Tobacco—Options

TOBACCO — OPTIONS

ERIC LIU

Cynthia A. Rice 10/28/99 11:50:42 AM

Record Type: Record

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

cc: J. Eric Gould/OPD/EOP@EOP, Eugenia Chough/OPD/EOP@EOP, Victoria A. Wachino/OMB/EOP@EOP, Richard J. Turman/OMB/EOP

Subject: Public Health Groups Release Poll Showing Support for Tobacco Tax

Today, the American Cancer Society, the American Heart Association, the Campaign for Tobacco Free Kids are releasing poll numbers from a survey of likely voters conducted by the Mellman Group and Market Strategies Inc (a GOP firm). The survey found that when asked how they would balance the federal budget: 63 percent said the cigarette tax; 13 percent said cut spending on programs; and 6 percent said spend Social Security. Majorities of Democrats, Independents, and Republicans favor increasing the cigarette tax over other alternatives.

I've got a whole packet of nifty charts I'll get around to you all shortly. The groups are distributing packets on the Hill too.

Message Sent To:

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Joshua Gotbaum/OMB/EOP@EOP
Daniel N. Mendelson/OMB/EOP@EOP
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AMERICAN CANCER SOCIETY
Hope. Progress. Answers.

CAMPAIGN for TOBACCO-FREE Kids

American Heart Association
Fighting Heart Disease and Stroke

For Immediate Release
October 28,1999

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NEW POLL SHOWS STRONG PUBLIC SUPPORT FOR TOBACCO TAX INCREASE

–Voters Overwhelmingly Prefer Tobacco Tax Increase to Program Spending Cuts or Raiding the Social Security Trust Fund –

Washington, DC – As Congress and the President try to resolve the current budget impasse, a new poll released today clearly demonstrates that voters would rather raise the federal excise tax on cigarettes than cut program spending or use funds from the Social Security Trust Fund to balance the federal budget.

The survey of 800 likely voters, conducted by The Mellman Group, Inc., a prominent Democratic polling firm, and Market Strategies, Inc., a well-known Republican polling firm, showed that when asked if they would prefer spending some of the Social Security Trust Fund, cutting spending for programs or raising taxes on cigarettes in order to balance the federal budget:

- 63 percent would raise the cigarette tax;
- 13 percent would cut spending on programs; and
- 6 percent would spend some of the Social Security Trust Fund.

"The tobacco tax is a way to fix the budget impasse while, at the same time, protecting millions of kids from the allure of tobacco," said M. Cass Wheeler, chief executive officer of the American Heart Association. "Congress and the President should heed the will of the American people and get the job done."

-- more --

"Everyone, including the tobacco companies, has known for years that raising the price of cigarettes is one of the most effective ways to reduce youth smoking," added John R. Seffrin, chief executive officer of the American Cancer Society. "In California, which raised its state tax by 50 cents, sales dropped by 30 percent during the first half of 1999. A federal tobacco tax increase of 55 cents would prevent over two million kids alive today from becoming smokers, averting roughly 700,000 premature deaths."

The support for increasing the cigarette excise tax crosses party and ideological lines, as well as demographic boundaries such as income, age and gender. Majorities of Democrats, independents and Republicans favor increasing the cigarette tax over the other alternatives and <u>by a margin of at least two to one</u>.

Among conservative Republicans, voters are much more likely to favor raising the cigarette tax (48%) to cutting program spending (31%), or using the Social Security Trust Fund (6%). Smokers and low-income voters also favor the cigarette tax increase over the other alternatives.

"Increasing the tobacco tax is clearly the most preferred solution to the budget impasse across the spectrum of American voters," said Mark Mellman, President and CEO of The Mellman Group, Inc.

At a time when Americans generally resist tax increases, the poll also demonstrates that few voters would view negatively a candidate's vote for the tobacco tax. Just 21 percent said a vote for a 55 cent cigarette tax increase would be a "very convincing" reason to vote against a candidate. In contrast, many more respondents said voting to spend money from the Social Security Trust Fund (37%), voting to cut education spending (37%), voting to cut health care spending (31%), and voting to cut Medicare (42%) would be a "very convincing" reason to vote against a candidate.

"Clearly, the public views the tobacco tax in a separate category from income or other taxes, perhaps perceiving it more as a fee on smokers. Therefore, they are not inclined to punish lawmakers who support a measure which will improve the public health," said Dimitri Pantazopoulos, Washington Partner of Market Strategies, Inc.

The poll results were released today by the American Heart Association, the American Cancer Society and the Campaign for Tobacco-Free Kids. The survey of 800 likely voters was conducted October 23 – October 26 by The Mellman Group, Inc. and Market Strategies, Inc. The survey has a margin of error of plus or minus 3.5 percentage points.

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Presentation Of Findings From A National Survey Of 800 Likely Voters

The Mellman Group, Inc.

Market Strategies, Inc.

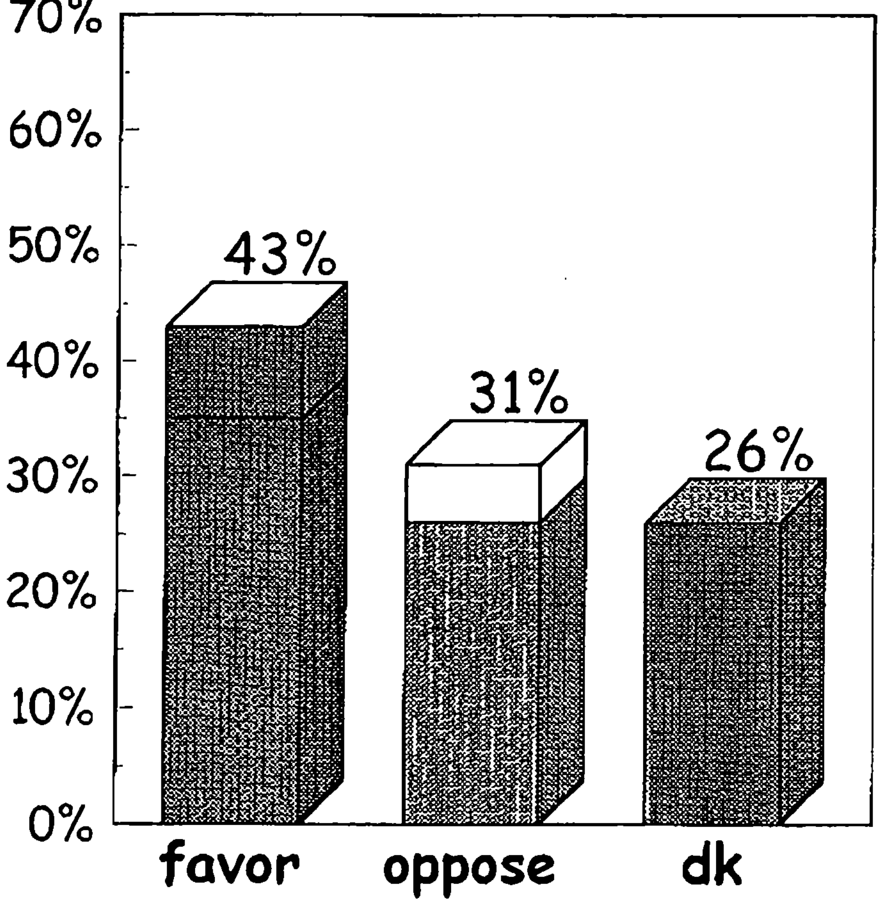
October 1999

Methodology

- 800 likely general election voters
- Interviewing from October 23-26, 1999
- The margin of error for the sample overall is +/-3.5%

While Voters Are Not Anxious To Raise Cigarette Taxes, A Large Majority Support An Increase To Reduce Youth Smoking

Do you favor or oppose increasing taxes on cigarettes by 55 cents per pack or don't you have an opinion on this?



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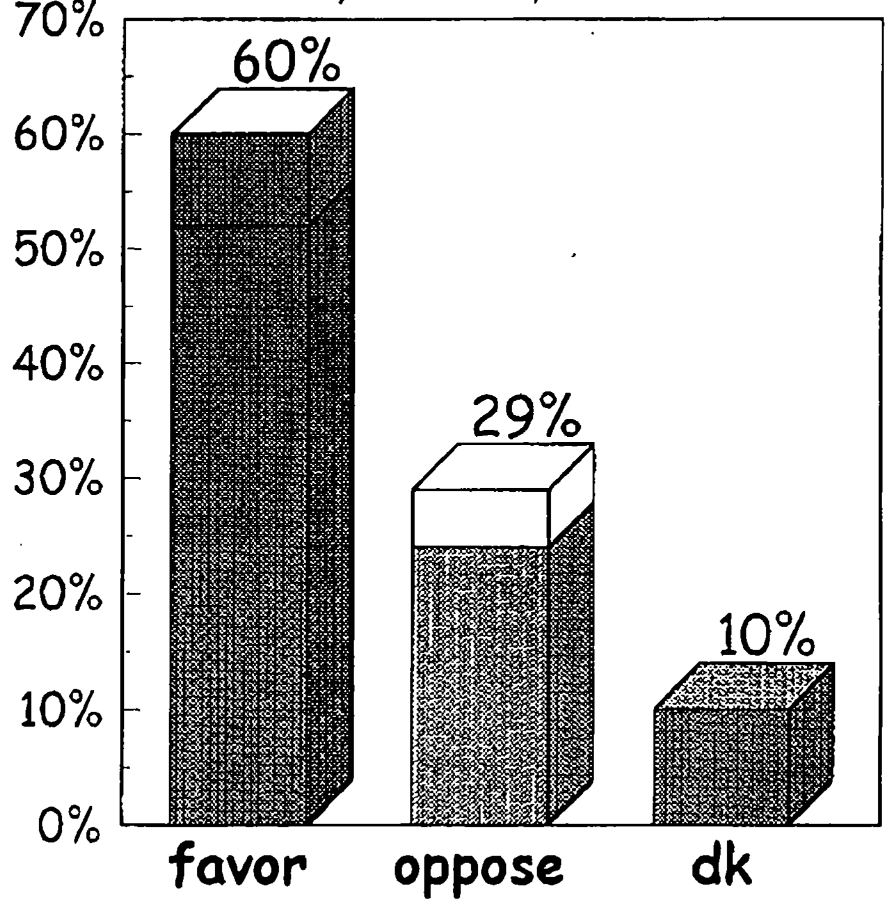
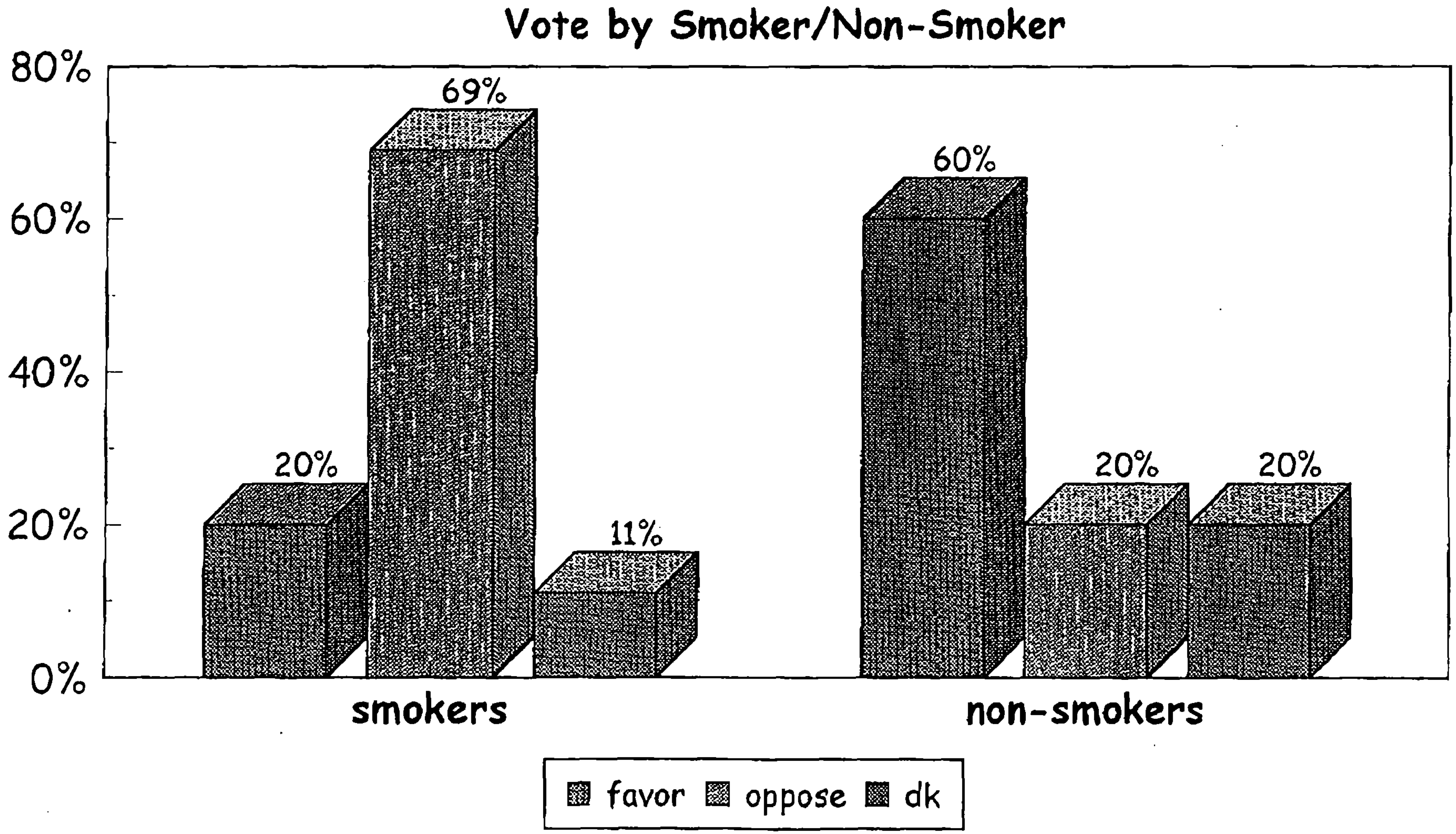


The Mellman Group, Inc. -- Market Strategies, Inc. Oct. 1999

Only Current Smokers Oppose A Cigarette Tax Increase

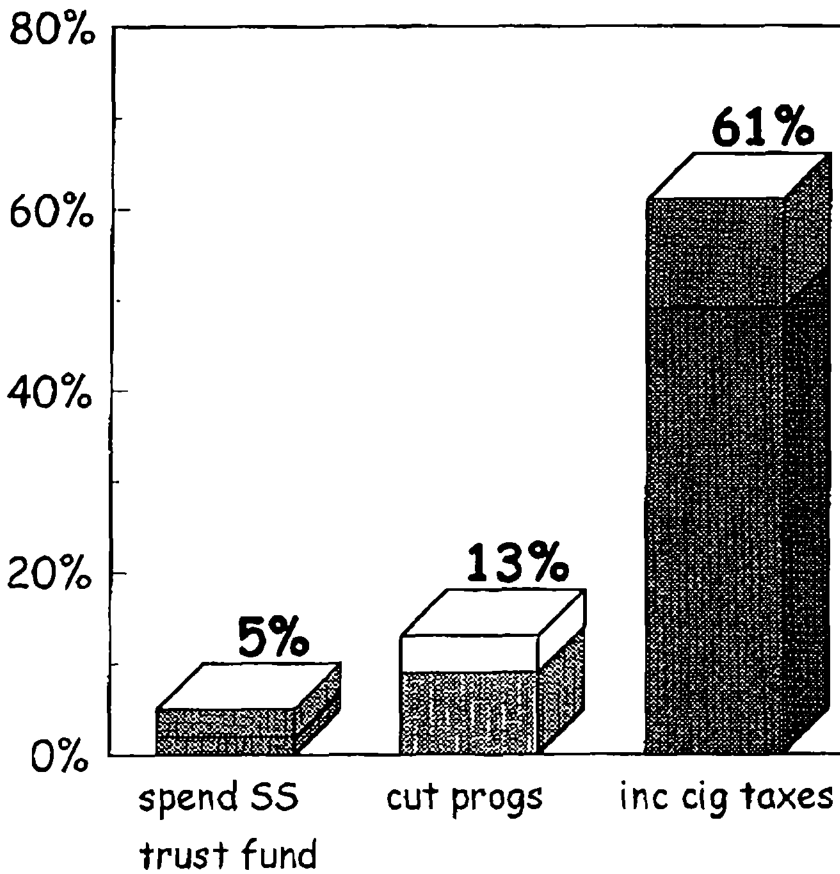


The Mellman Group, Inc. -- Market Strategies, Inc. Oct. 1999

Raising Cigarette Taxes Is By Far The Most Popular Way To Deal With The Budget Impasse

Which would you prefer Congress and the President do in order to balance the federal budget?

w/out price tags



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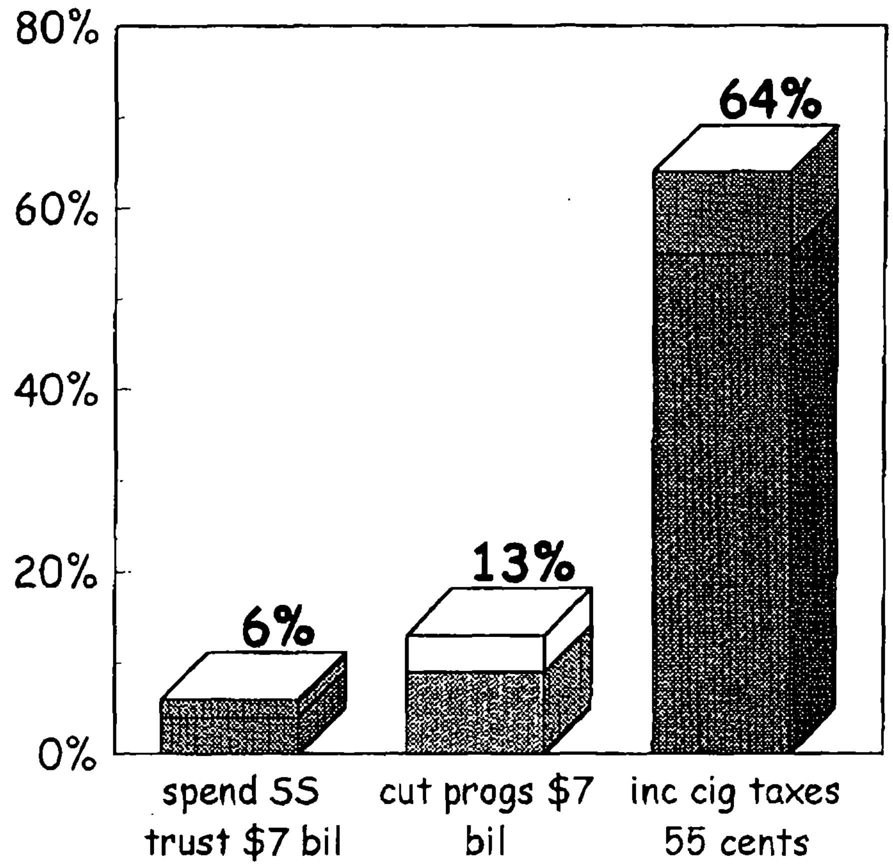
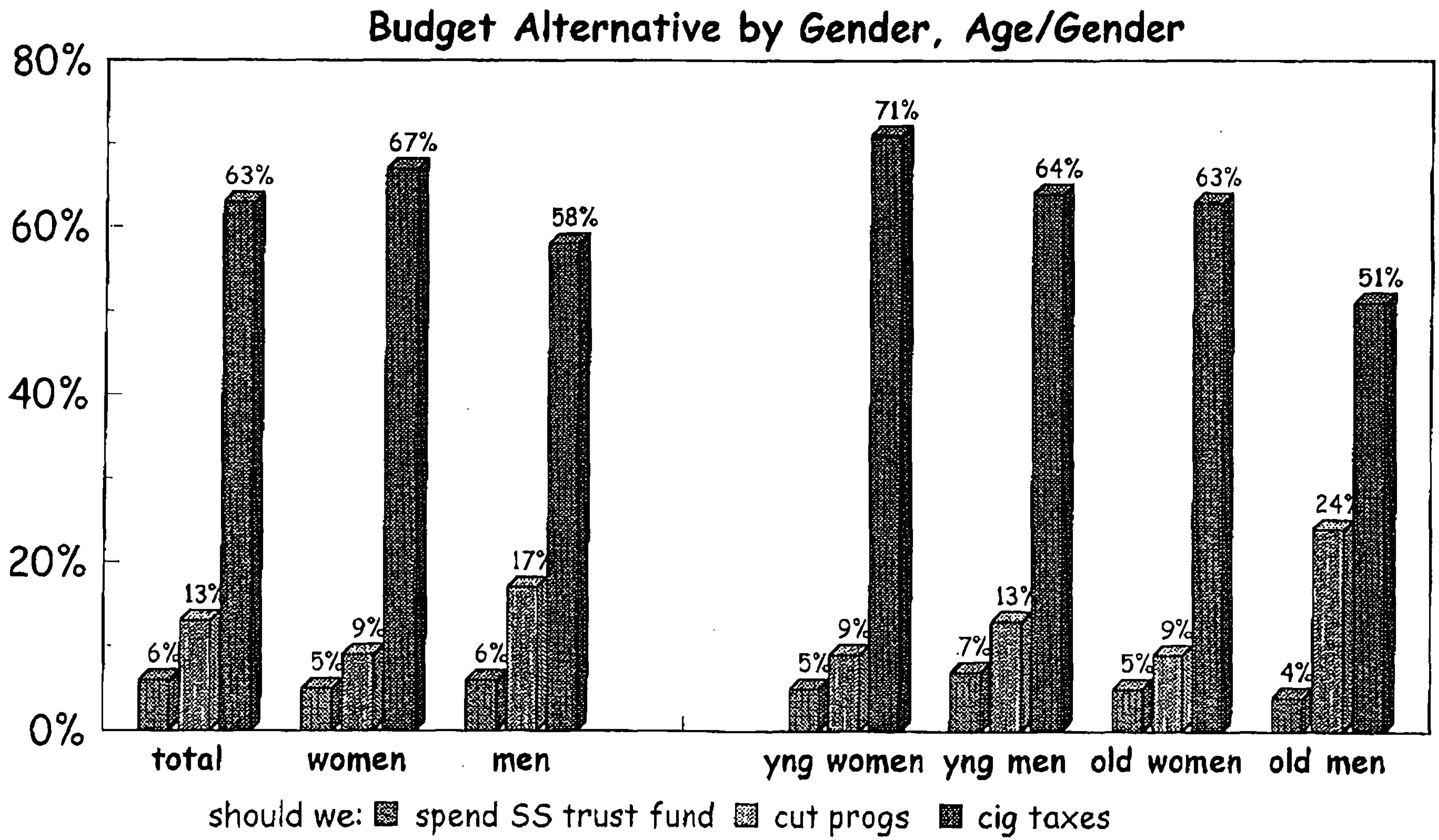


The Mellman Group, Inc. -- Market Strategies, Inc. Oct. 1999

The Strong Preference For Raising Cigarette Taxes Cuts Across Age And Gender Lines



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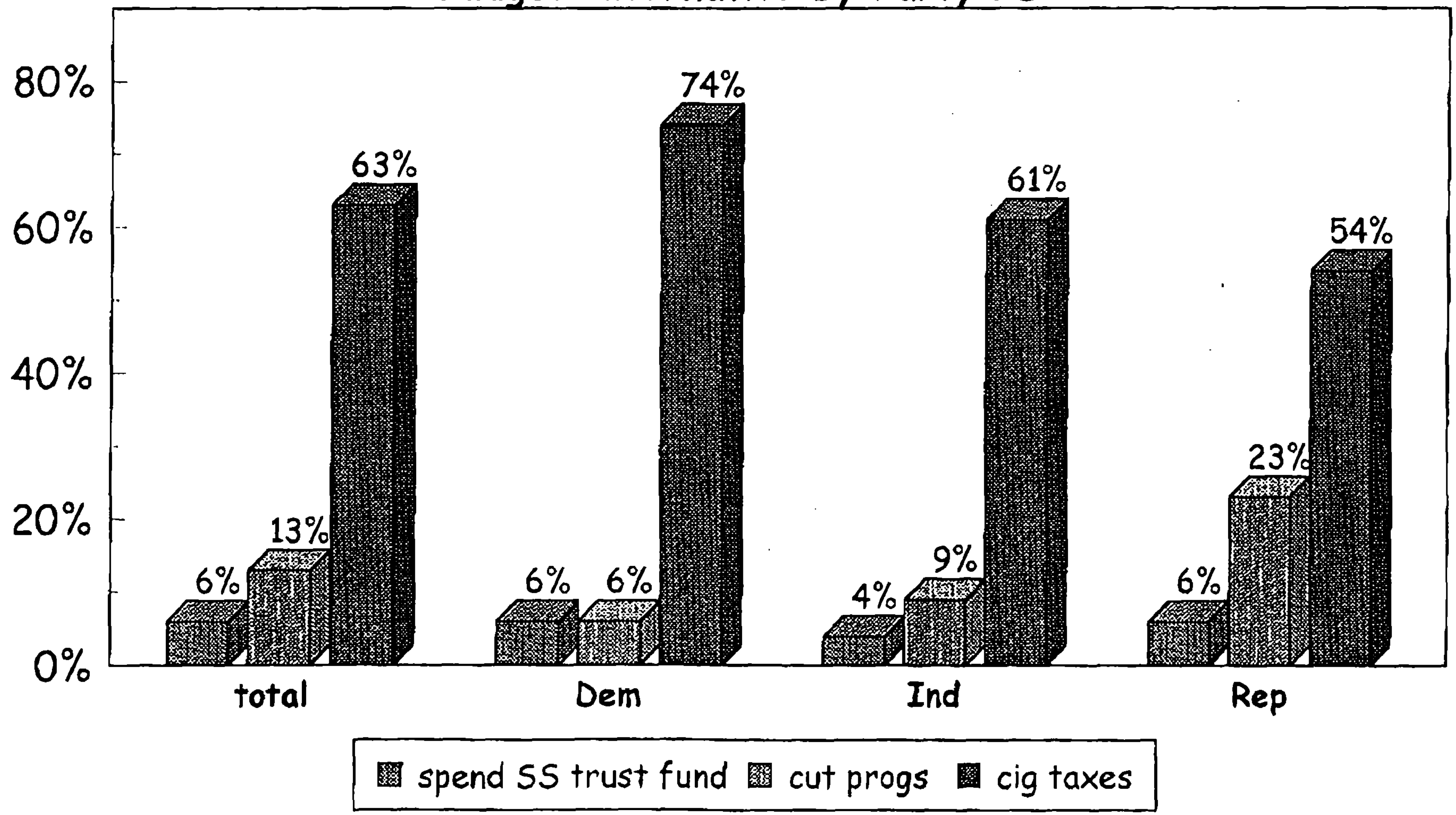
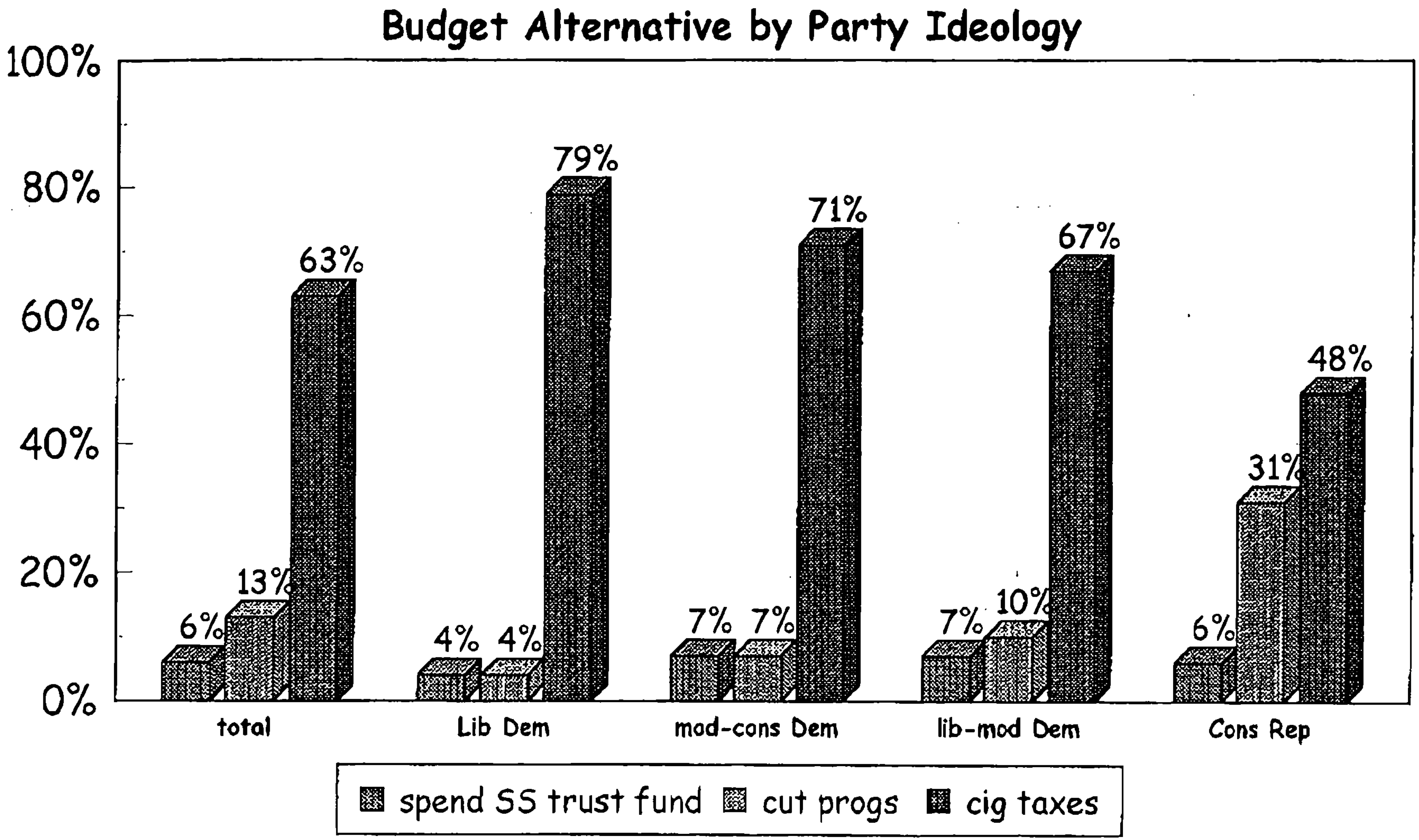
Preference For A Cigarette Tax Increase Cuts Across Party Lines

Budget Alternative by Party ID



The Mellman Group, Inc. -- Market Strategies, Inc. Oct. 1999

Even A Plurality Of Conservative Republicans Favor Raising Cigarette Taxes Over Cutting Spending



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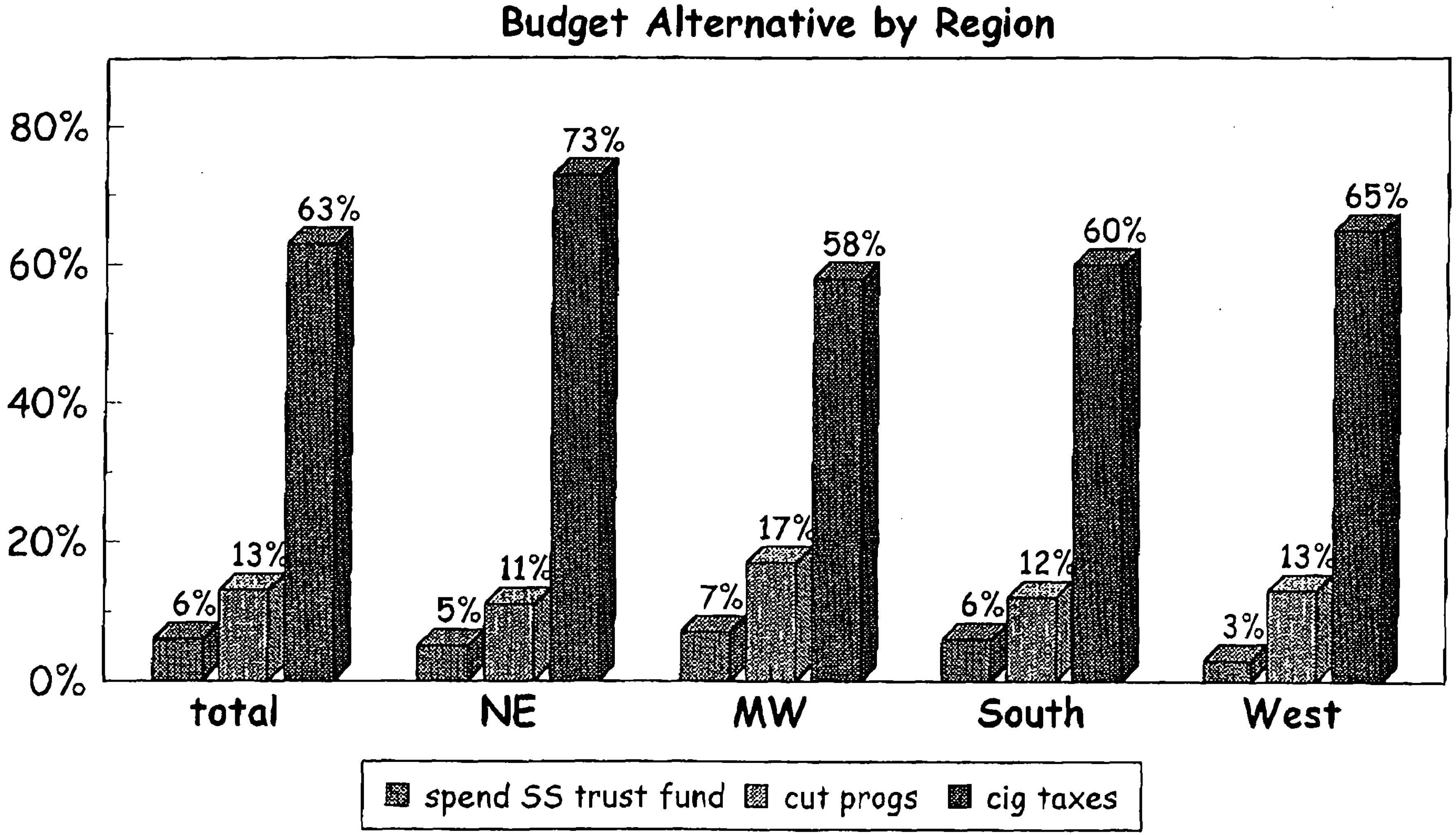
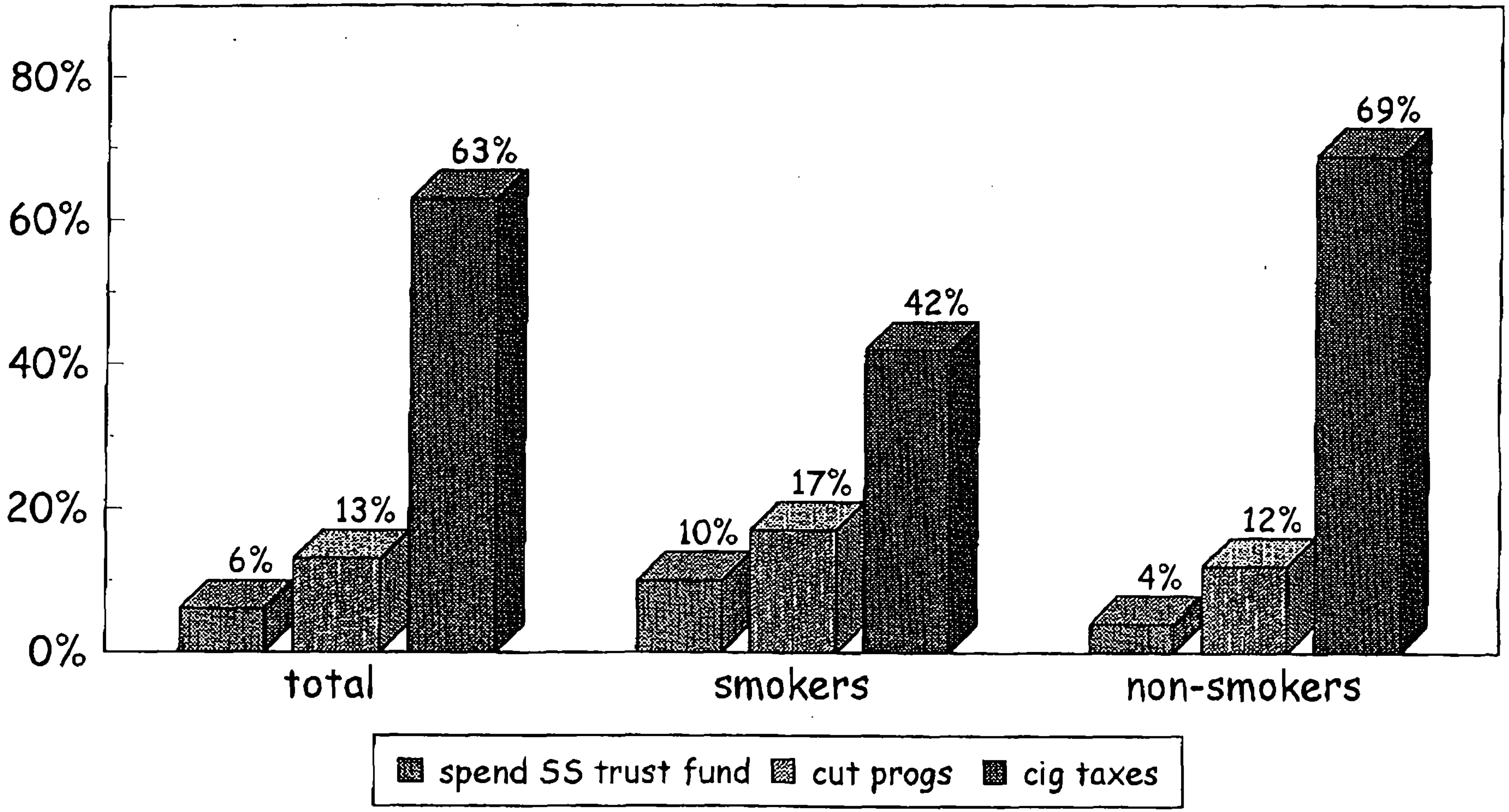
Large Majorities In All Regions Prefer Raising Cigarette Taxes To Other Budget Options



The Mellman Group, Inc. -- Market Strategies, Inc. Oct. 1999

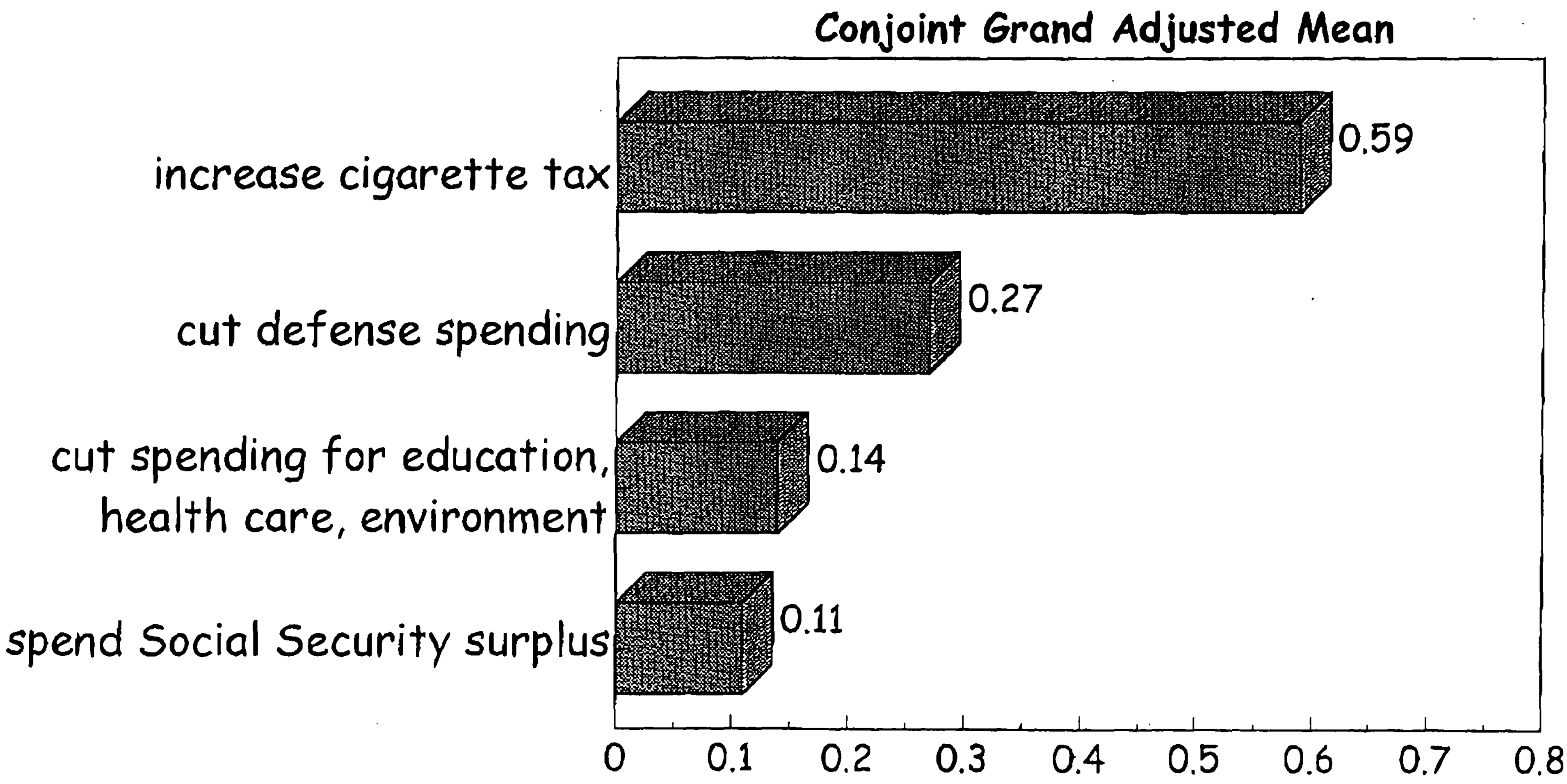
A Plurality Of Smokers Favor Raising Taxes On Cigarettes Over Spending Cuts Or Using The Social Security Trust Fund

Budget Alternative by Smoker/Non-Smoker



The Mellman Group, Inc. -- Market Strategies, Inc. Oct. 1999

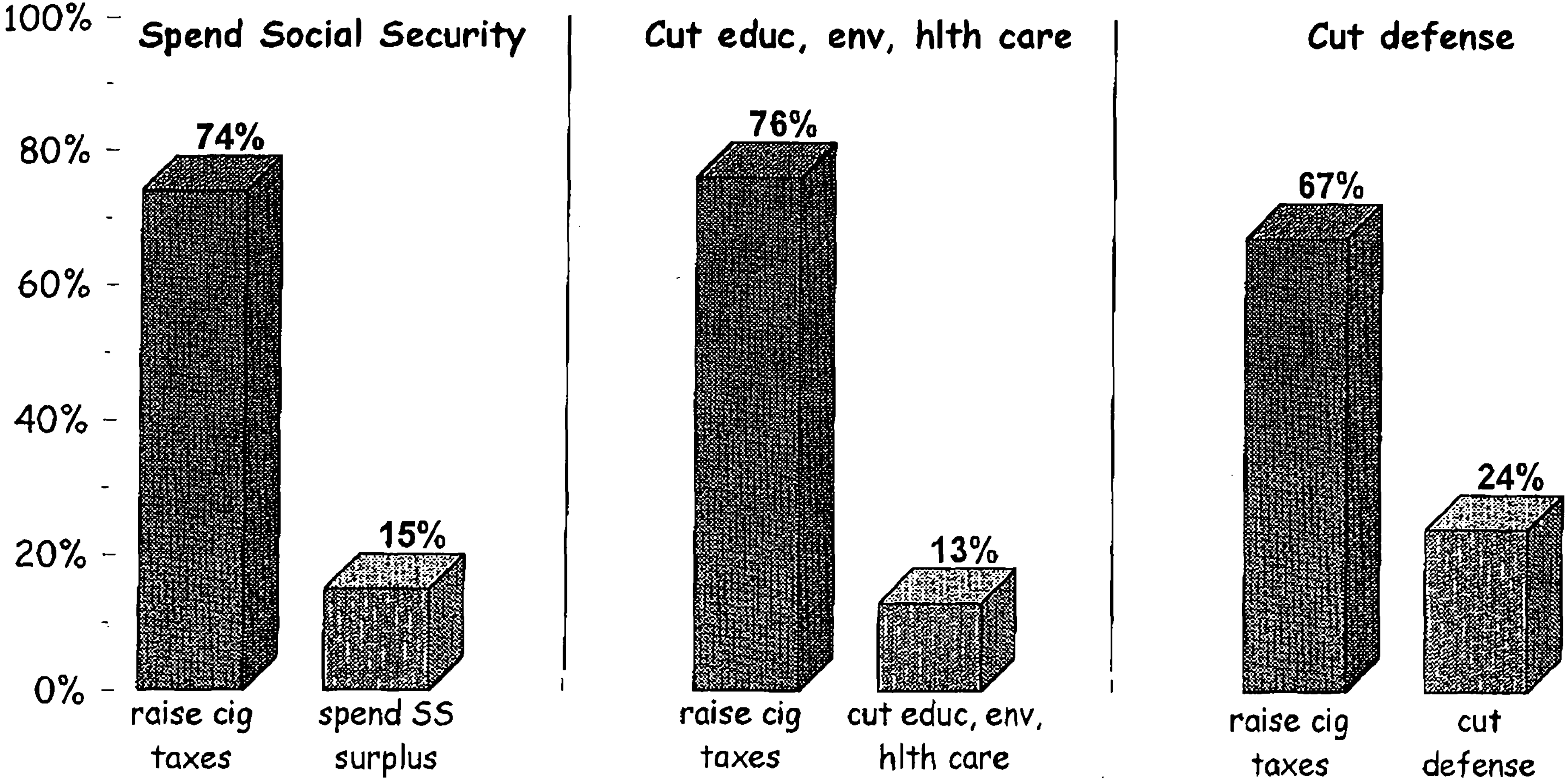
When Preferences Are Traded Off In A Conjoint Analysis, Raising Cigarette Taxes Is By Far The Preferred Alternative



The Mellman Group, Inc. -- Market Strategies, Inc. Oct. 1999

In Trading Off Individual Options, Raising Cigarette Taxes Is The Clear Preference Of The Vast Majority

Should we raise cigarette taxes or...



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This Preference Is Consistent Across All Parts Of The Country

Grand Adjusted Mean

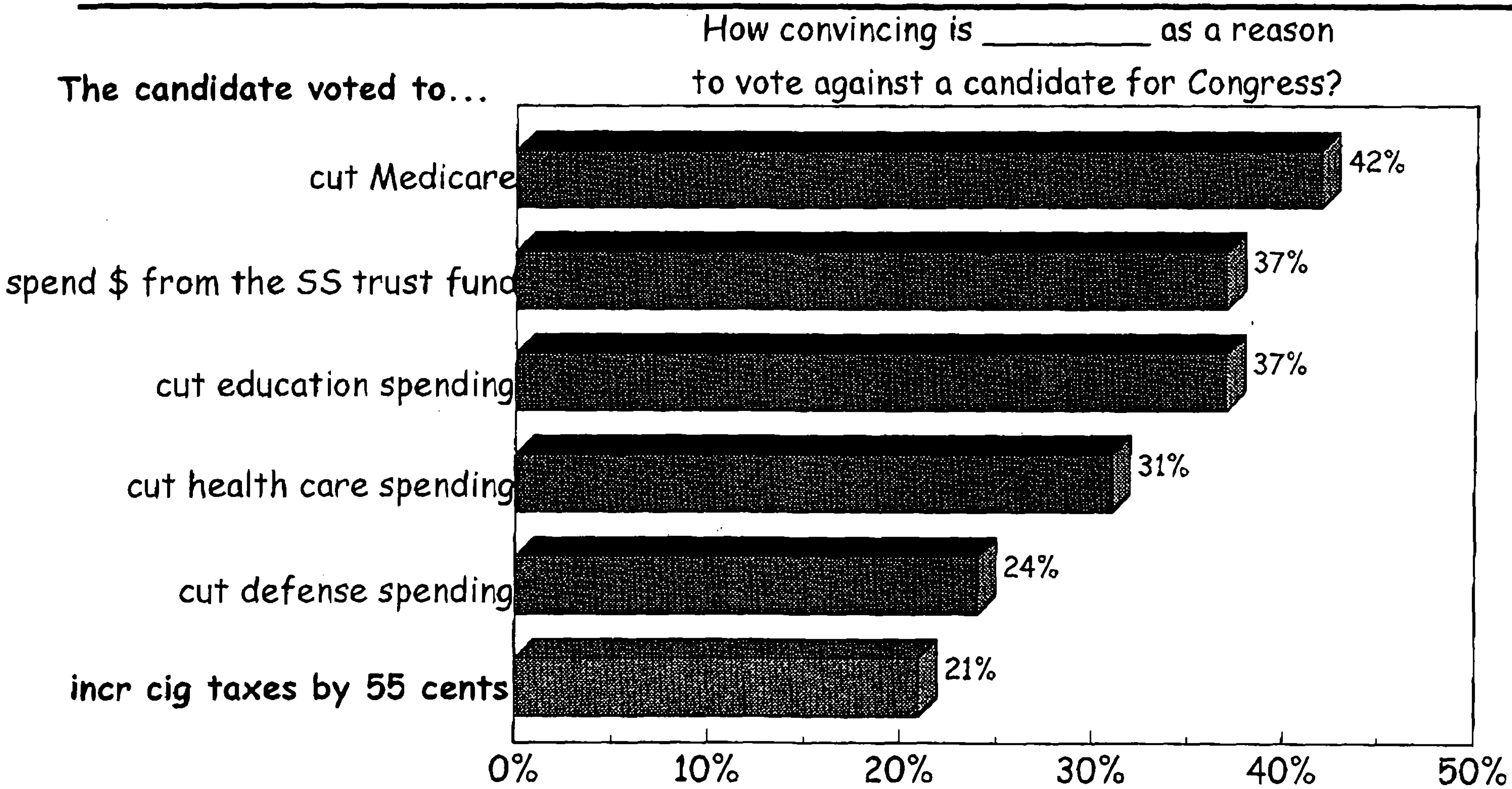
	Total	NE	MW	South	West
increase cigarette tax	.59	.65	.56	.58	.58
cut defense spending	.27	.28	.27	.25	.28
cut spending for education, health care, environment	.14	.14	.14	.14	.15
spend Social Security surplus	.11	.13	.10	.11	.10

When Given The Same Choices, Smokers Too Select An Increase In The Cigarette Tax

Grand Adjusted Mean

	Total	Smoke	No smoke
increase cigarette tax	.59	.37	.65
cut defense spending	.27	.29	.27
cut spending for education, health care, environment	.14	.16	.14
spend Social Security surplus	.11	.16	.10

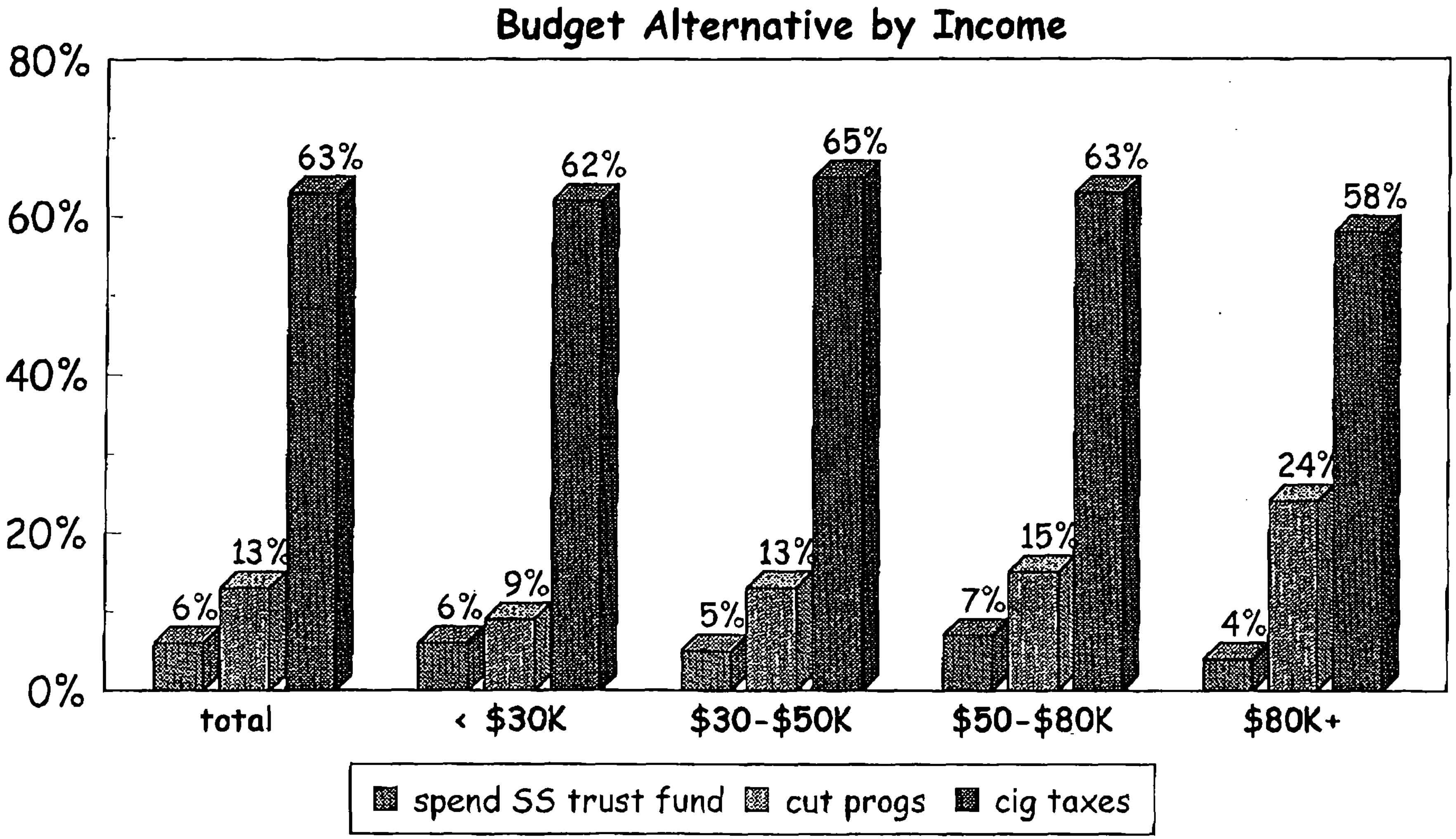
Using The Social Security Trust Fund Or Cutting Domestic Programs Are Much More Compelling Campaign Attacks Than Is Support For Higher Cigarette Taxes



The Mellman Group, Inc. -- Market Strategies, Inc. Oct. 1999

Voters Are Support've Of Rais'ng Cigarette Taxes Regardless Of Income

Lower Income Voters Are Actually Slightly More Supportive Of Raising Cigarette Taxes



The Mellman Group, Inc. -- Market Strategies, Inc. Oct. 1999

While Voters Are Not Anxious To Raise Cigarette Taxes, A Large Majority Support An Increase To Reduce Youth Smoking

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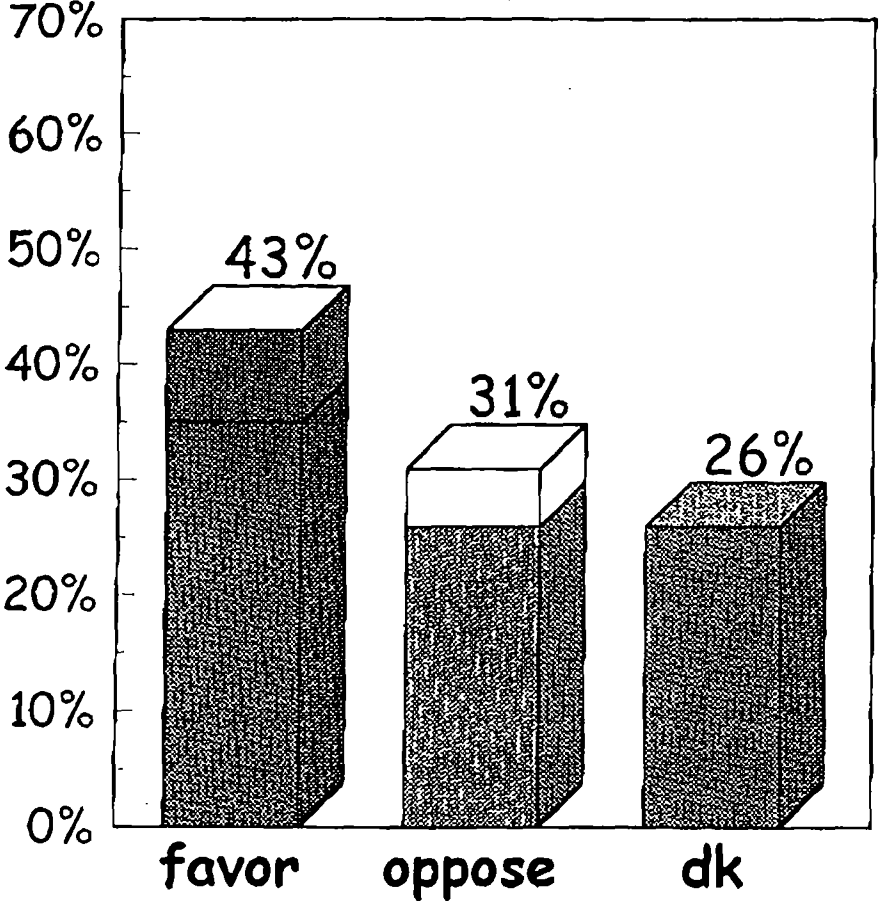
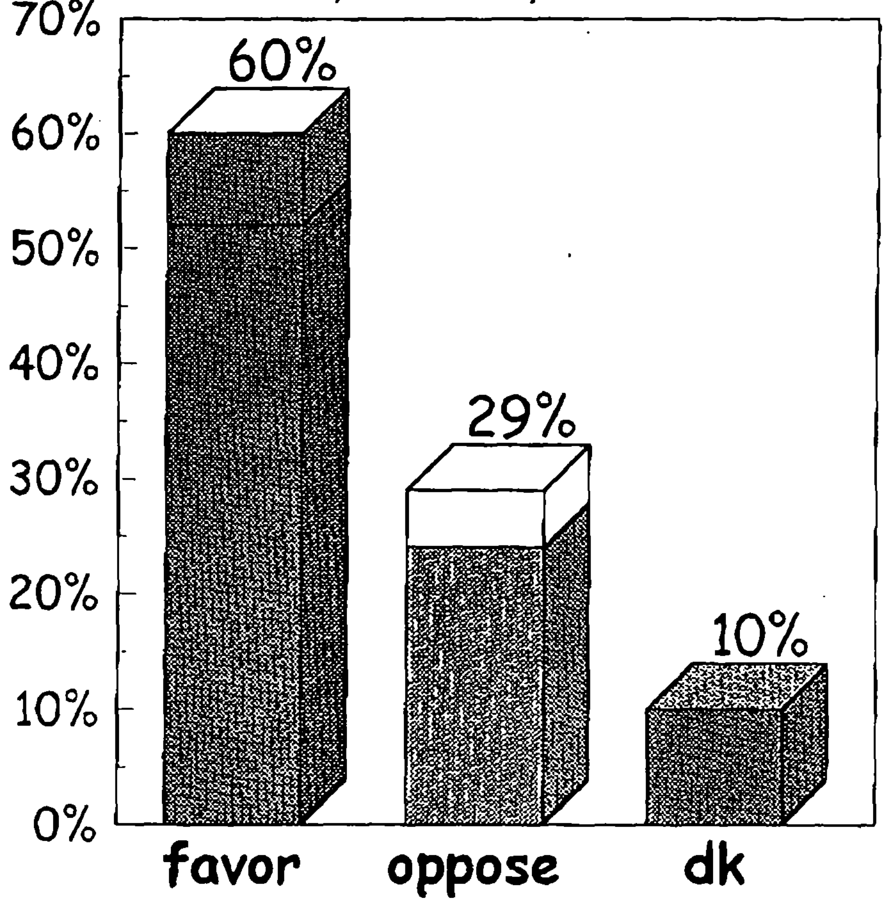


Do you favor or oppose increasing taxes on cigarettes by 55 cents per pack to reduce smoking among kids -- or don't you have an opinion on this?



The Mellman Group, Inc. -- Market Strategies, Inc. Oct. 1999

Tobacco-
Offsets

Tobacco Options

In the coming weeks, we may wish to push Congress to use tobacco offsets to pay for our budget priorities. Below are three basic types of proposals for which we could advocate: 1) the 55 cent excise tax included in our FY 2000 budget, either described as a per-pack price increase or as a per-child smoker levy; 2) an additional per-child smoker assessment; or 3) surcharges such as those included in last year's McCain bill.

Option 1: Push Congress to Enact 55 Cent Tobacco Price Increase

The President's FY 2000 budget proposes to increase the cigarette price per pack by 55 cents, and to accelerate a 15 cent price increase in current law, raising $8 billion in FY 2000 and $34 billion over five years.

The President could make the case that the Congress should abandon its dangerous and risky budget strategy that will squander the surplus and make draconian cuts in critical programs, and instead adopt the fiscally responsible offsets in his budget. The tobacco price increase will reduce youth smoking, and transfer $8 billion from tobacco revenues to programs that will save lives and make Americans healthier. Congress should side with America's families, not the tobacco industry.

We could describe this 55 cent per pack tax as $2,100 per child smoker – i.e., the industry should pay a tax of $2,100 for every underage child who smokes.

Pros: Would reinforce our message of fiscal discipline and emphasize that we've proposed investments in health care and education that can be achieved if Congress has the political will to stand up to the tobacco industry. Our budget fully funds Labor-HHS and other critical priorities using this and other offsets, so why can't Congress?

Cons: Emphasizing the tax gives Republicans another chance to say they're for cutting taxes and we're for increasing them.

Option 2: Additional Per Child Smoker Assessment

The President could propose a per-child smoker assessment on the tobacco industry, in addition to the 55 cent excise tax he's already proposed in his budget. There are many ways this could be structured:

Technical Assistance Options Provided to Harkin

Senator Harkin's staff asked for technical assistance in developing options to raise $4 billion to be used in the Labor-HHS appropriations bill. We provided these:

- A one-time payment of $1,200 per child raises about $4.4 billion in FY 2000, less about $600 million in lost excise tax revenues, for a net revenue effect of $3.8 billion. This payment amounts to 22 cents per pack; because such payments would be nondeductible for the companies, retail prices would go up by 33 cents per pack.

- A one-time payment of $900 per child raises about $3.4 billion in FY 2000, less about $500 million in lost excise tax revenues, for a net effect of $2.9 billion. This translates into 17 cents per pack in payment, and a 26-cent increase in retail prices.

Options Considered for Funding Supplementals

In late July-early August we were considering sending two supplemental requests to Congress, one relative small (about $500 million) and one multi-billion agriculture proposal. The following option was drafted but not used:

Congress would enact a one-time assessment requiring tobacco companies to pay a fixed amount based on the number of underaged smokers. The assessment would take two forms:

- ***Industry-Wide Payment:*** A fixed payment based on our current estimate of the number of underaged smokers, to be assessed on the industry in proportion to each company's overall market share.

- ***Company-Specific Payment:*** Each company would also be assessed a fixed amount based on estimated shares of underage youth smoking *by company brands*. This recognizes that some companies might try to pick up youth share while other companies are reducing theirs.

	Assessment Per Underage Smoker	Total Assessment (millions $)
Company-Specific Assessment	$ 200	$ 800
Industry-Wide Assessment	$ 1,350	$ 5,400
Total	$ 1,550	$ 6,200

The overall payment per underage smoker would be $1,550, which is a Treasury estimate of the lifetime profit from a smoker who becomes addicted by age 18.

New Option

Treasury has developed a new option, which I received tonight from OMB, which would use a per-child smoker payment to provide an on-going incentive to companies. Under this option, companies would pay a per-child amount in FY 2000 based on the 4 million current child smokers. A $1,425 per child payment would raise $5.7 billion in FY 2000. In subsequent years, companies would be assessed based on the number of new underage smokers (estimated to be about 1 million a year), raising about $1.6 billion a year.

Pros of these Options: Raises money in a way that seems distinct from the 55 cent excise tax (though the excise tax, as noted above, can be described in "per-child" terms).

Cons of these Options: 1) Proposing new offsets at this stage undercuts our arguments that all the investments we've proposed are fully funded; 2) Using tobacco revenues to fund new spending programs reinforces the stereotype that we view tobacco as a cash cow, that we want to raise tobacco prices just to spend money, not to reduce youth smoking 3) The Justice Department has preliminary concerns that a one-time assessment could be an unconstitutional "bill of attainder" though this may be addressed by Treasury's new proposal.

Option 3: McCain bill

The McCain tobacco bill endorsed by the President last year contained both industry-wide and company-specific surcharges that companies would have to pay if youth smoking did not decline by 60 percent over 10 years, as follows:

Number of Years after Enactment	Required Percentage Reduction in Youth Smoking	Industry-Wide Surcharge	Company-Specific Surcharge
Years 1 and 2	None	N/A	N/A
Years 3 and 4	15 percent	Surcharges are based on the percentage points by which target is missed: $80 million per percentage point (missed by 1-5 points); $160 million per percentage point (missed by 6-10 points) $240 million per percentage point (missed by 11 points or more). Penalties are capped at $4 billion/year.	$1,000 per teen by which the company misses the youth smoking reduction target. No cap on penalties.
Years 5 and 6	30 percent		
Years 7, 8, 9	50 percent		
Years 10 and thereafter	60 percent		

For example, if by year five youth smoking had only declined by 20 percent, the industry would have to pay (80 x 5) + (160 x 5) or $1.2 billion (companies would pay a share based on their share of the overall cigarette market). In addition, any company who missed the youth smoking targets would have to pay an additional $1,000 per child for every young person smoking one of its brands of cigarettes.

Pros: 1) Tying the surcharges to youth smoking reduction goals will provide companies with more of an incentive to reduce youth smoking; 2) Provides multi-year funding, unlike most of the per-child options above; 3) This structure has been reviewed favorably by the Justice Department's constitutional lawyers.

Cons: 1) Strong industry opposition (more than to excise tax); 2) Liberal Democrats would want higher surcharges (Durbin amended the McCain bill to increase company-specific surcharges).

Tobacco - options

Cynthia A. Rice 09/08/99 03:47:46 PM

Record Type: Non-Record

To: Bruce N. Reed/OPD/EOP@EOP, Eric P. Liu/OPD/EOP@EOP

cc: J. Eric Gould/OPD/EOP@EOP
Subject: Latest Harkin tobacco plan

Spoke to Peter Reinecke. Here's the update:

Timing: Labor-HHS Senate appropriations markup may be as soon as next Tuesday. However, it has as you know been postponed many times, and it may be again.

The Harkin Proposal: The bill sets a target of reducing youth smoking by 15 percent between 1999 and 2000. If overall, youth smoking declines by 5 percent or less, the industry will pay an $8 billion penalty in FY 2000; by 6-10 percent, a $6 billion penalty; or by 11-15 percent, a $4 billion penalty. The penalty will be paid by the companies based on youth market share (making it a company-specific penalty), but companies that meet the 15 percent target will not have to pay. (Peter thinks a company-specific proposal will get more member support because it makes clear we're holding the companies accountable.) The penalty would be non-deductible. The proposal is at CBO for scoring, and Peter expects to hear back shortly.

0-5% $8B
6-10 $6B
11-15 $4B

Our Proposal: This is different from ours mainly because it is 1) company-specific 2) uses a youth smoking target, and varies the penalty by degree to which the target is missed; and 3) it only raises funds in FY 2000.

I did not outline our proposal for Peter -- didn't think we were ready for that. They do not have information on our draft proposal (OMB had given Harkin's folks, at their earlier request, the legislative language for the budget excise tax proposals already in our budget and, we of course, gave Harkin earlier technical assistance).

Next Steps: What do you think? Generally, I think it's clever, and if it gets a favorable reception we might want to adopt it except I think we should make it completely an industry wide penalty. There are a number of technical problems that need to be fixed (see below) -- Peter didn't ask for technical assistance (his main goal is ensuring CBO will score him savings), but we may want to give him some. He said it was OK to share with OMB but not HHS (actually, HHS has gotten wind of this because CBO called them to get technical information about the tobacco surveys.) I'll update OMB.

Technical Issues: In concept, they've crafted this in a way that recognizes that we won't have good brand-specific youth smoking data until FY 2000 (because the progress toward the 15 percent target is based on youth smoking regardless of brand, which we have for both FY 1999 and FY 2000, and then the FY 2000 penalty is divided by youth market share). However, the proposal uses the University of Michigan study, which doesn't have good brand specific data (it should use the SAMSHA survey instead I think). Also, the language uses the word "penalty" rather than "surcharge" as prefered by DOJ and it seems to have some unusual judicial review provisions (determination is made by HHS Secretary but any action filed by manufaturer is reviewed by AG and then -- this last part is normal -- can be appealed to the DC Circuit of the U.S. Court of Appeals (only on "arbitrary and capricious" standard which is good for us)). None of this matters if the proposal doesn't go anywhere, except it makes it harder for use to defend against the predictable criticism if we can't say "Justice Department says it's constitutional" and "HHS

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Prw Tax

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$6B

$2B

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Years 10 and thereafter	60 percent	$80 million per percentage point (missed by 1-5 points); $160 million per percentage point (missed by 6-10 points) $240 million per percentage point (missed by 11 points or more). Penalties are capped at $4 billion/year.	No cap on penalties.

For example, if by year five youth smoking had only declined by 20 percent, the industry would have to pay (80 x 5) + (160 x 5) or $1.2 billion (companies would pay a share based on their share of the overall cigarette market). In addition, any company who missed the youth smoking targets would have to pay an additional $1,000 per child for every young person smoking one of its brands of cigarettes.

Pros: 1) Tying the surcharges to youth smoking reduction goals will provide companies with more of an incentive to reduce youth smoking; 2) Provides multi-year funding, unlike most of the per-child options above; 3) This structure has been reviewed favorably by the Justice Department's constitutional lawyers.

Cons: 1) Strong industry opposition (more than to excise tax); 2) Liberal Democrats would want higher surcharges (Durbin amended the McCain bill to increase company-specific surcharges).

Providing On-Going Incentives to Reduce Underage Smoking

Proposal

- To give tobacco companies immediate and on-going incentives to reduce teen smoking, they would be penalized in FY2000 for the existing *stock* of teen smokers, and then would be penalized in subsequent years for the annual net *flow* of new teen smokers.

- The penalty per kid would be based on the present discounted value of future profits that a tobacco company would make as teen smokers go on to become adult smokers – which was estimated at $1,350 in 1998. To maintain the per-kid penalty in real terms over time it would be indexed to the CPI, so its nominal level would be about $1,425 in FY2000. [OMB has suggested updating the PDV estimate annually based on new profit data, but Treasury has concerns about defending changes in the estimate.]

- Teen smokers would be defined as those under 18 who report having smoked in the past month. Due to uncertainties about estimating teen market shares for each company, the penalty would be allocated according to total market share (it would be an "industry" penalty) and thus would likely be passed on to prices. It would also be non-deductible.

- The proposal would work as follows. If there are 4 million teen smokers in FY2000, then the total penalty payment would be $5.7 billion. The number of new teen smokers in FY2001 would be calculated by (a) subtracting from the FY2000 number those who are 17 and thus become legal smokers in FY2001, and then (b) subtracting the remainder from the total number of teen smokers in FY2001.

  -- Thus, if there are 1 million 17-year old smokers in FY2000, then the number of " carry-over" teen smokers would be 3 million. If there are 5 million teen smokers in FY2001, then the number of new teen smokers in FY2001 would be 2 million.

Analysis

- Since about one-fourth of underage smokers are 17 year olds, the number of new teen smokers in FY2001 would indeed be the total number of teen smokers in FY2001 minus about 3 million.

- In equilibrium, our model indicates that there will continue to be about 4 million under-age smokers in any given year under this proposal. Thus, the net number of new teen smokers every year will be approximately one million, and annual penalty payments would average about $1.6 billion in nominal terms through 2009.

- It is worth noting that these figures for the *net* number of new teen smokers in a given year reflect both the number of underage teen smokers who did not smoke in the prior year AND the number of underage teens who smoked in the prior year but have stopped. Companies are thus given "credit" if underage smokers stop smoking before they turn 18 (just as the PDV calculations took into account the fact that all teen smokers do not go on to become adult smokers). This reflects the view that it is just as worthwhile to stop a kid who has already started smoking as it is to keep one from starting – as well as metho-dological issues that arise in determining whether a given teen smoked in the prior year.

- The relatively constant number of teen smokers that is projected reflects the offsetting effects of (a) higher real prices as these industry penalties are fully passed through to price – about 13 cents per pack on average, if the payments are non-deductible – which lower the teen smoking rate, and (b) the increasing teen population over time.
  - -- As in previous analyses, we would expect the effects of lumpy payments on prices to be smoothed.

- Higher cigarette prices would also have offsetting effects on federal cigarette excise tax revenues and possibly on other revenues, but these have not been estimated here.

Implementation Options

- HHS has begun administering a new and more detailed survey on teen smoking that is expected to generate more precise estimates than have been available in the past, but concerns exist about whether its statistical properties will be sufficiently defensible to serve as a basis for penalty payments – at least in FY2000.

- Two options thus exist for how to implement this proposal. One would treat the FY2000 penalty as fixed, with annual payments in following years determined by the actual number of new teen smokers based on the improved survey. This would provide certain revenue in the first year and on-going incentives to reduce teen smoking thereafter, but could be criticized as a "taking" (whose effects on cigarette prices are less certain).

- A second option would require the $5.7 billion payment in FY2000, based on the initial estimates, but to correct any errors in the subsequent year.
  - -- For example, if the true total number of teen smokers in FY2000 (and subsequent years) was not 4 million but 3 million, then this methodology would result in no penalty payments in FY2001; regular payments would resume in FY2002. If instead the true total number was 5 million every year, then the payment in FY2001 would be nearly $3 billion (since there would be about 2 million "penalty teens"), and then would settle down thereafter.

- The second option maintains the link between teen smoking and penalty payments throughout, and thus may be more defensible on policy grounds, but could generate a hiccup in FY2001 if the initial estimates are off and may raise scoring questions at CBO.