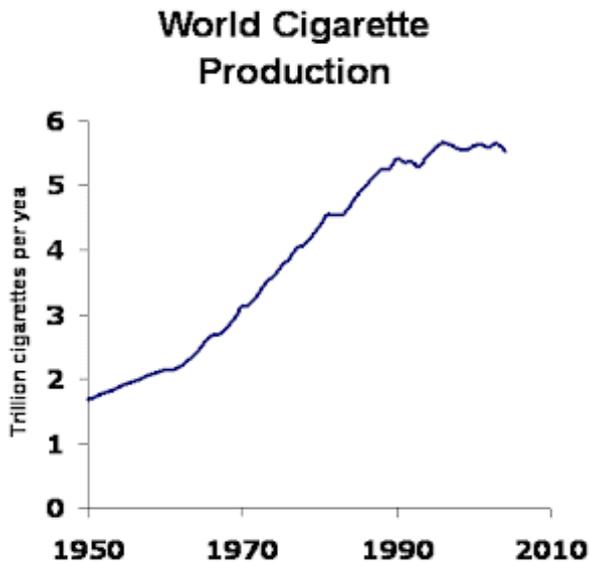


Cap and trade for cigarettes



If a country wanted to reduce tobacco use to a level that meant it was comparable with other public health risks, then why not simply reduce the amount that can be sold or number of customers they can have, by allocating quotas to manufacturers and allowing trade in quotas? This proposal has surfaced in the US as a legislative proposal: [Help End Addiction to Lethal Tobacco Habits Act](#) (geddit?) [[full text](#)] by Senator Enzi. This is partly in response to the pointless industry-

sponsored [Family Smoking Protection and Tobacco Control Act](#) , which mystifyingly also attracts support from big US public health campaigns. I think they have vested misplaced faith in regulation and regulatory bureaucracies. The Enzi approach is an alternative and the idea also has people talking in the public health world [[article in New Zealand Herald](#) and [here](#)]. But does it make sense? I'm not so sure... here are a few tentative thoughts (and I'd welcome responses from those promoting the idea)...

1. What does cap and trade add compared to increasing taxation on tobacco? Both systems tend to raise prices and bring supply and demand into line. Taxes, however, have the great benefit that the premium paid flows to the government, rather than the tobacco company (unless the quotas are auctioned, which I would recommend as an amendment to the Enzi Bill, in which case the premium flows to the government, but adds a lot of complexity).

2. The 'allocation programme' is cumbersome. Based on historic market share, Enzi's proposal grants important rights (effectively access to market) to incumbents. Again it could be improved by auctioning quotas, but adds nothing to cigarette taxes. The Enzi proposal actually makes the *number of users* the regulated quantity... but given the great heterogeneity in what makes a user and how much this changes over time, this is a really poor idea for a regulatory base.

3. Control of price volatility will dominate quota setting. This is a major problem with cap and trade systems (and we are suffering from this in the EU Emission Trading Scheme)... Whilst it is possible to set, quotas as Senator Enzi does, that give a desired outcome with certainty, in practice politicians are not indifferent to price hikes in widely used products. The result will be a fudge on quota setting that effectively guarantees that the price volatility is manageable. An economist's view is one thing, but these ideas have to be seen in terms of *political economy*.

4. Physiology. Smokers control their nicotine dose from smoking and, within limits, can get their fix from fewer cigarettes. This effect is already seen with poorer smokers, who will often smoke fewer cigarettes but achieve a higher blood-nicotine level by smoking more intensively. This is an issue for taxation of course, but proponents should remember that there isn't a linear relationship between a quota (whether number of sticks or number of users) and health impact.

5. Gaming. With complex regulation and definitions, there always comes the scope for innovative gaming. And you would surely expect that here. If the quota is users, can some new product be designed that takes them out of the user definition? Can users be encouraged to lie to surveys? If the quota is measured in product terms, can longer cigarettes be introduced?

6. Scope of responsibility. It's generally a good principle of regulation to give organisations duties or targets only for things they have control over. Tobacco companies don't control the number of users, they are just one influence - health care support for quitting, taxation, public health advertising, smoke-free policies, marketing restrictions are all more important. They can control the quantity of product they sell and its price.

7. Legal constraints. The slightest sign that the allocation regime disadvantages importers or foreign brands, then a challenge at the WTO would be expected. In fact, it would happen just to get in the way. Anti-trust law or other consumer protection principles might be expected to be deployed by those disadvantaged in the market carve up. What would happen when people wished to bring in cigarettes they'd bought overseas?

8. Distraction. This could tie up administrators in knots and expend valuable

political capital to little purpose. I think there is only a limited role for supply-side interventions in reducing harm from tobacco. these are primarily by:

- raising the price through taxation that keeps pace with growth in incomes, and so reduces affordability of tobacco use over time;
- differentiating the tax rates according to the harm. I strongly support a much lower tax rate for smokeless tobacco products and no tax differentiation between smoked products (eg. by tar or nicotine yield) as there is no real health difference between smoking products, whatever you've been led to believe about 'lights' etc.
- giving meaningful information to tobacco users about relative risk of products - again, especially about the vast difference in risk between smoking and smokeless tobacco.

More important are the measures designed to act on the demand side - smoke-free policies, advertising bans, support for quitting, counter-advertising being the most effective.

9. Finally, an advantage. Where taxation is a dirty word and political non-starter cap and trade systems can have much the same economic effect (raising the price at the margin) but may be more easily implemented than a tax. Something similar happened with the [US Master Settlement Agreement](#) in which State Attorneys general sued the companies for health care costs, won \$250 billion settlement, causing the companies to raise prices by 40-50 US cents to pay for it. Not far off taxation, but a lot of lawyers got rich too. I think lawyers would do well from a cap and trade system too... and that's never a good sign.

Of course... I very much doubt Senator Enzi's proposal will go anywhere, but always worth discussing innovative ideas.