

Meddlesome preferences and rent extraction: the tobacco shakedown

Tobacco has become an arena of civil warfare throughout the Western world over the past half-century or so. This war has been fueled by an ideological rhetoric that speaks of the costs that smokers place on nonsmokers (Office of Technology Assessment (1985)(1993)). The state claims to wage the war to protect innocent nonsmokers from predatory attacks by smokers. This claim has now been thoroughly refuted, starting with Tollison and Wagner (1988), as extended in Tollison and Wagner (1992). Whereas Tollison and Wagner argue that those costs are borne wholly by smokers, such authors as Manning et al. (1989), Gravelle and Zimmerman (1994), and Viscusi (1997) argue that there are some modest costs shifted onto nonsmokers, but that those costs are significantly less than the excise taxes that are currently imposed on cigarettes. As a result, smokers do not impose costs on nonsmokers but rather subsidize nonsmokers. Yet the war on tobacco continues, and in a big way. What the continuation of the war perhaps illustrates is the interaction between meddlesome preferences and rent extraction.

A social democracy with the large government it entails carries within itself tendencies to transform tolerant preferences into meddlesome preferences (Buchanan 1986). A market economy supports tolerance across different preferences within a society, a collective economy does not. If health care is organized through private property within a market economy, people are responsible for the costs of their health care. People who engage in risky occupations, dangerous leisure time activities, or unhealthy lifestyles would bear

the medical costs associated with those personal choices. If people who ride motorcycles incur higher medical costs on average than people who do not, they will bear the higher costs. If people who smoke incur higher medical costs, they will bear those costs. The provision of medical care within the framework offered by the principles of property and contract does nothing to undermine support for the liberal principle of mutual toleration over preferences.

As health care comes increasingly to be financed collectively, however, tolerance over personal choices can give way to intolerance, due to the shifts in political and personal incentives that collectivization creates. The actuarial evidence shows that people who smoke have lower average life expectancies than nonsmokers, though there are many smokers who lead long lives and nonsmokers who die early. Insurance within a market economy charges different prices to people in different risk categories that reflect the different costs of providing service (McCormick, Tollison, and Wagner (1997)).

It is different with collective provision and its replacement of market pricing with tax financing or state-regulated pricing. People who make relatively low use of a service form a natural interest group, whose members have interests that are opposed to those who might make relatively high use. What was a matter of a simple toleration of different choices of lifestyles under market arrangements becomes a matter of political interest and activity. In the presence of collective provision, the costs of activities that entail above-average costs will be shifted partially onto those whose activities entail below-average costs. The transfer of medical care from a market-based to a collective-based mode of organization

generates pressures for a similar transfer of control regarding a variety of other personal choices. Activities that have expected costs of health care that are higher than average become of concern to people who dislike those activities, because they now are paying for some of the costs associated with those activities. Toleration recedes as collective provision replaces market provision, as tolerant preferences are transformed into meddlesome preferences.

The state necessarily becomes a battleground for the adjudication of disputes over personal lifestyles. When economic activity is organized according to the principles of property and contract, a society can tolerate peacefully a variety of such lifestyles because those who conduct more costly patterns of life pay for them. But once the market principle of personal responsibility is abridged for some principle of collective responsibility, interest groups are automatically established that will bring personal lifestyles onto the political agenda, which in turn generates opportunities for rent extraction.

A huge literature on rent seeking has been inspired by Gordon Tullock's (1967) seminal articulation. Fred McChesney (1997) advances rent extraction as a closely related cousin to rent seeking. Rent seeking and rent extraction are to politics what bribery and extortion are to ordinary people. For ordinary people, these kinds of activity are wrong. But in politics they are business as usual. Rent seeking describes what people have in mind by lobbying. It refers to the payments people make to secure political favors. A sports magnate would like special tax treatment for a stadium he is building. He lobbies to get this enacted. Or, more likely, hires someone to do this for him. In this regard, it is noteworthy

that few defeated or retired legislators return to their home districts. Most of them stay in Washington, where their value as lobbyists is high.

But rent seeking is only part of the story of money and politics, and perhaps only the smaller part. Rent extraction may be even more significant. It refers to the payments people make to avoid being victimized by politically harmful measures. If rent seeking would be called bribery if it occurred between private persons, rent extraction would be called extortion. McChensey (p. 2) uses Citicorp as an example of how corporations react to political rent extraction. "The nation's largest banking company employs eight registered lobbyists in its Washington office. In addition, six law firms represent Citicorp's interests on Capitol Hill. No one should judge this strike force ineffective by how little banking legislation gets through: The lobbyists spend most of their time blocking and blunting changes that could hurt Citicorp's extensive credit-card operations, student-loan business or ever-broadening financial-service offerings."

McChesney notes that rent extraction by politicians is similar to the practice of "mud farming" that William Faulkner described in *The Reivers*. Late at night, farmers would plough up portions of the dirt roads in front of their houses, and then soak the roads. The cars that passed by during the day would get stuck in the mud. The drivers faced a choice. They could abandon their cars. Or they could pay the farmers to hitch up their mules and pull out the stuck cars-- for a price, of course.

There is one vital difference between rent seeking and rent extraction that should not be ignored, and which may explain why the former has received more

attention than the latter. With rent seeking, politicians are portrayed as relatively passive victims. They are deluged by lobbyists, and on occasion capitulate to them. The politician is caught in a squeeze between the intensity of special interests and the quietude of the public interest.

With rent extraction, however, politicians are in the forefront of the action. They are the active initiators who continually look for targets. Those targets, like the drivers who came across the mud farmers, have a choice. They can ignore the politicians and lose a lot of their wealth. Or they can participate politically, thereby softening their losses.

Not all rent extraction must be produced politically. Rent extraction can be farmed out, much as with the tax farming of old. A practice called tax farming has been traced back at least 4000 years to ancient Mesopotamia (Webber and Wildavsky 1986). Real farmers raise food from their land. Tax farmers raised revenue from the people who inhabited the lands of some ruler. It is only natural that a practice that has been employed in so many places over 4000 years would show many differences in the particular details by which it operated.

The central idea of tax farming, however, was the same everywhere. A ruler wanted to extract revenue from his subjects, and hired someone to do the extraction. Typically a tax farmer would be awarded a monopoly to harvest taxes from a particular area. In many cases a ruler would assign a revenue quota to the tax farmer. A tax farmer who failed to deliver his quota of revenue would be liable for the shortage.

Tax farmers were generally wealthy men who became even wealthier through tax farming. The ruler's chief concern was to get his desired revenue. If the tax farmer failed to extract sufficient revenue from the people, the ruler could collect the shortage from the tax farmer himself. A ruler would not want to hire a tax farmer who was poor because only a wealthy tax farmer could assure satisfaction of the ruler's appetite for revenue.

While tax farmers were liable for shortages, tax farming was generally a profitable business. Whatever wealth a tax farmer started with, he could generally add to it nicely through tax farming. Tax farmers who extracted revenues beyond their quotas could keep the difference. Such a tax farmer would not invoke a ruler's wrath so long as he raised sufficient revenue for the ruler. From time to time rulers would use such devices as soliciting bids for the right to be a tax farmer, in an effort to increase their share of the tax farmer's harvest.

Tax farming has been widely regarded as a practice of autocracy and not of democracy, for in democracy taxation is the province of the legislature. Despite this common presumption, it would seem as though a form of tax farming has erupted recently in the United States. It takes the form of lawyers filing class action suits, where the results of those suits replace what otherwise would have required legislation to accomplish. The tobacco settlement is a recent case in point (Wagner 1999). The major tobacco companies settled a suit with all state governments throughout the land for \$246 billion. The revenues are already accruing to the states, and are being used for a wide variety of purposes from A to Z.

The lawyers in this case are modern-day tax farmers. They have used the tobacco companies as a vehicle for collecting taxes on smokers. Instead of state legislatures roughly doubling their tobacco taxes, the lawyers collected the taxes themselves through the tobacco settlement. What makes the analogy with tax farming complete is that the lawyer-tax farmers were able to keep many billions of dollars for themselves. The majority of the revenue collected by the tax farmers of old went to the rulers. It is the same for our new form of tax farming.

The tobacco settlement is not the first case of modern tax farming and other cases are now in process. Before tobacco, there was asbestos. Since tobacco, there is gun manufacturing (Levy, in press). What exists in these cases is a form of tax farming, only the farmers wear suits and work mostly in offices. They find people from whom to extract revenue, and typically focus on the easiest and most lucrative targets, which are those targets whose pockets are thought to be the deepest. The new tax farmers keep a good chunk of the revenue they collect for themselves. The remainder goes to politically favored purposes in one form or another. The tobacco litigation involved the state attorneys general in hiring private law firms, and with many of those firms making contributions to political campaigns on behalf of their sponsors.

The recent settlement between the major tobacco companies and the American states illustrates modern tax farming at work. The states could have legislated tax increases on cigarettes, as they have often done. Perhaps influenced by a political calculus that forecast strong opposition to tax increases, they supported suits instead. They farmed out tax collection to law firms rather

than resorting to legislation. Meddlesome preferences that were generated in a context of rational ignorance and Paretian non-logical conduct (Pareto 1935), made this shakedown appear to most people to be not a disguised form of tax but rather justice at work. Most legislators are lawyers, and the growth of democratic tax farming may well strengthen the commingling of law and politics.

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