

NLWJC - Kagan

DPC - Box 005 - Folder 014

Budget Materials - FY2000 Tobacco

~~Handwritten scribble~~

Elena Kagan

DPC -

11670/14357

Tobacco Policy & Budget Issues

The FY 2000 Budget will build on the 1998 State Attorneys General Tobacco Settlement and the President's prior proposals. The Administration will renew its focus on improving public health -- particularly children's health -- by pursuing efforts to curtail youth smoking.

1. Reduce youth smoking by raising the cost of cigarettes [\$1.10 per pack next year].

Proposing a 55 cent excise tax increase immediately and accelerating the already legislated 15 cent increase would -- combined with the 1998 State Attorneys General agreement -- raise prices next year to the \$1.10 range proposed by the President (though the original proposal phased that increase in thru 2003). (The SAG agreement costs about 40 cents per pack, though the tobacco companies have increased prices by more than that.)

Public health experts agree that the single most effective way to reduce youth smoking is to raise the cost of cigarettes: for every 10 cents added to the price of cigarettes, approximately 270,000 fewer teenagers will begin smoking over the next five years -- and more than 90,000 premature deaths will be avoided.

2. Use the funds to repay the costs the Federal government incurs from tobacco.

The net receipts from these increases would be about \$8.1 billion in 2000, and \$35 billion between 2000 and 2004 (see Table 1). These receipts would relieve tobacco-related costs already borne by taxpayers. The Federal government already spends nearly \$9 billion each year caring for the damage caused by tobacco, in the Department of Defense, VA, HHS (including NIH, IHS, FDA, and CDC), and OPM. (See Table 2). These receipts could repay those costs.

3. Reach Agreement with States on the Use of Tobacco Company Settlements rather than Implementing Legal Recoupment of the Federal Share.

The Federal government has a legal obligation to recoup its fair share of Medicaid costs recovered by states from tobacco companies. The President has already said he is willing to waive these funds, which total some \$5 billion per year, if the states and Congress reach a satisfactory agreement under which they commit to apply the Federal share to programs that [otherwise would be borne by Federal taxpayers] OR [implement common Federal and state objectives].

We would not rely on any recoupment funds, or any agreement to waive recoupment to support program efforts in FY2000. This would provide a full year to develop satisfactory legislation with the Congress and the states. In order to make clear the Administration's obligation to recoup these funds, however, we could initiate recoupment administratively in 1999.

After an agreement and beginning in FY 2001, we would assume that recoupment legislation would permit incremental Federal resources to be applied, up to \$5 billion per year, to critical priorities. No specific decisions have yet been made on which initiatives would be funded.

Table 3 shows a range of possibilities, including child care and tobacco-related health and public health costs (e.g., cancer clinical trials, cessation, etc.)

4. Confirm the full authority of the Food and Drug Administration (FDA) to regulate tobacco products.

As the President noted only a few months ago, in order to keep young people from smoking we need to confirm the FDA's authority over tobacco products. The FDA can help kids stop before they start: by halting advertising targeted at children and curbing minors' access to tobacco products.

5. Seek recovery of tobacco-related Medicare costs. Use the funds to pay for a new Medicare prescription drug benefit.

Tobacco companies have now agreed to pay all 50 states for the costs that states incurred in treating tobacco-related illnesses under Medicaid and other programs. The Federal government, which incurs some \$16 billion in costs each year to treat tobacco-related disease under Medicare, could do the same. (Some will argue that smoking "saves" health care costs by shortening life, but this argument was not persuasive in the state Medicaid proceedings.) The Administration can propose legislation directing the Department of Justice to sue tobacco companies to recover these tobacco-related Medicare costs. When successful, the proceeds would be sufficient to provide a long-sought new Medicare benefit: covering the cost of prescription drugs. The FY2000 Budget includes funding (\$10 million) for the Department of Justice to initiate action and recover these costs.

Tobacco-Related Public Health & Education Programs in the FY2000 Budget

CDC: FY 99 enacted level is \$74 million. FY 2000 latest OMB offer would provide an additional \$27 million mostly for tobacco prevention and education efforts.

FDA: FY 99 enacted level is \$34 million. FY 2000 latest offer is an additional \$34 million, for a total of \$68 million. The increase would be used for tobacco outreach and enforcement efforts.

NIH: FY 99 enacted includes an estimated \$486 million in direct, tobacco-related research. In FY 2000, no additional tobacco-related research has been provided. (Note: it is expected that the final settlement for the NIH will include an additional \$406 million over '99 enacted, but none of these amounts are specifically directed at tobacco-related research).

IHS: FY 99 enacted includes \$225 million in clinical and preventive services that can be attributed to tobacco-related health care. In FY 2000, no additional amounts have been targeted for tobacco, although the health care services portion of the IHS budget will increase by about \$150 million or 8 percent.

VA: The FY 99 enacted levels include \$16 million for smoking cessation for core veterans. No specific tobacco-related additions have been identified for FY 2000.

No Specific Funding Provisions

Farmers: No specific amounts targeted for tobacco in FY 1999 or 2000.

DOD: No specific amounts in either FY 1999 or 2000. (This is based on previous information from OMB's National Security Division that they could not accommodate a \$60 million tobacco initiative.

International: No specific amounts for international tobacco control activities in FY 1999 or 2000.

NET RECEIPTS FROM TOBACCO PRICE INCREASE
 (Net revenues in billions of dollars; per pack equivalents in real 2000 dollars)

TABLE 1
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	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>Total</u> <u>2000-04</u>
State settlement at cost 1/:						
Net payments to States and others.....	8.1	8.9	10.1	10.2	8.9	46.2
Per pack equivalent increase.....	0.37	0.40	0.46	0.45	0.38	
Additional Federal increase:						
Accelerate 15 cent excise to 10/1/99...	1.1	0.7	0.2	0.0	0.0	2.0
55 cents per pack increase 2/	7.0	6.5	6.5	6.5	6.9	33.4
TOTAL	8.1	7.2	6.7	6.5	6.9	35.4

1/ Reflects November 1998 AG settlement proposal plus existing four State settlements, adjusted for inflation and volume. Assumes all remaining States participate in November 1998 settlement. Assumes no reductions for non-participating manufacturers, released claims, or Federal legislation.
 2/ Per pack amounts would be increased for inflation starting in 2001.

TABLE 2

Tobacco-Related Costs

(\$ in billions)

1) Tobacco-related health care costs	FY99 Enacted*
Veterans Affairs	3.60
OPM FEHB Program	1.90
Department of Defense	1.27
Indian Health Service	<u>0.21</u>
Subtotal	6.98
 2) Tobacco-related public health education programs	
Centers for Disease Control	0.07
Food and Drug Administration	<u>0.03</u>
Subtotal	0.10
 3) NIH Tobacco-Related Research	
NIH	1.70
 4) Tobacco/Drug-related spending	
SAMHSA--Substance Abuse Block Grant	1.59
SAMHSA--Substance Abuse Treatment KDA	0.15
SAMHSA--Substance Abuse Prevention KDA	0.09
SAMHSA--Targeted Capacity Expansion	0.02
SAMHSA--Youth Substance Abuse Prevention Initiative	<u>0.07</u>
Subtotal	1.92

* The FY99 numbers are placeholders that will be replaced with FY2000 numbers after decisions are complete.

TABLE 3
Federal Grant Programs to States That Could Be Assumed by States
(\$ in millions)

	<u>FY99 Enacted</u>	<u>FY00 Passback</u>
Tranche I		
Safe and Drug Free Schools -- EDUC	441	366
Substance Abuse Block Grant -- SAMHSA	1,585	1,585
Subtotal, Tranche I	<u>2,026</u>	<u>1,951</u>
Tranche II		
Class Size - EDUC	1,200	1,300
Child Care Block Grant -- ACF	1,000	1,183
Subtotal, Tranche II	<u>2,200</u>	<u>2,483</u>
Subtotal, Tranches I and II	4,226	4,434
Tranche III		
State Tobacco Control -- CDC	51	51
Preventive Health & Health Services Block Grant -- CDC *	150	120
Maternal and Child Health Block Grant -- HRSA	700	700
Immunization State Grants -- CDC	139	139
Breast/Cervical Cancer Screening Grants -- CDC	159	159
Residential Drug Treatment State Grants -- DOJ	63	65
Subtotal, Tranche III	<u>1,263</u>	<u>1,235</u>
Total	<u>5,489</u>	<u>5,668</u>

* Could also move \$45 million from the Violent Crime Reduction Trust Fund

Tobacco-Related Health Care Costs in Federal Programs

(FY 2000 BA, in billions of dollars)

Veterans	4.0
OPM Federal Employees Health Benefits Program*.....	2.2
Department of Defense.....	1.7
Indian Health Service.....	0.3
Total.....	8.1

* OPM FEHBP figure includes the total premium costs, and is not broken down by enrollee share (28%) and Federal share (72%), which is consistent with the state Medicaid suit method.

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Federal Grant Programs to States That Could Be Assumed by States

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Maternal and Child Health Block Grant -- HRSA	700	700
Immunization State Grants -- CDC	139	139
Breast/Cervical Cancer Screening Grants -- CDC	159	159
Residential Drug Treatment State Grants -- DOJ	63	65
Subtotal, Tranche III	1,308	1,280
Total	5,534	5,713

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FOR TAX

Estimate of Tobacco-Related Costs by Agency
(\$ in billions)

	Estimated FY 99 Enacted
1. Veterans Affairs	\$3.60
2. OPM FEHB Program	1.90
3. National Institutes of Health	1.74
4. Department of Defense	1.27
5. Indian Health Service	0.21
6. Centers for Disease Control	0.07
7. Food and Drug Administration	0.03
Total	\$8.82

3.4
1.9

1.27

6.77

~~2.7~~

~~6.98~~

7

6 + 1
so + tax
accelerated
old tax

Re

Potential Tobacco Initiatives (\$ in millions)

	<u>FY 1999 Enacted</u>	<u>FY 2000 Passback</u>	<u>Potential Initiative</u>	<u>Comment</u>
Tobacco Farmers	0	0	+50	Provides funds for growers' lost value of production quota.
Cessation				
a. State Medicaid	0	0	+40	Would require state Medicaid coverage for prescription and non-prescription drugs for smoking cessation. Currently, 17-20 states offer this optional benefit under their Medicaid programs.
b. VA	16	16	+0	\$16 M in passback funds would pay for cessation services for core veterans. Funds beyond this level would fund cessation services for an expanded veterans population. At this time, the Administration has not agreed to VA's broader proposal to offer a range of VA services to an expanded population.
c. DOD	0	0	+60	Includes reimbursement for over-the-counter smoking cessation products as part of military health care coverage.
d. Public Health Grants	0	0	+300 to 500	New HHS grants to states or health plans to operate smoking cessation programs and to make the nicotine patch free.
e. OPM	0	0	+20	Target \$20 M in funding through Employee Assistance Programs/OPM in funding to encourage Federal agencies to operate smoking cessation programs for their Federal civilian employees.
HHS				
a. FDA	34	34	+100	Would provide additional funds for tobacco outreach and enforcement (random retail compliance checks), with an estimated 50 percent of the funds in state grants
b. CDC	100	100	+300	Grants to states for prevention and education efforts, such as the development of educational materials and funding for local agencies to conduct programs targeted to high-risk groups, and collaborative efforts with enforcement agencies:
	0	0	+0	National advertising -- funding has not been included here because it is part of the State AG Settlement.
International	0	0	+100	Funds international tobacco control activities to raise awareness of health problems related to tobacco use.
TOTAL	150	150	+970 to 1170	

Note: If tobacco tax money is used to fund State grant programs, e.g. CDC state prevention and education grants, Medicaid, FDA enforcement, or Public Health Grants, the funds could be subject to the State Settlement's offset provisions.

4 yrs. 2001-4

2 → 86

3 billion - child care

5 billion left

1. ~~4~~ billion Medicare buy-in
+ other health

3. ~~2~~ billion left

~~billions~~

Options for Tobacco Presentation
(FY 2000 BA, in billions of dollars)

Option 1: Tobacco-Related Health Care Costs in Federal Programs

Veterans Affairs.....	4.0
OPM FEHB Program.....	2.2
Department of Defense.....	1.6
HHS: Health Care Costs in Indian Health Service.....	0.3
Subtotal.....	8.0
Increase in Federal Drug Control Budget (exc. emergencies)	0.1
TOTAL, Option 1.....	8.1
MEMO (non-add): Remainder of Drug Budget Increase (exc. emergencies)	0.4

TOTAL

Elene

with a
slightly
aggressive
approach,
we
could have
all health
care.

0.1

I am
sure
we
can
spread
this
if we
still
want
to.

Bruce -
From Jack, this morning.
Looks good to go.

Elene

Stopping Youth Smoking: Every day, 3,000 children become regular smokers and 1,000 have their lives shortened because of it. Almost 90 percent of adult smokers began smoking by age 18 and today, 4.5 million children aged 12 to 17 -- 37 percent of all high school students -- smoke cigarettes. Tobacco is linked to over 400,000 deaths a year from cancer, respiratory illness, heart disease and other problems. To end this public health crisis, we must have a focused public health effort to reduce youth smoking. The 1998 State Attorneys General Tobacco Settlement was an important step in the right direction, as the tobacco industry affirmed its responsibility to pay for health care costs caused by tobacco, but more must be done to protect our children and preserve public health. The Administration is pursuing a two-pronged approach believes a few key additional steps to reduce youth smoking must be taken at the national level:

Raise the price of cigarettes, so fewer young people start to smoke. Public health experts agree that the single most effective way to cut youth smoking is to raise the price of cigarettes: ~~For every 10 cents additional per pack, estimates show that 270,000 fewer teenagers will begin smoking over the next five years -- and more than 90,000 premature deaths will be avoided as a result.~~ Last year, the President called for an increase of \$1.10 per pack (in constant dollars) to help cut youth smoking ~~in half within five years.~~ This year, we can build on the increases already agreed to between the tobacco companies and the states and those already legislated by the Congress and ~~As a result, we can work with the Congress and, with a single propose an~~ increase of only half this amount. ~~reach the target this year.~~

The funds that result from this policy will cover tobacco-related health care costs. Each year, the Federal government spends billions of dollars treating tobacco-related diseases ~~--in~~ for our armed forces, our veterans, and our federal employees ~~others~~. It is fitting that the tobacco industry reimburse US taxpayers for these costs, just as it has already agreed to do for the states.

Give Reaffirm the Food and Drug Administration's full authority to keep cigarettes out of the hands of children. The Administration will again propose legislation that confirms the FDA's authority to regulate tobacco products in order to halt advertising targeted at children, and to curb minors' access to tobacco products. ~~make sure that cigarettes are not sold to them.~~ While the state settlement limits tobacco advertising, it still allows certain marketing practices targeted at children, including newspaper and magazine advertising and retail signs near schools. Moreover, only by reaffirming FDA's authority can Congress ensure that America's children are protected from the next generation of tobacco industry marketing. We should take this matter out of the courts and ensure that the FDA -- the nation's leading health consumer protection agency, providing oversight over food, drugs, and medical devices -- has full

authority to protect our children from tobacco.

Support critical public health efforts to prevent youth smoking. To help support tobacco prevention programs in states and local communities, the Administration's budget will double the funding for the Food and Drug Administration's tobacco budget to \$68 million and increase funding for the Centers for Disease Control's tobacco control efforts by one-third, from \$73 to \$100 million. In addition, the Administration will continue to support measures to hold the tobacco industry accountable for reducing youth smoking.

Protect farmers and farming communities. The Administration remains committed to protecting tobacco farmers and their communities, and is monitoring closely on-going efforts by state, farmer, and industry representatives to provide funding and purchase commitments to tobacco farmers. The Administration looks forward to working with all parties, as needed, to ensure the financial well-being of tobacco farmers, their families, and their communities. Farmers never marketed cigarettes to children; they should be protected.

Since US taxpayers paid a substantial portion of the Medicaid costs that were the basis for much of the state settlement with the tobacco companies, Federal law requires that the Federal government recoup its share. However, the Administration ~~will again support legislation to waive direct Federal recoupment, if states agree to use a portion of funds from the settlement for programs currently financed by Federal taxpayers.~~ is open to working with the states to enact tobacco legislation that, among other things, resolves these federal claims in exchange for a commitment by the states to use tobacco money for efforts to reduce youth smoking, public health and children's programs, and affected rural communities.

In addition to these Medicaid costs, tobacco-related health problems have cost the Medicare program billions of dollars over the last three decades. To recover these losses, the U.S. Department of Justice intends to bring suit against the tobacco industry, and the new FY 2000 budget will contain \$20 million to pay for necessary legal costs. All recoveries will be used to preserve and protect Medicare for future generations.

[NOTE: THIS LAST PARAGRAPH MAY NEED TO BE DROPPED]

~~Tobacco is linked to over 400,000 deaths a year from cancer, respiratory illness, heart disease, and other health problems. Each year, a million young people become regular smokers, 300,000 of whom will die earlier as a result. The budget includes \$61 million of additional funds for tobacco-related activities in the CDC and the FDA - \$27 million of which will pay for expanding CDC's existing State-based tobacco prevention activities, and \$34 million of which will support FDA's outreach and enforcement activities.~~

DRAFT

TOTAL BUDGET RESOURCES
THEORETICALLY AVAILABLE FROM TOBACCO

(- 34¢
(they raised 45¢ new -
6¢ since Jan 1, 98
71¢ since June 20)

	2000 Option A	2000 Option B	2001	2002	2003	2004	2000 - 04 Option A	2000 - 04 Option B
Fed. & State Tobacco Receipts (per pack)	\$0.62	\$0.75	\$0.80	\$0.90	\$1.00	\$1.10		
Federal Receipts After State Share	\$0.28	\$0.41	\$0.43	\$0.48	\$0.58	\$0.75		
<u>Federal Tobacco Receipts</u>	<u>3.8</u>	<u>5.3</u>	<u>5.6</u>	<u>5.9</u>	<u>7.1</u>	<u>9.3</u>	<u>31.7</u>	<u>33.2</u>
<u>Maximum State Recoupable Funds</u>	<u>4.2</u>	<u>4.2</u>	<u>4.6</u>	<u>5.3</u>	<u>5.4</u>	<u>4.8</u>	<u>24.3</u>	<u>24.3</u>
8.0								
Revenues from Additional \$.50/pack increase	4.5						30	over 5

Accelerating - FY 2000¹⁶ if all excise tax
moved as far back as possible.

FY 2000 7.8 b in fed + fed share of state share in last year's budget
based on 75¢

43 b

Defuse + VA smoking related health costs -
at least 4b per year

Tobacco Meeting
November 11, 1998

I. Tobacco Tax

A. Size

B. Uses

1. Non-health spending (as in last year's budget)
2. Medical research and/or public health spending (increases or base?)
3. Tax cuts -- long-term health and/or non-health
4. Farmers
5. Medicare

II. State Settlement

A. Menu in budget?

B. Assume revenues from HCFA claims?

III. Medicare Suit

A. Legislation

B. Negotiations

Handwritten notes

I. Taxes

- a. Size
Uses
- B. ~~Expenditure~~

1. Sum. cost yr.
2. Tax cuts - health + other
3. research + / in public health (As above)
4. farmers - IB
5. Medicare

- ① Best = off budget authority (4th Circuit)
- ② Don't buy things w/dn't buy anyway
- =
- ③ Like us to use for other things
- ④ Buying at base will be transparent - OMB commentators

II. State Settlement

- a. Plan ^{excess of} in budget
- ~~b. Plan outside of budget~~
- c. Assume resources from HCFA claims?

III. Medicare suit

- a. Legislation
- b. Negotiations

130 FDA

Victoria A. Wachino 01/15/99 11:13:23 AM

Record Type: Record

To: Elena Kagan/OPD/EOP
 cc: Joshua Gotbaum/OMB/EOP, Laura Emmett/WHO/EOP
 Subject: REVISED tobacco receipts and uses, per Josh

TOBACCO RECEIPTS AND USES IN FY 2000
 (in billions of dollars)

Receipts

55 cent per pack increase*.....	6.9
Accelerate BBA 15 cent increase.....	1.1
Total.....	8.0

Tobacco-Related Health Care Costs in Federal Programs

Veterans	4.0
Federal Employees Health Benefits Program**.....	2.2
Department of Defense.....	1.6
Indian Health Service.....	0.3
Total.....	8.0

* Includes BATF excise tax shift of \$381M.

** OPM FEHBP figure includes the total premium costs, and is not broken down by enrollee (28%) and Federal share (72%), which is consistent with the state Medicaid suit method.

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Stopping Youth Smoking: Every day, 3,000 children become smokers -- 1,000 have their lives shortened because of it. Almost 90 percent of adult smokers began smoking by age 18 and today, 4.5 million children aged 12 to 17 -- 37 percent of all high school students -- smoke cigarettes. Tobacco is linked to over 400,000 deaths a year from cancer, respiratory illness, heart disease and other problems. To end this public health crisis, we must have a focused public health effort to reduce youth smoking. The 1998 State tobacco settlement was an important step in the right direction, but more must be done to protect our children and hold the tobacco industry accountable. The Administration believes additional steps must be taken at the national level to reduce youth smoking:

- *Raise the price of cigarettes so fewer young people start to smoke:* Public health experts agree that the single most effective way to cut youth smoking is to raise the price of cigarettes. Last year, the President called for an increase of \$1.10 per pack (in constant dollars) to help cut youth smoking in half within five years. This year, we build on increases already agreed to between the tobacco companies and the States and those already legislated by the Congress. As a result, we can reach the target with a legislated increase of half this amount.

The funds that result from this policy will offset tobacco-related Federal health care costs. Each year, the Federal Government spends billions of dollars treating tobacco-related diseases for our Armed Forces, veterans, and Federal employees. It is fitting that the tobacco industry reimburse U.S. taxpayers for these costs, just as it has already agreed to do for the states.

- *Reaffirm the Food and Drug Administration (FDA) full authority to keep cigarettes out of the hands of children:* The Administration will again support legislation that confirms the FDA's authority to regulate tobacco products in order to halt advertising targeted at children, and to curb minors access to tobacco products. While the State settlement limits tobacco advertising, it still allows certain marketing practices targeted at children, including newspaper and magazine advertising and retail signs near schools. Moreover, only by affirming FDA's authority can Congress ensure that America's children are protected from the next generation of tobacco industry marketing. We should take this matter out of the courts and ensure that the FDA -- the nation's leading health consumer protection agency, providing oversight for food, drugs, and medical devices -- has full authority to protect our children from tobacco.
- *Support critical public health efforts to prevent youth smoking:* To help support tobacco prevention programs in States and local communities, the Administration's budget will double the funding for FDA's tobacco budget to \$68 million and increase funding for the Centers for Disease Control's tobacco control efforts by one-third, from \$74 to \$101 million. In addition, the Administration will continue to support measures that hold the tobacco industry accountable for reducing youth smoking.
- *Protect farmers and farming communities:* The Administration remains committed to protecting farmers and their communities, and is monitoring closely on-going efforts by

State, farmer, and industry representatives to provide funding and purchase commitments to tobacco farmers. The Administration will work with all parties, as needed, to ensure the financial well-being of tobacco farmers, their families, and communities.

Since U.S. taxpayers paid a substantial portion of the Medicaid costs that were the basis for much of the State settlement with the tobacco companies, Federal law requires that the Federal Government recoup its share. However, the Administration will work with the States and the Congress to enact tobacco legislation that, among other things, resolves these Federal claims in exchange for a commitment by the States to use tobacco money to support shared national and state priorities which reduce youth smoking, promote public health and children's program, and assist affected rural communities.

In addition to these Medicaid costs, tobacco-related health problems have cost Medicare and other Federal programs billions of dollars each year. To recover these losses, the U.S. Department of Justice intends to bring suit against the tobacco industry, and the Budget contains \$20 million to pay for necessary legal costs. The Administration will propose that recoveries will be used to enhance the security of Medicare for future generations.

Options for Tobacco Presentation
 (BA, in billions of dollars)

30-Dec-98

01:25 PM

BRB:ELR

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Option 1: Tobacco-Related Health Care Costs and Public Health

Education programs:

Veterans Affairs.....	3.6
OPM FEHB Program.....	2.0
Department of Defense.....	1.2
HHS: Tobacco and Other Health Care Costs in Public Health Education	
Research Programs (IHS, CDC, FDA, NIH).....	1.4
Total, Option 1.....	8.1

Option 2: Research Fund:

Tobacco Related Research: NIH.....	1.5
Non-Tobacco Related Research: NIH.....	6.6

Total, Option 2.....	8.1
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MEMO (non-add): NIH General Fund Appropriation.....	7.8
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Total, NIH.....	15.9
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Option 3: Drug-Related Spending:

Education.....	0.7
HHS (Including SAMHSA).....	2.7
Justice	4.7

Total.....	8.1
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MEMO (non-add): Other Federal Drug Control Funding.....	9.4
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Total, Federal Drug Control Funding.....	17.5
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THE WHITE HOUSE

WASHINGTON

December 28, 1998

MEMORANDUM FOR THE CHIEF OF STAFF

FROM: Jack Lew, Bruce Reed

SUBJECT: Tobacco Budget Policy

This memorandum briefly sets out recommendations regarding (1) how the budget will allocate the proceeds of our proposed increase in the tobacco excise tax; (2) how we will handle the issue of recouping a share of state tobacco settlements; and (3) how we will use any funds resulting from a federal lawsuit against the tobacco companies.

1. Federal Tobacco Tax

Our budget will propose a 55-cent per-pack increase in the tobacco excise tax beginning in FY 2000, as well as the acceleration of a previously enacted 15-cent per-pack increase to FY 2000. The 55-cent tax hike is about equal to our last year's proposal (a phased-in increase of between \$.62 and \$1.10) minus the cost of the state settlements (about \$.40); it also can be explained as half of the \$1.10 proposal. This total tax package nets about \$35 billion over five years, with the tax increase responsible for about \$6.5 billion each year and the acceleration chipping in another \$1 billion or so in the first and second years (see attached chart).

We must choose between two different approaches to allocating this money. First, the budget could show that this money is going to pick up the direct health care costs (exclusive of Medicare) that the federal government incurs as a result of smoking. These numbers almost precisely line up: by our calculations, DOD, VA, and OPM spend almost \$7 billion each year in smoking-related health care costs. This budget treatment is analogous to the theory the states used in presenting their legal claims -- *i.e.*, that they were seeking reimbursement to the taxpayer for costs directly attributable to tobacco companies. Second, the budget could show that this money is going to certain (somewhat related) federal program costs. The two principal contenders are NIH research and anti-drug programs. In either case, the proceeds of the tobacco tax increase would far exceed the yearly increases that our budget proposes in these programs, but would fall far short of their current levels of base funding (see attached chart).

DPC and OMB recommend the first approach. We do not think we can easily justify linking tobacco revenues to programs for which we have not requested very substantial budget increases. We think that this approach would expose us both to the charge that we are using our tobacco policy to meet our budgetary needs and to the charge that our NIH and/or anti-drug proposals are hollow. In addition, the idea of funding anti-drug programs through tobacco is likely to anger the public health community. Although the first approach (*i.e.*, funding direct

tobacco-related health care costs) does not give any real lift to tobacco legislation, it has a clear logic to it (as the state suits showed) and minimizes our exposure to public criticism.

2. State Tobacco Funds

Our budget presumes that starting in FY 2001, the federal government will recoup \$4 to \$5 billion each year from the states' tobacco settlements. This figure represents the full amount of the federal government's claim against the states (i.e., 57 percent of their Medicaid recoveries). Because this money would go into the base if we were to recover it through the usual administrative process, our budget contemplates that Congress will effect the recoupment by passing legislation that assigns these funds to specified programs and purposes (effectively requiring states to buy out part of the federal base). We recommend that we take advantage of the level of generality permissible in the outyears and refrain from listing the particular programs involved in this scheme, so as to avoid unnecessary fights with the states and interest groups.

We will explain that we have chosen to defer spending this money until FY 2001 so that we can work with the states and Congress over the next year on a mutually agreeable menu of programs to which the funds should be directed. At the same time, we will keep pressure on the states by aggressively pursuing administrative mechanisms for recovering these monies. (The states may doubt whether we have the will to take these administrative measures, but they would doubt even more Congress's inclination to pass legislation diverting their funds to the federal base budget over their objection.) The critical step in this administrative process involves calculating the amount of each state's settlement award representing reimbursement for Medicaid costs; once that is done, HCFA has the legal right to deduct this amount from federal Medicaid payments.

3. Federal Tobacco Suit

We (and Bruce Lindsey) are meeting with representatives of the Justice Department next week to discuss their plan for bringing a lawsuit against the tobacco industry. Our sense is that they are proceeding in a way that we will find acceptable. Our FY 2000 budget includes \$20 million for the purpose of bringing this suit. (The money would go to the Justice Department, but the Department could reimburse HHS, DOD, VA, and/or OPM for expenses incurred.) We have not yet discussed with Justice Department officials our idea for announcing this suit in the State of the Union.

We recommend that when we announce this suit, we say that any money arising from it should go toward reforming and strengthening the Medicare program, including through the addition of a new prescription drug benefit. This approach would enable the President to begin talking about a Medicare prescription drug benefit this year; it also could increase the pressure on Congress to pass Senator Graham's legislation facilitating our suit. Although we almost certainly would need legislation to allocate funds from a lawsuit to the Medicare program, we do not recommend submitting such legislation prior to bringing the suit.

FAX

TO: Bruce Reed and Elena Kagan

FROM: Josh Gotbaum
Office of Management and Budget

PAGES TO FOLLOW: 4

Attached for your information is the tobacco section of the budget chapter on Health. All references to tobacco are marked.

at group rates. It also includes a new investment to strengthen nursing home quality; an innovative housing initiative to create and integrate assisted living facilities and Medicaid home and community-based long-term care; and a new Medicaid option that equalizes eligibility for people with long-term care needs in community settings.

- **Improving access to health insurance** by providing over [\$2.5] billion over 5 years for new health insurance options for people ages 55 to 65; increasing access to insurance for small businesses through purchasing coalitions; extending Medicare and Medicaid for workers with disabilities; restoring Medicaid eligibility to legal immigrants affected by welfare reform; extending Medicaid eligibility to foster children up to age 21; improving the transitional Medicaid for people moving from welfare to work; and providing states with additional funds for children's health insurance outreach.
- **Safeguarding and improving public health** through a stringent tobacco control policy; a new \$1 billion program over 5 years that funds local communities to integrate traditional safety net providers (e.g., public hospitals and clinics) into networks that help the uninsured; and important initiatives to address coverage of cancer clinical trials, the challenges of AIDS, racial disparities in health, bioterrorism, asthma, and mental health. ✓
- **Improving fiscal soundness of Medicare and Medicaid** through a series of proposals, including aggressive efforts to reduce Medicare fraud, waste and abuse, to improve the management of these important programs.

Long-Term Care

The need for long-term care will surely be one of the great challenges as the baby boom generation ages. Unlike acute care, long-term care is rarely paid for by private insurance and Medicare, requiring out-of-pocket expenditures. It also takes a financial and emotional toll on family and friends on whom the burden of unpaid care often falls. The budget proposes a multi-faceted initiative, as follows:

New Tax Credit for Long-Term Care: This tax credit will help people with chronic illness or the families with whom they live. People with significant long-term care needs or their caregivers would receive a \$1,000 tax credit beginning in 2000. Approximately 2 million people would benefit, at a cost of \$5.5 billion.

New National Family Caregivers Program: This program is designed to assist approximately 250,000 families caring for elderly relatives who are chronically ill or disabled. It would receive \$125 million next year to support a caregiver support system in all states that provides information, education, counseling, and respite services directly to caregiving families.

National Long-Term Care Information Campaign: This campaign will help Medicare beneficiaries and their families better understand their long-term care options. Information for

reform.

- *Pregnant Women.* States would have the option to provide Medicaid coverage to qualified legal immigrants who become pregnant and who entered the U.S. after enactment of welfare reform. Such coverage would help reduce the number of high-risk pregnancies, ensure healthier children, and lower the cost of emergency Medicaid deliveries.
- *SSI Recipients.* The budget provides funding for Medicaid benefits to immigrants who became eligible for the program as a result of SSI restorations proposed in the budget.

Other Medicaid Improvements: The budget supports a number of important initiatives to expand Medicaid coverage including:

- *Children's Health Insurance Outreach:* This initiative, designed to inform eligible children and their families about the CHIP program and Medicaid, will provide States with flexibility to develop innovative and effective approaches.
- *Transitional Medicaid simplification:* The budget proposes to simplify and improve transitional Medicaid programs to help the working poor, whose income makes them ineligible for the traditional Medicaid program. By eliminating burdensome reporting requirements and giving states an incentive to serve more working families, this proposal would help beneficiaries retain temporary health insurance through Medicaid until they can secure private insurance.
- *Foster Care Medicaid benefits:* The budget would give States the choice to extend Medicaid eligibility to children up to age 21 who were eligible for Foster Care assistance at age 18. Continued access to medical, mental health and rehabilitative care beyond age 18 is critical to ensuring that these youth can successfully make the transition from foster care to independent living.
- *Aid for the territories:* The budget proposes \$144 million in increased funding under CHIP for Puerto Rico and the other four territories, fulfilling the President's promise to provide more equitable funding for children's health care in the insular areas.

Renewed Commitment to Public Health

This budget affirms the Administration's commitment to improving public health, with renewed emphasis on measures to combat smoking, especially among young people. This budget also increases access to powerful AIDS therapies, enhances food safety, promotes childhood immunization, improves reporting of public health threats, and reduces infant mortality.

Stopping Youth Smoking: Every day, 3,000 children become smokers; 1,000 have their lives

shortened because of it. Almost 90 percent of adult smokers began smoking by age 18 and today, 4.5 million children aged 12 to 17 -- 37 percent of all high school students -- smoke cigarettes. Tobacco is linked to over 400,000 deaths a year from cancer, respiratory illness, heart disease and other problems. To end this public health crisis, we must have a focused public health effort to reduce youth smoking. The 1998 state tobacco settlement was an important step in the right direction, but more must be done to protect our children and hold the tobacco industry accountable. The Administration believes additional steps must be taken at the national level to reduce youth smoking:

- *Raise the price of cigarettes, so fewer young people start to smoke.* Public health experts agree that the single most effective way to cut youth smoking is to raise the price of cigarettes. Last year, the President called for an increase of \$1.10 per pack (in constant dollars) to help cut youth smoking in half within five years. This year, we build on the increases already agreed to between the tobacco companies and the states and those already legislated by the Congress. As a result, we can reach the target with a legislated increase of half this amount.

may be added:

The funds that result from this policy will cover tobacco-related health care costs. Each year, the Federal government spends billions of dollars treating tobacco-related diseases for our armed forces, veterans, and federal employees. It is fitting that the tobacco industry reimburse U.S. taxpayers for these costs, just as it has already agreed to do for the States.

- *Reaffirm the Food and Drug Administration's full authority to keep cigarettes out of the hands of children.* The Administration will again support legislation that confirms the FDA's authority to regulate tobacco products in order to halt advertising targeted at children, and to curb minors' access to tobacco products. While the state settlement limits tobacco advertising, it still allows certain marketing practices targeted at children, including newspaper and magazine advertising and retail signs near schools. Moreover, only by reaffirming FDA's authority can Congress ensure that America's children are protected from the next generation of tobacco industry marketing. We should take this matter out of the courts and ensure that the FDA -- the nation's leading health consumer protection agency, providing oversight over food, drugs, and medical devices -- has full authority to protect our children from tobacco.
- *Support critical public health efforts to prevent youth smoking.* To help support tobacco prevention programs in states and local communities, the Administration's budget will double the funding for the Food and Drug Administration's tobacco budget to \$68 million and increase funding for the Centers for Disease Control's tobacco control efforts by one-third, from \$73 to \$100 million. In addition, the Administration will continue to support measures that hold the tobacco industry accountable for reducing youth smoking.

- *Protect farmers and farming communities.* The Administration is monitoring closely on-

going efforts by state, farmer, and industry representatives to provide funding and purchase commitments to tobacco farmers. The Administration will, with the help of all relevant parties, ensure the financial well-being of tobacco farmers, their families, and their communities.

Since US taxpayers paid a substantial portion of the Medicaid costs that were the basis for much of the state settlement with the tobacco companies, Federal law requires that the Federal government recoup its share. However, the Administration will work with the States and the Congress to enact tobacco legislation that, among other things, resolves these federal claims in exchange for a commitment by the states to use tobacco money to support shared national and state priorities which reduce youth smoking, promote public health and children's programs, and assist affected rural communities.

In addition to these Medicaid costs, tobacco-related health problems have cost the Medicare program billions of dollars each year. To recover these losses, the U.S. Department of Justice intends to bring suit against the tobacco industry, and the 2000 budget contains \$20 million to pay for necessary legal costs. The Administration will propose that all recoveries will be used to preserve and protect Medicare for future generations.

Safeguarding and Improving Public Health: The budget will include numerous policies to improve the health and health systems in the U.S. These include:

- ***Reinforcing the Nation's Safety-Net:*** A new public health initiative in 2000 would strengthen the health care safety-net for uninsured and other at-risk individuals. The initiative, which makes use of competitive grants, is designed to encourage local public officials to work closely with providers of care to improve coordination of the delivery of services, to establish accountability in the system for assuring adequate patient care, improving the quality of care and expanding access for the uninsured.
- ***Increasing Biomedical Research:*** Biomedical research is a foundation for combating disease and providing new technologies, from the eradication of smallpox to the disappearance of polio in the Western Hemisphere to prevalence of cardiac pacemakers and organ transplants that help restore normal lives. In last year's budget, the President made a commitment to increasing the NIH budget by 50% over five years. Last year, the NIH received a historic \$2 billion increase, putting us ahead of schedule in meeting the President's commitment to expanding biomedical research. This year, with an investment of \$15,932 million in the NIH -- an increase of \$321 million -- the budget renews the commitment to biomedical research that is the foundation for new innovations to improve health and prevent disease. At this level, NIH is poised to enter the next century supporting new advances in research that have already begun to revolutionize the way we prevent, diagnose, and cure disease.
- ***Medicare Cancer Clinical Trial Demonstration:*** The budget would give more Americans

TOBACCO RECEIPTS AND USES IN FY 2000
(in billions of dollars)

Receipts

55 cent per pack increase*	6.9
Accelerate BBA 15 cent increase.....	1.1
Total.....	8.0

Tobacco-Related Health Care Costs in Federal Programs

Veterans	4.0
Federal Employees Health Benefits Program**.....	2.2
Department of Defense.....	1.6
Indian Health Service.....	0.3
Total***	8.0

* Includes BATF excise tax shift of \$381M.

** OPM FEHBP figure includes the total premium costs, and is not broken down by enrollee share (28%) and Federal share (72%), which is consistent with the state Medicaid suit method.

***Sum totals may not add due to rounding.



Cynthia A. Rice

01/11/99 06:22:21 PM

Record Type: Record

To: See the distribution list at the bottom of this message

cc:

bcc:

Subject: REVISED Edits to OMB's tobacco write-up



bud0111b.wpd Please look at revised and give me any comments tonight. Where I had conflicting comments I took Bruce's. Let me flag:

(1) While Tom didn't jump at the chance to make a moral case for purchase guarantees, we worked in the concept under farmers. (I also added affected rural communities under the menu)

(2) Treasury believes the state settlement plus a) 55 cents b) accelerated excise tax and c) FDA we will cut youth smoking in half. However, I left this point out because of Bruce's concern we couldn't have it both ways (downplay the tax amount and still say we're meeting our goal). Treasury believes the state settlement plus the other price increases will reduce youth smoking by 30 percent (this includes a very small nonprice effect which rises to 10 percent under our plan when full FDA authority is assumed).

(3) I added more on FDA as suggested -- any comments?

(4) Linda Ricci is on alert we may need to pull the Medicare graph -- she will let me know the drop dead time.

Cynthia A. Rice



Cynthia A. Rice

01/11/99 03:35:23 PM

Record Type: Record

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

cc: Thomas L. Freedman/OPD/EOP, J. Eric Gould/OPD/EOP, Cathy R. Mays/OPD/EOP, Laura Emmett/WHO/EOP

Subject: Edits to OMB's tobacco write-up



budg0111.wpd Here's my effort to edit OMB's tobacco budget section -- I'm still not sure it strikes

the right tone. In particular, how do you want to describe the price increase? Do you want to say it will enable us to cut youth smoking in half? I edited that and other parts out to tone it down a bit.

Also, do you want the Medicare suit in there? I added it. I also took a stab at farmers. I'll tell Linda Ricci we're working on it.

Message Sent To:

Bruce N. Reed/OPD/EOP
Elena Kagan/OPD/EOP
Thomas L. Freedman/OPD/EOP
J. Eric Gould/OPD/EOP
Cathy R. Mays/OPD/EOP
Laura Emmett/WHO/EOP

Stopping Youth Smoking: Every day, 3,000 children become regular smokers and 1,000 have their lives shortened because of it. Almost 90 percent of adult smokers began smoking by age 18 and today, 4.5 million children aged 12 to 17 -- 37 percent of all high school students -- smoke cigarettes. Tobacco is linked to over 400,000 deaths a year from cancer, respiratory illness, heart disease and other problems. To end this public health crisis, we must have a focused public health effort to reduce youth smoking. The 1998 State Attorneys General Tobacco-S state tobacco settlement was an important step in the right direction, as the tobacco industry affirmed its responsibility to pay for health care costs caused by tobacco. but more must be done to protect our children and preserve public health hold the tobacco industry accountable. The Administration is pursuing a two-pronged approach believes a few key additional steps to reduce youth smoking must be taken at the national level:

Raise the price of cigarettes, so fewer young people start to smoke. Public health experts agree that the single most effective way to cut youth smoking is to raise the price of cigarettes. ~~For every 10 cents additional per pack, estimates show that 270,000 fewer teenagers will begin smoking over the next five years -- and more than 90,000 premature deaths will be avoided as a result. Last year, the President called for an increase of \$1.10 per pack (in constant dollars) to help cut youth smoking in half within five years. This year, we can build on the increases already agreed to between the tobacco companies and the states and those already legislated by the Congress and As a result, we can work with the Congress and, with a single propose an increase of only half this amount. reach the target this year.~~

The funds that result from this policy will cover tobacco-related health care costs. Each year, the Federal government spends billions of dollars treating tobacco-related diseases -- in for our armed forces, our veterans, and our federal employees others. It is fitting that the tobacco industry reimburse US taxpayers for these costs, just as it has already agreed to do for the states.

Give Reaffirm the Food and Drug Administration's full authority to keep cigarettes out of the hands of children. The Administration will again propose legislation that confirms the FDA's authority to regulate tobacco products in order to halt advertising targeted at children, and to curb minors' access to tobacco products. ~~make sure that cigarettes are not sold to them. While the state settlement limits tobacco advertising, it still allows certain marketing practices targeted at children, including newspaper and magazine advertising and retail signs near schools. Moreover, only by reaffirming FDA's authority can Congress ensure that America's children are protected from the next generation of tobacco industry marketing. We should take this matter out of the courts and ensure that the FDA -- the nation's leading health consumer protection agency, providing oversight over food, drugs, and medical devices -- has full authority to protect our children from tobacco.~~

Support critical public health efforts to prevent youth smoking. To help support tobacco prevention programs in states and local communities, the Administration's budget will double the funding for the Food and Drug Administration's tobacco budget to \$68 million and increase funding for the Centers for Disease Control's tobacco control efforts by one-third.

from \$73 to \$100 million. In addition, the Administration will continue to support measures to hold the tobacco industry accountable for reducing youth smoking.

Protect farmers and farming communities. The Administration remains committed to protecting tobacco farmers and their communities, and is monitoring closely on-going efforts by state, farmer, and industry representatives to provide funding and purchase commitments to tobacco farmers. The Administration looks forward to working with all parties, as needed, to ensure the financial well-being of tobacco farmers, their families, and their communities. Farmers who never marketed cigarettes to children and worked hard to sell a legal crop should be protected.

Since US taxpayers paid a substantial portion of the Medicaid costs that were the basis for much of the state settlement with the tobacco companies, Federal law requires that the Federal government recoup its share. However, the Administration will again support legislation to waive direct Federal recoupment, if states agree to use a portion of funds from the settlement for programs currently financed by Federal taxpayers. is open to working with the states to enact tobacco legislation that, among other things, resolves these federal claims in exchange for a commitment by the states to use tobacco money for efforts to reduce youth smoking, public health and children's programs, and affected rural communities.

In addition to these Medicaid costs, tobacco-related health problems have cost the Medicare program billions of dollars over the last three decades. To recover these losses, the U.S. Department of Justice intends to bring suit against the tobacco industry, and the new FY 2000 budget will contain \$20 million to pay for necessary legal costs. All recoveries will be used to preserve and protect Medicare for future generations.

Tobacco is linked to over 400,000 deaths a year from cancer, respiratory illness, heart disease, and other health problems. Each year, a million young people become regular smokers, 300,000 of whom will die earlier as a result. The budget includes \$61 million of additional funds for tobacco-related activities in the CDC and the FDA--\$27 million of which will pay for expanding CDC's existing State-based tobacco prevention activities, and \$34 million of which will support FDA's outreach and enforcement activities.

CIGARETTE PRICE INCREASES

Question: The State Attorneys General Agreement with the tobacco companies is expected to result in an increase of about 40 cents per pack by FY 2000. The President's budget assumes a 55 cent per pack excise tax increase, plus the acceleration of a previously enacted 15 cent per pack increase under the 1997 Balanced Budget Amendment (BBA). Aren't these increases just a bigger version of the tobacco tax increase that was defeated in the Senate last year, which only started at 62 cents per pack and then ramped up to \$1.10 per pack after five years?

Answer: Every day 3,000 children become smokers -- 1,000 have their lives shortened because of it. Almost 90 percent of adult smokers began smoking by age 18.

Public health experts agree that the single most effective way to cut youth smoking is to raise the price of cigarettes.

Last year, the President called for an increase of \$1.10 per pack (in constant dollars) to help cut youth smoking in half within five years.

This year, we can build on increases already agreed to between the tobacco companies and the States and those already legislated by the Congress. As a result, we can reach our targets to reduce underage smoking with a legislated increase of half the \$1.10 per pack amount.

This increase also will ensure that tobacco companies, rather than taxpayers, pay the costs imposed on the federal government by the tobacco industry. The 55-cent increase will cover the tobacco-related health costs incurred by the Department of Defense, the Veteran's Administration, the Federal Employees Health Benefits Program, and the Indian Health Service.

Background: The acceleration of the 15 cent excise tax would make the entire tax effective October 1, 1999, instead of the current law framework which would raise the excise tax 10 cents effective January 1, 2000 and another 5 cents effective January 1, 2002.

TOBACCO TAXES AND SMUGGLING

Question: The combined effect of recent state settlements, scheduled increases in federal tobacco taxes, and your proposed \$0.55 per-pack increase in the federal tax will raise the effective tax on cigarettes by about \$1.00 per-pack. Is this large tax increase likely to cause a serious smuggling problem?

Answer: The Budget contains \$5.2 million for enhanced enforcement at ATF. This increase will provide additional staff to enable ATF to accommodate increased monitoring and the investigative efforts needed to deter, identify and suppress illegal diversion activities.

The State Attorney Generals' settlement has a labeling requirement for exported cigarettes, and current law gives ATF authority to require export labeling beginning in the year 2000. Clear "EXPORT ONLY" labels on exported cigarettes should make smuggling these cigarettes back into the U.S. more difficult.

Even with the Administration's proposed tax increase, the total tax on cigarettes in the U.S. would remain low by world standards, and would remain well below the tax imposed by Canada at the height of its smuggling problem.

USES OF ADDITIONAL TOBACCO REVENUES

Question: The President's FY 2000 budget assumes that \$8 billion will be received in additional tobacco revenues. What programs included in the Budget will be funded by these additional revenues?

Answer: Tobacco-related health problems cost the Federal government billions of dollars each year. In the case of tobacco, The Administration is seeking reimbursement to the taxpayer for costs directly attributable to the tobacco companies.

Exclusive of Medicare, we have calculated the tobacco-related health care costs in FY 2000 for four major Federal programs listed below:

		<u>\$ in Billions</u>
Veterans Affairs	--	4.0
FEHB	--	2.2
Defense	--	1.6
Indian Health Service	--	<u>0.3</u>
		8.0

Background: 1. The overall programs shown above are funded in the President's budget. If pressed on whether this funding is contingent, note that obviously we would work with the Congress to fund the programs.

2. The House Veterans Affairs Committee has informally indicated that they may seek legislation to fence off a share of any tobacco-related litigation proceeds for veterans programs given the level of tobacco-related costs attributable to veterans. To our knowledge, the Committee has not yet contemplated language to earmark tax revenues. The Committee is still upset that \$17 billion in PAYGO savings from clarifying eligibility for service-related disability compensation for veteran tobacco-related illnesses contained in last year's Transportation Equity Act (TEA-21) did not go to veterans programs. The 2000 Budget includes a new \$56 million smoking cessation program available to any honorably discharged veteran to reduce tobacco-related disease within the veteran population.

MEDICAID TOBACCO RECOUPMENT POLICY

Questions: What is the Administration's Medicaid tobacco recoupment policy in the Budget? Why wait until FY 2001 to begin claiming the Federal share of the state tobacco settlements? Why is there a discrepancy between the CBO and the Administration's estimate regarding the amount that the federal government will ultimately recoup from the states?

Answers: Current Medicaid law requires HCFA to recoup the Federal share (on average 57%) of all state third-party liability collections, including the recent state tobacco settlements. Since U.S. taxpayers paid a substantial portion of the Medicaid costs that were the basis for the state settlements, the Budget assumes the Federal government will follow the law and claim its share of the proceeds. However, the Administration again proposes to work with the States and the Congress to enact tobacco legislation that, among other things, resolves these Federal claims in exchange for a commitment by the States to use tobacco money to support shared state and national priorities which reduce youth smoking, promote public health and children's programs, and assist affected rural communities.

The Administration has delayed action on claiming the Federal share of the state tobacco settlements until FY 2001 so that we can work with the States and Congress over the next year on mutually agreeable legislation.

The Administration believes that Medicaid costs were the basis for the states' recovery, whereas CBO assumed that only half of the state settlement funds were attributable to Medicaid. Moreover, CBO assumed that there is a 25 percent probability that HCFA will successfully retrieve the funds from the states.

Background: The Budget envisions legislation that would waive HCFA's ability to recoup the Federal share in exchange for a commitment by the States to use the Federal share to support shared state and national priorities. Savings assumed in the Budget under this tobacco recoupment "allowance" sum to \$4.6 billion (BA) in FY 2001 and \$18.9 billion (BA) over FY 2001-2004.

Note that CBO will also likely score a PAYGO cost (roughly \$3 billion over five years) to the provision in the legislation that would waive HCFA's recoupment authority, which would thus reduce

available savings. However, OMB would not score a PAYGO cost to this legislation given that it includes no tobacco recoupment collections in the Medicaid current law baseline.

DEPARTMENT OF JUSTICE LITIGATION

Questions: What is the Department of Justice doing in relation to developing a plan to sue the tobacco industry? How does this lawsuit relate to the proposed claim for recoupment of a portion of the state's settlement money?

Answers: The Justice Department is preparing a litigation plan to take the tobacco companies to court to recover certain federal health care expenditures caused by tobacco use.

The Justice Department has concluded that there are viable grounds to recover federal funds paid out as a result of tobacco-related illnesses and is creating a task force to make decisions on the best way to bring litigation.

There is no connection at all between the lawsuit and recoupment. The task force will be evaluating claims against the tobacco companies, not the states. Issues concerning recoupment of the state settlements are entirely separate and distinct.

Background: In FY 1999, the Department of Justice will fund the task force out of existing funds. However, the FY 2000 budget contains \$20 million to pay for expenses related to the suit.

COSTS OF SMOKING TO MEDICARE AND OTHER FEDERAL HEALTH CARE PROGRAMS

Question: What are the Administration's estimates of the costs of smoking to the Medicare, Medicaid, and other federal health care programs?

Answer: The federal government has incurred hundreds of billions of dollars tobacco-related health costs. For one year (FY 2000) alone, the Administration estimates the federal government has incurred \$8 billion dollars in tobacco-related health costs in Defense, Veterans Affairs, FEHBP, and Indian Health Service. However, we have not yet conducted a formal analysis of the past costs in these four programs, nor of the past or present costs in the Medicare program. We will be carefully analyzing these questions as part of the Justice Department's upcoming suit against the tobacco industry.

Background: Exclusive of Medicare, we have calculated the tobacco-related health care costs in FY 2000 for four major Federal programs listed below:

		\$ in Billions
Veterans Affairs	--	4.0
FEHB	--	2.2
Defense	--	1.6
Indian Health Service	--	<u>0.3</u>
		8.0

We have not yet conducted a formal analysis of the past costs in these four programs, nor of the past or present costs in the Medicare program and we believe it is critical that we not make statements specifying the magnitude of potential liability in advance of the filing of the Department of Justice lawsuit.

The President said in the State of the Union that "Smoking has cost taxpayers hundreds of billions of dollars in Medicare and other programs." This remark was intended to include present and past costs in Medicare, Defense, Veterans, FEHBP, and Indian Health Services (past costs for Medicare could date back to its creation in 1965). At this time, no decision has been made on whether to estimate Medicaid tobacco costs.

PROTECTION FOR TOBACCO FARMERS

Question: The combined effect of the State Attorneys General Settlement Agreement and the President's proposed per pack price increases will certainly have an effect on tobacco volumes and crop requirements. What assistance does the President's budget include for tobacco farmers?

Answer: States, farmer, and industry representatives recently produced a \$5 billion agreement to provide financial assistance to tobacco farmers and their communities. The Administration supports this agreement, and remains committed to protect tobacco farmers and their communities. The Administration will work with all parties, as needed, to ensure the financial well-being of tobacco farmers, their families, and their communities.

Background: During the Senate's consideration of the McCain tobacco legislation in the spring of 1998, a number of Congressional proposals were offered to compensate farmers and tobacco-dependent communities for the effects of the expected decrease in consumer demand for tobacco, and tobacco farmer's income, as the result of higher tobacco taxes. Much of the benefit from these farm compensation proposals actually would not have gone to farmers; instead the money would have been received by those who own the production quotas to grow tobacco that USDA made available in the 1930's and that have provided a continued income to the quota owners from quota leasing or rentals.

Additional: The Administration made supportive statements about some of the Congressional tobacco farmer proposals that surfaced last spring, but that support was conditioned on gaining agreement on comprehensive tobacco legislation. At this point, however, the Administration wishes to avoid any premature commitments on particular forms of tobacco farmer assistance, and therefore has not included proposals in the FY 2000 Budget.

FDA AUTHORITY TO REGULATE TOBACCO PRODUCTS

- Question:** The Administration has indicated it will support providing the FDA full authority to regulate tobacco products. Will the Administration support legislation that includes changes proposed in last year's Senate Commerce Committee bill or are other alternatives acceptable?
- Answer:** The Administration will support legislation that confirms the FDA's authority to regulate tobacco products in order to halt advertising targeted at children, and to curb minors' access to tobacco products. This goal can be achieved by legislation contained in last year's Senate Commerce Committee bill or other legislation reaffirming FDA's full authority over tobacco products.
- Background:** During consideration of the McCain tobacco legislation last spring, the DPC negotiated a compromise version of the FDA tobacco authority language. The McCain bill language created a separate chapter in the Food, Drug, and Cosmetic Act giving the FDA explicit authority over access to and advertising of tobacco products, in order to ensure that FDA regulation of tobacco did not impinge on the regulation of other products. The objective this year would be to gain agreement on the language included in McCain, or on language that otherwise confirms FDA's full authority over tobacco products.

TOBACCO - PUBLIC HEALTH SPENDING

Question: Is the Administration proposing increases for tobacco-related public health (cessation, advertising, education and enforcement)?

Answer: Yes, the FY 2000 Budget includes a \$122.2 million increase for tobacco-related public health:

- +\$34 million for FDA for a total of \$68 million
- +\$27 million for CDC for a total of \$101 million
- +\$56 million for a VA smoking cessation program
- +\$5.2 million for ATF enforcement

Total: \$122.2 million

Background: Increases will specifically be used for the following:

- FDA's funding will be used to continue the commissioning of state/local officials to enforce access restrictions of the FDA tobacco regulation to conduct unannounced visits to retailers using adolescents younger than 18 who attempt to purchase cigarettes or smokeless tobacco. FDA will also expand outreach efforts.
- CDC will enhance existing State-based tobacco control activities (e.g., ASSIST).
- VA's Smoking Cessation program can be utilized by *any* veteran who began smoking during military service to the extent that resources are available. Private service providers will be used to implement this program on a per capita basis to ensure wider access throughout the Nation.
- ATF's initiative provides additional staff to enable this agency to accommodate the increased number of controlled entities, the increased monitoring, and the investigative efforts needed to deter, identify and suppress illegal diversion activities.

CHILD CARE AND TOBACCO FUNDING

Question: Is the Administration again going to propose to fund child care and other activities unrelated to tobacco by raising taxes on smokers?

Answer: No. The President remains committed to a comprehensive child care initiative that assists parents in their search for affordable, quality child care and he is proposing to increase child care funding by \$3.6 billion over 1999. However, none of this increase is paid for with tobacco funds. Instead, tobacco funds will reimburse the government for direct health costs incurred by the government as a result of tobacco products.

Background: A central component of both the 1999 and 2000 child care initiative is a \$7.5 billion (over five years) increase in funding for the Child Care and Development Fund to assist low-income families with their child care costs. Last year, this piece of the proposal was funded with receipts from proposed tobacco legislation.

USDA TOBACCO USER FEE

Question: Explain the USDA tobacco user fee, and what does the Budget do for tobacco farmers?

Answer: The FY 2000 Budget proposes to cover the administrative costs of the federal tobacco programs by expanding the expiring assessment on marketings of tobacco. This "user fee" would increase from 1 percent of tobacco marketings (including imports) to two percent. The portion levied on farmers (0.5 percent) would remain the same as at present, while the charge to cigarette manufacturers would increase from 0.5 percent to 1.5 percent. The fee would raise about \$60 million in FY 2000.

States, farmer, and industry representatives recently produced a \$5 billion agreement to provide financial assistance to tobacco farmers and their communities. The Administration supports this agreement, and remains committed to protecting tobacco farmers and their communities. The Administration will work with all parties, as needed, to ensure the financial well-being of tobacco farmers, their families, and their communities.

Background: USDA incurs about \$60 million in costs for programs that assist tobacco growers, including administering price support loans to tobacco grower cooperatives, crop insurance, and marketing oversight. The 1993 OBRA imposed a marketing assessment for deficit reduction on the tobacco program, which is required to operate at "no net cost" to the taxpayer anyway (ensured through a different assessment on cooperatives to cover any losses on their price-support loans). The deficit reduction fee is set to expire with the 1998 crop (with the final collection in FY 1999). The Budget proposal would extend and expand the fee, on a fiscal year basis, and provide discretionary savings. These savings helped to offset higher funding for USDA count-based office staff.

WHAT IS MEDICAID RECOUPMENT PAYING FOR?

Questions: The Budget shows a negative \$4.6 billion allowance in FY 2001 growing to negative \$4.8 billion in FY 2004. What is this allowance for? Specifically, what discretionary spending will be reduced?

Answers: The Budget envisions legislation that would waive HCFA's ability to recoup the Federal share in exchange for a commitment by the States to use tobacco money to support shared state and national priorities which reduce youth smoking, promote public health and children's programs, and assist affected rural communities. We will work with the Congress and the States to determine the appropriate mix of programs.

Background: Last year, the Administration proposed a menu of specific programs that states could fund, including child care, substance abuse and mental health programs, and Safe and Drug Free Schools. We are beginning discussions on what a menu for recoupment legislation might include.

Tobacco Policies in the FY 2000 Budget

Every day, 3,000 children become smokers -- 1,000 have their lives shortened because of it. Almost 90 percent of adult smokers began smoking by age 18 and today, 4.5 million children aged 12 to 17 -- 37 percent of all high school students -- smoke cigarettes. Tobacco is linked to over 400,000 deaths a year from cancer, respiratory illness, heart disease and other problems.

The 1998 State tobacco settlement was an important step in the right direction, but more must be done to protect our children and hold the tobacco industry accountable. The Budget therefore mentions the following tobacco policies: 1) price increase; 2) FDA authority; 3) public health investments; 4) tobacco-related Federal health cost litigation; 5) farmers; and 6) recoupment negotiations, as discussed below:

(1) Raising the Price of Cigarettes to Discourage Youth Tobacco Use

Last year, the President called for an increase of \$1.10 per pack to help cut youth smoking in half. This year, we can build on price increases already agreed to between the tobacco companies and the States and those already legislated by the Congress.

The FY 2000 Budget contains three revenue components:

- A 55 cents per-pack increase to be collected through tobacco excise taxes.
- Acceleration of the BBA's 15 cents excise tax. The 1997 Balanced Budget Agreement (BBA) raised the excise tax 10 cents per-pack effective January 1, 2000 and another 5 cents effective January 1, 2002, for a cumulative 15 cent increase. The FY 2000 Budget accelerates the effective date of this entire tax by one year, effective October 1, 1999.
- The BATF excise shift. Treasury assumes that revenues will be lower than we estimated in 2000 because smokers will stock up in FY 1999, before the 70 cent total price increase takes effect. The stocking up effect reduces 2000 revenues, but increases 1999 revenues by \$304 million. To capture the 1999 revenues for use in 2000, Treasury came up with an excise tax shift. The shift loses money in 1999 and gains in 2000, more or less canceling out the stocking up effect. Note that the shift applies to all excise taxes collected by BATF, not just tobacco.

Federal Receipts Raised from Tobacco Excise Taxes (in billions)

Year	1999	2000	2001	2002	2003	2004	00-04
55 cents	.165	6.525	6.426	6.426	6.418	6.400	32.195
BBA 15 cent	.139	1.081	0.679	0.163	-----	-----	1.923
Shift BATF	<u>-.381</u>	<u>.381</u>	<u>-----</u>	<u>-----</u>	<u>-----</u>	<u>-----</u>	<u>.381</u>
Net Receipts	-.077	7.987	7.105	6.589	6.418	6.400	34.499

In FY 2000, these revenues are attributable to tobacco-related health care costs in the following Federal programs (as displayed in Table S-___).

<u>Federal Program</u>	<u>Tobacco-Related Costs</u> (in billions)
Veterans' Affairs	4.0
OPM FEHB ¹	2.2
Department of Defense	1.6
Indian Health Service	<u>0.3</u>
TOTAL	\$8.0

The programs above are funded in the Budget and funding is not contingent upon tobacco receipts.

(2) Re-Affirm Full FDA Authority to Regulate Tobacco Products

The Administration will again support legislation that confirms the FDA's authority to regulate tobacco products in order to halt advertising targeted at children and to curb minors' access to tobacco products.

(3) Support Public Health Initiatives To Curb Tobacco Use

The Budget includes \$122.2 million **additional** funds for tobacco-related activities in CDC, FDA, VA, and ATF:

- \$27 million for expanding CDC's existing State-based tobacco prevention activities. The FY 2000 increase brings CDC's tobacco budget to \$101 million, \$73 million (+37%) above FY 1999.
- \$34 million for FDA's outreach and enforcement activities. FDA's increase doubles its tobacco budget to \$68 million.
- \$56 million for a smoking cessation program in VA for any honorably discharged veteran who began smoking in the military.
- \$5.2 million for enhanced enforcement at ATF to prevent evasion of tobacco taxes.

(4) Lawsuits to Recover Tobacco-Related Federal Health Care Costs

1/ OPM Federal Employee Health Benefits Program figure includes the total premium costs, and is not broken down by enrollee share (28%) and Federal share (72%).

The FY 2000 Budget proposes \$20 million for the Department of Justice to finance costs incurred in preparing and bringing litigation against tobacco companies for tobacco-related Federal health costs. The Justice Department has concluded that there are viable legal grounds to recover tobacco-related health care costs and is forming a task force to make decisions on the litigation. The Justice Department has noted two possible theories on which to proceed -- the Medical Care Recovery Act and the Medicare Secondary Payer Act -- but the eventual litigation could rely on additional theories as well.

(5) Protecting Farmers and Farming Communities [Note: the FY 2000 budget does not include additional funds for tobacco farmers].

States, farmer, and industry representatives recently produced a \$5 billion agreement to provide financial assistance to tobacco farmers and their communities. This Administration supports this agreement and remains committed to protecting tobacco farmers and their communities. The Administration will work with all parties, as needed, to ensure the financial well-being of tobacco farmers, their families, and their communities.

(6) Claiming the Federal Share of State Tobacco Settlements

Since U.S. taxpayers paid a substantial portion of the Medicaid costs that were the basis for the State settlement with the tobacco companies, Federal law requires that the Federal Government recoup its share. However, the Administration will work with the States and the Congress to enact tobacco legislation that, among other things, resolves these Federal claims in exchange for a commitment by the States to use tobacco money to support shared national and State priorities which reduce youth smoking, promote public health and children's programs, and assist affected rural communities.

The amounts below represent the estimated Federal share (roughly 57 percent) of tobacco industry payments under the State Attorneys General Settlement Agreement.

Year-by-Year Forgone Recoupment (in billions)

Year	2000	2001	2002	2003	2004	2001-04
Non-Recoupment	0.0	4.6	4.7	4.8	4.8	18.9

Text of FY 2000 Budget Language on Tobacco

Stopping Youth Smoking: Every day, 3,000 children become smokers -- 1,000 have their lives shortened because of it. Almost 90 percent of adult smokers began smoking by age 18 and today, 4.5 million children aged 12 to 17 -- 37 percent of all high school students -- smoke cigarettes. Tobacco is linked to over 400,000 deaths a year from cancer, respiratory illness, heart disease and other problems. To end this public health crisis, we must have a focused public health effort to reduce youth smoking. The 1998 State tobacco settlement was an important step in the right direction, but more must be done to protect our children and hold the tobacco industry accountable. The Administration believes additional steps must be taken at the national level to reduce youth smoking:

- ***Raise the price of cigarettes so fewer young people start to smoke:*** Public health experts agree that the single most effective way to cut youth smoking is to raise the price of cigarettes. Last year, the President called for an increase of \$1.10 per pack (in constant dollars) to help cut youth smoking in half within five years. This year, we build on increases already agreed to between the tobacco companies and the States and those already legislated by the Congress. As a result, we can reach the target with a legislated increase of half this amount.

The funds that result from this policy will offset tobacco-related Federal health care costs. Each year, the Federal Government spends billions of dollars treating tobacco-related diseases for our Armed Forces, veterans, and Federal employees. It is fitting that the tobacco industry reimburse U.S. taxpayers for these costs, just as it has already agreed to do for the states.

- ***Reaffirm the Food and Drug Administration (FDA) full authority to keep cigarettes out of the hands of children:*** The Administration will again support legislation that confirms the FDA's authority to regulate tobacco products in order to halt advertising targeted at children, and to curb minors access to tobacco products. While the State settlement limits tobacco advertising, it still allows certain marketing practices targeted at children, including newspaper and magazine advertising and retail signs near schools. Moreover, only by affirming FDA's authority can Congress ensure that America's children are protected from the next generation of tobacco industry marketing. We should take this matter out of the courts and ensure that the FDA -- the nation's leading health consumer protection agency, providing oversight for food, drugs, and medical devices -- has full authority to protect our children from tobacco.
- ***Support critical public health efforts to prevent youth smoking:*** To help support tobacco prevention programs in States and local communities, the Administration's budget will double the funding for FDA's tobacco budget to \$68 million and increase funding for the Centers for Disease Control's tobacco control efforts by one-third, from \$74 to \$101 million. In addition, the Administration will continue to support measures that hold the tobacco industry accountable for reducing youth smoking.

- *Protect farmers and farming communities:* The Administration remains committed to protecting farmers and their communities, and is monitoring closely on-going efforts by State, farmer, and industry representatives to provide funding and purchase commitments to tobacco farmers. The Administration will work with all parties, as needed, to ensure the financial well-being of tobacco farmers, their families, and communities.

Since U.S. taxpayers paid a substantial portion of the Medicaid costs that were the basis for much of the State settlement with the tobacco companies, Federal law requires that the Federal Government recoup its share. However, the Administration will work with the States and the Congress to enact tobacco legislation that, among other things, resolves these Federal claims in exchange for a commitment by the States to use tobacco money to support shared national and state priorities which reduce youth smoking, promote public health and children's program, and assist affected rural communities.

In addition to these Medicaid costs, tobacco-related health problems have cost Medicare and other Federal programs billions of dollars each year. To recover these losses, the U.S. Department of Justice intends to bring suit against the tobacco industry, and the Budget contains \$20 million to pay for necessary legal costs. The Administration will propose that recoveries will be used to enhance the security of Medicare for future generations.