

NLWJC - Kagan

DPC - Box 043 - Folder 007

Tobacco-Settlement: Budget [1]

**JOSHUA
GOTBAUM**
06/30/98 05:31:22 PM



Record Type: Non-Record

To: Bruce N. Reed/OPD/EOP
cc: See the distribution list at the bottom of this message
Subject: Tobacco Price and Revenue Runs

Per your request. The table below shows the effect of the original AG proposal. The McCain numbers are still being modified to reflect the Durbin amendment.

ROUGH JCT SCORING OF TOBACCO BILLS

	<u>AG Settlement</u>	<u>Hatch</u>	<u>McCain Mgr's Amd</u>	<u>McCain Price Cap*</u>
Additional cost per pack, 2008 (real 1999 \$):				
From base payment	.64	.69	1.10	1.10
From surcharge**	<u>.06</u>	<u>.25</u>	<u>.19</u>	<u>.19</u>
Total	.70	.94	1.29	1.29
25-year payments (real 1999 \$B):				
Base payments	267	291	419	408
Youth surcharges	<u>19</u>	<u>80</u>	<u>59</u>	<u>59</u>
Total***	286	371	478	467
5-year net revenues (nominal \$)				
	40.3	45.7	64.8	58.9

*Reflects original S. 1415 surcharge, prior to Durbin amendment.
**Average for 2007-2009. Based on Treasury scoring. McCain surcharge is after-tax.
***Does not include feedback from youth surcharges to base payments.

Message Copied To:

Elena Kagan/OPD/EOP
Cynthia A. Rice/OPD/EOP
Cynthia Dailard/OPD/EOP
Patrick G. Locke/OMB/EOP
Richard J. Turman/OMB/EOP



Executive Office of the President
Office of Management & Budget

To: **Bruce Reed, Elena Kagan**

Fax: **6-2878**

Pages (inc cvr): **2**

From: **Joshua Gotbaum**
Executive Associate Director
OEOB Room 254
Washington, DC 20503

May 28, 1998 9:21 PM

(202) 395-9188 Fax (202) 395-3995

Re: **Initial Payment**

Is the initial payment dead? Given the already reduced levels of the base payment, if it goes the totals get to levels that Erskine (at least once) thought were a problem.

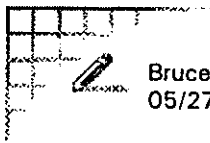
When you get a chance, please call.

Spending Scenarios
(In Billions of Nominal Dollars – FY99-03)

	McCain Base	Manager's Amend. Less Upfront	% Reduction From Base	Manager's Amend. with Gramm Amend.	% Reduction From Base
RECEIPTS				FY99-03	
Net Receipts	69.0	58.9		58.9	
Less Upfront Payment		51.9		51.9	
USES					
Health & Related Research	15.2	11.4	-33%	1.3	-91%
Public Health	15.2	11.4	-33%	1.3	-91%
State Funds, Direct	27.6	20.8	-33%	2.3	-91%
Farmers & Farm Communities	11.0	8.3	-33%	0.9	-91%
Gramm Amendment	<u>0.0</u>	<u>0.0</u>		<u>46.0</u>	
Total Uses	69.0	51.9		51.9	

FFI

*old, very
big Gramm*



Bruce N. Reed
05/27/98 10:45:04 AM

Record Type: Record

To: Elena Kagan/OPD/EOP

cc:

Subject: Tobacco math

If you had to make room for a tax cut, you could do something like this:

	<u>1st Five Years</u>	<u>2nd Five Years</u>
Farmers	10B	8B
States	25B*	25B*
Research	10B	10B
Public Health	5B**	5B**
Tax Cut	10B	25B
Receipts (JCT est.)	60B	73B***

* State share includes minimum of \$3B for cessation, \$2B for tobacco prevention, education, and enforcement. Remaining \$20B is split 50/50 with menu.

** Public health includes \$2.5B for counterads, \$1.2B for FDA, \$1B for intl & surveys, \$300m for ATF.

*** This does not include the possible use of lookback money, which JCT estimates at \$12B in 2nd five years. That money could be used to supplement the public health and state public health pots.

If we needed a bigger tax cut in the first 5 years, I would suggest taking it out of research, or a combination of farmers/states/research. Payment caps on farmers (\$75,000 per year) might help stretch the farm price tag out. I'd rather not cut the state share if we can avoid it.

Tobacco Letter

060238 05:04pm From: 202-624-5313 To:
JUN 02 '98 04:34PM NAT'L GOVERNORS' ASSOCIATION

Page 003

P. 2/2

**NATIONAL
GOVERNORS
ASSOCIATION**

George V. Voinovich
Governor of Ohio
Chairman

Raymond C. Scheppach
Executive Director

Thomas R. Carper
Governor of Delaware
Vice Chairman

Hall of the States
444 North Capital Street
Washington, D.C. 20001-1512
Telephone (202) 624-5800



June 2, 1998

The Honorable Trent Lott
Majority Leader
United States Senate
Washington, DC 20510

Dear Senator Lott:

As the Senate continues to consider tobacco legislation, the Governors want to make clear that we will oppose any amendments that would effectively reduce the \$196.5 billion in tobacco settlement funds dedicated to states to settle state lawsuits. Naturally, the federal government is free to prioritize how it will use those tobacco revenues generated by S. 1415 not reserved for the states - a total in S. 1415 that will exceed \$300 billion over twenty-five years. These federally prioritized uses of tobacco revenues, however, must not cut into the state settlement pool.

If national tobacco legislation is intended to settle the state lawsuits against the tobacco industry, states must receive a portion of the new tobacco revenues sufficient to resolve their claims. S. 1415 dedicates \$196.5 billion to the states over twenty-five years, a total consistent with the level negotiated by the state attorneys general with the tobacco industry in the original June 20, 1997, agreement. Preserving this state settlement pool, free from federal recoupment efforts, is one of the Governors' highest priorities related to S. 1415.

If we can clarify our concerns, please let us know.

Sincerely,

George V. Voinovich
Governor George V. Voinovich

Tom Carper
Governor Thomas R. Carper



George V. Voinovich
Governor of Ohio
Chairman

Raymond C. Scheppach
Executive Director

Thomas R. Carper
Governor of Delaware
Vice Chairman

Hall of the States
444 North Capitol Street
Washington, D.C. 20001-1512
Telephone (202) 624-5300



June 4, 1998

The Honorable Trent Lott
Majority Leader
United States Senate
Washington, D.C. 20510

The Honorable Thomas A. Daschle
Minority Leader
United States Senate
Washington, D.C. 20510

Dear Senators Lott and Daschle:

As the Senate continues to consider tobacco legislation, the nation's Governors want to make clear that we will oppose any amendments that would effectively reduce the \$196.5 billion in tobacco settlement funds dedicated to states and territories to settle state lawsuits. Naturally, the federal government is free to prioritize how it will use those tobacco revenues generated by S. 1415 not reserved for the states and territories - a total that will exceed \$300 billion over twenty-five years. These federally prioritized uses of tobacco revenues, however, must not cut into the state settlement pool.

If national tobacco legislation is intended to settle the state and territories' lawsuits against the tobacco industry, they must receive a portion of the new tobacco revenues sufficient to resolve their claims. S. 1415 dedicates \$196.5 billion to the states and territories over twenty-five years, a total consistent with the level negotiated by the state attorneys general with the tobacco industry in the original June 20, 1997, agreement. Preserving this state settlement pool, free from federal recoupment efforts, is one of the Governors' highest priorities related to S. 1415.

Reducing the size of the state tobacco settlement pool will significantly jeopardize all states and territories, including those that have individually settled their own lawsuits. Such a decision would force the Governors to reconsider our position on the state financing section of the overall bill.

Sincerely,

George V. Voinovich
Governor George V. Voinovich
State of Ohio

Tom Carper
Governor Thomas R. Carper
State of Delaware

Ray Romer
Governor Ray Romer
State of Colorado

Lawton Chiles
Governor Lawton Chiles
State of Florida

Patrick G. Locke

05/29/98 04:53:35 PM

Record Type: Record

To: Laura Emmett/WHO/EOP

cc: Joshua Gotbaum/OMB/EOP, Richard J. Turman/OMB/EOP

Subject: Tables from Inflation Email

Attached is a 1-2-3 spreadsheet file that contains two sheets with the two tables of results for different McCain bill inflation options that were in the email that Josh forwarded to Elena Kagan. The first table shows the effect over 1999-2003 of inflating the per pack payments from a 1998 base year instead of a 1999 base year. The second table shows the effect over 25 years of dropping the 3% inflation floor. The file is set up to print out the two tables if you just select print from the 1-2-3 menu.



s1415inf.wk

EFFECT OF INFLATING S. 1415 PAYMENTS FROM 1998 VERSUS 1999
(In billions of dollars)

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>99-03</u>
Base year of 1999	14.3	8.9	10.0	12.5	13.2	58.9
Base year of 1998	<u>14.5</u>	<u>9.2</u>	<u>10.3</u>	<u>12.9</u>	<u>13.6</u>	<u>60.4</u>
Difference	0.2	0.3	0.3	0.4	0.4	1.5

EFFECT OF 3% INFLATION FLOOR ON S. 1415 25-YEAR PAYMENT STREAM
(In billions of dollars)

	5 Year Total (1999-2003)		25-Year Total (1999-2023)	
	<u>Nominal</u>	<u>Real</u>	<u>Nominal</u>	<u>Real</u>
Without volume adjustment:				
3% floor	102.5	96.6	755.7	516.0
No floor	102.5	96.6	707.0	487.3
With volume adjustment:				
3% floor	98.3	92.6	693.3	476.3
No floor	97.2	91.7	647.1	448.0

**JOSHUA
GOTBAUM**

05/29/98 04:53:31 PM



Record Type: Non-Record

To: Elena Kagan/OPD/EOP

cc:

Subject: Estimated Effects of Changes in Inflaters

Here are the estimates of the effects of two possible changes in handling of inflation.

Effect of inflating from 1998 rather than 1999

If we price out the 0.65/0.70/0.80/1.00/1.10 price path, but use a base year of 1998 rather than 1999 for converting into nominal dollars, we get the following results for estimated JCT scoring:

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>99-03</u>
Base year of 1999	14.3	8.9	10.0	12.5	13.2	58.9
Base year of 1998	<u>14.5</u>	<u>9.2</u>	<u>10.3</u>	<u>12.9</u>	<u>13.6</u>	<u>60.4</u>
Difference	0.2	0.3	0.3	0.4	0.4	1.5

Effect of removing the 3% inflation floor

Under OMB scoring, removing the 3% inflation floor will have a significant effect in the long term, because our basic inflation assumption is for 2.3% CPI growth. There would be less of an effect under JCT scoring because CBO assumes 2.8% CPI growth. The following results are on OMB scoring. The "volume adjustment" is defined here as adjusting payments to achieve the proposed 0.65/0.70/0.80/1.00/1.10 path for the price increase per pack, in real 1999 dollars. The year by year stream is in the attached spreadsheet file (in the FloorNV and FloorVA sheets).

	5 Year Total (1999-2003)		25-Year Total (1999-2023)	
	<u>Nominal</u>	<u>Real</u>	<u>Nominal</u>	<u>Real</u>
Without volume adjustment:				
3% floor	102.5	96.6	755.7	516.0
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3% floor	98.3	92.6	693.3	476.3
No floor	97.2	91.7	647.1	448.0

The \$516 billion figure without volume adjustment should be familiar. The \$476 billion figure with volume adjustment is new. The last time that we ran 25-year numbers it was using the volume adjustment in the manager's amendment (80% of 1997 volume starting in 2002), with a 25-year total of \$480 billion.

Proposed Uses of Tobacco Legislation Receipts

(In Billions of Nominal Dollars)
 25 Year Spending of Based on JCT Scoring of \$46 - \$1.10/pcsk.

		Proposed Manager's Amendment																															
		Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13	Year 14	Year 15	Year 16	Year 17	Year 18	Year 19	Year 20	Year 21	Year 22	Year 23	Year 24	Year 25	FY99-03	FY99-08	FY99-23				
RECEIPTS	%	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23							
Net Receipts, per JCT		15.4	11.0	12.5	12.7	13.2	13.6	14.3	14.8	15.4																	64.8						
Net Receipts	100%	14.3	8.9	10.0	12.5	13.2	13.7	14.2	14.7	15.3	15.6	16.1	16.6	17.1	17.6	18.1	18.6	19.2	19.7	20.3	20.9	21.5	22.1	22.7	23.4	24.0	58.9	100%	132.4	100%	430	100%	
Net Receipts less Veterans		13.7	8.3	9.4	11.9	12.6	13.1	13.6	14.1	14.7	15.0	15.5	16.0	16.5	17.0	17.5	18.0	18.6	19.1	19.7	20.3	20.9	21.5	22.1	22.8	23.4							
USES																																	
Veterans		0.8	0.6	0.6	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	3.0	9%	6.0	9%	15.0	9%	
Health & Health-Related Research NIH NSF Critical Cancer Trials CDC/ANPPR	23%	3.0	1.8	2.1	2.8	2.8	2.9	3.0	3.1	3.2	3.3	3.4	3.5	3.6	3.7	3.9	4.0	4.1	4.2	4.3	4.5	4.6	4.7	4.9	5.0	5.1	12.3	21%	27.8	21%	91.4	21%	
Public Health Cessation Indian Health Service Prevention & Education (Prev., Advisory, Support) Licensing & Enforcement (PCA, Licensing, Anti-Smuggling) FDA (Revenue minus Subsidies) Critical Cancer Trials	23%	3.0	1.8	2.1	2.6	2.8	2.9	3.0	3.1	3.2	3.3	3.4	3.5	3.6	3.7	3.9	4.0	4.1	4.2	4.3	4.5	4.6	4.7	4.9	5.0	5.1	12.3	21%	27.8	21%	91.4	21%	
State Funds, Direct <i>(40% 40%)</i>		5.5	3.3	3.6	4.8	5.0	5.2	5.4	5.6	5.9	6.0	7.8	8.0	8.3	8.5	8.8	9.0	9.3	9.8	9.9	10.2	10.5	10.8	11.1	11.4	11.7	22.3	38%	50.5	38%	195.0	40%	
Farmers & Farm Communities <i>(19% 19%)</i>		2.2	1.3	1.5	1.9	2.0	2.1	2.2	2.3	2.4	2.4	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.8	0.8	0.8	0.8	0.3	0.0	0.0	0.0	8.9	15%	20.2	15%	28.5	7%	
Medicare HI Trust Fund <i>(0% 0%)</i>											0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.8	1.3	1.3	1.4					8.5	3%	
Grants																																	
TOTAL USES	100%	14.3	8.9	10.0	12.5	13.2	13.7	14.2	14.7	15.3	15.6	16.1	16.6	17.1	17.6	18.1	18.6	19.2	19.7	20.3	20.9	21.5	22.1	22.7	23.4	24.0	58.9		132.4		430		
Subtotal: Research; Public Health; Medicare Research, Public Health, Medicare as % of Total Spending		8.2	3.7	4.1	6.2	6.5	6.8	6.8	6.9	7.0	6.6	7.1	7.3	7.6	7.8	8.0	8.2	8.3	8.7	8.8	8.9	9.0	9.0	10.4	11.8	11.4	11.7	34.8		85.8		191.2	
		42%	41%	41%	42%	42%	42%	42%	42%	42%	42%	44%	44%	44%	44%	44%	44%	44%	44%	44%	44%	44%	44%	49%	49%	49%	49%	62%		62%		44%	

EFFECT OF 3% INFLATION FLOOR ON S. 1415 25-YEAR PAYMENT STREAM
(In billions of dollars)

	5 Year Total (1999-2003)		25-Year Total (1999-2023)	
	<u>Nominal</u>	<u>Real</u>	<u>Nominal</u>	<u>Real</u>
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(In billions of dollars)

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>99-03</u>
Base year of 1999	14.3	8.9	10.0	12.5	13.2	58.9
Base year of 1998	<u>14.5</u>	<u>9.2</u>	<u>10.3</u>	<u>12.9</u>	<u>13.6</u>	<u>60.4</u>
Difference	0.2	0.3	0.3	0.4	0.4	1.5

Model predicting effects of S.1415 (McCain)

McCain S.1415: Real Payments & Penalties (billions) total = \$473
 TCRTF & Liscensing Fees (billions) total = \$7
 Look Back Penalties Not Deductible
 First Six Payments are not Volume-Adjusted

Assumptions:
 Price Elasticity of Total Demand = -0.40
 Price Elasticity of Teen Prevalence = -0.60
 Annual Effect of Non-price Provisions on Teen Prevalence = -0.65%
 Rate at which cost increases are passed through via price incre = 100%

Year	Predicted Real Volume-Adjusted Settlement Payments (\$billions)	Real Price Increase due to Payments	Real Price Increase Due to Fed. Tax	Real Price Increase Due to Look Back	Real Price Increase Due to Non-Deductibility	Real Price Increase Due to TCRTF & License Fee	Total Real Price Increase	Real Retail Price	Predicted Total Domestic Consumption (billion packs)	Predicted Change In Teen Prev. (percent)	Target Change In Teen Prev. (percent)	Real Look Back Penalties (\$billions)	Real Net After-tax Profit (\$billions)
Current			\$0.00					\$1.95	23.0				\$4.5
1999	\$10.0	\$0.48	\$0.00	\$0.00	\$0.00	\$0.12	\$0.60	\$2.55	20.7	-16.2	0	\$0.0	\$4.6
2000	\$14.4	\$0.73	\$0.10	\$0.00	\$0.00	\$0.12	\$0.95	\$2.90	19.5	-23.0	0	\$0.0	\$4.4
2001	\$15.4	\$0.80	\$0.09	\$0.00	\$0.00	\$0.12	\$1.01	\$2.96	19.3	-24.4	-15	\$0.0	\$4.3
2002	\$17.7	\$0.94	\$0.14	\$0.00	\$0.00	\$0.12	\$1.20	\$3.15	18.7	-27.7	-15	\$0.0	\$4.2
2003	\$21.0	\$1.15	\$0.14	\$0.00	\$0.00	\$0.12	\$1.41	\$3.36	18.1	-30.9	-30	\$0.0	\$4.0
2004	\$23.6	\$1.33	\$0.14	\$0.00	\$0.00	\$0.12	\$1.59	\$3.54	17.6	-33.4	-30	\$0.0	\$3.9
2005	\$16.8	\$0.91	\$0.14	\$0.00	\$0.00	\$0.11	\$1.16	\$3.11	18.4	-28.5	-50	\$0.0	\$4.2
2006	\$16.7	\$0.91	\$0.14	\$0.01	\$0.00	\$0.11	\$1.17	\$3.12	18.3	-29.1	-50	\$0.1	\$4.2
2007	\$16.0	\$0.91	\$0.14	\$0.20	\$0.11	\$0.11	\$1.46	\$3.41	17.6	-33.3	-50	\$3.5	\$4.0
2008	\$16.0	\$0.91	\$0.14	\$0.16	\$0.09	\$0.11	\$1.40	\$3.35	17.6	-33.0	-60	\$2.8	\$4.0
2009	\$16.1	\$0.91	\$0.14	\$0.16	\$0.09	\$0.04	\$1.34	\$3.29	17.6	-32.6	-60	\$2.9	\$4.0
2010	\$15.8	\$0.91	\$0.14	\$0.20	\$0.11	\$0.04	\$1.39	\$3.34	17.4	-33.7	-60	\$3.5	\$3.9
2011	\$15.7	\$0.91	\$0.14	\$0.20	\$0.11	\$0.03	\$1.39	\$3.34	17.3	-34.2	-60	\$3.5	\$3.9
2012	\$15.7	\$0.91	\$0.14	\$0.20	\$0.11	\$0.03	\$1.39	\$3.34	17.2	-34.6	-60	\$3.5	\$3.9
2013	\$15.6	\$0.91	\$0.14	\$0.20	\$0.11	\$0.03	\$1.40	\$3.35	17.1	-35.0	-60	\$3.5	\$3.9
2014	\$15.5	\$0.91	\$0.14	\$0.21	\$0.11	\$0.03	\$1.40	\$3.35	17.0	-35.5	-60	\$3.5	\$3.9
2015	\$15.4	\$0.91	\$0.14	\$0.21	\$0.11	\$0.03	\$1.40	\$3.35	16.9	-35.9	-60	\$3.5	\$3.8
2016	\$15.3	\$0.91	\$0.14	\$0.21	\$0.11	\$0.03	\$1.40	\$3.35	16.8	-36.3	-60	\$3.5	\$3.8
2017	\$15.2	\$0.91	\$0.14	\$0.21	\$0.11	\$0.03	\$1.40	\$3.35	16.7	-36.8	-60	\$3.5	\$3.8
2018	\$15.1	\$0.91	\$0.14	\$0.21	\$0.11	\$0.03	\$1.40	\$3.35	16.6	-37.2	-60	\$3.5	\$3.8
2019	\$15.0	\$0.91	\$0.14	\$0.21	\$0.11	\$0.03	\$1.40	\$3.35	16.5	-37.6	-60	\$3.5	\$3.7
2020	\$14.9	\$0.91	\$0.14	\$0.21	\$0.12	\$0.03	\$1.40	\$3.35	16.4	-38.0	-60	\$3.5	\$3.7
2021	\$14.8	\$0.91	\$0.14	\$0.22	\$0.12	\$0.03	\$1.41	\$3.36	16.3	-38.4	-60	\$3.5	\$3.7
2022	\$14.7	\$0.91	\$0.14	\$0.22	\$0.12	\$0.03	\$1.41	\$3.36	16.2	-38.8	-60	\$3.5	\$3.7
2023	\$14.6	\$0.91	\$0.14	\$0.22	\$0.12	\$0.03	\$1.41	\$3.36	16.1	-39.3	-60	\$3.5	\$3.6
2024	\$14.5	\$0.91	\$0.14	\$0.22	\$0.12	\$0.02	\$1.41	\$3.36	16.0	-39.7	-60	\$3.5	\$3.6
Total	\$411.4											\$61.8	\$102.5
% Change								72%		-31%			

Real = 1997 dollars

Budget 5/15

Upfront -	only for partic. / assume for budg purposes	<u>total</u> 65.5
Farmers - 10.4	- no subdiv.	50 - unrestricted
States - 26.2	- NGA memo	50 - restricted - menu of 6 props
Research - 14.4	- NIH CDC ACPR Centrals - 1	2 -> 6% can go for or model on children's health.
Pub Health - 14.4		
	cessati - 4	
	Preventive + Ed. (Advertising / Surveys) - 6	
	Licensing + Enforcement - 3	
	International - 1	
	Indian Health - 1/2	

**JOSHUA
GOTBAUM**
05/19/98 10:31:47 PM



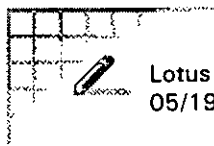
Record Type: Non-Record

To: Elena Kagan/OPD/EOP, Bruce N. Reed/OPD/EOP, Christopher C. Jennings/OPD/EOP
cc:
Subject: Re: McCain, Mack agree on our cancer trials proposal. Josh (Sent to: ELENA KAGAN [Pager])

Apparently the pager system wasn't working.

McCain personally negotiated the agreement with Senator Mack. Under it, the cost of clinical cancer trials will be split between the public health account and the health research account, as Chris suggested.

----- Forwarded by Joshua Gotbaum/OMB/EOP on 05/19/98 10:29 PM -----



Lotus Pager Gateway
05/19/98 08:40:05 PM

Record Type: Record

To: Joshua Gotbaum/OMB/EOP@EOP
cc:
Subject: Re: McCain, Mack agree on our cancer trials proposal. Josh (Sent to: ELENA KAGAN [Pager])

To: ELENA (Pager) #KAGAN
CHRISTOPHER (Pager) #JENNINGS
BRUCE N. (Pager) #REED
cc:
From: Joshua Gotbaum
Date: 5/19/1998
Time: 19:23:59
Subject: McCain, Mack agree on our cancer trials proposal. Josh
Body:

Priority:

Message history for recipient ELENA KAGAN [Pager]
Tuesday 19 May 1998 20:35:52 Eastern Standard Time - Message received by Pager Gateway
Tuesday 19 May 1998 20:37:01 Eastern Standard Time - Message received by Paging Service

**JOSHUA
GOTBAUM**
05/19/98 11:23:45 PM



Record Type: Non-Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP

cc:

Subject: Effect of Senate tobacco revenues on Medicare HI Trust Fund.

In case it becomes useful to use a portion of the revenues for things other than Medicare, you should know that amount of revenue we're talking about is too small to affect the overall finances of the HI trust fund. They could be reduced (or increased) without changing this. The analysis below explains why:

The Senate tobacco bill would dedicate residual tobacco funds for the HI Trust Fund. We dropped the projected tobacco revenues into our HI Trust Fund model (1998 Trustees' assumptions). Our model projects that the tobacco revenues would have little to any effect on the solvency of the HI Trust Fund.

To estimate the revenues, we took the latest tobacco tables (supplied by Greg White) and converted the fiscal year numbers to calendar year numbers. (Our HI model is expressed in calendar years.) Starting in CY2008, we calculate \$0.5 billion is to be transferred to the HI Trust Fund. In CY2009, \$2.2 billion is projected to be transferred and this transfer grows to about \$4.0 billion by CY2023. Without tobacco revenues, our HI model projects an operating deficit of \$32 billion in CY2008 alone, growing to an operating deficit of \$242 billion in CY2023. In short, the tobacco revenues are no where near enough to reduce these operating deficits.

We have walked through this analysis with OACT and they agree with our results.

Please let me know if you have any questions.

Tol-at-budget

**JOSHUA
GOTBAUM**
05/20/98 12:35:25 AM



Record Type: Non-Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP

cc:

Subject: State Excise Tax Loss

Per your request.

----- Forwarded by Joshua Gotbaum/OMB/EOP on 05/20/98 12:34 AM -----

Patrick G. Locke



● 05/18/98 04:55:18 PM

Subject: State Excise Tax Loss

Running the latest version of McCain through the model, I get state excise tax losses for 1999-2003 as follows:

\$8.0 billion under OMB assumptions

\$13.0 billion under faux JCT assumptions

The reason JCT is so much higher is that they have losses due to increased smuggling as well as losses due to lower cigarette consumption.

S. 1415: Revised Funding of Clinical Cancer Trials

- Currently, S. 1415 provides for a three-year program making Medicare eligibles for participation in cutting edge clinical cancer trials. This program is currently proposed to be funded entirely from S. 1415's Health & Health-Related Research Account.
- Some supporters of the cancer clinical trial program are concerned that these funds would reduce funds available for other research purposes, such as NIH.
- As an alternative, the **funding of the cancer clinical trials program could be shared equally between the Research account and the Public Health Programs Account.**
- In each account, there would be a requirement to fund \$375 million over three years. No funds would be provided thereafter.
- As a result, the minimum funding within the Health Research account for NIH could be raised. The minimums for that account would be:
 - **NIH: 79% (vs previous 75%) Would be minimum of \$11.9 bn over 5 yrs.**
 - NSF 0% (vs previous 1%) No minimum.
 - CDC/AHCPR 12% (No change) Minimum \$1.7 b over 5.
- Allocations within the Public Health account would not be changed, except to add the minimum funding for cancer trials.

Possible Uses of Tobacco Legislation Receipts
(Farmers \$18B, States \$26B, PH and Research Hit Proportionately)
(In Billions of Dollars - FY98-03 Unless Noted)

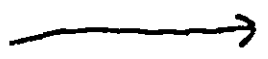
RECEIPTS	Budget	Compromise		Proposed Strateger's Amendment					Manager's Amendment			
		\$	%	Year 1 FY98	Year 2 FY99	Year 3 FY01	Year 4 FY02	Year 5 FY03	FY98-01	FY98-02	FY98-03	
Gross Payments	85											
Net Receipts ^{1/}	85	62	73%	15.4	11.0	12.5	12.8	13.8	65.5	142.7	480.4	
<i>Initial Payment, net (Excluded too Remote)</i>		7										
Net Receipts Less Farmers and States				2.2	0.8	1.5	7.7	8.3	21.3	67.6	258.2	
USES												
Health & Health-Related Research	21.4	13.5	63%	4.6	0.3	0.8	3.8	4.1	10.7	33.8	129.1	
NIH	17.0			1.1	0.0	0.3	3.1	3.4	9.0			
NSF <i>(Excluded from Research)</i>	2.9			0.0	0.0	0.0	0.1	0.1	0.3			
Clinical Cancer Trials	0.8			0.2	0.3	0.3	0.3	0.3	0.8			
COCA/NCPR	0.4			0.2	0.0	0.1	0.5	0.8	1.8			
Public Health	9.5	13.5	142%	1.8	0.3	0.8	3.8	4.1	10.7	33.8	129.1	
Cautions	5.3			0.5	0.1	0.2	1.2	1.2	3.2			
Indian Health Service	0.1			0.1	0.0	0.0	0.2	0.2	0.5			
Prevention & Education <i>(Print, Advertising, Events)</i>	3.0			0.8	0.2	0.4	2.2	2.4	6.1			
State Prevention	0.4								2.0			
Coastal Advertising	2.4								2.0			
International	0.3			0.1	0.0	0.1	0.3	0.3	0.8			
Surveys <i>(passive/active)</i>				0.2	0.2	0.2	0.2	0.2	0.8			
Licensing & Enforcement <i>(FDA, Licenses, Ad-Targeting)</i>	1.2			0.3	0.1	0.2	0.8	0.8	2.1			
FDA <i>(States with Sub-award)</i>	1.2			0.7	0.3	0.3	0.3	0.3	1.8 <i>(100-000)</i>			
State Funds, Direct	28.4	29.0	102%	6.2	4.4	5.0	5.1	5.5	28.2	57.1	184.1	
Unspecified	7%			3.1	2.2	2.5	2.8	2.9	13.1			
Specified	8%			3.1	2.2	2.5	2.8	2.9	12.1			
Farmers & Farm Communities	28.5	0.8	3%	5.0	6.0	6.0	6.0	6.0	18.0	18.0	18.0	
Compensation		3.0		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other Research <i>(State Chgs, NDA, etc)</i>		5.1		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other <i>(Medicare, etc)</i>		6.9	7.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
TOTAL USES	88	69	78%	15.4	11.0	12.5	12.8	13.8	65.5	142.7	480.4	
FUNDS REMAINING (DEFICIT)	0.0	0.0		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	

Assessing within Accounts

Est. %	\$ FY98	Est. %	\$ FY98
75%	8.0	80%	8.5
7%	0.1	0%	0.0
9%	0.2	8%	0.2
12%	1.2	10%	1.0
68%	9.6	100%	11.2
20%	2.7	35%	2.7
3%	0.3	7%	0.7
50%	5.8	45%	6.9
5%	1.8	5%	2.4
3%	1.8	8%	2.4
1%	0.5	1%	1.8
2%	0.5	2%	0.8
8%	4.3	17%	6.7
17.5%	1.8	22.5%	2.4
60%	10.2	100%	12.8

4r1 2 3
 -55% -88% -71%

[Holding states constant]
 % Reduction to Public
 Health + Research
 Compared to Manager's
 Amend.



Possible Uses of Tobacco Legislation Receipts
(Farmers \$18B, States \$26B, PH and Research Hlt Proportionately)
(in Billions of Fiscal Dollars— FY99-03 Unless Noted)

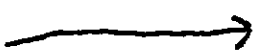
RECEIPTS	Budget	Comprosize \$ %	Proposed Manager's Amendment					Manager's Amendment			
			Year 1 FY99	Year 2 FY00	Year 3 FY01	Year 4 FY02	Year 5 FY03	FY99-03	FY99-03	FY99-03	
Gross Payments	85										
Net Receipts ^{1/}	66	62 100%	15.4	11.0	12.5	12.8	13.8	65.5	142.7	480.4	
<small>Incll Payments, net (Excluded from Revenue)</small>		7									
Net Receipts Less Farmers and States			3.1	0.8	1.6	7.7	4.3	21.3	67.8	258.2	
USES											
Health & Health-Related Research	21.1	13.5 64%	1.6	0.3	0.8	3.8	4.1	10.7	33.8	129.1	
NH	17.0		1.1	0.0	0.3	3.1	3.4	8.0			
NSF (manufacturers/retail)	2.9		0.0	0.0	0.0	0.1	0.1	0.3			
Clinical Cancer Trials	0.8		0.2	0.0	0.3			0.6			
COCA/NCPR	0.4		0.2	0.0	0.1	0.6	0.0	1.6			
Public Health	9.5	13.5 60%	1.6	0.3	0.8	3.8	4.1	10.7	33.8	129.1	
Coalition	5.3		0.5	0.1	0.2	1.2	1.2	3.2			
Indian Health Service	0.1		0.1	0.0	0.0	0.2	0.2	0.5			
Prevention & Education (PAC, Smoking, Abuse)	2.0		0.0	0.2	0.4	2.2	2.4	6.1			
State Prevention	0.4							2.0			
Courtesy-Advertising	2.4							2.0			
International	0.3		0.1	0.0	0.1	0.3	0.3	0.6			
Statewide prevention			0.0	0.1	0.2	0.1	0.2	0.6			
Licensing & Enforcement (PAC, Licensing, Anti-Smuggling)	1.2		0.3	0.1	0.2	0.8	0.8	2.1			
FDA (includes VHA sub-account)	1.2		0.2	0.3	0.3	0.3	0.3	1.2 (over-est)			
State Funds, Direct	28.4	23.0 40%	6.2	4.4	5.0	5.1	5.6	28.2	57.1	104.1	
Unspecified	4%	10.7									
Specified	80%	15.7									
Farmers & Farm Communities	28.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.0	13.0	
Compensation	3.0		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other Research (cattle Charge, NISA, etc)	5.1		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other/Medicare ^{2/}	8.0	7.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
TOTAL USES	88	69 117%	15.4	11.0	12.5	12.8	13.8	65.5	142.7	480.4	
FUNDS REMAINING (DEFICIT)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	

Allocation within Accounts

Est. %	\$ FY99	Est. %	\$ FY03
79%	8.0	80%	8.0
7%	0.1	9%	0.5
8%	0.2	8%	0.2
12%	1.2	18%	1.9
90%	8.6	100%	11.2
20%	2.7	30%	3.7
3%	0.3	7%	0.7
62%	0.3	40%	0.9
3%	1.8	3%	2.4
3%	1.8	3%	2.4
1%	0.5	1%	1.0
3%	0.5	3%	0.9
4%	0.5	4%	0.7
77.0%	1.8	22.0%	2.4
80%	10.2	130%	13.8

4r1 2 3
 -55% -88% -71%

[Holding States Constant]
 % Reduction to Public
 Health + Research
 Compared to Manager's
 Amend.



85044

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Congress of the United States

JOINT COMMITTEE ON TAXATION
1015 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-6453
(202) 225-3621

LINDY L. PAULL
CHIEF OF STAFF
MARY M. SCHMITT
DEPUTY CHIEF OF STAFF
(LAW)
BERNARD A. SCHMITT
DEPUTY CHIEF OF STAFF
(REVENUE ANALYSIS)

May 19, 1998

Honorable John McCain
United States Senate
Washington, DC 20510

Dear Senator McCain:

This letter is in response to your request for a revenue estimate of the manager's amendment to S. 1415 offered May 18, 1998.

In order to complete the estimate of the manager's amendment to S. 1415, we assumed that the base payment for years beginning in 2003 and thereafter is \$23.6 billion before the volume and inflation adjustments.

Our estimate presents the net revenue effects of the manager's amendment to S. 1415. These net amounts differ from the gross payments required under the manager's amendment for several reasons. First, the general tobacco industry payments are converted to fiscal year payments. Second, the general tobacco industry payments are reduced by an income and payroll tax offset in the same way that net receipts from an excise tax are calculated. Third, the higher price for tobacco products resulting from the proposal reduces net receipts generated from present-law tobacco excise taxes because of reduced tobacco consumption. Finally, because the proposal is expected to supercede most of the State-by-State settlements that are implicit in the Congressional Budget Office baseline receipts forecast, much of the negative indirect effect of the anticipated State-by-State settlements on receipts is reversed.

We estimate that the manager's amendment to S. 1415 will have the following effects on Federal fiscal year budget receipts:

Congress of the United States
 JOINT COMMITTEE ON TAXATION
 Washington, DC 20515-6453

Honorable John McCain
 United States Senate

Page 2

	Fiscal Years [Billions of Dollars]										
	1999	2000	2001	2002	2003	2004	2005	2006	2007	1999-02	2003-07
1. General industry payments.....	15.4	11.0	12.5	12.7	13.2	13.8	14.3	14.8	15.4	51.5	71.5
2. Look-back assessment [1]	--	--	--	--	--	1.0	0.6	4.0	3.1	--	8.7
3. Total of S. 1415 as amended.....	15.4	11.0	12.5	12.7	13.2	14.8	14.9	18.8	18.5	51.5	80.2
General industry payments per pack.....[2]	\$0.76	\$0.89	\$1.06	\$1.11	\$1.24	\$1.28	\$1.32	\$1.36	\$1.40		

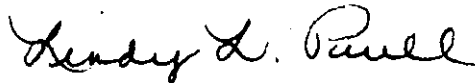
Note: Details may not add to totals due to rounding.

[1] This net revenue reflects the effect of reduced excise tax receipts because of the assumption that the penalty excise tax payments are passed through in the price of tobacco products.

[2] Presented on a calendar year basis and without regard to look-back assessments.

I hope this information is helpful to you. If we can be of further assistance, please let me know.

Sincerely,



Lindy L. Faull

13-May-98 10:49pm

#98-3 090 R
 VERY PRELIMINARY
 13-May-98

ESTIMATED REVENUE EFFECT OF S. 1415
REPORTED BY THE JOINT COMMITTEE ON COMMERCE, SCIENCE, TECHNOLOGY AND
POSSIBLE SUBSTITUTE

(Billions of Dollars)

nominal
 69.4 w/ upmt (7)
 ↓
 62

Provision	Effective	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1998-02	2003-07
I. S. 1415, as Reported [2]													
1. General industry payments.....	10/1/98	—	15.4	11.0	12.5	14.4	16.1	17.0	11.3	9.9	10.6	53.3	64.9
2. Wholesale fee.....	10/1/98	—	1.0	1.1	1.1	1.2	1.2	1.3	1.4	1.4	1.5	4.4	6.8
3. Look-back assessment [3].....	tyba 12/31/02	—	—	—	—	—	—	0.2	0.1	4.1	4.3	—	8.7
Total of S. 1415, as Reported.....		—	16.4	12.1	13.6	15.5	17.3	18.5	12.8	15.4	16.4	57.7	80.4
General Industry Payments Per Pack [4] (nominal).....	10/1/98	\$0.75	\$0.76	\$0.89	\$1.06	\$1.49	\$1.89	\$2.02	\$0.82	\$0.86	\$0.90		
II. Substitute Proposed National Tobacco Settlement (of 6/20/97) payment amounts (general and look-back assessments) for payments under S. 1415													
1. General industry payments.....	10/1/98	—	7.9	8.2	8.9	10.8	12.8	13.8	14.3	14.6	15.0	35.7	70.4
2. Look-back assessment [3].....	tyba 12/31/02	—	—	—	—	—	1.5	1.3	1.3	1.4	1.5	—	6.9
Total of Option II.....		—	7.9	8.2	8.9	10.8	14.3	15.1	15.6	16.0	16.5	35.7	77.4
General Industry Payments Per Pack [4] (nominal).....	—	\$0.50	\$0.50	\$0.58	\$0.82	\$0.92	\$1.17	\$1.25	\$1.26	\$1.27	\$1.28		

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column: tyba = taxable years beginning after

- (1) Estimates are presented on a net basis receipts.
- (2) Estimate assumes the following regarding S. 1415: (1) inflation adjustments to general industry payments commence 6th full year after the date of enactment (2004 and thereafter); (2) volume adjustments to general industry payments commence 7th full year after the date of enactment (2005 and thereafter) and use volume on 1996 as base volume; (3) payments provisions apply to importers as well as to domestic manufacturers; (4) deductible industry payments will be deductible when payments are made; and (5) late payment penalties will be modified, as necessary, to effectively penalize late payments.
- (3) This net revenue reflects the effect of reduced excise tax receipts because of the assumption that the penalty excise tax payments are passed through in the price of tobacco products.
- (4) Presented on a calendar year basis and without regard to look-back assessments.

ID:

MAY 13 '98

22:53 No. 002 P.02

<u>Pages</u>	<u>Pages based on...</u>	<u>62</u>	+	7
22	13.5 to research	17		
22	13.5 to pub health	14		
16	10 farmers	10		
40	25 rates	25		
	<hr/>			
	55			

Vets - 5 billion
to reimburse health care systems

Medicare + low middle class health care tax cut

Kerry - wants for child care

x 90
762 -

Comparison of State Spending Menus

Bills	McCain	Strawman Proposal	Conrad	Harkin/Chafee
Structure	"A State may use funds received under [the State Litigation Settlement Account] as the state determines appropriate."	Some unrestricted funding for states and a menu of 5 funding options, three of which have specified amounts.	Specified percentage of Trust Fund for various state programs and some unrestricted funding for states.	Specified percentage of Trust Funds amounts for state payments. Includes: 1) base payment (states can use at their discretion); 2) block grant (various specified options); 3) bonus pool for states who exceed youth smoking targets. For each state's total funds: - No more than 50% of each state's funds can be used at the state's discretion for any activities it chooses (#1); - No less than 50% must be used to augment a specified range of state and federal programs (#2).
List of Items/Earmarks	None.	<p>Some unrestricted funding of a certain percentage (X%).</p> <p>State spending options (Y %):</p> <p>1) Tobacco Public Health Education, Treatment, and Prevention*</p> <p>2) Child Care*</p> <p>3) Medicaid Outreach* CHIP</p> <p>4) Education/Class Size</p> <p>5) child welfare teacher quality</p> <p>*Specific amounts (from the Budget) required to be spent on these two items.</p>	<p>Some unrestricted funding for states.</p> <p>Specific Earmarks for:</p> <p>1) Child Care/Early Development (\$13.9 billion)</p> <p>2) Class Size (\$4.9 billion)</p> <p>3) Medicaid Outreach/Enrollment (\$3.3 billion)</p>	<p>Block grants (#2) can be used for the following 20 programs:</p> <p>- State programs under MCH Block Grant, SAMHSA, Preventive Health Block Grant, TANF, WIC, IDEA Part B, SSBG and CSBG, Food Stamps, LIHEAP, Medical Assistance Programs, and for:</p> <p>- Federal programs: Head Start, Even Start, CHCs, child welfare, federally funded child care programs, child abuse, education programs, CHIP, federally-funded child care programs, other anti-tobacco/health programs</p>

break this out <

DRAFT

5/12/98

DRAFT

Tobacco - budget

DRAFT

Possible Uses of Tobacco Legislation Receipts

(Dollars in Billions -- FY99-03)

RECEIPTS	Budget	Conrad	Agency	McCain	Strawman
Gross Payments (inflation & volume adj.)	95	119	NA	103	103
Net Receipts	66	82	NA	71	71

USES

Public Health	27.1	29	34	29	26
NIH and Other Health Research	17.3	18	20	15	18.3
Public Health, Other	9	11	13	14	8
McCain 15% Set-Aside for Prev./Cess./Media/Control				11	0
Cessation	5	3	4	**	2.5
Counter-advertising - <i>30/50 CDC - some not advert same to states</i>	2	3	2	**	1
CDC Prevention - <i>Assist + impact: st-hand (funnel thru NIC/CDC) 0.4 Tobacco control people love</i>	1.5	4	4	**	2
Funded from Specified State Uses					-1
Surveys - agency		0.5	1	**	0.8
FDA Enforcement	1	2	1	2	1.2
International	0.3	0.2	0.4	1	1
Indian Health Service	0	1	2	**	0.3
Community Health Centers -- Treatment				2	0
ATF/Customs Enforcement	0	0		**	0
ATF Anti-Tobacco Smuggling				**	0
State Retail Licensing Program				**	0
Minority Counter-Advertising				**	0
Other Minority Tobacco-Related Activities (DPC)				**	0
Environmental Tobacco Smoke (ETS)			0.5		0.25
State	26	34		26	26
Unrestricted	11	12			9.3
Specified (e.g. Class Size, Medicaid Outreach, Child Care, Prev.)	16	22			16.7
Child Care				**	0
Medicaid Cessation Drug Benefit				****	0
Compensation	3	0	18	15	?
Compensation for Individuals (Liability)	3	0		0	?
Asbestos				12	0
Vending Machines				3	0
Veterans (VA)			18	0	0
Farmers & Farm Communities	0.5	10	10	10.5	?
Other Specified in Budget	9	1			8.7
Cancer Clinical Trials	1	1			0.8
Other RFA Research in Budget (e.g. NSF, Commerce)	8	0			7.9
Other (e.g. HI Trust Fund, Deficit Reduction, IOM Study)		8		0.08	0
Total Uses	66	82		80	60.8
Remaining	0	0		-9	10.4

McC has grants to indivs (vouchers)

plund up by 9

(17.3 NIH/1 CDC/ACR)

states - there 6 q Medicaid Medicaid Koop's cessation

states: 69 plus bonds

out of fees 46 over 5

1.3

not vacc + health est: huge mistake to put down; convince them get some of above lines.

*McCain includes \$12.5 billion over 5 years for an NIH Tobacco-Related Research Initiative and \$2.4 billion over 5 years for CDC tobacco-related surveillance and epidemiologic studies and prevention research.

**Funding not specified in the McCain bill.

***The bill provides \$196.5 billion over 25 years for States, but does not provide year-by-year funding. We have assumed the same five-year \$26 billion stream assumed in the Settlement.

****Scoring in process.

*****Strawman assumes the Administration's licensing/anti-smuggling proposal, which is 100% fee-financed.

*****Includes a \$1 billion set-aside for State prevention activities.

lookbacks - create public health trust fund. w just allocation - out pub. health lines phrase in term of addition

Donna: more symmetry for research / public health.

12/14 12/12

5/8/98

13



**Executive Office of the President
Office of Management and Budget**

May 8, 1998

To: Elena Kagan

Fax: 6-2878 Phone: 6-5844
Pages (inc. cover): 2

From: Joshua Gotbaum
Executive Associate Director
OEOB Room 254
(202) 395-9188 Fax: (202) 395-3174

Revised Draft Spending Straw Man

Attached per our discussion is a revised draft. It has not been shared with HHS or Treasury.

It brings the public health spending roughly back to HHS-requested levels by assuming use of \$3 billion over 5 years of state tobacco funds (thereby crowding out child care, etc.). It does not fund a specific level of farmer assistance, but has \$8.6b unused and \$8b of non-health research (NSF, et al.). On enforcement, it includes \$250m of enforcement funds for ATF/Customs that we hope can be funded by fees instead.

Obviously, this would represent a change from some budget priorities (some up, many down). After you've had a chance to review, please call to discuss next steps.

Possible Uses of Tobacco Legislation Receipts

(Dollars in Billions -- FY99-03)

RECEIPTS	Budget	Conrad	Agency	McCain	Strawman	
					\$	% of Net Receipts
Gross Payments	95	119		103	103	144%
Net Receipts	66	82	NA	71	71	100%
USES						
Public Health	27	29	34	29	31 (28)	44%
Health Research, NIH & Other	17	18	20	15	18	26%
Public Health Treatment, Education, Enforcement, Etc.	9	11	13	14	13	18%
S. 1415 Set-Aside for Prev./Cess./Media/Control				11		
Cessation	5	3	4		4	6%
<i>Funded from State Funds</i>					-2	
Counter-advertising	2	3	2		1	1%
Smoking Prevention	0.4	1.5	4		3	4%
<i>Funded from State Funds</i>					-1	
Surveys		0.5	1		1	1%
International	0.3	0.2	0.4	1	1	1%
Indian Health Service	0	1	2		0.25	0%
Licensing & Enforcement	1	2	1	2	3	4%
Public Health Excluding Uses Funded with State Funds					28	39%
State Funds, Direct	26	34	26	26	26	37%
Unrestricted	11	12			9	13%
Specified (inc. public health, Medicaid outreach, child care)	16	22			17	23%
Farmers & Farm Communities	0.5	10	10	10.5	?	?
Compensation	3	0	18	15	0	0%
Other Specified in Budget	9	1	9		9	12%
Cancer Clinical Trials	1	1			1	1%
Other RFA Research in Budget (e.g. NSF, Commerce)	8	0			8	11%
Other (e.g. HI Fund, Deficit Reduction)		8		0.08	0	0%
Total Uses	66	82	97	80	63	88%
Remaining	0	0		-9	8.6	12%

Alloc of non-research public health \$s

Assume \$14

Cessation 4
Trade 2.5
Prevention 2.5
Surveys .75
Int'l 1
Indian ~~1.0~~ .5

→ 11.25

Licensing + enf

FDA enforcement 1.2

ATF - smuggling .3

State bonus - licensing 1.25

→ 2.75

= ~~11.25~~
14.00

**JOSHUA
GOTBAUM**

05/06/98 08:06:40 PM



Record Type: Non-Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP, Cynthia A. Rice/OPD/EOP
cc: Cynthia Dailard/OPD/EOP, Joseph J. Minarik/OMB/EOP, Richard J. Turman/OMB/EOP
Subject: JCT estimate of McCain bill could be \$2 or more.

Based on staff conversations and using more conservative assumptions about pass-through, smuggling and coverage of products other than cigarettes, JCT will likely estimate a real per pack increase of "\$2 and change" under S 1415 by 2003-2008. (CBO contracted out the revenue part of the estimate to JCT, as Karl predicted.)

We'll know more tomorrow.



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

THE DIRECTOR

May 1, 1998

The Honorable John McCain
Chairman
Committee on Commerce, Science, and Transportation
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

You asked us to review a private analysis of S. 1415 that has been furnished to the Committee, in which total tobacco industry payments were estimated to be over \$700 billion over 25 years. We found a number of areas in which that analysis substantially overstates these payments, and identify the adjustments that need to be made below. Once these adjustments are made, the resulting payment schedule is at the levels presented to your Committee during the markup of S. 1415: \$516 billion over 25 years, or \$499 billion if the bill's volume adjustment is taken into account.

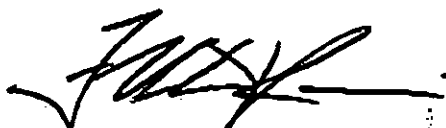
- ◆ *Addition of Items Already Included in the Base Levels* -- The analysis includes additional payments to assist farmers and their communities and those affected by asbestos. However, S. 1415, as adopted, funds these uses via the base payment -- it does not propose additional assessments to support them. The specified amounts in the Tobacco Community Revitalization Trust Fund are to be transferred from the National Tobacco Settlement Trust Fund (\$1012). Similarly, we understand that the version of the asbestos amendment adopted by the Committee specifies that the asbestos provisions are contingent upon funding the Trust fund.
- ◆ *Assumption that Youth Smoking Targets are Not Achieved* -- The analysis assumes that the youth smoking reduction target levels agreed upon by the industry in its discussions with the state attorneys general will not be achieved, and by such a wide margin that lookback assessments of almost \$4 billion dollars are levied every year. Section 202 of S. 1415 limits this surcharge to \$3.5 billion. In the attached table, it is assumed over the 25-year period that no youth surcharges are imposed. The industry's acceptance of these targets and the Administration's own analysis suggests that any surcharge, if required, is likely to be far below the maximum. In its own five-year Budget projections, the Administration assumes that the targets will be met and that no surcharges will be imposed during that period.
- ◆ *Mixing Inflated & Constant Dollars* -- Most analyses of tobacco legislation work in constant (uninflated) or "real" dollars; otherwise, inflation over the 25-year period makes any total seem larger. (For example, the \$368 billion estimated by the state attorneys general is in constant dollars; if calculated in current dollars, the total would be \$539.9

1
billion.) Unfortunately, the tables in the private analysis combine both constant and inflated dollar figures in the first two columns, and thereby overstate the size of the payments in real terms.

Table 1 shows how each of these corrections or adjustments would affect the final result. The last column shows the gross industry payments of S. 1415. In real FY 1999 dollars, base assessments under S. 1415 are estimated to total \$516.1 billion over 25 years. In inflated (current) dollars, payments would total \$755.9 billion over the same period. By way of comparison, the equivalent estimates for the state attorneys general proposal are \$368.5 billion and \$539.9 billion, respectively. Like the private analysis, these estimates do not include the volume adjustment provided in S. 1415 and the state attorneys general proposal, which would reduce payments. Table 2 shows the comparable totals.

We hope this is helpful. We look forward to working with you and other members of the Congress to enact comprehensive tobacco legislation that preserves our children and our health.

Sincerely,



Franklin D. Raines

Enclosures

TABLE 1

**ANALYSIS OF TOBACCO INDUSTRY PAYMENTS UNDER S. 1415
Corrections/Adjustments to Estimates in Private Analysis**

In Billions of Real 1999 Dollars

	Total Claimed in Analysis	Corrections/Adjustments			Corrected S. 1415 Industry Payments in Constant FY99\$
		Items Already in Base Pmt	If Youth Targets Are Met*	Correct Inflation	
Initial Pmt	10.0				10.0
1999	17.5	-3.1		0.0	14.4
2000	19.0	-3.6		-0.4	15.0
2001	22.8	-5.1		-1.0	16.7
2002	30.1	-5.1	-4.0	-1.4	19.6
2003	32.7	-5.1	-4.0	-2.6	21.0
2004	33.7	-6.1	-4.0	-2.6	21.0
2005	30.2	-2.7	-4.0	-2.6	21.0
2006	30.2	-2.7	-4.0	-2.6	21.0
2007	30.2	-2.7	-4.0	-2.6	21.0
2008	30.2	-2.7	-4.0	-2.6	21.0
2009	28.6	-1.1	-4.0	-2.6	21.0
2010	28.6	-1.1	-4.0	-2.6	21.0
2011	28.6	-1.1	-4.0	-2.6	21.0
2012	28.6	-1.1	-4.0	-2.6	21.0
2013	28.6	-1.1	-4.0	-2.6	21.0
2014	28.6	-1.1	-4.0	-2.6	21.0
2015	28.1	-0.5	-4.0	-2.6	21.0
2016	28.1	-0.5	-4.0	-2.6	21.0
2017	28.1	-0.5	-4.0	-2.6	21.0
2018	28.1	-0.5	-4.0	-2.6	21.0
2019	28.1	-0.5	-4.0	-2.6	21.0
2020	28.1	-0.5	-4.0	-2.6	21.0
2021	28.1	-0.5	-4.0	-2.6	21.0
2022	28.1	-0.5	-4.0	-2.6	21.0
2023	28.1	-0.5	-4.0	-2.6	21.0
Total 25 Yrs	<u>710.7</u> **	<u>-49.5</u>	<u>-87.1</u>	<u>-58.0</u>	<u>516.1</u>
Total 5 Yrs	<u>132.0</u>	<u>-22.0</u>	<u>-7.9</u>	<u>-5.5</u>	<u>96.6</u>

Assumes no volume adjustment and youth targets are met.

* In the analysis, maximum youth surcharge was displayed as \$3.96b; in S. 1415, actual maximum is \$3.5b.

** Without assumed maximum youth surcharges, would be 8923.8.

COMPARISON OF PAYMENTS UNDER S. 1415 & AG PROPOSAL
In Billions of Constant 1999 Dollars

Takes into Account Volume Adjustment

	S 1415	State AG's*
	Real 99\$	Real 99\$
1999	24.4	18.0
2000	15.0	8.6
2001	16.7	10.2
2002	19.6	12.0
2003	21.0	12.6
2004	20.9	12.6
2005	20.8	12.5
2006	20.7	12.5
2007	20.7	12.4
2008	20.6	12.4
2009	20.5	12.3
2010	20.4	12.3
2011	20.3	12.2
2012	20.2	12.2
2013	20.2	12.1
2014	20.1	12.1
2015	20.0	12.0
2016	19.9	11.9
2017	19.8	11.9
2018	19.7	11.8
2019	19.6	11.8
2020	19.6	11.7
2021	19.6	11.7
2022	19.4	11.6
2023	<u>19.3</u>	<u>11.5</u>
Total 25 Yrs	<u>498.8</u>	<u>302.9</u>
Total 5 Yrs	<u>95.6</u>	<u>61.4</u>

Assumes youth targets met; initial payment in FY 1999; volume adjustment begins in 2004
 * Assumes implementation in FY99; no credit for civil lawsuits.

COMMERCE TOBACCO BILL
Preliminary Estimates

Year	National Tobacco Settlement Trust Fund				Tobacco Community Revitalization Trust Fund	Tobacco Asbestos Trust Fund	GRAND TOTAL
	Initial Payment	Annual Base Amount *	State Litigation Settlement Account	Maximum Potential Lookback Assessments			
1999	10	6.54	7.86		2.10	1.00	27.50
2000		7.54	7.86		2.10	1.50	19.00
2001		9.84	7.86		2.10	3.00	22.80
2002		13.14	7.86	3.96	2.10	3.00	30.06
2003		15.74	7.86	3.96	2.10	3.00	32.66
2004		16.45	7.86	3.96	2.10	4.00	34.37
2005		17.18	7.86	3.96	2.10	0.55	31.65
2006		17.93	7.86	3.96	2.10	0.55	32.40
2007		18.70	7.86	3.96	2.10	0.55	33.17
2008		19.50	7.86	3.96	2.10	0.55	33.97
2009		20.32	7.86	3.96	0.50	0.55	33.19
2010		21.17	7.86	3.96	0.50	0.55	34.04
2011		22.04	7.86	3.96	0.50	0.55	34.91
2012		22.93	7.86	3.96	0.50	0.55	35.80
2013		23.86	7.86	3.96	0.50	0.55	36.73
2014		24.81	7.86	3.96	0.50	0.55	37.68
2015		25.79	7.86	3.96	0.50		38.11
2016		26.80	7.86	3.96	0.50		39.12
2017		27.84	7.86	3.96	0.50		40.16
2018		28.91	7.86	3.96	0.50		41.23
2019		30.01	7.86	3.96	0.50		42.33
2020		31.15	7.86	3.96	0.50		43.47
2021		32.32	7.86	3.96	0.50		44.64
2022		33.52	7.86	3.96	0.50		45.84
2023		34.76	7.86	3.96	0.50		47.08
TOTAL, 25 years	10.00	548.77	196.50	87.12	28.50	21.00	891.89
TOTAL, 5 years	10.00	52.80	39.30	7.92	10.50	11.50	132.02

* = Annual base amount does not include State Litigation Settlement Account, is adjusted for 3% inflation after the 6th year, but is not adjusted for potential reductions in volume of tobacco sales.

MP/L

COMMERCE TOBACCO BILL
Preliminary Estimates

Year	National Tobacco Settlement Trust Fund				Tobacco Community Revitalization Trust Fund	Tobacco Asbestos Trust Fund	GRAND TOTAL
	Initial Payment	Annual Base Amount *	State Litigation Settlement Account	Maximum Potential Lookback Assessments			
1999	10	6.54	7.86		2.10	1.00	27.50
2000		7.54	7.86		2.10	1.50	19.00
2001		9.84	7.86		2.10	3.00	22.80
2002		13.14	7.86	3.96	2.10	3.00	30.06
2003		15.74	7.86	3.96	2.10	3.00	32.66
2004		15.74	7.86	3.96	2.10	4.00	33.66
2005		15.74	7.86	3.96	2.10	0.55	30.21
2006		15.74	7.86	3.96	2.10	0.55	30.21
2007		15.74	7.86	3.96	2.10	0.55	30.21
2008		15.74	7.86	3.96	2.10	0.55	30.21
2009		15.74	7.86	3.96	0.50	0.55	28.61
2010		15.74	7.86	3.96	0.50	0.55	28.61
2011		15.74	7.86	3.96	0.50	0.55	28.61
2012		15.74	7.86	3.96	0.50	0.55	28.61
2013		15.74	7.86	3.96	0.50	0.55	28.61
2014		15.74	7.86	3.96	0.50	0.55	28.61
2015		15.74	7.86	3.96	0.50		28.06
2016		15.74	7.86	3.96	0.50		28.06
2017		15.74	7.86	3.96	0.50		28.06
2018		15.74	7.86	3.96	0.50		28.06
2019		15.74	7.86	3.96	0.50		28.06
2020		15.74	7.86	3.96	0.50		28.06
2021		15.74	7.86	3.96	0.50		28.06
2022		15.74	7.86	3.96	0.50		28.06
2023		15.74	7.86	3.96	0.50		28.06
TOTAL, 25 years	10.00	367.60	196.50	87.12	28.50	21.00	710.72
TOTAL, 5 years	10.00	52.80	39.30	7.92	10.50	11.50	132.02

* = Annual base amount does not include State Litigation Settlement Account, and is not adjusted for inflation or potential reductions in volume of tobacco sales after the 6th year.

WHAT'S NEW IN THE COMMERCE COMMITTEE TOBACCO BILL

Source: 4/23/98 legislative draft

NEW TAXES, FEES, PENALTIES, ASSESSMENTS, ETC

National Tobacco Settlement Trust Fund	\$367.6 billion over 25 years, not including state litigation settlement account, and not adjusted for inflation or volume, Section 401 & 403, page 152.
State Litigation Settlement Account	\$196.5 billion over 25 years, Section 402, page 155.
Lookback assessments for underage use	Up to \$3.96 billion per year beginning in 3 rd year, Section 203, page 104.
Tobacco Community Revitalization Trust Fund	\$28.5 billion over 25 years, Section 1011 & 1012, page 247.
Special asbestos/tobacco victim assessment	\$21 billion over 15 years, Section 1205, page 415.
Penalties for non-payment of industry payments	\$100,000 per day after 60 days late, Section 407, page 167.
Document/trade secret good faith penalties	\$10,000 per violation, Section 910, page 241.
Tobacco product distribution licensing fee	\$1 per 1000 cigarettes manufactured, Section 1121, page 353.
Settlement Reserve Fund	Non-participating tobacco companies must pay 150% of what they would otherwise owe into escrow to make liability payments.

NEW COMMITTEES / COMMISSIONS / REPORTS

Tobacco products scientific advisory committee, Section 915, page 88.

Attorney fee arbitration panel, Section 707, page 207.

Tobacco agreement accountability panel, Section 801(a), page 216.

National tobacco documents review board, Section 906, page 235.

National tobacco task force, Section 2802, page 343.

NIH Office of Tobacco Related Research, Section 2804, page 350.

Tobacco vending reimbursal corporation, Section 1191(b)(2), page 392.

NEW PROGRAM AUTHORIZATIONS

National Institutes of Health	\$25 billion over 10 years, Section 2804, page 347.
Centers for Disease Control	\$4.195 billion over 10 years, Section 2803, page 345.
FDA administration & enforcement	\$300 million per year, Section 408, page 169.
American Center on Global Health and Tobacco	\$150 million per year, Section 1132, page 357.
Child Care Development Block Grants	Such sums as may be necessary, Section 411, page 169.
National smoking cessation program	Such sums as may be necessary, Section 221, page 128.
National tobacco-free public education program	Such sums as may be necessary, Section 222, page 132.
National community action program	Such sums as may be necessary, Section 223, page 133.
State retail licensing program - state grants	Not specified, Section 224, page 133.
Indian tribe enforcement grants	Not specified, Section 603(d)(3), page 180.
Indian tribe public health grants	Not specified, Section 603(f), page 183.
Tort trust fund	Not specified, Section 710, page 215.
National tobacco document depository	Not specified, Section 903, page 226.
Tobacco farmer quota payments	\$1.65 billion per year, Section 1011(d)(1), page 248.

USDA operation of tobacco program	Such sums as may be necessary, Section 1011(d)(2), page 249.
Tobacco community economic development grants	\$10.5 billion over 25 years, Section 1011(d)(3), page 249.
Tobacco worker transition program	\$25 million per year, Section 1011(d)(4), page 249.
Farmer opportunity grants	\$1.44 billion over 25 years, Section 1011(d)(5), page 249.
Institute of Medicine study	\$750,000, Section 2801, page 341.
International tobacco control trust fund	Not specified, Section 1131, page 356.
Prevention of tobacco smuggling	Such sums as may be necessary, Section 1150, page 383.
School/community tobacco education grants	Such sums as may be necessary, Section 1172, page 385.
Counter advertising programs	Such sums as may be necessary, Section 1173, page 388.
Community and migrant health centers	\$300 million per year / 10 years, Section 1174, page 389.
Compensation to tobacco vending owners	Such sums as may be necessary, Section 1191(d), page 398.
Tobacco asbestos trust fund	\$20 billion thru 2014, Section 1202, page 415.
Veterans affairs tobacco recovery fund	Not specified, Section 9101(c), page 424.

FAX

Office of Management and Budget
Executive Office of the President
Washington, DC 20503

TO: Elena Kagan
John Gruber

Response to Nichols

FROM: Josh Gotbaum
Executive Associate Director

Date: April 29, 1998

Fax #: 6-2878
622-2633

Pages (excluding this cover sheet): 2

COMMENTS:

As faxed to John Raidt (@ 8:15 pm)

COMPARISON OF PAYMENTS UNDER S. 1415 & AG PROPOSAL
In Billions of Real & Constant 1999 Dollars

	S 1415		State AG's*	
	Nominal	Real 99\$	Nominal	Real 99\$
1999	24.4	24.4	18.5	18.5
2000	16.4	15.0	9.8	9.6
2001	17.7	16.7	12.2	11.5
2002	21.4	19.6	15.3	14.0
2003	23.6	21.0	16.9	15.0
2004	24.3	21.0	17.4	15.0
2005	25.0	21.0	17.9	15.0
2006	25.8	21.0	18.4	15.0
2007	26.6	21.0	19.0	15.0
2008	27.4	21.0	19.6	15.0
2009	28.2	21.0	20.2	15.0
2010	29.0	21.0	20.8	15.0
2011	29.9	21.0	21.4	15.0
2012	30.8	21.0	22.0	15.0
2013	31.7	21.0	22.7	15.0
2014	32.7	21.0	23.4	15.0
2015	33.7	21.0	24.1	15.0
2016	34.7	21.0	24.8	15.0
2017	35.7	21.0	25.5	15.0
2018	36.8	21.0	26.3	15.0
2019	37.9	21.0	27.1	15.0
2020	39.0	21.0	27.9	15.0
2021	40.2	21.0	28.7	15.0
2022	41.4	21.0	29.6	15.0
2023	<u>42.6</u>	<u>21.0</u>	<u>30.5</u>	<u>15.0</u>
Total 25 Yrs	<u>755.9</u>	<u>516.1</u>	<u>539.9</u>	<u>368.5</u>
Total 5 Yrs	<u>102.5</u>	<u>96.6</u>	<u>72.7</u>	<u>68.5</u>

Assumes youth targets met.

* Assumes no credit for civil lawsuits.

COMPARISON OF PAYMENTS UNDER S. 1415 & AG PROPOSAL
In Billions of Real & Constant 1999 Dollars

Taken into Account Volume Adjustment

	S 1415		State AG's*	
	Nominal	Real 99\$	Nominal	Real 99\$
1999	24.4	24.4	18.0	18.0
2000	15.4	15.0	8.9	8.6
2001	17.7	16.7	10.8	10.2
2002	21.4	19.6	13.1	12.0
2003	23.6	21.0	14.2	12.6
2004	24.2	20.9	14.6	12.6
2005	24.9	20.8	15.0	12.5
2006	25.5	20.7	15.3	12.5
2007	26.2	20.7	15.7	12.4
2008	26.9	20.6	16.1	12.4
2009	27.5	20.5	16.6	12.3
2010	28.3	20.4	17.0	12.3
2011	29.0	20.3	17.4	12.2
2012	29.7	20.2	17.8	12.2
2013	30.5	20.2	18.3	12.1
2014	31.3	20.1	18.8	12.1
2015	32.1	20.0	19.3	12.0
2016	32.9	19.9	19.7	11.9
2017	33.7	19.8	20.2	11.9
2018	34.6	19.7	20.6	11.8
2019	35.5	19.6	21.3	11.8
2020	36.4	19.6	21.8	11.7
2021	37.3	19.5	22.3	11.7
2022	38.2	19.4	22.9	11.6
2023	<u>39.2</u>	<u>19.3</u>	<u>23.5</u>	<u>11.5</u>
Total 25 Yrs	<u>726.4</u>	<u>498.8</u>	<u>439.4</u>	<u>302.9</u>
Total 5 Yrs	<u>102.5</u>	<u>96.6</u>	<u>65.0</u>	<u>61.4</u>

Assumes youth targets met.

* Assumes no credit for civil lawsuits.

Comparison of Tobacco Receipts to Possible Uses of Funds

(BA over FY99-03 -- Nominal \$ in Billions)

RECEIPTS	Budget	McCain	Conrad		
Annual Assessments, Gross	95	93	104		
Up-Front Payment, Gross	0	<u>10</u>	<u>15</u>		
Total Gross Payments	<u>95</u>	<u>103</u>	<u>119</u>		
Net Receipts (after offsets)	<u>66</u>	<u>71</u>	<u>82</u>		
USES FINANCED WITH TOBACCO RECEIPTS	Budget	McCain	Conrad	Other	Source for Other
Public Health Activities					
NIH & Other Health Research	17		18	16	<i>Chafee/Harkin</i>
FDA	1	2	2	2	<i>Settlement</i>
Cessation	5 *		3	6	<i>Settlement</i>
Counter-Advertising	2 *		3	3	<i>Settlement</i>
Prevention Activities	<u>0.4</u>		<u>2</u>	1	<i>Settlement</i>
Total	<u>27</u>	2	<u>27</u>	27	
Unrestricted State Funds	11 *	26 **	12	26	<i>Settlement</i>
Farmers	0.5 *	11	10	10	<i>Chafee/Harkin</i>
Payments for Judgments & Settlements	3 *	0	0	17	<i>Chafee/Harkin</i>
Specified Spending in Budget					
Child Care	8		14	20	<i>Kennedy</i>
Medicaid Outreach	1		3		
Class Size	7		5		
Cancer Clinical Trials	1		1		
Other RFA Research in Budget (e.g. NSF, Commerce)	<u>8</u>		<u>0</u>		
Total, specified	<u>24</u>		<u>23</u>	20	
Other					
CDC Youth Surveys			0.5	1	<i>Chafee/Harkin</i>
Medicare HI Trust Fund			3		
Smuggling			0	1	<i>Chafee/Harkin</i>
International	0.3 *	1	0.2	0.5	<i>Chafee/Harkin</i>
Asbestos/Black Lung			0		
Veterans Compensation			0	10	
Indian Health			1	1	<i>Chafee/Harkin</i>
Vending Machine Compensation			0		
Sports Teams/Event Sponsorship			0.1	0.3	<i>Settlement</i>
ETS			0	1	<i>Chafee/Harkin</i>
Reducing the Public Debt			5		
Reduce Youth Drug Use			1		
Other			0		
Tax Expenditures					
Tax Credit for Health Insurance				10	<i>Archer***</i>
Tax Credit for Stay-at-Home Mothers					
Child Care Tax Credits				6	<i>Budget****</i>
TOTAL LISTED USES	66	39	82	129	
RECEIPTS LESS SPENDING	0	32	0	NA	

*Not specified in Budget. Placeholders within "Other Uses" line on S-7 Table.

**OMB Estimate. The McCain bill provides only a 25-year state number of \$196.5 billion.

***Source is 3/30 New York Times Article on Archer Proposal. No JCT/OTA Scoring Available.

****Not financed with Tobacco Receipts.



Cynthia A. Rice

04/10/98 02:28:09 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP

cc:

Subject: \$6.5 liability and memo to POTUS

OMB staff (who just got the COS memo) just raised this fact --

If \$26 billion over five years for liability is within the \$1.10, this also means that we probably don't have \$15 billion left after spending \$10 billion over 5 years for farmers; \$10 billion for cessation, counteradvertising, and other public health programs; \$10-15 billion for NIH; and \$20-25 billion for states.

----- Forwarded by Cynthia A. Rice/OPD/EOP on 04/10/98 02:22 PM -----



Cynthia A. Rice

04/10/98 11:42:23 AM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP

cc: Laura Emmett/WHO/EOP, Cynthia Dailard/OPD/EOP

Subject: Question re: \$6.5 liability and budget

Our assumption is that McCain wanted \$5.2 billion of \$6.5 liability fund to be part of the annual assessment, right, i.e., within the \$1.10? And the \$1.3 billion co-pay would be outside, right?

You should know that the table OMB handed out at the meeting yesterday assumes all the \$6.5 billion is outside the annual payment. In other words, the table shows \$32 billion in "receipts less spending" because they did not assume \$26 billion (\$5.2 billion x 5 years) is eaten up by the liability fund.

Obviously, then, we have less money to play with than expected.

1

COMPARISON OF PAYMENTS UNDER S. 1415 & AG PROPOSAL
In Billions of Nominal or Constant 1999 Dollars

BASE PAYMENTS With VOLUME ADJUSTMENT
Youth Targets Met

	State AG's*		S 1415	
	Nominal	Real 99\$	Nominal	Real 99\$
1999	18.0	18.0	24.4	24.4
2000	8.9	8.6	15.4	15.0
2001	10.8	10.2	17.7	16.7
2002	13.1	12.0	21.4	19.6
2003	14.2	12.6	23.6	21.0
2004	14.6	12.6	24.2	20.9
2005	15.0	12.5	24.9	20.8
2006	15.3	12.5	25.5	20.7
2007	15.7	12.4	26.2	20.7
2008	16.1	12.4	26.9	20.6
2009	16.6	12.3	27.5	20.5
2010	17.0	12.3	28.3	20.4
2011	17.4	12.2	29.0	20.3
2012	17.9	12.2	29.7	20.2
2013	18.3	12.1	30.5	20.2
2014	18.8	12.1	31.3	20.1
2015	19.3	12.0	32.1	20.0
2016	19.7	11.9	32.9	19.9
2017	20.2	11.9	33.7	19.8
2018	20.8	11.8	34.6	19.7
2019	21.3	11.8	35.5	19.6
2020	21.8	11.7	36.4	19.6
2021	22.3	11.7	37.3	19.5
2022	22.9	11.6	38.2	19.4
2023	<u>23.5</u>	<u>11.5</u>	<u>39.2</u>	<u>19.3</u>
Total 25 Yrs	<u>439.4</u>	<u>302.9</u>	<u>726.4</u>	<u>498.8</u>
Total 5 Yrs	<u>65.0</u>	<u>61.4</u>	<u>102.5</u>	<u>96.6</u>

* Assumes implementation in FY99; no credit for civil lawsuits.

ANALYSIS OF PAYMENTS UNDER S. 1415 & AG PROPOSAL
 In Billions of Nominal or Constant 1999 Dollars

BASE PAYMENTS

Youth Targets Met, No Volume Adjustments

	State AG's*		S 1415	
	Nominal	Real 99\$	Nominal	Real 99\$
1999	18.5	18.5	24.4	24.4
2000	9.8	9.5	15.4	15.0
2001	12.2	11.5	17.7	16.7
2002	15.3	14.0	21.4	19.6
2003	16.9	15.0	23.6	21.0
2004	17.4	15.0	24.3	21.0
2005	17.9	15.0	25.0	21.0
2006	18.4	15.0	25.8	21.0
2007	19.0	15.0	26.6	21.0
2008	19.6	15.0	27.4	21.0
2009	20.2	15.0	28.2	21.0
2010	20.8	15.0	29.0	21.0
2011	21.4	15.0	29.9	21.0
2012	22.0	15.0	30.8	21.0
2013	22.7	15.0	31.7	21.0
2014	23.4	15.0	32.7	21.0
2015	24.1	15.0	33.7	21.0
2016	24.8	15.0	34.7	21.0
2017	25.5	15.0	35.7	21.0
2018	26.3	15.0	36.8	21.0
2019	27.1	15.0	37.9	21.0
2020	27.9	15.0	39.0	21.0
2021	28.7	15.0	40.2	21.0
2022	29.6	15.0	41.4	21.0
2023	<u>30.5</u>	<u>15.0</u>	<u>42.6</u>	<u>21.0</u>
Total 25 Yrs	<u>539.9</u>	<u>368.5</u>	<u>755.9</u>	<u>516.1</u>
Total 5 Yrs	<u>72.7</u>	<u>68.5</u>	<u>102.5</u>	<u>96.6</u>

* Assumes implementation in FY99; no credit for civil lawsuits.

ANALYSIS OF PAYMENTS UNDER S. 1415 & AG PROPOSAL
 In Billions of Nominal or Constant 1999 Dollars

BASE PAYMENTS + MAXIMUM POSSIBLE LOOKBACK
INCLUDES VOLUME ADJUSTMENTS
Assumes Youth Targets Never Met

	State AG's*		S 1415	
	Nominal	Real 99\$	Nominal	Real 99\$
1999	18.0	18.0	24.4	24.4
2000	8.9	8.6	15.4	15.0
2001	10.8	10.2	17.7	16.7
2002	13.1	12.0	25.3	23.1
2003	16.5	14.6	27.6	24.5
2004	17.2	14.8	28.3	24.4
2005	17.3	14.5	29.1	24.3
2006	17.9	14.5	29.8	24.3
2007	18.5	14.6	30.6	24.2
2008	18.7	14.4	31.4	24.1
2009	19.4	14.4	32.3	24.0
2010	19.9	14.4	33.1	23.9
2011	20.4	14.3	34.0	23.8
2012	21.0	14.3	34.9	23.7
2013	21.5	14.2	35.8	23.6
2014	22.1	14.2	36.7	23.6
2015	22.6	14.1	37.7	23.5
2016	23.2	14.1	38.6	23.4
2017	23.8	14.0	39.6	23.3
2018	24.4	13.9	40.7	23.2
2019	25.1	13.9	41.7	23.1
2020	25.7	13.8	42.8	23.0
2021	26.4	13.8	43.9	22.9
2022	27.0	13.7	45.0	22.8
2023	27.7	13.6	46.2	22.7
Total 25 Yrs	<u>507.2</u>	<u>346.9</u>	<u>842.5</u>	<u>575.5</u>
Total 5 Yrs	<u>67.2</u>	<u>63.4</u>	<u>110.4</u>	<u>103.7</u>

* Assumes implementation in FY99; no credit for civil lawsuits.

ANALYSIS OF PAYMENTS UNDER S. 1415 & AG PROPOSAL
 In Billions of Nominal or Constant 1999 Dollars

BASE PAYMENTS + MAXIMUM POSSIBLE LOOKBACK

Youth Targets Never Met, No Volume Adjustments

	State AG's*		S 1415	
	Nominal	Real 99\$	Nominal	Real 99\$
1999	18.5	18.5	24.4	24.4
2000	9.8	9.5	15.4	15.0
2001	12.2	11.5	17.7	16.7
2002	15.3	14.0	25.3	23.1
2003	19.3	17.1	27.6	24.5
2004	19.8	17.1	28.4	24.5
2005	20.4	17.1	29.3	24.5
2006	21.1	17.1	30.1	24.5
2007	21.7	17.1	31.0	24.5
2008	22.3	17.1	32.0	24.5
2009	23.0	17.1	32.9	24.5
2010	23.7	17.1	33.9	24.5
2011	24.4	17.1	34.9	24.5
2012	25.1	17.1	36.0	24.5
2013	25.9	17.1	37.1	24.5
2014	26.7	17.1	38.2	24.5
2015	27.5	17.1	39.3	24.5
2016	28.3	17.1	40.5	24.5
2017	29.1	17.1	41.7	24.5
2018	30.0	17.1	43.0	24.5
2019	30.9	17.1	44.2	24.5
2020	31.9	17.1	45.6	24.5
2021	32.8	17.1	46.9	24.5
2022	33.8	17.1	48.3	24.5
2023	<u>34.8</u>	<u>17.1</u>	<u>49.8</u>	<u>24.5</u>
Total 25 Yrs	<u>608.4</u>	<u>413.1</u>	<u>873.5</u>	<u>593.6</u>
Total 5 Yrs	<u>75.1</u>	<u>70.6</u>	<u>110.4</u>	<u>103.7</u>

* Assumes implementation in FY99; no credit for civil lawsuits.

ANALYSIS OF PAYMENTS UNDER S. 1415
 In Billions of Nominal or Constant 1999 Dollars

EFFECT OF CORRECTING VOLUME ADJUSTMENT IN S. 1415
Using Changes from Prior Year vs Using 1996 as Base
Assumes Youth Targets Never Met – Maximum Youth Surcharge

	Base Adj't on Prior Year		Base on 1996 Levels	
	Nominal	Real 99\$	Nominal	Real 99\$
1999	24.4	24.4	24.4	24.4
2000	15.4	15.0	15.4	15.0
2001	17.7	16.7	17.7	16.7
2002	25.3	23.1	25.3	23.1
2003	27.6	24.5	27.6	24.5
2004	28.3	24.4	28.4	24.5
2005	29.1	24.3	22.8	19.1
2006	29.8	24.3	23.4	19.1
2007	30.6	24.2	24.1	19.0
2008	31.4	24.1	24.7	18.9
2009	32.3	24.0	25.3	18.9
2010	33.1	23.9	26.0	18.8
2011	34.0	23.8	26.7	18.7
2012	34.9	23.7	27.4	18.7
2013	35.8	23.6	28.1	18.6
2014	36.7	23.6	28.9	18.5
2015	37.7	23.5	29.6	18.5
2016	38.6	23.4	30.4	18.4
2017	39.6	23.3	31.2	18.3
2018	40.7	23.2	32.0	18.3
2019	41.7	23.1	32.9	18.2
2020	42.8	23.0	33.7	18.1
2021	43.9	22.9	34.6	18.1
2022	45.0	22.8	35.5	18.0
2023	46.2	22.7	36.4	17.9
Total 25 Yrs	<u>842.5</u>	<u>575.5</u>	<u>692.6</u>	<u>480.1</u>
Total 5 Yrs	<u>110.4</u>	<u>103.7</u>	<u>110.4</u>	<u>103.7</u>

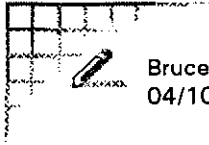
Section 404(b)(2) provides that, beginning in 2005, payments shall be adjusted to reflect changes in consumption. However, as drafted, the base year for adjustment is 1996, rather than 2003. As a result, the provision would reduce the base payment and resulting price levels sharply in 2005 and thereafter.

ANALYSIS OF PAYMENTS UNDER S. 1415
In Billions of Nominal or Constant 1999 Dollars

EFFECT OF (ERRONEOUSLY) INFLATION INDEXING FROM YEAR 4

	S 1415		S 1415	
	Inflated from Year 6		If Inflated from Year 4*	
	Not Volume Adjusted Teen Targets Met		Not Volume Adjusted Teen Targets Met	
	Nominal	Real 99\$	Nominal	Real 99\$
1999	24.4	24.4	24.4	24.4
2000	15.4	15.0	15.4	15.0
2001	17.7	16.7	17.7	16.7
2002	21.4	19.6	22.0	20.2
2003	23.6	21.0	25.0	22.3
2004	24.3	21.0	25.8	22.3
2005	25.0	21.0	26.6	22.3
2006	25.8	21.0	27.4	22.3
2007	26.6	21.0	28.2	22.3
2008	27.4	21.0	29.0	22.3
2009	28.2	21.0	29.9	22.3
2010	29.0	21.0	30.8	22.3
2011	29.9	21.0	31.7	22.3
2012	30.8	21.0	32.7	22.3
2013	31.7	21.0	33.7	22.3
2014	32.7	21.0	34.7	22.3
2015	33.7	21.0	35.7	22.3
2016	34.7	21.0	36.8	22.3
2017	35.7	21.0	37.9	22.3
2018	36.8	21.0	39.0	22.3
2019	37.9	21.0	40.2	22.3
2020	39.0	21.0	41.4	22.3
2021	40.2	21.0	42.6	22.3
2022	41.4	21.0	43.9	22.3
2023	42.6	21.0	45.2	22.3
Total 25 Yrs	<u>755.9</u>	<u>516.1</u>	<u>797.8</u>	<u>543.5</u>
Total 5 Yrs	<u>102.5</u>	<u>96.6</u>	<u>104.6</u>	<u>98.5</u>

* N.B.: This example is provided only to illustrate the effect of a misreading of S. 1415. In the example, base amounts are inflated beginning in year 4. Although Sec. 404(1)(A) might be misconstrued, as providing for inflation adjustment in year 5 ("fourth calendar year after enactment"), the actual payment requirement is Section 403, which makes clear that no base amount adjustments take place before year 6 (Section 403(b)(6), p 403).




Bruce N. Reed
04/10/98 11:52:18 AM

Record Type: Record

To: Cynthia A. Rice/OPD/EOP

cc: Elena Kagan/OPD/EOP, Laura Emmett/WHO/EOP, Cynthia Dailard/OPD/EOP

Subject: Re: Question re: \$6.5 liability and budget 

Yes, you're right. In any event, it's a difficult scoring issue. We asked Jack about it last night. We should keep working with them to see how they would score it if it were part of the annual payment



**Executive Office of the President
Office of Management and Budget**

April 28, 1998

To: Bruce Reed, Elena Kagan

Fax: 622-2633 Phone:
Pages (inc. cover): 2

**From: Joshua Gotbaum
Executive Associate Director
OEOB Room 254
(202) 395-9188 Fax: (202) 395-3174**

Conversion Table

As agreed.

**IF YOU RECEIVED THIS IN ERROR, PLEASE CALL US IMMEDIATELY AT (202) 395-9188
THANK YOU. Any dissemination, distribution or copying of this message is strictly prohibited.**

CONVERSION OF FIXED TOBACCO INDUSTRY PAYMENT TO PER PACK EQUIVALENT

	1999	2000	2001	2002	2003	
Total Payment in Current Year Dollars (billions)*	14.4	15.4	17.7	21.4	23.6	
Total Payment in Constant 1999 Dollars	14.4	15.0	16.7	19.6	21.0	
Portion of payment on cigarettes**	93%	13.4	13.9	15.5	18.2	19.5
Estimated Number of Packs Sold*** (billions)	20.7	19.9	19.4	18.2	17.7	
Payment per Pack	\$ 0.65	\$ 0.70	\$ 0.80	\$ 1.00	\$ 1.10	

* Payment schedule contained in S. 1415

** 7% of payment assumed to be passed on to other tobacco products

*** Reflects change in consumption due to higher prices. 23% reduction from 1998 to 2003 based upon semilogarithmic demand function with initial elasticity of -0.45.

CONVERSION OF FIXED TOBACCO INDUSTRY PAYMENT TO PER PACK EQUIVALENT

	1999	2000	2001	2002	2003	
Total Payment in Current Year Dollars (billions)*	14.4	15.4	17.7	21.4	23.6	
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** 7% of payment assumed to be passed on to other tobacco products

*** Reflects change in consumption due to higher prices. 23% reduction from 1998 to 2003 based upon semilogarithmic demand function with initial elasticity of -0.45.

Table 1

Average Price Per Pack of Small Cigarettes
FY 1999 Budget Assumptions

Calendar Years	1998	1999	2000	2001	2002	2003
Nominal Prices						
Baseline Price Assumption 1/	1.94	1.99	2.14	2.18	2.29	2.34
FY99 Budget price increases	0.00	0.63	0.82	0.95	1.09	1.24
Total Price	1.94	2.62	2.96	3.13	3.38	3.58
Real Prices (1998 \$)						
Baseline Price Assumption	1.94	1.94	2.04	2.04	2.09	2.09
FY99 Budget price increases	0.00	0.62	0.78	0.89	1.00	1.10
Total Price	1.94	2.56	2.82	2.93	3.09	3.19

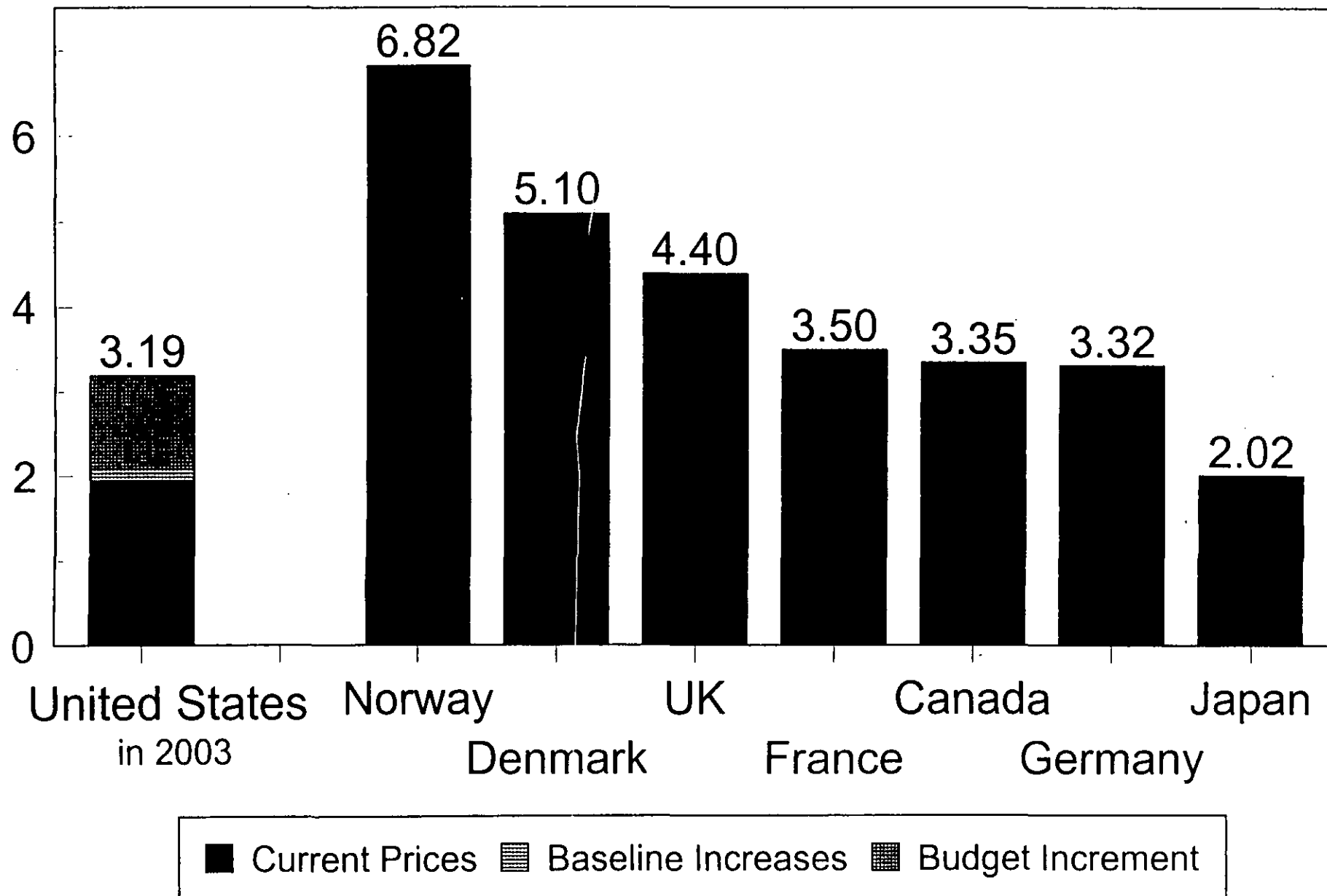
1/ Price assumed is weighted average of premium, generic, and discount cigarettes sold as singles, cartons and case.

TABLE 2: Health Benefits of President's Budget

Baseline Number of Teen Smokers Between 1999-2003	7.6 Million
Percent Reduction due to Price Increase	-29%
Percent Reduction due to Access and Marketing Restrictions	-11%
Cumulative Percent Reduction	-40%
Reduction in Number of Teen Smokers 1999-2003	-3.0 Million
Premature Deaths Avoided	-1.0 Million

National Estimates

Figure 1: Real International Cigarette Prices



Source: United Nations, Tobacco Merchants Association, CIA, World Fact Book, Smith Barney Estimates from Smith Barney Tobacco Research, October 22, 1997.

United States figure includes current price, baseline increases, and budget increment in 2003. All others are 1996 equivalent US (\$) retail tobacco prices.

CONVERSION OF FIXED TOBACCO INDUSTRY PAYMENT TO PER PACK EQUIVALENT

		1999	2000	2001	2002	2003
Total Payment in Current Year Dollars (billions)*		14.4	15.4	17.7	21.4	23.6
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** 7% of payment assumed to be passed on to other tobacco products

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Cynthia A. Rice

04/23/98 06:49:32 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP, Laura Emmett/WHO/EOP, Cynthia Dailard/OPD/EOP

cc:

Subject: Bruce -- you asked Gruber about Moody's analysis

Moody's apparently did not realize that the industry payments for the first five years include an implicit volume adjustment -- thus, they think the \$1.10 is really much higher. Gruber's called to explain, but this re-inforced his views that we may want to include a volume adjustment at a some point.

He is also asking whether tying some of ^Y all of the assessments to the youth lookback penalties would help us in the pr war -- by giving us a better argument against the "you're taxing adults" angle. I don't see it, do you?

Tob-budget



Cynthia A. Rice

04/10/98 10:25:31 AM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP
cc: Laura Emmett/WHO/EOP, Cynthia Dailard/OPD/EOP
Subject: Joint Tax has told Conrad that his bill scores like ours

Jon Gruber says that the Joint Tax Committee has told Conrad that his bill -- without the up-front payment -- scores the same as ours, implying our \$1.10 is really a \$1.50. I'll add this to the Q&A list.

Tob-net-budget



Cynthia A. Rice

04/10/98 11:42:23 AM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP
cc: Laura Emmett/WHO/EOP, Cynthia Dailard/OPD/EOP
Subject: Question re: \$6.5 liability and budget

Our assumption is that McCain wanted \$5.2 billion of \$6.5 liability fund to be part of the annual assessment, right, i.e., within the \$1.10? And the \$1.3 billion co-pay would be outside, right?

You should know that the table OMB handed out at the meeting yesterday assumes all the \$6.5 billion is outside the annual payment. In other words, the table shows \$32 billion in "receipts less spending" because they did not assume \$26 billion (\$5.2 billion x 5 years) is eaten up by the liability fund.

Obviously, then, we have less money to play with than expected.

Internal - with #s -
and lump payment

Draft Tobacco Assessment Language

Under this approach, receipts would be miscellaneous receipts, not tax receipts.

- Administration is by the Attorney General, not Treasury.
- The assessments are not collected by the IRS or BATF in the manner of excise taxes.
- The assessment is a fixed dollar amount and does not vary by sales, as does an excise tax.
- The assessment is a lump sum based on the market share of the prior calendar year for which data is available. In other words, the assessment due on January 1, 1999 would be based on the calendar year 1997 market share.
- Unlike excise taxes, the payors in this case are getting something out of the legislation (e.g., liability relief, in McCain's bill).
- The assessment also accomplishes a national purpose -- reducing teenage smoking.

SAMPLE LEGISLATIVE LANGUAGE

**TITLE ___ - NATIONAL YOUTH SMOKING AND HEALTH TRUST FUND
SEC. ___. ESTABLISHMENT OF TRUST FUND.**

(a) CREATION-

(1) **IN GENERAL-** There is established in the Treasury of the United States a trust fund to be known as the 'National Youth Smoking and Health Trust Fund', consisting of such amounts as may be appropriated or credited to the Trust Fund.

(2) **TRUSTEES-** The trustees of the Trust Fund shall be the Secretary of Health and Human Services, the Secretary of Treasury, and the Attorney General.

(b) TRANSFERS- There are hereby appropriated and transferred to the Trust Fund 75 percent of--

(1) amounts repaid or recovered under section ___, including interest thereon;

(2) amounts equivalent to amounts received under section ___; and

(3) amounts paid as fines or penalties, including interest thereon, under section ___.

SEC. ___. PAYMENTS OF ASSESSMENTS.

(a) DEFINITION OF ASSESSMENT SHARE- In this section, the term 'assessment share' means the ratio of--

(1) the number of units produced or imported for domestic consumption by a tobacco product manufacturer or tobacco product importer for the preceding calendar year; to

(2) the number of units produced or imported for domestic consumption by all tobacco product manufacturers or tobacco product importers for the preceding calendar year.

(b) DETERMINATIONS- Not later than September 30 of each calendar year, the Attorney General shall--

(1) determine--

(A) the assessment share of each a tobacco product manufacturer or tobacco product importer for the calendar year;

(B) the total amount of annual payments for the calendar year under subsection (c)(2); and

(C) the amount of an assessment payable by a tobacco product manufacturer or tobacco product importer for the fiscal year under subsection (c)(2); and

(2) notify each tobacco product manufacturer or tobacco product importer of the determinations made under paragraph (1) with respect to the manufacturer or importer.

(c) TOTAL AMOUNT OF PAYMENT-

[(1) **INITIAL PAYMENT-** Each industry source shall pay to the Trust Fund on the date of enactment of this Act, \$ _____ for 1998.]

[Some bills provide for an up-front payment, though the Budget does not; defer on issue]

(2) ANNUAL ASSESSMENTS- Each tobacco product manufacturer or tobacco product importer shall pay to the Trust Fund for each calendar year, beginning on January 1 of the year following the year in which this Act is enacted, and each January 1 thereafter, an annual payment equal to such tobacco product manufacturer or tobacco product importer's assessment share of--

(A) with respect to the first year for which payments are to be made, an amount of \$13,000,000,000;

(B) with respect to the second year for which payments are to be made, an amount of \$16,000,000,000;

(C) with respect to the third year for which payments are to be made, an amount of \$18,000,000,000;

(D) with respect to the fourth year for which payments are to be made, an amount of \$19,000,000,000;

(E) with respect to the fifth year for which payments are to be made, an amount of \$22,000,000,000; and

(F) with respect to the sixth year and each subsequent year, the amount shall be adjusted each year to reflect the increase in the Consumer Price Index for all urban consumers (as published by the Bureau of Labor Statistics) from the second preceding calendar year to the preceding calendar year, whichever is greater.

Security meeting 4-8

you're

circumference: 10¢ up, 3.56% reduction (fewer & fewer absolute number of kids)

20¢ each - for state effects (20¢)
 gets up to \$1.50
 ↓
 circumvent declines
 ↓
 or taxes need to go up
 ↓
 circumvent declines still further

(20¢) smuggling
 ↓
 as if circumvent declines
 ↓
 so cos. need to raise prices more on each pack to meet payment

Point: We are giving \$ back to states; this should mitigate state response.

FAX

Office of Management and Budget
Executive Office of the President
Washington, DC 20503

TO: John Raidt
Ivan Schlager

FROM: Josh Gotbaum
Executive Associate Director
202-395-9188

Date: March 26, 1998

Fax #: 224-1259

Pages (excluding this cover sheet): 3

COMMENTS:

Attachment: (1) language for the assessments based on the stream of numbers discussed
(2) penalty numbers

SAMPLE ASSESSMENT LANGUAGE**TITLE __--NATIONAL YOUTH SMOKING AND HEALTH TRUST FUND
SEC. __. ESTABLISHMENT OF TRUST FUND.****(a) CREATION-**

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(2) **TRUSTEES-** The trustees of the Trust Fund shall be the Secretary of Health and Human Services, the Secretary of Treasury, and the Attorney General.

(b) TRANSFERS- There are hereby appropriated and transferred to the Trust Fund 75 percent of--

(1) amounts repaid or recovered under section __, including interest thereon;

(2) amounts equivalent to amounts received under section __; and

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SEC. __. PAYMENTS OF ASSESSMENTS.

(a) DEFINITION OF ASSESSMENT SHARE- In this section, the term 'assessment share' means the ratio of--

(1) the number of pounds of tobacco removed from a factory or export warehouse (excluding tax exempt transfers to export warehouses) by a tobacco product manufacturer or tobacco product importer for the preceding calendar year; to

(2) the number of pounds of tobacco removed from a factory or export warehouse (excluding tax exempt transfers to export warehouses) by all tobacco product manufacturers or tobacco product importers for the preceding calendar year.

(b) DETERMINATIONS- Not later than September 30 of each calendar year, the Attorney General shall--

(1) determine--

(A) the assessment share of each tobacco product manufacturer or tobacco product importer for the calendar year;

(B) the total amount of annual payments in the following year under subsection (c)(2); and

(C) the amount of an assessment payable by a tobacco product manufacturer or tobacco product importer for the following calendar year under subsection (c)(2); and

(2) notify each tobacco product manufacturer or tobacco product importer of the determinations made under paragraph (1) with respect to the manufacturer or importer.

(c) TOTAL AMOUNT OF PAYMENT-

[(1) INITIAL PAYMENT- Each tobacco manufacturer or tobacco product importer shall pay to the United States Treasury on the date of enactment of this Act, an initial payment equal to such tobacco manufacturer or tobacco product importer's assessment share of \$_____.]

(2) ANNUAL ASSESSMENTS- Each tobacco product manufacturer or tobacco product importer shall pay to the Trust Fund for each calendar year, within 120 days of notification under (b)(2), an annual payment equal to such tobacco product manufacturer or tobacco product importer's assessment share of--

(A) with respect to the first year in which payments are to be made, an amount of \$14,400,000,000;

(B) with respect to the second year in which payments are to be made, an amount of \$15,400,000,000;

(C) with respect to the third year in which payments are to be made, an amount of \$17,700,000,000;

(D) with respect to the fourth year in which payments are to be made, an amount of \$21,400,000,000;

(E) with respect to the fifth year in which payments are to be made, an amount of \$23,600,000,000; and

(F) with respect to the sixth year and each subsequent year in which payments are to be made, the amount shall be adjusted each year to reflect the increase in the Consumer Price Index for all urban consumers (as published by the Bureau of Labor Statistics) from the second preceding calendar year to the preceding calendar year.

Internal
(with #s)

SAMPLE LEGISLATIVE LANGUAGE

**TITLE __--NATIONAL YOUTH SMOKING AND HEALTH TRUST FUND
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- (2) notify each tobacco product manufacturer or tobacco product importer of the determinations made under paragraph (1) with respect to the manufacturer or importer.**

(2) ANNUAL ASSESSMENTS- Each tobacco product manufacturer or tobacco product importer shall pay to the Trust Fund for each calendar year, beginning on January 1 of the year following the year in which this Act is enacted, and each January 1 thereafter, an annual payment equal to such tobacco product manufacturer or tobacco product importer's assessment share of--

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(D) with respect to the fourth year for which payments are to be made, an amount of \$19,000,000,000;

(E) with respect to the fifth year for which payments are to be made, an amount of \$22,000,000,000; and

(F) with respect to the sixth year and each subsequent year, the amount shall be adjusted each year to reflect the increase in the Consumer Price Index for all urban consumers (as published by the Bureau of Labor Statistics) from the second preceding calendar year to the preceding calendar year, whichever is greater.

with up trust
payment language

Internal
(with #s)

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TREASURY DEPUTY SECRETARY LAWRENCE H. SUMMERS
SENATE COMMITTEE ON COMMERCE, SCIENCE AND TRANSPORTATION
March 24, 1998

Mr Chairman, thank you for giving me this opportunity to discuss economic and financial aspects of tobacco legislation proposals presently before Congress. As you know, President Clinton strongly supports the efforts of yourselves and others in Congress to forge comprehensive legislation, consistent with the principles he outlined last fall, to protect America's children from the deadly threat of smoking.

At Treasury and throughout the Administration we have been and will remain one hundred percent committed to working with this Committee and others in Congress to address an issue of such enormous consequence for the health of the American people and our economy.

I would like to focus my remarks today on the proposals in the President's budget and their implications for public health, something that will depend critically on the increase in cigarette prices. I will also address the concern that comprehensive tobacco legislation in line with the President's core principles would impose unmanageable adjustment costs on tobacco suppliers and the tobacco industry as a whole.

First, however, let me say a few words about the background for this discussion: the enormous burden that smoking imposes on our nation and our economy; the need to cut teen smoking to start reducing that burden; and the President's call for comprehensive legislation to achieve that goal.

I. Combating Smoking: the Need for a Comprehensive Approach

1. The Human and Economic Costs of Smoking

Smoking is by far the largest preventable cause of premature death in the U.S. As Dr. David Satcher noted in his testimony last week, over 400,000 Americans die each year of tobacco-related diseases. This toll exceeds the deaths from AIDS, homicide, suicide, alcohol use, illegal drug use, fires and auto accidents combined. Recent estimates suggest that on present patterns of tobacco-use, an estimated 25 million of today's Americans will die prematurely from a smoking-related disease.

Behind these heavy human costs of smoking lie equally heavy economic costs for our nation:

- we spend about \$60 billion each year treating smoking related illnesses. On its own, smoking during pregnancy -- which results in 2500 fetal deaths and doubles the odds of being born with low birth weight and potentially suffering problems later in life as a result -- costs the country some \$3-4 billion every year;

- fires caused by smokers cost another \$500 million -- and 2000 lives -- per year;
- smokers with group life insurance push up the premiums of the non-smokers in their insurance pool by about \$4 billion dollars per year;

We must also consider the enormous cost to our economy from all the premature retirements and premature deaths of productive workers that are caused by smoking -- amounting to \$60 billion or more in lost wages.

2. The Importance of Reducing Teen Smoking

There is a strong consensus on the need to reduce smoking in this country and the heavy costs that smoking brings with it. And there is an equally strong consensus on the most effective way to achieve that goal. It is to stop smoking when it starts -- in adolescence. Nine out of ten smokers start when they are in their teens. And the record shows that once they start smoking, they are unlikely to stop.

Each day, 3000 young people become regular smokers. Fully one third of them will have their lives cut short by it, because it causes an addiction that is very hard to shake later on. Nearly half of teen daily smokers think they will not be smoking five years later. Yet only one fifth actually manage to quit. One half of teen smokers try to quit and fail; and by age 18, two-thirds have already regretted starting. The regret is understandable: nearly half of adult smokers try to quit every year, but only about 2.5 percent succeed.

3. The Need For a Comprehensive Approach

The Administration's efforts are guided by another lesson of experience: that preventing youth smoking demands a comprehensive attack on the problem, an approach that makes tobacco companies part of the solution. The fact is that the piecemeal approaches of past years have not worked. Youth smoking has continued to grow through the 1990s and shows no sign of declining.

What is required is a coordinated, comprehensive approach based around the five core components that the President outlined last fall:

- a combination of annual payments and penalties designed to achieve targeted reductions in teen smoking by raising the price of a pack of cigarettes by up to \$1.50.
- full authority for the Food and Drug Administration to regulate tobacco products;
- real changes in the way the tobacco industry does business, including an end to marketing and promotion to children.

- progress toward other public health goals, including biomedical and cancer research, a reduction of second-hand smoke, promotion of smoking cessation programs, and other urgent priorities
- protection for tobacco farmers and their communities

We believe that all five of these components are critical to a solution and are mutually reinforcing: the effectiveness of any one is substantially increased by the presence of the others. For example, studies in Massachusetts and California suggest that while increasing the price of cigarettes is one of the most cost-effective short-term strategies for reducing tobacco consumption, the ability to sustain that reduction is significantly increased when the price increase comes with a comprehensive anti-smoking campaign along the lines outlined above. And the more we are able to coordinate our efforts across state and county lines, the more effective such an approach will be.

II. The Economic Implications of a Comprehensive Approach

It is in the nature of this comprehensive approach to combat youth smoking that it will involve many parts of our government working together. Thus, several of the components I have described will properly be matters for other departments to address. In my remarks I shall focus mainly on two interrelated aspects of the Administration's approach that are of particular relevance to Treasury: the implications for the pricing of cigarettes and the prevalence of youth smoking. I also will say a few words about the implications for tobacco farmers and manufacturers.

1. The Implications for Cigarette Prices and Youth Smoking

Implications for Prices

A large body of evidence suggests that the most effective way to reduce smoking by young people is to raise the price of cigarettes. Thus, to measure the impact of any tobacco legislation on youth smoking we need to measure the impact on the price of cigarettes to consumers.

The President's budget calls for assessments which would result in cigarette price increases. As Table 1 shows, the budget plan's impact on prices would rise from 62 cents in 1999 to \$1.10 in 2003 in constant dollars. Let me be clear: this figure represents the increases that would be directly attributable to the passage of comprehensive legislation. It does not represent the anticipated increase in the base price of cigarettes during a period in which a number of relevant features of the surrounding environment will be changing. For example, there is the increase in federal excise taxes scheduled to take place over the next five years.

As Table 1 further indicates, we anticipate that without any legislation the baseline price will rise

from \$1.94 today to \$2.09 in 2003 in real terms. Combining this rise in the baseline price with the \$1.10 increase resulting from the President's budget, the total price of a pack of cigarettes in 2003, in constant dollars, is projected to be \$3.19.

Mr. Chairman, although such price levels are common in many other countries, they are higher than those we have experienced in the United States. We have been and will continue to be mindful of the many uncertainties about how an increase of this kind will ultimately translate into retail prices. Because our primary goal in this endeavor is to advance public health through the reduction of teen smoking, we have been conservative in many of our calculations in order not to risk falling short of our goals.

Specifically:

- we have assumed that wholesalers and retailers will not add their existing mark-ups to the settlement costs passed on by manufacturers. In fact, virtually all of the relevant empirical evidence¹ suggests that there will be very little "pyramiding" of this kind. That is why the FTC, in their analysis of the original Attorneys General settlement, assume in their baseline that there would not be this kind of mark-up of the payments made by manufacturers in the prices paid by consumers.
- we assume the major increase in pricing nationwide would come as a consequence of federal action in the context of comprehensive legislation, and not as a result of significant tax increases on the part of the states.
- finally, we have not included in our forecasts the additional impact of state sales taxes on the final price of cigarettes, on the grounds that these are not part of the posted price of cigarettes at the point of sale.

It may be that, as several commentators have suggested, these assumptions -- along with our assumptions on other matters such as black and gray market activity, which I will discuss below -- are too conservative.² I might also note, in this context, that we have assumed that the vast

¹For example, Barnett, Keeler, and Hu's 1995 study estimated a pass-through rate from federal taxes to retail prices of about 102 percent over the 1955 to 1990 period. Sumner's 1981 study over state tax increases the 1954-1978 period found a pass-through rate of 103 to 107 percent, and Merriman's 1994 study estimated a rate of 106 percent.

²For example, Martin Feldman of Salomon, Smith, Barney has estimated that the President's budget will result in a total price per pack which is 34 cents beyond our estimate of \$3.19. However, 30 cents of this extra rise can be explained by his assumption that wholesalers and retailers will add to their existing price mark-ups -- an assumption which runs against virtually all relevant empirical evidence. Another prominent industry analyst, Gary Black of

majority of the legislation's cost will be passed on to United States consumers of domestic cigarettes rather than to the shareholders in tobacco companies or consumers of other goods produced by these companies. Clearly the uncertainties involved leave room for reasonable people to disagree.

If our estimates turn out to have understated the eventual impact on prices -- which we do not expect -- the health benefits envisioned in the President's budget would be achieved that much more quickly. Our estimates show that for every 10 cents added to the price of cigarettes, approximately 700,000 fewer teenagers will begin smoking -- and more than 200,000 premature deaths will be avoided.

Overall Implications for Youth Smoking

As I noted earlier, the impact of any given price increase on youth smoking will be significantly increased by other elements of the comprehensive approach the President has called for -- notably, a crackdown on youth marketing and advertising by tobacco companies and more effective enforcement of legal restrictions on tobacco sales to young people.

Studies have found a 69 percent decline in daily use by seventh and eighth graders in Woodridge, Illinois following legislation and enforcement of restrictions on cigarette sales to minors, and a 44 percent decline in junior high school students' smoking in Leominster, Massachusetts as a result of strictly enforced sales restrictions. For our own estimates, we used a conservative assumption that experts have recommended -- that comprehensive sales and marketing restrictions will reduce youth smoking by about 15%.

The combination of the price increase anticipated above and the tighter restrictions on youth access and marketing leads to dramatic reductions in youth smoking. Table 2 presents these results, showing that the price increase reduces teenage smoking by 29%. Youth access and market restrictions reduce teenage smoking by an additional 11%. Furthermore, we estimate that our plan will:

- reduce the number of youths smoking each year by as many as 1.9 million by 2003;
- reduce the cumulative number of youths who smoke between now and 2003 by 3 million;
- and avoid roughly 1 million premature deaths as a result.

These estimates suggest the value of such a comprehensive approach to combating teen smoking. But we cannot and will not let our success in this effort depend on the accuracy of today's best

Sanford Bernstein, in his analysis of the June 20 settlement, projects these mark-ups will actually fall.

estimates. The many uncertainties involved in making these predictions only underline the importance of incorporating in any legislation the Administration's concrete targets for reducing youth smoking. These aim to cut youth smoking by 30% after 5 years, 50% after 7 years, and 60% after 10 years. And in the strong youth lookback penalties that the President has proposed we have additional insurance that these targets will be met.

We have had fruitful discussions with the staffs of a number of members of both the House and Senate about the appropriate structure of youth lookback penalties, and we recognize that there are several different ways of providing the necessary insurance. But we believe that any lookback penalty structure should not be tax deductible and should meet two principles:

- it must be levied on both the industry as a whole and on individual companies specifically. These two types of penalty structures serve two different purposes. The industry penalties, which are likely to be passed on to price, provide "price insurance", relying on the best tool we have (cigarette prices) to lower youth smoking if we miss our targets. The company specific penalties, on the other hand, provide "non-price insurance," holding specific companies accountable for their actions in selling tobacco products to youth and thereby providing a profit incentive to take other actions to reduce youth use of their products.
- the penalties must be sizeable in those cases where the industry or specific firms miss their targets by a substantial margin. This could be accomplished, for example, by having penalties that increase with the distance the company is from its target.

Let me add that as part of our economic analysis we have also considered issues relating to possible black and gray market activity following legislation. As Figure 1 shows, even in the context of legislation that produced a price increase significantly higher than that presently being considered, cigarette prices in the United States would still be significantly lower than has proved workable in other countries.

The fact that the price increase is primarily to be achieved through direct payments by the tobacco companies should significantly ease the task of enforcement relative to other cases in which the increase is achieved through higher excise taxes at the retail level. But as you know, we have been working with your staff and others on a proposed system of licensing and registration to control the diversion of tobacco and prevent any smuggling that may occur.

2. The Implications For the Tobacco Industry

Questions have arisen about the impact of legislation on tobacco manufacturers and their suppliers. We are confident that the changes in pricing and behavior that we are seeking can be achieved without putting producers' livelihoods or the health of the broader economy at risk.

Tobacco farmers

There are more than 124,000 American farmers engaged in the production of tobacco in this country. Largely concentrated in certain, heavily tobacco-dependent regions, they and their families have already been forced to undergo difficult adjustments as the overall demand for tobacco in this country has declined. We cannot and will not leave these highly vulnerable families and communities behind in crafting a comprehensive approach to reducing smoking much faster in the years to come.

That is why one of the President's principles is protection for tobacco farmers and their communities. And it is why we have supported, in this context, the efforts of the many Senators and House members who have been working to provide for this protection. One method of protecting these farmers is continuing production control programs, such as that included in the LEAF Act supported by Senators Ford, Hollings, and Frist. The Administration agrees that controls on production can be one element of a system that meets the President's five principles, and we look forward to being able to support the product of your work in this area.

As we go forward the President is committed to working with Congress to find the best way both to protect the health of our children and to protect the economic well-being of our farmers. So, too are the coalition for public health and tobacco farming organizations that last week endorsed a set of principles with which both groups could agree. These organizations include the Burley Tobacco Growers Cooperative, the Flue-Cured Tobacco Stabilization Corporation, the American Heart Association, the American Cancer Society, and the Campaign for Tobacco Free Kids. And let me add: we are determined that one important use of the funds raised by higher prices on cigarettes will be the provision of funds to protect the economic well-being of tobacco farmers and their communities.

Tobacco manufacturers

The best evidence suggests that comprehensive legislation consistent with the President's five principles would come at some detriment to the profitability of American tobacco companies. However, it is important to bear in mind that a central feature of both the settlement and all of the legislation that has been proposed to date is an expectation -- indeed, an express desire -- that companies will pass the costs on to the price of tobacco products.

To the extent that the costs are indeed passed on to prices, the impact on the profitability of these companies will be less than many have perhaps imagined and certainly insufficient to create major disturbance to the economy. The FTC analysis of the June 20 Attorneys General settlement suggested that the total impact of the settlement would lead to, at most, a 15 percent reduction in tobacco industry profits. Applying similar methodologies to the President's budget proposals -- and bearing in mind, once again, the very large uncertainties that exist -- suggests a reduction in operating profits of around 23 percent.

There is also the separate question of how the market would value any given stream of profits in

the event that comprehensive legislation reduced some portion of the substantial legal uncertainties these companies presently face. It has been widely acknowledged by Wall Street analysts that the resolution of some of the uncertainties facing this industry will increase the market valuation of the future income streams of tobacco firms. This effect would tend to offset the reduction that I noted in the level of these future income streams.

III. Concluding Remarks

Members of the Committee, as the President has said: "we stand on the verge of one of the greatest public health achievements in history -- an historic triumph in our fight to protect America's children from the deadly threat of tobacco." The opportunity is there for the taking: in the comprehensive, five-part approach that the President has called for and so many in Congress are striving to achieve.

The stakes are high. Every day that we do not take action means that another 3,000 young people will become regular smokers. Just in the time that I have been speaking to you, 20 children have started smoking, and 7 of them will die prematurely as a result. We cannot afford to delay one child longer. If we pass comprehensive legislation that meets the targets laid out in our budget, in five years' time around 40 percent fewer American children will be smokers; in 10 years time, the number will have been halved. I look forward to working closely with you, Mr Chairman, with the members of this committee and with others in Congress as we work to take this historic step forward for the future of our nation and the future of our economy. I would now welcome any questions.