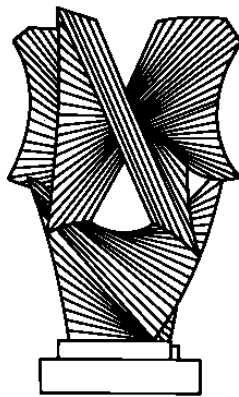


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The Nanny Corporation and the Market for Paternalism

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The Nanny Corporation and the Market for Paternalism

M. Todd Henderson

“Men want to putter around their homes;
Mr. Pullman insisted on doing the puttering himself.”¹

INTRODUCTION

In 2004, Michigan-based Weyco Inc. told employees who smoked that they had 15 months to quit, and when four employees refused to submit to a breath test, the firm fired them.² The logic behind Weyco’s decision is simple—firms bear some of the costs of individuals smoking (including higher health insurance costs, lower productivity, increased absenteeism, etc.) and therefore have an incentive to reduce these costs. Or, looking at it another way, employees who smoke raise the costs for the other stakeholders in the corporation: other employees pay higher insurance premiums or accept lower wages than they otherwise would, shareholders see lower returns, creditors are at increased risk, and so on. In economic terms, the firm is forcing employees to internalize the negative externalities they impose on other claimants of firm value. Weyco’s chief executive summarized this rationale nicely: “I pay the bills around here. So I’m going to set the expectations.”³

Weyco is not alone. Numerous other firms are increasingly setting standards for employee conduct (beyond prescribing illegal conduct) that interfere with what seemed in the past to be private decisions, since they were made in places or at times (for example, at home) that were beyond the reach of employer monitoring and even law. Some firms even go so far as to send inspectors to employee homes to check compliance of employees and their families with firm-specified health and behavior guidelines. All of these paternalistic actions are motivated by firm desires to reduce costs, mostly health care costs, for which employers are bearing an increasingly large burden.

Several academic accounts of corporate nannyism exist,⁴ but in analyzing these programs piecemeal and from a rights-based approach⁵ (viewing corporate

¹Ida M. Tarbell describing the paternalism of George Pullman in his eponymous company town, Pullman, Illinois, quoted in John S. Garner, *Introduction*, in JOHN S. GARNER, ED., *THE COMPANY TOWN: ARCHITECTURE AND SOCIETY IN THE EARLY INDUSTRIAL AGE* 7 (1992).

²Marisa Schultz et al., “Workers fume as firms ban smoking at home,” *Detroit News*, Jan. 27, 2005, available at <http://www.detnews.com/2005/business/0501/27/A01-71823.htm>.

³Interview with Morley Safer on 60 Minutes (?), transcript available at <http://www.thetechzone.com/forums/showthread.php?referrerid=8876&threadid=86321>.

⁴See, for example, Karen Chadwick, *Is Leisure-Time Smoking a Valid Employment Consideration*, 70 ALB. L. REV. 117 (2006); Terry Dworkin, *It's My Life - Leave Me Alone: Off the Job Employee Associational Privacy Rights*, 35 AM. BUS. L.J. 47 (1997); Lewis Maltby and Bernard Dushman, *Whose Life Is It Anyway -- Employer Control of Off-Duty Behavior*, 13 ST. LOUIS U. PUB. L. REV. 645 (1994);

efforts as intrusive and negative), they miss the most important aspect of the rise of corporate nannyism. Firms don't act paternalistically because the managers of the firm want to do so but rather because employees and owners of the firm demand that they do. Individuals in common pools—employees in firms, shareholders in firms, individuals in insurance plans, and citizens in a jurisdiction—want the managers of those common pools to act paternalistically toward other individuals, because this lowers the costs of being in the pool. Firms are simply responding to this demand.

Contrary to the rights-based accounts, paternalism by firms is generally not premised on malice, invidious discrimination, or exploitation of unequal bargaining power between managers and employees. It is, in fact, inevitable in cases where third parties bear some costs of others' behavior. For example, the current health care model puts most of the costs on third parties, namely firms and the government, so we should expect each of these types of organizations to provide paternalism to reduce these costs. So if firms see increased health care costs or labor costs (through lower productivity) as a result of employee smoking, they will rationally try to reduce smoking by employees, say by not employing smokers or charging smokers sufficiently to offset the costs they are imposing on others within the firm (be they shareholders or other employees).

Seeing paternalism as a natural consequence of our current welfare system (either corporate or statist) allows us to recast the debate about paternalism. In effect, firms and the government are both providers of nanny rules in what we might call the "market for paternalism." Both providers in this market offer nanny rules in response to demand for them from individuals in common pools, be they political jurisdictions, firms, or insurance pools. These individuals, who pay more (or accept less) than they otherwise would, demand rules to force fellow employees or citizens to bear their own costs to avoid compelled cross-subsidies of costly behavior. The government can satisfy this demand with statutes proscribing certain behaviors, providing information to attempt voluntary changes in behavior, or imposing taxes to force cost bearing. Firms can do all of these things too, although they may have slightly different names. Accordingly, we can think of the government and firms competing in a sense to deliver paternalism, which is demanded by individuals. Politicians compete to offer these

Ann Rives, *You're Not the Boss of Me: A Call for Federal Lifestyle Discrimination Legislation*, 74 *GEO. WASH. L. REV.* 553 (2006); Christopher Valleau, *If You're Smoking You're Fired: How Tobacco Could Be Dangerous to More Than Your Health*, 10 *DePaul J. Health Care L.* 457 (2007); Marvin Hill & Emily Delacenseri, *Procrustean Beds and Draconian Choices: Lifestyle Regulations and Officious Intermeddlers - Bosses, Workers, Courts and Labor Arbitrators*, 57 *MO. L. REV.* 51 (1992); MARVIN HILL AND JAMES WRIGHT: *EMPLOYEE LIFESTYLE AND OFF-DUTY CONDUCT REGULATION* (1993).

⁵ See http://www.nytimes.com/2005/02/08/business/_08smoking.html?_r=2&oref=slogin (quoting Lewis Maltby, president of the National Workrights Institute: "Once you cross the line and allow employers to control any type of behavior that's not related to job performance, there's no limit to the harm that can and will be done.").

rules to be reelected, to get campaign contributions, and to maximize their utility, whatever it is. Managers do the same, but, given the constraints of the markets in which they operate, are generally directed to acting in ways that align their interests (making money) with those of shareholders.

This positive account of nannyism is a necessary (but currently missing) foundation for the normative analysis other scholars engage in on this subject. We cannot answer the normative question of whether firms should be engaging in nannyism without knowing why they are doing it. The positive account consists of five parts, which track the outline of this paper.

First, the economic case for nannyism, which will tell us the reason firms are increasingly engaging in this type of employee regulation. The answer is the elimination of cross-subsidies and the forced internalization of externalities imposed on fellow members of common pools.

Second, the history of corporate nannyism, which will tell us how these rules are deployed in practice, and whether they are used for good or bad reasons, and whether they are checked by market forces. The key takeaway from this brief history is that corporate nannies act predominately in cases in which employee conduct increases firm costs, and that labor markets provide a strong check on firm overreaching. This was true even when labor markets were much less liquid than today and worked best when nanny rules were linked directly with reducing bottom-line costs.

Third, the advantages of corporate nannyism compared with state nannyism, which will tell us whether we should, in the marginal case, prefer nanny rules from state or corporate actors. There are reasons to believe corporate nannies are superior to their state analogs in some cases. For instance, corporate policies are subjected to more instantaneous feedback from labor markets, which reduces overreaching but also helps solve information problems in ways likely to reduce the sum of decision and error costs. This section also shows that there is no theory under which the state or firm will always be superior at imposing nanny limitations on behavior.

Fourth, the regulatory environment for using nanny rules. The government is not only a provider of nanny rules, but it also regulates firms in providing these rules. This regulation has the potential to distort efficient outcomes unless it is premised on legitimate advantages of states in providing paternalism. This section shows how many existing court cases, statutes, and rules stand in the way of an efficient market for paternalism.

And, finally, the normative questions about whether corporate nannyism is socially beneficial and suggestions for policy responses. On the normative issues, thinkers from John Stuart Mill to Milton Friedman assert that the state has no business interfering in private decisions, like whether to eat trans fats, bungee jump, or smoke. Friedman famously wrote: "I don't think the state has

any more right to tell me what to put in my mouth than it has to tell me what can come out of my mouth.”⁶ This paper puts these issues largely to one side, since the premise of these objections assumes that others aren’t bearing costs from what is going in Friedman’s mouth. In a world with social paying, there is inevitably paternalism. In light of this, the relevant question is only whether we should favor one nanny over another, which is just another way of asking how the market for paternalism should be regulated.

In terms of policy, the argument that there exists a market for paternalism and that firms have potential advantages in its efficient delivery bears not only on the wisdom of the existing regulations that may distort the market, but also on the current debate about eliminating employer financed health care. Although moving away from this model to either an individual model or a national model has virtues and vices, one benefit not yet considered is the potential that a more liberalized role for firms in the market for paternalism would have on reducing costly behaviors like smoking or overeating.

I. THE THEORY OF NANNYISM

Nannies exist because some individuals are viewed as incapable of making good decisions or fending for themselves. The classic example is an adult, like Mary Poppins, acting *in loco parentis*. Presumably there have been nannies in this role for all of human times. “Nannyism,” however, describes a seemingly more modern phenomenon in which political entities—pejoratively, the “nanny state”—prohibit certain types of behavior, such as riding a motorcycle without a helmet, eating trans fats, or talking on a cell phone while driving. The nanny state “began in earnest with seat-belt regulations and compulsory helmet wearing in the 1980s.”⁷ States are not alone in acting this way, which is what this paper is about.

The nanny’s belief that individuals are disabled, and thus the motivation of the nanny, could be benign or self-serving. Some nannies will be motivated by a genuine desire to help the individual or to force an individual to internalize the costs of their behavior, while some will be motivated by a desire to impose their own idiosyncratic preferences on others. In reality, most cases will involve some mix of these two motives, as the ability to distinguish between these two categories may be imperfect for even the most self-less nannies. Let us consider each of them.

⁶Interview Rob Kampia of the Marijuana Policy Project, Nov. 2006, available at: <http://www.youtube.com/watch?v=rMJ3eX4BwTA..>

⁷DAVID HARSANYI, THE NANNY STATE at 13.

A. “Good” Nannies

There are several reasons why an individual might not objectively be able to make good decisions: incapacity (as in the case of infants or the mentally infirm), lack of information, insufficient processing skills, or a disconnect between reaping the benefits of an action and paying its costs.⁸ Most of these are unobjectionable and not really “nannyism,” as it is defined in this paper. But since they are related and an understanding of their scope is relevant for defining what nannyism is, let us consider them in turn.

Few, if any, object to nannyism for minors or the provision of information by third parties, although the latter may be subject to cost-benefit criticisms. Deciding for individuals because they are deemed incapable of using the necessary information to make good decisions is theoretically unobjectionable, but likely a much harder case in practice.

Processing problems are a trickier case. It is well documented that individuals may suffer from various behavioral heuristics preventing them from accurately forecasting expected costs and benefits in ways that skew decisions from the optimal ones. A first move here is for a third party to use default rules—what Cass Sunstein and Richard Thaler call “nudges”—to encourage better overall decision making.⁹ Unlike providing information, which is generally not considered nanny-like behavior, nudging is paternalism, although its advocates claim it is soft-core paternalism because it preserves choice. Whatever we call it, the idea of manipulating decisions that are perceived by outsiders to be erroneous may be good or bad from a social welfare perspective. The answer likely varies by topic, insider, outsider, and circumstance, such that the concept of nudging is unobjectionable, but the application in particular cases may be socially costly.¹⁰ (In this paper, we will compare the use of nudging by firms and the government with the hope of determining which type of third party is likely to have more good nudges than bad.)

The easiest case in which paternalism is justified is when individuals are imposing costs on others, and since this is the primary justification for most modern nannyism, it is worth spending some time fleshing it out.

1. Internalization of externalities

Economists call costs imposed on others “externalities,” and argue if individuals do not bear the full costs of their conduct, we will get socially inefficient levels of production of it. Smoking is a classic example: if individuals

⁸ “Costs” includes all social, real dollar, and other costs arising from a particular form of conduct.

⁹ See CASS SUNSTEIN & RICHARD THALER, *NUDGE* (2008).

¹⁰ See Robert Frank, *Should Public Policy Respond to Positional Externalities?*, 92 J. PUBLIC ECON. 1777 (2008).

are not forced to pay the costs of their conduct (say, compensating victims of second-hand smoke or taxpayers who subsidize their health care costs), individuals will smoke too much. This class of cases likely represents the largest source of nanny motivation, although the lines here will be blurry. Nannies may make errors in determining the existence of or size of the externalities, or may use externality arguments as an excuse to aggrandize power, to oppress political outsiders, or to try to impose their own views on others. Perhaps most ominously, externality arguments inevitably sweep in far too much and may lead to obviously troubling intervention by third parties. Constraints on reducing errors or overreaching are therefore essential to efficient nannyism.

In the abstract, however, the idea of forcing internalization of costs is unobjectionable. Even libertarians should not be troubled in theory by attempts to get individuals to pay the full social costs of their conduct. These efforts meet John Stuart Mill's test of liberty—a state may not prevent individuals from acting, except where doing so would bring harm to others. In this way and in these cases, nannies serve an important social welfare function by substituting the judgment of cost bearers for cost imposers.

Externalities, which undergird good “nannyism” for competent adults, arise in two ways. First, individuals may not internalize costs over all of their future selves. That is, the current self may not consider fully costs imposed on the future self, and therefore engage in activities that are welfare reducing for the entire collection of selves. Second, individuals may not internalize costs imposed on others.¹¹

The regulation of smoking evidences both of these forms. Legislation aimed at reducing smoking, including taxes, bans, and limits on advertising, is premised on both protecting individuals from themselves (that is, protecting future selves) and protecting others from the deleterious effects of smoking. “Others” here includes anyone who will bear a cost from someone else's smoking, including waiters, other patrons, family members, and taxpayers or individuals in common insurance pools with the smokers, who bear increased health expenditure costs. Not bearing these full costs of smoking means individuals will smoke at inefficient levels.¹²

¹¹ Both of these involve difficult calculations and empirical evidence. In addition, the intra-individual calculation portends potentially invidious determinations of individuals' “true” preferences. In other words, the sum of decision costs and error costs are likely to be high in both cases, but are likely to be higher in the intra-individual case.

¹² The existence of risk-pooled health insurance does not in of itself lead to an externality problem. “The externality arises only if health insurance premiums do not reflect enrollee weight, such as if heterogeneous (obese and non-obese) enrollees are lumped into a single risk pool. In the case when premiums are actuarially fair, even if individuals are fully insured, they will still have an incentive to decrease expected medical care expenditures through weight loss as weight loss lowers health insurance premiums.” Jay Bhattacharya & Neeraj Sood, Health Insurance and the Obesity Externality, Working Paper 11529, <http://www.nber.org/papers/w11529>.

There is a definitional question here, however, as this externality problem is what underlies everything from environmental laws to the tort system and criminal law.¹³ In this sense, all regulation is a form of nannyism. But this isn't what the term usually means. "Nannyism" is defined narrowly to relate primarily to the choices made by individuals that are historically regarded as personal, such as what to eat, what to drink, whether to smoke, what to do in one's spare time, and so on. Nannies take care of children and police their choices about what to play with, what to wear, what to eat, when to sleep, and other personal matters. It is this parallel policing of adults that gives rise to the term nannyism. For purposes of this paper, the analysis is restricted to predominately those activities that may increase health care costs. The analysis may be extendable to other costs, but this may be tricky, as more and more law and social behavior is implicated, and internalization arguments can easily become difficult to untangle from excuses for invidious discrimination.¹⁴ These contours are examined below.

2. Paying, and what that means

There are generally two choices for the payment of the social costs of activities. Most obviously, we could hold individuals or individual entities responsible for the costs they impose on others or society. This approach has been widely advocated in various literatures as the most effective way of creating the optimal social incentives. If individuals bear the full costs of their actions (that is, internalize all the costs they impose on others), then we would expect the individuals to police their own conduct in ways that strike the efficient balance between utility gain and loss (or benefit and cost). Taxes are a common mechanism for doing this. But there may be many cases in which individuals cannot pay, are not sufficiently sensitive to costs, are viewed as victims or unable to pay, or are not the least cost avoiders. Taxes may be regressive, individuals may be judgment proof, or other entities may be able to provide particular monitoring functions at lower cost across multiple individuals because of economies of scale and scope. Individuals may also suffer from systematic decision making biases, which would blunt the perceived benefits of cost internalization.

If individuals who generate costs are unable to pay or would be unable to make welfare-maximizing decisions in any event, law looks to the other option for paying costs, third parties. The most common example in the law is the payment, either voluntarily or legally required, by an entity, like a corporation or the

¹³ Pollution is the archetypical example. By forcing firms to pay for the social costs of pollution, say through an emissions tax, society can ensure that firms do not produce at inefficient levels.

¹⁴ There are numerous activities, behaviors, or characteristics that are protected by common and statutory law, and that are not within the scope of nannyism as defined in this paper. For example, rights of association, religion, race, sexuality, speech, etc.

government. An example of the former is the doctrine of respondeat superior; an example of the latter is the social safety net found in programs ranging from Social Security to Medicaid.

It is in this cost bearing by third parties that nannyism starts. Third parties who are liable for the costs imposed by others will inevitably engage in actions designed to reduce those costs. In fact, it would be irrational for the third parties to not try to influence the behavior of the individuals imposing the costs, since it would be subsidizing socially inefficient conduct. In effect, the third-party payor is acting as if it were the individual forced to bear all its costs, and would be expected to act accordingly.

Since conduct considered “private” inevitably produces social or group costs, nannyism is a certainty. As long as others are paying for the costs imposed by individuals, the others will want a say in conduct that purports to generate those costs. This is true whether the third-party payor is the corporation or the government. As shown below, company towns had similar levels of paternalism, regardless of whether the owner was a firm or the federal government.¹⁵ This is true today as well. Both firms and the government, which pay most health care expenditures, are increasingly active in policing health and safety practices in an attempt to reduce health care costs. To cite just one example, both firms and governments are using or considering using taxes on individual weight or body mass index (BMI) to try to reduce the incidence of obesity by forcing individuals to bear the full costs of their eating.¹⁶

Nannyism should also be expected to grow in proportion to the costs born by third parties. It is therefore no surprise to see an increase in nanny laws and nanny-like behavior at times in which much of the responsibility for paying the social costs of conduct have shifted from individuals to the state, firms, and others. Accordingly, we should expect to see more state nannyism in jurisdictions where costs are more socialized. A recent survey in the United Kingdom supports this conclusion. In a country where all health care costs are borne by the state, 75 percent of citizens want more government intervention to discourage people from unhealthy eating habits.¹⁷

The same trend is seen domestically, as federal, state, and local governments bear increasing health care costs, both directly and indirectly through lost productivity. The so-called “Twinkie tax,” a one percent tax on soft drinks, candy, fast food, and other “unhealthy” food is a classic example. Proposed by Yale food researcher Kelly Brownell, the tax was seriously

¹⁵ See *infra* note ____.

¹⁶ See, e.g., “Obesity boom will cost tax payers,” BBC.com (Oct. 7, 2008), available at <http://news.bbc.co.uk/1/hi/health/7656214.stm> (showing costs to taxpayers and predicting future fat tax); “Government unit ‘urges fat tax,’” BBC.com (Feb. 19, 2004), available at <http://news.bbc.co.uk/1/hi/health/3502053.stm> (noting that the government is considering a fat tax).

¹⁷ HARSANYI, NANNY STATE, *supra* note ____ at 10-11.

considered by New York City, Detroit, and numerous other state and local governments.¹⁸ Arguments for the tax range from the costs imposed on government, the inability of individuals to resist the temptations their future selves will later regret, and the costs imposed on other third parties, like airlines who pay higher fuel costs flying heavier people around.¹⁹ Another example is smoking. Both private firms and some governments have effectively banned smoking, even if done in the privacy of one's car or apartment. As detailed below, several firms have explicit policies forbidding the hiring or employment of smokers, while in 2006 Belmont, California banned smoking anywhere in the city, even in private residences.²⁰

Costs are therefore the door through which nannyism comes, but attempts to restrain them may not be objectionable to all but the most strident libertarians, unless they cross some line. Few would object to the cameras installed on delivery trucks or government-run hospitals from serving predominately healthy food. The real line-drawing problem arises when the link between conduct and costs becomes more attenuated or outside of a certain sphere of third-party influence. It might be obvious that a city could ban firefighters from smoking on the job, but what about at home? No one would criticize an airline that restricted pilots from drinking while flying, but what about when off duty when there is no chance of spillover to work hours? Smoking and drinking after hours in both cases may raise costs, both in terms of risk and health insurance outlays, but there is an intuition that the restrictions on private behavior are different in some way, more out of bounds.

Of course, third-party payors will have to balance of the costs of imposing restrictions versus benefits of cost reduction, and this may provide a natural break on extending nannyism too far down the causal chain. We will see below that the ability to do this calculation and several other features of corporations may give them an advantage (over the government) at being benign and efficient nannies.

B. "Bad" Nannies

There are two ways in which nannyism, whatever its source, may be socially suboptimal. The first type of bad nanny is one with good intentions that makes mistakes in calculating the social costs and benefits from particular behaviors. There are a variety of miscalculations that are possible. Nannies may reasonably believe externalities exist when they do not (false positive) or that there are no externalities from a particular behavior when in fact there are (false

¹⁸ Id at 37-40. *See also* Suzanne Leigh, "'Twinkie Tax' worth a try in fight against obesity," USA TODAY, Dec. 1, 2004.

¹⁹ For a discussion, see section __ below.

²⁰ HARSANYI, NANNY STATE, *supra* note __ at 125.

negative). Even when externalities are plain, nannies may systematically misestimate the costs imposed on society by individual behaviors, including failing to consider the potential for unintended consequences from restricting individual liberty. Thus nanny rules can be either under or over-inclusive, or, given heterogeneous preferences among regulated individuals, differential impact of rules on behavior, and imperfect enforcement, both at the same time. These potential errors will be especially apparent because nannies have limited resources for determining the costs and benefits of particular rules. In light of these potential errors, the optimal nanny will be one that minimizes the sum of decision costs and error costs. A comparison along this dimension between corporate and democratic nannies is made below.

The second type of bad nanny is one that uses a position of power to try to impose selfish and potentially socially costly preferences on others. The only difference between this group and the first group of bad nannies is the intent of the nanny; the “mistakes” may be the same, but the motivation will be different and the mistakes will be deliberate in a sense. For example, a rule-maker, be it a legislator or corporate chief, may think smoking is selfish and disgusting or believe smokers are innocent rubes coerced by greedy tobacco companies, and therefore prefer a world in which no one smoked. The rule-maker’s preferences may be roughly aligned or 180 degrees divergent from the socially optimal policy, but in each case the rule maker is likely to couch justifications for the nanny rules in benign terms linked with alleged externalities and social costs. These justifications will mask the possibility of the nannies acting as idiosyncratic busybodies or rent seekers.

Examples of bad nannyism are familiar, including most famously Prohibition, where do-gooders known as the Temperance Movement succeeded in banning the sale and consumption of alcohol, but underestimated human nature and the criminal consequences of driving alcohol underground. The Temperance Movement believed that alcohol consumption imposed costs on society,²¹ which it certainly does, but erred in imposing a regulatory regime that was disproportionate to the actual costs of the conduct. The government as nanny believed that it could reduce the costs imposed by drinking without raising other costs and distorting natural behaviors in unpredictable ways. In other words, the cost-benefit calculation done by the regulator excluded the dynamic costs that arose from the regulation itself.

Distinguishing between bad nanny types (or between good and bad nannies) will be difficult. The more difficult it is to sort ex ante between good and bad, the greater the opportunity for nannies to rent seek and profit from imposing nanny rules. The most obvious example of this is the “Bootleggers and

²¹ JACK S. BLOCKER, DAVID M. FAHEY, AND IAN R. TYRRELL EDS. ALCOHOL AND TEMPERANCE IN MODERN HISTORY: AN INTERNATIONAL ENCYCLOPEDIA 2 VOL. (2003).

Baptists” theory.²² Both those who sell alcohol illicitly (bootleggers) and those who oppose drinking on moral grounds (Baptists) have incentives to restrict the sale of alcohol, either entirely or, less ambitiously, on Sundays. The economic and moral arguments generate an “unholy alliance” that politicians can exploit by taking money from the former and using the arguments of the latter to get votes.

The exploitation of moral or social cost arguments for private economic (or political) gains is not limited to politicians. Businesses can use government power for this end too. For instance, the first child labor laws in England, which were proposed to Parliament by a blue-ribbon commission composed of mill owners who, by virtue of their technological advantage over rival mills, could afford to and in fact preferred to raise the costs of labor by reducing its supply.²³ It is also true today, cutting both for and against nanny rules. Tobacco companies and the ACLU have teamed up to support legislation restricting the ability of employers to ban smoking outside of the workplace. Tobacco companies obviously want to maintain their market, while the ACLU wants to protect privacy interests in general. This modern application of “Bootleggers and Baptists”, call it “Cigarette Vendors and Constitutional Defenders,” is based on the economic interests of the tobacco companies and the political views of the ACLU. This alliance of interests similarly provides politicians with the lucrative go-between possibilities—they can take money from tobacco companies while claiming to support the restrictions on corporate nannyism with rhetoric about privacy and the Bill of Rights. In any event, this public choice-like story makes it difficult to unpack the virtue of the restrictions on individual liberty.

In light of these mixed motives and the difficulty in interpreting them, the best one can probably say is that we can only tell good from bad, or one type of bad from another, based on outcomes. Nanny rules that persevere and do not generate widespread consensus about excessive burdens are generally good, while others are bad. The problem, of course, is that sorting ex post in this way will be biased by the sensitivity of nannies to political or market forces. If these forces are weak, socially inefficient rules may survive, even if they are known to be such, unless the cost of the inefficiency is enough to overcome this weakness. In light of this, it is essential to assign the locus of nannyism to those situations or entities that will be subjected to the most rigorous political or market checks.

When there are monopolies of power, there is by definition less constraint on action, by either political or market forces. Politicians who face no election threat or who have constituents with very high costs of moving jurisdictions are less likely to deliver nanny rules that come close to efficiency; corporations that are monopsonists in the labor market are similarly subject to less oversight that

²² Bruce Yandle, “Bootleggers and Baptists: The Education of a Regulatory Economist.” 7 REGULATION 12 (1983).

²³ Id.

would help constrain bad nannyism. Firms are subject to much greater oversight by labor, product, and capital markets than politicians are by elections, and therefore should be preferred nannies, all else being equal.

But first let us consider the ways in which corporations are increasingly engaging in nannyism. The history of corporate nannyism supports the claim that the deployment of paternalist rules by firms is tied to externalities imposed by employees and is, even in relatively illiquid labor markets, dramatically constrained by market forces.

II. CORPORATE NANNYISM

The history of corporate nannyism is about economics, not domination. By tracing the rise of modern nannyism by firms back to its origins—in so-called company towns—the motivations of and constraints on firm nannyism are plain.

A. Origins

The first manifestation of corporate nannyism as we think of it today was in the development and operation of “company towns” during the early industrial revolution.²⁴ Company towns, like Pullman, Illinois, and Coulee Dam, Washington, were communities in which a single business built, owned, and operated the entire town. These towns appeared throughout the industrializing West (England, France, America, Sweden, and Germany) during the 1830s, and were common in some locations and in some industries until the 1940s.²⁵ This was an era that combined rapid industrialization and the exploitation of natural resources in remote locations,²⁶ with the development of various social movements concerned with improving public morality. The combination of Victorian sensibilities, business growth, and physical isolation provided a perfect formula for business owners to take a strong nanny approach to workers.

Companies provided everything for employees in company towns—homes, stores, parks, roads, entertainment, medical clinics, and on and on—all of which were owned by the business enterprise, often a single entrepreneur, like George Pullman or Frank Gilchrist. Many company towns paid for public amenities, like

²⁴ A leading historian of company towns defines the nanny corporation in this context was one in which “the paternalism of the owner extended beyond the bare-bones architectural requirements of factories or mines.” See John S. Garner, *Introduction*, in JOHN S. GARNER, ED., *THE COMPANY TOWN: ARCHITECTURE AND SOCIETY IN THE EARLY INDUSTRIAL AGE* 4 (1992) (Hereinafter, GARNER, INTRODUCTION).

²⁵ *Id.* at 3.

²⁶ “Mining companies establishing themselves in isolated areas often found it necessary to provide housing for workers in order to get them to come.” JAMES B. ALLEN, *THE COMPANY TOWN IN THE AMERICAN WEST* 7 (1966).

sewage, garbage collecting, and gas lighting, that only the “most affluent suburbs of the time could afford.”²⁷

To paraphrase Adam Smith, these amenities were not provided out of benevolence but self-interest on the part of the firm. Companies needed to build towns with amenities on site to attract workers to remote locations for difficult and often dangerous work in mining, timber, or construction.²⁸ Even in relatively straightforward industries, like mills, historians attribute the provision of amenities to the fact that “[m]ill owners had to furnish housing to obtain a labor force.”²⁹

Self-interest (not benevolence or busy-bodiness) also explained the link between firm ownership of the town and firm intervention in the seemingly private lives of employees.³⁰ Firm ownership of the physical and human capital in company towns led inexorably to paternalism to control costs and maintain the firm’s investment. As one historian describes it, “[g]enerosity . . . brought intrusiveness.”³¹ Company town bosses “used their power as the owners of the village to control their employees,”³² because it was cost-effective and efficient for them to do so.³³ Paternalism wasn’t about “seek[ing] to reform the laboring classes or correct social evils,” but was about minimizing the firm’s labor and other costs—in short, it was a “ploy to attract and retain workers.”³⁴

From the perspective of the firms, nannyism was justified because firms were paying for nearly all the costs of running the town and feeding and caring for employees, as well as bearing all of the costs of misbehavior on the part of employees. Drunkenness led to absenteeism or accidents and mistreatment of one’s home, which was owned by the firm, caused the firm to spend money to preserve its investment in it and the other homes surrounding it. Companies did not expect to recoup investments in towns through direct income, but rather viewed amenities as “subsidies to the employee” for which it therefore had the right to “demand certain concessions” from employees.³⁵

²⁷ See GARNER, INTRODUCTION, *supra* note __ at 7.

²⁸ ALLEN, THE COMPANY TOWN, *supra* note __ at 6-7.

²⁹ Margaret Crawford, *Earl S. Drapier and the Company Town in the American South*, in GARNER, THE COMPANY TOWN: ARCHITECTURE AND SOCIETY, *supra* note __ at 144.

³⁰ Owners often couched their paternalism in benevolent and moral terms – “We keenly and genuinely feel our responsibility toward that which has been entrusted to us. We believe in the dignity of man and the worth of the individual.” – but these are laid bare by the economic realities of the situation. ALLEN, THE COMPANY TOWN, *supra* note __ at 123.

³¹ CRAWFORD, *EARL S. DRAPIER*, *supra* note __ at 144.

³² *Id.* at 146.

³³ To be sure, some owner/nannies took a “genuine interest in the welfare” of their workers, meaning the owners derived some personal utility from trying to impose their values on others. See GARNER, INTRODUCTION, *supra* note __ at 4.

³⁴ *Id.* at 8.

³⁵ ALLEN, THE COMPANY TOWN, *supra* note __ at 122-23.

Control was pervasive. Companies regulated drinking, smoking, gambling, cleanliness, speech, association rights, and also, more generally, morals. Companies would monitor employees in public and private settings, and would fire those who, in the view of the firm's bosses, were "straying from the path of virtue."³⁶ Workers were also disciplined for trivialities, like failing to maintain their homes and yards in good condition. One company town boss, Frank Gilchrist of Gilchrist, Oregon, "drove around town, upbraiding those whose yards weren't clean and tidy."³⁷ Gilchrist did this not only because of his personal preferences about tidiness, but because he was highly subsidizing the rent of employees' homes—it was partially *his* yard.³⁸ Firms also regulated private behaviors inside homes. The owner of one mill "made a practice of walking around [workers' houses] at nine o'clock every night to knock on the doors of those who were still up to tell them to put out the lights and go to bed."³⁹ These policies lead historians of company towns to characterize some entrepreneurs as "playing God" with their workers.⁴⁰

There were many reasons for playing God, all of which were directed at the firm's bottom line. Paternalism helped recruit employees and reduce turnover, since it was often accompanied by generous welfare programs and it was frequently associated with safe, cheap, and happy places to live and work.⁴¹ For example, after a tremendous increase in absenteeism and turnover at a molybdenum mine in Climax, Colorado, the president of the firm, Arthur Bunker, ordered a nanny program, called "Design for Man," to be implemented to "stabilize employment." The company provided numerous welfare programs and amenities, and, lo and behold, turnover was reduced.⁴² Nannyism also helped businesses "maintain their financial investment in buildings and grounds" as well as the human capital deployed by the firm.⁴³

The link between ownership and control, or, in economic terms, the cost bearing function and the cost prevention function, is supported by the fact that the level of nannyism in company towns was proportional to the amount of the firm's ownership stake in the town. Towns that provided lots of free amenities, like housing and recreational facilities, were ruled by "benevolent despot[s],"

³⁶ LINDA CARLSON, *COMPANY TOWNS OF THE PACIFIC NORTHWEST* 189 (2003).

³⁷ CARLSON, *COMPANY TOWNS*, *supra* note __ at 192-93.

³⁸ CARLSON, *COMPANY TOWNS*, *supra* note __ at 210 ("In Gilchrist, Oregon, the lumberman who subsidized his employees' rent was the same man who personally chastised workers who didn't maintain their yards to his satisfaction.").

³⁹ CRAWFORD, EARL S. DRAPTER, *supra* note __ at 146.

⁴⁰ CARLSON, *COMPANY TOWNS*, *supra* note __ at 193.

⁴¹ See GARNER, INTRODUCTION, *supra* note __ at 4.

⁴² ALLEN, *THE COMPANY TOWN*, *supra* note __ at 124.

⁴³ GARNER, INTRODUCTION, *supra* note __ at 3. The construction of a new mining town at Tyrone, New Mexico by the Phelps Dodge Corporation in 1914 cost about \$1 million or about \$162 million in 2007 dollars, not to mention the ongoing costs of upkeep. See ALLEN, *THE COMPANY TOWN*, *supra* note __ at 122-23.

while “[a]t the other extreme were towns that furnished few amenities but imposed few controls.”⁴⁴

On the surface and in general, company towns were deemed to be successful experiments in a new kind of worker-manager relationship, and as visions for a new way of improving social welfare. Observers in the 1860s, 1890s, and as late as the 1920s, remarked about the social progress and “upliftment” created by the “pleasing environments” of company towns.⁴⁵ The corporate nanny was born as an alternative to government paternalism for improving individual social welfare. There were sensible reasons why outsourcing paternalism to private firms might have been socially optimal at the time of the company town. Most obviously, many of these towns were remote and government monitoring of behavior would be much more costly and not necessarily better than private monitoring and enforcement.⁴⁶

Corporate nannyism in company towns ended when company towns fell out of fashion. One theory for their demise blames excessive paternalism. Overbearing nannyism undoubtedly played a role in the demise of certain towns. Corporate chiefs, like George Pullman, were known as “meddlesome and oppressive,”⁴⁷ and this undoubtedly contributed to conflict between workers and management in company towns.⁴⁸ Although some believe “[p]aternalism was Pullman’s undoing,” in general worker mobility constrained arbitrary and capricious corporate nannyism, even when the firm had a large ownership stake in workers and their possessions. Employees had exit options, and these were effective substitutes for their lack of voice in the affairs of the town.⁴⁹ “Skilled labor was relatively unfettered,”⁵⁰ and this was reinforced by the fact that life in company towns was one of few owned possessions that would tie workers to

⁴⁴ CRAWFORD, EARL S. DRAPTER, *supra* note __ at 147.

⁴⁵ GARNER, INTRODUCTION, *supra* note __ at 5.

⁴⁶ When the government operated company towns, it acted in the same way as private firms. Government-run company towns, like Coulee Dam, Washington (near Grand Coulee Dam), had strict controls on the type of businesses in town and the types of behavior that were acceptable by residents. CARLSON, COMPANY TOWNS, *supra* note __ at 191-93. Historical accounts conclude that “[t]he federal government also was well known for its paternalism [in company towns it managed].” *Id* at 194.

⁴⁷ Some historical accounts criticize company town nannyism as being a “haphazard and piecemeal endeavor erratically applied according to the inclinations of individual owners and managers.” CRAWFORD, EARL S. DRAPTER, *supra* note __ at 146. One example of a “benevolent despot,” was Ellison Smith, who ran Pelzer, South Carolina. Smith, who hated dogs, provided housing free of charge and countless amenities for his workers, but “indulged his own prejudices by restricting after-dark activities and banning dogs from the village.” *Id* at 147.

⁴⁸ See GARNER, INTRODUCTION, *supra* note __ at 4, 7.

⁴⁹ ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (Harvard 1970).

⁵⁰ Labor mobility for unskilled workers may have made their options fewer and therefore their potential for abuse at the hands of corporate nannies more likely. But this assumes that company town managers could tailor degrees of paternalism proportional to workers’ labor mobility. Although this may have been true, there is no evidence of it in the leading historical accounts. It is also less likely for modern corporate nannies, which do not use tailored paternalism and generally compete in very liquid labor markets.

particular locations.⁵¹ The ability of workers to opt out of oppressive company towns was so easy and prevalent that historians refer to claims of capture of employees by firms in company towns as “an exaggeration”—“[w]orkers unsatisfied with their situation could pick up and leave.”⁵²

By the 1920s, more workers were choosing to do so, since the booming economy made other options attractive. Workers recognized the trade off between firm-provided amenities and wages, and many “would [have] prefer[ed] a larger paycheck,”⁵³ and so opted for work that would provide cash in lieu of amenities. Firms were finding out that buying loyalty with amenities, which were coupled with paternalism, was unsustainable, especially when paternalism was not proportional to the costs being imposed on the firm. Pullman failed in part because of market constraints on excessive nannyism.

The history of company towns provides strong foundational support for the claims made below about the role of corporate nannyism in modern America. Nannyism arose not out of bias or for ulterior motives, but rather to control costs being born directly by the firm. The level of paternalism on the part of firms was directly proportional to the impact that behavior had on the firm’s bottom line, meaning firms that were not paying things like health care costs did not engage in nanny-like regulations of health. In addition, labor markets provided a check on excessive nannyism. Where corporate chiefs meddled too much, workers fled, preferring cash to amenities plus nanny rules, thereby providing a market check on inefficient nannyism.

B. Henry Ford’s “Sociological Department”

Not all corporate nannies of this era were operating company towns.⁵⁴ Henry Ford deployed a vast “Sociological Department” to supervise the private conduct of Ford employees, none of whom were living in homes paid for directly by Ford Motor Company or shopping in company stores. The deployment and eventual disbandment of the Sociological Department, however, comports with the history of company towns described above.

Ford instituted his nanny program in direct response to adverse labor conditions. The assembly line manufacturing process he instituted was

⁵¹ See John S. Garner, *Introduction*, in JOHN S. GARNER, ED., *THE COMPANY TOWN: ARCHITECTURE AND SOCIETY IN THE EARLY INDUSTRIAL AGE* 6 (1992).

⁵² See *id* at 6.

⁵³ CRAWFORD, EARL S. DRAPTER, *supra* note ___ at 155.

⁵⁴ The Ford Motor Company did eventually provide free legal services to protect employees from dishonest real-estate agents, see FORD R. BRYAN, *FRIENDS, FAMILIES & FORAYS: SCENES FROM THE LIFE AND TIMES OF HENRY FORD* 277 (2002, Wayne State University Press), established the “Employees’ Savings and Loan Association” as a bank the employees could use, in an effort to encourage thrift and saving, STEVEN WATTS, *THE PEOPLE’S TYCOON: HENRY FORD AND THE AMERICAN CENTURY* 204 (2005, Alfred A. Knopf), and had physicians available around-the-clock to tend to sick employees. *Id* at 205.

wonderfully efficient and productive, but it made the work monotonous, and as a result during the years 1911 to 1913, Ford Motor suffered extremely high employee absenteeism and turnover. Ford responded in January 1914 by offering employees a dramatic increase in pay—the famous \$5 day—but reasonably worried that some workers might spend the windfall in ways that would undermine his labor efficiency goals. Ford also believed that workers from healthy, stable and harmonious homes make more productive workers.⁵⁵

Ford set up a “Sociological Department”⁵⁶ to ensure the precondition that workers “not debauch the additional money [they] receive[]” under the \$5 day.⁵⁷ Workers who drank, did not save, or otherwise did not comport with Ford’s views of the good life, would not qualify for the wage.⁵⁸ In fact, employees did not automatically qualify for the \$5-a-day pay increase. Instead, they had to undergo provisional monitoring by the Sociological Department. Two years after the pay increase was implemented, 90 percent of company employees had qualified. Qualification could be revoked at any time, however, if officials believed the employee was engaging in undesirable behavior. If the department found that an employee was not living up to standards, he would be put on a 6-month probation period and his pay would be cut. If, at the end of that time period, significant improvement had not taken place, he would be fired.⁵⁹

The Department deployed a team of 150 to investigate the lifestyle of each Ford employee and ensure that they were not participating in activities that would make them ineligible for the wage increase, such as smoking, drinking, gambling, and prostitution.⁶⁰ Inspectors also examined employees spending and saving habits.⁶¹ If inspectors detected problems, they were able to offer employees advice on issues including childcare, money management, alcohol abuse, personal hygiene, and house maintenance.⁶² Ford used the Sociological Department to “shape the character, domestic life, and financial habits of Ford workers.”⁶³ His goals, although couched in moralistic terms, were purely economic—the purpose was to reduce the uncertainty of labor costs that arose because of the introduction of assembly-line manufacturing.

⁵⁵ WATTS, THE PEOPLE’S TYCOON, *supra* note ___ at 201.

⁵⁶ Ford was inspired to start the sociological department when he visited his friend Percival Perry, who manufactured and sold Ford cars in England, and had started a similar program with an increase in wages to combat worker dissatisfaction. BRYAN, FRIENDS, FAMILIES & FORAYS, *supra* note ___ at 277-278.

⁵⁷ Meyer, *supra* note 45 at 125.

⁵⁸ In Ford’s words, an eligible worker “must show himself sober, saving, steady, industrious and must satisfy the superintendent and staff that his money will not be wasted in riotous living.”

⁵⁹ ROSE W. LANE, HENRY FORD’S OWN STORY 23 (E.O. Jones 1917).

⁶⁰ ALVARADO & ALVARADO, DRAWING CONCLUSIONS, *supra* note _ at 42; BRYAN, FRIENDS, FAMILIES & FORAYS, *supra* note ___ at 277-278.

⁶¹ WATTS, THE PEOPLE’S TYCOON, *supra* note ___ at 203.

⁶² WATTS, THE PEOPLE’S TYCOON, *supra* note ___ at 204

⁶³ *Id.* at 205.

Ford's Sociological Department was well received by many of the progressive-era industrial leaders and politicians of the time, who believed that it would help resolve the tensions between workers and industrialists and reform workers into more responsible citizens.⁶⁴ Reformers including Ida Tarbell and John R. Commons were particularly praising of Ford's efforts.⁶⁵ In 1915, however, the Congressional Commission on Industrial Relations became concerned with Ford's efforts to assume "so large a measure of responsibility, not only for the labor conditions in its plants, but also for the social and moral surroundings of its employees."⁶⁶ In his testimony, Ford justified his programs as an earnest effort to improve the lives of his workers.⁶⁷ Ford's program received additional criticism from many newspapers, the majority of which were concerned that his programs were overly paternalistic, raising workers wages, but treating them like children in exchange.⁶⁸

The Sociological Department came to an end when Ford opened the River Rouge plant in 1920. Ford manager Charles E. Sorensen claimed that the department would interfere with production, and Henry Ford claimed to have had tired of the experiment.⁶⁹ By the time Ford wrote his memoirs in 1922, his views on paternalism and the work of his Sociological Department had completely changed. He wrote:

[P]aternalism has no place in industry. Welfare work that consists in prying into employees' private concerns is out of date. Men need counsel and men need help, oftentimes-special help; and all this ought to be rendered for decency's sake. But the broad workable plan of investment and participation will do more to solidify industry and strengthen organization than will any social work on the outside. Without changing the principle we have changed the method of payment.⁷⁰

Ford's reflection is revealing—he notes that Ford Motor Company continued to invest in worker retention, but shifted from nannyism to inclusion (called participation) in the firm's decision making process. The move to corporate democracy from corporate paternalism reflected broader trends in society, not the least of which was the rise of powerful labor unions, which aggressively pushed for worker protection from termination (thus undermining the essential threat that made corporate nannyism possible) and more control

⁶⁴ WATTS, THE PEOPLE'S TYCOON, *supra* note __ at 212

⁶⁵ *Id.* at 223.

⁶⁶ *Id.* at 219-20.

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ BRYAN, FRIENDS, FAMILIES & FORAYS, *supra* note __ at 281.

⁷⁰ HENRY FORD, MY LIFE & WORK 130 (Kessinger 2004).

over the firm. Ford's competitors also started to be able to offer competitive wages, and thus the thickening of the labor market also dramatically reduced Ford's control over workers. Just as in the case of company towns, the ability to sell one's labor down the street at another similar firm provided a natural break on the reach of the corporate nanny.

After Ford's grand experiment, corporate nannyism abated. There were undoubtedly cases of firms trying to force employees to internalize the costs they imposed on others, but the power of unions and the highly liquid labor markets in this country constrained this behavior to isolated cases. In addition, the biggest driver of modern corporate nannyism—health care costs—was much less of a concern. Prevailing social norms at the time, like widespread accepting of smoking, and external factors, like dramatically lower health-care costs on average, were sufficient to make any corporate concern over employee behavior much less important for firms. Moreover, it wasn't until the 1980s revolution in the way executives were compensated that “shareholder value” became the rallying cry of managers and the be-all-end-all of firm management. In a world in which maximizing the value of shares is paramount, firms will inevitably care more about employee behavior and things like health care costs, since these costs go right to the bottom line of firm profitability. It is to this modern era of corporate nannyism that we now turn.

C. The Modern Corporate Nanny

Corporate nannies today are concerned mostly about employee health care costs and issues.⁷¹ Health care costs include direct costs, such as insurance costs, as well as indirect costs, such as lost productivity, absenteeism caused by illnesses, and other secondary costs. The reasons are plain. These costs go directly to firms' bottom lines, are large and growing, are susceptible to nanny rules, and other potential externality-causing firm activities have fallen by the wayside. Unlike the era of company towns, most firms do not own employee housing, the shops where employees buy everything, or provide services like parks, hospitals, and recreational facilities. Corporate nanny activities today are concerned only with activities associated clearly with firm costs.

⁷¹ Firms are also increasingly deploying nanny-like programs to encourage a variety of other “good” behaviors. For example, Pacificare gives employees bonuses (in the form of prizes, like iPods) for taking classes on managing their personal finances, learning about art, teaching their children not to watch television or play video games, and so on. See Ariana Eunjung Cha, “Firms Make It Their Business to Push Health Incentives, Monitoring Aimed at Cutting Costs,” WASH. POST A01, Feb. 20, 2005, available at <http://www.washingtonpost.com/wp-dyn/articles/A38566-2005Feb19.html>. These programs are unobjectionable, since the stakes are low, but they amount to penalizing employees who don't do these things.

About 60 percent of Americans receive their health insurance through their employers,⁷² and in 2006, firms spent nearly \$500 billion on employee health insurance.⁷³ Since employers are paying and paying a lot, they obviously have a strong interest in improving employee health. This interest is growing because health care expenditures are rising rapidly: from 1960 to 2005, health care costs rose as a percent of all wages and salaries from about 1 percent to almost 10 percent.⁷⁴ According to the nonprofit research firm the Kaiser Family Foundation, health insurance premiums have risen about 60 percent per year since 2000. In addition, US firms are believed to be at a disadvantage on the global market, since companies in other nations pay much less in health care costs. (The US average is about 13 percent of total payroll spent on health benefits, compared with about 4 percent for Japan, German, and the United Kingdom.)⁷⁵

Two of the biggest causes of these costs are smoking and obesity,⁷⁶ and firms are beginning to compete with the government in trying to control them. Obesity, for example, was estimated to have increased health care costs and lost productivity by over \$70 billion annually in 1994,⁷⁷ and the percentage of adults classified as obese has increased from about 12 percent then to over 21 percent in 2001.⁷⁸ The percentages are undoubtedly much higher today. More recent estimates ballpark the cost of obese individuals at over \$700 per individual per year compared with individuals of normal weight.⁷⁹ Studies also find that less than 15 percent of these extra costs are financed through patient out-of-pocket payments.⁸⁰ This means overweight people impose significant direct and indirect

⁷² Kaiser Family Foundation and Health Research and Educational Trust, "Employer Health Benefits: 2007 Annual Survey," 2007.

⁷³ Office of the Actuary, "National Health Expenditures: Table 5," Centers for Medicare & Medicaid Services, 2006 (calculated as Private Business Expenditures less "other private" and "other public").

⁷⁴ Bureau of Economic Analysis, "National Income and Product Accounts Table," 1960-2006 (tables 2.2A and 7.8). The increase is even more striking if one excludes firms that do not offer coverage or employees who opt out of coverage – health care costs are nearly 20 percent of total compensation paid. Bureau of Labor Statistics, "Employer Costs for Employee Compensation," Sept. 2007.

⁷⁵ International Social Security Association, "Social Security Programs Throughout the World," 2005 and 2006, reprinted in Sarah Axen & Elizabeth Carpenter, "The Employer Health Care Burden," The New America Foundation, Issue Brief, May 2008.

⁷⁶ Both smoking and obesity are correlated with an increased risk of diabetes, hypertension, heart disease, stroke, and other chronic and debilitating conditions. Roland Sturm, *The Effects of Obesity, Smoking, and Drinking on Medical Problems and Costs*, 21 HEALTH AFFAIRS 245 (2002).

⁷⁷ A.M. Wolf & G.A. Colditz, *The Cost of Obesity*, 5 PHARMACOECONOMICS 34 (1994).

⁷⁸ Ali H. Mokdad et al. *The Spread of the Obesity Epidemic in the United States, 1991-1998*, 282 JAMA 1519 (1999); Ali H. Mokdad, et al., *Prevalence of Obesity, Diabetes, and Obesity-Related Health Risk Factors, 2001*, 289 JAMA 76 (2003).

⁷⁹ Eric A. Finkelstein, et al., *National Medical Spending Attributable to Overweight and Obesity: How Much, and Who's Paying?*, 26 HEALTH AFFAIRS W3-219 (2003).

⁸⁰ Id.

externalities on skinnier people in common insurance pools or with common employers.

Smoking causes similar externalities. A 2002 study by the Centers for Disease Control found that annual productivity losses and health care costs were \$3,391 a smoker. To put this number into the corporate context, if Walmart employees smoke at the average rate for US adults, Walmart would face an additional \$1.4 billion in expected health care costs compared with a zero tolerance problem for smoking.⁸¹ In the aggregate economy, this figure would be over \$100 billion.⁸²

To combat these and other externality causing behaviors firms are using a variety of voluntary (carrots) and involuntary (sticks) incentives.⁸³ As discussed below, legal uncertainty and regulatory distortion has limited experimentation somewhat to date, but more and more firms are deploying nanny rules designed to force employees to internalize the costs they are imposing on others.

1. Carrots

Numerous companies have adopted voluntary programs designed to improve employee health and offset the over \$4000 per year in increased health care costs from obesity and smoking. For example, IBM has a variety of “rebate” programs that pay employees to act in ways likely to drive down health insurance costs. Specifically, IBM pays employees who agree to eat healthy, exercise, and not smoke \$150 per year, \$300 if they get their entire family to do the same. The system is voluntary and involves self reporting progress through an online application.⁸⁴ Similar programs exist at Aetna (\$345 per year for completing

⁸¹ Walmart has about 2 million employees, *see*

<http://money.cnn.com/magazines/fortune/global500/2007/snapshots/2255.html>;

<http://www.cdc.gov/mmwr/preview/mmwrhtml/mm5444a2.htm> (about 20% of US adults are smokers).

⁸² Based on a labor force of 150 million, *see* <https://www.cia.gov/library/publications/the-world-factbook/print/us.html>.

⁸³ It is also possible that firms could “charge” employees for things like obesity indirectly through lower wages for the lower productivity that accompanies the condition. There is some evidence for this. The literature on obesity-based wage differences finds that heavier individuals earn less than lighter ones, and that these differences are based on lower productivity levels. *See* C.A. Register and D.R. Williams, *Wage Effects of Obesity Among Young Workers*, 71 SOCIAL SCIENCE QUARTERLY 130 (1990); J.A. Pagan and A. Davila, *Obesity, Occupational Attainment, and Earnings*, 78 SOCIAL SCIENCE QUARTERLY 756 (1997); J. Cawley, *An Instrumental Variables Approach to Measuring the Effect of Body Weight on Employment Disability*, 35 HEALTH SERVICES RESEARCH 1159 (2000). This method of cost internalization is likely insufficient. It may be illegal for firms to lower wages for the health related aspects of certain conditions or behaviors. It also applies only to behaviors or conditions that manifest themselves in productivity losses. Finally, it is not transparent to the worker, so there are no obvious incentives for employees to lose weight or change whatever the behavior is.

⁸⁴ *See* IBM Press Release, “IBM’s New Children’s Health Rebate for Employees Helps Families Attain a Healthy Lifestyle Extends Company’s Wellness Incentive Programs, Enabling Employees to Earn \$150 Cash Incentive,” (Oct. 24, 2007), available at <http://www-03.ibm.com/press/us/en/pressrelease/22496.wss>.

online courses in health and weight management)⁸⁵, Dell (rebate of about 10 percent for employees filing out annual health survey and participating in health improvement program)⁸⁶, Pacificare Health Systems (\$390 per year for participating in online health training program),⁸⁷ and many other firms.

Carrots may seem more appealing than sticks, but the two are largely indistinguishable. For one, there is no practical economic difference between “rebates” and “fines” without first defining a baseline level of cost. Imagine there are two individual employees, each of whom is charged \$100 for health insurance by the firm. The first individual volunteers for the health improvement program, earning a \$10 “rebate” on insurance costs, while the second employee does not. The first employee is paying \$90, while the second is paying \$100. The situation is no different than setting the insurance costs at \$90 and fining the second individual \$10 for not joining the program.

Another related reason is that in a world of rebates or fines, individual disclosures will unravel so that what seems voluntary may not indeed be voluntary. To see this, imagine again a firm with two employees, one of whom is a smoker and one of whom is not. The firm puts the individuals in a common pool of insurance, such that the blended insurance rate paid by each is the same and assumes that one of them is a smoker, but not identifying which one. If the firm provides voluntary opportunities for the non-smoker to signal this good attribute, the implication is that the other employee is a smoker, even if that employee doesn't say anything about whether she is or isn't. This may be optimal for the firm, but it highlights that voluntary programs can have the effect of quickly sorting employees (that is the point), and as a result revealing as much about volunteers as non-volunteers. As such, any losses suffered by the non-volunteers, such as privacy losses, will be the same in an environment of carrots as sticks.

There are some differences between carrots and sticks, which are evident when we examine the sticks as used by firms today.

2. Sticks

Involuntary programs, or sticks, are more varied than voluntary ones. Corporations currently deploy “no hiring” policies, mandatory health assessments, and penalties, including financial penalties and termination, for certain behaviors. Because, as discussed below, legal risk and uncertainty is

⁸⁵ Best Employers God Winners, WGBH.org (June 17, 2005), available at http://www.wbgh.org/healthtopics/best_employer_docs/best_employers_gold_winners_617.pdf.

⁸⁶ Dell Press Release (Nov. 15, 2006), available at http://www.dell.com/content/topics/global.aspx/corp/pressoffice/en/2006/2006_11_15_aus_000?c=us&l=en&s=corp.

⁸⁷ Ariana E. Cha, “Firms Make It Their Business to Push Health,” WASH. POST A01 (Feb. 20, 2005), available at <http://www.washingtonpost.com/wp-dyn/articles/A38566-2005Feb19.html>.

undoubtedly higher for firms deploying these programs than voluntary ones, they are more rare and are often led by individual managers that feel passionately about them. Typical is Jim Hagedorn, the CEO of Scotts Miracle-Gro Company, who admits that this “is an area where CEOs are afraid to go.”⁸⁸ He argues, however, that as healthcare costs have exploded (Scotts’s annual healthcare bill soared 43% in 4 years, amounting to 20% of the company’s net profits), and “the government and health insurance industry weren’t doing anything to solve the crisis,” companies “paying the bills” were the ones who needed to take action.⁸⁹ According to him and others, this action also needed to be increasingly sticks. In the experience of Scotts, wellness programs offering incentives like gym discounts or healthy eating bonuses weren’t sufficient to motivate employees the way that docking pay will. As the Benefits Chief of Scotts said, “We tried carrots; carrots didn’t work.”

The different types of mandatory programs currently deployed by firms can be seen by comparing the range of firm policies aimed at deterring smoking. The simplest program is to implement a “no smokers” hiring policy like Alaska Airlines has had since the mid-1980s and Union Pacific has had since 2004.⁹⁰ Firms like Weyco, mentioned above, take this a step further by not only hiring only non-smokers, but also firing current employees who fail nicotine tests. (As part of its no-hiring policy, Alaska Airlines told applicants they would be tested for nicotine use, but there is no public evidence that they ever did so.)⁹¹ A slightly less aggressive approach is to charge higher insurance premiums for smokers. Several employers, such as J.P. Morgan Chase, Northwest Airlines, Pepsi Co, and Meijer, do this. One prominent example is Navistar International Corporation, which charges smokers \$50 per month to help defray increased health insurance premiums.⁹² Weyco’s program was recently expanded to include the spouses of employees; if a husband or wife fails a monthly nicotine test, the employee pays an additional \$80 per month penalty until the spouse quits smoking.

Importantly, if \$3000 per year per (or more) employee cost of smoking noted above is a reasonable estimate, the \$50 per month penalty (\$600 per year) used by Navistar does not reflect the full costs imposed by the smoking employee. The difference may be because of a different, local estimate of the costs of smoking and/or an estimate that the incentive provided by the penalty is

⁸⁸ See “Get Healthy—Or Else,” *BUS. WEEK* (Feb. 26, 2007), available at http://www.businessweek.com/magazine/content/07_09/b4023001.htm.

⁸⁹ Id. “I told my people that you cannot expect us, the company, to just continue to pay these kinds of increases and not say to our people you are partly responsible.” Id.

⁹⁰ Jeremy W. Peters, “Company’s Smoking Ban Means Off-Hours, Too,” *NY TIMES* (Feb. 8, 2005), available at http://www.nytimes.com/2005/02/08/business/08smoking.html?_r=2&oref=slogin.

⁹¹ Id.

⁹² Cha, “Firms Make It Their Business,” *supra* note ____.

sufficient to deter all smokers (say, because social norms will fill the gap once a program is implemented).

This may also suggest that the optimal level of smoking or obesity at the firm level is not zero, or, to say it another way, that individuals in the common pool do not demand complete cessation of the offending and costly behavior. This might be because employees that impose costs might also have unique benefits that offset these costs, on average at the level set by the firm. Smokers might be particularly productive workers, for example, and the firm may be simply summing the benefits and costs to find the optimal level of deterrence. Another possibility is that the individuals demanding nanny rules are unwilling to bear the costs on them from a more draconian program. Significant and valuable liberty interests, for one, might be at stake in more aggressive programs, and individuals who are forced to bear the costs of the behavior may weigh these in any deterrence calculation. Or, to put it another way, the firm might reasonably believe that forcing smokers to internalize all of their costs would send negative signals to the labor market that might raise the firm's labor costs, even among non-smokers. For example, non-smokers might not want to work for a firm that charged employers because the policy signals something about the firm that is expected to raise the costs for the individual employee from working there. This signal could be simply that the firm is likely to have a low tolerance for any cross-subsidies, say on productivity or other considerations beyond smoking that the employee might be concerned about. Someone who is a shirker or a skydiver might reasonably believe a non-smoking policy reveals that this is a place where they shouldn't work.

Another possibility is that employers do not bear the full insurance-based costs of employee health, and are therefore not properly incentivized to reduce behaviors to their optimal level. For example, the federal government pays most health care for individuals over the age of 65 through a mandatory program under Medicare. This means that illnesses that manifest after that age are not part of the employer calculation, since the employer does not have to pay for them. A final possibility is that firms are risk averse, especially in light of the legal uncertainty of the rules limiting corporate nannyism discussed below, and thus are slowly deploying nanny rules to build acceptance in the labor market before moving to full cost internalization.

Some firms have gone far beyond hiring policies or insurance penalties for employee behaviors, like smoking or being obese. For example, Clarian Health developed a mandatory wellness program that, starting in 2009, will charge employees based on the obesity. Employees with BMI's over 30 will be charged \$10 per paycheck, along with \$5 each for tobacco use, cholesterol over 130, blood pressure above 140/90, and glucose levels over 120. Western & Southern Financial Group charges employees whose BMI is too high a tiered fee between

\$15-75 a month; the charge can be adjusted if the BMI improves. So far more companies have focused on tobacco use, but BMI is another simple (though potentially inaccurate and certainly incomplete) way to measure an employee's health risks associated with obesity.

Firms have also implemented more comprehensive programs covering a wider range of behaviors, including those of employees' families. Scotts has taken the most innovative and comprehensive approach so far. Employees are required to take an exhaustive and highly personal health risk assessment, asking questions like: "Do you smoke? Drink? What did your parents die of? Do you feel down, sad, hopeless? Burned out? How is your relationship with your spouse? Your kids?" If employees balk, they are forced to pay additional monthly health insurance premiums (about \$40 per month) on the theory that silence is a signal of poor quality or that penalties are necessary to force disclosure.

The surveys are not just for sorting. Once employees fill out the assessment, the firm analyzes the physical, mental, and family health histories of each employee, cross-references that information with insurance claims data, and then sets up each "at risk" employee with a health coach and action plan. To ensure that personal information is not used for illicit purposes, firms routinely use third party vendors to handle the programs. Those who don't comply with the action plan pay an additional health care penalty (about \$67 per month). This plan was designed to charge employees for not doing something to make themselves healthier, regardless of whether they actually have more insurance claims or cost the company more money. This design was used because at the time employers were forbidden from passing along increased health care costs to individual employees based on their particular characteristics. Federal law, known as HIPAA, was recently changed to allow companies to pass along a portion of the extra cost for insuring them. As discussed below, this is likely to increase the use of penalty programs that directly link payments to individualized costs.

Health assessments, like those run by Scotts, are eerily reminiscent of Ford's "Sociological Department," and even CEOs concede the programs have "Big Brother" overtones. Participation rates are very high, however, and having programs run by a third-party, which most do, alleviates some privacy concerns and reduces the potential for abuse. In addition, the programs have been extremely successful. Though in its early stages, the Scotts program has already been successful in making employees healthier (and in purely business terms, cheaper). Deadly latent health problems have been revealed and corrected, several employees have lost a significant amount of weight, 30% of tobacco using

employees have quit (as of February 2007), and a “get healthy” peer pressure fills the office.⁹³

More generally, a review of over 70 published studies on corporate wellness programs finds that every dollar invested in them yields about \$3.50 in benefits from reduced health care costs and improved productivity through reduced absenteeism.⁹⁴ The research data suggest that certain characteristics are clearly associated with increased costs (e.g., excessive body weight and high levels of stress), while others are more speculative (e.g., cholesterol, alcohol abuse, and hypertension). The uncertainty about what works and what doesn’t seem to work points out the need for experimentation and deployment in an environment in which data will be available and in which those responsible for implementing the programs will have the incentives to collect and process it in an efficient manner. These issues will be discussed below.

These benefits are not enough, however, to conclude that corporate nannyism is a good thing. It might be, for instance, that governments could accomplish similar or better improvements at lower cost. Governments and firms are, in fact, competitors in providing nanny rules to force internalization of costs, and this means that we need an analysis of the potential comparative advantages of firms before we can conclude that corporate nannyism is a good thing.

III. THE ADVANTAGES OF CORPORATE NANNYISM

Although nannyism is ubiquitous in a world of third-party payors it is subjected to wide-spread criticism. There are dozens of books, articles, and think-tank white papers devoted to exposing excessive nannyism and arguing for its elimination from our society.⁹⁵ The criticisms focus almost entirely on state-sponsored paternalism. Critics ignore two things: first, nannyism by third party cost bearers is inevitable and social welfare maximizing, insofar as individuals are forced to bear the costs of their activities; and second, non-state entities, like business corporations, are increasingly engaging in nannyism. With these things in mind, the only relevant question is who is the most efficient nanny.

One response might be that firms should simply act as nannies when it is efficient for them to do so and not when it is not. This approach ignores, however, that the government is a competitor in the “market for paternalism,” and may put in place laws or rules that may bias the market in favor of government provision of paternalism and against firm provision of the same. This dynamic is discussed below. This section offers several reasons why the nanny corporation may be

⁹³ See “Get Healthy—Or Else,” *supra* note __.

⁹⁴ See Steven G. Aldana, *Financial Impact of Health Promotion Programs: A Comprehensive Review of the Literature*, 15 AM. J. HEALTH PROMOTION 296 (2001).

⁹⁵ HARSANYI, NANNY STATE, *supra* note __ at 125

superior to the nanny state at writing efficient rules, and thus undermines any policies biasing the delivery of paternalism away from corporate actors.

A. Constraining Overreaching

Just as nannyism is inevitable, so too is the risk of overreaching.⁹⁶ If the nanny does not accurately measure the size or source of externalities, either out of self-interest or mistake, the rules it sets will be socially inefficient. The first advantage that corporations have over the state in making rules designed to internalize socially costly actions by individuals is the constraint on overreaching provided by competitive markets for capital, labor, and products. Nanny rules are inevitably implemented by imperfect agents (either of the citizenry or shareholders), and markets provide more discipline over inevitable agency costs than political elections.⁹⁷ Although this argument is relatively straightforward, it is worth unpacking it a bit to see the full advantage of firms along this dimension.

1. Opt out

At the most basic level, competition for labor should constrain firms from imposing restrictions on employee conduct that are excessive or out of relation to the costs that conduct imposes on the firm's owners. Corporations face relentless and finely tuned labor markets in which they are constantly making tradeoffs between benefits and wages on the one hand and demands and requirements on the other hand. Firms that miscalculate—say by imposing too much cost on workers or by forcing them to internalize costs where there are none—will find their labor costs increase, and as a result, their competitive position compromised.

The brief history of company towns in America shows the power of labor markets to constrain overreaching by corporate nannies, even in cases where labor markets functioned only modestly well. Company towns were isolated geographically, attracted specialized labor, and were therefore often monopsony buyers of labor over large geographic and skill areas. And yet, the ability of individual employees to leave oppressive company towns was a significant factor in limiting corporate nannyism, and led to the downfall of several company towns. Today, where labor markets are much more liquid and there are not any

⁹⁶ It is in light of the tendency of some nannies to get carried away, the difficulty in making optimal nanny regulations, and the imperfect nature of monitoring nanny agents, that corporate nannies are superior to their state analogs.

⁹⁷ The idea that market discipline constrains agency costs is not a new one. *See* Richard McAdams, "The Political Economy of Criminal Law and Procedure: The Pessimists' View," in Paul H. Robinson, Kimberly Ferzan & Stephen P. Garvey (eds.), *CRIMINAL LAW CONVERSATIONS* (Oxford 2009) ("[M]arket discipline is probably more reliable than electoral politics at driving into extinction an entity that is bad at controlling agency costs.").

employers with monopoly power in labor markets, the discipline is even more powerful. The fact that nanny rules are now used exclusively to reduce fairly obvious firm costs—like health care—supports this claim.

A key feature that provides a break on overreaching is the ability for employees to opt out by leaving the control of the nanny. This will be much easier with corporate nannies than state ones. Employees can go to another firm much more easily than they can go to another jurisdiction; the switching costs are simply much lower. Very few individuals have firm-specific human capital commitments, while nearly everyone has jurisdiction-specific commitments. Houses, friends, family, and so on are often tied to locations, as well as the very powerful sense of place that many people feel. With job turnover at an all-time high and the age of the Company Man long gone, these costs are much lower for employees than citizens.⁹⁸

The ability to opt out of a political jurisdiction will depend, of course, on the locus of the nanny rule in question. The more localized the rule, the lower the switching costs for individuals, all else being equal, since it is much easier to move streets than cities than states than countries. The smaller the political entity deploying the nanny rule, the more it looks like a firm and therefore has some of the advantages of corporate nannyism. Of course, investments in communities are almost always going to be much higher than investments in firms; houses, are typically larger and stickier investments than investments in firm-specific human capital. (As such, we might expect jurisdictions with lots of renters to be more accountable to their principals and thus write more efficient nanny rules, all else being equal.)

Firm nanny rules also offer more opt out options than state ones. In the case of firm health-related penalties, individuals can also opt to pay for their own insurance. In firms with pay-as-you-smoke policies, individuals can choose to pay the smoking penalties. Or, if the firm charges higher insurance premiums for smokers, the individual can buy individual insurance outside of the employment relationship. This is not an option not only in the case of state bans, but also in state-sponsored insurance schemes. Individuals simply cannot opt out of government mandated health plans (such as Medicare, which is effectively mandatory for individuals over 65), and especially if there is a federally mandated single-payer health care system.

⁹⁸ The opt-out option is seen clearly in the case of the Weyco smoking ban. About 20 employees have kicked the habit as a result of the threat, but others have chosen to leave. One employee quit on the grounds that the policy, which told her what she could and could not do in her own house, was offensive to her. "You feel like you have no rights. You're all alone. It's the most helpless feeling you can imagine," Ms. Epolito, 48, said. http://www.nytimes.com/2005/02/08/business/08smoking.html?_r=1&oref=slogin. Other employees, like Christine Boyd who smoked for 10 years, decided that choosing her job over cigarettes was "a no-brainer." Id.

Governments also have monopoly on the application of legal force through the police power, and therefore can make opt out impossible in some cases. Governments can and have historically criminalized some nanny rules, meaning the price of the opt out option can be the loss of liberty.⁹⁹ This may be efficient in some sense, if the greater penalties are calibrated with less enforcement. Even then, however, there may still be proportionality and just dessert arguments about the penalties, and the risks of error in determining the externalities will be much greater.

2. Accountability

Corporate nannies are also subjected to significantly greater oversight than government ones. This can be seen by comparing the accountability of politicians, who design, deploy, and implement state nanny rules, and firm managers, who do the same for corporate nanny rules. The mechanisms and frequency of accountability are different and stronger in the case of managers. Politicians are generally disciplined only through periodic political elections, while in firms there are two ways in which managers are held to task for their decisions.

First, like politicians, corporate bosses face episodic “elections,” since they are usually terminable at will by the board of directors, which in turn is elected every year (or more often) by the shareholders. But corporate “elections,” be they formal or informal, take place more frequently, are likely to be influenced by nanny policies, and are more effective at replacing disloyal or incompetent agents.

Most obviously, the average tenure for CEOs of the largest thousand public companies (about 4 years) is less than half that of the average member of Congress (about 10 years).¹⁰⁰ The weakness of political discipline is also evidenced by the fact that most incumbent politicians win reelection. For the past four decades, over 95 percent of congressional incumbents have been reelected, and according to political scientists, less than 20 percent of congressional races

⁹⁹ For an egregious case, *see* *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935). The Schechter brothers, Jewish butchers from Brooklyn, were convicted on over 60 counts for violating the National Recovery Act. They violated certain provisions of the “Code of Fair Competition for the Live Poultry Industry of the Metropolitan Area in and About the City of New York,” including “competing too hard” and allowing customers to select birds to be killed (as required by certain religious precepts). Historical accounts put much of the blame on the statute, which was overturned by the Supreme Court, on unions, which lobbied to force non-union firms out of business. There is also a strongly anti-Semitic tone to the regulations and prosecution. *See* AMITY SHALE, *THE FORGOTTEN MAN* (2008). In other words, externality arguments – health, unfair competition – were used to justify socially inefficient and undesirable preferences.

¹⁰⁰ The average tenure in the 108th Congress was 9 years and 11 months. The longest serving member served 47 years in the House and 44 years in the Senate. No public company CEO has had that long a run. In additions, Senate terms are 6 years in themselves, which is longer than the expected run for any CEO.

are competitive, meaning the winner won less than 60 percent of the vote.¹⁰¹ Similar results obtain in political races at nearly all levels of government. It is possible that these results are evidence that politicians calibrate the amount of paternalism nearly perfectly, but this is unlikely. For one, the existence of a vibrant anti-paternalist movement suggests significant overreaching that is not manifest at the ballot box.

In addition, nanny issues may not be sufficient to move elections, and, in any event, politicians need satisfy only 50 percent plus one of the electorate to be reelected. This means that not only will elections not check abuse against minority views (say, in favor of smoking or being obese), but also that the minorities will not be able to opt out of any majoritarian rule. If anything, discipline may arise in a sort-of punctuated equilibrium model in which voter frustration with nannyism may get so severe as to impact an election. Another way of saying this is that employees voting with their feet will determine what “excessive” is, and that the costs for employees to move between firms are much lower than the costs of individuals moving jurisdictions or voting out incumbent politicians.¹⁰²

The discipline of political elections is at much greater intervals, so it reflects the judgment of voters in a lumpy fashion, as opposed to hiring and firing decisions, which happen daily for firms. This lumpiness means not only that political outcomes will lag citizen preferences, but also that nanny issues may get lost in the numerous factors that influence elections when they come. The point is obvious, but to see it, imagine that the only constraint on the nanny rules of a firm was an election of the CEO every four years. This election might be about a firm’s anti-smoking policy, but it would also likely be about the return to shareholders, compliance with laws, and other bigger picture issues. Corporate human resources policies aren’t judged collectively, episodically, and in an aggregated fashion, but are evaluated every time the firm interacts with its employees or the labor market.¹⁰³ In short, CEOs are also constantly evaluated by the labor market in ways that politicians generally are not.

¹⁰¹ See Alan I. Abramowitz, et al., *Incumbency, Redistricting, and the Decline of Competition in U.S. House Elections*, 68 J. POLITICS 75 (2005) (figures 2-3).

¹⁰² While both employment decisions and individual decisions to move in or out of jurisdiction are complicated by a variety of other factors, it will be easier to isolate the cause and effect of corporate policies. Firms can and do run experiments of sorts to test the impact of changes in one element of an employment package on the cost of labor. Corporate policies are much more easily changed than law and the ability to see an immediate impact makes this possible.

¹⁰³ Anup Malani points out how political accountability might be the same as corporate accountability, by noting how laws are just local amenities, like nice weather or a vibrant music scene, and have a measurable impact on movements of citizens in and out of a jurisdiction. See Anup Malani, *Valuing Laws as Local Amenities*, 121 HARV. L. REV. 1273 (2008). Accepting this as true, the accountability is still much less for political actors. While a human resources executive sees the impact of a particular employment policy – say, increased premiums for overweight employees or a no-smoking policy – every time they make any employment decision, the politician who passes a law banning smoking is unlikely to be able to tie this

Second, corporate managers are compensated with high-powered incentives tied to the firm's economic performance, which in turn will be influenced by continual feedback of labor (and, to a lesser extent, capital and product) markets, which will in turn be impacted by any nanny rules. So if a firm implements an anti-smoking policy that raises labor costs without offsetting increases in productivity or reduced health care expenses, and thus puts the firm in a worse cost position vis-à-vis competitors, this can be expected to reduce the firm's financial performance and therefore managers' compensation. It is, of course, possible that this negative will be offset by other moves the firm makes, say launching a great new project, but analysts and investors incorporate all firm information into stock prices, so increased labor costs will make the firm worse off than it would be otherwise, and this will be reflected in the firm's value.

Politicians are, in contrast, paid a flat fee, and their pay is not tied directly in any way to the efficiency of any nanny policy. A similar mistake in the implementation of a government-imposed no smoking policy may generate political discontent, but unless it reaches some critical mass, it is not priced by the political market. Politicians do see the impact of their votes (in the aggregate) in the fund raising market. Those with views popular with moneyed interests (either individuals or groups) will find they are more likely to hold on to their seats and will have more money to pass out to help others get elected, thus improving their status within the party. This market is unlikely to be highly responsive to the feedback on nanny laws, however, since there are many political sides of nanny issues for politicians that they can use to extract contributions. The existence and intensity of these sides need not be correlated with the social cost of a particular nanny policy. The ACLU and tobacco companies or fast food firms may press strongly for anti-nanny legislation in ways that dominate other interests. In other words, market prices are continual distributions, while political prices are lumpy ones, which by definition provides more slack for mistakes.

3. Legal restrictions

Firms also face much more stringent legal restrictions on their conduct than government entities deploying nanny rules. Unfaithful or inept agents are subject to greater legal risk if they are firm managers than politicians. Firm managers are subject to a panoply of legal regimes designed to insure their fidelity to the owners of the firm (that is, the shareholders). For instance, managers can be sued by the firm or the firm's owners for breach of various

directly to net losses in population, and even if this is possible, it is only likely to be significantly attenuated from the decision, and thus a much less powerful signal.

fiduciary duties, be subjected to SEC enforcement proceedings, and be indicted for any criminal conduct, such as diverting shareholder monies for personal use. In contrast, the only meaningful constraint on political behavior beyond elections is criminal charges for bribery. The burden of proof is higher in criminal cases, and this coupled with the fact that there is no private right of action against politicians, means there are relatively few cases compared with corporate litigation to police behavior.

Existing state law also will protect against the worst potential abuses of nanny rules by opportunistic agents. Consider, for example, an employee whose pension is about to vest and is fired on the ground that her smoking habit is inconsistent with a newly enacted firm policy against employing smokers. Two well-established bodies of law, one state and one federal, make this kind of opportunism illegal and untenable for firms. The federal pension law, ERISA, for example, explicitly prohibits firms, even in at-will regimes, from engaging in employment decisions that would deprive individuals of federally guaranteed pensions.¹⁰⁴ In addition, state common law, even in at-will regimes, clearly provides for relief in situations in which monies or benefits that are already earned are taken from employees under the guise of employment decisions.¹⁰⁵ There is some state-by-state variation in what counts as “earned,” with some states holding that bonuses or contractual promises—e.g., an increase in compensation after remaining at a firm for a certain period—are protected from firm opportunism. So, at the least, employees should feel at least as well protected from nanny rules being used as an end run around their employment rights in their state or federal law regime as they would if there were no nanny rules.

B. More and Better Tailoring

A second advantage of corporate nannies compared with state ones is that the rules are more likely to be narrowly tailored, that is, to impose costs on individuals in amounts equal (or nearly so) to the costs these individuals impose on others (be they shareholders or other citizens). Information about the efficacy and efficiency of nanny rules is relayed to corporate managers much more frequently than through political elections and with much greater power than it is for politicians making similar decisions in light of managers’ high-powered incentives. These two arguments can be thought as the frequency and amplitude of the feedback loop.

¹⁰⁴ ERISA 88 stat 829 § 510 (The Employee Retirement Income Security Act of 1974).

¹⁰⁵ *See, e.g.*, *Wakefield v. Northern Telecom, Inc.*, 769 F.2d 109, 112-13 (2d Cir. 1986) (holding a firm cannot fire an employ to deny an already-earned commission).

Firms use nanny rules to reduce specific costs of the firm, such as health care costs, labor costs, or legal risk. When rules are imposed, the impact on costs is felt quickly and readily observable by the firm's managers. The discipline is not just binary (have or do not have) but continuous, since the feedback loop from markets will give the firm's managers precise information about the impact of the rules. For example, a no-smoking policy will quickly impact a firm's operating costs. The policy will almost certainly lower insurance costs, but it will undoubtedly have other effects as well. It may cause the firm's wages to rise, as the firm may have to pay more to attract workers who will be subject to the policy (and are uniquely valuable to the firm) or who put some value on employers not having these rules. These latter employees may be concerned about their externality-causing behaviors being captured by future rules or believe that the nannyism signals something else unattractive about the firm—say, a low tolerance for shirking. Pointing in the other direction, the firm's productivity may increase as the result of healthier and happier employees, say by reducing absenteeism caused by smoking-related illnesses.

The cause and effect will be highly salient for a firm's managers, who are compensated based on defined metrics, which are highly sensitive to the outcomes of nanny rules. This is likely true up and down the hierarchy. For example, a human resources manager may be paid a cash bonus based on the cost efficiency of her management of the firm's health care budget, and therefore will have the right incentives to force employees to internalize the costs they impose on the firm. And, at the top, the CEO's pay, which is highly correlated with firm financial performance, will be highly sensitive to the aggregate impact on firm costs and performance.

Politicians may have some of the similar aims (improving health in a jurisdiction), but face no similar optimization constraint. Politicians are not incentivized to optimize rules, but merely get them right enough to satisfy enough voters to win an election or garner enough political support for horse-trading of various sorts. For the saliency reasons mentioned above, this fact means political nannyism is unlikely to be well calibrated, since there is likely to be nothing but a very crude voter check on the accuracy of nanny rules.

There is an information or data component of this, an error component, and an accountability component, and private parties are likely to outperform their public counterparts in each. In terms of information, the government is not trading off directly against wages and productivity, so it will be more difficult to quantify metrics against which to measure the costs of nanny rules. For example, a no-smoking policy imposed by the government would be designed to improve overall health of the smoking citizenry, perhaps measured by total health care expenditures they add, but there is a very complicated tradeoff here in knowing the social externality. Most obviously, health care costs of a particular

jurisdiction, be it federal, local, or state, will represent only a share of the total costs, and thus jurisdictions will not have perfect incentives to adopt the right level of control. Third-party insurance could solve this problem to some extent, since the insurers would presumably adjust premiums to reflect their best estimates of the costs of various behavioral choices. But this kind of pricing function likely only exists for non-government insurers, since these prices are the only ones set by market forces.

Firms are also likely to see the benefits of behaviors in ways that governmental entities will not. There may be, for example, an upside (say, increased cognitive function and thus productivity) from smoking. Firms will see this benefit directly and be able to weigh it against the increased health-care and other costs that smokers impose on the firm. The state, which also pays for substantial health care costs, sees the downside from a ban, but the upside from smoking is non-existent or much more attenuated. A smoker-friendly jurisdiction might attract workers in industries where this productivity difference is large, and this might increase the size and efficiency of the tax base. But unless these gains are very large or distributed fairly evenly across the jurisdiction (both of which are unlikely), the gains from a smoking ban will swamp any offsetting benefits from a smoker-friendly policy. This is an especially likely outcome because of the nature of electoral politics discussed above. There is no reason to believe that industries in which there would be these types of benefits will be powerful, especially since there are likely to be businesses pitted against businesses, workers pitted against workers, and so on.

This discussion points to another corporate advantage—sorting by employees will be better than sorting by citizens, thus allowing optimization of rules and a lower cost of deploying nanny rules. Blanket rules, be they by firm or by jurisdiction, will be easier to implement, but have the downside of being overinclusive or underinclusive. Effective sorting, however, can help solve this problem—firms where smokers impose no externalities or where the gains from smoking exceed the costs can hire smokers, while those where they do can refuse. It is much more difficult for cities and states to do this. Smaller jurisdictions will be better along this dimension, *ceteris paribus*, but since firms are generally smaller than political subdivisions, this means nanny rules are less likely to be overinclusive or underinclusive. Firms are also more likely to attract individuals with similar preferences on particular issues, like smoking, eating, or other health-related issues. Firm cultures—being healthy, loving the outdoors, etc.—are routinely advertised to the labor market; it is much more difficult for cities, which are larger and more diverse, to do this.

Not only will firms have better and more continuously updated information in the form of feedback from markets, they also will have an advantage in their ability to correct the inevitable errors that will be part of

optimizing programs designed to reduce or eliminate externalities. As noted above, the calculations about what causes externalities, how big they are, and what the best way to reduce them given the heterogeneity of individual utility functions and the inevitable unintended consequences of these kinds of judgments, are likely to be impossible to make in the abstract. Trial and error is the only possible method of achieving the optimal rules, especially when conditions will be highly localized.¹⁰⁶ Along this dimension, firms are bound to be far superior because, among other things, of the dispersal of decision making authority—individual managers are making finely tuned labor market decisions constantly that get immediate feedback from the market—and the greater number of individuals and firms creating and testing rules.

One example of this is the possibility that anti-bad behavior policies may backfire by encouraging individuals to engage in the conduct being discouraged. There are stories suggesting that this is the case for government policies banning smoking or drinking alcohol. Firm nanny rules may not suffer from this problem, since they will not be legal bans but merely corporate policies, which may not generate the same rebellious reaction. In addition, if the reaction does obtain in the corporate context, firms will be able to adapt more quickly by altering or eliminating the nanny rule.

Not only will feedback be better, but the ability to respond to market signals will be easier and faster. Firm decisions are made by fiat: what the CEO says goes. This means nanny rules can be deployed, changed, and abandoned with much greater frequency and ease. The more general point here is that the lower the transaction costs in using and adjusting nanny rules, the more responsive they are likely to be to efficiency concerns. Dictators would have this advantage in the political realm, as would smaller governments and jurisdictions, where decision making is quicker and less costly. There will, of course, be some slack in the feedback loop because the costs of monitoring firms is not zero. The relevant question is not whether firms are perfect along this dimension, but instead better compared with the alternatives. (The potential that slack may be greater in the aggregate for corporate nannies than government ones is discussed below.)

C. Broader Scope

A third advantage of corporate nannies is the ability to more easily implement nanny rules that cover behavior at all times, and thus more likely to

¹⁰⁶ The limits of human knowledge in the face of complex problems and the ability for markets of dispersed agents to achieve efficient results through trial and error is the central insight of the work of, among others, F.A. Hayek. See F.A. Hayek, *THE FATAL CONCEIT* (Chicago 1991) (“The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design.”).

cause internalization of all costs by individuals. A state or local government could ban smoking in public places or even in one's home, but this would not prevent smoking in non-covered locations and, given limited and imperfect enforcement mechanisms, would not fully impose externalities on smokers. State-imposed nanny laws are, for this reason, likely to be broad but shallow—they can cover every individual with one law, but this law will be temporally and spatially limited. In contrast, a firm can adopt a policy that would capture smoking done at any time and place by requiring individuals to be non-smokers as a condition of employment or imposing on smokers an increased health insurance premium or other cost. The rule would be narrow but deep, in that it would be only one employer but would cover all incidence of smoking. Whether a series of narrow and deep corporate rules improves social welfare more than a broad but shallow law is an empirical question. But corporate rules are likely to be more effective if widely adopted. There may be, however, barriers to widespread adoption (discussed below) or duplicative costs from this method of deployment. This discussion merely highlights this advantage of corporate nannyism, all else being equal.

1. Broad government policies

The government can, of course, write laws that are broad and deep. It is not obvious, however, that this is superior to a narrow and deep strategy deployed by many firms. There are two general ways in which the government can write broad and deep laws. First, the government could ban the behavior and enforce the ban with civil or criminal penalties. Returning to the example of smoking, the state could simply outlaw the manufacture, sale, and use of tobacco products. This approach does not preserve choice, however, and in a world with heterogeneous preferences among individuals and imperfect information, is likely to be suboptimal for that reason, except in cases where the benefits are clearly dwarfed by any potential benefits and there are or are likely to be close substitutes for the behavior. (A ban on the sale of trans fats might be a good example of a compelling case that meets this criteria.) Mistakes, which may be inevitable given the complexity of these issues, will be much more costly in the case of bans, if for no other reason than socially beneficial choices will be unavailable for some period of time. In addition, bans may give rise to more negative unintended consequences. The experience with the ban on alcohol during the Prohibition era provides a ready example of how social policy of this sort is plagued by the potential for unintended consequences to overwhelm any benefits of the ban, and how individuals' long-standing preferences are not easily manipulated by governments.

The other manner in which the government can be both broad and deep is the use of penalties, better known as (Pigovian) taxes. A tax on a pack of cigarettes penalizes smoking no matter where or when the smoker chooses to smoke. At first taxes seem like an elegant solution, since in addition to spatial and temporal benefits, they can be adjusted, can be used in experiments to estimate optimal levels, and they can be tailored to optimal levels based on different levels of enforcement by the government. There are numerous problems with the use of taxes in both theory and practice, however, that dramatically limit their effectiveness and efficiency in this context.

2. Shortcomings of government taxes

a. Setting the tax

First, for taxes to work well at internalizing individuals' externalities, they must be set at the right level—that is, at approximately the level of the total social cost imposed by each individual. There are, however, no easy answers to the questions of which actions impose externalities, what the size of these externalities are, or what the impact of internalization will be on unobservable elements of individual utility functions. In other words, decision costs and error costs are likely high when third parties make assessments about externalities, especially when, as noted above, the feedback from externality estimates to actual costs and benefits is noisy or impossible to quantify.

A simple example of this can be seen in the current debate about the best solutions to the issue of global warming. The conventional wisdom among economists is that carbon emissions impose an externality on others, by contributing to an increase in global temperatures, which it is believed will cause a litany of harms to befall humanity. There is, however, much dispute about the existence of these externalities and even more dispute about their size. So while economists generally support a Pigovian tax on carbon emission to force internalization of harms caused, there is a huge range in expert valuations of the needed size of the tax (and thus the estimate of the externality). Consider two estimates from leading researchers in this area: William Nordhaus argues that a tax of about \$30 per ton of carbon (rising to about \$85 in 2050) is about right, while Nicholas Stern concludes that a tax of about \$300 per ton is necessary to optimize private carbon emissions.¹⁰⁷ The merits of this debate are beyond the scope of this paper; the point here is simply that these calculations are messy and

¹⁰⁷ Compare William Nordhaus, "Critical Assumptions in the Stern Review on Climate Change," 317 *Science* 201 (July 13, 2007) with NICHOLAS STERN, *THE ECONOMICS OF CLIMATE CHANGE* (Cambridge 2006).

highly uncertain, even when millions of dollars and bright minds are at work in estimating the answers.¹⁰⁸

While the scale of most nanny regulations will be smaller and the calculations less complex, the problems inherent in estimating the actual social or firm-specific costs from, say, smoking, remain daunting. As noted above, actuarial tables will reflect some of these, and insurance companies are as well placed as anyone to make estimates, but the complicated nature of health care payments in this country, coupled with the other benefits and costs of banning smoking or eating trans fats, make any attempt to exactly quantify the costs of behaviors very difficult. This perhaps explains the variation in policies of various political entities—some, but not all, localities ban “unhealthy” choices, and those that do choose a wide range of methods and reaches of the programs.

Firms, of course, will face these same problems in designing their own internal nanny regulations. The difference in expected efficiency is getting the right answers not through deliberation and study but rather market-based and market-disciplined experimentation. It is only through repeated experimentation and tinkering that the optimal Pigovian taxes be discovered. This is especially true since the calculation involves not only macro issues, like health care costs, but also localized data and information too, like employee happiness and productivity. Pigovian taxes implemented by governments could be equally efficient if set and updated as often, if based on feedback from market experiences, and if magnified by the high-powered incentives that drive firm manager conduct. None of these factors, however, obtains in the current process of setting sin taxes, either at the legislative or executive level.

b. What to tax

Second, the questions about what to tax are significant. Say a government wanted to reduce obesity through taxation. The most common suggestion is to tax food; the Twinkie tax discussed above is a classic example. It could tax foods with lots of sugar or carbohydrates or fats, but these components are only loosely correlated with weight. Putting aside issues of regressivity and political feasibility (considered immediately below), it isn't clear that even an omniscient government could determine how much to tax a Twinkie in order to optimize social consumption of them. Food is just one of many inputs that determine

¹⁰⁸ Another example of this forecasting problem can be seen in Europe's carbon emissions market. The cap-and-trade system was highly sensitive to the number of initial permits, and the process for determining this number was set based on political compromise. The number of permits was set too high, which drove the price to near zero and caused the market, designed to force firms to internalize their costs, to nearly collapse. *See* James Kanter, “Carbon Prices Tumble as Global Downturn Bites,” *NY TIMES* (January 21, 2009); Carter F. Bales & Richard D. Duke, “Containing Climate Change: An Opportunity for U.S. Leadership,” *87 Foreign Affairs* 78 (Sep./Oct. 2008).

weight (another important one is exercise), and taxing it alone without consideration of the others is likely to impose large social costs without clear benefits. Taxing inputs instead of outcomes is likely to be both over and underinclusive, and given the other incentives for government tax authorities, doubtfully correlated with externalities.

Taxing food will also be hopelessly complicated. Food is composed of numerous ingredients and is not inherently good or bad. A candy bar eaten by an obese child every day is likely to have one effect, while one eaten by a marathon runner another, and the tax will thus not likely capture the externalities (positive and negative) in each case. In addition, the administrative burden in trying to ascertain the costs and benefits of each food or each ingredient are likely to be daunting if not impossible. Food taxes, like other taxes, are likely to generate substantial political opposition, from powerful interests on the supply and demand side, and especially because any taxes are likely to be highly regressive.¹⁰⁹ Moreover, the inevitable compromises inherent in the tax-setting process are likely to distort the cost-allocation process from the optimal one, assuming we could know what that is.

Taxing food may also lead to perverse consequences. Recent research suggests that the best way to reduce obesity is to *lower* food prices, not raise them. Professors Charles Courtemanche and Art Carden find that the presence of so-called big box retailers (that is, Walmart, Sam's Club, Costco, etc.) lowers overall food prices, which in turn increases the consumption of fruits and vegetables, especially for "women, minorities, urban residents, and the poor."¹¹⁰ This study simply highlights the difficulty in taxing inputs instead of focusing on outputs.

Another series of studies supports the argument, by comparing the types of foods that are healthy and unhealthy. The studies find that energy dense food is less healthy but also less expensive, while less energy dense foods are more healthy and more expensive.¹¹¹ From this, the authors argue that imposing higher taxes on food, without regard to this tradeoff, would have negative distributional consequences.

The obvious solution to these problems is to tax weight, since that is what allegedly imposes social costs. But this may be politically very difficult to do.

¹⁰⁹ An example is the recent failure of Governor David Patterson's proposed 18 percent tax on non-diet sodas in New York State, which was withdrawn after widespread disapproval. See "Paterson Admits Obesity Tax Plan Has Failed," wcbstv.com, (Feb 13, 2009) available at <http://wcbstv.com/politics/obesity.tax.soda.2.934147.html>.

¹¹⁰ See Charles Courtemanche and Art Carden, "The Skinny on Big Box Retailing: Wal-Mart, Warehouse Clubs, and Obesity," Working Paper Series, Sept. 4, 2008, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1263316.

¹¹¹ Adam Drewnowski, *Obesity and the Food Environment: Dietary Energy Density and Diet Costs*, 27 AM. J. PREVENTIVE MED. 154 (2004); Adam Drewnowski & Nicole Darmon, *Food Choices and Diet Costs: An Economic Analysis*, 135 J. NUTRITION 900 (2005).

Political consensus would have to be garnered, and it would have to overcome inevitable interest groups for obese individuals, scientific claims about genetic predisposition, and socio-economic claims about access to and affordability of high-quality and healthy foods. The need to achieve political consensus and resistance to taxes generally are another reason they are likely inferior to corporate programs. There has been some movement in this direction in other countries—the United Kingdom is considering a tax on health care rates tied to body mass index—but it is not a serious part of the current debate on health care costs here in the US.

Enforceability of a weight tax would also be difficult. One can imagine all sorts of possible ways of government monitoring of individual weight, but the real and political costs are likely to be very high. For example, the government could set up weigh stations, say at federal, state, or local agencies or doctors' offices, and mandate every individual in a family weigh in before paying their taxes. The silliness of this idea is reinforced by the fact that almost 40 percent of the population (and statistically likely to be more obese and to be on the government's health care dime) pay no taxes. It also ignores the problem inherent in single-time weigh-ins: individuals would have incentives to binge diet before weigh ins, as every pound means dollars. This kind of behavior is unlikely to be healthy, but would be very likely in this regime. Moreover, testing like this would inevitably raise Fourth Amendment challenges, since these tests would arguably be "searches." Although various types of searches may eventually be declared "reasonable," the existence of constitutional rights in the background raises the cost of developing these programs and of innovation.

Firms in contrast can easily deploy low-cost and regularized mechanisms for measuring weight (or, more likely, body-mass index), since employees generally report to an office or place of work each day. In fact, some firms are already doing this. Stepping on to a scale periodically at work may seem intrusive to some, but it is far less costly than the government model described above. The same result obtains for smoking, drug use, or other dangerous activities.

c. Who to tax

Third, broad, state-imposed taxes are regressive, and thus likely to impact poor individuals more harshly than wealthier ones. For example, assume the government determines that the social cost of the average individual consuming a Twinkie or a pack of cigarettes is \$2. Wealthy individuals may not alter their behavior because of the small amount of the tax (leading to under-internalization), while poorer ones will be disproportionately effected. While it is difficult to say that there can be over-internalization, since presumably no smoking or consumption of Twinkies might be a good thing, the economic impact

for poorer individual may be concerning, and therefore help mobilize opposition to this type of tax regime.

Company-imposed “taxes” on unhealthy or otherwise costly activities might be regressive too, since flat fees for certain activities would have the same impact that state-imposed taxes would. But, unlike political taxes, firm penalties may be easily tailored to the individuals’ wealth in ways that would optimize the externality tax. For example, firms could impose Pigovian taxes on weight or smoking or other unhealthy activity by increasing insurance premia for employees proportional to wage levels. This would be impossible to do with a Twinkie tax or cigarette tax, since sales of all such products would have to be taxed differently depending on the buyer’s income. The government could optimize in the same way firms could by using the tax code instead of sales taxes, but this would involve general taxes unrelated to specific activities, would involve steep administrative costs, and, in any event, would not cover many individuals that pay no income taxes. Firms not only can do this but they have incentives to do so, since they are not fundraising with nanny taxes but are trying to assign costs where they arise. If firms over or under-assign these costs, the impact will be felt in the firm’s labor or other costs.

d. How taxes are spent

Fourth and finally, the money from political taxes can be (and is likely to be) diverted from paying for the costs imposed by a given activity to pay for some other government program, and, as a result, the amount of regulation will not be proportional to the harm caused by the activity, but rather to the political power of the relevant interest groups. For example, the billions of dollars in settlements states received from cigarette companies were intended to help offset increased state medical costs for smokers, but most of these monies were diverted to other purposes.¹¹² It might be argued that this diversion merely frees up additional monies that would have been spent on the other purposes to be spent on health. There is no evidence to support this claim of fungibility, but it is possible. That said, the argument misses the point. By delinking the raising of monies from the cost those monies are supposed to offset, the probability that the externality tax will be set at the socially optimal level is reduced. This is because the tax rate (or cost imposed) is unlikely to be set correctly at first, and without a linkage between money in and costs reduced, the feedback effect that would help

¹¹² According to a March 2005 GAO report, about 60 percent of these funds were used to balance state books or for general purposes, while about 20 percent were used for “health.” See “Tobacco Settlement: States’ Allocations of Fiscal Year 2004 and Expected Fiscal Year 2005 Payments,” GAO Report (2005), available at <http://www.gao.gov/new.items/d05312.pdf>.

establish the optimal tax rate is lost.¹¹³ This feedback is powerful for firms, since nanny taxes are useful only insofar as they directly offset behavior-specific costs. If firms charge too much for smoking, labor costs will rise and the firm will be disadvantaged vis-à-vis other firms. There is also no evidence or reason to believe managers are using nanny taxes as a way of aggrandizing power or lining their own pockets. If managers wanted to do this, there are much easier and better ways.

The argument for the greater accountability of corporate nannies here is premised on the assumption that what the nanny does with the money ex post influences the setting of the nanny level ex ante.¹¹⁴ If the costs are not fed back to the rule-setting mechanism, there is less constraint on agents from taking monies saved by the nannyism for personal (as opposed to their principals') use. This is a familiar agency-cost problem, and the argument here is that agency costs are lower in the corporate context than the state context, especially when it comes to the deployment of revenues raised or saved.

Some related problems are that the state may sue to recoup costs that are ultimately paid by the federal government, and therefore delink the imposition of costs and benefits. This may also happen within different branches of government within a particular jurisdiction. A good example of this problem is seen in the experience of the State of West Virginia's use of litigation to recoup the costs imposed by abuse of the drug OxyContin from its manufacturer. The attorney general of West Virginia appointed four law firms to sue the manufacturers, ultimately collecting settlements totaling \$10 million. The suit was brought on behalf of West Virginia's Medicaid program, but the attorney general's office kept the \$6.7 million that was not paid to the law firms in the case. According to press accounts, "[t]he federal government, which pays a significant portion of the state's Medicaid bills, remains furious the program received none of the settlement"¹¹⁵

Firms have not sued for recoupment, and therefore are not susceptible to the shortcomings of litigation incentives. Instead, firms focus almost entirely on ex ante nanny regulations. And whether firms engaged in this kind of activity or traditional Pigovian taxes, there is no chance of diversion, since cost savings run directly to the firm's bottom line.¹¹⁶ In addition, any monies likely to be

¹¹³ It doesn't really matter what the rule-setter does with the money it collects or saves, as long as the amount of the externality is set appropriately. So, if a nanny had a computer that revealed perfectly the societal cost of smoking, the nanny could set the Pigovian tax or adjust a ban in ways so as to impose exactly that cost on individual smokers. If this is set correctly, the state could burn the money or give it away to the poor in Ethiopia, and still achieve the optimal level of internalization.

¹¹⁴ This problem is especially acute in cases in where the government uses litigation to recoup payments made from the parties allegedly responsible for causing the harm in the first place.

¹¹⁵ Kimberly Strassel, "Challenging Spitzerism at the Polls," WALL ST. J. A11 (Aug. 1, 2008).

¹¹⁶ If a weakness in this argument is executive pay, then that is a problem with executive pay that should be resolved on those terms.

raised/saved by firms are trivial in comparison to firm value. Accordingly, the possibility of biasing firm-value decisions, say by sabotaging labor markets to increase firm revenues, is difficult to imagine, since CEOs have high-powered incentives to maximize firm value. In contrast, political officials do not have the same high-powered incentives, and therefore the potential for manipulation and self-serving conduct is much higher. For example, in the case from West Virginia above, the attorney general is accused of routing the state's prosecution of the case, and \$3.3 million in fees, to law firms that helped fund his campaign. In addition, the amounts at stake (from either settlements or sin taxes) are large compared with state budgets.¹¹⁷

A related problem is that state-imposed taxes are likely to be much stickier than corporation-imposed taxes. While a firm can adjust a nanny "tax" on smokers or skydivers or the obese on a daily basis depending on feedback from the labor market, idiosyncrasies of individual cases, and new evidence about the existence and magnitude of externalities, political entities cannot be so nimble. Removing taxes requires political consensus, which is often difficult to build on tax issues, especially when the effect will be depriving the jurisdiction of revenues.¹¹⁸

An example of the potential for diversion, resulting mismatch, and stickiness of taxes is the current regime in Pennsylvania for taxing alcohol. In 1936, after a major flood killed 24 people and caused millions in property damage in Johnstown,¹¹⁹ the legislature instituted a *temporary* tax of 10 percent on all alcohol sales to raise the \$41 million needed to rebuild the city.¹²⁰ The goal was achieved five years later, but the tax didn't die. In fact, it survives today, nearly seven decades after its purpose was achieved. And it was raised over the years, standing at 18 percent today. The tax, which raises over \$200 million per year, is not used to offset the externalities from alcohol consumption—e.g., paying for abuse treatment centers, victims of alcohol-related crimes, etc.—but rather goes into the general public fisc for legislators to hand out as they see fit. The delinkage from costs, the tendency to use so-called sin taxes for other purposes, and the stickiness of this tax all undermine the claim of Pigovian tax efficiency in the case of nanny laws.

Taxes may be either too low or too high—the point is they are not

¹¹⁷ State taxes on just tobacco were about \$13 billion in 2005, while total state expenditures were about \$1 trillion.

¹¹⁸ The two biggest sin taxes – alcohol and tobacco – account for about 3 percent of total state revenues for states like New York, California, and Illinois. For some other states, like Nevada, the amount is closer to 5 percent. Estimates made by author based on data from state department of revenue web sites. *See, e.g.*, <http://www.revenue.state.il.us/>.

¹¹⁹ This is not *the* Johnstown Flood; that was in 1889.

¹²⁰ See "Drinkers Still Pay Flood Relief Tax Enacted in 1936," (July 12, 2005), available at <http://www.wgal.com/news/4711497/detail.html?subid=22100741&q=1;bp=t>.

implemented based on actual costs, and therefore are likely to be socially inefficient. Moreover, it is unlikely that the taxes would be too low. To be sure, Americans generally abhor taxes, but sin taxes are a notable exception to this rule, and once sin taxes become sources of general revenue, the only constraints on them is high-cost political action. As for other potential nanny taxes (non-sin, non-minority), these are likely to face significant political opposition since people generally dislike paying taxes. For example, taxes on weight would impact a large percent of the population, and would therefore likely be opposed by strong political forces. This obstacle will be much lower for employer-imposed fees or taxes designed to achieve the same goals. In fact, as discussed above, employer programs can be disguised in ways that make them more palatable (that is, carrots instead of sticks) than any potential government program.

D. Greater Experimentation

Increased experimentation in the design and implementation of nanny rules is another advantage corporate nannies may have over state ones. Given the uncertainty about the existence and size of externalities, as well as the optimal way of forcing their internalization, a policy that encourages experimentation with different types and degrees of nannyism is preferable to a one-size-fits-all approach. Corporate nannyism is bound to result in more experimentation on the margin than political nannyism for several reasons. Most obviously, there are many more firms than political subdivisions, and therefore, assuming a constant level of innovation and use among all third parties, we would expect this to result in simply more different nanny rules.

There is also reason to believe that rates of innovation and use will be much higher among corporations. As discussed below, there are some limits placed on the reach of nanny rules imposed by federal and state laws, including constitutional provisions. These laws will fall more heavily on state nannies, because of the state-actor limit on the reach of constitutional prohibitions. For example, constitutions in New Jersey, New York, California, and elsewhere define certain health conditions, like obesity and high-blood pressure, as protected. This limits the ability of states somewhat, either in law making or in employment considerations, to engage in externality discrimination. Private employers are not as obviously affected by this limitation since no state action is generally involved in private business decisions. (Some state statutes and constitutional provisions apply specifically to private employers.)

Innovation is likely to be much higher in private firms for another reason—the lack of a need for broad political consensus to enact nanny regulations. Political entities in this country are democracies, while firms are dictatorships. While a majority of legislators (and thus the population) in a

particular jurisdiction must support a new nanny rule, firms can implement new rules without debate, explicit approval from those effected, and without a vote of owners. Building a political consensus on, say, banning smoking in a jurisdiction, is costly, in that legislators must first educate themselves on the issues, then convince their constituents and each other about the merits of the ban, and finally manage the interest group struggle that such a ban will surely engender. The time, money, and political capital necessary to achieve consensus on nanny issues is undoubtedly significant. Especially compared with how a firm would approach the same rule. Shareholders vote (by selling shares) not on corporate policies but corporate outcomes. This means that there is no input on employment policies by either workers or owners, but merely a check on them based on market reactions (of either labor costs or share price). Since the accountability check is *ex post* rather than *ex ante*, there will be, *ceteris paribus*, more experimentation.

The point made above about the cost of nanny rules hitting a firm's bottom line quickly and clearly also points in the direction of more experimentation. When decision makers have feedback about what works and what doesn't work they are more likely to engage in numerous small experiments, since the impact can be measured and good policies adopted and expanded, while bad policies are abandoned. Since managers are insulated by and large from removal for mistakes, unless they serious impact firm earnings or are not made in good faith, and since managers' compensation is highly correlated with outcomes, this also supports experimentation. To be sure, politicians can take polls, both *ex ante* and *ex post*, on the desirability of nanny rules. Politicians may not want to wait for *ex post* polls, since the damage to reputation may already have been done, and *ex ante* polls may not be as informative about true preferences. In addition, it is not clear that polling is an effective way of measuring the efficiency of rules intended to internalize costs. It may be that a majority of individuals in a jurisdiction favors a smoking ban, simply because they do not like the smell of smoke, but the ban might impose large dead weight losses on society. In the corporate context, where labor costs would be immediately impacted by a similar ban, the identification of costs and benefits of the policy would be more obvious.

A final point about experimentation is worth mentioning—firms are likely to adopt “good” nanny rules deployed by other firms. Corporate policies will be publicly disclosed, and this will allow other firms to adopt policies that work. And, since competitors will want to match cost-saving policies, and firms in other industries will want to lower costs as well, efficient nanny rules will be copied quickly and ubiquitously. There will no doubt be copying by political jurisdictions too, and we have seen some of this as smoking bans and other nanny laws have proliferated over the past few years. Given the point above about political consensus, it would be not unreasonable to suggest that corporate nanny rules

will be more viral than state ones. But, at a minimum, there is no reason to believe corporate cascades will be less likely than political ones.

E. Better Monitoring

In terms of practically designing and enforcing nanny rules, firms may have a significant advantage over the state when it comes to monitoring individuals, since most employees are physically at their place of employment for many hours per day. Imagine a state and a firm that both want to charge individuals differential health care premiums based on their body mass index. (The United Kingdom, which pays health costs for all citizens out of tax revenues, has considered this, as have several private American corporations.) While the firm can require employees to literally step on the scale at set or random intervals when they come to work, the state would have to additionally mandate doctor visits at the same intervals or send health inspectors to individuals' homes to enforce the policy. This would add enormous costs to the health care system, which may even swamp the benefits of the internalization effort in the first place. Although the idea of health inspectors visiting homes sounds Orwellian, some governments are doing exactly this. Taiwan deploys inspectors to check up on individuals who meet certain criteria established by the national health authorities.¹²¹

To be sure, the monitoring advantage will depend on the type of nanny regulation. The state may have monitoring advantages for certain types of regulations for three reasons. First, the state has already deployed numerous government officials, like police officers, who may be better positioned to monitor certain activities. A ban on cell phone use while driving is a good example of when this is probably true. The police, or more and more traffic cameras, are a more effective and efficient way to enforce this rule than if individual firms deployed a redundant force to monitor employees while driving to and from work and on off days. Some firms have a no-cell-phone-while-driving policy, but these likely piggyback on state or local ordinances, in that individuals getting tickets for this may face job consequences. There are some cases in which firms have actually fired individuals for violating this policy, without any state involvement.¹²² But these are likely to be rare and serve more as a statement of principles or a very weak deterrent.

¹²¹ See, e.g., Interview with Uwe Reinhardt & Tsung-mei Cheng, *Frontline: Sick Around the World*, available at <http://www.pbs.org/wgbh/pages/frontline/sickaroundtheworld/interviews/reinhardt.html> (comment of Tsung-mei Cheng) (“So currently the rules are, say, if a patient goes to see a doctor [a certain amount], . . . the person then gets a visit from the government, the Bureau of National Health Insurance, and they have a little chat.”).

¹²² An employee of BP in Texas was recently fired after his boss observed him talking on his cell phone while driving. This might sound extreme, but consider the potential liability that firms face from this

When evaluating nanny rules along the dimension of deterrence, it is important to keep in mind that the state has an advantage in the type and severity of penalties it can impose. And since deterrence is simply the product of the probability of detection and the expected penalty, the state can, *ceteris paribus*, achieve greater deterrence. The state can imprison violators of nanny rules, while firms can impose only quasi-fines or loss of employment. This means that the state can get more deterrence with less enforcement/monitoring costs. Whether this balances out the dramatically reduced monitoring costs for firms described above will depend on the type of nanny rule—in some cases (like the cell phone ban) will, while in others (obesity rules) it may not.

Although a characterization of which nanny rules are more efficiently provided by the state and which by private firms is beyond the scope of this paper, some boundaries are clear. It would be difficult for a firm to monitor whether individual employees are consuming trans fats sold by restaurants or food companies; it would be much less costly and more effective to simply ban the use of trans fats in foods. On the other hand, charging smokers higher insurance premiums is something firms can do much more efficiently, since they can easily test individuals at work randomly for smoking. (The state could try to achieve the same result through the use of Pigovian taxes on smoking, but, as discussed above, this is unlikely to be as efficient as corporate efforts.)

We can be confident that firms will choose to implement nanny rules where they have some comparative advantage or can free ride on the efforts of the state. In this way, corporate nannyism is likely to be a compliment to, rather than substitute for, state nannyism. In other words, there is a market of sorts for the provision of nanny rules, and insofar as the playing field is level, we should expect the market to sort rules efficiently.

F. Less Politics

A final suite of benefits of corporate nannyism arises because they involve fewer political considerations, meaning outcomes are more probable and less likely to be abused by powerful political interests. The first of these is the practical advantage that comes from the fact that there is an existing and fairly powerful political movement devoted to restraining the nanny state. As mentioned above, political consensus is needed to adopt state nanny rules, whereas CEOs can adopt them via fiat. And there are political forces strongly opposed to extensions of state nannyism. There are numerous websites, magazines, and books devoted to nothing but resisting the nanny state. David

behavior. In a recent case, International Paper paid over \$5 million to settle a claim that its employee using a cell phone while driving caused an accident in which a woman lost an arm. See Janet Conley, "Cell Phone Use in Car Leads to \$5.2 Million Payout by Employer," *Law.com*, Feb. 13, 2008, available at <http://www.law.com/jsp/article.jsp?id=1202815251120>.

Harsanyi's recent expose—"The Nanny State"—is typical of this genre, as is "Reason" magazine, and for that matter the Libertarian Party. Even when anti-nannyism is not central, it is often significant. A large number of articles and positions taken by right-leaning commentators, scholars, think tanks, and politicians contain a healthy dose of libertarian thinking on state regulation of individual behaviors.

No such thing currently exists for corporate nannyism, so it is simply easier at this point for firms to adopt nanny rules. Proposed extensions of nanny rules in the political sphere are met with resistance politicians, interest groups, and commentators on the other side of the issue; there are no analogs that consistently oppose corporate nannyism. There have been some attempts to push back against nanny efforts by firms to date, but these have been small, disorganized, timid, and largely unsuccessful compared with resistance to state analogs.

Some individual employees have filed lawsuits to contest nanny rules or particular outcomes (usually getting fired), but these rarely succeed. (These cases are discussed more fully below.) Where these cases do succeed, there is usually some state statute or constitutional provision that undergirds the argument; this is another type of push back, as discussed above. Although law can be useful in this regard, it is by far the exception and not the rule when the current landscape of corporate nannyism is examined.

Since employee acquiescence in corporate nannyism may be in part caused by a collective action problem, unions or collective bargaining would seem to provide a potential counterweight. As a practical matter, unions are far weaker today than they were just a few decades ago, representing just 8 percent of the non-governmental workforce compared with 35 percent in 1940.¹²³ So even if one expected the degree of corporate nannyism to vary based on the level of unionization in an industry or across firms, unions would provide very little break on this trend given their relatively weak position overall in the economy. This weak position means that even unionized firms may be able to impose nanny rules with low costs/resistance, since their relative competitive position will drive employment policies. In other words, firms will either impose nanny rules to force individuals to internalize costs or, if they cannot because of union push back, reduce some other form of employee compensation. Since this latter tactic is likely to apply across the board, the existence of unions will lead, on the margin, to a subsidy for cost externalizers.

Another political consideration that cuts in favor of corporate nannyism is the potential for nannyism to pervert the political process. This might happen in several ways. For one, money raised/saved from nanny regulations can be

¹²³ Bureau of Labor Statistics, Table 3. Union affiliation of employed wage and salary workers by occupation and industry. <http://www.bls.gov/news.release/union2.t03.htm>.

diverted from its intended purpose to other purposes that satisfy the preferences of legislators or other constituencies. Since agency costs are undoubtedly higher in the political environment, this risk is especially likely to arise. If this happens, it not only may cause an inefficient level of nannyism, but it also may erode public confidence in the political process, at least for the constituencies that are not benefiting from the redirection. The examples cited above about the West Virginia Attorney General diverting funds from nanny settlements and the example of the misallocation of cigarette settlements are just two of the many examples of this and how the negative effect it can have.

Ironically, if these opportunities for rent seeking by political actors arise, this may lead to under-detering nanny rules. For example, if the state imposes a Pigovian tax on cigarettes and this tax becomes a source of significant revenue for the state, the state may have suboptimal incentives to set the right level of the tax. Once the behavior becomes a profit source, the state has the incentive to optimize the return from the behavior, not to minimize the social costs of the behavior. It may be, for instance, that banning the sale of cigarettes is socially optimal, but politicians would have an incentive to keep it legally solely for the money.

This possibility is impossible to imagine in the case of firm-based nanny rules, which are not about raising revenue but reducing costs, are not divertible (since there is but one bottom line and firm managers are constrained by legal duties and reputation from expropriation), and would be competed away in labor markets if excessive. In addition, unlike other firm policies, cost reductions through nanny rules cannot be used to raise barriers to entry or create otherwise anticompetitive positions.

IV. OBJECTIONS AND DISADVANTAGES

This section raises some potential objections and limits on corporate nannyism.

First, the tailoring feedback loop may not work if firms are monopsonists in the labor market. This is just another way of saying that nannyism will be well calibrated only when there are restraints on the power of the rule setter. This is true whether the nanny is the firm or the government. If either party has a monopoly over labor or citizenship, there is less restriction on what they can do and therefore more possibility of abuse or errors going uncorrected.

No employer, however, has sufficient leverage in the labor markets to impose costs on employees without risk for the employer. Unlike in product markets where firms can conceivably have monopoly positions, there are no firms who are the only one that can employ particular skills. Microsoft utterly dominates the personal computer market, but computer engineers and programmers have innumerable other options, including rival firms, different

computer industries, the government, academia, and self-employment. The examples of the company towns described above provide nice support for this claim. Despite the remote location of these towns and much less robust labor markets (due to higher transportation costs, less labor market mobility, fewer employers, less skilled labor, macroeconomic conditions, and so on), company towns found they could not get away with arbitrary rules that did not reflect the preferences of their employees.¹²⁴

Second, corporate rules may not take into consideration all the relevant costs and benefits of their policies. The government must, as a matter of political necessity, take into consideration the benefits of smokers in ways that are broader than firms, and if these are large, government nannyism might be more effective on the margin. One reason why firms do not fully internalize the social costs of their rules is the existence of government welfare policies. Since firms do not pay all of the health care costs of employees over the lifespan of the employee, and since health care problems from particular ailments may arise after firm-paid insurance lapses, firms may not have the optimal incentives to deter particular behaviors. For example, the federal government pays most health care for workers over the age of 65 through an effectively mandatory Medicare plan.¹²⁵ This means that firms can put some health care costs onto the federal government, and therefore are not incentivized at the proper level to reduce behaviors to the optimal level. To solve this problem, one would have to do away with government subsidies or charge differential amounts based on behaviors or conditions.

Liberty interests are another example. Of costs that may not be captured in firm-based calculations. Citizens, whether they engage in the targeted behavior or not, may value the liberty interest inherent in choice. These are very difficult to measure in the abstract, to aggregate, or to trade off. Some of these values and concerns will be part of firm-level calculations, as regulated by the labor market. Happiness, for one, will be something integral to a firm's calculation of the intra-firm social welfare calculation. Others, like liberty interests, however, will not be relevant, except insofar as they impact employee utility directly and in ways observable by firms. If these interests are significant, labor markets should force firms to take them into consideration. After all firms already spend considerably to satisfy employees' non-monetary preferences. For example, firms offer

¹²⁴ Historians note that “[w]orkers unsatisfied with their situation could pick up and leave.” John S. Garner, *Introduction*, in JOHN S. GARNER, ED., *THE COMPANY TOWN: ARCHITECTURE AND SOCIETY IN THE EARLY INDUSTRIAL AGE* 7 (1992).

¹²⁵ Medicare, the health insurance policy for Americans over the age 65, is effectively mandatory for individuals over 65. Opting out of the program is extremely expensive because, in part, it requires forgoing all other government retirement benefits, as well as paying very high amounts for personal insurance. See Social Security Administration, Policy No. HI 00801.002, “Waiver of HI Entitlement by Monthly Beneficiary,” <http://policy.ssa.gov/poms.nsf/lnx/0600801002>.

pleasing work environments, fringe benefits, support services, company picnics, and numerous other things designed to make employees happier in their work and lives. To be sure, these are selfish acts on the part of the firm to increase productivity, but they are directly in response to individuals' demands for happiness at work. A smoking ban, say one that included smoking at any time, that would alienate workers and make them feel unfairly monitored by their firm would be no different than the firm failing to provide comfortable chairs—workers will leave the firm or demand higher wages to offset the loss of utility.

Market constraints may work well where the non-monetary utility is sufficiently large for individuals to factor into employment decisions on the margin,¹²⁶ but may not where the interests are collectively large but individually small. This is the familiar collective action problem, and it may inhibit the ability of labor markets to clear these preferences of individual employees. In these cases, however, there remain political backstops that can account for these preferences. Unions, legislatures or courts can intervene to recognize and protect interests that are not relevant to firm employment decisions but that impose costs on society. Here the law merely acts to internalize to the firm the negative externalities it is imposing on society by not taking into account individual preferences in its attempt to internalize to the individual employee its costs imposed on the firm. For example, citizens in a particular jurisdiction may value the freedom from monitoring of their private lives very highly, but not enough for any individual to resist monitoring by an employer. In this case, there may be political pressure to restrict this kind of monitoring by employers. There is a danger that this type of political check will be used in ways that unbalance the playing field in the direction of state power and state provision of paternalism, since this enables the state (and the politicians that run it) to keep power, extract campaign contributions from lobbyists and citizens, and so on. In addition, political consideration may inevitably represent concentrated political interests—this is part of the “Bootleggers & Baptists” or “Cigarette Vendors and Constitutional Defenders” problem. This question is considered below.

Third, there is the possibility that if firm nanny rules are widely deployed, the sum of error costs (in the feedback loop) will be greater than those in the political context. This is an application of the Hand Formula to nannyism: many corporate rules with small error costs may exceed a few political rules with larger error costs. This is an empirical question that cannot be answered in the abstract. At this time, however, there are many more political rules than corporate ones, and it seems like there is convergence between what political and corporate forces want to regulate. This was true in the era of company towns, when both corporate and government owners acted similarly, and there is every indication

¹²⁶ As in other contexts, not everyone has to be sophisticated or sensitive to these issues, since the marginal buyers will be the price setters.

that the things one is interested in regulating—smoking, obesity, dangerous activities—the other is as well.

Fourth, there is a risk that the kind of corporate nannyism defended in this argument will be extended to invidious or otherwise unacceptable forms of discrimination, such as “no-Republicans” or “no-homosexuals” policies. Although some employees or citizens may have a preference for this kind of discrimination,¹²⁷ society may reasonably want to discourage individuals from acting on their preferences for this type of discrimination, because it is actually not demanded or because the cost borne by the individuals discriminated against exceeds the benefits of those doing the discrimination. There are some examples in the case law and press about firms firing individuals for such things as adultery,¹²⁸ but the nanny rules as defined in this paper are different. This type of discrimination is not part of the “market for paternalism” because it is not inevitable: governments cannot engage in this kind of discrimination because of existing statutes, and therefore the arguments about competition with firms does not obtain. Only those behaviors that directly lead to costs and are provided by both the government and private firms are those covered by this argument.¹²⁹ Moreover, where there is invidious discrimination, on its face or in its impact, the government can intervene, either with a statute or judicial doctrine, to limit firm opportunism or abuse.¹³⁰ Thus attempts to use cost internalization as a pretext for satisfying preferences for racial, gender, or other socially destructive forms of discrimination are illegal or can easily be made so. If the class of invidious discrimination is expanded, to, say, obesity, it should be recognized that this will crowd out private provision of nanny rules, which may reduce the efficiency of social policies designed to control them.

A fifth potential objection is that some nanny programs couched in voluntary terms may be more coercive for lower-income employees. According to Mark A. Rothstein, director of the Institute for Bioethics, Health Policy and Law at the University of Louisville School of Medicine, current corporate nannyism amounts to a “tax that some of the lower-paid workers perhaps can't afford.”¹³¹ The regressivity problem exists with any cost-bearing rules, however, whether a

¹²⁷ GARY S. BECKER, *THE ECONOMICS OF DISCRIMINATION* (Chicago 1971).

¹²⁸ See, e.g., *City of Sherman v. Henry*, 928 S.W.2d 464 (Tex. 1996) (holding that police officer fired for having adulterous relationship with another officer's wife was not deprived of constitutionally protected rights).

¹²⁹ There are reasons to believe that even invidious discrimination is not problematic. Employers compete in markets for labor, and assuming these are liquid and there are no monopsonist buyers of labor, these markets constrain excesses, such as not hiring short people. If a firm refuses to hire short people, it will be losing the opportunity to hire productive workers, its labor costs will rise, and it will be disadvantaged vis-a-vis competitors who draw from the entire labor pool. Firms will therefore have incentives not to discriminate in ways that are not related to productivity or other costs.

¹³⁰ For example, taking a pension. See *infra* note ___ and accompanying text.

¹³¹ See <http://www.washingtonpost.com/wp-dyn/articles/A38566-2005Feb19.html>.

firm or the state is imposing them. Unless one has a theory about why the political process is more likely to avoid this problem than the labor market, the argument fails. And certainly society's experience with certain sin taxes, which fall disproportionately on the poor, are an example of government failure in this regard. While firms will not always get it right or be superior to governments in this regard, as discussed above, there are ways firms can adjust policies and pay to take account of these problems in ways it would be difficult for political entities to do.

A sixth objection might be that costly behaviors by individuals are not correlated, and that there may be a benefit from merely letting one individual's cost-imposing behavior cancel out another's. So, if all employees were either, say, smokers or obese skydivers, the costs imposed on each group on the other would be offset, and therefore the efficient strategy would be not impose any cost-shifting scheme. This scenario is possible, but seems highly unlikely. Risky behaviors, either health or activity related, are likely correlated, so that the employees can be roughly divided into cost bearers and cost imposers. In any event, if it is true, firms are likely well positioned to figure this out, and, are more likely than governments to be able to discriminate against employees by group when it isn't true.

A final potential objection is the question of whether the potentially corrosive impacts of nannyism on individual and social wellbeing that have been documented are worse in the corporate or political context. Immanuel Kant described the potential dark side of nannyism in his 1784 essay, "An Answer to the Question: 'What is Enlightenment?'"¹³² Kant argued that the objects of nannyism were living in a perpetual state of "immaturity," which in turn created a caste of "guardians" who would act opportunistically and to the detriment of the governed. The end result was a society of "docile creatures" and "autocratic despotism and profiteering or power-grabbing oppression."¹³³ Kant's critique is in accord with latter criticisms of collectivism by F.A. Hayek and others.¹³⁴ But it applies not only in cases of mass nannyism, but also in microcases, like at the firm level.

The experience at some company towns demonstrates Kant's concerns. In a description of company towns in the West, James Allen concludes that "employees frequently neglected their yards and houses, having learned to depend on the company for everything."¹³⁵ Kant called individuals in this state

¹³² Kant's essay was a response to a question – "What is enlightenment?" – posed to readers of the German periodical *Berlinische Monatsschrift*. Kant had the winning essay, and it was published in the December 1784 issue. The essay, in English and German, is available at http://sap.ereau.de/kant/what_is_enlightenment/.

¹³³ *Id.*

¹³⁴ F.A. HAYEK, *THE ROAD TO SERFDOM* (1945).

¹³⁵ JAMES B. ALLEN, *THE COMPANY TOWN IN THE AMERICAN WEST* 124-25 (1966).

unenlightened “domestic livestock,” and any society composed of them unable to flourish. Allen goes on to describe how corporate nannyism as practiced in company towns also led to suboptimal investments on the part of citizens:

Since the company was supposed to take care of house maintenance, . . . many residents refused even to care for small items, feeling almost as if they had been cheated if they did some work which the company out to . . . do.

Perhaps more perversely, nannyism also created a creep toward equal outcomes, regardless of merit or even need. Allen quotes an official from the company town of Hannah, Wyoming, on the demand for company-supplied equality:

If we did something for Mrs. Jackson, we could almost be our bottom dollar that the next morning Mrs. Tacalon, or Scarapelli, would be there wanting the same identical things, even though they didn't need it.

Benefits became obligations when dissociated from the typical decisions of individuals operating in a world of scarcity.

The inefficiency of the collectivist urge was something that some firms managed well, while others, like Pullman's company town, did not. Given the state of society at the time, Allen concludes that “[p]aternalism was a necessity . . . but one which most would gladly eliminate when all economic factors permitted such a move.”¹³⁶ The parallel to modern corporate nannyism is direct and apt. Firms might prefer a world in which individuals paid most health care costs or the state did, and thus relieving them of their obligation to force individuals to bear the costs of their behavior. While possible, neither of these is likely in the short-run, given the rather intractable nature of the health care debate in this country. That said, these two non-firm options are the stated positions of dominant political parties, and one might eventually be enacted into law in one form or another. While firms might prefer this outcome, since it would relieve them of the hassle of managing nanny programs and the potential risk from mismanaging them, it might be a negative for society to allow firms to opt out of the market for paternalism.

There is reason to believe, however, that the nanny state will be worse at creating docile bodies than the nanny corporation. For one, the state has a monopoly on physical violence, and therefore individuals that violate state nanny rules can have their liberty infringed. Although if calibrated correctly, this increased punishment might simply provide additional deterrence at lower cost than firms can provide, this result is highly dependent on getting the nanny rules

¹³⁶ *Id.* at 127.

right. There are, for example, many examples of individuals being jailed for violating state nanny regulations that seem to represent the influence of those with political power more than efficient cost internalization methods.¹³⁷

In choosing the lesser of two evils—worker sheep or citizen sheep—another reason to favor corporate nannyism is that there are participation benefits in public life that might be corroded by excessive nannyism by governments. In other words, a democratic government may rely more heavily on having informed constituents who are used to educating themselves and making reasoned decisions than firms. This is because the fear of overextension that Kant worried about is less likely to come to pass in the corporate context. In addition, the barriers to adoption are much lower in the case of firms, while the market check is lower in the case of the government. So if we want lots of nanny rules with discipline, we should, *ceteris paribus*, choose corporations as the favored deliverer of paternalism in the market.

* * *

These advantages and disadvantages do not point solely in the direction of favoring corporate nannyism over state nannyism in all or even most cases. The discussion simply points out some potential advantages and disadvantages of corporate rules in certain circumstances. Firms might be expected to supply nanny rules when it is efficient for them to do so, say because of better monitoring, lower agency costs, or the like, and not to do so when government rules could be supplied at lower cost for a given efficacy level. So, looking at the provision of nanny rules in the market for paternalism, it would be reasonable to conclude that the mix of nanny rules maps to this efficiency. The problem, however, is that there are government rules, regulations, statutes, constitutional provisions, and case law that may distort the market from efficiency. It is to this issue that we now turn.

V. REGULATION OF NANNYISM

The market for paternalism, like the market for altruism,¹³⁸ is somewhat unique, in that the government is both a participant in and regulator of the market. The risk is that the government will use its power to control how private firms deploy nanny regulations in order to discriminate in favor of state regulation based on factors other than the relative efficiency of the state versus firms in deploying nanny rules. If there are reasons why private firms are likely to be better or worse than governments in implementing and enforcing nanny rules,

¹³⁷ See *infra* note ___ and accompanying text (discussion of the Sick Chicken case).

¹³⁸ See M. Todd Henderson & Anup Malani, *Corporate Philanthropy and the Market for Altruism*, ___ COLUM. L. REV. ___ (2009).

then some bias in favor of one or the other may be justified. The discussion above, however, shows that there are some potential advantages of corporate nannies in particular cases, while government nannies may be superior in other cases. Unfortunately, this section shows that the current regulatory environment for corporate nannies is both highly uncertain and biased against firm nannies. Although there have been some recent changes moving in the direction of more freedom for firms to use nanny rules, the playing field is still strongly tilted against corporate nannies.

Regardless of whether a nanny is a corporation or the state, the policy concerns are the same. The big issues are the sum of decision costs and error costs in the evaluation of externalities and the implementation of nanny rules; the magnitude of derivative social welfare losses, such as privacy losses; and the ability of individuals or groups to impose their own idiosyncratic (and socially wasteful) preferences on others without sufficient safeguards. All of these are problems in both private and public context. Unless there is a theory about why these issues are systematically worse for the private as opposed to public sector, then government shouldn't distinguish between the delivery mechanism for paternalism. This section shows how federal and state law discriminates against corporate nannies, and how changing these policies could improve social welfare.

A. Codified Law

1. State law

While most states follow the common law employment-at-will regime, which allows an employee to be terminated at any time with or without cause, 29 states and the District of Columbia have laws on the books restricting the ability to fire an employee for certain legal, off-duty activities.¹³⁹ While some the statutes provide leeway, for example, allowing firms to charge differential insurance premiums based on tobacco use, the impact of these laws has been to significantly chill the use of nanny rules by firms. Jack Welch, former CEO of GE, told a CEO deploying an aggressive nanny program: "Man, you have balls of steel." The CEO was puzzled: "[w]hy aren't the American employers dealing aggressively with these issues of wellness when they're the ones footing the bill?" Answering this question, however, the CEO admits that a "lot of people are watching to see how badly we get sued."¹⁴⁰ A suit would bring bad publicity, impose legal costs on the firm, and would, if lost, mean the investments in the program would be wasted. The hard costs on the downside highlight a central problem with uncertainty in this area. Firms that innovate in nanny rules will pay

¹³⁹ See <http://www.washingtonpost.com/wp-dyn/articles/A38566-2005Feb19.html>.

¹⁴⁰ http://www.businessweek.com/magazine/content/07_09/b4023005.htm.

these costs, but will not be able to capture all of the benefits from the innovation, since other firms can easily copy successful policies.

These so called “lifestyle discrimination statutes” fall into one of two general categories: those protecting (1) use of lawful products or engaging in legal activities; (2) tobacco or alcohol only. In the first category, there are a total of ten states, with five making it unlawful for an employer to treat an employee or applicant less favorably because of the individual’s off-duty, off-premises use of any lawful product or lawful consumable product.¹⁴¹ These statutes thus protect employees who use tobacco, alcohol, or any other “product” that might be objectionable to an employer. For example, the Illinois Right to Privacy in the Workplace Act¹⁴² bans employment discrimination based on an employee’s or applicant’s use of lawful products off the premises of the employer during nonworking hours. Like eight other states with similar statutes¹⁴³, however, the statute seems to, but does not clearly, allow employers to pass higher health insurance costs onto employees who use tobacco.¹⁴⁴

Five other states have a broader regime that make it unlawful for an employer to treat an employee (and in some states, an applicant) less favorably because of any “lawful activity.”¹⁴⁵ Presumably this includes not only the act of using a lawful product, but also activities unrelated to products, such as skydiving, engaging in political activities, and so on.

Some states with specific exceptions from lawful activity statutes that allow companies to charge employees that smoke higher health care insurance premiums. The nine are: Illinois, Minnesota, Montana, New York, North Carolina, South Dakota, West Virginia, Wisconsin, and Wyoming. In addition twenty-two states expressly recognize exceptions based on particular employee’s job responsibilities (e.g. an employer’s restriction of off-duty smoking by a cessation-of-smoking coordinator for a local hospital) or the nature of the employer’s business (e.g., the American Cancer Society’s prohibition of off-duty smoking).

At the other extreme, the other broad category of statutes are those in which specific products are signaled out for special treatment. There are 19 states with statutes prohibiting employers from discriminating against employees who smoke, meaning they can’t be fired, not hired, paid less, or penalized in any way

¹⁴¹ The five “lawful product statutes” are in Illinois, Minnesota, Montana, Nevada, and North Carolina.

¹⁴² See 820 IL CS 55/1.

¹⁴³ Illinois, Minnesota, Montana, New York, North Carolina, South Dakota, West Virginia, Wisconsin, and Wyoming all allow employers to pass on higher insurance charges to particular employees based on their tobacco use.

¹⁴⁴ After the act was passed by the Illinois legislature in 1991, the governor wrote an official message 1991 ILL. ALS 807, 20 (Lexis) explaining the Bill in no way interferes with programs designed to promote health among employees as “these programs are beneficial and should be encouraged.”

¹⁴⁵ “Lawful activity statutes” are found in California, Colorado, New York, and North Dakota.

for smoking off duty.¹⁴⁶ Connecticut's "smoker's rights" law is typical:

No employer or agent of any employer shall require, as a condition of employment, that any employee or prospective employee refrain from smoking or using tobacco products outside the course of his employment, or otherwise discriminate against any individual with respect to compensation, terms, conditions or privileges of employment for smoking or using tobacco products outside the course of his employment, provided any nonprofit organization or corporation whose primary purpose is to discourage use of tobacco products by the general public shall be exempt from the provisions of this section.¹⁴⁷

In addition, thirteen states prohibit employers from discrimination against or regulating individuals using alcohol during non-work hours.¹⁴⁸ These statutes seem to have little purpose other than to interfere with the employment at-will relationship, unlike Title VII which aims to prevent discrimination on factors unrelated to business judgment. Twenty states have no statutory protection at all so employment remains purely at-will, subject to the federal anti-discrimination acts.

The bulk of the lifestyle discrimination statutes were passed in the early 1990's, stemming from an interest in protecting employee privacy (particularly with respect to an employee's sexual preferences) and forcing employers to base their decisions on business or performance related reasons. They were initially passed in "pro-employee" states like California, Illinois and New York as well as rural Western "pro-privacy" or libertarian states like North Dakota, Nevada, Montana, and Colorado. After the early 1990's almost no lifestyle discrimination statutes were passed until recently when the Michigan House approved a "Workers Activities" bill in direct response to Weyco's policy of firing smokers.¹⁴⁹ This is another kind of risk, since a seemingly permissive legal regime is always

¹⁴⁶ See, e.g., Ind. Code § 22-5-4-1 (1991); Ky. Rev. Stat. Ann. § 344.040 (1990); La. Rev. Stat. Ann. § 762 (1991); Miss. Code Ann. §71-7-33 (1991); NJ Rev. Stat. § 34:6B-1 (1991); NM Stat. Ann. § 50-11-3 (1991); RI Gen. Laws § 23-20.7.1-1 (1990); SC Code Ann. § 41-1-85 (1990); SD Codified Laws Ann. § 60-4-14 (1991); Tenn. Code Ann. § 50-1-304 (1990). Many of these states are ones with a strong tobacco presence (like Virginia, West Virginia, South Carolina, etc.)

¹⁴⁷ Conn. Gen. Stat. 31-40s. Employers can, of course, continue to ban smoking at their business locations, even if the employee is not on duty. Conn. Gen. Stat. 31-40q.

¹⁴⁸ See "State Lawful Products Statutes" at <http://www.bnabooks.com/ababna/state/2005/gudas.doc> for a detailed analysis of each state's law and interpretive decisions.

¹⁴⁹ The workers rights bills are Michigan House Bills 4532, 4887, and 4926-27. On May 15, 2008 the legal activity bill passed the House 63-45; separate bills included in the overall package would also prevent employers from firing, refusing to hire, or discriminating against employees based on their credit history, physical appearance or health passed by narrower margins. http://hosted.ap.org/dynamic/stories/M/MI_WORKERS_RIGHTS_MIOL-?SITE=MIDTF&SECTION=HOME&TEMPLATE=DEFAULT.

subject to change, and any subsequent change would make investments in the firm's programs wasteful.

The hodgepodge of state statutes creates a highly uncertain environment for firms. Even in states in which smoking is explicitly protected as a non-firing behavior, there remain questions about whether firms can charge smokers differently for the costs they impose. In addition, for firms with employees in multiple jurisdictions, firms must set their policies based on the most restrictive state law. The water is further muddied by the overlay of federal law, various constitutional protections, and case law interpreting state and federal law. The next sections take on these issues.

2. Federal law

Three federal statutes speak directly to the leeway granted corporate nannies. The Health Insurance Portability and Accountability Act (HIPAA), the Americans with Disabilities Act (ADA), and the Employee Retirement Income Security Act of 1974 (ERISA), provide background rules consistent with a narrow conception of the role of private nannies. While none of these statutes speak directly to the deployment of nanny rules by corporations, the language of each has been used to justify or criticize nanny rules as deployed.

a. HIPAA

The nondiscrimination provisions of HIPAA generally prohibit group health plans (like those offered by firms) from charging individuals different premiums or contributions or imposing different deductible, co-payment or other cost sharing requirements based on a "health factor." Basically, an employer paying more for employee A than employee B for health care is prohibited from passing along that higher cost to A in the form of higher premiums, deductibles, or co-payments. Since this federal law is supreme, even for private firms, it provided a strong deterrent for any corporate nanny rules (both carrots and sticks) that would have the effect of forcing individuals to internalize the costs they impose on others in group health plans.

There are two narrow exceptions that give firms some leeway in designing nanny programs. First, if a wellness program offers a reward that is *not* based on an individual satisfying a standard related to a health factor, then the program automatically complies with the nondiscrimination requirements. Examples of non-health factor programs are: reimbursing gym memberships; participating in health screenings or diagnostic testing which provides a reward based on participation and not outcome; a program which encourages preventative care by waiving the co-payment or deductible requirement for the costs of prenatal care or well visits; or a program that reimburses smoking cessation classes without

regard to the result. In other words, providing information or non-judgmental carrots is protected by HIPAA under a theory that these are the least likely to be abused; they are, of course, the least likely to be effective too. Companies' experience with carrots have been disappointing, as voluntary programs do not force a change in individual incentives.

A second exception tries to ameliorate this limitation. The HIPAA regulations include an exception to the anti-discrimination rule for "bona fide wellness programs."¹⁵⁰ The term was, however, undefined for many years, resulting in no reduction in uncertainty for firms wanting to charge employees for their conduct. In addition, at least three federal departments—the Departments of Treasury, Labor, and Health & Human Services—were potential enforcers of firm compliance with HIPAA regulations. This additional complexity prevented many firms from experimenting with nanny programs, despite the fact that these departments stated that they would not take any enforcement action against a firm that sought to comply in good faith with the regulations. This promise was, according to businesses, cold comfort for the average risk-averse corporation.¹⁵¹ In other words, standards (instead of specific rules) resulted in overdeterrence, especially since the first firm to test these standards would bear all of the litigation costs and risks, while other firms could easily copy the result if successful.

To reduce uncertainty inherent in these standards, in 2001, the government undertook a rulemaking to "implement and clarify" the term "bona fide wellness program." When the proposed HIPAA exceptions were published on January 8, 2001, the three departments proposed three options of 10, 15, or 20 percent, as the upper limit which employers could charge or reward employees under a bona fide wellness program. The departments explicitly rejected the idea of allowing employers to pass on the full cost associated with a health factor because it "might be so large as to have the effect of denying coverage to certain individuals" and the administrative burden of the calculations could be too great.¹⁵² The approach finally adopted, however, was simply to remind companies about the pledge by the three departments not to bring enforcement actions. Since the pledge was not legally binding and the contours of what would "bona fide" were highly uncertain, especially in light of conflicting state and federal statutes and case law, there is no public information about any firms charging increased health insurance premiums until 2007, when the wellness program regulation adopted a rule instead of a standard.

¹⁵⁰ Notice of Proposed Rulemaking, 66 Fed. Reg. 1421 (January 8, 2001); DOL Prop. Reg. § 2590.702(f).

¹⁵¹ See http://www.businessweek.com/bwdaily/dnflash/content/aug2007/db2007081_804238.htm.

¹⁵² Notice of Proposed Rulemaking, *supra* note ____.

Six years later, the rules were finalized and the departments went with a 20 percent limit to give employers “a greater opportunity to encourage healthy behaviors through programs of health promotion and disease prevention.”¹⁵³ It was only when the HIPAA regulations clearly stated that companies could charge employees up to an additional 20 percent in their premiums for activities like smoking did firms like Clarian announce policies of charging employees for smoking, BMIs over 30, and other health violations. Once the uncertainty was reduced, lots of programs have been announced.

This modest move in the direction of encouraging corporate nannyism is significant, but limits the ability of firms to charge employees the full costs of the costs they impose. For example, in 2007, the average health care costs per person was about \$7600,¹⁵⁴ but smokers add about \$3400 in additional costs and obese individuals add another \$700 per year. Assuming health care insurance premiums are proportional to costs, this means an obese smoker would have to be charged over 50 percent more than a non-smoker of average weight to equalize premiums according to cost. (Smokers alone would have to be charged over 40 percent more than non-smokers.) But HIPAA limits premium differences to 20 percent, meaning firms will be unable to force individuals to bear all their costs, which in turn means that there will be socially inefficient levels of smoking. It also may lead to a perverse result, since firms may rationally choose to fire those individuals for whom they cannot charge the full costs of their behavior. The federal rule, which is designed to protect them, may result in less choice and lower levels of protection than one that permits firms discretion on how to charge.

One might argue that the federal limit of 20 percent should simply be raised to a higher amount, maybe 50 percent, which is the estimate for a sort of worst-case scenario for destructive personal behavior (that is, an obese smoker). The problem with this, of course, is that the optimal level is impossible to know in advance without lots of experimentation, is subject to rapid changes depending on innumerable circumstances, will likely vary widely by firm and by individual, and, if set incorrectly, will generate significant under or overdeterrence. A much better approach would be to allow firms to adapt to local circumstances, update continuously, and experiment with different programs to find what is effective. Employers could be checked (imperfectly) by ex post litigation when policies are used for invidious purposes.

¹⁵³ Internal Revenue Bulletin, Feb 5, 2007: http://www.irs.gov/irb/2007-06_IRB/ar11.html. Under this exception a wellness program which charges employees more for smoking is lawful as long as the extra charge does not exceed 20% of the total cost of health insurance coverage for the employee.

¹⁵⁴ National Coalition on Health Care. <http://www.nchc.org/facts/cost.shtml>

b. ADA

The ADA, which prohibits employers from discriminating in employment and benefits against a qualified individual with a disability, may also inhibit efficient pricing of health externalities.¹⁵⁵ The ADA prohibits medical inquiries or examinations of applicants and employees regarding the existence, nature or severity of a disability unless it is a job-related. All employees, and not just those with disabilities, are covered with the ADA and therefore not required to answer questions about past medical history. Standing alone, these provisions might provide significant impediments to the kind of high-powered programs that require health surveys and treat employees with potentially genetic differences differently.

The ADA, however, excepts most wellness programs if (1) participation is voluntary, (2) any health information obtained remains confidential and separate from other employment records, and (3) health information obtained is not used to limit health insurance coverage eligibility or take adverse employment action. The voluntariness requirement has been very broadly interpreted by the 7th Circuit; anything short of “Don Corleone’s ‘Make him an offer he can’t refuse’” will be considered voluntary.¹⁵⁶ Further limiting the ADA’s applicability to wellness programs is case law, including Supreme Court precedent, holding remediable addictions, like smoking, not to be a disability within the coverage of the ADA.¹⁵⁷ These requirements are not as strict as the HIPAA wellness program guidelines, so if a company is adhering to HIPAA, the ADA will likely be satisfied.

Nevertheless, the ADA is commonly used as a cause of action in litigation arising from nanny rules, and it usually survives a motion to dismiss. This means implementing firms will bear litigation costs in many, if not all, cases, and thus deploy fewer rules than they otherwise would in the absence of the law. Getting this calibration right will be difficult, and it is unlikely that multiple courts imposing different rules across jurisdictions are likely to come to the most efficient use of the statute; especially since it seems redundant with other statutes and not clearly about wellness programs.

c. ERISA

The law protecting pensions and other employee benefits, known as ERISA,¹⁵⁸ may also inhibit free contracting over the allocation of social costs from employee behaviors. ERISA was enacted to protect the interests of

¹⁵⁵ 42 USCA § 12101 et seq.

¹⁵⁶ *Henn v. National Geographic Society*, 819 F.2d 824, 826 (7th Cir. 1987)

¹⁵⁷ *See, generally*, *Rose v. Home Depot U.S.A., Inc.*, 186 F. Supp. 2d 595 (D. Md. 2002), *See also* *Sutton v. United Airlines, Inc.*, 527 U.S. 471 (1999).

¹⁵⁸ Employee Retirement Income Security Act (ERISA), Pub.L. 93-406, 88 Stat. 829 (Sept. 2, 1974).

employee benefit plan participants by requiring disclosure of financial and other information to employees, establishing standards of conduct for fiduciaries, and providing access to federal courts. Its provisions can be used to prohibit employers from discriminating against employees in benefits or taking action against them to keep them from receiving benefits entitled to them by federal law or corporate contract. For example, § 510 makes it unlawful for any employer to “discharge, fine, suspend, expel, discipline, or discriminate against a participant ... for the purpose of interfering with the attainment of any right to which such participant may become entitled under the plan.” So an employee who has, say, pension and health care rights pursuant to a contract with the firm that is covered by ERISA may be unable to fire or otherwise influence the employee because of the rights granted by federal law in these benefits.

Very few cases exist on this question, but those that do suggest the question of whether ERISA applies to nanny rules, like a no-smoking policy, is a factual question that is not appropriately raised at the motion to dismiss phase. In a recent federal case from Massachusetts, the district court allowed an ERISA claim to go to a jury in the case of a new hire who was allegedly dismissed (or, in the view of the defendant firm, never hired fully at all) for failing to submit to a nicotine urine test. According to the court, the “section 510 does not apply to those instances where the loss of benefits was a mere consequence of, but not a motivating factor behind, a termination of employment . . . And . . . section 510 relates to discriminatory conduct directed against individuals, not to actions involving the plan in general.”¹⁵⁹ Neither of these is capable of resolution at the motion to dismiss stage, meaning litigation costs in defending plans will be significant.

d. Other federal statutes

Several other federal statutes are commonly deployed by employees seeking redress for terminations or other adverse employment events. Most of these create colorable claims, meaning they have the potential to impose costs on and therefore be used to extract settlements from employers, but have been largely unsuccessful in court.¹⁶⁰

The Rehabilitation Act of 1973, however, provides a greater potential deterrent to employer nanny programs. Section 504 of the Act prohibits

¹⁵⁹ *Rodrigues v. Scotts Co. LLC*, 2008 U.S. Dist. LEXIS 6682 (D. Mass. Jan. 30, 2008)

¹⁶⁰ Fired employees have also tried to invoke Title VII of the Civil Rights Act of 1964, which prohibits discrimination in employment on the basis of race, color, religion, sex, and national origin. These efforts have largely failed. While disparate impact arguments can be made, the Supreme Court held in *New York City Transit Authority v. Beazer* that a policy refusing to hire individuals with past narcotic addiction was constitutional. 440 US 568 (1979). The Court held that the restriction bore a “manifest relationship to the employment” and this was sufficient to rebut plaintiff’s claims of racial disparate impact.

discrimination based on any “handicap” in any program receiving federal monetary assistance.¹⁶¹ Although narrower than the ADA in its coverage of employers, there is case law suggesting that the scope of potential liability is more broad. There are state cases interpreting the Act or analogous state provisions suggesting that (morbid) obesity,¹⁶² alcoholism or drug use,¹⁶³ and nicotine addiction (that is, smoking) are protected handicaps under the Act, and therefore cannot be the basis of employment decisions of any kind if the employee is “otherwise qualified” for the job.

B. Case Law

As evident from the discussion about the interpretation of ERISA, courts are influential in defining the law in this area, and, it turns out, creating additional uncertainty and confusion for firms who may want to innovate with nanny rules. This section briefly surveys 42 cases on health-related employment actions based on nanny rules over the last four decades. This survey is not a complete picture of all cases on this subject, but it does include most of the biggest cases and a fairly drawn sample from all the state and federal cases.

Of the randomly drawn cases in the survey, courts upheld the employer’s (either a private firm or a governmental entity acting in an employment capacity) nanny rule about 60 percent of the time.¹⁶⁴ Although employers are more likely to win than lose these cases, this win-rate is sufficient to create a significant amount of uncertainty about judicial treatment of these programs.

The complaints in these cases involved only state law in about 70 percent of the cases, with the rest being federal claims or, in one case, both state and federal causes of action. The federal/state breakdown largely tracks the nature of the employer in question: 75 percent of the cases brought against private (i.e., non-governmental) employers alleged only state law claims, while 65 percent of

¹⁶¹ 29 U.S.C. §793(a) (1988).

¹⁶² See *Civil Service Commission of Pittsburgh v. Penn. Human Relations Comm.*, 591 A.2d 281 (Pa. 1991) (holding morbid obesity is a handicap under Pennsylvania statute using same language as the Rehabilitation Act); *State Div. of Human Rights v. Xerox*, 480 N.E.2d 695, 698 (NY 1985) (rejecting defendant’s claims of mutability and holding that obesity is protected handicap under state statute using language from the Act).

¹⁶³ Current use of drugs and alcohol is not generally protected by courts or in state statutes, but prior use often is. See 29 USC § 706(8) (C) (1982) (defining the term handicap to exclude individuals whose current use of alcohol or drugs inhibits them from performing the duties of a job). Some state statutes expressly exclude these individuals from the definition of handicap, see, e.g., *Ariz. Rev. Stat. Ann. § 41-1461(4) (a)* (1956), but courts are split on the issue. Compare *Clowes v. Terminix Int’l Inc.*, 538 A.2d 794 (NJ 1988) (holding alcoholism is a handicap); *Connecticut Gen. Life Ins. Co. v. Wisc. Dep’t of Indus., Labor, and Human Relations*, 273 N.W. 2d 206, 212-223 (Wis. 1979) (same), and *Doe v. Roe, Inc.* 539 NYS2d 876 (NY 1989) (holding drug addiction is handicap) with *Welsh v. Municipality of Anchorage*, 676 P2d 602 (Alaska 1984) (holding alcoholism is not a handicap); and *Phillips v. City of Seattle*, 766 P.2d 1099, 1103 (Wash. 1989) (same).

¹⁶⁴ Private employers win about 80 percent of the cases, while public employers win about 50 percent.

the cases brought against governments as employer alleged only federal law claims.

1. State law

Although employers win in their defense of nanny rules more often than not, state common law is replete with cases in which employees have been able to win back their jobs or get damages for wrongful nanny-based dismissals. There are four primary theories under which plaintiffs prevail: (1) the lack of a business purpose; (2) the existence of a protected handicap; (3) the violation of a privacy interest; or (4) the failure to consider less burdensome alternatives.

First, several cases hold that employer policies, such as banning smoking, must be in furtherance of a legitimate business purpose. Like business-purpose tests in other areas of law, this reasoning just begs the question of what is “legitimate” and what is a “business purpose.” The answers are not at all clear on the face of particular firm policies and there is no codification, so the contours of permissible and impermissible conduct are found only in state common law cases. For example, courts in Indiana and North Dakota hold that a private employer’s ban on employee smoking and drinking during non-working hours was not reasonably related to the furtherance of the firm’s business.¹⁶⁵ A New Jersey court reached the same conclusion for an employee dismissed because of obesity.¹⁶⁶ The reasoning in these cases is conclusory at best, as they define “reasonable” based on the outcome of the case—what the court believes is reasonably related to the firm’s interests can only be gleaned from the result. In general, however, courts describe off-duty regulations as reasonable only if there is some direct threat from the conduct to the firm’s business.¹⁶⁷ For example, the *Best Lock* court cites with approval a case from Wisconsin in which the employer was able to show that its no-drinking policy was a sine qua non for obtaining vehicle insurance in its business delivering supplies to taverns, and thus overcome plaintiff’s discrimination claim.¹⁶⁸ This ground of decision should be sufficient to justify the reasonableness of health insurance cost reducing schemes, since the argument is nearly identical, but few courts have seen this connection.

Some courts in other jurisdictions do come out the other way. Most courts uphold the restrictions indirectly. In some cases, the court finds that the behavior in question spilled over from off-duty to on-duty hours, where every court

¹⁶⁵ *Best Lock Corp. v. Review Board of Indiana Dept. of Empl.*, 572 N.E.2d 520 (Ind. 1991); *Olson v. Job Service N.D.*, 379 N.W.2d 285 (N.D. 1985).

¹⁶⁶ *Gimello v. Agency Rent-A-Car*, 594 A.2d 264 (N.J. 1991).

¹⁶⁷ *See, e.g., Best Lock Corp.*, 572 N.E.2d at 524.

¹⁶⁸ *Gregory v. Anderson*, 14 Wis.2d 130 (1961).

permits the banning of activities such as drinking alcohol or smoking.¹⁶⁹ In others, it is because the behavior is covered by other state or federal rules, such as drinking alcohol before piloting a commercial airliner.¹⁷⁰ Finally, some courts approve employer discrimination, but only in cases where linked directly with a bona fide occupational qualification (BFOQ), such as fireman or cement workers not smoking.¹⁷¹

A few cases, however, find simply that the employer is entitled to adhere strictly to an employment at will regime, unless the conduct in question is covered by a specific state statute or constitutional provision protecting it. Typical is *Stevens v. Inland Waters Inc.*, where a Michigan court held that an employee fired for being a smoker was not entitled to the protection of the Michigan Handicappers' Civil Rights Act.¹⁷² The court held that smoking or nicotine addiction is not a handicap with the meaning of the Act, because it does not "substantially limit a major life activity."¹⁷³

Although these cases support a private employer's rights to terminate employees who drink alcohol or smoke or eat too much, the reasoning misses the point that firms banning smoking are simply responding to a demand for paternalism in an attempt to reduce healthcare costs. Reducing health care costs should sufficient business reason to justify these decisions when it is given that these employees impose large costs on other stakeholders of the firm.

Second, a few courts, especially in California and New York, hold that certain behaviors or individual characteristics are protected handicaps that trump background employment at will rules. In both states, for example, courts hold that high blood pressure, without regard to cause, is a protected handicap under state law.¹⁷⁴ The same results obtain for obesity in a couple of states.¹⁷⁵ For

¹⁶⁹ See, e.g., *Tucker v. Astro Aluminum Heat Treating Co.*, 2005 Cal. App. Unpub. LEXIS 11220 (unpublished) (Cal. App. 2005) (summary judgment granted, because plaintiff didn't sufficiently demonstrate implausibility of employer's nondiscriminatory reasons for firing based on drinking with spillover into work hours).

¹⁷⁰ *Pederson v. Omni Air Int'l Inc.*, Minn.App. Unpub. LEXIS 1079, (Minn. App. 2007) (holding employer rules and FAA regulations expressly prohibited this conduct).

¹⁷¹ In the first case it is incompatible with the employer's mission and in the second because the dust in the air at the workplace can, when coupled with smoking lead to illnesses. See, e.g., *Wood v. S.D. Cement Plant*, 588 N.W.2d 227 (S.D. 1999).

¹⁷² *Stevens v. Inland Waters, Inc.*, 220 Mich.App. 212 (1996). Section 202(1)(b) of the HCRA, M.C.L. § 37.1202(1)(b); M.S.A. § 3.550(202)(1)(b), provides that an employer shall not "[d]ischarge or otherwise discriminate against an individual with respect to compensation or the terms, conditions, or privileges of employment, because of a handicap that is unrelated to the individual's ability to perform the duties of a particular job or position."

¹⁷³ *Id.* at 215.

¹⁷⁴ See *Arnot Ogden Mem. Hospital v. State. Div. of Human Rgts.* 67 A.D.2d 543 (NY 1979) (rejecting an applicant based on successfully treated high blood pressure is impermissible discrimination.); *American Nat. Ins. Co. v. Fair Employment*, 32 Cal.3d 603 (Cal. 1982) (holding high blood pressure is a protected handicap under California Fair Employment Practice Act); *State Div. of Human Rights ex rel. Pecci v. S.A. Cook Factory*, 132 A.D.2d 935 (NY 1978) (holding hypertension is protected handicap).

example, in a New York case, the court held that an overweight employee was protected by a state antidiscrimination law that protected both correctable and noncorrectable “diseases.”¹⁷⁶ The court found that obesity was covered by the law and that discrimination based solely on an individual’s weight is impermissible.

These cases raise the obvious question of where one draws the line between protected and unprotected physical ailments. Several cases, for example, hold that diseases like AIDS and cancer are protected against the typical employment at will regime.¹⁷⁷ Distinguishing between behaviors or characteristics that are susceptible to incentives should not be difficult in most cases. The baseline in this paper uses is whether the nanny rules are inevitable, regardless of the provider. So both governments and firms are currently trying to reduce smoking and overeating through various measures, and thus policies protecting these behaviors are obviously counterproductive. The same cannot be said of various genetic diseases. There will be cases in which claims are made about genetic predispositions to obesity or the like, but courts will be incapable of making these judgments and thus should steer clear of attempting to fashion policy based on arm-chair science. As discussed above, giving firms wide discretion here—say to charge by the pound—will increase the chances of reducing overall health care costs while preserving choice for individuals. And, if it turns out that firms systematically overreach in ways that externalize unavoidable costs on to society, legislatures or courts can address these abuses. A survey of the cases suggests this has not occurred.

Third, courts occasionally invoke privacy considerations to find in favor of employees subjected to firm nanny rules. Although employer drug testing is long standing and widely accepted notwithstanding privacy considerations, extension to smoking, obesity, high blood pressure, and other behavior-driven physical conditions is more controversial. A few recent cases have allowed plaintiffs to proceed to jury trial on claims that firm nanny policies invade employees’ privacy. In *Rodrigues v. Scotts Co.*, the plaintiff employee’s urine was tested and found positive for nicotine, and so, under Scotts’s no smoking policy, he was fired.¹⁷⁸ The district court rejected the firm’s motion to dismiss under a Massachusetts privacy statute.¹⁷⁹ Courts reach similar results under Pennsylvania and New York tort law.¹⁸⁰

¹⁷⁵ *Gimello v. Agency Rent-A-Car*, 594 A.2d 264 (N.J. 1991); *State Div. of Human Rights v. Xerox Corp.* 480 N.E.2d 695 (NY 1985).

¹⁷⁶ *State Div. of Human Rights v. Xerox Corp.*, 480 N.E.2d 695 (N.Y. 1985).

¹⁷⁷ *Burris v. City of Phoenix* 179 Ariz. 35 (1993) (holding cancer is a protected handicap under Arizona law); *Raytheon Co. v. Cal. Fair Empl. & Housing Com* 212 Cal.App.3d 1242 (1989) (holding AIDS is a physical handicap under California law).

¹⁷⁸ 2008 WL 251971 (D.Mass. 2008)

¹⁷⁹ *See* Mass. Gen. Laws c. 214 section 1B.

¹⁸⁰ *Borse v. Piece Goods Shop, Inc.*, 963 F.2d 611 (3d Cir. 1992) (holding employee discharged for failing to take drug test could state an invasion of privacy claim under Pennsylvania tort law if the testing

Finally, there is some precedent for courts imposing on firms an obligation to provide alternative accommodations for employees before permitting termination for behaviors like smoking or excessive drinking of alcohol. For instance, in *Haltom v. Southland Title of Orange County*, the trial court observed that the employer had an obligation under California law to explore reasonable accommodations for an alcoholic employee.¹⁸¹ The court remanded for further fact finding, noting that the employer has a burden to use reasonable efforts to inform employees of disability accommodations, including alcoholism treatment. Many firms have deployed these programs alongside hiring restrictions or cost imposition schemes.

Meanwhile, courts interpreting lawful activity statutes have tried in some cases to limit their reach, while using rhetoric that is expansive in the ways it might protect employees. For example, in the only published decision analyzing and applying the Colorado Lawful Activity, the federal court upheld the firing of an employee who disparaged his employer in a letter to the editor of a local newspaper, and in doing so noted that the statute “was meant to provide a shield to employees who engage in activities that are personally distasteful to their employer, but which activities are legal and unrelated to an employee’s job duties”.¹⁸² The court goes on to explain that the statute was meant to protect the job security of: “homosexuals who would otherwise be fired by an employer who discriminates against gay people, members of Ross Perot’s new political party who are employed by a fervent democrat, *or even smokers who are employed by an employer with strong anti-tobacco feelings.*”¹⁸³

In short, the state legal landscape is highly variable, confusing, and subject to change at any time, since states cannot credibly pre-commit to legislate or not legislate on a particular subject. The confusing and contradictory precedents are made even less clear by the relatively small number of cases in general and in any particular jurisdiction. The small sample size reduces the accuracy of forecasting. The result is significant uncertainty for firms, as well little ground to estimate the predictability of the current legal environment. In addition, as noted above, the variance across states means employers with employees in multiple jurisdictions will have to adjust firm-wide policies to the most restrictive state policy on the legality of nanny rules.

Federal law, which we turn to next, is clearer and in some cases more permissive, but also discriminates against private provision of nanny rules.

revealed personal information unrelated to the workplace); In the Matter of Dickson 6 A.D.3d 1022 (N.Y. 2004) (rejecting firing of employee who consumed a beer while off duty on company premises, and calling the action “a substantial and highly offensive intrusion from seclusion.”).

¹⁸¹ *Haltom v. Southland Title of Orange County*, 2008 WL 4151837, Cal. App. 4 Dist. (Sept. 10, 2008).

¹⁸² *Marsh v. Delta Air Lines, Inc.*, 952 F. Supp. 1458, 1462-1463 (D. Col. 1997).

¹⁸³ *Id.* (emphasis added).

2. Federal law

Plaintiff employees invoking federal law do so under the range of federal statutes discussed above (e.g., ERISA, ADA), as well as constitutional protections, like the “right to privacy” or the Due Process clause. (Federal cases involve public employers more often, such as firemen and school teachers, which means constitutional arguments have potentially more bite.¹⁸⁴) Federal cases are somewhat supportive of employer attempts to force employees to internalize their costs, but these precedents are still far from settled in that direction and, because federal law is more often invoked against public employees, of less value to private employers. In fact, one might recharacterize the judicial treatment of public-employer cases as government favoritism of one of the providers of paternalism in the market, namely, the government. Whatever the case, the numerous federal cases do not resolve favorably enough in the direction of employers, either public or private, to make the adoption of nanny rules a safe bet.

There are several theories under which courts reject employer attempts to force employees to bear the costs of their conduct. In *Cook v. Rhode Island*, a morbidly obese attendant at a state-run hospital was not hired when she reapplied for her position after a voluntary absence of some time.¹⁸⁵ The hospital claimed that her obesity would interfere with her ability to perform her job and would “put her at greater risk of developing serious ailments,” which would in turn “promote absenteeism and increase the likelihood of workers' compensation claims.”¹⁸⁶ Plaintiff sued under the Rehabilitation Act, alleging that she suffered from a disability and was not hired solely for that reason.

The jury returned a verdict for plaintiff, and the appeals court affirmed, rejecting defendant’s counterarguments of mutability and voluntariness. In affirming the jury verdict, the court opened a wide door for potential plaintiffs by holding that not only are actual disabilities protected but also cases in which the employer merely believes the employee is disabled within the meaning of the Rehabilitation Act. In other words, the employer was forced to pay hundreds of thousands of dollars in damages, as well as litigation costs, because it, no doubt correctly, believed that plaintiff’s weight was likely to impose costs on other employees and the state.

¹⁸⁴ The “state action doctrine” means actions by public employers will implicate more constitutional rights than private ones. *See, e.g.,* *Briggs v. North Muskegon Police Dept.*, 746 F.2d 1475 (6th Cir. 1984) (holding termination of police officer for cohabitation with married woman who was not his wife was unconstitutional). This additional scrutiny for government agencies acting in an employment (as opposed to governance) function makes no sense. The Supreme Court seems to be accord in general terms. *See, e.g.,* *Engquist v. Oregon Dept of Agriculture*, 553 U.S. ___ (2008) (holding government employee’s constitutional rights are not as robust when government is acting as an employer).

¹⁸⁵ 10 F.3d 17 (1st Cir. 1993).

¹⁸⁶ *Id.* at 21.

As in *Cook*, most cases are permitted to go to the jury in this area of law. A challenge to the Scotts Co. employment policies discussed above is indicative.¹⁸⁷ Scotts adopted a nicotine-free policy, both at and away from work, for its employees. Scotts' justification for its policy "was to save money on medical insurance costs and to promote healthy lifestyles among its employees." The plaintiff employee's urine was tested and found positive for nicotine, and so he was fired. His suit survived a motion to dismiss under state law (a privacy claim) and a claim under ERISA § 510, to wit, by terminating his employment, Scotts interfered with his attainment of benefits and rights under Scotts' ERISA plans that he would have become eligible for but for the termination. The court allowed the case to go to the jury, notwithstanding the fact that the plaintiff was employed, if at all, for a period of only a few days. In addition, ERISA requires that the "the loss of benefits was a mere consequence of, but not a motivating factor behind, a termination of employment," and that it "relates to discriminatory conduct directed against individuals, not to actions involving the plan in general."¹⁸⁸ That plaintiff's claim survived under a statute designed to prevent firm opportunism with respect to employee pension benefits suggests the extent to which courts will sometimes go to prevent the deployment of nanny rules.

In those cases in which federal courts uphold nanny rules, they often avoid the difficult issues of privacy or discrimination by enforcing private contracts about the behavior in question. In two unpublished opinions, circuit courts upheld the termination of employees accused of consuming alcohol on the ground of breaching a contractual agreement with their employer not to do so or to complete alcohol treatment.¹⁸⁹ This line of cases, although not strong precedents, suggest firms should ground their nanny regulations in specific employee contracts.

Significant uncertainty remains nevertheless, as there remain open questions on important issues, like whether smoking, obesity, high blood pressure, and so on are disabilities within the meaning the ADA, Rehabilitation Act, and other federal statutes.¹⁹⁰ To make matter worse in terms of expected litigation costs for employers planning on using nanny rules, courts generally emphasize using a case-by-case approach for each employee and situation.¹⁹¹

¹⁸⁷ *Rodrigues v. Scotts Co., LLC*, 2008 WL 251971 (D.Mass. 2008).

¹⁸⁸ *Id.*

¹⁸⁹ *Wobser v. PPG Indus.*, 2000 U.S. App. LEXIS 2377 (9th Cir. 2000); *Cole v. Exxon-Mobile Corporation*, 142 Fed. Appx. 52 (3rd Cir. 2005).

¹⁹⁰ *Compare EEOC v. Watkins Motor Lines*, 463 F.3d 436 (6th Cir. 2006) (holding obesity is not an ADA impairment unless it stems from a physiological condition) *with Cook v. Rhode Island*, 10 F.3d 17 (1st Cir. 1993) (holding obesity is an impairment under the Rehabilitation Act).

¹⁹¹ *Aldrich v. Boeing Co.*, 146 F.3d 1265 (10th Cir.1998).

C. Going Forward

This section has shown that state and federal statutes and case law create significant uncertainty about the legality of private nanny rules, even in the absence of state action. This bias in delivery mechanism of paternalism demanded by individuals in common pools means that the firms will be deterred from meeting this demand on the margin. Coupled with the disadvantages of government entities in delivering nanny rules means that there may be insufficient amounts of nanny rules and the ones that are produced may be suboptimal. If the barrier to the creation of a cost-internalizing rule is higher in the case of government rules, as is probably the case in some instances, then a bias against firm provision of nanny rules means too few will be provided by producers in the market for paternalism. And, if the mechanisms of accountability, feedback, and tailoring described above are better for corporate nannies, then the rules that are promulgated by government entities (when corporate ones are deterred) are likely to be less efficient than if the market playing field were level.

The case for corporate paternalism set forth above does not necessarily obtain in all cases, so it would be premature and likely erroneous to suggest that all of the statutes and case law described above are wrongheaded. It is equally absurd, however, that legislatures and courts protect something like “smokers’ rights” from the discipline of the market. It is one thing to be cautious about legal bans or taxes that might fall disproportionately on the poor, but arguments restricting private firms from forcing individuals to internalize their costs make no sense, especially when the government may inevitably be forced to take the same steps. And, the existence of bans on private nannyism that exist side by side with legal and overt state nannyism is even less defensible. The public choice story told above may be the driver of these laws, and, if so, reason enough for their repeal.

This does not mean, however, that all anti-discrimination provisions are inefficient or that there is no place for some employment protections or safeguards. Statutes, like ERISA, and common-law cases enforcing vested benefits or pensions against opportunism survive easily in this analysis. So too might laws requiring firms to put in place safeguards—like third-party administration—that minimize the risk of abuse by individual firms or managers. Beyond this, the law is likely to do more harm than good unless based on a compelling theory about the efficiency of the two different providers in the market for altruism.

CONCLUSION

Individuals in common cost-bearing pools, such as political jurisdictions or firms, demand paternalism to reduce subsidizing costly behavior on the part of other individuals in the pool. Instead of viewing nannyism as necessarily the product of irrational or rent-seeking behavior on the part of decisionmakers, either politicians or managers, this account views them as simply responding to the demand for paternalism by individuals. In this way, corporate regulations banning certain individual behaviors, such as smoking, are simply a response to a demand from firm stakeholders, such as employees and investors, to reduce firm costs.

Viewing nannyism in this way allows one to see that firms and the government are competitors in the delivery of cost-reducing regulations of individual behaviors. This then allows one to examine the relative comparative advantages and disadvantages of these competitors in the market. This paper has shown how firms have heretofore underappreciated advantages in delivering paternalism through nanny-type regulations. Chief among these is the constraint provided by labor, product, and capital markets in constraining firms from overreaching or diverting the benefits of nanny regulations away from paying the costs imposed by the behavior in question. Firms can also write broad prohibitions in ways that are sometimes more difficult for governments. States, on the other hand, may have advantages both in the severity of the penalties that can be employed (and thus less need for enforcement costs) and in covering behaviors, such as consuming specific foods like trans fats, that may be difficult for firms to observe.

From this, one might conclude that firms should simply provide nanny protections when it is efficient for them to do so and likewise for the state. The market for paternalism is unusual, however, in that the government is not only a producer of paternalism, but also a regulator of the market for paternalism. This paper has shown how a variety of state and federal statutes, regulations, and judicial decisions may distort the market by limiting firm provision of efficient nanny rules or creating sufficient uncertainty for firms to reduce innovation in this area.

For a social policy with broad support—like reducing smoking incidence in the population—the relevant question should be which provider of paternalism is better on the margin at deterring the behavior. While government and firm nannyism are not necessarily substitutes and can work together, policy makers should be attune to how best to allocate the burden of nannying. At present, firms are inhibited from charging smokers the full cost they impose on the firm and its stakeholders by federal and state law. These barriers should be removed and

allow the cost of smoking, overeating, skydiving, and so on to be set by the market.

There will inevitably be line-drawing problems, since society can be thought of as one big subsidy of everyone's bad behaviors. This recharacterization of corporate nannyism elides this objection by focusing only on those behaviors where third-party payors inevitably are involved in trying to reduce the behavior in question. When comparing corporate nannyism with state nannyism on these issues—say, reducing smoking or obesity—it is clear that the former may often be superior. This conclusion is relevant not only for the federal and state law described above, but also for the ongoing debate about who pays for health care in this country and how much we all pay. For example, the proposal to move away from the employer-based health insurance model has many virtues, but this paper points to a strong counter argument: if paternalism is inevitable for solving some health care cost problems, firms may be the preferred and more efficient provider.

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