same risk of significant future health care expenses.

about the unresponsiveness of both regulators and regulated firms that is implicit in the Hanson and Logue criticism of this type of regulatory approach. According to Hanson and Logue, if by some miracle a regulator were to happen upon a requirement that produced efficiency at the present moment, the regulator would be unlikely to adapt to changing circumstances.²⁴⁰ In addition, they assert that the regulated firms would be deprived of an incentive to develop new technologies.²⁴¹

Hanson and Logue are undoubtedly correct in their concerns about the relationship between regulators and regulated industries. A substantial body of literature sounds cautionary notes about such phenomena as industry capture of agencies and unintended consequences of regulations.²⁴² Our difference with Hanson and Logue is more a matter of how one responds to the existence of those risks. If command-and-control regulations are capable of producing significant social good,²⁴³ then we believe that the appropriate response to the potentially efficiency-threatening effects of regulations is to build in as much protection from those effects as is feasible and otherwise justified.

In any event, we are not persuaded that the magnitude of the problem is as great as Hanson and Logue suggest. Regulatory agencies could very well be capable of periodic reassessment of a situation and corrective action called for by that reassessment. Furthermore, we think that the experience in other regulatory settings suggests that the tobacco companies are unlikely to be subject to the technology-freezing effects that Hanson and Logue predict. In our view, it is just as likely, if not more likely, that the regulated firms will devote resources to research and development efforts that can improve market share and lower costs within a particular regulatory regime. If the specific regulatory demands

²⁴⁰ Hanson & Logue, *Costs*, *supra* note 6, at 1265.

²⁴¹ *Id.* at 1339.

²⁴² See, e.g., Peter L. Kahn, *Regulation and Simple Arithmetic: Shifting the Perspective on Tort Reform*, 72 N.C. L. REV. 1129, 1181 (1994) (describing effect of funding cuts and anti-regulatory rhetoric on agency morale); Teresa Moran Schwartz, *Punitive Damages and Regulated Products*, 42 AM. U. L. REV. 1335, 1347-52 (1993) (discussing regulatory failures at the FDA).

²⁴³ Part IV.B. *infra* sets forth the bases for our strong belief that command-and-control regulations do produce significant social good.

prove to be inappropriate as their consequences are felt, we think that the history of the regulatory state in this country provides a basis for predicting that the political process would be employed by the industry in ways that can bring the task of dealing with those objections to prominence in the regulatory agenda.²⁴⁴

b. Realistic Sanctions for Performance-Based Regulations. Our principal reaction to the Hanson and Logue treatment of performance-based regulation is based on the same disagreement with the ultimate goal that we have identified above. If securing an improvement in the state of affairs is substituted for the attainment of optimality, then performance-based regulations offer significant opportunities to improve safety and to move toward a correction of market imperfections.

When considering how performance standards will actually operate, however, it is important to set up a plausible hypothesis. Hanson and Logue stack the deck against such standards when they use as a model a regulation that sets a nicotine level standard that would be enforced by a ban on cigarettes.²⁴⁵ It is more likely that the consequence of missing the performance standard would be a monetary penalty rather than a ban of the product.²⁴⁶ Sanctions that are perceived as unrealistically harsh can change the operation

²⁴⁴ The experience with National Highway Traffic Safety Administration occupant protection system requirements for motor vehicles is one example of agency responsiveness to practicability concerns raised by a regulated industry. For a detailed account of the regulation of auto safety see JERRY L. MASHAW & DAVID L. HARFST, *THE STRUGGLE FOR AUTO SAFETY* (1990). The Clean Air Act offers another illustration of an effective industry assertion of the economic consequences of proposed regulation. For a thorough examination of its history see BRUCE A. ACKERMAN & WILLIAM T. HASSLER, *CLEAN COAL/DIRTY AIR* (1981).

²⁴⁵ Hanson & Logue, *Costs*, *supra* note 6, at 1267. They repeat this depiction of a sanction in connection with performance-based standards for youth smoking levels. *Id.* at 1268.

²⁴⁶ Bans are more likely to be used as a sanction after it has been determined that there is no reason to subject society to the risks associated with a product and no way to eliminate those risks from the product. See, e.g., Consumer Product Safety Act, 15 U.S.C. § 2057 (1994) (stating procedure for banning hazardous products). We are not saying that bans are an impossible sanction; rather, we are expressing skepticism that they are a plausible component of a performance-based regulation of the kind that Hanson and Logue discuss.

of the decisionmaking process in ways that distort the overall assessment of that approach.²⁴⁷

Hanson and Logue arguably illustrate this distortion in their critique of the performance-based regulations set out in the 1997 settlement agreement.²⁴⁸ They express considerable skepticism that the Food and Drug Administration (FDA) would act aggressively as an efficiency-enhancing regulator, basing that opinion on the failure of the agency to utilize the authority it has arguably had for many years.²⁴⁹

We would point to that same history of regulatory inertia as an illustration of why performance-based regulations need to be evaluated under an operating assumption that reasonable sanctions would be attached to non-attainment. The most likely explanation for the FDA's record of limited action on tobacco products prior to 1995²⁵⁰ is an understandable reluctance to have exercised an authority that was never more than implicit in a way that might have resulted in an explicit removal of that authority from the agency. It is virtually certain that any move toward banning cigarettes would have had that effect. Indeed, the explicit exclusion of tobacco products from the regulatory authority delegated by the major consumer protection legislation from 1966 to 1976²⁵¹ justifies an inference that Congressional reaction to the FDA stepping forward on this issue would have been strong and swift, perhaps

²⁴⁷ One could refer to the evidence of prosecutors making lower charging decisions because of discomfort with mandatory sentencing requirements that are seen as too drastic. See generally Jeffrey Standen, *Plea Bargaining in the Shadow of the Guidelines*, 81 CALIF. L. REV. 1471, 1505-12 (1993) (noting that enhanced prosecutorial discretion under the guidelines cuts both ways). The point we are making is that there must be a realistic chance of the agency enforcing a standard if the standard is going to serve as a model of how such a regulatory approach will work.

²⁴⁸ See Hanson & Logue, *Costs supra* note 6, at 1340-41 (discussing weakness of FDA's authority to promulgate performance standards).

²⁴⁹ *Id.* at 1341.

²⁵⁰ The first significant foray by the FDA was its issuance of a proposed rule in that year. Regulations Restricting the Sale and Distribution of Cigarettes and Smokeless Tobacco Products To Protect Children and Adolescents, 60 Fed. Reg. 41314 (1995) (proposed Aug. 11, 1995).

²⁵¹ See RICHARD KLUGER, *ASHES TO ASHES* 375 (1996) (citing instances of congressional exclusion of tobacco products from the scope of the Fair Labeling and Packaging Act of 1966, the Controlled Substances Act of 1970, the Consumer Product Safety Act of 1972, and the Toxic Substances Act of 1976).

even threatening the agency's ability to act in other areas of its responsibility.

When the focus shifts to a consideration of sanctions that do not threaten the viability of the industry, such as those contained in the 1997 settlement agreement, it is more likely that performance-based regulations will become an effective tool in the regulatory mix, capable of producing results that are efficient in the less demanding sense described above and that are beneficial on other dimensions as well. Indeed, the fact that the penalty proposed for failing to meet the performance standard for reducing the level of underage smoking does *not* threaten the survival of the industry could be seen as one of its strengths, rather than as simply another weakness.²⁵² A performance-based regulation of this sort could, in conjunction with and as part of a comprehensive and multidimensional scheme, provide at least some incentive for the industry to address the problem dealt with by the regulation. One could see standards of this sort as more hortatory than punitive, attempting to overcome inertia within the industry and beginning a push in a socially desirable direction.

c. The Positive Effects of Regulation through Ex Ante Taxes. Hanson and Logue's position on ex ante taxes on cigarettes offers a clear example of how the quest for the perfect can distract attention from the benefits of an incremental advance to the good. While they are undoubtedly correct in their belief that an excise tax on cigarettes would not be levied at the rate that would produce perfect efficiency in the market,²⁵³ we think that even within their own analytical framework they are insufficiently appreciative of the benefits that do flow from such a tax.

We contend later in this Article that excise taxes are the single most effective method of responding to a number of the serious justice concerns that are encountered in the tobacco setting. Even if we were to set aside those justice concerns for the moment and concentrate on the goal of allocative efficiency in the tobacco

²⁵² See Hanson & Logue, *Costs*, *supra* note 6, at 1332-33 (criticizing small increase in price that would be needed to cover the penalty for non-attainment of youth smoking levels under look-back provisions of 1997 proposed settlement).

²⁵³ See *id.* at 1269-71 (discussing difficulty in arriving at efficient tax rate).

industry, ex ante taxes do more to enhance efficiency than any other form of legal intervention. It is evident that the driving force behind Hanson and Logue's legal intervention in the cigarette market is the reduction in demand attributable to the higher price that will result from the implementation of their approach. For the most part, the benefits of their approach would occur regardless of the specific mechanism that leads to that higher price.²⁵⁴ In the situation where the current price of cigarettes is as dramatically lower than its social costs as Hanson and Logue say it is, we think that the appropriate reaction to ex ante regulation through increased rates of excise taxes should be more approving of the efficiency gains than critical of its failure to attain optimality. Their recognition that excise taxes could move the "aggregate activity levels . . . closer to the optimal levels"²⁵⁵ needs to be kept in the proper perspective. This regulatory approach is capable of having a significant and direct effect on the level of consumption,²⁵⁶ and may be the only effective way of using a pricing mechanism to accomplish that result at reasonable levels of administrative expense.

Some other aspects of Hanson and Logue's treatment of excise taxes are less than compelling. One of their concerns is the adverse effect of a single rate of taxation. Their position is that a failure to discriminate in tax rates among products with different risk levels can lower the incentive for manufacturers to invest in greater safety.²⁵⁷ They are also concerned about the potential for "errors of commission" and "errors of omission" as smokers consume too much or too little, respectively, of the product as compared to their

²⁵⁴ The expectation that there will be activity level efficiency gains is consistent with the statement in the text. While the occurrence of care level gains are arguably a different matter, we suspect that those are less likely to result from the Hanson and Logue approach, so the improbability of their occurring as a result of ex ante taxation is not a comparative disadvantage of this regulatory approach.

²⁵⁵ Hanson & Logue, *Costs*, *supra* note 6, at 1273.

²⁵⁶ The statement by Hanson and Logue that excise tax rates could be adjusted to correct problems that flow from an incorrect rate, *id.* at 1272-1273, seems to be an acknowledgement of the point that we made above that one of the strengths of regulatory approaches that involve legislative or administrative agency action is the ability to monitor and respond to the consequences of the action. See *supra* Part III.B.2.a.

²⁵⁷ Hanson & Logue, *Costs*, *supra* note 6, at 1271-72.

consumption levels if they were perfectly and individually informed of the risks.²⁵⁸

We are not persuaded that the safety disincentive that concerns Hanson and Logue is a serious risk. Experience in other product settings, such as automobiles, would suggest that there is a market niche that a producer can claim by marketing with a focus on safety.²⁵⁹ To be sure, filling that niche would require the firms in the tobacco industry to engage in meaningful competition on something other than brand identity and price. Allegations have been made that the industry has violated antitrust laws by conspiring to fix product quality,²⁶⁰ and the continuation of such conspiracies would make competition over product safety less likely. As long as the anticompetitive practices of the industry were kept in check, however, we would anticipate a recognition of the potential for market advantages by members of the tobacco industry as a response to enhanced regulation and higher rates of taxation.

A very real concern is the phenomenon that Hanson and Logue refer to as "errors of commission"—excessive rates of smoking because of smokers underestimating the risk of a particular brand of cigarette.²⁶¹ That phenomenon is not a reason to be skeptical about the effectiveness of excise taxes. In no other aspect are the incremental efficiency gains from excise taxes more likely to occur. The higher price attributable to the excise tax has a beneficial effect in lowering demand among consumers prone to this type of inefficient behavior. Furthermore, as a practical matter, excise taxes that were levied specifically for public policy reasons rather than for general revenue-raising purposes would almost certainly distinguish among categories of cigarettes according to at least rough measures of their risk differentials.²⁶²

²⁵⁸ *Id.* at 1272.

²⁵⁹ See Daniel Givelber, *Cigarette Law*, 73 *IND. L.J.* 867, 887 (1998) (noting theory and explaining why practice of tobacco industry has not been consistent with theory); Note, *supra* note 151, at 895 (exploring "Volvo effect" in which safety advertising helps to achieve accident-reduction goal of tort law).

²⁶⁰ See Einer Elhauge, *Foul Smoke*, *WASH. POST*, Aug. 4, 1998, at A15 (discussing allegation that "cigarette manufacturers have agreed among themselves not to compete on product safety").

²⁶¹ Hanson & Logue, *Costs*, *supra* note 6, at 1271-72.

²⁶² See Evans & Farrelly, *supra* note 238, at 594 (proposing that excise taxes should be assessed on the basis of tar and nicotine content of cigarettes).

Errors of "omission" present a more curious feature of the tobacco setting.²⁶³ Hanson and Logue place this label on what might be described as a "double counting" phenomenon. A rational consumer who was perfectly informed about the risks of smoking would make efficient decisions about smoking. Imposition of an excise tax on the cigarettes purchased by that consumer would add to, rather than substitute for, the deterrence produced by perfect information, causing the consumer to smoke too little. This analysis highlights the problem of using cigarettes as the proving ground for economic theory that may have considerable value in other settings. When a product has as little (or no) social utility as is often claimed about cigarettes, then any putative errors of omission could be seen instead as an incidental and indirect means of obtaining the benefits of reduced smoking. What may appear at first glance to be a theoretical drawback to this regulatory approach from an economic perspective could, thus, be transformed into what is actually a practical benefit when additional perspectives are introduced into the policy analysis.

By and large, our critique of the details of Hanson and Logue's treatment of command-and-control, performance-based, and ex ante excise tax regulations identifies instances in which we think they have overestimated the drawbacks of the approaches or underappreciated the contributions that the approaches make to a multi-pronged attack on the problem. Although it is true that they do acknowledge that these other approaches have merit in certain circumstances,²⁶⁴ it is nevertheless also true that they consign these approaches to roles that are supplemental to their preferred approach. It is to the purported advantages of this approach that we now turn.

d. The Drawbacks to Regulation through Ex Post Liability. Just as we have suggested that Hanson and Logue undervalue the

²⁶³ Hanson & Logue, *Costs*, *supra* note 6, at 1272.

²⁶⁴ See *id.* at 1267-68 (discussing advantages of performance-based regulation over command-and-control regulation); *id.* at 1270 (detailing occasions when ex ante, performance-based, and command-and-control regulation have beneficial uses); *id.* at 1272-73 (analyzing positive effects of ex ante taxes); see also Hanson et al., *Blueprint*, *supra* note 7, at 527-28 (criticizing command-and-control, performance-based regulation, and excise taxes while recognizing that those approaches should at times be used).

other approaches, our critique of their evaluation of their ex post victim-initiated incentive-based approach leads us to conclude that they overestimate the benefits that would flow from the adoption of that approach. In some instances, we think their analysis makes assumptions that are difficult to credit, while in others, they downplay problems that we consider to be significant obstacles to the accomplishment of their objective.

Arguably, the single greatest shortcoming in the justification of enterprise liability and smokers' compensation is the belief that an ex post liability approach uses a decisionmaking process that leads to an efficient result. The predicate to their approach, Hanson and Logue contend, is "the regulator . . . charging the manufacturer, ex post, for any costs that the product winds up causing."²⁶⁵ When the manufacturer continues to operate in a legal regime in which it knows that charge will be assessed, it must incorporate its exposure to liability into its decisionmaking about product design and production levels, with the consumer ultimately required to internalize the costs that previously were externalized.²⁶⁶ We believe that it is unrealistic to assume that the quantification of "any costs" the product causes is any more within the grasp of decisionmakers who would be called upon to determine it than are the tasks for which Hanson and Logue found regulators to be ill-equipped in the other approaches. Deciding what counts as a cost of smoking and assigning a value to those costs introduce elements that are conceptually controversial and factually indeterminate.

Even if some consensus could be reached about how to make those decisions, the tobacco setting contains features that make the Hanson and Logue result of efficient levels of care and activity less likely to occur here than in other injury contexts. In their discussion of imperfect information as a contributor to market failure, Hanson and Logue correctly note that a distinctive characteristic of smoking-related harms is the lengthy time gap between the activity and the onset of the harm.²⁶⁷ When the legal system intervenes employing a technique that has a focus on ex post liability, the costs

²⁶⁵ Hanson & Logue, *Costs*, *supra* note 6, at 1273.

²⁶⁶ *Id.*

²⁶⁷ *Id.* at 1203-06.

that are attributed to smoking will be assessed at a much later time than the decisions about use were actually made.

Under the approach advocated by Hanson and Logue, the cigarette manufacturers' "ex ante expected cost calculation" and "determin[ation], ex ante [of] optimal product design . . . and optimal quantity"²⁶⁸ will be made on the basis of the prediction of an ex post liability assessment that is removed in time from either of two critical dates: the time in the past when the person currently being compensated decided whether and how much to smoke, and the time in the future when the harms to current smokers manifest themselves in order to be valued and compensated. Under those circumstances, it is simply implausible to conclude that the effects of compensation under this sort of legal regulation will any more closely correspond to the perfect efficiency that their economic model holds out as the goal than the other approaches that they denigrate.

As they develop their approach and criticize the proposed 1997 settlement, Hanson and Logue make a number of adjustments or accommodations that cause the compensation provided under their approach to deviate from the initial premise that it would entail a full ex post assessment of any costs that are caused by smoking. For example, as a way of avoiding anticipated moral hazard objections to their approach, they limit the compensation they would provide to "compensation that is currently provided through public and private insurance mechanisms."²⁶⁹ One of Hanson and Logue's most compelling accomplishments in *The Costs of Cigarettes* is their demonstration that substantial costs of smoking are externalized under the current legal regime. It is disconcerting, to put it mildly, to find them so willing to remove from their compensation scheme the categories of costs that are most likely to be externalized under the current state of affairs and that are *not* now covered by private and public insurance. Those categories would include pain and suffering of the smokers who develop health problems, emotional distress of the family members of those ill smokers, and noneconomic losses to the survivors of smokers who die from smoking-related illnesses. A scheme that excludes compensation for these categories of losses is a far cry from one that reaches perfect

²⁶⁸ *Id.* at 1273.

²⁶⁹ *Id.* at 1280.

efficiency through a simple ex post charge of any costs that are caused by smoking.

The modification of their approach to exclude compensation for particular categories of very real harms is an instance in which Hanson and Logue attempt to accommodate the strains of transferring the abstract economic model to an operational setting, and do so only at significant cost to the integrity of their model. Their description of how their approach would work also includes examples of what we would refer to as a "spill-over effect." By this term, we refer to the situation in which a doctrinal modification designed to deal with the unique properties of a particular injury situation is not easily confined within that situation, and begins to affect the shape of the doctrine in other applications. Mass tort litigation in the last three decades abounds with illustrations of this phenomenon: the "market share liability" theory developed to deal with the indeterminacy of causation in the DES cases;²⁷⁰ the distortion of the state-of-the-art defense in the asbestos cases when rehashing the issue of whether the industry could have known about the risks of exposure that insulation installers experienced became a pointless exercise in raising the costs of litigation;²⁷¹ the stress on the evidentiary process in the Bendectin cases when the legal system was asked to make decisions about liability when the scientific evidence was still lacking;²⁷² and the stretching of the

²⁷⁰ See, e.g., *Sindell v. Abbott Labs.*, 607 P.2d 924 (Cal. 1980) (holding DES manufacturer liable under market share approach), *cert. denied*, 449 U.S. 912 (1980); *Smith v. Cutter Biological, Inc.*, 823 P.2d 717 (Haw. 1991) (holding blood products manufacturer liable under market share liability); *Martin v. Abbott Lab.*, 689 P.2d 368 (Wash. 1984) (holding DES manufacturer liable under market share liability); see also David A. Fischer, *Products Liability—An Analysis of Market Share Liability*, 34 VAND. L. REV. 1623 (1981) (presenting basic contours of market share liability).

²⁷¹ See, e.g., *Beshada v. Johns-Manville Prods. Corp.*, 447 A.2d 539, 548 (N.J. 1982) (holding state-of-the-art defense unavailable in failure to warn case, in part because it would "greatly add to costs both sides incur in trying a case"); Patricia M. Danzon, *Tort Reform and the Role of Government in Private Insurance Markets*, 13 J. LEGAL STUD. 517, 535-36 (1985) (discussing efficiency considerations of state-of-the-art defense).

²⁷² See, e.g., *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579 (1993) (establishing test for admissibility of scientific evidence); MICHAEL D. GREEN, *BENDECTIN AND BIRTH DEFECTS: THE CHALLENGES OF MASS TOXIC SUBSTANCES LITIGATION* (1996) (detailing history, structure, and consequences of Bendectin litigation); Heidi L. Feldman, *Science and Uncertainty in Mass Exposure Litigation*, 74 TEX. L. REV. 1 (1995) (discussing admissibility of scientific evidence).

boundaries of the class action prerequisites to fit the demands of potential classes that are both huge and amorphous.²⁷³

The clearest instance of a potential spill over in the Hanson and Logue approach occurs in connection with their discussion of the transition issues that are raised by imposing significant liability for harms caused by conduct that occurred decades in the past. After a careful account of the risk of insolvency that the industry would face if their scheme were to be implemented, Hanson and Logue characterize those fears in a number of ways: as exaggerated, as not unique to their approach, and as a necessary corollary to a commitment to a free market system.²⁷⁴ As part of their response, they suggest that one way to deal with the problem of firms that were judgment-proof would be "to eliminate or weaken the doctrine of limited shareholder liability," allowing claimants to "go after the assets not only of the cigarette companies themselves but also of the tobacco company shareholders."²⁷⁵

It is difficult to tell how serious Hanson and Logue are about this feature of their discussion. They go on to suggest that a "financial responsibility" requirement could be imposed on firms in the industry,²⁷⁶ but that does nothing to address the problems attributable to liability for harms caused well prior to the adoption of the plan. Our concern is that a proposal that requires such a dramatic departure from a central premise of a settled body of law is considerably weakened, either because of the improbability of its occurrence or because of the serious consequences that could be expected to follow its occurrence in this specific setting.

Let us make clear the nature of our critique. We are not critical of Hanson and Logue for advocating a system that attempts to compensate for some of the harms of smoking. As we will show below, we think that compensation of a particular sort is an essential component of a socially responsible approach to the

²⁷³ See, e.g., *Castano v. American Tobacco Co.*, 160 F.R.D. 544 (E.D. La. 1995) (ordering class certification in action on behalf of all nicotine-dependent smokers and their dependents), *rev'd*, 84 F.3d 734 (5th Cir. 1996).

²⁷⁴ See Hanson & Logue, *Costs*, *supra* note 6, at 1301-12 (discounting fears of collapse of tobacco industry).

²⁷⁵ *Id.* at 1309-10.

²⁷⁶ *Id.* at 1311.

problem. The objection that we offer here is that, *on their own terms*, the approach advocated by Hanson and Logue cannot be justified on an efficiency basis. Indeed, given the analysis that we offer in the next Part of our article, it would appear that a version of the ex ante excise tax method of legal intervention in the market for cigarettes offers the greatest promise of promoting efficiency.

The central theme of our critique of this approach to the costs of cigarettes contains a clear lesson for how to proceed. If the approach preferred by Hanson and Logue is incapable of achieving the goal they identify as paramount in their analysis, then something has to change. Either one must modify the rationale asserted for their method, or one must place greater reliance on other approaches that may be similarly handicapped when it comes to attaining perfect efficiency but that serve social policy objectives other than efficiency.

Our critique of Hanson and Logue's analysis should not detract from the realization that they offer many insights into the pluses and minuses of the various approaches to dealing with the costs of cigarettes. The legal, economic, and administrative commentary that follows their work will necessarily be enriched by the breadth and depth of those insights.

Nevertheless, the conclusion that we draw from an examination of the treatment that Hanson and Logue give to the various regulatory approaches is that the appropriate way to take advantage of the work they have done is to incorporate it into a substantially different method of tackling the question of how the legal system should respond to the harmful consequences of tobacco products. The next Part of our Article presents a "fresh start" at answering that question, one that we believe has considerable promise as a practicable and politically feasible method of responding to the economic, medical, legal, and social justice implications of smoking-related harm.

IV. POLICY CONSIDERATIONS AND SMOKING ISSUES: A FRESH START

For all of its considerable sophistication and insight into the economics of smoking-related harms, we conclude that Hanson and

Logue's narrow focus on economic efficiency fails to accommodate other vitally important factors that should drive the analysis. In identifying both the policy ends and the methodological means that must be taken into account in any realistic attempt to confront the health-related harms associated with smoking, a "fresh start" is both timely and needed.

It would be presumptuous to start anew without indicating the route to be taken and explaining why that path is different from what has come before. Our intent in this fresh start is to pave the way for constructing a tobacco policy built from components that are derived from an exercise in comprehensive policy analysis, rather than the result of "coincidence"²⁷⁷ or the vagaries of the political process.²⁷⁸ The appropriate methodology for that policymaking effort is to identify the policy considerations that need to be addressed and then to select the most effective means of accommodating those considerations, recognizing that tensions among these various policies need to be acknowledged forthrightly and dealt with as well as possible.

A number of the components of a tobacco policy developed in this way correspond to statutory and regulatory measures that have been proposed or enacted in the past. In our view, while that may demonstrate the political viability of those measures, it is not a sufficient reason for their inclusion within an overall policy. Our purpose is ultimately to highlight a range of measures that are derived from the policy considerations we outline and that are sensitive to the constraints presented by current political and economic conditions.

We come at the project of developing a tobacco policy with a belief that justice considerations have priority over purely economic concerns or political matters. Once these justice concerns have been

²⁷⁷ See *id.* at 1342 ("[T]he coincidence of the amount of the payments under the [1997 negotiated settlement] agreement [between the tobacco companies and the attorneys general] and the amount necessary to cover future Medicaid costs could be just that—pure coincidence.").

²⁷⁸ One account of the origin of the 1997 settlement's \$368 billion figure attributes it to White House deputy counsel Bruce Lindsey's calculation on a napkin at a meeting with some of the key negotiators. CARRICK MOLLENKAMP ET AL., *THE PEOPLE VS. BIG TOBACCO: HOW THE STATES TOOK ON THE CIGARETTE GIANTS*, at 219-20 (1998).

articulated and their strength determined,²⁷⁹ efficiency considerations and the political environment can serve as constraints on the solutions that are proposed, even if only to acknowledge that a substantial loss of efficiency might be required to address a particular justice consideration or that the most desirable outcome from a justice perspective has no realistic chance of being adopted because of intractable political opposition. In a sense, then, we have reversed the polarity on the moral compass that drives law and economics analysis. Unlike Calabresi and those who follow in his steps, we begin with an analysis of the demands of justice and then bring "other efficiency" and political concerns into play, rather than starting with efficiency and noting "other justice" concerns that may exist.²⁸⁰

One of the risks of an academic policymaking enterprise is that it never develops a clear focus and remains little more than a laundry list of items that should be included in a nebulous balancing of interests.²⁸¹ While there can be a significant benefit from the effort to locate all of the interests that are implicated in a situation, our hope is that a greater structure can be given to the process by indicating the order in which the relevant considerations are to be addressed.²⁸²

Our decision to place justice concerns at the heart of the policymaking process has an important methodological consequence. Once justice considerations have been identified, our approach would not allow them to be trumped by considerations that rank lower in the hierarchy. Economic and political concerns will necessarily inform the policy discussion about the wisdom and the feasibility of promoting those justice concerns through particular

²⁷⁹ The justifications for the details of the proposals that follow are based on principles in the Dworkinian sense of standards to be observed because of "a requirement of justice or fairness or some other dimension of morality," RONALD DWORIN, *TAKING RIGHTS SERIOUSLY* 22 (1978), and that exert stronger or weaker force depending on the particular application to which they are put. *Id.* at 26.

²⁸⁰ CALABRESI, *supra* note 11, at 24-26.

²⁸¹ RONALD DWORIN, *A MATTER OF PRINCIPLE* 73 (1985) (describing the philosophical flaw in interest balancing).

²⁸² For a thoughtful exploration of how to order values and interests in tort law, see David G. Owen, *Philosophical Foundations of Fault in Tort Law*, in *PHILOSOPHICAL FOUNDATIONS OF TORT LAW* 201, 216-20 (David G. Owen ed., 1995) [hereinafter *PHILOSOPHICAL FOUNDATIONS*].

proposals. Even in the construction of specific program components, however, the notion of hierarchy implies that economic considerations and political constraints should impinge upon the satisfaction of justice-based claims only in the least intrusive manner. The approach we advocate thus turns a free-for-all balancing process into an analysis that is conducted according to ground rules about when and to what extent particular considerations will be permitted to interfere with the implementation of policies designed to promote other concerns.

Section A offers a brief identification of the different policy considerations that need to be addressed in formulating a tobacco policy. In Section B, we examine the various regulatory approaches to determine how the different forms of legal intervention might address those policy considerations. Much of what Hanson and Logue have said about the inefficiency that remains in the market for cigarettes even after the application of most regulatory approaches will be taken as given. Our purpose here is to identify what these different approaches might do *well*, rather than to relegate them to an inferior status because of their inadequacies when viewed solely from an economic efficiency perspective.

The approach that we describe here arguably has an important pragmatic dimension. Given the highly politicized atmosphere that invariably develops around discussions of tobacco legislation, there is a special need for sensitivity to the strength of the forces that are at odds in this setting. Proposals that proceed from questionable premises will have a brief shelf-life under the intense scrutiny they will receive in such a charged policy arena. Similar reservations are warranted for proposals that take no notice of the reality that the "other side" has interests that have to be acknowledged as real and as entitled to inclusion within the debate.

In a setting like this, we believe that a justice-centered approach has particular appeal for a number of reasons. First, it opens the discussion with the most important issue. Our central question is what is right, rather than what is most efficient, or what is most politically expedient. Second, by staking out greater justice as a legitimate end, it opens the door for the development of policy proposals aimed at goals that are significant and achievable. Solutions that are not perfect can be viewed as promising first steps,

rather than being discarded because they fail to resolve all aspects of an extremely complex set of problems. Third, by acknowledging the full range of interests that are affected by the issues surrounding legal intervention in the tobacco setting, it holds out the promise that all the relevant constituencies can be kept in the discussion. No solution is ever going to garner sufficient political support if it dismisses all of the interests of a significant constituency. The policy debate is best served when it takes place in a form that invites inclusion in the discussion rather than one that assures rejection because of the exclusion of a set of interests. Placing those interests in a moral framework allows the initial focus to be a consideration of which justice principles underlie our social policy. Building on whatever agreement can be developed at that level, the policy debate can then turn to a full airing of the nature and strength of the justice base of the different interests.

A. THE RANGE OF POLICY CONSIDERATIONS IN THE TOBACCO SETTING

The description of the policy considerations that need to be addressed in the tobacco setting distinguishes among justice concerns, economic considerations, and political constraints. As was true of Hanson and Logue's taxonomy of regulatory approaches, we do not pretend that the boundaries between these categories are necessarily clearly defined or immutable.²⁸³ Although the categorization can become a matter of contention, we believe that even a rough characterization of the nature of a policy concern is essential to the prioritization that is required under our justice-centered approach to policymaking.

1. *Justice Concerns.* This Section describes four considerations that we believe need to be at the heart of the development of a sound tobacco policy. Those considerations are corrective justice, retributive justice, distributive justice, and personal autonomy.

²⁸³ See Hanson & Logue, *Costs*, *supra* note 6, at 1263 n.422 (acknowledging that the distinctions they draw "are not perfect and in some instances blur"); see also JEFFRIE G. MURPHY & JEAN HAMPTON, *FORGIVENESS AND MERCY* 114 (1988) (citing view that retribution is a species of distributive justice); Richard W. Wright, *Rights, Justice, and Tort Law*, in *PHILOSOPHICAL FOUNDATIONS*, *supra* note 282, at 159, 175 (classifying retributive justice as a subset of corrective justice).

We have chosen to characterize this cluster of considerations as "justice concerns" for two reasons. First, from a purely semantic perspective, we were reluctant to describe these concerns in negative terms, i.e., as "non-economic" or "non-political." Because we believe these concerns should be the central features of a tobacco policy, it is important to begin with a positive statement that captures in ordinary language terms the force that they should have. Second, and more importantly, describing these matters as "justice concerns" is usefully evocative of subsequent steps in the policymaking process that we advocate. On one level, the label "justice concerns" suggests that these matters are valued in their own right, rather than merely as instrumental measures toward another overarching goal. Furthermore, the use of the term "justice concerns" suggests that an identification of these matters will have consequences for the policy discourse, most notably by opening the way for a consideration of the justice-based claims that various parties could assert in the tobacco setting. In sum, locating these considerations at the heart of the policymaking process and describing them as justice concerns helps to frame the debate in what we believe is a desirable and useful manner.

We do not attempt in the confines of this Article to offer philosophical justifications of the theories of justice that underlie each of these concerns. The literature on justice and rights is massive, and the theories are often illuminating. Our exercise begins at a later stage, when someone whose well-being is affected by a tobacco policy offers a plausible assertion that some fundamental matter of justice for that person needs to be taken into account. There is certainly a place for the close analysis of different conceptions of justice, especially in a society which displays as much moral pluralism as ours. Nevertheless, our belief is this is not that place. For our purposes, an assertion is entitled to recognition in the policymaking process when it is based on a justice principle that has been accepted within our political and legal discourse. The likelihood of a consensus developing around an assertion would increase if it were supportable by more than one theory of justice that operates

within that arena,²⁸⁴ but consensus at that level of theory is not a prerequisite under our approach.

a. Corrective Justice. Corrective justice is concerned with wrongful gains and losses.²⁸⁵ The traditional concept of corrective justice focuses on the problem of unjust enrichment, that is, when one party directly gains something at the expense of another.²⁸⁶ In such cases, restitution satisfies the requirements of corrective justice by returning the property to its rightful owner, while at the same time depriving the wrongdoer of any ill-gotten gains.²⁸⁷ It has also been suggested that those who engage in wrongdoing have a moral duty to compensate injured parties even though they do not realize any financial gain from their wrongdoing at the victim's expense.²⁸⁸ Under this theory, for example, a speeding motorist who negligently injures a pedestrian would be obligated to compensate the injured party even though the tortfeasor did not profit financially from the victim's injury.²⁸⁹ Finally, there is another principle that provides that one who benefits from a lawful, but dangerous, activity is morally obligated to compensate those who are injured by the activity, particularly nonparticipants.²⁹⁰ This notion provides moral support for the concept of enterprise liability²⁹¹ and might be included within an expansive definition of corrective justice.

Principles of corrective justice are highly relevant to the smoking issue. The predatory marketing practices of tobacco companies,

²⁸⁴ See, e.g., Richard A. Posner, *Wealth Maximization and Tort Law: A Philosophical Inquiry*, in PHILOSOPHICAL FOUNDATIONS, *supra* note 282, at 99, 108-111 (stating that the wealth maximization theory of Chicago-school law and economics is consistent with Aristotelian and Kantian deontological theories of justice).

²⁸⁵ Ausness, *Alternative to Strict Liability*, *supra* note 9, at 1093.

²⁸⁶ See Alan L. Calnan, *Distributive and Corrective Justice Issues in Contemporary Tobacco Litigation*, 27 SW. U. L. REV. 577, 602-03 (1998) (arguing that corrective justice requires wrongdoer to reimburse victim for exact amount of loss).

²⁸⁷ Emily L. Sherwin, *Constructive Trusts in Bankruptcy*, 1989 U. ILL. L. REV. 297, 330.

²⁸⁸ Calnan, *supra* note 286, at 603-04.

²⁸⁹ See Jules Coleman, *Corrective Justice and Wrongful Gain*, 11 J. LEGAL STUD. 421, 425 (1982) (describing this scenario but suggesting that such a duty to compensate may be based on distributive rather than corrective justice concerns).

²⁹⁰ Wertheimer, *supra* note 16, at 408.

²⁹¹ See Fleming James, Jr., *An Evaluation of the Fault Concept*, 32 TENN. L. REV. 394, 399-400 (1965) ("This point of view, which may be called enterprise liability, is most simply stated by the proposition that an activity . . . should pay for the accident loss it causes because, as a general proposition, each enterprise in our society should pay its own way.").

coupled with their refusal to disclose health risks and their alleged manipulation of nicotine levels in cigarettes would certainly qualify as wrongdoing.²⁹² Moreover, this wrongful conduct has undeniably caused serious injuries to smokers and nonsmokers alike. Consequently, principles of corrective justice appear to support liability regimes that compel tobacco companies to compensate smoking victims for their injuries. Principles of corrective justice, at least under an expansive version of that concept, may also be invoked to justify a compensation scheme which requires *smokers* (as opposed to tobacco companies) to compensate nonsmokers who suffer tobacco-related harms, even though smokers have not personally engaged in any unlawful conduct.

b. Retributive Justice. Retributive principles dictate that punishment be imposed when the actor has voluntarily and inexcusably committed a wrongful act.²⁹³ At the same time, principles of retributive justice also provide that punishment should only be imposed when the wrongdoer's guilt is established pursuant to a fair and reliable adjudicative process and for offenses that have been authoritatively declared to be wrongful before their commission.²⁹⁴ Moreover, any punishment imposed on a wrongdoer must be reasonably proportioned to the gravity of the offense.²⁹⁵

Punishment of wrongdoing serves a number of socially useful functions. First, it helps to restore the injured party's emotional equilibrium.²⁹⁶ Although the criminal process traditionally provides a means of vindication for victims of wrongdoing, tort liability can also act as a vindictory mechanism.²⁹⁷ For example, the trial of tort

²⁹² See *infra* notes 301-305 and accompanying text.

²⁹³ Dorsey D. Ellis, *Fairness and Efficiency in the Law of Punitive Damages*, 56 S. CAL. L. REV. 1, 5 (1982).

²⁹⁴ *Id.* at 5-7.

²⁹⁵ *Id.* at 6.

²⁹⁶ David G. Owen, *Punitive Damages in Products Liability Litigation*, 74 MICH. L. REV. 1257, 1279 (1976).

²⁹⁷ See Joseph W. Little, *Up With Torts*, 24 SAN DIEGO L. REV. 861, 869 (1987) ("Damaged people want compensation; there is no denying that. They also want accountability, which in a civilized society means access to a forum and a set of rules by which they may publicly prove themselves right and someone else wrong."); Steven D. Smith, *The Critics and the "Crisis": A Reassessment of the Current Conceptions of Tort Law*, 72 CORNELL L. REV. 765, 783-85 (1987) (discussing the need to respond to the "sense of injustice" felt by accident victims).

claims provides a public forum for victims to tell their story and to receive emotional support from the community.²⁹⁸

Punishment may also express society's disapproval of the defendant's conduct and act as an affirmation of its commitment to prevailing moral and legal standards.²⁹⁹ The retributive process can also reinforce community norms of conduct and rectitude by providing a degree of public accountability for those who violate them.³⁰⁰ In particular, moral values are strengthened when powerful violators, such as government institutions and large corporations, are publicly called to account.

Principles of retributive justice should not be ignored when we are dealing with smoking-related issues. As mentioned above, tobacco companies are highly culpable.³⁰¹ Through their agents, tobacco companies have concealed information from the public,³⁰² denied, in the face of overwhelming scientific evidence, that smoking is harmful,³⁰³ engaged in advertising practices that were intended

²⁹⁸ Peter A. Bell, *Analyzing Tort Law: The Flawed Promise of Neocontract*, 74 MINN. L. REV. 1177, 1218 (1990) ("This opportunity to speak and be heard about personal tragedy may be the most important feature of tort for accident victims, more important in some ways than obtaining monetary compensation."); Leslie Bender, *Feminist (Re)Torts: Thoughts on the Liability Crisis, Mass Torts, Power, and Responsibilities*, 1990 DUKE L.J. 848, 862 (1990) ("Tort litigation provides a place for victims to tell their stories to the public and make the perpetrators listen.").

²⁹⁹ ARTHUR GOODHART, *ENGLISH LAW AND MORAL LAW* 93 (1953) ("Retribution in punishment is an expression of the community's disapproval of crime, and if this retribution is not given recognition the disapproval may also disappear.").

³⁰⁰ See Mary J. Davis, *Design Defect Liability: In Search of a Standard of Responsibility*, 39 WAYNE L. REV. 1217, 1227 (1993) ("This goal [of vindication] is achieved through compensating the victim, the sense of retribution and rectification that attaches to that compensation and the reallocation of loss that takes place."); Timothy D. Lytton, *Responsibility for Human Suffering: Awareness, Participation, and the Frontiers of Tort Law*, 78 CORNELL L. REV. 470, 504 (1993) ("Tort law not only remedies injustice by imposing damage awards, it also exposes normative features of relations between parties by articulating and applying conceptions of responsibility.").

³⁰¹ A selection of tobacco industry documents from the Medicaid third-party liability action in Florida can be found in Symposium, *Transcript of The Florida Tobacco Litigation—Fact, Law, Policy, and Significance*, 25 FLA. ST. U. L. REV. 737, 815-90 (1998).

³⁰² See Ellen Wertheimer, *The Smoke Gets in Their Eyes: Product Category Liability and Alternative Feasible Designs in the Third Restatement*, 61 TENN. L. REV. 1429, 1452-53 (1994) (declaring that "there is evidence that the cigarette industry as a whole has worked long and hard to conceal the true extent of the dangers of smoking").

³⁰³ See Robert T. Krebs, Note, *Castano v. American Tobacco Co.: Class Treatment of Mass Torts Is Going Up in Smoke*, 24 N. KY. L. REV. 673, 676 (1997) (stating that "[e]ven after the [1964 Surgeon General's] Report, the tobacco companies claimed there was a lack

to encourage illegal cigarette sales to minors,³⁰⁴ and allegedly manipulated nicotine levels in cigarettes in order to keep their customers addicted.³⁰⁵ Arguably, acts such as these cry out for retribution.

c. Distributive Justice. Distributive justice is concerned with the allocation of goods or resources among individuals.³⁰⁶ Criteria for a just distribution are not universal but often vary according to the moral or cultural values of a society.³⁰⁷ Thus, in some societies, resources might be distributed according to rank or social status. In this country, however, merit, need, and risk creation are traditional distributive criteria.³⁰⁸ Thus, those who are economically productive should be permitted to enjoy the wealth they have created.³⁰⁹ At the same time, principles of distributive justice support the distribution of extra benefits to our most needy and dependent citizens.³¹⁰ Finally, society has a moral obligation to restrain those who impose risks upon others.³¹¹

Many forms of tobacco regulation have potentially adverse distributive effects. For example, in a society where smokers tend to be economically less well-off than nonsmokers,³¹² incentive-based regulations that raise the price of cigarettes will fall most heavily upon the less wealthy elements of the population. That in itself may not be a compelling reason to keep the price low. Distributive concerns may also be implicated, however, if the social cost of caring

of direct causal link between smoking and cancers").

³⁰⁴ See Frank J. Vandall, *Reallocating the Costs of Smoking: The Application of Absolute Liability to Cigarette Manufacturers*, 52 OHIO ST. L.J. 405, 420 (1991) (claiming that cigarette marketing is directed at underage consumers).

³⁰⁵ See Karen E. Meade, Comment, *Breaking Through the Tobacco Industry's Smoke Screen: State Lawsuits for Reimbursement of Medical Expenses*, 17 J. LEGAL MED. 113, 133-35 (1996) (stating that documents obtained from Brown & Williamson's files revealed that tobacco companies manipulated nicotine levels).

³⁰⁶ Calnan, *supra* note 286, at 589.

³⁰⁷ *Id.* at 589-90.

³⁰⁸ See ALAN CALNAN, *JUSTICE AND TORT LAW* 85-98 (1997) (discussing different distributive criteria).

³⁰⁹ *Id.* at 88.

³¹⁰ *Id.* at 88-89.

³¹¹ *Id.*

³¹² See Alan Schwartz, *Views of Addiction and the Duty to Warn*, 75 VA. L. REV. 509, 526-27 (1989) (declaring that persons of low social and economic status are more likely to smoke than those who are relatively better off).

for those who are harmed by cigarettes is shifted away from the people whose behavior leads to the harm and is spread across members of the population who do not smoke or derive any direct benefit from smoking. Those concerns may be alleviated by measures that concentrate the financial cost on those whose behavior creates the risk, as well as by steps to reduce the total harm that is caused.³¹³ In addition, regulatory efforts that substantially reduce the market for cigarettes will cause great financial hardship for certain segments of the population such as tobacco farmers and their employees, many of whom are not wealthy.³¹⁴

d. Personal Autonomy. The principle of personal autonomy means that individuals should be free to shape their own destinies.³¹⁵ This principle is deeply embedded in our political and legal culture, and is protected by public and private law. Constitutional guarantees in the Bill of Rights uphold the personal autonomy of individuals against overreaching by the government, while tort law protects against unwarranted interference with personal autonomy by private institutions and individuals.³¹⁶

Government actions that prohibit the sale of cigarettes to adults, or that deliberately raise cigarette prices in order to restrict consumption, impair the ability of consumers to decide for themselves whether or how much to smoke. Restrictions on advertising and promotional activities by tobacco companies also affect personal

³¹³ See Jules Coleman, *The Practice of Corrective Justice*, in PHILOSOPHICAL FOUNDATIONS, *supra* note 282, at 53, 68-69 (distinguishing loss distribution schemes from corrective justice). *But see* Wright, *supra* note 283, at 159, 180 (asserting that utilitarian loss-spreading, not distributive justice, is the basis for injury compensation schemes in which those engaged in risky activities pay *ex ante* according to some measure of anticipated harm).

³¹⁴ See Ausness, *Preemption*, *supra* note 9, at 955-57 (discussing the economic effects of tobacco regulation on third parties).

³¹⁵ See Roger B. Dworkin, *Medical Law and Ethics in the Post-Autonomy Age*, 68 IND. L.J. 727, 727 (1993) ("To the liberal individual (that is, the typical American) it [autonomy] means the ability and opportunity to *choose* one's course of action and to *act* to effectuate one's choice."). For a discussion of the historical development of the concept of personal autonomy see Adam B. Seligman, *Individualism as Principle: Its Emergence, Institutionalization, and Contradictions*, 72 IND. L.J. 503, 514-24 (1997).

³¹⁶ David G. Owen, *The Moral Foundations of Punitive Damages*, 40 ALA. L. REV. 705, 708 (1989); *see also* John B. Attanasio, *Aggregate Autonomy, the Difference Principle, and the Calabresian Approach to Products Liability*, in PHILOSOPHICAL FOUNDATIONS, *supra* note 282, at 299-318 (maintaining that autonomy is the dominant, though not exclusive, value that shapes tort law).

autonomy by limiting information about available product choices. However, the marketing efforts of tobacco companies may also have an impact upon the personal autonomy of consumers. Thus, for example, false statements about the health effects of smoking make it impossible for consumers to make rational choices about smoking.³¹⁷ In addition, the marketing of a product known to be dangerous arguably constitutes a direct assault on the physical integrity of those consumers who are injured by smoking.

2. *Economic Considerations.*

a. Allocative Efficiency. Allocative efficiency is concerned with the distribution of resources in a way that maximizes social welfare. In our economic system, market forces play the predominant role in directing resources to their most productive uses, that is, the uses most preferred by consumers.³¹⁸ However, as Hanson and Logue point out, various conditions may impair the market's ability to allocate resources efficiently.³¹⁹ For example, accident costs will be excessive if producers fail to invest adequately in product safety.³²⁰ Accident costs may also be too high if consumers fail to take future costs into account when they make consumption decisions or if consumers externalize accident costs to others.³²¹

Hanson and Logue maintain that the market for cigarettes is inefficient because neither tobacco companies nor smokers fully internalize the social costs of smoking when they make production and consumption decisions. Accordingly, allocative efficiency would be enhanced if the legal system were to intervene to force greater internalization of those social costs.³²² We agree with much of Hanson and Logue's economic analysis, although as indicated in

³¹⁷ See Attanasio, *supra* note 316, at 317 ("Truth helps to determine the extent of actual choice. One would encounter grave difficulty formulating one's life plan without accurate information. . . . For example, one cannot assume a risk that, because of inaccurate information, one does not realize exists.").

³¹⁸ See A. Mitchell Polinsky, *Economic Analysis as a Potentially Defective Product: A Buyer's Guide to Posner's Economic Analysis of Law*, 87 HARV. L. REV. 1655, 1666-67 (1974) (discussing how an efficient market will allocate resources in accordance with consumer preferences).

³¹⁹ Hanson & Logue, *Costs*, *supra* note 6, at 1175-78.

³²⁰ *Id.* at 1177.

³²¹ *Id.* at 1176-77.

³²² *Id.*

Part III, we do have questions about whether the situation is quite as serious as they claim.

b. Loss Spreading. Another efficiency-oriented goal in this setting is to minimize the economic dislocation, known as secondary accident costs, associated with product-related injuries.³²³ Economic theory assumes that secondary accident costs can be reduced if primary accident costs are spread among a large group instead of being concentrated on individual victims.³²⁴ The declining marginal utility of money theory is one of the traditional justifications for spreading losses.³²⁵ According to this theory, as a person's wealth increases, each additional dollar provides less utility than the previous dollar.³²⁶ Therefore, overall utility is increased if the high-utility dollars lost by accident victims are replaced by lower-utility dollars provided by members of a large risk pool.

Various mechanisms may be employed to spread losses. First-party insurance is the loss-spreading device that most individuals use. This involves commercial insurers who pool together large numbers of persons to diversify risk, while at the same time segregating those persons into smaller risk pools for purposes of calculating premiums.³²⁷ These techniques allow insurance companies to calculate risk exposure accurately while providing their customers with competitive rates. Private insurers currently provide an array of insurance coverage, including health, life, disability, property damage, and liability insurance.

³²³ See CALABRESI, *supra* note 11, at 27.

³²⁴ See Stanley Ingber, *Rethinking Intangible Injuries: A Focus on Remedy*, 73 CALIF. L. REV. 772, 794 (1985) ("Spreading the impact of loss over time or among a class of individuals will decrease economic dislocation, thereby reducing secondary costs.").

³²⁵ See Guido Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L.J. 499, 517-18 (1961) (discussing social and economic justifications for loss spreading).

³²⁶ See Steven P. Croley & Jon D. Hanson, *The Nonpecuniary Costs of Accidents: Pain-and-Suffering Damages in Tort Law*, 108 HARV. L. REV. 1785, 1794 (1995) ("That principle holds that, in general, the marginal utility a person derives from her first dollar is greater than the marginal utility the person derives from her second dollar."); Herbert Hovenkamp, *Legislation, Well-Being, and Public Choice*, 57 U. CHI. L. REV. 63, 70 (1990) ("Most people believe that money is subject to declining marginal utility. That is, as a person's wealth increases, she derives less utility from each individual dollar.").

³²⁷ See George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521, 1540-45 (1987).

Government programs also serve as a mechanism for loss spreading. Some programs, such as Medicare, resemble private insurance in the sense that individuals pay for insurance protection by contributing premiums. Unlike private insurance, however, government loss-spreading programs usually charge the same premium to every participant. Other programs, such as Medicaid, are financed from general revenues rather than by premiums from members of a defined risk pool. Consequently, taxpayers, rather than insureds, ultimately bear losses that occur.³²⁸

In theory, product sellers, particularly manufacturers, can spread losses in much the same manner as employers.³²⁹ Producers can either purchase liability insurance from private insurers or they can self-insure. In either case, they can pass the cost of compensation on to their customers in the form of higher prices.³³⁰ At least in the case of producers who sell to a mass market, the incremental cost to customers is likely to be quite small.³³¹ Furthermore, it is assumed that producer liability provides cheaper and more comprehensive protection for some categories of harm to injured consumers than they could obtain by purchasing their own first-party insurance coverage.³³²

c. Administrative Efficiency. Administrative efficiency is concerned with minimizing administrative or transaction costs.³³³

³²⁸ Thus, it may be more accurate to characterize Medicaid and similar programs as wealth transfer schemes rather than as insurance arrangements.

³²⁹ See Sheila L. Birnbaum, *Unmasking the Test for Design Defect: From Negligence [to Warranty] to Strict Liability to Negligence*, 33 VAND. L. REV. 593, 596 (1980) ("The manufacturer can spread the risk through insurance and price adjustments, whereas the individual might suffer a crushing financial blow underwriting the loss himself").

³³⁰ See Page Keeton, *Products Liability—Some Observations About Allocation of Risks*, 64 MICH. L. REV. 1329, 1333 (1966) ("The assumption is that the manufacturer can shift the loss to the consumers by charging higher prices for the products.").

³³¹ See James B. Sales, *The Service-Sales Transaction: A Citadel Under Assault*, 10 ST. MARY'S L.J. 13, 16 (1978) ("Since the retailer, manufacturer and others participating in the marketing chain possess a reasonably vast marketing public, the proportionate increase in cost to the public is theoretically minimal when compared to the loss suffered by the injured consumer.").

³³² First-party insurance typically provides no coverage for pain and suffering. George L. Priest, *Can Absolute Manufacturer Liability Be Defended?*, 9 YALE J. ON REG. 237, 242-43 (1992). Such losses are, of course, fully recoverable under tort law, at least in the absence of tort reform legislation setting caps on the amount of nonpecuniary loss that can be compensated.

³³³ CALABRESI, *supra* note 11, at 225.

Administrative efficiency is not so much an end in itself as it is a factor that must be taken into account when making policy decisions.³³⁴ For example, administrative costs may completely foreclose a regulatory option when the allocative efficiency gains associated with that approach are outweighed by its administrative costs. Thus, in the absence of strong noneconomic imperatives, we would expect policymakers to reject a regulatory option that saves x dollars in accident costs if it costs $2x$ dollars to implement. Even among cost-effective options, administrative efficiency may dictate that one approach be preferred over another more costly alternative when efficiency gains are the same. Thus, if we assume that both alternative *A* and alternative *B* each save $5x$ dollars in accident costs, and if we further assume that alternative *A* costs x dollars to implement, while alternative *B* costs $2x$ dollars to implement, it would be more efficient, all other things being equal, to choose alternative *A*. Finally, considerations of administrative efficiency might influence the specific design of a particular regulatory choice. Thus, for example, in formulating regulations or designing compensation systems, policymakers may choose to simplify factfinding with respect to issues like causation or damages, which are potentially very complex in tobacco policymaking, in order to keep administrative costs within reasonable bounds. Consequently, administrative costs may limit the scope or design of particular regulatory options.

3. *Political Constraints.* Regulatory policy with respect to smoking not only gives rise to legal, economic and moral questions; it also involves hard-nosed politics. Various groups, such as those injured by exposure to cigarette smoke, public health officials, insurance companies, and Medicare and Medicaid administrators, all have a stake in securing measures to control cigarette consumption or in forcing greater internalization by smokers and manufacturers of smoking-related costs. However, other groups, at least equally powerful, such as tobacco companies, tobacco farmers, the advertising media, and firms that benefit from the sale of cigarettes, are likely to oppose such measures. Given the stakes involved and

³³⁴ LeBel, *Endgame*, *supra* note 9, at 473.

the experience of the last few decades, we can expect the debate about smoking policy to continue to be spirited and contentious.

One would hope that the political process would be able to resolve the smoking issue in a way that best promotes the public interest. Unfortunately, public choice theory and recent experiences with federal tobacco legislation suggest otherwise. Public choice theory treats legislation as a commodity that is sold by legislators to interest groups.³³⁵ According to this decidedly unromanticized view of the legislative process, legislators offer taxes, subsidies, regulations and other forms of government intervention as a means of enhancing the welfare of various groups.³³⁶ Groups with conflicting interests must then bid for the sort of legislation that best fits their needs. Payment to legislators in return for these favors may take the form of campaign contributions, political support, or other favors.³³⁷ If the market for legislation is efficient, legislation will be enacted that benefits those who derive the greatest value from it.³³⁸

Public choice theory also suggests that proposed legislation concentrating burdens or benefits within a narrow segment of the population is more likely to generate interest group activity than proposals that distribute costs or benefits more broadly.³³⁹ Thus, interest groups will bid to get legislation enacted that channels benefits in their direction and they will bid to prevent legislation from being enacted that imposes economic or regulatory burdens on them. By the same token, a "free rider" phenomenon makes it more difficult to energize interest group support for legislative proposals that diffuse burdens or benefits among a broad spectrum of the

³³⁵ One branch of public choice theory treats legislative voting as an activity in which rational behavior by individual legislators may lead to results that only a minority of citizens support. See Frank H. Easterbrook, *Statutes' Domains*, 50 U. CHI. L. REV. 533, 547-48 (1983). The other branch of public choice theory, and the one that we are concerned with, focuses on the interaction between interest groups and legislators.

³³⁶ Jonathan R. Macey, *Public Choice: The Theory of the Firm and the Theory of Market Exchange*, 74 CORNELL L. REV. 43, 46 (1988).

³³⁷ William M. Landes & Richard A. Posner, *The Independent Judiciary in an Interest-Group Perspective*, 18 J.L. & ECON. 875, 877 (1975).

³³⁸ Richard A. Posner, *Economics, Politics, and the Reading of Statutes and the Constitution*, 49 U. CHI. L. REV. 263, 265 (1982).

³³⁹ See William N. Eskridge, Jr., *Politics Without Romance: Implications of Public Choice Theory for Statutory Interpretation*, 74 VA. L. REV. 275, 286-87 (1988) (examining free rider problem and interest group formation).

population.³⁴⁰ Thus, legislation is unlikely to emerge when, because of diluted benefits, there is little organized demand for it, and when there is strong opposition to it from interest groups objecting to its concentrated costs.³⁴¹ Finally, because legislators want to maximize the benefits they receive from interest groups, when a particular legislative proposal provides both concentrated costs and benefits, legislators will often search for compromise positions in order to avoid alienating supporters with competing interests.³⁴²

Recent events suggest that the public choice model has much to tell us about the probable course of tobacco regulation. In the spring of 1998, there seemed to be a good deal of support for a legislative package based on the proposed settlement between the cigarette companies and various state officials.³⁴³ Initially, tobacco companies did not oppose the proposed statute, presumably because they felt that they could live with the regulatory provisions and pass any costs imposed by the legislation on to their customers. However, as the proposed legislation became increasingly burdensome to the tobacco industry, the industry reversed its position and began to oppose the bill.³⁴⁴ As predicted by public choice theory, the tobacco industry and other special interests then devoted considerable political and financial resources to defeat the proposed legislation.³⁴⁵ On the other hand, since the benefits of the proposed regulatory scheme were widespread and diffuse, those who would have

³⁴⁰ See DANIEL A. FARBER & PHILIP P. FRICKEY, *LAW AND PUBLIC CHOICE: A CRITICAL INTRODUCTION* 23-24 (1991) (describing the economic theory of legislation but also criticizing the narrowness of the theory's focus, particularly in its exclusion of a role for ideology).

³⁴¹ Eskridge, *supra* note 339, at 288-89.

³⁴² Macey, *supra* note 336, at 46.

³⁴³ See Tobacco Products Control Act of 1998, S. 1415, 105th Cong., originally introduced by Senator John McCain (R-Ariz.) on November 7, 1997, and subsequently approved in a modified version on April 1, 1998, by a 19-1 vote of the Senate Commerce Committee chaired by Senator McCain.

³⁴⁴ See Steven F. Goldstone, Speech to National Press Club (Apr. 8, 1998), available in LEXIS, News Library, Script File (announcement by tobacco company CEO of opposition to bill approved by Senate Commerce Committee).

³⁴⁵ See, e.g., Ceci Connolly, *Big Tobacco to Fight Legislation with Ad Blitz, Lobbying Network*, WASH. POST, April 30, 1998, at A6 (discussing industry's campaign attempting to convince viewers that legislation will lead to tax increases and black market); Melinda Henneberger, *A Big Ad Campaign Helps Stall the Bill to Reduce Smoking*, N.Y. TIMES, May 22, 1998, at A1 (discussing tobacco industry's ad campaign).

benefitted from this legislation failed to organize effectively and, thus, failed to compete for legislative favor. As a consequence, the bill ultimately failed to pass in the Senate.³⁴⁶

All of this suggests that the influence of raw politics on the legislative process cannot be ignored. In particular, public choice theory suggests that any legislative proposal to regulate smoking should avoid concentrating costs on a single group, such as the tobacco industry, especially if the benefits of the legislation are viewed as diffuse, such as reduced levels of underage smoking, and not immediate in nature.

B. A POLICY-ORIENTED PERSPECTIVE ON THE METHODS OF LEGAL INTERVENTION IN THE TOBACCO SETTING

It is sometimes said that this country is unique in its propensity to treat so many social problems as susceptible to legal solutions.³⁴⁷ If "over-legalization" is a legitimate complaint about our society, then it ought to be counted as a strength that the legal system makes available such a wide range of techniques for attacking problems.

We have earlier noted the indebtedness that participants in the policy debate over smoking-related harms owe to Hanson and Logue for, among other things, the taxonomy of regulatory approaches that they employ in *The Costs of Cigarettes*.³⁴⁸ Although we disagree with the priority they assign to ex post incentive-based responses, we acknowledge that they have sharpened the focus on the strengths and weaknesses of the different approaches.

Hanson and Logue's assessment of the different approaches takes place in the context of an economic efficiency goal. In the preceding Section, we have set out the considerations that we contend should

³⁴⁶ 144 CONG. REC. S6486 (daily ed. June 17, 1998) (recommittal of Tobacco Products Control Act of 1998, S. 1415, following unsuccessful attempts by legislative supporters of the measure to invoke cloture and cut off debate).

³⁴⁷ See, e.g., Gerald Torres, *Taking and Giving: Police Power, Public Value, and Private Right*, 26 ENVTL. L. 1, 25 (1996) ("Translation of political issues into legal issues and issues of 'rights' . . . reflects traditional American ways of confronting difficult social problems").

³⁴⁸ Hanson & Logue, *Costs*, *supra* note 6, at 1263.

be included within the construction of a tobacco policy. As a corollary to that expanded set of ends, this Section looks at the regulatory approaches to determine which of the means are particularly well-adapted to promoting those ends.³⁴⁹

For the most part, in this Section we use the same categorization that Hanson and Logue have employed in their work: command-and-control regulation, performance-based regulation, and incentive-based regulation (further divided between *ex ante* and *ex post*, as well as between victim-initiated and state-initiated). We do make two refinements of that classificatory scheme, however, to improve the understanding of how, and how well, the legal system can respond to the problems generated by smoking. First, in keeping with the concern we expressed earlier,³⁵⁰ we would draw an initial distinction between "direct regulation" and "incentive-based control." While this distinction may appear to be merely a semantic difference from Hanson and Logue, we think it captures an important ordinary language conceptualization of the ways in which a legal system can act. In essence, that division is between direct and indirect control, or from another perspective, between control that focuses on how the regulated party acts and control that focuses on the consequences of that party's action.³⁵¹ We have placed both command-and-control and performance-based approaches within the category of direct regulation. We also have retained the subcategories that Hanson and Logue set out within our category of incentive-based controls, that is, *ex ante* taxation and *ex post* liability.

The other modification that we make to the Hanson and Logue taxonomy is the addition of a third subcategory within incentive-based controls. Both of the Hanson and Logue subcategories employ incentives in a negative way, by requiring the regulated party to pay *ex ante* or *ex post* a sum of money to the state or to the victims of its

³⁴⁹ For an analysis of legal intervention that focuses more closely on dealing with the economic effects of smoking, see Ausness, *Paying*, *supra* note 9.

³⁵⁰ See *supra* note 103 (noting that term "regulatory" should be understood to include private causes of action as well as governmental intervention).

³⁵¹ See also Lawrence Lessig, *The New Chicago School*, 27 J. LEG. STUD. 661, 671 (1998) (explaining that law regulates directly when "it tells individuals how they ought to behave and it threatens a punishment if they deviate from that directed behavior"; it regulates indirectly when it "changes the constraints of" another structure, such as the market, citing taxes on cigarettes as an illustration).

activity. A more complete view of the options for legal regulation of tobacco would bring the notion of positive incentives into the mix, and we do so here, using "subsidies" as this third type of incentive-based control.

1. *Direct Regulation.* Shifting the focus from how direct regulation cannot achieve perfect efficiency to how it enables other policy considerations to be addressed will establish a more positive view of the importance of this regulatory technique within an overall tobacco policy. Perhaps the greatest strength of direct regulation is its ability to respond quickly when the direction of reform is known and agreed upon. Hanson and Logue are unquestionably correct when they note the improbability of a regulatory agency being able to construct accurate supply and demand curves for all possible circumstances within a particular market,³⁵² but the ability to predict market behavior under various conditions is not necessarily the appropriate question to ask. Reasonable policymaking on a subject that is both as controversial and as subject to uncertainty as tobacco can legitimately proceed from an identification of the *direction* of desired change, even while conceding uncertainty about the precise *magnitude* of the change that is needed.

Direct regulation is also the most effective method of implementing basic value judgments that a society has made about an activity. When there is widespread agreement, for example, that the next generation of youth should be protected from exploitation, direct regulation of the behavior of the potential exploiters and of the victims can be used to promote the goal of intergenerational justice.

The mandate of direct regulation can lower the risk of frustration of societal goals, by taking out of the hands of the regulated party at least some of the options that would interfere with those goals. The effectiveness of incentive-based regulation by definition depends on the parties' behavior responding to the incentive. Economic analysis of incentives recognizes that in many instances a party's behavior can remain the same, even though it would now be more costly.³⁵³

³⁵² Hanson & Logue, *Costs*, *supra* note 6, at 1264-65.

³⁵³ See, e.g., Richard A. Posner, *A Theory of Negligence*, 1 J. LEGAL STUD. 29, 33 (1972) ("When the cost of accidents is less than the cost of prevention, a rational profit-maximizing enterprise will pay tort judgments to the accident victims rather than incur the larger cost of avoiding liability.").

To refer again to the youth smoking context, when the decision has been made to reduce the incidence of smoking by young people, direct regulation in the form of restrictions on sale and possession, or as performance standards that must be met, can serve as benchmarks against which to measure and react to the behavior of the regulated parties. Enforcement of marketing restrictions or sanctions for nonattainment can keep the focus on the behavior itself, rather than on the indirect gains attributable to the operation of market forces through a pricing mechanism that may or may not be effective.³⁵⁴ When securing the change in behavior is deemed to be more important than allowing the autonomy to choose between modifying the behavior or paying the higher cost resulting from application of the incentive, direct regulation can be a more effective form of governmental intervention.

Another significant positive feature of direct regulation is the administrative efficiency advantage it can have over other forms of legal intervention. Regulations can be comparatively inexpensive for government to adopt and enforce when they are uniform, imposed at the source of the problem, and restrict the need for the exercise of discretion, as they could be in the tobacco context. Regulations that call for less interpretation of their applicability and scope can also lower the investment that the regulated parties have to make in planning their behavior.

Retributive considerations can be addressed by direct regulation in the form of sanctions for violations. In some circumstances, the retribution may occur in the form of financial penalties paid by a corporate entity. In others, the responsibility may be affixed to individuals whose misconduct was particularly egregious, and may open the door not only to personal financial obligations but to penalties in the form of loss of liberty as well.

Retributive concerns have two dimensions—punishment and protection from punishment. In addition to providing notice that deviations will be punished, direct regulation can serve as a method of creating and reinforcing a sense of security that certain behavior will not be subject to retribution. Unsettling expectations can have

³⁵⁴ See, e.g., Hanson & Logue, *Costs*, *supra* note 6, at 1332-33 (suggesting that even the fine that could be imposed under the proposed tobacco settlement of 1997 for nonattainment of youth smoking reduction goals was far too low to induce compliance).

dramatic effects on the economy. Regulations that mandate particular behavior can also be enacted so that they create safe harbors within which activity can proceed without fear of a subsequent determination that the behavior will be found wrongful and a sanction imposed.³⁵⁵

2. Incentive-Based Controls.

a. *Ex Ante Taxation.* Ex ante taxation is the lowest cost method of forcing manufacturers and consumers to internalize costs associated with a product. As long as the goal is the realistic one of greater social cost internalization, rather than the idealized goal of perfect cost internalization, levying an excise tax promotes allocative efficiency without requiring administrative expenses that cut deeply into that efficiency gain.

Ex ante taxation allows the legal system to impose a portion of the social costs of a product at the point in the distribution process where it is thought to be most effective. If, for example, a legislature concluded that a tax increase would be most effective if it were reflected in the price that consumers pay, it could impose the tax at the retail level, rather than at the production level where manufacturers may blunt its force by dispersing it throughout the enterprise. In addition, ex ante taxation assures that the costs will be spread across the industry in proportion to whatever unit of taxation is chosen.³⁵⁶ In contrast to ex post liability, the cost internalization effect of ex ante taxation does not depend on the fortuity of potential claimants coming forward.

Ex ante taxation is also an effective way of creating a funding source for future projects.³⁵⁷ The stream of revenue is fairly predictable, allowing for greater confidence in the investment in an administrative structure to accomplish particular ends. More than

³⁵⁵ See, e.g., N.J. STAT. ANN. § 2A:58c-5c (West 1998) (prohibiting award of punitive damages under some circumstances where product is regulated by Food and Drug Administration).

³⁵⁶ See, e.g., 26 U.S.C. § 4131 (establishing the rate of taxation used to finance the compensation fund under the National Childhood Vaccine Injury Act.).

³⁵⁷ Each of us has written in more detail about the benefits of using excise taxes to finance solutions to particular problems. See PAULA A. LEBEL, JOHN BARLEYCORN MUST PAY: COMPENSATING THE VICTIMS OF DRINKING DRIVERS 225-338 (1992) (alcohol-related automobile accidents); Ausness, *Paying*, *supra* note 9, at 568-75 (tobacco); LeBel, *End-game*, *supra* note 9, at 483-93 (tobacco).

any other regulatory technique, *ex ante* taxation serves as a method of linking payments by manufacturers and consumers to particular public policy targets. The revenues generated by the tax can be earmarked for projects that directly address the consequences of the product's use, attempting to reduce the incidence of harm in the future as well as to spread the costs of those consequences over a population segment that is more closely identified with the production of the harm.³⁵⁸

b. Ex Post Liability. Hanson and Logue distinguish between *ex post* liability schemes that are state-initiated and those that are initiated by the victims of the activity on which liability is being imposed.³⁵⁹ The policy considerations that are beneficially addressed by *ex post* liability can be different depending on which type of initiation of the liability process is permitted.

State-initiated liability schemes can eliminate a layer of administrative expense by taking some litigation costs out of the liability process and by meeting some other costs in ways that are likely to be less expensive than victim-initiated systems. For example, administrative costs can be lower for state initiated liability programs in which liability is established for broad classes of victims or harms, without a need for individual victims to come forward. Furthermore, even if individual identification is part of a compensation program that is funded by an *ex post* imposition of liability, state initiation of the determination of liability can achieve economies of scale in the establishment of the obligation to pay, leaving the distribution of payments to victims to an administrative claims process that can be streamlined to reduce the costly step of individualized fact determinations, to minimize delay, and to lower the need for claimants to secure private representation.

Corrective justice concerns can be met directly by state-initiated *ex post* liability if one were to view the victim as the state that is initiating the claim. That notion of the state-as-victim is the basis for Medicaid third-party subrogation provisions that are written into

³⁵⁸ See, e.g., MASS. GEN. LAWS ANN. ch. 64C, § 7(C) (West 1996) (Health Care Protection Fund to finance health programs related to smoking, financed by additional excise tax on cigarettes).

³⁵⁹ Hanson & Logue, *Costs*, *supra* note 6, at 1263.

federal and state law with coverage that extends well beyond the cigarette context.³⁶⁰ In addition, corrective justice concerns can be met more indirectly if the funds recovered in the liability process are used for the benefit of those who have been victimized by the activity being held liable. In this situation, the state would be seen as the surrogate for those who have been harmed.

A similar sort of corrective justice consideration could be addressed by ex post state-initiated liability if the harm is seen as some social cost that is widely distributed across the population and is higher for each individual than it would be if it were more concentrated on those responsible for creating the costs. If the taxes necessary to support Medicaid, for example, could be reduced because smoking-related health care costs were being recovered from the tobacco industry, then the overpayment of those taxes by nonsmokers would be corrected by the liability scheme.

Victim-initiated ex post liability is the most direct method of promoting a corrective justice goal. The underlying premise is that the wrongdoer pays a specific victim for the harm caused to that victim. In a sense, this liability method is corrective justice on a retail basis, as opposed to the wholesale corrective justice of state-initiated ex post liability or ex ante taxation. At the same time, retributive justice considerations can also be addressed by incorporating some punitive element into the payments that are ordered after liability has been established and the level of culpability has been determined to rise to the appropriate level.

c. Subsidies. Subsidies can be effective techniques for promoting public policy objectives directly. Subsidies can work in two distinct ways. First, they could influence particular behavior in a way that is less intrusive than direct regulation. Second, they could be employed to reduce the hardship associated with certain government actions. For example, a legislature could offer tax reductions to firms that meet policy goals or whose conduct contributes to some identified social good. That example illustrates

³⁶⁰ See, e.g., FLA. STAT. ch. 409.910(7)(B)(1) (1990 & 1996 Supp.) (providing for reimbursement of State expenses). Although the Florida version of the Medicaid third-party liability statute is not on its face limited to tobacco, it has received that narrowing construction by executive order of the governor. Symposium, *supra* note 301, at 739 (transcript of remarks by Governor Lawton Chiles).

how a policy justification could have been developed for the tax break that was a widely criticized and ultimately repealed component of the Congressional effort to implement the 1997 settlement.³⁶¹ We are not saying that this particular tax credit was justified; indeed, the secrecy with which it was enacted raises questions about its legitimacy. The point is that subsidies can play an important role as incentives for parties to cooperate in the development and implementation of a policy that serves the overall public good.

When legitimate social ends are accurately seen as being in tension, subsidies can be used to reduce the harm suffered by those whose interests are adversely affected in order to promote the greater overall good. If a tobacco policy were to lead to a shrinking of the tobacco industry, subsidies would be an important part of the effort to minimize the economic dislocation associated with that contraction.

V. JUSTICE AND TOBACCO POLICY: TRANSLATING THEORY INTO PRACTICE

In Part IV, we offered a “fresh start” for tobacco policymaking by identifying the policy considerations that must be taken into account in any realistic attempt to confront the health-related harms associated with smoking, and by assessing the capability of different methods of regulation to address those considerations. We are now in a position to demonstrate the operation of our justice-centered approach to tobacco policy.

That approach begins with a translation of the policy considerations that were identified in Part IV.B. into a series of justice claims derived from those considerations. Section A describes the major claims that could be asserted in the context of developing a tobacco policy. In Section B, we use those justice claims as the basis for justifying a number of components of a comprehensive tobacco

³⁶¹ Congress enacted a \$50 billion tax credit for the tobacco industry in the summer of 1997, but following intense criticism, the credit was repealed by the Senate on September 10 and by the House of Representatives a week later. Ceci Connolly & John E. Yang, *Like Senate, House Votes to Repeal \$50 Billion Tax Break for Tobacco Firms*, WASH. POST, Sept. 18, 1997, at A7.

policy. The description of those components illustrates the methodology that we set out in Part IV.A.: justice claims are identified, the feasibility of enforcing those claims in particular ways is determined after looking at economic considerations and political constraints, and the most effective techniques for legal intervention are called into play.

At the outset of this exercise, we offer this disclaimer: This Article has had two significant goals. The first has been to question the appropriateness of analyzing tobacco policy from a predominantly economic perspective. We have used the work of Hanson and Logue as the vehicle for raising this issue, viewing their work as the most important of the recent economic analyses of the legal system's treatment of tobacco-related problems.

A second goal is to describe an approach that we believe to be more appropriate for dealing with the complexity and the controversy that surround tobacco policymaking. We do not pretend that our description of that approach is fully fleshed out. The two Sections of this Part will provide a view of the framework of the analytical approach we propose and will illustrate the type of policy justifications that can be constructed using that framework. Considerable work is required for any approach, ours included, to be successful in integrating all of the facets and implications of the current state of affairs into a tobacco policy that is comprehensive, coherent, and principled. Our hope is that the model we set out here offers a useful avenue for arriving at such a policy objective.

A. JUSTICE CLAIMS IN THE TOBACCO SETTING

The initial step in the construction of a policymaking approach that is centered around justice concerns is an identification of the parties who can legitimately assert a justice-based claim.³⁶² When the policymaking context revolves around the adverse consequences of smoking, the roster of those with a call on our attention includes smokers, nonsmokers, the tobacco industry (which we further separate into the cigarette manufacturers themselves and other

³⁶² In some instances, as will be seen below, the formulation of the inquiry focuses on those for whom claims can be asserted.

tobacco-related enterprises, such as growers and distributors), those in the next generations who will assume some of the burden and be exposed to some of the risk of those adverse consequences, and citizens of foreign nations.

1. *Claims on Behalf of Smokers.* Personal autonomy considerations lie at the heart of the justice claims that can be asserted by smokers. Consumption of cigarettes is a hazardous activity, but that characterization is certainly not unique to smoking. A good deal of modern life is risky, even foolishly harmful to one's self when viewed objectively, but nevertheless considered to be within the province of individual choice. Within limits defined by the rights of others, smokers should be entitled to choose to experience the different levels of pleasure associated with smoking.³⁶³ Consequently, autonomy concerns militate against an outright ban on the production and distribution of tobacco products.

However, the autonomy of the smoker to decide what risks to encounter to gain pleasure is diminished by factors that make the decision to smoke less informed than it otherwise might be. Informed choice is hindered most directly by industry conduct that distorts the appreciation of the health risks of smoking. An autonomy-centered claim by smokers would demand protection against such industry practices as misrepresentations about the health effects of cigarettes, concealment of the results of tobacco-related health research, and efforts to interfere with the operation of normal scientific and medical research processes.

Even if the stream of information is not blocked by the practices that should be prohibited, the exercise of choice by the smoker can be affected by other practices. Included within this category are industry measures directed at the consumer and at the product. For choice to be free, consumers need to be protected from predatory marketing practices by the industry. The most significant aspect of this protection relates to efforts to attract those who are below the age at which smoking is legal, and that issue is addressed below³⁶⁴ as part of the intergenerational justice concerns. Although underage smokers are the most apparent victims of predatory marketing

³⁶³ Those pleasures are described in ROBERT KLEIN, *CIGARETTES ARE SUBLIME* (1993).

³⁶⁴ See *infra* Part V.A.4.

practices, the legitimacy of the decisions made by adult smokers could also be affected by marketing techniques that undermine the information about the risks and benefits of smoking. Sophisticated advertising campaigns that make subtle claims about a lifestyle enhancement attributable to smoking are one example of this sort of practice.³⁶⁵ Consumer-oriented practices that would be prohibited by concern for a smoker's autonomy also include public relations efforts outside of the direct advertising context, such as the continued assertion of scientifically unreasonable claims.

Industry practices in product design can also be considered predatory when they interfere with the decisionmaking process of an informed consumer. Enhancing the addictive properties of cigarettes constitutes the clearest example of this sort of practice. Although addictiveness may be a property of cigarettes that is inseparable from the pleasure of smoking, in the same sense that an intoxicating effect is an inherent part of the pleasure of consumption of alcohol, consumer autonomy requires that, at the very least, the magnitude of the addictiveness should not be manipulated without clear communication to the smoker of the greater risk that is being encountered.

The addictive nature of cigarettes raises another autonomy concern. The range of decisions open to a consumer includes not only whether to begin smoking and how much to smoke, but also whether to discontinue smoking. Industry conduct that contributes to a lack of appreciation of the dimension of the difficulty that addictiveness lends to that decision would be implicated by this concern. Furthermore, insofar as addiction is a consequence of a deliberate choice by the tobacco industry to maintain consumer demand levels, corrective justice notions support a claim by smokers that the industry contribute to efforts to counteract the addictive effects of cigarettes. The entire burden of such efforts would not shift to the industry, however, because smokers themselves bear

³⁶⁵ The restriction of advertising and promotional speech that does not constitute fraudulent or misleading communication poses serious constitutional and sociological questions. For an insightful consideration of those questions, see generally R. GEORGE WRIGHT, *SELLING WORDS: FREE SPEECH IN A COMMERCIAL CULTURE* 78-107 (1997).

some of the responsibility for undertaking the behavior that realistically must have been known to be difficult to cease.

Individual responsibility is the corollary to personal autonomy, and its impact for tobacco policymaking extends well beyond the addiction context. After decades of widely disseminated information that smoking is hazardous to health, it is simply implausible to entertain justice claims from smokers if those claims ignore the substantial responsibility that smokers themselves bear for the adverse health effects of their decisions. Nevertheless, it is just as implausible to believe that the decisions of smokers have been unaffected by the decades of deception, manipulation, and concealment on the part of the tobacco industry. When both aspects of this situation are taken into account, the result is that smokers have a legitimate corrective justice claim arising out of the ill health suffered from consumption of cigarettes, but that claim is weakened by the individual responsibility for the behavior that exposes them to the risk of disease.

In theory, one could hope for some finely calibrated scale of justice that would produce a measurement of the extent to which the corrective justice claims by smokers were actually offset by their own responsibility for proceeding with an ill-informed but nevertheless not totally uninformed course of conduct. In practice, of course, policy decisions are necessarily less precise and admittedly fall short of perfect justice. At the very least, however, even a rough judgment about the corrective justice calculus for the health consequences of smoking leads to a conclusion that recovery by individual smokers of the costs of their tobacco-related disease should be viewed with considerable skepticism, if not rejected altogether.

Rejecting liability to individual smokers as part of a tobacco policy can be supported on efficiency grounds as well. Liability claims ultimately result in a shifting of costs among smokers, i.e., from the smokers who pay the higher price for cigarettes to those smokers who are successful in their actions to recover damages. Administrative efficiency considerations suggest that first-party insurers are a better vehicle for effectuating that sort of transfer, particularly if the insurance industry responds to incentives to perform greater segregation of smokers in the insurance ratemaking process.

Even though corrective justice principles may not, on balance, lead to a policy of awarding smokers compensation for the harm they suffer from cigarettes, retributive justice considerations come into play when a decades-long history of industry lies and cover-ups has contributed to the public health situation in which we find ourselves. Smokers, as well as others, could have their retributive justice interests vindicated by a sanction imposed on the industry. Fines are the most obvious way of punishing the industry, and the industry could be required to make a suitably large payment as one component of a comprehensive tobacco policy.³⁶⁶

Safety concerns play a significant role in tobacco policymaking. Smokers have an interest in not suffering needlessly in order to obtain the pleasure they seek from smoking. On that ground, and heavily reinforced by allocative efficiency principles, tobacco companies could be required by command-and-control or performance-based regulation to reduce the adverse health effects associated with smoking to the maximum feasible extent.

2. *Claims on Behalf of Nonsmokers.* Nonsmokers can be impacted by the costs of cigarettes in a variety of ways. When considering the justice claims that might be asserted on their behalf, it is useful to distinguish among the different roles that nonsmokers might occupy in relation to tobacco. The four principal roles are those of taxpayers, insureds, family members and close friends of smokers who suffer tobacco-related disease or death, and persons exposed to smoke and other harmful effects of cigarette consumption by others.

As taxpayers, nonsmokers have a legal responsibility to provide revenue for social programs to deal with the consequences of smoking, even though they do not experience the pleasures associated with smoking. The Medicaid third-party liability claims at the heart of the state attorneys general actions against the tobacco industry are an indirect form of assertion of a claim of this sort on behalf of taxpayers.

When the interests of nonsmoker taxpayers themselves are considered, as opposed to the notion of the state as victim, the first

³⁶⁶ Apparently the 1997 settlement agreement set this figure at \$60 billion. MOLLENKAMP ET AL., *supra* note 278, at 220.

instinct may be to characterize the justice claim as one of corrective justice: tobacco companies and smokers cause financial harm to nonsmokers whose share of the fiscal responsibility is higher than it otherwise would be. On reflection, however, it appears that claims of this sort could also rest on distributive justice grounds. Operating on distributive justice principles, responsibility for causation of the harm would be matched with an obligation to support the programs that are needed to deal with the harm. Administrative efficiency provides one rationale for basing this obligation on distributive rather than corrective justice grounds. Categories of smoking-related costs can be aggregated and shifted to the tobacco industry without a need for the more precise moral calculus that corrective justice could require. Former smokers, for example, would present an issue under corrective justice—how much of the smoking-related cost is attributable to their smoking—that can be avoided under a distributive justice scheme that used the tobacco industry as a vehicle for distributing those costs.

A similar claim can be made on behalf of nonsmokers who pay insurance premiums for coverage that extends to the losses suffered by smokers. Rather than spreading the costs of smoking over insurance pools that include people who do not contribute to the causation of those costs, distributive justice principles could support a demand that the tobacco industry be required to pay for those costs in a more direct fashion. Administrative efficiency might suggest that payment to health care providers themselves would be a superior method of vindicating this interest,³⁶⁷ although as a practical matter, the payments may need to be channeled to public and private insurers as intermediaries. With the industry assuming some of the responsibility for paying the health care costs of smoking, the effect here, as with taxpayers, is to reduce the amount of those costs that would have to be spread over the population of nonsmokers.

Family members and close friends of smokers who become ill or die because of cigarette consumption could raise a corrective justice claim against the industry whose egregious conduct over the last four or five decades has expanded the scope of the problem. This

³⁶⁷ Ausness, *Paying*, *supra* note 9, at 573.

claim is similar to the corrective justice claim of smokers themselves, but because in this instance it is asserted by those who are morally blameless with regard to the decision to smoke, it may be entitled to somewhat greater recognition on an individual basis. While smokers are generally excluded from compensation under the principles developed under our approach, nonsmokers could be given some nominal participation in the proceeds of a monetary sanction imposed on the industry, perhaps in the form of a modest death benefit to a surviving spouse or dependent child.³⁶⁸

The remaining role in which nonsmokers can be affected by the consumption of cigarettes is as passive victims of the harms caused by smokers to others. The adverse health effects of environmental tobacco smoke would clearly fall into this category, as would the prenatal harm experienced by children of smokers. Collateral damage from smoking-related fires constitute another form of loss that can be inflicted on nonsmokers. Corrective justice may be the most appropriate foundation for claims of this sort, with a demand that those responsible for the harm—smokers and the industry itself—compensate for the harm suffered by the nonsmokers. Here, as with other justice claims, administrative efficiency considerations may affect the manner in which this interest is vindicated, but the claim itself is one of the strongest demands that justice can make for individual compensation.

3. *Claims on Behalf of the Tobacco Industry.* The temptation to demonize the tobacco industry is strong, but sound public policy-making requires that its interests be taken into account as well. Incorporating those interests within the same analytical framework that is used to acknowledge claims of other constituencies can avoid the extremes of assigning no merit to the claims that arise from the industry, on the one hand, or of resigning oneself to the political influence that such a wealthy industry can purchase.

The economic actors who are involved in some way in the production and marketing of cigarettes occupy a number of different roles. While their differences call for somewhat different approaches, the central claim that can be asserted on behalf of all of them is to ease the transition from a state of affairs in which they

³⁶⁸ LeBel, *Endgame*, *supra* note 9, at 492-93.

were subjected to virtually no legal responsibility for the harm caused by tobacco products to a new regime in which that responsibility is substantial. The regulatory technique that lends itself most readily to accommodating these transitional claims is the subsidy.

A useful distinction can be drawn among the agricultural, the manufacturing, and the distribution aspects of the tobacco industry. Tobacco growers and those whose livelihood revolves around providing goods and services to this agricultural segment have legitimate claims that the serious social problems associated with tobacco consumption should not be solved in a way that results in a disproportionate impact on them.

Just as loss spreading concerns lead to measures to distribute the financial consequences of personal injury across a broad spectrum of the population, so too can subsidies serve a similar distributive function for the economic dislocation attendant upon a shift in the public attitude toward and the legal regulation of tobacco. The subsidies could take various forms. Farming as a way of life is central to the image of this country, and those who engage in it deserve some support. If land on which tobacco is now being grown would not be as profitable if diverted to other agricultural uses, then sound social policy could indicate the application of subsidies to those other crops. In a sense, then, the price support structure would shift from tobacco to alternative crops. People who chose to leave farming altogether could be supported in employment training and relocation. Impact payments could be made to communities that suffer serious economic loss as a result of implementation of a new tobacco policy, in much the same way that the federal government provides payments to local communities around military bases to offset the increased demands for services as a result of the military presence.³⁶⁹

The manufacturers of cigarettes are arguably in a more ambiguous moral position than tobacco growers. The wrongful conduct on the part of the firms within the tobacco industry creates justice claims of other parties and at the same time weakens the claims that might be asserted on behalf of the industry. The minimum claims that could be raised by the industry include the right to face

³⁶⁹ See 20 U.S.C. §§ 7701-7714 (1994).

punishment that is proportional to the offense and the right not to be punished for offenses that were not authoritatively declared to be wrongful at the time of commission. Stating these claims in the abstract is one thing; translating them into concrete determinations of the magnitude of the wrong is a good deal more difficult. At the least, sanctions that threaten the economic viability of the industry need to be approached with the same level of awareness and deliberation that would be used if similarly serious sanctions were considered for an individual.

If a comprehensive tobacco policymaking process results in a continued presence of cigarettes on the market, the industry would have additional assertions that it could make. A legal product properly made is entitled to be distributed in ways that do not unreasonably interfere with the operation of the industry or the satisfaction of consumer demand. Consideration of the justice claims on behalf of smokers identified constraints on advertising and public relations efforts by the industry, but outside of those constraints, the industry should be able to present its product to the public in ways that are comparable to other legal, but risky, products or activities.

If a tobacco policy were to be adopted in a responsible way and with widespread support, the industry would also be entitled to rely on compliance with the terms of that policy as protection from future sanctions being imposed. While this reliance would operate in the form of a "safe harbor" for regulatory compliance,³⁷⁰ the basic thrust of the claim extends beyond specific government mandates. The essence of this claim is that a comprehensive public policy adopted in a responsible way creates, in effect, a new social compact with respect to tobacco. The terms of a policy of that sort are entitled to considerably greater respect in the future than could reasonably be claimed for any of the particular elements of a legal regime that has developed as haphazardly and as irresponsibly as the one that currently exists for tobacco.

³⁷⁰ See Richard C. Ausness, *The Case for a "Strong" Regulatory Compliance Defense*, 55 MD. L. REV. 1210, 1213 (1996) (taking position that compliance with certain federal safety standards should protect sellers from liability).

Should legal intervention in the tobacco industry result in downsizing, then people who are employed in the industry or who depend on the industry should receive the same relief from economic dislocation that was described earlier for agricultural workers. Subsidies for job retraining, relocation, and easing the impact on local communities are as necessary in this context as they are in the agricultural context, however much the farm setting may be distinguished by being viewed through the lens of romance and national myth.

4. *Claims on Behalf of Future Generations.* The obligations of intergenerational justice can run in two directions. The clearest example of the recognition of such an obligation from younger to older generations in this country is Social Security.³⁷¹ In the tobacco setting, the obligation to future generations is likely to be a more significant matter. Justice claims on behalf of future generations can be seen as arising from near term and from longer term perspectives. The distinguishing characteristic of claims of this sort is their demand that present action must offer protection for the interests of those who are not yet part of the public policymaking process. Gains and losses for current players are not the only elements that enter the moral calculus. Justice requires that the position of those who are to follow must be given respect.

In the near term, the focus of intergenerational justice is on young people who are below the age at which fully informed and responsible decisions are likely to be made about the use of tobacco products. At its most fundamental level, this claim asserts that the members of the next generation of adults must not be seen as objects of pure economic exploitation. The current industry practice of cultivating "replacement smokers" from those who are young enough to be impressionable and who are also more likely to become addicted violates that demand. To meet the minimum requirements of justice in this regard, the tobacco industry would have to postpone the initial lure for use of its products until the targets reach an age

³⁷¹ See Gary S. Becker & Kevin W. Murphy, *The Family and The State*, 31 J.L. & ECON. 1, 9 (1988) (characterizing Social Security as part of a social compact between generations); Robert B. Reich, *Whatever Happened to the American Social Compact?*, 50 ME. L. REV. 1, 4 (1998) (identifying social insurance, including Social Security, as an integral component of this country's social compact).

at which the decision would be more rational and informed. Society at large, through its governmental institutions, has a comparable responsibility to establish and enforce meaningful and effective protective measures for young people.

The long term intergenerational justice claims in the tobacco setting demand that the social, economic, and political issues be dealt with responsibly and in a timely fashion. Simply blundering along in a manner that is responsive only to the strongest and most immediate stimulus fails to satisfy the entitlements of generations as yet unborn. The duty of those in positions of responsibility today is to take steps to assure that the problems that can be addressed in the short term are not put off, and that long term solutions are put into place to the maximum extent feasible.

5. *Claims on Behalf of Citizens of Foreign Countries.* A common characterization of the agreement that was reached by the tobacco industry and the attorneys general of a majority of the states in the summer of 1997 described that ultimately fruitless venture as a "global" settlement. That characterization displays the same hubris that is found in labeling the contest to decide supremacy among thirty baseball teams from this country and Canada as the "World" Series. In the tobacco setting, however, the misnomer may too easily serve as a way of papering over a very serious issue of international justice.

Citizens of other countries are arguably entitled not to be exploited in ways that would not be tolerated for our own citizens.³⁷² The readiness with which the major tobacco firms approached the settlement that had a price tag of more than \$367 billion over twenty-five years may be viewed as Hanson and Logue and others have done, that is, as indicating that the industry is so profitable and the sting of the settlement is so minimal that little good is being accomplished by going forward along that path.³⁷³ Another,

³⁷² In effect, we would interject into the policy arena an international corrective justice element, as a counterpart to the international distributive justice idea raised by others. See, e.g., David A.J. Richards, *International Distributive Justice*, in NOMOS XXIV, *supra* note 236, at 275 (applying distributive justice principles to relations between states).

³⁷³ See Hanson & Logue, *Costs*, *supra* note 6, at 1345-49 (assessing proposed settlement).

somewhat more sinister, explanation sees the national tobacco policy as a relatively insignificant part of the future marketing strategies of the multinational tobacco industry. Any restrictions on sales and profits domestically can, in this view, be more than offset by the enormous potential of markets that are only now opening up to the leading firms of the industry.³⁷⁴

Unless the citizens of foreign nations are explicitly deemed to be entitled to less protection and respect than our own citizens, international justice concerns require that their interests be reflected in any policy that is developed in this country. We would not go so far as to say that all aspects of a tobacco policy should apply equally inside and outside the borders of this country. Our focus is more prohibitive than integrative: the demand is that foreign citizens not be more exploited than our own citizens, rather than that the full range of rights afforded to our citizens be open to citizens of other countries. Accordingly, the financial components of the policy would not be available on an international basis, but any feature of a tobacco policy that places demands on the industry with regard to the design and manufacture, the information conveyed, and the marketing of cigarettes needs to be as applicable to foreign sales as they are to the domestic market.

B. COMPONENTS OF A JUSTICE-CENTERED TOBACCO POLICY: ILLUSTRATING THE NEW APPROACH

The last portion of our examination of the legal system's intervention in the tobacco industry brings together the policy considerations and the justice claims in specific policy proposals to employ the various regulatory techniques in a comprehensive integrated multifaceted tobacco policy. The discussions within the preceding Section and in Part IV anticipate the items that we would include within a tobacco policy. At the same time, we would extend to this part of our exercise the disclaimer that we are illustrating an analytical model rather than pretending to have worked out all the details of the policy that meets the goals we have identified.

³⁷⁴ See KLUGER, *supra* note 89, at 709-22 (describing efforts by tobacco companies to enter foreign markets and United States government support of those efforts).

The components of a tobacco policy can be divided into financial, liability, marketing, and safety categories. For each of these categories, we set out the principal measures that are called for by our examination of the elements of a justice-based approach.

1. *Financial Components.* The central feature of a tobacco policy developed along the lines we have pursued is a higher tax on cigarettes with the revenue raised by that tax being devoted to specific tobacco-related projects. This tax would be levied *ex ante* at the source of production of cigarettes. The revenue collected in this way would be spent on health care, on smoking cessation and avoidance programs, and on subsidies to minimize the economic dislocation following the adoption of a tobacco policy that reduces the level of consumption of cigarettes.

The most important of the uses of the increased tax revenue is the payment of some of the costs of treating tobacco-related illness. To lower administrative costs, we would have these payments made directly from the revenue collection agency to the health care financing agency of the state and perhaps to private insurers of health care expenses, distributed proportionally to the representation of smokers within the relevant population. As a result of this transfer of funds, the expenditure of other public and private funds for health care costs would be lower than they otherwise would be.³⁷⁵ Nonsmokers would thus be subjected to less of a direct economic burden of caring for smokers.

The distributive effect of this component of the tobacco policy could be enhanced in a number of ways. Private insurers could, for example, be required to segregate current smokers and former smokers with a medically significant history of smoking from nonsmokers as a condition for receipt of payments from the tax revenue generated in this fashion. As an additional incentive not to smoke, insurance premiums for the nonsmoking population could be reduced at a greater rate than the premiums that smokers pay. In

³⁷⁵ It should be noted that this does not necessarily mean that taxes to support public programs and premiums for health insurance would fall from their current levels. The best that may be expected would be a decrease in the rate of growth. Yet, in a period of rapidly increasing health care cost projections, even that decrease in cost would have a positive effect on the economy.

both instances, the effect would be to shift more of the financial burden of health care from nonsmokers to smokers.

The revenue from this increased tax on cigarettes supports the two other major financial components of the policy. Funds collected in this way would be used to support programs to encourage people not to begin smoking and to stop smoking if they have already begun. To be used most effectively, the funds for this element of the policy should support research as well as operational programs. Because the industry plays such an important role in the national economy, and regionally may be even more critical, the tax payments would also be used to fund measures to ease the effects of a decline in the size of the industry. Those measures would include worker retraining and relocation, farm subsidies for alternative crops, and research efforts to identify profitable alternative uses of the agricultural resources currently devoted to tobacco.

The relative share of the revenue spent on the different components of the policy would need to be adjusted over time to reflect changes that occur in the tobacco environment. Initially, smoking avoidance and cessation programs would receive significant funding, with less spent on impact payments. As the effect of those programs and the higher price begins to be felt, the need for easing the impact of industry downsizing would become more pressing, leading to more spending on that component. These two components can be seen as occupying a reciprocal relationship. As fewer people smoke, the need for impact payments increases; similarly, as the industry shrinks, the anti-smoking campaigns would require less of an investment.

Tobacco proposals that impose prohibitive taxes or that subject the industry to massive liability have a built-in flaw that limits their effectiveness: the beneficial uses of the funds raised in taxes or collected as damages are threatened as the financial viability of the industry becomes more perilous. If former smokers are going to be compensated at levels that bankrupt the industry, then the source of funding for other aspects of reform will disappear.

An advantage of our policy approach is that it assumes that the industry will continue to function, but in a manner by which it internalizes more of its costs than under the current legal regime. The increased taxes required under our approach would be expected

to have a depressing effect on marginal demand, which admittedly would mean that the future revenue stream would be lowered. That lower demand indicates, however, that the future social costs of cigarettes are going to be lower. Overall, as the various components of the policy operate to shrink the percentage of the population that smokes, the harmful effects of smoking would diminish as well. A decline in the revenue collected from cigarettes would therefore be a sign of the success of the policy.

2. Liability Components. Our approach gives little weight to the claims of smokers to be compensated for the harm they have suffered as a result of cigarette consumption. Instead, our focus for the financial aspects of the policymaking process is on requiring the tobacco industry to shoulder a portion of the financial responsibility for the health care costs related to smoking. Accordingly, the tobacco policy developed in the manner we propose would include an immunity provision protecting the industry from liability to smokers for personal injury caused by smoking.

Nonsmokers are concededly less complicit in the harms they suffer. In particular, nonsmokers who are injured as a result of environmental tobacco smoke have a stronger moral claim to be compensated for that harm. The legal basis for such a recovery is, however, still relatively undeveloped. Our approach to this aspect of tobacco liability would be to extend the retroactive immunity described above so that it encompasses past claims for ETS harm. Responsibility for the costs of treating these harms would be partially shifted to the industry under the health care payment feature of the financial component of our policy.

Prospective liability for harm to nonsmokers may be a useful adjunct to the financial component, increasing the incentive for the industry to take steps to reduce the incidence of this harm. In this instance, the range of options available to the industry include modifying the product design so that fewer harms occur, raising the price of the product so that liability costs are covered, or encouraging third parties (such as managers of workplaces and public places) to take steps to reduce the level of exposure to the harmful effects of smoking. The legal intervention of ex post liability would therefore be brought into play in this limited arena where the

benefits of using the approach are identifiable and the potential detriment is fairly limited.

No tobacco policymaking enterprise can proceed without an acknowledgment of the wrongful conduct of the industry over many, many years. Our approach would include elements that address this conduct, without undermining the retroactive immunity from individual claims.

First, the industry would be required to pay a substantial sum of money specifically designated as a punitive measure for its long history of misconduct. To assure that any such punishment remains within the realm of just treatment of the industry, it will be important for it to be linked specifically to conduct, such as fraud, that was wrong, and known to be wrong, at the time the conduct occurred.³⁷⁶

Second, noncompliance with any of the provisions of the new comprehensive tobacco policy would subject the offenders to significant fines, set at a level that exceeded the financial gain to the offender by some multiple high enough to act as a substantial deterrent.³⁷⁷

3. *Marketing Components.* The two previous components of our approach to developing a tobacco policy have concentrated on ex ante taxation and ex post liability payments. In addition to the economic incentives and disincentives those components provide, our approach would make significant use of direct regulatory techniques. A major target of that regulation would be the marketing practices of the tobacco industry.

The first element of this policy component would be informational. In addition to the current warnings on cigarettes, more effective

³⁷⁶ The idea that there is an important distinction between a moral wrong and conduct that was illegal at the time of action has been articulated by Jeremy Bentham in terms that could be applicable to the tobacco industry in recent years. Bentham noted the importance of "defining an offence, and giving a clear and precise idea of it. For example, *hard-heartedness*, ingratitude, *perfidy*, and other vices which the popular sanction punishes, cannot come under the power of the law, unless they are defined as exactly as theft, homicide, or *perjury*." JEREMY BENTHAM, *THE PRINCIPLES OF LEGISLATION*, in *THEORY OF LEGISLATION* 1, 60-61 (Richard Hildreth trans., 1950) (emphasis added).

³⁷⁷ We would address in this way the concern expressed by Hanson and Logue that portions of the 1997 settlement agreement could profitably be ignored by the industry. See, e.g., Hanson & Logue, *Costs*, *supra* note 6, at 1332-34 (discussing underage smoking targets).

means of informing the public about the risks of smoking would be required. The hallmark of any regulation adopted as part of this effort must be effectiveness. The history of the tobacco industry creates an understandable air of skepticism about measures that result in unintended consequences.³⁷⁸ Research and monitoring would be essential aspects of this regulatory approach.

Restrictions on permissible targets of marketing campaigns would be the second essential element of this policy component. Age restrictions on sale and possession would be maintained and would be required to be enforced in meaningful ways. Advertising and public relations efforts would have to be conducted in ways that do not undermine the policy decision to postpone the allowable onset of smoking to an age when the decisions that are made about tobacco use are less likely to be as peer-oriented and impressionable.

4. *Safety Components.* Economic incentives will, under optimal circumstances, lead indirectly to greater safety, but direct regulation also has an important role to play in this component of a tobacco policy. As an initial matter, tobacco products need to be regulated to identify and eliminate harmful additives and contaminants that pose a risk independent of the "normal" carcinogenicity, addictiveness, and cardiopulmonary effects of cigarettes. Disclosure of contents to regulators is an important part of this regulatory effort, but the only way to assure the integrity of the products distributed to consumers is to inspect them and certify their safety.³⁷⁹

The promise of a perfectly safe cigarette may be more illusory than real. A product that has none of the risks of cigarettes as currently designed may lack so many of the features that make smoking pleasurable that it is no longer a cigarette in any meaningful sense. Requiring the elimination of all risk is, therefore, not a plausible part of a tobacco policy—it is instead the central element of a prohibitionist program. That being said, however, it is undoubt-

³⁷⁸ See, e.g., KLUGER, *supra* note 89, at 377 (noting that a ban on broadcast advertising of cigarettes and corollary lifting of an anti-smoking public service advertising requirement led to increase in tobacco sales).

³⁷⁹ The 1997 settlement agreement provided for disclosure of non-tobacco ingredients to the FDA, which was given responsibility to evaluate the safety of those ingredients, but the inspection requirement was concentrated on records rather than on the cigarettes themselves. See MOLLENKAMP ET AL., *supra* note 278, at 280-82 (describing the provisions of Title I, § F of the settlement agreement).

edly true that cigarettes currently possess excessive risk that could be wrung out of the product through design modifications that do not substantially diminish the smoking experience. Research into such changes needs to be encouraged, as does the implementation of desirable safety modifications. In an illustration of the symbiotic relationship among the components of a tobacco policy, the taxation under the financial component could vary according to the risk posed by the different product designs.³⁸⁰ Over time, one would expect a differential tax rate to provide an incentive for research and development and an increased market share for cigarettes that are less dangerous.

VI. CONCLUSION

Hanson and Logue have identified a number of serious market failures with respect to the sale of cigarettes. These include information inadequacies, cognitive limitations, insurance externalities and noninsurance externalities.³⁸¹ According to Hanson and Logue, consumers underestimate the costs of smoking because they lack accurate information about the addictive nature and long-term health consequences of smoking.³⁸² Moreover, even when such information is available, smokers are frequently unable to process it properly.³⁸³ In addition, smokers are often able to externalize smoking-related costs to nonsmokers. For example, private insurers seldom distinguish between smokers and nonsmokers when they set premium rates even though smokers file more claims.³⁸⁴ Smokers also externalize costs of ETS to nonsmokers.³⁸⁵ Finally, according to Hanson and Logue, smokers externalize costs from their present to their future selves.³⁸⁶

Hanson and Logue find that these market failures cause cigarette manufacturers to spend too little on safety and also cause smokers

³⁸⁰ See Evans & Farrelly, *supra* note 238, at 594 (stating that tax based on tar and nicotine content is more appropriate public health policy instrument than uniform tax).

³⁸¹ See generally Hanson & Logue, *Costs*, *supra* note 6, at 1181-1263.

³⁸² *Id.* at 1181-1223.

³⁸³ *Id.* at 1186-88.

³⁸⁴ *Id.* at 1224-29.

³⁸⁵ *Id.* at 1229-32.

³⁸⁶ *Id.* at 1240-41.

to overconsume cigarettes.³⁸⁷ Furthermore, they conclude the market for cigarettes is so inefficient that government intervention is warranted.³⁸⁸ However, Hanson and Logue reject such conventional responses as command-and-control regulations, performance-based standards, and *ex ante* incentive-based regulations.³⁸⁹ Instead, they propose a number of *ex post* incentive-based victim-initiated regulatory initiatives. One approach would hold tobacco companies strictly liable in tort for the adverse health consequences of smoking.³⁹⁰ The other would establish a smokers' compensation program under which injured parties could submit claims to an administrative tribunal.³⁹¹

While acknowledging the value of Hanson and Logue's work, we disagree with their normative perspective. Hanson and Logue's approach depicts the smoking issue in predominantly economic terms. Their solution is to correct the particular market failures involved, by raising the price of cigarettes, so that cigarette consumption will eventually settle at an optimal level. This perspective, while valid, is incomplete because it largely ignores the moral aspects of the problem.

We have taken a different path. First of all, we have assumed that moral issues are more important than economics, at least as far as tobacco policymaking is concerned. Consequently, our analysis began with an enumeration of the moral principles that must be taken into account in any comprehensive governmental response to the problem of smoking and health. These moral principles included corrective justice, retributive justice, distributive justice and personal autonomy. We then identified various groups who might make justice-based claims to protection or compensation. These included smokers, nonsmokers, various constituents of the tobacco industry, future generations, and citizens of foreign countries. We then illustrated how to base specific elements of a policy proposal for governmental action on those claims.

³⁸⁷ *Id.* at 1175-77.

³⁸⁸ *Id.* at 1263.

³⁸⁹ *Id.* at 1264-73.

³⁹⁰ *Id.* at 1282-83.

³⁹¹ *Id.* at 1283-96. *See generally* Hanson et al., *Blueprint*, *supra* note 7 (proposing smokers compensation scheme).

Our approach includes financial, liability, marketing, and safety components. The centerpiece of a policy developed under our approach is an excise tax levied on cigarette producers. The revenue raised by this tax would help to pay for health care research, consumer education, treatment of the health effects of smoking, and reduction of any economic dislocation caused by contraction of the tobacco industry. We would provide immunity from tort liability for the tobacco industry, but we would provide for civil or criminal liability for past actions that were clearly criminal or fraudulent at the time they were done. Our proposal would also vigorously regulate the marketing practices of the tobacco industry, particularly as they relate to underage consumers. Finally, our proposal would provide statutory authority for the federal government to impose reasonable safety goals on the tobacco industry.

Our approach would not eliminate cigarettes from the scene, nor would it ensure that they would be completely safe. It would ensure, however, that smokers paid for more of the social costs of smoking, and it would probably increase the costs of cigarettes sufficiently to reduce existing demand somewhat. In addition to promoting these instrumental objectives, our approach would also assure that the tobacco policymaking process will reflect our nation's commitment to a number of important moral values, lending greater legitimacy and stability to a policy so developed.