INFORMED BUDGETEER

TOBACCO SETTLEMENT: SPENDING THE PROCEEDS THE PRESIDENT'S 1999 BUDGET- COUNT THE WAYS

- The President's budget proposes spending $9.8 billion in FY 1999 and $65.5 billion through 2003 from "receipts" generated by tobacco settlement legislation. However, the President has yet to propose or endorse any specific legislation which would produce the resources needed pay for his initiatives.

- Of this $9.8 billion in expected "receipts" for 1999, $3.6 is displayed in the President's budget as a "dedicated offset" for the new Research Fund for America and is counted as an offset within the discretionary caps. *Through 2003, this amounts to a $25.3 billion increase in discretionary spending.*

- Other discretionary spending in 1999 includes: *$100 million for FDA enforcement* activities ($1.2 billion through 2003) and *$100 million for outreach* and other activities directed at reducing teenage smoking; and *$46 million to the Centers for Disease Control* to expand its state-based tobacco prevention activities.

- The President also proposes to use tobacco proceeds for a large increase in mandatory spending. These increases include:

  - a three-year *$750 million Medicare demonstration program* to cover recipients who participate in certain federally-sponsored cancer clinical trials;

  - a *$1.2 billion increase for child care and development block grants* to the states over existing spending for 1999 ($7.5 billion through 2003);

  - *$900 million through 2003 for outreach programs to enroll more children in Medicaid*;

  - *$1.2 billion in 1999 for a new federal program to reduce class size* in local public schools ($7.3 billion through 2003).

- The President proposes to spend the remaining tobacco proceeds *($3.4 billion for 1999, and $33.3 billion through 2003 on a variety of programs* which may be mandatory or discretionary), including additional unrestricted funds for states, federal smoking cessation programs and relief for tobacco farmers.

THE STATE ATTORNEYS GENERAL -PROTOCOL

- The Tobacco Agreement (the Protocol) reached by the Attorneys General of 41 states and the tobacco industry envisions payments by the industry of: a $10 billion initial payment, plus $8.5 billion for the first year rising to $15 billion by the fifth year -- for a total of $68.5 billion for the first 5 years (with an estimate of $368.5 over 25 years).

- The Protocol does not specify how the payments will be allocated between the federal and state governments. Some have suggested, however, that the states might expect to receive nearly 50% of the payments.

- In addition to providing for payments, the Protocol suggests the following spending:

1. **Public Health Trust Fund Presidential Commission:** members, including private sector researchers, public health officials, Attorneys General, Castano attorneys, & others will determine the specific tobacco related medical research to be funded. Amount: $17.5 billion over 5 years; $25 billion for years 1-8. Undetermined if funds are state or federal.

2. **Grants from HHS:** for various activities to reduce tobacco usage (includes grants to state health departments). Amount: $825 million over 5 years. Federal funds.

3. **FDA:** to carry out its regulatory and enforcement roles under the legislation (includes grants to states to assist in enforcement). Amount: $ 1.5 billion over 5 years. Federal funds.

4. **Community based tobacco control** (modeled on the ASSIST program). Amount: $500 million over 5 years. Funds to state and local governments.

5. **Research and development** to: prevent smoking and helping smokers to quit. Amount: $500 million over 5 years. Undetermined if funds are state or federal.

6. **Compensation to events**, teams, participants who previously had tobacco sponsors. Amount: $300 million over 5 years. Undetermined if funds are state or federal.

7. **Public Education Campaign.** Directed by an independent, non-profit board to make grants or contract with private sector to discourage and de-glamorize tobacco product usage. Amount: $2.5 billion over five years. Undetermined if funds are state or federal.

8. **Tobacco Use Cessation Trust Fund:** to aid individuals to quit smoking. Appears to be under the direction of the Secretary of HHS. Amount: $5.5 billion over 5 years. Undetermined if funds are state or federal.

9. **Annual Payments to States:** to fund health benefits program expenditures. It is estimated that the States will receive $193.5 billion over 25 years (of the total $368.5 billion) by the terms of the tobacco Protocol. See, testimony of Jeffrey Modisett (Attorney General of the State of Indiana) on December 8, 1997 before the subcommittee on Health and Environment of the House Committee on Commerce.

10. **Judgments and Settlement Fund:** establish and fund a tobacco products liability judgments and settlement fund. This fund is for individual plaintiffs seeking compensation. Contributions to this fund are capped at 33% of the annual industry base payment. Approximately $13.5 billion over 5 years. Undetermined if funds are state or federal.

Total Tobacco settlement Spending
(b=billions, m= millions)

	Federal	State	Undetermined	Total
Total: First Year	1.43 b	75 m*	5.1 b	$6.6 b*
Total: Five Years	7.83 b	500 m*	34.3 b	$42.6 b*

*The Protocol envisions that most of the undetermined funds will got to states. However, current Medicaid rules require third party collections to be shared with the federal government at the Medicaid matching rate which averages 57%. The Protocol is silent on what portion of the payments to states are reimbursement for Medicaid costs.

BUDGETING 201: WHY TAX RECEIPTS ARE NOT SPENDING REDUCTIONS

- By the President's own estimates, his budget fails to meet the statutory limits (or caps) on discretionary spending through discretionary spending reductions. The Administration claims it meets the caps by classifying $31 billion in revenues (see table below) as spending reductions for the purposes of meeting the discretionary caps.

- If one takes this to the extreme and all revenues were classified as spending reductions, the government would disappear! For 1999, the President's budget estimates that total outlays will equal $1.733 trillion and total receipts will equal $1.743 trillion, resulting in a budget surplus of $9.5 billion. If revenues were classified as spending reductions, spending would equal a negative $9.5 billion.

Proposed Tax Offsets to Discretionary Spending
($ in billions)

	1999	2000	2001	2002	4-year
Tobacco revenues	-3.6	-4.6	-5	-5.7	-18.9
Superfund excise taxes	-1.8	-1.4	-1.4	-1.4	-6
Fuels tax extension		-0.4	-0.4	-0.4	-1.2
New FAA fees		-1.7	-1.7	-1.7	-5.1
Total revenues	-5.4	-8.1	-8.5	-9.2	-31.2

- From a common sense standpoint, a revenue increase cannot be a spending reduction, but what does the law say?

- The 1990 Budget Enforcement Act (BEA) established an enforcement scheme that divided the budget into two categories. For discretionary spending, Congress established annual limits (or caps) on budget authority and outlays. For revenues and entitlement spending, the Congress established a "pay-as-you-go" mechanism to ensure that legislation did not cause a net increase in the deficit. The bipartisan budget agreement and the Balanced Budget Act of 1997 extended these caps and pay-as-you-go procedures through 2002.

- While the BEA provides for a number of adjustments to the caps, Section 251 of the Balanced Budget and Emergency Deficit Control Act provides no authority to OMB to offset discretionary spending with revenue increases for the purposes of meeting the discretionary caps. Section 251 also provides that estimates of discretionary spending shall be prepared in accordance with scorekeeping guidelines. The scorekeeping guidelines were originally published in the conference report accompanying the 1990 BEA and were revised in the conference report accompanying the Balanced Budget Act. Once again, nothing in the scorekeeping guidelines gives OMB the authority to classify a revenue increase as a discretionary spending reduction.

- The Clinton Administration has admitted in court that it does not have the authority to classify a revenue change as a change in spending for the purposes of the Line Item Veto Act.

- Last year, the President used his authority under the Line Item Veto Act to cancel an "open season" provision in the 1998 Treasury Postal Appropriations law that would have allowed federal employees to switch from the Civil Service Retirement System to the Federal Employees Retirement System. OMB estimated that this provision would result in a revenue loss and claimed a revenue loss constituted discretionary budget authority under the Line Item Veto Act. By classifying the revenue loss from canceling the open season as a spending increase, OMB initially argued that the President had the authority to cancel this provision under the Line Item Veto Act.

- The National Treasury Employees Union challenged the President's authority under the Line Item Veto Act to classify a revenue reduction as an increase in discretionary budget authority in the D.C. District Court. On January 6, 1998, the Justice Department entered into a consent decree that they had no authority to cancel this purported spending increase.

THE CLINTON BUDGET: IS THERE ANY ANALYSIS BEHIND THE NUMBERS?

- More money for child care? Sounds good, poll tested and mother approved. The President has requested over $21 billion in new funds for child care and related programs. The largest piece is an additional $7.2 billion in new mandatory funds for the Child Care and Development Block Grant (CCDBG), a program to states designed to give low income families assistance for child care as well as activities to expand the quantity and quality of day care.
- The *Bulletin*, of course, does not believe in polls relying rather on good analysis. Thus, the logical question for good budgeteers is: do states need more money for CCDBG?

- In 1996, Congress passed a sweeping welfare reform bill that, among other things, increased the amount of funds available to states for child care. There are three main streams of child care funding: a discretionary block grant (CCDBG), an entitlement block grant and a matched child care entitlement. In 1997, these programs were funded at $1 billion, $1.2 billion and $0.7 billion, and the matched block grant will rise to $1.5 billion by 2002.

- While the streams are different from a budget standpoint, programmatically there is no real difference since states may transfer funds between child care programs. On top of interfund transfers, states may also transfer up to 30 percent of Temporary Assistance for Needy Families funds (the grant for cash assistance and training) into child care.

- In 1997 States used slightly more than 72 percent of the available funds, and less than 30 percent of available matching funds. The Administration responds that states have obligated 99.7 percent of funds and that states will outlay (draw down from the Treasury) over the next year. States have an extra year to actually request payments. Normally when funds are obligated, the Treasury will eventually pay the claim. However, child care program rules dictate that funds not used by states will be redistributed by the Secretary. Thus states have the incentive to say they will use the funds (obligate) to preserve their rights to the money. An obligation therefore does not necessarily mean the states will outlay the funds.

- Are states simply slow in drawing down funds? Based on Monthly Treasury Statements (MTS), a report which tracks funds outlayed from the U.S. Treasury, states do not seem to be increasing their outlays. Each month's outlays as reported by MTS is composed of current year (FY 1998) and prior year outlays. Apart from the usual flurry of outlays settling up prior year claims, the outlays for 1998 have settled back to a rate of about 80 percent for the year. These spend out rates trail closely to the CBO Baseline, which shows states won't use the full amount of available funds until 2003. Despite running a surplus in TANF, states have not transferred additional funds from TANF to child care.

Senate Budget Committee Hearing Schedule

February 19: CBO/GAO Staff Briefing: Budgeting a Surplus: Lessons Learned from other Nations and State Governments. Dirksen 608, 10:00 am.

February 24: Social Security Task Force Meeting. Witness: OMB Director Frank Raines. Dirksen 608, 2:00 pm.

February 25: Long term Budget Issues. Witnesses: Bill Frenzel and Timothy Penny, Co-Chairman, Committee for a Responsible Federal Budget; Paul Poser, Director, Federal Budget Issues, GAO; Eugene Steuerle, Urban Institute. Dirksen 608, 10:00 am.

February 26: International Affairs Task Force Meeting. Witnesses: David Aaron, Undersecretary, Department of Commerce; Edmund Rice, Executive Director, Coalition for Employment through Exports; Ben Nelson, Director, International Relations &Trade Issues, GAO. Dirksen 608, 10:00 am.