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Tobacco Industry Documents: Myron Johnston [1]

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PHILIP MORRIS

2022216179

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1.	
ID:	**2022216179/6180**
AUTHOR:	JOHNSTON,M
RECIPIENT:	ZOLER,J
COPIED:	GEE,E GOLDFARB,A HOUGHTON,K LEVY,C MEYER,L MILLER,K TINDALL,J
DATE:	19870903
TYPE:	MEMORANDUM
TITLE:	HANDLING AN EXCISE TAX INCREASE
REQUEST NUMBER:	R1-004

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PHILIP MORRIS U. S. A.

INTER-OFFICE CORRESPONDENCE

Richmond, Virginia

To: . Mr. Joe Zaler Date: September 3, 1987

From: . Myron Johnston

Subject: . Handling an excise tax increase

I have been asked for my views as to how we should pass on the price increase in the event of an increase in the excise tax. My choice is to do what I suggested to Wally McDowell in 1982: Pass on the increase in one fell swoop and make it clear to smokers that the government is solely responsible for the price increase, advertise to that effect, suggest that people stock up to avoid the price increase, and recommend that they refrigerate their cigarettes "to preserve their freshness." (It would be necessary to emphasize that point or we would get a lot of hostile complaints.) Then when people exhaust their supply and go to the store to buy more, they will be less likely to remember what they last paid and will be less likely to suffer from "sticker shock." As a result, they should be less likely to use the price increase as an incentive to stop smoking or reduce their consumption.

Last time, of course, we increased prices five times between February of 1982 and January of 1983. In less than a year the price went from $20.20 to $26.90 per thousand ($2.70 more than the tax), and this fact was not lost on consumers, who could legitimately blame the manufacturers for the price increases. While price increases of this magnitude might have been tolerated during the rapid escalation in the overall inflation rate between 1977 and 1981, the increase in the price of cigarettes in 1982 83 was made even more dramatic by the fact that the overall rate of inflation was slowing considerably. You may recall from the article I sent you that Jeffery Harris of MIT calculated, on the basis of the Lewin and Coate data, that the 1982-83 round of price increases caused two million adults to quit smoking and prevented 600,000 teenagers from starting to smoke. Those teenagers are now 19 21 years old, and since about 70 percent of 18-21 year-olds and 35 percent of older smokers smoke a PM brand, this means that 700,000 of those adult quitters had been PM smokers and 420,000 of the non-starters would have been PM smokers. Thus, if Harris is right, we were hit disproportionately hard. We don't need to have that happen again.

I think it is reasonable to assume that wholesalers and retailers will behave pretty much as they did in 1982. The wholesalers liquidated their inventories to avoid paying the floor tax, consumers did not stockpile to any great extent (probably in part because the price increase did not occur suddenly), and the retailers, who faced no floor tax, stocked up because of the profit potential. They stocked up on everything, that is, except Philip Morris brands. B&W loaded in November, Reynolds in December, and we did not load, with the result that, in Richmond at least, the shelves were virtually bare of PM brands. I remember one irate 7-Eleven manager, who knew that I worked at PM, holding up

2022216179

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a pack of Marlboro Lights and telling me that that was his entire stock of Marlboro Lights, and that he was not due for another delivery for two days. He was losing sales, and we may very well have lost some smokers. We certainly incurred the wrath of retailers who lost sales because they were out of our brands. We don't need to have that happen again either.

Thus my recommendation is to take the increase all at once; advertise, blaming it on the feds and encouraging smokers to stockpile; increase prices only to the extent of the tax; and make sure that the cigarettes that the retailers stockpile are our brands this time. We might also take the opportunity to again point out the regressive nature of the tax and tell smokers what percent of the price of a pack of cigarettes in their state is due to taxes.

The only problem I can see with this approach is that we might not have enough production capacity to fill the orders if smokers do stockpile heavily.

MEJ:f

cc: Ed Gee
Art Goldfarb
Ken Houghton
Carolyn Levy
Leo Mayer
Karen Miller
John Tindall
Central File

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MEMORANDUM

TO: Jerry Mande — By fax: 202-456-6027
The White House — 2 pages

FROM: David T. Sweanor
Senior Legal Counsel

RE: Philip Morris & Prices and Kids

DATE: May 20, 1997

The Philip Morris documents mentioned on ABC last night are being faxed to me by Keith Summa at ABC. If they are clear enough I will re-fax them to you.

These documents are apparently also available on the Philip Morris web site. Apparently numbers are required to access specific documents. For the September 19, 1981 document the numbers are 2045259412/13/14/15.

Also, even the most recent SEC filings of Philip Morris acknowledge the role of taxes. I am sending along p. 4 of their December 31, 1997 10-K filing.

Let me know if there is anything further I can do to assist you,

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Cigarettes are subject to substantial excise taxes in the United States and to similar taxes in most foreign markets. The United States federal excise tax on cigarettes is currently $12 per 1,000 cigarettes ($0.24 per pack of 20 cigarettes). In August 1997, legislation was enacted that will raise the federal excise tax to $17 per 1,000 cigarettes ($0.34 per pack of 20 cigarettes) starting in the year 2000 and then to $19.50 per 1,000 cigarettes ($0.39 per pack of 20 cigarettes) in 2002. In general, excise taxes and other cigarette-related taxes levied by the federal government and by various states, counties and municipalities have been increasing, and additional increases have been proposed at the federal level and in a number of states. These taxes vary considerably and, when combined with sales taxes and the current federal excise tax, may be as high as $1.50 per pack in a given locality.

In the opinion of PM Inc. and Philip Morris International, past increases in excise and similar taxes have had an adverse impact on sales of cigarettes. Any future increases, the extent of which cannot be predicted, could result in volume declines for the cigarette industry, including PM Inc. and Philip Morris International, and might cause sales to shift from the premium segment to the discount segment.

Reports with respect to the alleged harmful physical effects of cigarette smoking have been publicized for many years, and the sale, promotion and use of cigarettes continue to be subject to increasing governmental regulation. Since 1964, the Surgeon General of the United States and the Secretary of Health and Human Services have released a number of reports linking cigarette smoking with a broad range of health hazards, including various types of cancer, coronary heart disease and chronic lung disease, and recommending various governmental measures to reduce the incidence of smoking. The 1988, 1990, 1992 and 1994 reports focus upon the "addictive" nature of cigarettes, the effects of smoking cessation, the decrease in smoking in the United States, and the economic and regulatory aspects of smoking in the Western Hemisphere, and cigarette smoking by adolescents, particularly the "addictive" nature of cigarette smoking in adolescence.

Studies with respect to the alleged health risks of ETS to nonsmokers (including lung cancer, respiratory and coronary illnesses, and other conditions) have also received significant publicity. In 1986, the Surgeon General of the United States and the National Academy of Sciences reported that non-smokers were at increased risk of lung cancer and respiratory illness due to ETS. In January 1993, the United States Environmental Protection Agency (the "EPA") issued a report concluding, among other things, that ETS is a human lung carcinogen and that ETS increases certain health risks for young children. In June 1993, PM Inc. joined five other representatives of the tobacco manufacturing and related industries in a lawsuit against the EPA, seeking a declaration that the EPA does not have the authority to regulate ETS, and that, in view of the available scientific evidence and the EPA's failure to follow its own guidelines in making the determination, the EPA's final risk assessment be declared arbitrary and capricious and ordered withdrawn. The outcome of this lawsuit cannot be predicted. The EPA report, together with adverse publicity on ETS, has resulted in the adoption of governmental and privately imposed limitations that restrict or ban cigarette smoking in certain public places and places of employment.

The Comprehensive Smoking Education Act (the "Smoking Education Act"), enacted in 1984, requires cigarette manufacturers and importers to include the following warning statements in rotating sequence on cigarette packages and in advertisements: "SURGEON GENERAL'S WARNING: Smoking Causes Lung Cancer, Heart Disease, Emphysema, And May Complicate Pregnancy"; "SURGEON GENERAL'S WARNING: Quitting Smoking Now Greatly Reduces Serious Risks to Your Health"; "SURGEON GENERAL'S WARNING: Smoking By Pregnant Women May Result in Fetal Injury, Premature Birth, And Low Birth Weight"; and "SURGEON GENERAL'S WARNING: Cigarette Smoke Contains Carbon Monoxide." The Smoking Education Act also covers the size and format of warnings on cigarette packages and in cigarette advertising, and prescribes a modified version of the warnings for outdoor billboard advertisements.

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johnston,m

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DATE:	19750521
TYPE:	MEMORANDUM
TITLE:	THE DECLINE IN THE RATE OF GROWTH OF MARLBORO RED
REQUEST NUMBER:	R1-147

2.	
ID:	**1000306196/6197**
AUTHOR:	JOHNSTON,M
RECIPIENT:	UDOW,A
COPIED:	DUNN,WL EICHORN,PA SELIGMAN,RB WAKEHAM,H
DATE:	19701228
TYPE:	MEMORANDUM
TITLE:	SWITCHERS AND QUANTITY PER DAY
REQUEST NUMBER:	R1-004 R1-150

3.	
ID:	**1000353938/3952**
AUTHOR:	DUNN,WL JOHNSTON,M OSDENE,TS RYAN,F SCHORI,T
RECIPIENT:	BURNS,K DAWSON,R DAYLOR,F EICHORN,P FAGAN,R GANNON,W GRAHAM,R HIND,J KOSAKOWSKI,B LASZLO,T LOWITZ,D MEYER,L MUTTER,W OSMALOV,J RESNIK,FE THOMSON,R WAKEHAM,H WILL,F
COPIED:	
DATE:	19730628
TYPE:	REPORT
TITLE:	1600 - SMOKER PSYCHOLOGY 1600 ANNUAL REPORT
REQUEST NUMBER:	RS-CFL R1-004 R1-071 R1-072 R1-075 R1-076 R1-080 R1-084 R1-141 R1-147 R1-150 R3-011 R3-012

4.	

ID:	**1000360936/0956**
AUTHOR:	DUNN,WL JONES,BW
RECIPIENT:	CLAFLIN,W DANIEL,H DAYLOR,F FAGAN,R GANNON,W GAUVIN,P GOODMAN,B HOUCK,W JOHNSTON,M LEVY,C LIESER,R MARTIN,P MEYER,L OSDENE,TS OSMALOV,H REYNOLDS,F RYAN,F SELIGMAN,RB THOMSON,R WAKEHAM,H
COPIED:	
DATE:	19760300
TYPE:	REPORT
TITLE:	1600 - SMOKER PSYCHOLOGY MANIPULATING SMOKE IMPACT IN VERY LOW (LESS THAN 8 MG TAR) DELIVERY CIGARETTES (R2-3533)
REQUEST NUMBER:	RS-CFL R1-004 R1-041 R1-061 R1-072 R1-075 R1-077 R1-080 R1-083 R1-087 R1-141 R1-147 R1-149 R1-150 R3-011

5.	
ID:	**1000368057/8081**
AUTHOR:	DUNN,WL RYAN,FJ
RECIPIENT:	DANIEL,H FAGAN,R FAUST,P GULLOTTA,F HOLBERT,N JOHNSTON,M LEVY,C MARTIN,P OSDENE,TS RESNIK,FE SELIGMAN,RB UDOW,A ZOLER,J
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DATE:	19780300
TYPE:	REPORT
TITLE:	1600 - SMOKER PSYCHOLOGY EXIT - BRAND CIGARETTES: A STUDY OF EX-SMOKERS
REQUEST NUMBER:	R1-004 R1-048 R1-061 R1-071 R1-072 R1-073 R1-074 R1-076 R1-083 R1-102 R1-103 R1-141 R1-147 R1-149

6.	
ID:	**1000743421**
AUTHOR:	JOHNSTON,M
RECIPIENT:	UDOW,A
COPIED:	
DATE:	19760527
TYPE:	MEMORANDUM
TITLE:	WHY KIDS SMOKE
REQUEST NUMBER:	RS-CFL

7.	
ID:	**1000743958/3959**
AUTHOR:	JOHNSTON,M RYAN,F
RECIPIENT:	DUNN,WL
COPIED:	DANIEL,H LEVY,C OSDENE,TS SELIGMAN,RB THOMSON,R WAKEHAM,H
DATE:	19760408
TYPE:	MEMORANDUM
TITLE:	TEENAGE SMOKING
REQUEST NUMBER:	RS-CFL

8.	
ID:	**1000744089/4096**
AUTHOR:	UDOW,A
RECIPIENT:	MORGAN,JJ
COPIED:	BUDNE,TA DANIEL,H HOLBERT,NB JOHNSTON,M JOHNSTON,M MAZZITELLI,D SELIGMAN,RB THOMSON,RN XXHARRY
DATE:	19760602
TYPE:	MEMORANDUM
TITLE:	WHY PEOPLE START TO SMOKE
REQUEST NUMBER:	RS-CFL

9.	
ID:	1000766888
AUTHOR:	JOHNSTON,M
RECIPIENT:	ZOLER,J
COPIED:	DANIEL,HG FAGAN,R THOMSON,RN UDOW,A
DATE:	19790222
TYPE:	MEMORANDUM
TITLE:	THE INCIDENCE OF TEENAGE SMOKING
REQUEST NUMBER:	RS-CFL

10.	
ID:	1000766893/6894
AUTHOR:	JOHNSTON,M
RECIPIENT:	DANIEL,H
COPIED:	CANTILE,AF DAYLOR,FL MARTIN,PG MEYER,LF THOMSON,RN
DATE:	19790214
TYPE:	MEMORANDUM
TITLE:	PROPOSAL TO DETERMINE WHAT QUALITIES ARE IMPORTANT TO SMOKERS OF DIFFERENT TYPES OF CIGARETTES
REQUEST NUMBER:	R1-083

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11.

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DATE:	19810807
TYPE:	MEMORANDUM
TITLE:	AVERAGE DAILY CIGARETTE CONSUMPTION BY DELIVERY LEVEL AND MEASURES OF SOCIO-ECONOMIC STATUS
REQUEST NUMBER:	R1-004

12.

ID:	**1000808009/8015**
AUTHOR:	JOHNSTON,M
RECIPIENT:	DANIEL,H
COPIED:	GOODALE,T HAUSERMANN,M MEYERS,P MEYER,L NELSON,D ROWE,C THOMSON,R UDOW,A ZOLER,J
DATE:	19820105
TYPE:	MEMORANDUM
TITLE:	CIGARETTE PRICE ELASTICITIES AND THE IMPLICATIONS FOR PHILIP MORRIS
REQUEST NUMBER:	R1-004

13.

ID:	**1000818300**
AUTHOR:	JOHNSTON,M
RECIPIENT:	UDOW,AL
COPIED:	DUNN,WL HAUSERMANN, M MEYER,L ROWE,C THOMSON,R
DATE:	19830113
TYPE:	MEMORANDUM
TITLE:	TRENDS IN CIGARETTE SMOKING PREVALENCE
REQUEST NUMBER:	RS-CFL

14.

ID:	1000818301/8307
AUTHOR:	JOHNSTON,M
RECIPIENT:	ZOLAR,J
COPIED:	DUNN,WL HAUSERMANN,M LEVY,C MEYER,L ROWE,C THOMSON,R
DATE:	19830119
TYPE:	MEMORANDUM
TITLE:	THE AGES AT WHICH PEOPLE START SMOKING
REQUEST NUMBER:	RS-CFL

15.	
ID:	1000869885/9896
AUTHOR:	JOHNSTON,M
RECIPIENT:	RESNIK,FE
COPIED:	DUNN,WL EICHORN,PA SELIGMAN,RB WAKEHAM,H
DATE:	19680529
TYPE:	MEMORANDUM
TITLE:	HAVE AMERICAN CIGARETTE TASTES CHANGED? YOUR REQUEST
REQUEST NUMBER:	RS-CFL

16.	
ID:	1003285174/5178
AUTHOR:	JOHNSTON,M
RECIPIENT:	UDOW,A
COPIED:	DUNN,WL HAUSERMANN,M LEVY,C MEYER,L ROWE,C THOMSON,R
DATE:	19830218
TYPE:	MEMORANDUM
TITLE:	STILL MORE ON TRENDS IN CIGARETTE SMOKING PREVALENCE
REQUEST NUMBER:	R1-141

17.	
ID:	1003285192/5196
AUTHOR:	JOHNSTON,M
RECIPIENT:	UDOW,A
COPIED:	DUNN,WL HAUSERMANN,M MEYER,L ROWE,C THOMSON,R
DATE:	19830113
TYPE:	MEMORANDUM
TITLE:	TRENDS IN CIGARETTE SMOKING PREVALENCE
REQUEST NUMBER:	R1-141

18.	
ID:	1003285379/5384
AUTHOR:	JOHNSTON,M
RECIPIENT:	BROWN,R
COPIED:	DUNN,WL ROWE,CH THOMSON,RN
DATE:	19820729
TYPE:	MEMORANDUM
TITLE:	SMOKING PREVALENCE BY AGE, RACE, AND SEX
REQUEST NUMBER:	R1-141

19.	

ID:	**1003285497/5502**
AUTHOR:	JOHNSTON,M
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DATE:	19750521
TYPE:	MEMORANDUM
TITLE:	THE DECLINE IN THE RATE OF GROWTH OF MARLBORO RED
REQUEST NUMBER:	R1-141

20:

ID:	**1003288934/8949**
AUTHOR:	HOUCK,WG JONES,BW MEYER,L
RECIPIENT:	CLAFIN,W DANIEL,H DAYLOR,F DUNN,WL FAGAN,R GANNON,W GAUVIN,P JOHNSTON,M LEVY,C OSDENE,TS OSMALOV,J REYNOLDS RYAN,F SELIGMAN,RB WAKEHAM,H
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TITLE:	1600 - SMOKER PSYCHOLOGY LOW DELIVERY CIGARETTES AND INCREASED NICOTINE/TAR RATIOS, III
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RECIPIENT:	CLAFLIN,W DANIEL,H DAYLOR,F DUNN,WL GANNON,W GAUVIN,P JOHNSTON,M LEVY,C OSDENE,TS OSMALOV,J RESNIK,FE REYNOLDS,F RYAN,F THOMSON,R WAKEHAM,H
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DATE:	19751000
TYPE:	REPORT
TITLE:	1600 - SMOKER PSYCHOLOGY LOW DELIVERY CIGARETTES AND INCREASED NICOTINE/TAR RATIOS, A REPLICATION
REQUEST NUMBER:	R1-141

22.	
ID:	1003289951/9954
AUTHOR:	DUNN,W JOHNSTON,M RYAN,F SCHORI,T
RECIPIENT:	EICHORN,PA
COPIED:	
DATE:	19710908
TYPE:	MEMORANDUM
TITLE:	PLANS FOR 720000
REQUEST NUMBER:	R1-141

23.	
ID:	1003295064/5065
AUTHOR:	JOHNSTON,M RYAN,F
RECIPIENT:	DUNN,WL
COPIED:	DANIEL,H LEVY,C OSDENE,TS SELIGMAN,RB THOMSON,R WAKEHAM,H
DATE:	19760408
TYPE:	MEMORANDUM
TITLE:	TEENAGE SMOKING
REQUEST NUMBER:	R1-141

24.	

ID:	1003295188/5194
AUTHOR:	JOHNSTON,M
RECIPIENT:	ZOLER,J
COPIED:	DANIEL,H DAYLOR,F GOODALE,T LEVY,C MARTIN,P MEYER,L SELIGMAN,RB SPIELBERG,H THOMSON,R UDOW,A
DATE:	19800909
TYPE:	MEMORANDUM
TITLE:	SMOKERS OF NEWPORT
REQUEST NUMBER:	R1-141

25.

ID:	1003478116/8120
AUTHOR:	JOHNSTON,M
RECIPIENT:	UDOW,A
COPIED:	DUNN,WL HAUSERMANN,M LEVY,C MEYER,L ROWE,C THOMSON,R
DATE:	19830218
TYPE:	MEMORANDUM
TITLE:	STILL MORE ON TRENDS IN CIGARETTE SMOKING PREVALENCE
REQUEST NUMBER:	R1-004 R1-145

26.

ID:	1003478157/8163
AUTHOR:	JOHNSTON,M
RECIPIENT:	ZOLER,J
COPIED:	DUNN,WL HAUSERMANN,M LEVY,C MEYER,L ROWE,C THOMSON,R
DATE:	19830119
TYPE:	MEMORANDUM
TITLE:	THE AGES AT WHICH PEOPLE START SMOKING
REQUEST NUMBER:	R1-004 R1-145

27.

ID:	1003478185/8191
AUTHOR:	JOHNSTON,M
RECIPIENT:	DANIEL,H
COPIED:	GOODALE,T HAUSERMANN,M MEYERS,P MEYER,L NELSON,D ROWE,C THOMSON,R UDOW,A ZOLER,J
DATE:	19820105
TYPE:	MEMORANDUM
TITLE:	CIGARETTE PRICE ELASTICITIES AND THE IMPLICATIONS FOR PHILIP MORRIS
REQUEST NUMBER:	R1-004 R1-145

28.

ID:	1003478193/8196
AUTHOR:	JOHNSTON,M
RECIPIENT:	DANIEL,HG
COPIED:	GOODALE,TT MEYER,LF ROWE,CH THOMSON,RN ZOLER,JN
DATE:	19810917
TYPE:	MEMORANDUM
TITLE:	TEENAGE SMOKING AND THE FEDERAL EXCISE TAX ON CIGARETTES
REQUEST NUMBER:	R1-004 R1-145

29.

ID:	**1003636637/6638**
AUTHOR:	JOHNSTON,M
RECIPIENT:	SELIGMAN,RB
COPIED:	DANIEL,H GOODALE,T LEVY,C MEYER,L THOMSON,R ZOLER,J
DATE:	19810331
TYPE:	MEMORANDUM
TITLE:	YOUNG SMOKERS -- PREVALANCE, TRENDS, IMPLICATIONS, AND RELATED DEMOGRAPHIC TRENDS
REQUEST NUMBER:	R1-095 R1-096 R1-097

30.

ID:	**1003724416/4431**
AUTHOR:	DUNN,WL HOUCK,W JONES,B MEYER,LF
RECIPIENT:	CLAFLIN,W DANIEL,H DAYLOR,F FAGAN,R GANNON,W GAUVIN,P JOHNSTON,M LEVY,C OSDENE,TS OSMALOV,J REYNOLDS,F RYAN,F SELIGMAN,RB THOMSON,R WAKEHAM,H
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DATE:	19760609
TYPE:	REPORT
TITLE:	1600 - SMOKER PSYCHOLOGY LOW DELIVERY CIGARETTES AND INCREASED NICOTINE/TAR RATIOS, III (POL-1606)
REQUEST NUMBER:	R1-004 R1-149

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DATE:	19760408
TYPE:	MEMORANDUM
TITLE:	TEENAGE SMOKING
REQUEST NUMBER:	R1-004 R1-095 R1-096 R1-097 R1-144 R1-149 R1-150 R5-001

32.

ID:	**2001255544/5547**
AUTHOR:	JOHNSTON,M
RECIPIENT:	SUTER,M
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DATE:	19841217
TYPE:	MEMORANDUM
TITLE:	RIO AND HERCULES
REQUEST NUMBER:	R1-004

33.

ID:	**2001255670/5677**
AUTHOR:	JOHNSTON,M
RECIPIENT:	ZOLER,J
COPIED:	DUNN,W HAUSERMANN,M LEVY,C MEYER,L ROWE,C THOMSON,R
DATE:	19830119
TYPE:	MEMORANDUM
TITLE:	THE AGES AT WHICH PEOPLE START SMOKING
REQUEST NUMBER:	R1-004 R1-095 R1-096 R1-097

34.

ID:	2001256025/6044
AUTHOR:	JOHNSTON,M
RECIPIENT:	
COPIED:	
DATE:	
TYPE:	REPORT
TITLE:	COMMENTS ON THE MINNESOTA PLAN FOR NONSMOKING AND HEALTH
REQUEST NUMBER:	R1-004 R1-102

35.

ID:	2001256045/6104
AUTHOR:	JOHNSTON,M
RECIPIENT:	
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DATE:	
TYPE:	REPORT
TITLE:	COMMENTS ON THE MINNESOTA PLAN FOR NONSMOKING AND HEALTH
REQUEST NUMBER:	R1-004 R1-071 R1-102

36.

ID:	2001256722/6727
AUTHOR:	JOHNSTON,M
RECIPIENT:	UDOW,A
COPIED:	DUNN,W HAUSERMANN,M LEVY,C MEYER,L ROWE,C THOMSON,R
DATE:	19830218
TYPE:	MEMORANDUM
TITLE:	STILL MORE ON TRENDS IN CIGARETTE SMOKING PREVALENCE
REQUEST NUMBER:	R1-004 R1-037 R1-071 R1-092 R1-095 R1-096 R1-097 R1-109 R1-145

37.

ID:	2022157888/7889
AUTHOR:	JOHNSTON,M
RECIPIENT:	HAUSERMANN,M
COPIED:	FARONE,W ROWE,C RYAN,F
DATE:	19840314
TYPE:	MEMORANDUM
TITLE:	WHY I AM OPTIMISTIC ABOUT THE FUTURE OF THE INDUSTRY AND PHILIP MORRIS
REQUEST NUMBER:	RS-CFL R1-004 R1-095 R1-096 R1-097 R1-109 R1-145

38.

ID:	2022174188/4193
AUTHOR:	JOHNSTON,M
RECIPIENT:	NELSON,J
COPIED:	BORELLI,T CARCHMAN,R CHARLES,J GANTT,R LINCOLN,J MYRACLE,J NELSON,S OSDENE,T PAGES,B TINDALL,J
DATE:	19910812
TYPE:	MEMORANDUM
TITLE:	THOSE 434,175 DEATHS ALLEGEDLY CAUSED BY SMOKING
REQUEST NUMBER:	RS-CFL

39.

ID:	**2022200010/0011**
AUTHOR:	JOHNSTON,M
RECIPIENT:	NELSON,J
COPIED:	CLAFLIN,W DAYLOR,F ENNIS,D GAUVIN,P GOODALE,T HERETICK,D HOUGHTON,K JELTEMA,M JONES,D JONES,J LEVY,C MARTIN,P MEYER,L MYRACLE,J RYAN,F SPIELBERG,H TINDALL,J WEST,F WEXLER,L WU,L ZOLER,J
DATE:	19860207
TYPE:	MEMORANDUM
TITLE:	SMOKING AND WORK-LOSS DAYS
REQUEST NUMBER:	RS-CFL

40.

ID:	**2022214369/4395**
AUTHOR:	JOHNSTON,M
RECIPIENT:	ZOLER,J
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DATE:	19850815
TYPE:	MEMORANDUM
TITLE:	TRENDS IN SMOKING AMONG HIGH SCHOOL SENIORS
REQUEST NUMBER:	R1-004 R1-095 R1-096 R1-097

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ID:	**2022216179/6180**
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RECIPIENT:	ZOLER,J
COPIED:	GEE,E GOLDFARB,A HOUGHTON,K LEVY,C MEYER,L MILLER,K TINDALL,J
DATE:	19870903
TYPE:	MEMORANDUM
TITLE:	HANDLING AN EXCISE TAX INCREASE
REQUEST NUMBER:	R1-004

42.

ID:	**2022223059/3068**
AUTHOR:	SMITH,A
RECIPIENT:	YATRAKIS,G
COPIED:	CONFER,A GAUVIN,P HAGOOD,H HERETICK,R JELTEMA,M JOHNSTON,M MYRACLE,J NELSON,S SCOTT,F SPIELBERG,H TINDALL,J WEST,F
DATE:	19910124
TYPE:	MEMORANDUM
TITLE:	OC WALK-IN PANEL RESULTS FROM THE TAR / NICOTINE PROGRAM
REQUEST NUMBER:	R1-080 R1-083

43.

ID:	**2022249718/9721**
AUTHOR:	JOHNSTON,M
RECIPIENT:	DANIEL,HG
COPIED:	GOODALE,TT MEYER,LF ROWE,C THOMSON,RN ZOLER,JN
DATE:	19810917
TYPE:	MEMORANDUM
TITLE:	TEENAGE SMOKING AND THE FEDERAL EXCISE TAX ON CIGARETTES
REQUEST NUMBER:	

44.

ID:	2022258815/8823
AUTHOR:	JOHNSTON,M
RECIPIENT:	ZOLER,J
COPIED:	GEE,E HOUGHTON,K LEVY,C MYRACLE,J NELSON,J TINDALL,J WEXLER,L
DATE:	19880317
TYPE:	MEMORANDUM
TITLE:	SMOKING AMONG HIGH SCHOOL SENIORS
REQUEST NUMBER:	RS-CFL

45.

ID:	2023066583/6592
AUTHOR:	JOHNSTON,M
RECIPIENT:	SELIGMAN,RB
COPIED:	DUNN,W EICHORN,P MERRITT,H RESNIK,F THOMSON,R WAKEHAM,H
DATE:	19681216
TYPE:	MEMORANDUM
TITLE:	CIGARETTE SMOKING PATTERNS FROM THE POL NATIONAL ROSTER
REQUEST NUMBER:	R1-004 R1-095 R1-141 R1-149 R1-150 R3-012 R5-001

46.

ID:	2023451799/1812
AUTHOR:	DUNN,WL JR HOUCK,WG JONES,BW MEYER,LF
RECIPIENT:	CARCHMAN,R CLAFLIN,W DANIEL,H DAYLOR,F FAGAN,R GANNON,W GAUVIN,P JOHNSTON,M LEVY,C OSDENE,T OSMALOV,J REYNOLDS,F RYAN,F SELIGMAN,R THOMSON,R WAKEHAM,H
COPIED:	
DATE:	
TYPE:	REPORT
TITLE:	SMOKER PSYCHOLOGY LOW DELIVERY CIGARETTES AND INCREASED NICOTINE / TAR RATIOS, III (POL-1606)
REQUEST NUMBER:	R1-004 R1-072 R1-080 R1-084 R1-141 R1-147 R1-149 R1-150 R3-011

47.

ID:	2040282065
AUTHOR:	ZOLER,JN
RECIPIENT:	CAMPBELL,WI RESNIK,FE
COPIED:	JOHNSTON,M LEVY,C WEXLER,L
DATE:	19860906
TYPE:	MEMORANDUM
TITLE:	TRENDS IN SMOKING AMONG HIGH SCHOOL SENIORS
REQUEST NUMBER:	R1-004 R1-095 R1-096 R1-097 R1-145

48.

ID:	2040294218
AUTHOR:	ZOLER,J
RECIPIENT:	AGINS,S CAMPBELL,WI FITZMAURICE,RA HYSEN,M MERLO,E POOLE,G ROPER,R
COPIED:	JOHNSTON,M ROWE,C
DATE:	19840316
TYPE:	MEMORANDUM
TITLE:	SMOKER DEMOGRAPHICS
REQUEST NUMBER:	R1-004 R3-014

49.

ID:	**2055149601/9612**
AUTHOR:	DUNN,WL JR HOUCK,W JONES,BW MEYER,LF
RECIPIENT:	CLAFLIN,W DANIEL,H DAYLOR,F FAGAN,R GANNON,W GAUVIN,P JENNINGS JOHNSTON,M LEVY,C OSDENE,T OSMALOV,J REYNOLDS,F RYAN,F SELIGMAN,R THOMSON,R WAKEHAM,H
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TYPE:	REPORT
TITLE:	LOW DELIVERY CIGARETTES AND INCREASED NICOTINE / TAR RATIOS, III (POL-1606)
REQUEST NUMBER:	R1-141 R1-147 R1-149 R3-011

50.	
ID:	**2056267569/7584**
AUTHOR:	JOHNSTON,M
RECIPIENT:	GOODALE,T
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DATE:	19850918
TYPE:	MEMORANDUM
TITLE:	THE IMPLICATIONS OF THOSE STRANGE HAPPENINGS IN THE MENTHOL MARKET
REQUEST NUMBER:	R1-072 R1-073 R1-092 R1-094 R1-145

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TYPE:	REPORT
TITLE:	COMMENTS ON THE MINNESOTA PLAN FOR NONSMOKING AND HEALTH
REQUEST NUMBER:	R1-092

52.	
ID:	2057710831/0839
AUTHOR:	JOHNSTON,M
RECIPIENT:	ZOLER,J
COPIED:	DANIEL,HG DAYLOR,FL GOODALE,TT LEVY,CJ MEYER,LF SELIGMAN,RB THOMSON,RN
DATE:	19810807
TYPE:	MEMORANDUM
TITLE:	AVERAGE DAILY CIGARETTE CONSUMPTION BY DELIVERY LEVEL AND MEASURES OF SOCIO-ECONOMIC STATUS
REQUEST NUMBER:	R1-004

53.	
ID:	2058122141/2160
AUTHOR:	JOHNSTON,M
RECIPIENT:	
COPIED:	
DATE:	
TYPE:	REPORT
TITLE:	COMMENTS ON MINNESOTA PLAN FOR NONSMOKING AND HEALTH
REQUEST NUMBER:	R1-092 R1-095 R1-096 R1-097 R1-102

54.	

ID:	2058122161/2168
AUTHOR:	JOHNSTON,M
RECIPIENT:	GEE,E
COPIED:	
DATE:	19891027
TYPE:	MEMORANDUM
TITLE:	THOSE 400,000 DEATHS ALLEGEDLY CAUSED BY SMOKING AND DRINKING
REQUEST NUMBER:	R1-102

55.

ID:	2058122171/2172
AUTHOR:	JOHNSTON,M
RECIPIENT:	ZOLER,J
COPIED:	GEE,E HOUGHTON,K LONG,H MARTIN,P MEYER,L NELSON,J TINDALL,J
DATE:	19870715
TYPE:	MEMORANDUM
TITLE:	PRICE INCREASES AND CIGARETTE SALES - THE HARRIS ARTICLE
REQUEST NUMBER:	R1-004 R1-073 R1-094 R1-095 R1-109

56.

ID:	2058122197/2200
AUTHOR:	JOHNSTON,M
RECIPIENT:	DANIEL,HG
COPIED:	GOODALE,TT MEYER,LF ROWE,CH THOMPSON,RN ZOLER,JN
DATE:	19810917
TYPE:	MEMORANDUM
TITLE:	TEENAGE SMOKING AND FEDERAL EXCISE TAX ON CIGARETTES
REQUEST NUMBER:	R1-095 R1-096 R1-097 R1-107

57.

ID:	2058122207/2209
AUTHOR:	JOHNSTON,M
RECIPIENT:	GEE,E
COPIED:	CARTIN,P LEVY,C MYRACLE,J NELSON,S
DATE:	19920504
TYPE:	MEMORANDUM
TITLE:	PRICE ELASTICITY: MARLBORO RED AND OTHER BRANDS
REQUEST NUMBER:	R1-073 R1-092 R1-095 R1-096 R1-097

58.

ID:	2058122212/2218
AUTHOR:	JOHNSTON,M
RECIPIENT:	DANIEL,H
COPIED:	GOODALE,T HAUSERMANN,M MEYER,L MEYERS,P NELSON,D ROWE,C THOMSON,R UDOW,A ZOLER,J
DATE:	19820105
TYPE:	MEMORANDUM
TITLE:	CIGARETTE PRICE ELASTICITIES AND THE IMPLICATIONS FOR PHILIP MORRIS
REQUEST NUMBER:	R1-004 R1-095 R1-096 R1-097 R1-145

59.

ID:	**2058122422/2430**
AUTHOR:	JOHNSTON,M
RECIPIENT:	ZOLER,J
COPIED:	DANIEL,HG DAYLOR,FL GOODALE,TT LEVY,CJ MEYER,LF SELIGMAN,RB THOMSON,RN
DATE:	19810807
TYPE:	MEMORANDUM
TITLE:	AVERAGE DAILY CIGARETTE CONSUMPTION BY DELIVERY LEVEL AND MEASURES OF SOCIO-ECONOMIC STATUS
REQUEST NUMBER:	R1-004 R1-073 R1-149

60.

ID:	**2058122491/2497**
AUTHOR:	JOHNSTON,M
RECIPIENT:	NELSON,J
COPIED:	
DATE:	19900214
TYPE:	MEMORANDUM
TITLE:	MINNESOTA AND UTAH, THE 'HEALTHIEST' STATES
REQUEST NUMBER:	R1-028

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RECIPIENT:	NELSON,J
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DATE:	19910212
TYPE:	MEMORANDUM
TITLE:	DIFFERENCES BETWEEN SMOKERS AND NONSMOKERS
REQUEST NUMBER:	R1-025

62.

ID:	**2023776321/6331**
AUTHOR:	JOHNSTON,M
RECIPIENT:	ZOLER,J
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DATE:	19850815
TYPE:	MEMORANDUM
TITLE:	TRENDS IN SMOKING AMONG HIGH SCHOOL SENIORS
REQUEST NUMBER:	R1-004 R1-145

63.

ID:	**2023776340/6341**
AUTHOR:	JOHNSTON,M
RECIPIENT:	ZOLER,J
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DATE:	19851202
TYPE:	MEMORANDUM
TITLE:	SMOKING AMONG HIGH SCHOOL SENIORS - AN UPDATE
REQUEST NUMBER:	R1-004 R1-145

64.

ID:	2040282066/2092
AUTHOR:	JOHNSTON,M
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DATE:	19850815
TYPE:	MEMORANDUM
TITLE:	TRENDS IN SMOKING AMONG HIGH SCHOOL SENIORS
REQUEST NUMBER:	R1-004 R1-095 R1-096 R1-097 R1-145

65.

ID:	2040294219/4239
AUTHOR:	JOHNSTON,M
RECIPIENT:	MEYER,L
COPIED:	DANIEL,H DAYLOR,F DUNN,W ENNIS,D FARONE,W GAUVIN,P GOODALE,T HAUSERMANN,M LEVY,C REMINGTON,J RESNIK,F ROWE,C RYAN,F SAFRAN,S TINDALL,J UDOW,A ZOLER,J
DATE:	19840207
TYPE:	MEMORANDUM
TITLE:	SMOKING PREVALENCE - PART I, SMOKING PREVALENCE BY AGE, SEX, AND RACE
REQUEST NUMBER:	R1-004 R1-072 R1-073 R1-074 R1-094 R1-095 R1-096 R1-097 R1-141 R1-145 R3-014

66.

ID:	2040362910/2920
AUTHOR:	JOHNSTON,M
RECIPIENT:	LEVY,C
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DATE:	19850320
TYPE:	MEMORANDUM
TITLE:	STRANGE HAPPENINGS IN THE MENTHOL MARKET
REQUEST NUMBER:	R1-004

67.

ID:	2042329558/9561
AUTHOR:	JOHNSTON,M
RECIPIENT:	ZOLER,J
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DATE:	19880317
TYPE:	MEMORANDUM
TITLE:	SMOKING AMONG HIGH SCHOOL SENIORS
REQUEST NUMBER:	R1-092

68.

ID:	2042411825/1835
AUTHOR:	JOHNSTON,M
RECIPIENT:	LEVY,C
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DATE:	19850320
TYPE:	MEMORANDUM
TITLE:	STRANGE HAPPENINGS IN THE MENTHOL MARKET
REQUEST NUMBER:	R1-004 R1-145 R2-039

69.	
ID:	2048736951/6957
AUTHOR:	JOHNSTON,M
RECIPIENT:	ZOLER,J
COPIED:	DUNN,W HAUSERMAN,M LEVY,C MEYER,L ROWE,C THOMSON,R
DATE:	19830119
TYPE:	MEMORANDUM
TITLE:	THE AGES AT WHICH PEOPLE START SMOKING
REQUEST NUMBER:	R1-004 R1-095 R1-096 R1-097

70.	
ID:	2049456750/6757
AUTHOR:	JOHNSTON,M
RECIPIENT:	ROWE,C
COPIED:	DUNN,W FARONE,W HAUSERMANN,M MEYER,L RESNIK,F RYAN,F ZOLER,J
DATE:	19831027
TYPE:	MEMORANDUM
TITLE:	PHILIP MORRIS MENTHOL SHARE
REQUEST NUMBER:	R1-004 R1-145

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RECIPIENT:	CLAFLIN,W CLARK,D FAGAN,R GRAHAM,R JOHNSTON,M JONES,B MEYER,L OSDENE,TS RESNIK,FE RYAN,F SELIGMAN,RB SPIELBERG,H TINDALL,J WAKEHAM,H WATTS,L
COPIED:	
DATE:	19730300
TYPE:	REPORT
TITLE:	1600 - SMOKER PSYCHOLOGY SMOKING BEHAVIOR: REAL WORLD OBSERVATIONS
REQUEST NUMBER:	RS-CFL R1-004 R1-072 R1-083 R1-084 R1-141 R1-147 R1-149 R1-150 R3-010 R3-011

72.	
ID:	1000359382/9403
AUTHOR:	DUNN,WL HOUCK,WG JONES,B MARTIN,P MEYER,LF
RECIPIENT:	CLAFLIN,W DANIEL,H DAYLOR,F FAGAN,R GANNON,W GAUVIN,P JOHNSTON,M LEVY,C OSDENE,TS OSMALOV,J RESNIK,FE REYNOLDS,F RYAN,F THOMSON,R WAKEHAM,H
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DATE:	19751000
TYPE:	REPORT
TITLE:	1600 - SMOKER DSYCHOLOGY LOW DELIVERY CIGARETTES AND INCREASED NICOTINE/TAR RATIOS, A REPLICATION (R2-3537)
REQUEST NUMBER:	R1-004 R1-061 R1-062 R1-075 R1-077 R1-080 R1-084 R1-102 R1-103 R1-141 R1-147 R1-150 R3-011

73.	
ID:	1000390805/0806
AUTHOR:	JOHNSTON,M
RECIPIENT:	SELIGMAN,RB
COPIED:	DANIEL,H GOODALE,T LEVY,C MEYER,L ZOLER,J
DATE:	19810331
TYPE:	MEMORANDUM
TITLE:	YOUNG SMOKERS-PREVALENCE TRENDS, IMPLICATIONS, AND RELATED DEMOGRAPHIC TRENDS
REQUEST NUMBER:	R1-004 R1-073 R1-092 R1-094 R1-095 R1-096 R1-097 R1-102 R1-103 R1-107 R1-149 R4-006

74.

ID:	**2023776332/6338**
AUTHOR:	JOHNSTON,M
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DATE:	19850712
TYPE:	MEMORANDUM
TITLE:	THE WALL STREET JOURNAL ARTICLE ON SMOKING
REQUEST NUMBER:	R1-004 R1-073

75.

ID:	**2023776342/6353**
AUTHOR:	JOHNSTON,M
RECIPIENT:	MEYER,L
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DATE:	19850730
TYPE:	MEMORANDUM
TITLE:	TRENDS IN CIGARETTE SMOKING PREVALENCE
REQUEST NUMBER:	R1-004 R1-145

76.

ID:	**2045259412/9415**
AUTHOR:	JOHNSTON,M
RECIPIENT:	DANIEL,HG
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DATE:	19810917
TYPE:	MEMORANDUM
TITLE:	TEENAGE SMOKING AND THE FEDERAL EXCISE TAX ON CIGARETTES
REQUEST NUMBER:	R1-005 R1-107

77.

ID:	**2049456651/6654**
AUTHOR:	JOHNSTON,M
RECIPIENT:	DANIEL,HG
COPIED:	GOODALE,TT MEYER,LF ROWE,CH THOMSON,RN ZOLER,JN
DATE:	19810917
TYPE:	MEMORANDUM
TITLE:	TEENAGE SMOKING AND THE FEDERAL EXCISE TAX ON CIGARETTES
REQUEST NUMBER:	R1-093 R1-099

78.

ID:	**2049456696/6702**
AUTHOR:	JOHNSTON,M
RECIPIENT:	DANIEL,H
COPIED:	GOODALE,T HAUSERMANN,M MEYER,L MEYERS,P NELSON,D ROWE,C THOMSON,R UDOW,A ZOLER,J
DATE:	19820105
TYPE:	MEMORANDUM
TITLE:	CIGARETTE PRICE ELASTICITIES AND THE IMPLICATIONS FOR PHILIP MORRIS
REQUEST NUMBER:	R1-072 R1-073 R1-145

C82-02325

PHILIP MORRIS U. S. A.
INTER-OFFICE CORRESPONDENCE
RICHMOND, VIRGINIA

C84

To: Mr. Harry Daniel Date: January 5, 1982

From: Myron Johnston

Subject: Cigarette Price Elasticities and the Implications for Philip Morris

In an earlier memo ("Teenage Smoking and the Federal Excise Tax on Cigarettes," September 17, 1981) I reported on a National Bureau of Economic Research (NBER) working paper, "The Effect of Government Regulation on Teenage Smoking." In that study the authors used the recently released tapes of the 1966-1970 Health Examination Survey of the National Center for Health Statistics and constructed a rather elegant cross-sectional and longitudinal model of teenage smoking behavior. They concluded that the smoking participation elasticity of teenagers is -1.2 and that the total demand elasticity for teenagers is -1.4. This means that a ten percent increase in the price of cigarettes would lead to a decline of 12 percent in the number of teenagers who would otherwise begin to smoke and a 14 percent decline in the total number of cigarettes demanded by teenagers.

I have just finished examining another paper by two of the same authors entitled "The Potential for Using Excise Taxes to Reduce Smoking."* On the basis of the findings of this paper, population data, and data from the Public Health Service (PHS) tapes, the Tracking Study, and the PDR National Panel, I believe that cigarette price increases, whether of our own doing or as a result of excise tax increases, will have less effect on Philip Morris sales than the price elasticities alone would lead one to believe. Details of the paper and the reasons for my relative optimism are described below.

The Paper in Brief

In this study the authors used the recently released 1976 Health Interview Survey tapes, and, using essentially the same procedure used in the earlier paper, constructed the best model I have seen to date from which to calculate the price and income elasticities of cigarettes. With two other variables held constant, they calculate the overall price elasticity of cigarettes to be -0.42, which is about what the consensus has long held it to be. Thus, a ten percent increase in the price of cigarettes would lead to a 4.2 percent decline in sales. They found the income elasticity to be 0.08, which means that a ten percent increase in income would lead to slightly less than a one percent increase in the demand for cigarettes.

1000808009

*This paper has subsequently been published as NBER working paper #764. It was supported by a grant from the National Center for Health Services Research to the New Jersey Medical School. The authors are Eugene Lewit, Office of Primary Health Care Education, New Jersey Medical School, and Douglas Coate of the Department of Economics at Rutgers University and the NBER.

This paper is undoubtedly the best work I have seen to date on price and income elasticities of cigarettes, although, in fairness to other researchers (myself included) who have wrestled with this problem, it should be noted that the authors were privy to information not accessible to other investigators: The PHS public use tapes made available to the general public have been purged of all information that would compromise the confidentiality of the data (e.g. name and address). The authors of this paper, however, working as they did under a PHS grant, had the complete file and, on the basis of the addresses, were able to assign a price per pack figure for all respondents.

Price elasticity works in two ways. A change in price can cause a change in the number of people who use a product or in the quantity of a product the users consume, or, usually, both. In the case of cigarettes, the effect is primarily in the smoker participation rate (price elasticity of -0.26). The effect on the quantity of cigarettes demanded by smokers is much smaller (price elasticity of -0.10). Thus a ten percent increase in the price of cigarettes would cause a decline of 2.6 percent in the number of people who would have otherwise begun to smoke, and a decline of one percent in the number of cigarettes purchased by smokers. This relative insensitivity of sales to price changes on the part of current smokers is consistent with the POS National Panel data, which show little variation between states in the number of cigarettes smoked per day by smokers.

In the case of income elasticity, the situation is exactly the reverse: Changes in income have a greater effect on the consumption of cigarettes by smokers than on the smoker participation rate. Income elasticity for the smoker participation rate is 0.03, and for the quantity smoked by smokers 0.06. This is almost identical to the 0.065 correlation between income and consumption that was calculated for smokers on the POS National Poster, and the 0.061 and 0.057 correlations found for smokers from the two PHS tapes. (Memo, Johnston to Zoler, "Average Daily Cigarette Consumption by Delivery Level and Measures of Socio-Economic Status", August 7, 1981.) Thus changes in income have very little effect on the demand for cigarettes among smokers and even less effect on the number of people who smoke.

Price Elasticities by Age and Sex

As mentioned in my September 17 memo, many of us have hypothesized that price elasticities may be different for different demographic or socio-economic groups, and the authors, in their earlier paper, did indeed find that the smoking participation elasticity for teenagers was -1.2 and their total demand elasticity to be -1.4. In this later paper the authors investigate three different age groups: 20-25 year-olds, 26-35 year-olds, and persons over age 35. Results for these three age groups and teenagers are as follows:

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Table 1

Total Demand Elasticities and Smoker Participation Elasticities by Age

	Total Demand Elasticity	Smoking Participation Elasticity
Teenagers	-1.44	-1.19
20-25 year-olds	-0.89	-0.74
26-35 year-olds	-0.47*	-0.44*
Ages 36 and over	-0.65	-0.15*
Total	-0.42	-0.26

* Not significantly different from zero.

Note that the total demand elasticity for the total population is lower than for all of the subgroups (although the total demand elasticity for the 26-35 year-olds is not significantly different from zero). This is because, with increasing disaggregation of the data, the calculations become less precise and the confidence levels broader. Since the elasticities reported for the total population are more accurate than for the age groups, a better measure of the true elasticities can be obtained by adjusting the elasticities shown in Table 1 to the elasticities for the total population. These results are shown in Table 2.

Table 2

Total Demand Elasticities and Smoker Participation Elasticities, Ages 20 and over, Adjusted

	Total Demand Elasticity	Smoking Participation Elasticity
20-25 year-olds	-0.72	-0.64
26-35 year-olds	-0.38*	-0.38*
Ages 36 and over	-0.36	-0.13*
Total	-0.42	-0.26

* Not significantly different from zero.

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As noted in the earlier memo, price increases would affect the demand for cigarettes among teenagers chiefly through the smoker participation elasticity. That is, the chief effect would be to influence the decision as to whether or not to begin smoking, rather than to influence the demand for cigarettes among committed smokers. This appears to be true also of the 20-25 year olds, among whom the total demand elasticity is nearly twice that of the total population, and, as with the teenagers, appears to operate through the decision regarding beginning (or continuing) to smoke, since the smoker participation elasticity accounts for a great proportion of the aggregate demand elasticity.

Among the 26-35 year-olds the elasticities do not quite reach significance, but what elasticities do exist appear to operate chiefly through the smoker participation elasticities. I find this rather puzzling in view of the fact that the vast majority of smokers begin to smoke before age 20 and an even greater proportion before age 25. Probably the best explanation for the observed greater effect of smoker participation elasticities than of the demand for cigarettes by smokers among both the 20-25 year-olds and the 26-35 year-olds is to be found in the design of the study itself: This, as noted, was a cross-sectional study using 1976 data, and since the state-to-state price differentials had remained relatively constant for a number of years prior to 1976, the smoker participation elasticities of people in their twenties may be more apparent than real. That is, price may have had its impact on the decision to smoke several years prior to the study, when these people were still in their teens.

Among people over age 35 the overall demand elasticity is statistically significant, but it is not determinable whether it operates through the smoker participation elasticity (i.e. quitting) or the demand for cigarettes by smokers (i.e. cutting down). It is unfortunate that the authors did not disaggregate this older group still further. I suspect that the elasticities for people aged 36 to about 50 would have been non-significant, and those for the older ages significant, and it would have been useful to know through which mechanism price has an effect.

The authors further disaggregated the data to calculate the elasticities by age and sex. These unadjusted data are shown in Table 3.

Table 3

Total Demand Elasticities and Smoker Participation Elasticities by Age and Sex

	Total Demand Elasticity	Smoking Participation Elasticity
Males 20-25	-1.40	-1.28
26-35	-0.32*	-0.29*
36 and over	-0.66	-0.25*
Females 20-25	-0.30*	-0.34*
26-35	-0.53*	0.39*
36 and over	-0.12*	0.07*
Total	-0.42	-0.26

* Not significantly different from zero.

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The demand for cigarettes by females is generally insensitive to price: Not one of the elasticities for females is significantly different from zero. Among the 20-25 year-old males both the total demand elasticity and the smoking participation elasticities are significant, while the demand for cigarettes by smokers (not shown) is not. Thus total demand for cigarettes for this age group appears to have (or to have had) an effect through the decision regarding beginning to smoke.

For males 26 to 35 neither measure is significant, but price does seem to have an effect on total demand for males over 35, and among these males the effect is split between the smoking participation rate and the quantity smoked by smokers. While not directly comparable, this is intuitively consistent with the observation in my August 7 memo that income is more highly correlated with consumption for males than for females.

The Significance for Philip Morris

The conclusion to be drawn is that any increase in the price of cigarettes will have its greatest effect on the young, and, in particular, on young males. Unfortunately, it is among the young that we have our greatest market penetration, and theoretically price increases should affect Philip Morris to a greater extent than the total industry. For a variety of reasons, however, this may not be the case.

For one thing, we have a large and increasing share of female smokers, and females, in turn, constitute an increasing proportion of total smokers. Since females, as noted above, are relatively insensitive to price, those of our brands that have this greatest appeal to females (all of the 100's) would be relatively immune to price increases.

Since Marlboro has its greatest appeal to the young, and to young males in particular, it would appear to be particularly vulnerable to price increases. I am inclined to believe, however, that it is less vulnerable than these elasticities alone would suggest, thanks largely to the changing age composition of the population and to the fact that the Marlboro market has changed.

Consider first the changing age composition of the population. As I have noted on many occasions, the number of 15-19 year-olds peaked in 1976 and is now declining at the rate of about three percent per year. Furthermore, as I noted in my report on young smokers ("Young Smokers--Prevalence, Trends, Implications, and Related Demographic Trends", March 31, 1981), the prevalence of teenage smoking has been declining at an accelerating rate. As a result, teenagers, who accounted for about ten percent of all smokers (and seven percent of sales) in 1974, now account for only about 7.5 percent of smokers and five percent of sales. With the continued decline in the number of teenagers and in the teenage smoking prevalence rates, their importance as a market will continue to decline. Thus the elasticities will operate from an already low and declining base. The number of 20-24 year-olds reached its maximum in 1981 and will now begin to decline. As noted above, it is my opinion that the smoker participation elasticity for this group exerted its

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effect in years prior to the survey, and is therefore overstated to a certain extent. This group, too, will decline in importance relative to the total smoking population, even in the absence of any effect of price elasticities, as a result of the decline in the number of 20-24 year-olds and the declining prevalence rates of people moving into that age group. This under-25 group is, of course, much more important to Marlboro than to the total industry, but it is less important now than in 1974: Our share of this market held steady while the number of smokers declined.

Conversely, Marlboro's share of the 25-44 year-old smokers has been increasing. Between 1974 and 1981 its share of 25-34 year-old smokers increased from 11.1 percent to 14.1 percent while that of 35-44 year-old smokers rose from 5.8 to seven percent. Meanwhile the total population aged 25-44 increased at an average annual rate of 3.0 percent. As a result, even though smoking prevalence rates among people in this age group declined, people 25 to 44 now account for about 45 percent of all Marlboro Red smokers--up from about 37 percent in 1974--and, since they have a higher average daily consumption than younger smokers, account for about 50 percent of sales. This group, it should be noted, includes the group in which the price elasticity is not significantly different from zero. Furthermore, the number of 25-44 year-olds will grow at an average annual rate of 2.7 percent over the next five years, and the smoking prevalence in this group, which declined from 44.5 percent in 1974 to 39.7 percent in 1978, has begun to level off.

It is, however, the changes that have taken place over the past decade in the educational and occupational characteristics of smokers of Marlboro Red that give me the greatest cause for optimism. Ten years ago Marlboro had its highest market share among college-educated white collar workers, and among students. Now, for all age groups, its market share is lowest among the upper white collar workers and highest among the lower blue collar workers. There is, in fact, an almost perfect inverse relationship between occupational level and Marlboro market penetration. Even among the 18-24 year-olds, blue collar workers are about 50 percent more likely to smoke Marlboro Red than are students. It is also the blue collar workers who are most likely to smoke, least likely to quit smoking, and who have the highest average daily cigarette consumption, while the upper white collar workers are least likely to have ever smoked, most likely to quit, and who have, other things held constant, the lowest average daily consumption.

There is also, for both sexes and all age groups, an almost perfect inverse relationship between Marlboro Red share and educational attainment. Smokers who have not graduated from high school are about twice as likely to smoke Marlboro Red as college graduates. As was the case with occupation, so also with education: The higher the level of educational attainment the greater the probability of never starting smoking, the greater the probability of quitting, and the lower the average daily consumption.

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Although perhaps not related to elasticities of demand for cigarettes, there is one other factor that should help insulate us from any adverse effects of an increase in excise taxes on cigarettes: the racial composition of smokers of Philip Morris brands. There have, to my knowledge, been no studies that addressed the question of racial differences in cigarette demand elasticities, but whether because of different price or income elasticities, or some social phenomenon, the fact is that, at least since 1974, smoking prevalence among blacks has declined much more sharply than among whites. This is true of both sexes and virtually all age groups, and appears in both cross-sectional and cohort data. (This was reported for teenagers in my May 1991 report on young smokers, and an examination of racial differences among adults based on the PHS data will appear in a forthcoming memo.) At any rate, for whatever reason, the fact that our market is about 95 percent white will help to ameliorate the ill effects of an excise tax increase, or any other form of price increase.

Unfortunately, we know nothing about the relative price (or income) elasticities of demand for cigarettes among different occupational groups or levels of education. What we do know about their relative propensities to smoke, coupled with the changes that have occurred in the age composition of the population and in the characteristics of smokers of our brands, leads me to believe that price increases will have less effect on Philip Morris sales than the bare price elasticities alone would lead one to believe.

MEJ:f

cc: Max Hausermann
Leo Meyer
Richard Thomson
Jon Zoler
Tom Goodale
Al Udow
Douglas Nelson
Peter Meyers
Colon Rowe

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PHILIP MORRIS

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TITLE:	HANDLING AN EXCISE TAX INCREASE
REQUEST NUMBER:	R1-004

RETURN TO MAIN PAGE

PHILIP MORRIS U. S. A.

INTER-OFFICE CORRESPONDENCE

Richmond, Virginia

To: Mr. Jon Zaler Date: September 3, 1987

From: Myron Johnston

Subject: Handling an excise tax increase

I have been asked for my views as to how we should pass on the price increase in the event of an increase in the excise tax. My choice is to do what I suggested to Wally McDowell in 1982: Pass on the increase in one fell swoop and make it clear to smokers that the government is solely responsible for the price increase, advertise to that effect, suggest that people stock up to avoid the price increase, and recommend that they refrigerate their cigarettes "to preserve their freshness." (It would be necessary to emphasize that point or we would get a lot of beetle complaints.) Then when people exhaust their supply and go to the store to buy more, they will be less likely to remember what they last paid and will be less likely to suffer from "sticker shock." As a result, they should be less likely to use the price increase as an incentive to stop smoking or reduce their consumption.

Last time, of course, we increased prices five times between February of 1982 and January of 1983. In less than a year the price went from $20.20 to $26.90 per thousand ($2.70 more than the tax), and this fact was not lost on consumers, who could legitimately blame the manufacturers for the price increases. While price increases of this magnitude might have been tolerated during the rapid escalation in the overall inflation rate between 1977 and 1981, the increase in the price of cigarettes in 1982 83 was made even more dramatic by the fact that the overall rate of inflation was slowing considerably. You may recall from the article I sent you that Jeffery Harris of MIT calculated, on the basis of the Lewin and Coate data, that the 1982-83 round of price increases caused two million adults to quit smoking and prevented 600,000 teenagers from starting to smoke. Those teenagers are now 18 21 years old, and since about 70 percent of 18-21 year-olds and 35 percent of older smokers smoke a PM brand, this means that 700,000 of those adult quitters had been PM smokers and 420,000 of the non-starters would have been PM smokers. Thus, if Harris is right, we were hit disproportionately hard. We don't need to have that happen again.

I think it is reasonable to assume that wholesalers and retailers will behave pretty much as they did in 1982. The wholesalers liquidated their inventories to avoid paying the floor tax, consumers did not stockpile to any great extent (probably in part because the price increase did not occur suddenly), and the retailers, who faced no floor tax, stocked up because of the profit potential. They stocked up on everything, that is, except Philip Morris brands. B&W loaded in November, Reynolds in December, and we did not load, with the result that, in Richmond at least, the shelves were virtually bare of PM brands. I remember one irate 7-Eleven manager, who knew that I worked at PM, holding up

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a pack of Marlboro Lights and telling me that that was his entire stock of Marlboro Lights, and that he was not due for another delivery for two days. He was losing sales, and we may very well have lost some smokers. We certainly incurred the wrath of retailers who lost sales because they were out of our brands. We don't need to have that happen again either.

Thus my recommendation is to take the increase all at once; advertise, blaming it on the feds and encouraging smokers to stockpile; increase prices only to the extent of the tax; and make sure that the cigarettes that the retailers stockpile are our brands this time. We might also take the opportunity to again point out the regressive nature of the tax and tell smokers what percent of the price of a pack of cigarettes in their state is due to taxes.

The only problem I can see with this approach is that we might not have enough production capacity to fill the orders if smokers do stockpile heavily.

MEJ:f

cc: Ed Gee
Art Goldfarb
Ken Houghton
Carolyn Levy
Leo Meyer
Karen Miller
John Tindall
Central File

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PHILIP MORRIS U. S. A.

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To: . Mr. Jon Zoler Date: September 3, 1987

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The only problem I can see with this approach is that we might not have enough production capacity to fill the orders if smokers do stockpile heavily.

MEJ:f

cc: Ed Gee
Art Goldfarb
Ken Houghton
Carolyn Levy
Leo Meyer
Karen Miller
John Tindall
Central File

2022216180

September 27, 1982

TO: Mr. J. R. Moore

FROM: Ms. D. S. Burrows

RE: NBER MODELS OF PRICE SENSITIVITY BY AGE/SEX

BACKGROUND

In 1981, the National Bureau of Economic Research (NBER) published two models based on consumers' responses to government smoking surveys. Because the NBER models were cross-sectional (testing differences between people rather than over time) they were able to relate price separately to incidence and rate per day, by age and sex.

The NBER elasticities may not reflect the exact effects of price increases, since their models didn't deal with changes over time. However, the effects they found for other variables (race, income, working women, etc.) are highly consistent with our understanding of market dynamics. Thus, it is likely that the NBER models have correctly identified relative price sensitivity among age/sex groups.

A detailed critique of the NBER models is Attachment B.

SUMMARY OF FINDINGS

According to the NBER models:

- Teenagers and younger adult males are highly price sensitive.
- Men over 35 have above average price sensitivity.
- Women and 26-34 year old men are relatively immune to price.
- Price affects incidence; rate per day is virtually unchanged.

	NBER PRICE ELASTICITY AMONG:					
	TEENS	AGES 20-25		AGES 35+		TOTAL
	12-17	TOTAL	MALES	TOTAL	MALES	20+
EFFECT ON:						
Incidence	-1.19	- .74	-1.28	NA	NA	- .26
Consumption	-1.44	- .89	-1.40	- .45	- .66	- .42

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ATTACHMENT A

IMPORTANCE OF PRICE IMPACT BY AGE/SEX TO TOTAL INDUSTRY

I. 1982 IMPORTANCE TO INDUSTRY

	% OF SMOKERS	RATE PER DAY	IMPORTANCE = % OF TOTAL CONSUMPTION
Teenagers 12-17	4.0 E	17.4 E	2.2 E
Males 18-24	8.0	29.7	7.5
Males 35+	28.7	36.9	33.6
Total 18+	96.0	31.7	97.8
TOTAL	100.0	31.1 E	100.0

*Source: Tracker (% smokers first half 1982, rate in year 1981) adjusted for estimated teenage smoking.

II IMPORTANCE TO PRICE IMPACT: Sample calculation assumes 10% price increase and flat 623.0 billion industry. Importance of group to total changes independent of total volume or price change.

	IMPORTANCE TO INDUSTRY %	IMPORTANCE TO INDUSTRY BILLIONS	NBER ELASTICITY	LOSS FOLLOWING 10% PRICE INCREASE BILLIONS	LOSS FOLLOWING 10% PRICE INCREASE IMPORTANCE (%)
Teenagers 12-17	2.2%	13.7	-1.44	2.0	7.2%
Males 18-24	7.5	46.7	-1.40	6.5	23.6
Males 35+	33.6	209.3	- .66	13.8	50.0
Total 18+	97.8	609.3	- .42	25.6	92.8
TOTAL	100.0	623.0	- .44 E	27.6	100.0

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ATTACHMENT B

TECHNICAL SUPPLEMENT

SUMMARY AND CRITIQUE OF THE NBER MODELS

Lewit and Coate of the National Bureau of Economic Research developed two series of models relating cigarette prices (and other factors) to reported incidence, rate per day, and "total demand" (incidence times rate).

Although reported rates understate true consumption, the models would still be valid if the under-reporting was constant across the other variables -- geography, age, sex, etc. We ordinarily use this assumption ourselves.

Both studies were weakened by assuming that prices in all locales/outlets in a state were similar to the statewide average reported by TMA, plus local tax. This may be why both models had low adjusted R-squared values (.11 or less, but still significant).

Other aspects of the NBER studies are critiqued separately below, since each used a different data source, time period, and methodology.

THE OVER-20 MODELS

SOURCE: "The Potential for Using Excise Taxes to Reduce Smoking," Working Paper No. 78[illegible] of the National Bureau of Economic Research, by E. M. Lewit and and D. Coate, September, 1981.

This ordinary least squares model used data tapes of individual responses to the Health Interview Survey of 1976. It expressed incidence, rate, and "total demand" of respondents over age 20 as a linear function of:

- Retail price, defined as the TMA - reported average in the respondent's state, adjusted for any local taxes.
- Family income and size
- Sex
- Marital Status
- Health status (perceived)
- Region and city size
- Race
- Working woman or not

Using the full sample, price was not found to be a statistically significant factor in incidence, rate, or "total demand". Coefficients for most of the other variables were significant (at the 5% level) in a direction consistent with our consumer research findings.

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The models were respecified using a restricted sample which eliminated respondents within 20 miles of a lower priced state, on the premise that the price they actually paid might be lower than the assigned price ("border effect"). For the restricted sample, price was found to be a statistically significant factor in:

- Incidence and "total demand" among 20-25 year olds.
- "Total demand" among those over 35.

When the regressions were done by age/sex, significant coefficients were found only for males. Though none were found in the female regressions, the higher elasticity for males/females combined than for males alone may imply some effect among females.

Selected elasticities are tabulated on the next page. Only boxed values have statistical significance at normal levels.

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NBER ELASTICITIES AMONG PERSONS 20+ (1976)
(Sample Restricted to Eliminate Border Effect)

	REPORTED INCIDENCE	REPORTED RATE	"TOTAL DEMAND" (INC. x RATE)
RETAIL PRICE			
Total 20+	- .264*	- .037	- .416**
20-25	- .74*	- .20	- .89*
26-35	- .44	- .04	- .47
35+	- .15	- .15	- .45*
Males 20+			
20-25	-1.276**	- .171	-1.401*
26-35	- .292	+ .029	- .320
35+	- .246	- .204	- .638*
Females 20+			
20-25	- .136	- .026	- .302
26-35	- .388	- .134	- .577
35+	+ .066	- .077	- .118
INCOME			
Total 20+	+ .05	+ .06**	- .08**

*OLS coefficient statistically significant at 5% level (2-tailed test).

**OLS coefficient statistically significant at 1% level (2-tailed test).

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Since the NBER models are based on geographic differences in retail price at one point in time (1976), they do not translate directly to national changes over time:

- The positive income elasticity suggests that, over time, price elasticity should be applied to retail price deflated by some measure of consumer income. However, the price elasticities are strongly age/sex specific and income measures/projections are not available by age/sex.

- Since consumer prices may continue to rise faster than income (especially among young adults), using the CPI as a deflator probably yields conservative estimates of the price impact.

- Restricting the sample to eliminate "border effects" improved the model's applicability to the nation. However, it created some regional bias — Westerners rose from 18% to 29% of the sample while Northeasterners fell from 24% to 11%. This may have made the price elasticity more negative than the "true" national value, since positive coefficients were associated with residence in any region except the West.

Thus, the [illegible] NBER elasticities are imprecise for national price changes. However, they probably give a reasonable idea of the groups most affected by price and the orders of magnitude of the effects.

THE TEENAGE MODEL

SOURCE: "The Effects of Government Regulation on Teenage Smoking," by E. M. Lewit, D. Coate, and M. Grossman. Journal of Law and Economics, December, 1981.

These models used personal interview data from Cycle III of the Health Examination Survey*, conducted 1966-70. Incidence and rate findings from HES III seem reasonable, perhaps even a cut above most teenage studies. But it is not recent.

A major goal of this study was pre/post assessment of the Fairness Doctrine, which loaded television with anti-smoking commercials from 7/67 through 12/70. Other variables included:

*In Self-Reported Health Behavior and Attitudes of Youths 12-17 Years, United States. HEW, 1975.

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- TMA retail prices, adjusted to state cost-of-living and changes in the national CPI during the 4-year survey (an improvement over no adjustment, but still makeshift).
- Fairness Doctrine intensity versus cigarette advertising and amount of time spent watching TV
- Family income deflated by state cost-of-living
- Number of other children
- Parents' education
- Working mother or single parent
- Employment/allowance of youth respondent (detailed)
- Student status
- Age
- Sex
- Race
- Region and city size

Larger negative price elasticities were found. The coefficients were stable and statistically significant in all model specifications reported. The authors suggest that these large elasticities may incorporate other effects which the model did not include/capture separately. They suggest that the income related variables may have failed to represent the youth's actual discretionary income.

NBER PRICE ELASTICITIES AMONG YOUTH 12-17

	REPORTED INCIDENCE	REPORTED RATE	"TOTAL DEMAND" (INC. x RATE)
Total 12-17	- 1.19	- .25	- 1.44

The Fairness Doctrine was also found to have an important negative effect during its first year (accounting for a 3 percentage point drop in 12-17 incidence), but showed diminishing returns during its second and third year. Cigarette advertising on TV was found to partially offset the Doctrine effects. Thus, the absence of TV advertising after 1970 was implicitly a negative effect, but the absence of the Fairness was a larger implicit positive.

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Results for other variables were not reported.

Weaknesses in the teenage NBER model are:

- Loose estimation of price, loosely deflated.
- "Impure" price elasticity (probably somewhat inflated).
- Data from the late 1960's, which may not reflect today's market.

National application of this model has the same problems as in the adult model, except that the problem of estimating what teenagers perceive as "real" price change is even worse.

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CONCLUSIONS

In terms of immediate impact, the effect of price on males 35+ is most important. Half (50%) of the total drop in industry volume is attributable to males 35+, compared to 24% from younger adult males, and 7% from teenagers. (Calculated in Attachment A)

But, the loss of younger adult males and teenagers is more important to the long term, drying up the supply of new smokers to replace the old.* This is not a fixed loss to the industry: its importance increases with time. In ten years, increased rate per day would have been expected to raise this group's consumption by more than 50%.

Diane S. Burrows
MARKETING DEVELOPMENT DEPARTMENT

DSB/ch

cc: Mr. [redacted] Hribar
Mr. [redacted] Calyan
Mr. [redacted] Doten
Mr. R. A. Davis
MDI [redacted]

*As discussed in my 9/21/82 memo re "Estimated Change in Industry Trend Following F.E.T. Increase".

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PHILIP MORRIS U. S. A.

INTER-OFFICE CORRESPONDENCE

RICHMOND, VIRGINIA

To: Mr. Harry G. Daniel Date: September 17, 1981

From: Myron Johnston

Subject: Teenage Smoking and the Federal Excise Tax on Cigarettes

I have just finished studying a National Bureau of Economic Research (NBER) working paper entitled "The Effect of Government Regulation on Teenage Smoking."* In the paper the authors examine the impact on teenage smoking of (1) the excise tax on cigarettes, (2) the FCC Fairness Doctrine (i.e. the anti-smoking commercials), and (3) the cigarette advertising ban. This is by far the best study I have read concerning the effects of the anti-smoking commercials, and the only study I know of that attempts to determine the price elastfcity of cigarettes among different groups.

Because of the quality of the work, the prestige (and objectivity) of the NBER, and the fact that the excise tax on cigarettes has not changed in nearly 30 years, I think we need to take seriously their statement that "...if future reductions in youth smoking are desired, an increase in the Federal excise tax is a potent policy to accomplish this goal." Given that a further reduction in youth smoking IS the goal of many pressure groups and Federal agencies, and that the goal of balancing the Federal budget through budget cuts seems increasing elusive, I think we can expect an increase in the excise tax on cigarettes, probably within a year.

There are other things that lead me to believe that there will be increases in the Federal excise taxes on both cigarettes and alcoholic beverages: (1) It can be argued that excise taxes are "voluntary" taxes in that payment of them can be avoided by refraining from purchasing the product, and that therefore increasing excise taxes does not reduce discretionary incomes. (2) Both cigarettes and alcoholic beverages have low price elasticities, so the additional taxes can be passed on to the consumer with little adverse effect on the industries. (3) Prices of cigarettes and alcoholic beverages (as measured by the Consumer Price Index) have increased more slowly than prices generally. (4) Excise taxes contributed only 5.0 percent to total Federal revenues in 1980, down from 8.1 percent in 1970 and 12.5 percent in 1960. (5) A 25 percent increase in the excise taxes on cigarettes and alcoholic beverages would reduce the Federal deficit by over two billion dollars, yet have a minimal effect on the Consumer Price Index. Given the current price of gasoline and the state of the automobile industry, I do not think it would be politically feasible to raise excise taxes on cars or gasoline, but I think cigarettes and alcoholic beverages are fair game for increased taxes.

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*The paper is a part of the NBER's research program in Health Economics and was supported by grants from the National Science Foundation to the NBER and from the National Center for Health Services to the New Jersey Medical School. The authors are Eugene M. Lewit, Office of Primary Health Care Education, New Jersey Medical School; Douglas Coate, Department of Economics, Newark College of Arts and Sciences, Rutgers University; and Michael Grossman, Department of Economics, City University of New York Graduate School.

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Some of the findings reported in the paper are as follows:

Most researchers, myself included, have calculated that the best estimate of the price elasticity of cigarettes is about -0.4, i.e. that a ten percent increase in the retail price of cigarettes will cause a decline of about four percent in cigarette sales. Many of us have hypothesized that price elasticities are different for different demographic or socio-economic groups, e.g., that price increases would have less effect on the higher income groups and on the older and therefore more habituated smokers, than on other smokers. Because of the lack of any reliable data, this has remained until now strictly a hypothesis. The authors of this paper, however, have used the results of the 1966-1970 Health Examination Survey of the National Center for Health Statistics, and have constructed an elegant longitudinal and cross-sectional model of teenage smoking behavior. This has made it possible for them to calculate the price elasticity for teenagers and compare it with the generally accepted price elasticity of cigarettes for the total smoking population.

The authors conclude that the anti-smoking commercials represented a shock to the underlying upward trend in teenage smoking in the mid-1960's and early 1970's, particularly in the first year in which they were aired, but that the trend reasserted itself the following year, although teenage smoking remained at a lower level than would have been the case in the absence of the anti-smoking commercials. This is consistent with my findings that random shocks, such as the report of the Royal College of Physicians and Surgeons, the Readers Digest articles, and the reports of the Surgeon General, have brief effects, and that sales subsequently resume the upward trend, but more slowly and from a lower base. The authors also conclude that the cigarette advertising ban had a relatively minor effect in discouraging teenage smoking.

The most important finding, and the one of greatest significance to the company, is their calculation of the price elasticity of cigarettes among teenagers. They calculate that the smoking participation elasticity is -1.2, which means that a ten percent increase in the price of cigarettes would lead to a decline of 12 percent in the number of teenagers who would otherwise begin to smoke. Their calculation of the quantity smoked elasticity for teenagers is -1.4, which means that a ten percent increase in price would lead to a 14 percent decline in cigarette consumption by teenagers. This is in contrast to the aforementioned -0.4 elasticity for the total smoking population. In another paper, two of these authors, Lewit and Coate, found that smoking by young adults 20 to 24 is much more responsive to price than smoking by older adults, which again is consistent with the hypothesis mentioned above.

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The authors concede that one reason for the large price elasticities they found among teenagers is that the elasticities incorporate income effects and substitution effects, i.e., cross-elasticities. This, of course, is true of virtually all calculations of price elasticities. As a result of some of the relationships I discovered while working on my report on teenage smoking,* I am inclined to believe that cross-elasticities are particularly important in the case of teenagers. Among teenagers the prevalence of cigarette smoking is highly correlated with income (from either allowances or working) while there is no similar correlation between smoking prevalence and income among adults. Teenage smoking prevalence appears to have begun to decline among boys at about the time of the high teenage unemployment rates of the early 1970's, at which time the smoking prevalence among girls was still increasing, and it is the males who would be most likely to feel the impact of unemployment. Furthermore, it was among the older boys that the decline was greatest, and, again, one would expect that the older boys would feel the impact of unemployment more than the younger ones.

With regard to the substitution effects, or cross-elasticities, I think the most important substitution effect is with gasoline. In my study, I found that the cumulative smoking incidence among boys in 1976 was about the same as in 1979 up to the age of 15, but past the age of 16 (the age at which many of them would have access to a car), the 1979 incidence was substantially below that of 1976. Consider also that in 1967, for one dollar, a teenager could buy two gallons of gasoline and a pack of cigarettes. As recently as 1978, if teenage incomes kept pace with inflation, the same purchasing power would still buy a pack of cigarettes and two gallons of gasoline. With income continuing to increase with inflation, this was no longer possible for the 1979 teenager, and the 1980 teenager could not even afford the two gallons of gasoline. I think it is more than coincidental that the sharpest declines in smoking prevalence among teenage males occurred in 1979 and 1980, the years in which the price of gasoline rose most sharply. When it comes to a choice between smoking cigarettes or cruising around in his car, the average teenage male would probably choose the latter. If this cross-elasticity between cigarettes and gasoline is, indeed, related to the decline in smoking prevalence among teenagers, we would expect to see some moderation in the rate of decline in smoking among boys when the 1981 data become available.

In any event, and for whatever reason, it is clear that price has a pronounced effect on the smoking prevalence of teenagers, and that the goals of reducing teenage smoking and balancing the budget would both be served by increasing the Federal excise tax on cigarettes. It is worth quoting the authors somewhat extensively on one point: "Such a policy [increasing the Federal excise tax] may also be an effective way to curb the detrimental (sic) health effects of smoking in the long run without substantially harming the cigarette industry in the short run. Since youth and young adult price elasticities are much larger than adult price elasticities while adult smokers account for the bulk of cigarette sales, a substantial excise tax increase would substantially

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*"Young Smokers: Prevalence, Trends, Implications, and Related Demographics," March 31, 1981

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reduce smoking participation by young new smokers but leave industry sales largely unchanged. Given the evidence that individuals are considerably less likely to initiate smoking after age 25, it is quite possible that the cohort of young smokers who never begin to smoke as a result of the tax increase would never become regular smokers. As a consequence, over a period of several decades, aggregate smoking and its associated detrimental health effects would decline substantially."

It is worth noting that government actions designed to reduce smoking in the late 1960's and early 1970's served to moderate an underlying upward trend in teenage smoking, while any government action taken now will accelerate its present downward trend. Given a price elasticity of -0.4 for total cigarette sales and -1.2 for teenage smoking participation, a 25 percent increase in the excise tax could be expected to reduce industry sales to about 1.2 percent below what would be expected in the absence of such an increase, and to reduce the number of teenage smokers to 3.5 to 4.0 percent below the number that would otherwise be expected. The almost certainty of improved economic conditions, lower inflation rates, and increasing discretionary incomes over the next few years, however, should serve to moderate the adverse effect on sales of an excise tax increase. We can never look with equanimity on increases in the excise tax, but because of demographic trends and the improved economic outlook an increase at this time would probably be less harmful than it would have been at any other time in the past decade.

MEJ:f

cc: R. N. Thomson
J. N. Zoler
T. T. Goodale
C. H. Rowe
L. F. Meyer

1003478196

MN ATTY GENERAL Fax:6122974036 May 20 '98 13:22 P.14

September 27, 1982

TO: Mr. P. E. Calyan

FROM: Ms. D. S. Burrows

RE: MARKETING IMPLICATIONS OF THE NBER MODELS

The attached memo summarizes the findings of the National Bureau of Economic Research on the relative price sensitivity of age/sex groups, per your request.

A key finding is that younger adult males are highly sensitive to price. This suggests that the steep rise in prices expected in the coming months could threaten the long term vitality of the industry, by drying up the supply of new/younger adult smokers entering the market. It could also undermine the long range growth potential of brands which rely on new/younger smokers, including Marlboro and Newport.

There is no reason to assume that price makes the idea of smoking less appealing to younger adults. But price may create a barrier which prevents that appeal from developing into an ongoing choice to become a smoker.

RJR has an opportunity to break this price barrier with a brand targeted to younger adult males, the most sensitive group. Three approaches are possible:

1. A new younger adult male brand which offers imagery combined with lower price.

2. A larger, economy size pack of a new or existing brand.

3. Marketing "half-packs" (10's or 12's) of a new or existing younger adult male brand, in addition to 20's.

I recommend marketing "half-packs" because:

- Half-packs are a logical size for beginner smokers. As mature smokers, their rate will double (or more). Brand loyalty would carry this gain over to the brand's 20's.

- Younger smokers seem more sensitive to cash outlay than cost per cigarette. (Otherwise they would buy cartons, not packs.) Half-packs could reduce consumers' cash outlay by 30-40% versus branded 20's. Generic 20's only offer a 16% lower outlay.

- Low price would not imply a "cheap brand" nor require sacrifices in unit profit, marketing support, or quality.

- Newport 10's are showing up in regular outlets (not just vending), suggesting Lorillard may also be aware of this younger adult price sensitivity.

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Half-packs targeted to younger adults are not likely to achieve a large market share themselves: new smokers account for perhaps 1% of the market in a given year. But this is the percent Marlboro has compounded for 25 years. RJR's long term investment could pay off as handsomely.

Perhaps the half-pack idea could also be explored as a way to address the price sensitivity among older adults. The young and the old have two things in common: they have lower incomes and are light smokers.

Diane S. Burrows
MARKETING DEVELOPMENT DEPARTMENT

DSB/ch

cc: Mr. J. R. Moore
Mr. J. R. Hribar
Mr. W. W. Doten
Mr. R. A. Davis
MDIC

DSB/ch - 9/28/82
Code: 5.21

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THE PERSPECTIVE OF PM INTERNATIONAL
ON SMOKING AND HEALTH ISSUES

(Text of the discussion document used
at the meeting of top management)

March 29, 1985

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May 20 '98 13:23 P.17 Fax:6122972036

SMOKING AND HEALTH INITIATIVES - P.M. INTERNATIONAL

I would like to start off by saying that there are two things which pose an immediate and very serious problem for our industry. These are product liability and taxation. They threaten the very existence of the cigarette industry and they should therefore assume the highest priority for action and resource allocation.

Regarding product liability, I am aware that we are applying an enormous amount of legal talent and time to the problem. I am also aware that we have the best legal people in the U.S. working on this problem and my purpose this afternoon is not to comment on the legal aspects of how product liability is being handled. I do think we could do more in the public relations area on the problem, however, and I plan to make a specific suggestion on this later.

With regard to taxation, it is clear that in the U.S., and in most countries in which we operate, tax is becoming a major threat to our existence. Speaking for International I have to tell you that we have not done enough in the tax area. Our efforts have been sporadic, reactive and, though we have had some successes, our effectiveness in the tax area has been questionable to say the least. Again, I am going to make a specific proposal later as to how the industry can become more effective in dealing with the tax problem.

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May 20 '98 13:23 Fax:6122974036 MN HLTY GENERAL P.18

Thirdly, I want to say to you that in order to achieve lower taxation on our products, or achieve any of our objectives in the smoking and health area, it is crucial that we change the public's point of view towards our products. The current feeling of antagonism toward our products and our industry creates a climate which makes it easy for governments to increase taxes or take other measures against us.

This leads to the one key overall objective that Bumish raised in his memo of March 27, 1985 - how can we change the public's view towards smoking?

Firstly, I believe we must work harder to get smokers to help the industry. I would like to illustrate the points I want to make here by using the U.S. as an example - simply because most people around this table are very familiar with this market.

There are some 50 million smokers today in the U.S. I realize that research tells us that the majority of smokers wished they did not smoke and are, therefore, unlikely to be of much help to the industry. There are probably 5% or so of smokers who are ready to stand up for their habit and this would give us a body of some 2.5 million people. This is a large block of voters, even in a country as large as the U.S.

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On reason I believe that a greater proportion of our smokers would side with the industry. My guess is that a large number of our smokers must take the view that, though they may try to quit, they will probably not be successful. Having faced up to the fact that they will probably continue to smoke, I cannot believe that they will willingly accept higher taxes on cigarettes. On the one hand, therefore, we can probably mobilize a fairly large proportion of the 50 million smokers in the U.S. and this is a formidable number of voters.

Other groups such as the National Rifle Association have been highly successful at protecting a seemingly impossible cause. They have found a way to motivate and use their members and the politicians have responded.

It seems to me that homosexuals have made enormous progress in changing their image in this country in the last couple of decades. A few years back they were considered deranged, bad and immoral, but today they have become acceptable members of society. There must be a considerable body of social science in existence which could tell us how a group such as the homosexual movement has been able to change its public image so dramatically. We should research this material and perhaps learn from it.

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One of the most obvious areas where we could use our large smoker base in on the taxation issue; as I said earlier, I firmly believe many smokers would support us here. We could, for example, use pack inserts prior to a tax change. We would advise smokers of the likelihood of a tax increase, point out the unfairness of the action contemplated and request that they write to their elected representatives in government protesting the increase. Similar action would be taken on proposed legislation to restrict public smoking or smoking in the workplace.

In International we are planning to enlist the support of our smokers and try out some of the ideas I have just talked about. We will start with West Germany where a large tax increase is expected in 1987.

The second subject I wish to raise is <u>fairness in taxation</u>. It seems to me that we can exploit the window of opportunity offered by President Reagan's "fairness in taxation" campaign.

This is related to my first point but it is a marvelous opportunity to mobilize our smokers to protest the unfairness of cigarette taxes.

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The third thing I want to talk about is going public. I believe the industry should do more of this and we have a proposal this afternoon to go public in a different way.

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Andrew will now present an idea which he has developed which is aimed squarely at putting cigarettes into the same perspective that applies to other controversial products and issues.

Fourth, we must attack the anti-smoking groups and zealots more confidently than we have in the past. If we can cool their zeal just a bit, not only might smoking as a subject become less of an issue, but also smokers might begin to feel less embattled.

More perhaps we could commission a book on the "anti-industry industry" and show that our attackers actually make money out of their activities, a situation quite at variance with their image today.

Possibly too, we can discredit our critics. John Banzhaf for example, is alleged to be involved in the porno industry. Can't we use this somehow? If we start to dig around, we will certainly find anomalies which we can exploit. Internationally, we will start looking in countries where we are under severe pressure.

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Fifth, we need to work to protect the industry by doing everything possible to ensure that the Master Legislation is passed. This will provide some protection against exorbitant liability claims.

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Now, I am not a lawyer and don't profess to understand the issues. Maybe though, one possible way in which we could help with this legislation is to enlist third party support since product liability is presumably a wider issue than just tobacco. The pharmaceutical industry, the chemical industry, the nuclear power industry, and the food industry are all examples of threatened industries and there are probably others. Shouldn't we be able to weave a coalition of threatened industries? Andrew's libertad idea could help here.

We should also begin to work to establish a mind set in the public at large that bankrupting huge industries such as tobacco is unthinkable.

We have to make better use of the fact that tobacco is not like asbestos for example. At stake in our industry, and in others which are threatened, is employment for millions, and government revenues of billions. Why can't we begin to get articles placed and books written which develop scenarios for when the unthinkable happens? These could show what will happen to individuals, whole communities, and national economies for example. It just has to be possible to demonstrate that large industries cannot be made to disappear without extremely grave consequences.

Let's begin now to work to establish this mind set.

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The sixth point I want to make is that we are not using our very considerable clout with the media. A number of media proprietors that I have spoken to are sympathetic to our position - Rupert Murdoch and Malcolm Forbes are two good examples. The media like the money they make from our advertisements and they are an ally that we can and should exploit.

In most societies in the world today public opinion is formed, to a significant extent, by the news media and I believe we should make a concerted effort in our principal markets to influence the media to write articles or editorials positive to the industry position on the various aspects of the smoking controversy. I can't speak for the U.S. but I can tell you all that we are not doing enough in this area in International.

There is one further point which I would like to make. I made this point at our February planning meeting but I want to repeat it because it is important. The degree of success we have in influencing public opinion on smoking will depend, to a large extent, on the human resources we apply to the problem. In International we have not had enough people, or the right people, working on smoking issues. We are in the process of correcting this but a lot more needs to be done.

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As with any other aspect of our business, it all gets back to people and I firmly believe that this is one of the first things that we should all address.

Here is a list of the points that Andrew and I have discussed (pass it around). I am not suggesting these are the only things we should be doing and, of course, there are a number of other initatives which we are either taking or plan to take. We are suggesting these six items because we believe they are practical and reasonable initiatives we can take to protect our industry and to change the public's perception of smoking.

Thank you.

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