

Addiction as a market failure: using rational addiction results to justify tobacco regulation

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Abstract

Tobacco regulation efforts have been criticized by some academic economists for failing to provide adequate welfare-analytic justification. This paper attempts to address these criticisms. Unlike previous research that has discussed second-hand smoke and health care financing externalities, this paper develops the logic for identifying the much larger market failures attributable to the failure of smokers to fully internalize the costs of their addictive behavior. The focus is on teen addiction as a form of “intrapersonal” externality and observed adult consumption behavior consistent with partial myopia. The importance of peer effects, in the consideration of welfare impacts, is also emphasized. © 2000 Elsevier Science B.V. All rights reserved.

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1. Introduction

Most governments of developed nations, including those of the United States, Canada, France, Iceland, Finland, Norway, Portugal, Nine Eastern European countries, Sweden, Singapore, Italy, New Zealand, Australia, Japan, and South Africa, have initiated programs of tobacco control (Wyckham, 1997). These

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programs typically involve excise taxes aimed at demand reduction, restrictions on advertising, label warnings, access restrictions, etc. Tobacco control is clearly an important, worldwide public policy mission. At the same time, however, there has been an active line of economic research arguing against most tobacco control efforts. These economic arguments, based on the principles of consumer sovereignty, assert that tobacco control initiatives are inefficient and reduce the public welfare. Notable authors in this literature are Viscusi (e.g., Viscusi, 1991, 1994) and Tollison and Wagner (e.g., Tollison and Wagner, 1988, 1992). How can this state of affairs be reconciled?

Traditional analyses of the benefits and costs of tobacco regulation have focused on two primary externalities: (1) financial externalities of added health care cost burdens that smokers may impose on nonsmokers, and (2) environmental externalities of impacts that passive smoking and accidental fires may impose on nonsmokers. Many commentators in the tobacco control debate, however, see these externalities as relatively small. Regarding the burden that smokers may impose on the public through excess public health care costs, see for example, the estimates of Manning et al. (1991) and the conceptual discussion of Warner et al. (1995). Regarding the externality of second-hand smoking, see for example, the reviews by EPA (1992) and Gravelle and Zimmerman (1994).

The focus of this paper is on a third form of market failure — one that provides an alternative approach for the welfare-analytics of tobacco regulation. Since it concerns the costs that smokers fail to internalize and subsequently impose on themselves, this market failure can be thought of as an intrapersonal or addiction externality. As emphasized by many authors (see, for example, Schelling, 1986), by far the largest societal costs of smoking are the costs that smoking imposes on smokers themselves.¹ The innovation of this paper is to illustrate how a substantial portion of these costs, amounts sufficient to explain the broad interest in regulatory interventions, can be argued to result from market failure.

To develop this logic, this paper uses three fundamental arguments. The first and most well known has to do with age of consent and the externality that juvenile smokers impose on their future adult selves. To the extent that we as a society do not accept the revealed preferences of children as being indicative of their welfare and we believe that those under the age of consent should not smoke, then we believe that youth smoking represents a market failure. Furthermore, and this is the focus of the argument, to the extent that this youth smoking is addictive, it influences adult behavior and imposes an intrapersonal externality on adult welfare.

The second and perhaps more innovative argument involves the possibility of adult irrationality in cigarette consumption. Although the structure of the modeling approach makes precise estimation difficult, empirical results from the rational

¹ See Manning et al. (1991, Chapter 4), for an estimation and comparison of these costs.

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