Tobacco

Tobacco

CONRAD BRIEFING

Conrad - could work w/
McClain
Connie Mack

Nichols
- no tax
or
to tax cut

Medicare

Don't be excessively supportive

Turk / Robb

Durbin

$568 billion

Meets my test

Fazio on hse.

Waxman on hse.

Senate Democratic Task Force Tobacco Legislation

Democratic Caucus Review
2/10/98

The HEALTHY Kids Act

Responsible Tobacco Policy

- Protects Children
- Promotes the Public Health
- Helps Tobacco Farmers
- Resolves Federal, State and Local Legal Claims
- Invests in Children and Health Care
- Savings for Social Security and Medicare
- Reimburses Taxpayers

The HEALTHY Kids Act

Protects Children

1. A Healthy Price Increase
   - $1.50/pack health fee (phased in over three years)
2. Full FDA Authority
3. Strong Look-back Penalties
   - targets 2/3 reduction in youth smoking
   - penalties of 10 cents/pack on industry, 40 cents/pack on companies
4. Comprehensive Anti-tobacco Programs
   - counter-advertising, prevention, cessation, research
5. Retailer Compliance
   - State licensure
   - No sales to minors

The HEALTHY Kids Act
Promotes the Public Health

1. Second Hand Smoke
   - covers most public facilities
   - exempts bars, casinos, bingo parlors, hotel guest rooms, non-fast food small restaurants, prisons, tobacco shops, and private clubs
   - no state or local pre-emption
2. Document Disclosure
   - all relevant documents go to FDA
   - FDA makes public all documents
   - public health interest over-rides trade secret or attorney client privileges
3. International Tobacco Marketing Controls
   - no promotion of US tobacco exports
   - code of conduct: no marketing to foreign children
   - funds international tobacco control efforts
   - requires warning labels

The HEALTHY Kids Act

Helps Tobacco Farmers

1. Provides $10 billion over five years for assistance to farmers and their communities
2. Authorizes funding for--
   - Transition payments to farmers and quota holders
   - Rural and community economic development
   - Retraining for tobacco factory workers and tobacco farmers
   - College scholarships for farm families

The HEALTHY Kids Act

No Immunity

1. No special protection for future misconduct
2. No special protection against individuals' lawsuits for past misconduct
3. Resolves Federal, State and Local legal claims
   - States can opt-out of money and continue lawsuits
   - Cities and counties get a fair share of reimbursement
4. Attorney's Fees
   - Resolved by arbitration panel using ABA guidelines

The HEALTHY Kids Act

Invests in Children and Health, Savings for Social Security and Medicare, Reimburses Taxpayers

1. Payments to States (~~38~~%) 41.5%
   - unrestricted (~~15~~%) 14.5%
   - children's health care, child care, education (~~23~~%) 27%
2. Anti-tobacco Programs (~~17~~%) 15.5%
3. NIH Research (~~22~~%) 21%
4. Medicare (4% initially; grows to 10~~[illegible]~~%)
5. Social Security (6% initially; grows to 12~~[illegible]~~%)
6. Farmers (~~[illegible]~~% for first ten years, then phases out) 12%

Comparison of Tobacco Revenue and Spending

President's Budget and Healthy Kids Act

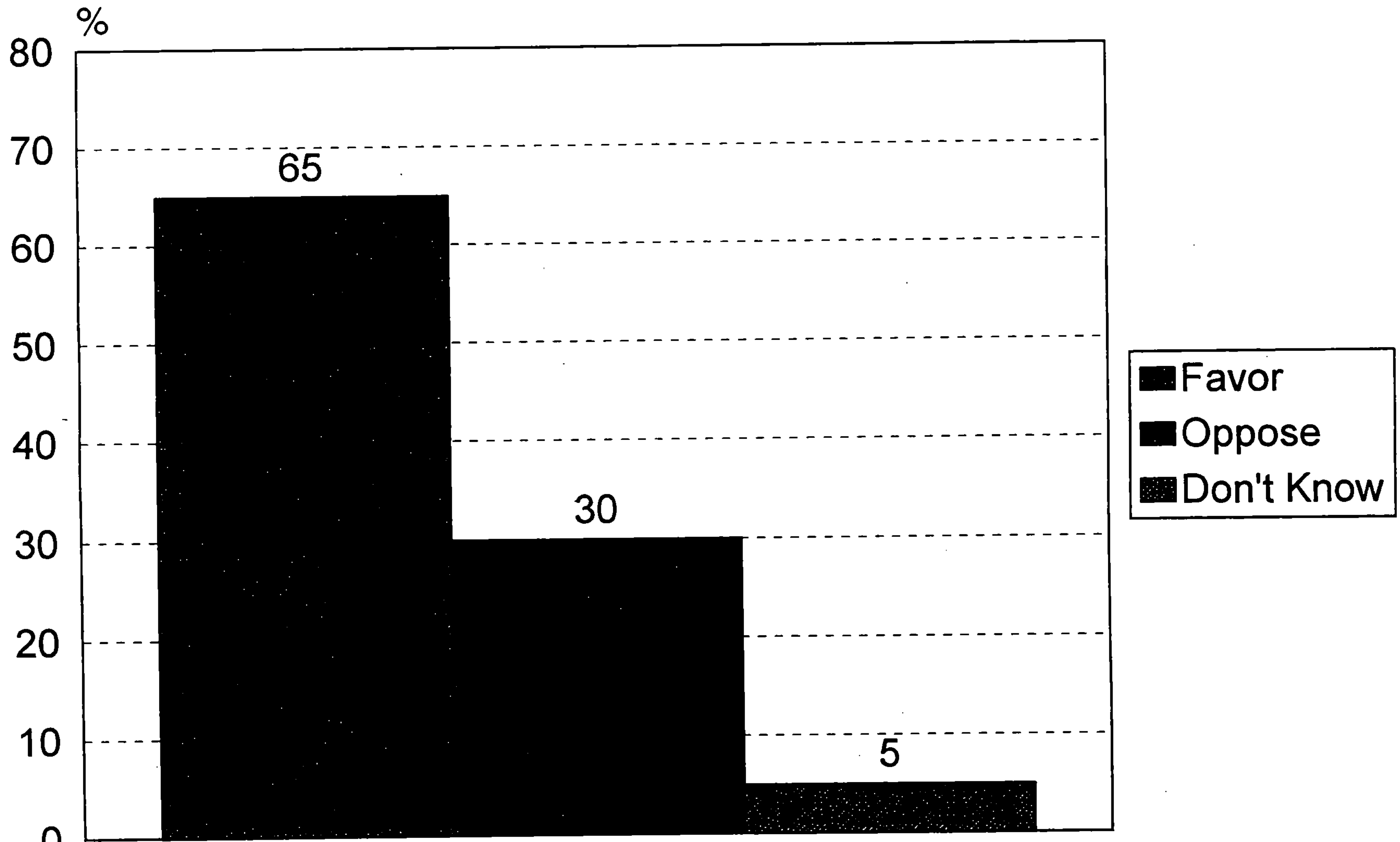
	Healthy Kids Act	President's Budget
Total Revenue (over five years)	about $~~78~~ 82 billion (estimate pending)	$65.5 billion
States -- unrestricted	$12 billion	$11.8 billion
States -- for child care, (14B) education, (5B), health insurance (3B)	$~~18~~ 22 billion	$15.7 billion
Research	$17 billion for NIH research	$25.3 billion ($17 B for NIH; $8 B for non-health)
Medicare	$3 billion	$0.8 billion
Farmers Anti-tobacco	$10 billion $13 billion	$12.1 billion for both
Savings for Social Security	$5 billion	0

Five Year Projections

Polling Data Shows High Level of Support for:

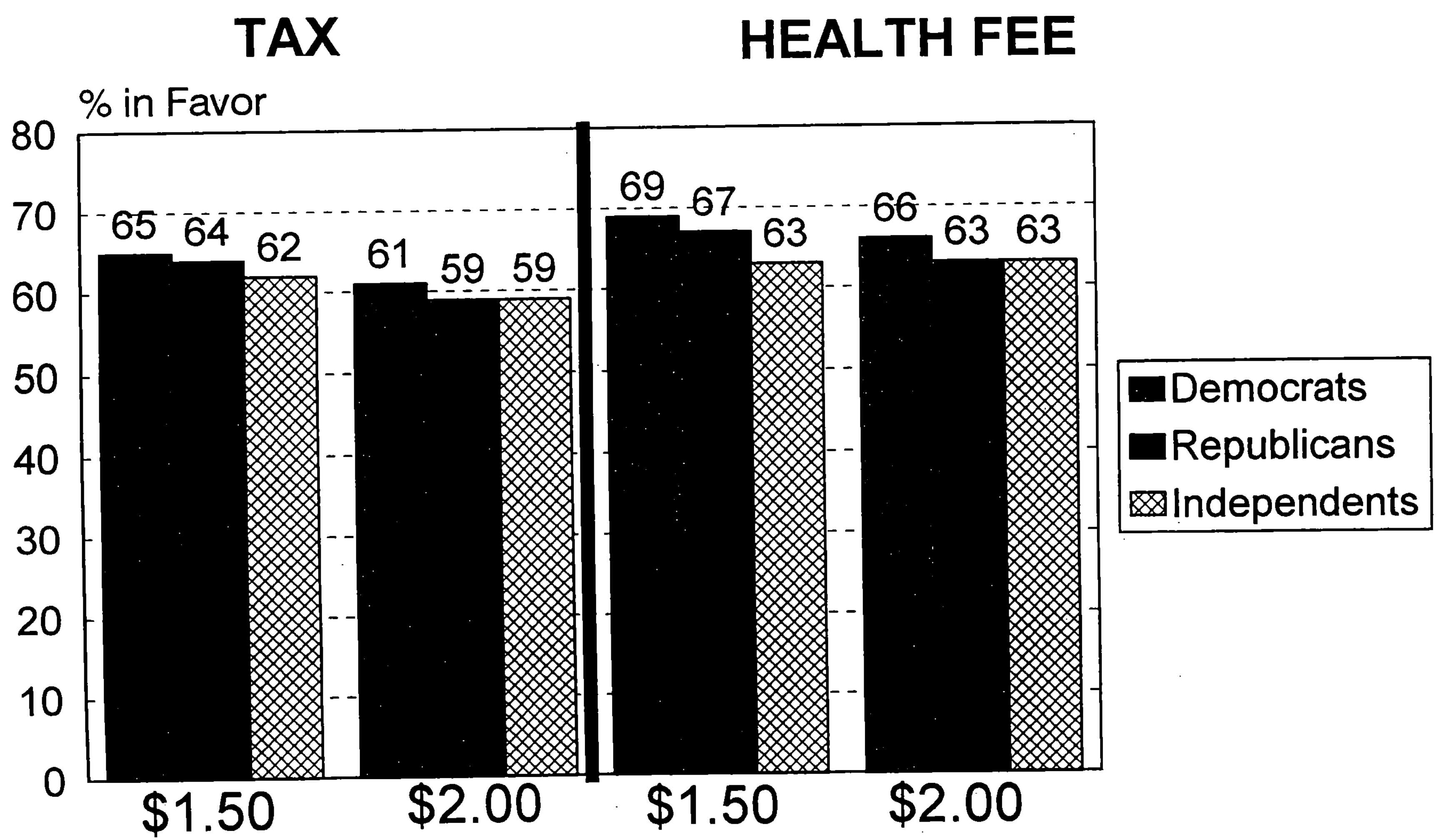
- Significant Per Pack Price Increase
- Strong Lookback Penalties
- No Industry Special Protections

Voters Support a $1.50 Health Fee for Youth Smoking Deterrence & Health Programs by a 2-1 Margin



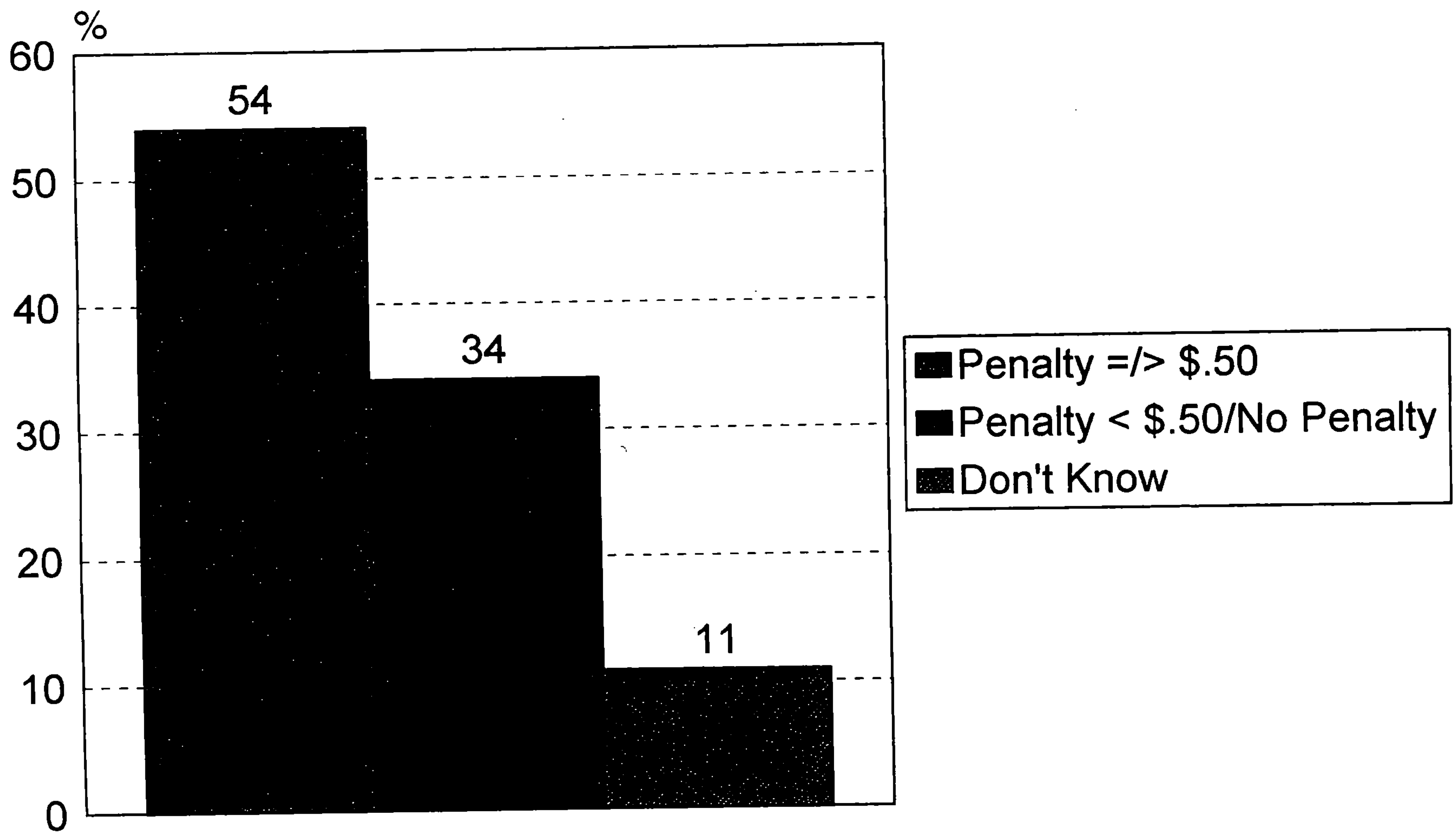
Source: Lake, Sosin, Snell, Perry Assoc. Survey, 1/98

Price Increase Support for Youth Smoking Deterrence and Health Programs Cuts Across Party Lines



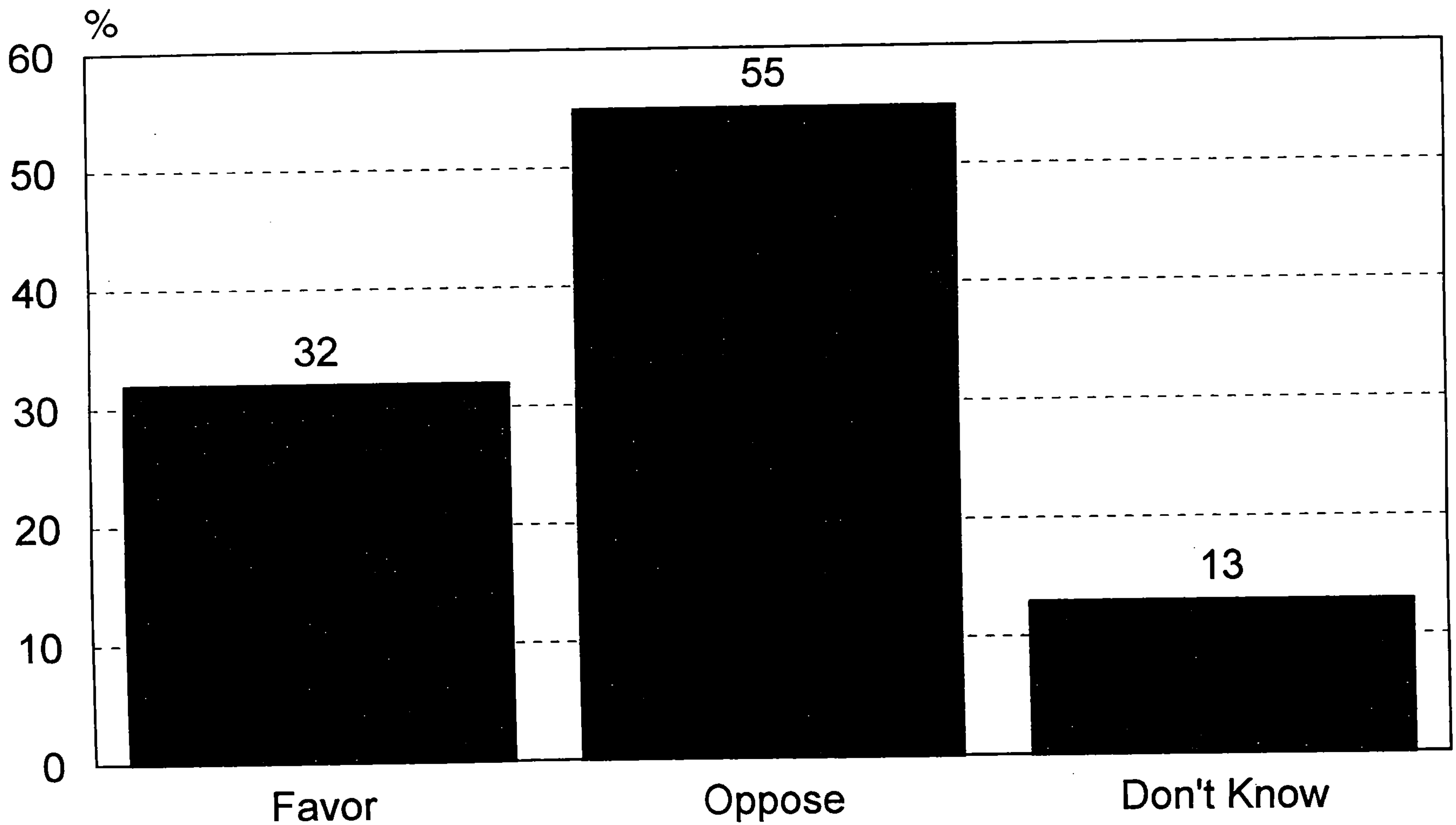
Source: Lake, Sosin, Snell, Perry Assoc. Survey, 1/98

Strong Support for Lookback Penalty of $.50 or More



Source: Lake, Sosin, Snell, Perry Assoc. Survey, 1/98

Voters Are Opposed to Providing Specia Protections to the Tobacco Industry



Source: Lake, Sosin, Snell, Perry Assoc. Survey, 1/98

HEALTHY Kids Act Accomplishes President Clinton's Objectives

President Clinton's Tobacco Principles	HEALTHY Kids Act
Reduce Teen Smoking Including Tough Penalties	X
Full FDA Authority	X
Change Industry Culture	X
Meet Additional Health Goals	X
Protect Tobacco Farmers and Communities	X

USA TODAY · THURSDAY, FEBRUARY 12, 1998

Lewis' lawyer calls grand jury 'an ordeal'

Lewinsky's mother will have to return for more testimony

By Judy Keen and Kevin Johnson USA TODAY

WASHINGTON — Marcia Lewis' lengthy grand jury appearance, nearly seven hours over two days, may just be a preview of the inquiry that awaits her daughter.

Whitewater independent counsel Kenneth Starr and his staff "are going to break my client down a piece at a time," attorney William Ginsburg told USA TODAY, referring to Lewis' daughter, former White House intern Monica Lewinsky.

"I would describe it as abuse," he said.

Starr is investigating whether President Clinton had an affair with Lewinsky and tried to cover it up. Clinton has denied the allegations.

Lewinsky was expected to go before the grand jury as early as today, but Ginsburg said his client never had a firm date on which to appear. He said she would testify "sometime in the next two weeks."

Lewis, her lower lip trembling, departed the courthouse Wednesday without comment on the arm of attorney Billy Martin and trailing a wedge of U.S. marshals. It was a starkly different image of a woman who the day before appeared upbeat and poised after her initial appearance.

When the grand jury session ended, a nurse and wheelchair were sent to the third floor where the panel met. But Martin said his client was not ill. "This is an ordeal that nobody should have to go through," he said.

Lewis' ordeal, however, is not yet over.

Martin said his client would have to return as early as today to complete her testimony.

Ginsburg's legal team, meanwhile, has filed court actions demanding that Lewinsky's grand jury summons be quashed. Separately, Ginsburg is seeking enforcement of what he says is an agreement providing his client with full immunity from prosecution in exchange for her testimony.

Starr has denied any such deal was reached.

In other related developments:

▶ Young & Rubicam, a New York holding company, has received a subpoena from the Starr grand jury seeking all documents relating to its contacts with Lewinsky and Vernon Jordan, a close friend of the president, according to people with knowledge of the subpoena.

Jordan contacted Young & Rubicam's chairman, Peter Georgescu, in an effort last December help Lewinsky find a job.

Starr is exploring whether Jordan, an influential Washington lawyer, assisted Lewinsky as part of a scheme to keep her quiet about an alleged affair with Clinton.

Jordan denies any such effort.

According to the people with knowledge of the subpoena, Young & Rubicam officials have not been directed to testify.

However, the company, which controls the giant advertising firm of the same name, was ordered to turn over any records shedding light on the Lewinsky matter. Lewinsky was interviewed twice by executives at a Young & Rubicam subsidiary but was not hired.

The subpoena was issued about two weeks ago, but its existence did not become known until Wednesday. Philippe Krakowsky, a spokesman for Young & Rubicam, said the company doesn't "comment on personnel matters."

▶ Hillary Rodham Clinton reasserted her support for her husband Wednesday, saying the allegations have no foundation.

"So I just advise everybody to just take a deep breath and watch this develop," she said.

▶ Clinton was spared questions about Lewinsky when business leaders visiting the White House drowned out reporters with applause for him.

"I'll take their questions, go ahead," Clinton said when reporters tried to ask him about Lewinsky and Iraq. As reporters asked questions, the cheering got louder and continued until Clinton left the room.

The executives, attending an awards ceremony, said the applause was spontaneous.

▶ The White House would not answer specific questions about a *Washington Post* report that retired Secret Service officer Lewis Fox ushered Lewinsky into the Oval Office in the fall of 1995. Fox could not be reached Wednesday at his home in Kirby, Pa., 60 miles south of Pittsburgh.

"I think he is out of the area," said Rodney Fox, who identified himself as Lewis' brother. "He won't be back until Monday."

▶ A Maryland county prosecutor is asking an independent state prosecutor to decide whether to investigate whether Linda Tripp violated state laws by secretly taping her conversations with Lewinsky, her former Pentagon co-worker.

Howard County State's Attorney Marna McLendon, the Republican prosecutor for the county where Tripp lives, sought Wednesday to avoid the appearance of a conflict of interest by handing the case over to state prosecutor Stephen Montanarelli.

▶ On Capitol Hill, House Republican staffers are researching what they'd have to do if Starr turns over evidence that Clinton may have committed an impeachable offense.

House leaders have discussed tapping a $4.4 million contingency fund in case they need to finance impeachment proceedings.

Contributing: Edward T. Pound, Paul Wiseman, Tamara Henry, Jessica Lee

▶ Currie, author linked, 10B

By Dennis Cook, AP

Day 2: Marcia Lewis and her attorney Billy Martin leave after finishing a second day of grand jury testimony about an alleged affair between her daughter, Monica Lewinsky, and President Clinton.

Parent-child relationship affords little legal protection

By Tony Mauro USA TODAY

Spouses cannot be forced to testify against each other, but parents and children can be required to do so in all 50 states, Northwestern University law professor Ronald Allen says.

Privileges or protections against testifying are rarely recognized, Allen says, and only when the potential damage to the relationship outweighs the prosecution's need for information.

While the marriage relationship would be severely strained if spouses testify against each other, parents and children are "stuck with each other" no matter what, he says.

When the child reaches adulthood, there is no formal relationship with the parent that the legal system would want to protect through the grant of a privilege anyway, Allen says.

In the real world, however, prosecutors rarely ask parents to testify against their children or vice versa "for humanitarian reasons," he says. "And normally, you would expect the parent or child to lie anyway, so why even ask?"

CAPITAL ROUNDUP

Democrats to rally behind Clinton, Gore

President Clinton and Vice President Gore go to Capitol Hill today for a "unity" rally with House and Senate Democrats who are about to unveil their legislative agenda. The event is intended to capitalize on Clinton's startling surge in the polls despite allegations that he had an affair with a White House intern and lied about it under oath.

Details of the agenda were being completed Wednesday. One item Clinton appears ready to endorse is a $1-an-hour increase in the $5.15 minimum wage. The plan is to boost it in two 50-cent increments over the next two or three years.

House Republicans returned from a three-day retreat committed to using the $100 billion Clinton wants for domestic initiatives over the next five years for tax cuts. "We're pretty confident about the way that choice comes out" with the voters, said Speaker Newt Gingrich, R-Ga.

JUDICIAL FIGHT: The Senate confirmed one controversial nominee for a federal trial judgeship but sent another back to the Judiciary Committee for further hearings.

AP

Massiah-Jackson: Nomination is on hold

Some conservatives argue that Margaret Morrow of California and Frederica Massiah-Jackson of Philadelphia would be judicial activists who would impose their own views rather than follow the law.

Morrow was confirmed on a 67-28 vote. Critics said her writings show a disdain for California's initiative process that allows voters to decide some issues. Judiciary Committee Chairman Orrin Hatch, R-Utah, supported Morrow after initial problems of getting "candid, responsive answers" from her last year.

The nomination of Massiah-Jackson was sent back to committee to deal with criticisms that emerged after the panel approved her 12-5 in October. Majority Leader Trent Lott, R-Miss., urged President Clinton to withdraw the nomination. Supporters say she's fully qualified and critics are manipulating an incomplete record. The White House said Clinton has no intention of withdrawing the nomination.

CLONING BAN: The Senate fell 12 votes short of the 60 needed to end debate and proceed with a vote on legislation to permanently ban human cloning, including creation of human embryos for research. The current ban covers federally funded projects but not private ones. There is widespread support for some sort of further ban, but many want more hearings on the issue.

VOTING FRAUD: The House today takes up a proposal to allow states to use Social Security and Immigration and Naturalization Service records to verify whether people who register to vote are eligible citizens. Anyone rejected would have a chance to prove citizenship through a birth certificate, passport, naturalization certificate or other document. Civil rights groups say it would open the door to discrimination against ethnic and racial minorities.

'FILEGATE' SUBPOENA: The House Government Reform and Oversight Committee has subpoenaed documents seeking to learn what first lady Hillary Rodham Clinton discussed with government lawyers concerning the White House's unauthorized acquisition of hundreds of FBI background checks on former Republican officials. *The Hill* newspaper, which covers Congress, said the subpoena was issued by Committee Chairman Dan Burton, R-Ind., on Feb. 3. Rep. Henry Waxman, D-Calif., the ranking minority member, said the matter already has been thoroughly investigated.

IMF MONEY: Congressional opponents of abortion told the Clinton administration that its request for $18 billion more for the International Monetary Fund to deal with the Asian financial crisis is threatened by Clinton's unwillingness to go along with restrictions on abortion. At issue are provisions that would prohibit U.S. funding of institutions that perform or promote abortions in foreign countries. Treasury Secretary Robert Rubin urged lawmakers not to link the package to family planning issues.

Written by Paul Leavitt with staff and wire reports

Pentagon aide Lewinsky got the VIP treatment

By Andrea Stone
USA TODAY

Monica Lewinsky got one of 60 VIP seats at the Air Force's 50th anniversary celebration at the Pentagon Sept. 18.

President Clinton spoke from a podium just in front of the distinguished-visitors section.

Lewinsky sat behind then-Secretary of the Army Togo West. Air Force Gen. Joseph Ralston, the vice chairman of the Joint Chiefs of Staff, was seated third from left in the first row.

The standing-room-only ceremony in the Pentagon's open-air courtyard was attended by 3,000 people.

Air Force Lt. Col. Steve Morteiro said the VIP section was reserved for service chiefs, four-star officers and White House staff.

Lewinsky was a confidential assistant to Defense Department spokesman Kenneth Bacon. How did she get a prime viewing spot?

Morteiro said he did not know.

But Col. Dick Bridges, another Pentagon spokesman, said only the first row of the VIP section was reserved for the service chiefs and White House staff.

He said the other seats were up for grabs.

White House spokesman Joe Lockhart directed questions to the Pentagon.

Lewinsky's lawyer, William Ginsburg, had no comment.

Department of Defense

On Sept. 18: Monica Lewinsky, left, sits in the VIP section behind front-row occupants like then-Army Secretary Togo West, left, and Air Force Gen. Joseph Ralston, third from left.

USA TODAY · THURSDAY, FEBRUARY 12, 1998

in the report but also give a floor speech outlining his

committee held 32 days of bitterly partisan hearings stretching four months last year, an exercise that never succeeded in fully gaging the public. As they sought to lay out a complicated tale with myriad of characters, investigators were constantly frustrated by the refusal of many central figures to cooperate.

The committee report was due Jan. 31, but a series of delays have pushed back its release.

Particularly sensitive have been negotiations with the CIA and FBI over intelligence data suggesting possible Chinese government involvement in the U.S. political system. The draft copy of the report obtained by the Los Angeles Times did not include the closely held China section.

However, the section reportedly says there is strong circumstantial evidence that the government of China funded, directed or encouraged illegal contributions, and that the Chinese likely used intermediaries to funnel money into U.S. election campaigns.

Democrats, meanwhile, fired back with a draft report of their own pointing out Republican abuses. They accused former Republican Party Chairman Haley Barbour of a ``scheme" to funnel foreign money to the GOP through the nonprofit National Policy Forum and called his denials ``not credible."

Senate Confirms Satcher as Surgeon General (Washn) By Marlene Cimons (c) 1998, Los Angeles Times

WASHINGTON After more than three years, the nation once again has a ``family doctor."

The Senate on Tuesday confirmed Dr. David Satcher, 56, as surgeon general, overcoming an effort by a handful of conservatives to thwart President Clinton's choice for the job. The position had been vacant since 1994, when the flamboyant Dr. Joycelyn Elders was fired.

The Senate approved Satcher, an educator and physician who was most recently director of the federal Centers for Disease Control and Prevention in Atlanta, on a 63-35 vote.

The confirmation vote came minutes after a key procedural battle in which the Senate agreed, 75-23, to end debate over the onetime inner-city doctor who years ago ran a free clinic in a church basement in the Watts area of Los Angeles.

Satcher is to be sworn in Friday for a dual role, also becoming assistant secretary of health for the Health and Human Services Department, a post with more influence on actual policy-making than surgeon general.

The surgeon general's job commands little inherent power, but it serves as a bully pulpit for promoting public health issues. Past surgeons general have focused the nation's attention on venereal disease, smoking and AIDS, often before the issues were widely discussed.

Elders was dismissed after making controversial comments about masturbation. And Clinton's first choice to succeed her, Dr. Henry W. Foster Jr., failed when an acrimonious partisan debate errupted over the number of abortions he had performed.

Satcher was nominated for the job in September and it initially appeared he would win quick confirmation. But a group of Republicans led by Sen. John Ashcroft, R-Mo., sought to derail the nomination, largely over Satcher's opposition to congressional efforts to ban late-term abortions.

The conservatives also opposed Satcher's support of a Third World AIDS study and of needle exchange programs to stem HIV transmission among intravenous drug users.

``America deserves better," Ashcroft said repeatedly from the Senate floor.

On the confirmation vote, 19 Republicans joined 44 Democrats in voting for Satcher's nomination. Voting against were 35 Repubicans.

Satcher promised ``to work hard to engage all Americans everywhere in a lively, ongoing conversation about physical activity, good nutrition, responsible behavior and other passports to good health and long life."

Clinton, in a clear reference to the criticisms directed st Satcher, praised him as ``a mainstream physician who is an eloquent advocate for the health of all Americans."

During the 1970s, Satcher served as interim dean at Charles R Drew Postgraduate Medical School in Los Angeles and chaired its family medicine department. While at Drew, he created an innovative program in which medical students studied for two years at the University of California, Los Angeles, School of Medicine and two years at Drew, where they then provided medical care to residents of Watts.

He was president of the Meharry Medical College in Nashville for 10 years. In that job, he challenged establishment academia to ensure that black medical students had the same educational opportunities as whites.

He became CDC director a job that also required Senate confirmation in 1993.

Satcher and his wife, Nola, a poet, have four children.

Dow Jones Hits Record High Despite Political, Economic Worries By Tom Petruno and Thomas S. Mulligan (c) 1998, Los Angeles Times

U.S. blue chip stock prices surged to new highs Tuesday, as the great 1990s bull market reasserted itself despite a growing list of political and economic worries.

The Dow Jones industrial average rocketed 115.09 points, or 1.4 percent, to a record 8,295.61, finally topping the previous record close of 8,259.31 set last Aug. 6 and further dimming the memory of last October's mini-crash.

The latest rally has no particular trigger, analysts said, but rather reflects the increasing urgency with which investors have been pouring money into the market in recent weeks seemingly ignoring the likelihood of a U.S.-Iraq military conflict, President Clinton's intern imbroglio and long-term concerns about East Asia's economy.

``Americans can't seem to worry about things for a protracted period," said Eric T. Miller, investment strategist at brokerage Donaldson, Lufkin & Jenrette Securities in San Francisco. ``Problems don't necessarily get solved, but people get tired of worrying about them."

Others said the market's gains this year, with the Dow now up nearly 5 percent since Jan. 1, in part represented a ``relief rally" that Asia's crisis at least appears to have stabilized, and that fourth-quarter earnings reports from many major U.S. companies were a bit better than expected.

In addition, January usually brings a torrent of fresh cash into many pension funds, challenging fund managers to find investments for that money.

``What could have been Dow 6,000 now is looking more like it's going to be Dow 9,000," said Dennis Jarrett, head of Jarrett Investment Research in Westport, Conn.

The Dow jumped 3.6 percent last week alone, and daily trading volume on the New York Stock Exchange has topped 650 million shares repeatedly since mid-January a pace well above what the market experienced for most of 1997.

What's more, the broadest blue-chip stock index, the Standard & Poor's 500, last Thursday hit its first new high since early December, topping the 1,000 mark for the first time. The S&P index has risen more than 200 percent since the current bull market began more than seven years ago.

And as has been the case for most of the past four years, the market has been led this year by shares of major U.S. multinational companies such as Microsoft Corp., General Electric and Walt Disney Co.

Indexes such as the Russell 2,000, which tracks smaller stocks, remain below their 1997 peaks despite the Dow's gains. The Russell index, while rallying on Tuesday, still must rise 3.1 percent to reach its record set last October.

The latest surge of money into big-name stocks reflects many fund managers' unwillingness to fight the trend, Jarrett said.

Because the blue-chip S&P index has beaten most fund managers' performance since 1994, ``If you're paid to outperform (the index) you feel that you've got to be buying the GEs and other major names" now, Jarrett said.

The appeal of those stocks, even as they become expensive, historically, relative to their underlying earnings, is in part a function of the ease with which investors can buy and sell them.

In the six months it has taken the Dow to hit a new high the market has experienced some of its wildest swings in a decade, including the Dow's biggest one-day point decline ever, a 554-point plunge on Oct. 27 as Asia's economic crisis came to a head.

The market's rising volatility has encouraged more institutional investors to stay in highly liquid stocks that they can easily exit, analysts say.

That has left many investors who own smaller stocks lagging far behind. Indeed, while 76 percent of New York Stock Exchange-listed issues rose in price in calendar 1997, only 52 percent of stocks listed on the Nasdaq market rose in price, while 46 percent fell in price. Nasdaq is the home of most smaller stocks.

Still, money is flowing back into the stock market, and into blue chip issues in particular, for more than technical reasons, most analysts admit.

Many investors simply believe that it makes more sense to stay in stocks than to be out of them, given a still-healthy U.S. economy and subdued interest rates and inflation.

"The individual investor has had it drummed into him over the last 10 years to focus on the long term," said Tony Dwyer, chief market strategist at Ladenburg Thalmann & Co.

Unlike in 1987-88, when small investors retreated from stocks in the wake of the October 1987 market crash, U.S. stock mutual funds have continued to attract money since last October's mini-crash.

Falling interest rates have helped. Long-term bond yields have edged up in recent weeks, but remain near the 20-year lows set in mid-January. Lower rates make stocks more attractive vs. fixed-income investments.

The trend in rates has been influenced by expectations that the U.S. economy will slow this year as Asia's economic turmoil reduces demand for American exports.

Christopher Low, senior economist for HSBC Markets Inc. in New York, said the U.S. economy is strong now, with consumer confidence close to a 30-year high.

But Low, echoing recent comments by Federal Reserve Board Chairman Alan Greenspan, said that the fallout from Asia's woes will start taking a toll later this year.

"There are some ugly shocks still to come" for the economy, Low said.

The National Association of Purchasing Managers' index of export orders is at an all-time low, a signal that export sales will drop off in the second half of the year, Low said.

Clinton, Senate Democrats Rally Around Tough Tobacco Bill (Washn) By Alissa J. Rubin (c) 1998, Los Angeles Times

WASHINGTON President Clinton and a wide swath of Senate Democrats are rallying around tough tobacco control legislation that would raise the price of a pack of cigarettes by $1.50 over the next three years and deny the tobacco industry the protection from future lawsuits that it seeks.

The legislation, authored by Sen. Kent Conrad, D-N.D., and slated for introduction Wednesday, signals the increasingly cold climate in Washington for the tobacco industry, which has sought smaller cigarette price increases and broad protection from future lawsuits.

If Conrad's bill wins the support of most Senate Democrats, as its sponsors predict, it will have more backing than any comprehensive bill introduced so far to implement the mammoth settlement reached last year by the tobacco companies and the states. It also is the only proposal to win a White House endorsement.

Ultimately, without Republican support, the measure is unlikely to become law in anything like its current form. Still, it has injected momentum into a process that had appeared all but stalled.

"Conrad's bill sends a pretty strong signal," said Sen. John B. Breaux, D-La., a conservative Democrat. "To object to it is swimming upstream."

Breaux said he was signing onto the bill, which would allow far greater federal regulation of tobacco products than the agreement reached last June by the states attorneys general and the industry.

Breaux's comments were echoed by many of the Democrats emerging from the party's weekly luncheon, where Conrad briefed his colleagues on the bill's provisions.

Conrad's decision to give little ground to the tobacco companies in terms of future legal protections met with little criticism from Republicans, suggesting they also are unlikely to support the limits on liability sought by the tobacco industry.

White House officials voiced strong support for Conrad's bill, but also made it clear they would continue to work with Congress on formulating proposals Clinton could endorse.

"We think that this is a real step forward on the road to passing a bill," said Bruce Reed, domestic policy director for the White House.

The Conrad proposal would:

Settle the current state and local lawsuits against the tobacco industry and preclude federal lawsuits against the industry. But unlike the agreement forged between the state attorneys general and the industry, it puts no limit on future class action lawsuits and no cap on the amount that the industry would have to pay out in a year.

Increase the per pack price of cigarettes by $1.50 (50 cents per year over the next three years). The state/industry agreement would increase the per pack price by 62 cents over the next five years.

Grant full FDA authority to regulate tobacco as a drug. The state/industry agreement would limit the FDA's control in th...

Reimburse tobacco farmers $10 billion over the next five years to compensate for losses due to reduced sales of tobacco because of reductions in smoking. The state/industry agreement does not address this issue.

Require a 67 percent reduction in youth smoking rates in 10 years. The state/industry agreement calls for a 60 percent drop.

The tobacco industry sharply criticized the major provisions of Conrad's bill. And they said their opposition would imperil a key part of the state/industry accord provision to halt tobacco advertising and marketing aimed at young people.

Steve Duchesne, a spokesman for the industry, noted that such a prohibition could not be accomplished without the industry's cooperation.

"Many of the advertising and marketing restrictions would be unconstitutional, and therefore could not be implemented unless the industry agreed to them," he said.

Vote Will Seek to Break Deadlock on Human Cloning Ban (Washn) By Edwin Chen (c) 1998, Los Angeles Times

WASHINGTON A bipartisan campaign to ban human cloning has stalled in Congress, where right-to-life forces who fear the destruction of genetically engineered embryos are pitted against those who contend a ban would block cutting-edge biomedical research.

In an effort to break the deadlock, Senate Majority Leader Trent Lott, R-Miss., has scheduled a vote Wednesday that could pave the way for the Senate to take up two competing measures to restrict cloning research. Whatever the outcome, it is now clear that the drive to outlaw human cloning will not proceed quickly or smoothly.

President Clinton first proposed a ban last year, responding to public clamor surrounding dramatic advances in animal cloning. His plan drew widespread support, although Congress never acted on it.

But opposition has intensified as the the scientific and pharmaceutical communities have issued dire warnings that an across-the-board ban would block pioneering research on diseases ranging from cancer to Alzheimer's.

Anti-abortion advocates are clamoring for a broad ban because they believe that any human cloning research necessarily involves the creation and destruction of genetically engineered human embryos.

That such a once-popular proposal has become mired in controversy reflects the fundamental difficulty Congress faces in grappling with complex scientific issues that have a profound moral dimension namely, when does life begin?

"Anything related to embryos or abortions is a big problem for Congress," said George Annas, a Boston University bioethicist.

The controversy, acknowledged Dr. George Q. Daley, a Harvard physician and geneticist who opposes a broad ban, "speaks directly to the definition of an embryo."

The stalemate is somewhat surprising, because virtually no one has spoken up in favor of human cloning. Clinton, Lott and House GOP Leader Dick Armey, R-Texas, have taken the lead in promoting a ban. And leading researchers have voluntarily pledged to shun such experiments.

Only G. Richard Seed, a maverick physicist in Chicago, has publicly advocated human cloning. Last month, he claimed to have assembled a team to begin such experiments, prompting a stampede in Washington to outlaw the practice even though most experts say human cloning is at least three to five years away in terms of technological know-how.

Cloning is a genetic engineering technique in which scientists create an identical duplicate, or clone, of a living object. Though still in its infancy, cloning has already yielded an array of biomedical and agricultural advances. But it has never been achieved in humans.

Cloning made international headlines a year ago when Scottish researchers announced they had cloned a sheep named Dolly.

In the normal reproductive process, an egg and a sperm fuse, combining the genes of a male and a female to produce an embryo. In cloning, only the genes of one parent are used, with scientists removing the DNA from an egg and replacing it with the DNA of the person to be cloned.

A bill offered by Sens. Christopher S. Bond, R-Mo., and Bill Frist, R-Tenn., a heart-lung transplant surgeon, would permanently ban that technique as applied to human cells, with violators subject to criminal penalties, including up to 10 years in prison.

Bond called for "an immediate debate on how far out on a moral cliff we are willing to let science proceed before we as a nation insist

CongressDaily/A.M.

FRIDAY, FEBRUARY 6, 1998

tobacco Conrad

Conrad Drafting Measure To Restrict Public Smoking

Sen. **Kent Conrad** of North Dakota, chairman of the Senate Democratic task force on tobacco, is crafting legislation that would set tough new federal rules restricting smoking in public places. According to a discussion draft of the bill presented by Conrad to several House Democrats Thursday and obtained by *CongressDaily*, "'The Healthy Kids Act' sets a minimum standard of federal protection against environmental tobacco smoke ... by restricting smoking in the vast majority of public facilities." However, according to one source, Conrad told House Democrats that, because of problems with the new California law restricting environmental smoke, the bill would probably contain exceptions for smoking in bars, nightclubs, smoking lounges and some other facilities.

HEALTH

White House officials indicated they are working closely with Conrad on the bill. Conrad told House Democrats that the White House would probably be supportive of the legislation, but stopped short of saying President Clinton has decided to endorse it, sources said.

Conrad's bill, according to the discussion draft, is tougher on the industry than the tobacco deal, calling for industry payments of 50 cents per pack in 1999, $1 per pack in 2000, and $1.50 per pack in 2001. Youth smoking rates would have to decline by 67 percent in 10 years, with the industry otherwise being liable for penalties of 10 cents per pack and individual companies for 40 cents per pack. While details of the draft, dated Wednesday, remain in flux, Conrad also is proposing that 38 percent of the revenues be devoted to the states "to reimburse them for tobacco-related costs," the document says. "Of the state share, 57 percent (or 23 percent of the total) — representing the federal share of Medicaid costs — is dedicated to child care, education and children's health," it adds. The document states that "anti-tobacco public health priorities" would receive 17

Continued on Page 8

Health

Continued from Page 1

percent of total revenues. Fifteen percent of revenues would be used to help "tobacco farmers adjust to reduced demand for tobacco."

After a transition period, these funds would be "split between Social Security and Medicare."

However, in the short term, 2 percent of the revenues would be immediately devoted to reimburse the Medicare trust fund for tobacco-related costs and 6 percent would go to reducing the debt and to the Social Security trust fund.

Conrad, according to the source, was noncommittal about when he might offer the bill, saying he was still working on details and seeking to garner support.

Meanwhile, **Reps. Roy Blunt**, R-Mo., and **Asa Hutchinson**, R-Ark., Thursday announced a new bill, "The Taxpayer Repayment Act," which would require that — should the tobacco settlement be enacted — any funds collected be devoted solely to programs specifically authorized by the legislation, and that they not be otherwise used to create new programs or expand existing ones.

The bill is squarely aimed at the array of new programs President Clinton's budget proposal would finance with money from the settlement, according to Blunt and Hutchinson.

Revenues not spent for such programs could be used only for debt reduction or tax relief.

Hutchinson and Blunt were joined at a Thursday afternoon news conference by **Rep. Joe Barton**, R-Texas, who expressed his support, and noted that cigarette makers "don't have the leverage" they had in previous Congresses.

House Majority Leader Armey also supports the bill by Blunt and Hutchinson, who sent out a "Dear Colleague" this week soliciting more support. Meanwhile, Republican and Democratic members of the House Judiciary Committee Thursday demanded more details from the White House on the type of tobacco proposal that Clinton favors, characterizing as insufficient the comments on the deal offered by an administration official at an all-day committee hearing.

Justice Department official David Ogden tipped the administration's hand on the liability issue — indicating the White House would support some form of immunity if doing so would facilitate passage of comprehensive tobacco legislation — but refused to offer many more details about the president's position on the settlement.

"It's not quite Passover, but why is this bill different from all other bills?" asked **Rep. Barney Frank**, D-Mass., seeking an explanation of why the administration has failed to deliver detailed legislation to Capitol Hill. Republicans, including **Rep. Howard Coble** of North Carolina, demanded that Ogden solicit a complete proposal from the White House.

Ogden did comment on one other aspect of the settlement, saying that although federal officials should seek "as much disclosure as we can get," the priority should be to craft legislation, since the imperative is to reduce youth smoking immediately.

Ogden also offered the Justice Department's opinion that legislation limiting punitive damages and class action suits would be constitutional if crafted in a "careful" manner.

Also Thursday, **Senate Budget ranking member Frank Lautenberg**, D-N.J., announced he had received an opinion from the Congressional Research Service saying that assessing a tax, as proposed by Lautenberg, is the best method to guarantee a rise in cigarette prices that could reduce youth smoking.

— *By Keith Koffler*

DISCUSSION DRAFT

Comparison of Major Elements of Tobacco Proposals

Issue	HEALTHY Kids	Kennedy	Hatch	Proposed Settlement
Payments Penalties non deductible No deductibility beyond	Payments of 50 cents/pack in 1999, $1.00 in 2000, and $1.50 in 2001. Subsequent payments indexed to medical inflation. Other tobacco products assessed equivalent amounts. Payments do not reduce other tax liability. Total revenue: about $560 B? payments themselves	Increase the excise tax by same amounts as HEALTHY Kids payments. These payments are not tax deductible; this effectively makes them 50% higher because manufacturers pay income tax on the payments. Total revenue: $550 B to Trust Fund plus $275 B in income tax = $825 B	Payments of about 67 cents/pack when fully phased in. Total revenue (after adjusting for volume decline): about $320 B.	Payments of about 62 cents/pack when fully phased in. Total revenue (after adjusting for volume decline): about $300 B.
Lookback No Anti-trust Exempt	Industry wide penalties of 10 cents/pack; company specific penalties of up to 40 cents/pack. Penalties double for repeated non-compliance.	Company specific penalties of up to $1.00/pack. Penalties double for repeated non-compliance. Tougher targets.	Industry-wide penalties of up to 20 cents/pack in first five years; 40 cents/pack thereafter. Rebates for companies that try to reduce teen smoking.	Industry wide penalties of up to 8 cents/pack. Rebates for companies that try to reduce teen smoking.
FDA Authority	Full authority	Full authority	Some restrictions	Many restrictions
Youth Access/Retailers	Requires State licensing and enforces youth access restrictions.	No provision (jurisdictional concern -- Labor vs. Commerce Cmte)	Requires State licensing and enforces youth access restrictions.	Requires State licensing and enforces youth access restrictions.

DISCUSSION DRAFT

Issue	HEALTHY Kids	Kennedy	Hatch	Proposed Settlement
Liability Protections pool →No class action protection No special privilege for tobacco company	Gives industry immunity from Federal, State and local suits for past misconduct. Settles Castano suits. No special privilege for future misconduct. No special privileges for claims by individuals.	No provision.	Settles all current suits. Broad immunity against all lawsuits: no aggregation or punitives for past misconduct; no aggregation for future misconduct.	Settles all current suits. Broad immunity against all lawsuits: no aggregation or punitives for past misconduct; no aggregation for future misconduct.
Attorney Fees Tob. comps. pay beyond attys fees	No payments from settlement funds. Arbitration panel decides payments based on ABA ethical guidelines.	No provision.	Similar to HEALTHY Kids.	No provision.
Farmers	Based on LEAF Act. Preserves tobacco farm program; reimburses farmers for lost quota; rural development, worker retraining, scholarships.	Ends tobacco program. Buys out quota.	Ends tobacco program. Buys out quota.	No provision. (But McCain includes LEAF Act.)
Documents	Turns over relevant documents to FDA. Allows FDA to make documents public. Trade secrets and attorney client privilege protected unless disclosure serves public health interest.	Turns over documents to Board. Attorney client privilege protected unless three judge panel rules that it has been improperly invoked. Regular discovery preserved.	Turns over documents to document depository. Attorney client privilege protected unless three judge panel rules that it has been improperly invoked. No regular discovery.	Turns over documents to document depository. Attorney client privilege protected unless three judge panel rules that it has been improperly invoked. No regular discovery.

DISCUSSION DRAFT

Issue	HEALTHY Kids	Kennedy	Hatch	Proposed Settlement
ETS	Restricts smoking in public places. Exempts Bars, hotel guest rooms, tobacconists, prisons, casinos and private clubs. Small restaurants	Similar. Exempts bars, hotel guest rooms, tobacconists, and prisons.	Similar. Exempts bars, hotel guest rooms, tobacconists, casinos, bingo parlors, and restaurants with fewer than 50 seats. No smoking in prisons.	Similar. Exempts bars, hotel guest rooms, tobacconists, prisons, casinos, bingo parlors, private clubs, and restaurants other than fast food.
Liggett	Allows Liggett to have its deal with States; exempts it from that portion of payments.	No provision.	No provision.	No provision.
Spending farmers	First makes LEAF payments of $2.1 B, $300 M to FDA, and $200 M to Native Americans. Splits remainder as follows: **25% to Federal Health** (NIH research and Medicare); **25% to States** (to reimburse Medicaid; Federal share directed to kids' health); **25% to anti-tobacco** programs; **25% to Children** (early childhood development, education, and/or debt reduction).	43% goes to States and anti-tobacco programs. 57% gets split between health research and early childhood programs. (Note: distribution is not clear.)	Sets aside $200 M for asbestos, $200 M for Native Americans, and $16 B over 25 years for agriculture. Splits remainder: 50% to States, 25% each to anti-tobacco programs and research. No-state portion subject to reduction if victims win suits against industry.	Gives 52% to States. Remainder funds anti-tobacco and trust fund for victims. (Note: allocation is very unclear.)

Table S-7. TOBACCO LEGISLATION

(In millions of dollars)

	Estimate 1999	2000	2001	2002	2003	Total 1999–2003
USES OF RECEIPTS FROM TOBACCO LEGISLATION						
Federally-operated Programs:						
Research Fund for America	3,609	4,586	4,952	5,713	6,344	25,204
Food and Drug Administration Enforcement Activities	125	206	265	273	281	1,151
Health and Human Services/Centers for Disease Control Smoking Prevention	71	73	74	76	77	370
Medicare Beneficiaries' Cancer Clinical Trials Demonstration	200	250	300	....	....	750
Subtotal, Federally-operated programs	4,005	5,115	5,591	6,062	6,703	27,475
State-administered Programs:						
Child Care and Development Block Grant	1,155	1,280	1,400	1,600	2,065	7,500
Medicaid Child Outreach Reforms	110	150	210	210	220	900
Class Size Initiative	1,100	1,300	1,500	1,700	1,735	7,335
Subtotal, State-administered programs	2,365	2,730	3,110	3,510	4,020	15,735
Other Uses (Includes unrestricted funds for States, cessation programs, farmer assistance, etc.)	3,425	3,943	4,582	4,972	5,362	22,284
Total Uses	9,795	11,787	13,283	14,544	16,085	65,494
TOBACCO LEGISLATION RECEIPTS PROPOSED	9,795	11,787	13,283	14,544	16,085	65,494

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DRAFT-- JANUARY 28, 1998

MEMORANDUM FOR THE CHIEF OF STAFF

FROM: BRUCE REED
ELENA KAGAN
~~LARRY STEIN~~

RE: TOBACCO STRATEGY UPDATE ~~AND WHITE HOUSE SUPPORT PLAN~~

I. PURPOSE

This memo outlines a legislative and communications strategy to enact a comprehensive tobacco bill containing the five policy elements the President called for on September 17th and reaffirmed in his 1998 State of the Union address.

II. BACKGROUND

The Administration is in a good position to push tobacco legislation through Congress over the next year. When the President announced the five key elements to his plan for comprehensive tobacco legislation in September 1997, he brought together support from the public health community, attorneys general, and many members of Congress. The President placed himself in the strategic position to aid Congress in formulating legislation without having a specific Administration legislative product that would become a lightening rod for criticism and diversionary tactics by opponents.

For a number of reasons, the Administration continues to have strong leverage in shaping and enacting tobacco legislation. First, there continues to be ~~very strong~~ bipartisan political recognition that the American public wants tough action to limit smoking. Second, the President continues to be the most powerful and popular voice against the tobacco industry and in support of the public health community. Finally, a number of legislative proposals and players are competing with each other in Congress, suggesting that the Administration has the ability to negotiate among the proposals to create a compromise we support. The legislation currently underway include a Senate Democratic leadership bill being formulated by Conrad, a Republican Senate leadership process under Nickles with Committee reports due by March 16, specific bills introduced by Senators Kennedy, Ford, Hatch among others, and hearings set by Rep. Blilely, Senator McCain, and other committee chairs.

Since September, we have maintained contact with parties on all sides of the issue, including members of Congress, industry representatives, and representatives of the health commnity, assuring them of the Administration's commitment to passing bipartisan, effective, legislation. In addtion, the Administration has provided technical support for drafting legislation for any member of Congress who requested it.

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As Congress goes back into session, attention will ~~shortly~~ shift to the ~~upcoming~~ congressional agenda. We believe th~~ere will soo~~n be an opportunity to ~~move to~~ more active ly participat~~ion~~ in the legislative process. Legislative proposals by Senate Democrats and Republicans are begining to take shape, and Senator McCain will be holding hearings and raising questions about relevant Administartion positions. In order to answer these questions, take advantage of the competition among congressional bills, and maintain Presidential momentum we recommend the following strategic steps.

III. NEXT STEPS

A. Congressional Strategy

B. Internal Structure

C. Presidential Events

I. Legislative Strategy

The Administration has an excellent opportunity to push tobacco legislation through Congress over the next year. The President's announcement earlier this month united the public health community for the first time and attracted bipartisan support from the nation's attorneys general and many members of Congress. The President's plan is simple and clear, and should command substantial public support-- and our main adversary, the tobacco industry, should ultimately accede to our demands.

Nevertheless, any tobacco bill will have to make its way through a tangle of overlapping committee jurisdictions and agendas. At least six committees in the Senate and four in the House can lay claim to some piece of this legislation, and dozens of members in both parties have a longstanding interest in tobacco from the standpoint of reducing teen smoking or protecting tobacco farmers. Republicans in particular recognize the political potency of the President's plan, and are very nervous about beig trapped into the appearance of defending the industry.

Our first step has therefore been to reassure the leadership and key committee chairs like Rep. Bliley that we are indeed serious about passing a bipartisan bill, and not just looking to sandbag them in an election year. The President's meeting with Congressional leaders, committee chairs, and ranking members was an important step in setting this tone from the outset: we're eager to work together to pass bipartisan legislation as early as possible next year, and we are ready to work in a collaborative fashion to get it done.

Our next step should be for Secretary Shalala, Secretary Glickman, and I, with the key players in both parties oer the remaining weeks of this session, to offer the Administration's expertise and to try to marshal bipartisan coaltions in both houses to prepare bills for introduction in January. It is too early to tell which members are in the best position to lead that effort. (Bliley is the key House Republican, Waxman and Fazio are important House Democrats; Hatch, Lugar, McCain, Jeffords, Mack, Campbell and several Republican moderates may be helpful in the Senate; Conrad, Lautenberg, Kennedy, and others are strong Senate Democrats). Ideally, we can lay the ground work for a center-out coalition in the Senate, along the lines of Hatch-kennedy or the Breaux-Chafee group, and work closely with Bliley, Waxman, and others in the House.

II. Communications Strategy

Over at least the next several months the crucial communications issue will be encouraging Congress to take up the issue of tobacco. The first option for encouraging Congress to move the legislation is to convince Members that the Administration is acting in good faith in seeking bi-partisan legislation. At the initial event on October 1st the President emphaiszed he was genuinely committed to enacting the legislation at the earliest date possible. Republican members reacted largely positively. We intend to continue to convey this bipartisan message. However, there remains a need for an active positive message, both to reinforce Congress' incentive to act and to maintain the Administration's strong public position as advocate onthis issue.

The communication startaegy utlizes a variety of devices for making the President's message voluable. These include: a series of town hall meetings held by the Vice-President (the first of which was held last week in Florida), meetings with punbPresident's comments could be structured according the themes of bi-partisanship and the need for quick action, using the following talking points.

In discussing the toabcco issue, the following points form the basis of the Adminstration's public message: harm to children everyday, harm from second hand to everyone, the opportunity to get something done now, willingness to compromise except around five points laid out by President. These points are: reducing teen smoking with tougher penalties, giving full authority for FDA to regulate tobacco, changing tobacco marketing to children, broad document disclosure, progress toward other health goals (second hand smoke), and protecting farmers and their communities. Finally, spokespersons for the Administration can urge Congress to act swiftly and produce legislation as early as possible next year.

III. White House Structure and Next Steps

Over the next several months the primary actions that the Administration will be required to take are legislative-- to encourage hearings and development of appropriate legislation-- and communications oriented-- to scheduling events to maintain public awareness of the issue. The following structure and working groups have been meeting to plan and develop these operations.

The primary tobacco planning meeting is the Tobacco Strategy Group. It has begun meeting every Thursday. The meeting includes representatives from the DPC, NEC, HHS, VPOTUS, OPL, Intergovernmental Affairs, CEA, Legislative Affairs, Treasury, USDA, and

DOJ. The function of the group is to coordinate policy and event planning.

The DPC also holds regular Tuesday meetings with the Vice-President's staff for event scheduling and strategy.

In addition there are two weekly telephone conference calls: first with Mike Moore's group including (Moore, Scruggs, and Coale), the second with members of the public health group including Kessler, Koop, Myers, and leading health organizations such as the American Heart Association, the American Medical Association, the American Cancer Society. These meetings will include the VP staff and HHS.

DRAFT

MEMORANDUM FOR ERSKINE BOWLES

FROM: BRUCE REED
ELENA KAGAN

RE: TOBACCO STRATEGY AND WHITE HOUSE SUPPORT PLAN

DATE: SEPTEMBER 30, 1997

The following plan is designed to provide communications and legislative support for the passage of a tobacco bill containing the five policy elements described by the President on September 17, 1997. The strategy's objective is passage of the bill by early next year.

The plan has three components. First, it lays out a legislative strategy based on the principles that: the bill will require bi-partisan support for final passage; that there will be some opposition to the bill reaching the floor and therefore a sustained Administration message is required; and that the greatest dangers to the bill's passage are delay and opponents' ability to fragment consideration of the issue in various Committees. Second, this memorandum describes a communication strategy to counter Congressional inaction by emphasizing the following themes: children and the health damage they suffer via inaction; the bi-partisan nature of this effort; and the need for Congress to take this matter up promptly. Finally, this memorandum suggests an internal White House working group support structure to further this effort.

I. Goals and Legislative Strategy

This proposal seeks to optimize the opportunities for passage of comprehensive tobacco legislation that includes the President's principles by early next year. The five key elements of the President's plan are: (1) a comprehensive approach to reducing youth smoking including tough penalties if targets are not met; (2) full authority for FDA to regulate tobacco targets; (3) changes in the way the tobacco industry behaves in marketing and disclosure; (4) progress toward other public health goals; and (5) protection for tobacco farmers and their communities.

While we believe the goal of passage of comprehensive legislation is feasible, a successful strategy will have to account for various attacks that are likely to be employed by opponents of the pact. We believe these arguments will be of three types. First, political opponents of the President have criticized the President for failing to submit full legislative language to Congress and blamed the President for any delay in passage of a bill. This has been the initial line of criticism following the President's announcement. Second, there is the possibility that opponents of an agreement will attempt to fragment and confuse the issues, eventually permitting perhaps only restricted portions of a bill to advance following lengthy hearings. Finally, opponents of legislation may make substantive attacks such as a law would not adequately protect farmers, that it might lead to restrictions on class action suits, or that it represents a windfall to lawyers.

The Administration has a number of arguments to deploy in response to these expected attacks. The strongest argument, and one supported by research data, indicates that the public is particularly frustrated by partisan bickering in the tobacco dispute, and anxious for solutions that will protect America's children. In addition, this President has a strong history of leadership on smoking issues and can draw upon that legacy in future disagreements with Congress.

The following chronology indicates the sequence in which these arguments might be played out, and the corresponding type of action that the Administration should be prepared to take.

a). POTUS announces principles for legislation. (Review of Agreement. Completed).

b). Outreach to Congressional leaders indicating Administration commitment to passing a bill. (On-going).

c). Public meeting with POTUS/VPOTUS and congressional leaders-- public statement that bill is important to country and should be top priority of next year. (Scheduled for October 1, 1997).

d). Congressional Action. Hearings begin, many pieces of legislation are introduced-- some bills are comprehensive, others are more limited. (Hearings have begun with Administration witnesses. Few bills introduced as yet).

e). Administration Action. Administration urges adherence to principles outlined by President. POTUS/VPOTUS events emphasizing need for action-- involve children, farmers, second-hand smoke science. POTUS urges issue not be fragmented and a comprehensive piece of legislation be passed. (VPOTUS has completed one event and has tentative plans for 3 regional events. POTUS to give statement at October 1st event. On-going).

f). Congressional Action Continues. Larger coalitions coalesce around Senatorial leaders on issue (Kennedy/Hatch likely to emerge as key Senatorial leaders) and House chairman (Rep. Bliley key House Republican).

g) Administration Endorsements. Administration uses following options to maintain progress of legislation: private meetings to encourage coalitions of legislators and encourage useful combinations of bills, public comment on aspects of pending legislation to indicate support; public comment/events to indicate criticism of pace of progress or negative direction of bill.

h) Congressional Vote Taking. Bills reach committee and floor. (Options for Presidential involvement include Presidential statement, SAP, or invitations to leaders to WH to coordinate/ resolve disputes.)

II. Communications Strategy

Over at least the next several months the crucial communications issue will be encouraging Congress to take up the issue of tobacco. At the initial event on October 1st we recommend emphasizing arguments that suggest it is in Congress' interest to move the legislation and to set a general timetable for action. The twin arguments that achieve this are stressing the bi-partisan source of the concern-- children-- and the need for prompt action.

The President's comments could be structured according the themes of bi-partisanship and the need for quick action, using the following talking points.

I.	Welcome.	Glad so many members could come. Demonstrates the breadth of interest.
II.	Crucial issue for America's future.	Thousands of kids start everyday. Not about money.
III.	Shouldn't be a political issue.	Need for bi-partisanship.
IV.	Outline crucial elements for bill.	Reduce teen smoking w/penalties, full authority for FDA to regulate tobacco, change tobacco marketing, broad document disclosure, progress toward other health goals (second hand smoke), protect farmers and their communities.
V.	Need for Prompt Action.	This is top of country's agenda. Let's agree we should get it done by next year.
VI.	Working Together.	Complex legislation, affects many people, many states. Recognize Congress will hold hearings, but this is too important for us not to get done.

As suggested above, either during the meeting or in meeting with the press the President is likely to be pressed as to why he didn't submit complete legislation. We suggest the President stress that he set out his priorities for the bill. The five principles he set out are clear. And that Congress should act and hold hearings and get a bill to the floor.

Other likely questions include:

Q. When should a bill pass?
A. It should be at the top of the agenda for this year. There is nothing more important than saving thousands of children from taking up smoking. Three thousands are starting everyday.

Q. Is POTUS just playing politics with this? Why didn't he show leadership?
A. He's taken this issue on from the first, and taken the issue this far, and is confident we will get a resolution of the issue. we will get a bill by working together.

Q. Will negotiations include industry?
A. The industry is a piece of this, but there isn't a need to negotiate with them.

Q. What is the role of the VPOTUS?
A. VPOTUS will take a leadership role in the legislation.

III. White House Structure and Next Steps

Over the next several months the primary actions that the Administration will be required to take are legislative-- to encourage hearings and development of appropriate legislation-- and communications oriented-- to scheduling events to maintain public awareness of the issue. The following structure and working groups have been meeting to plan and develop these operations.

Bruce Reed and Elena Kagan of the DPC are coordinating the Adinistration's response. The primary tobacco planning meeting is the Tobacco Strategy Group. It has begun meeting every Thursday. The meeting includes representatives from the DPC, NEC, HHS, VPOTUS, OPL, Intergovernmental Affairs, CEA, Legislative Affairs, Treasury, USDA, and DOJ. The function of the group is to coordinate policy and event planning.

The DPC also holds regular meetings with VPOTUS staff for event scheduling and strategy.

In addition there are two weekly telephone conference calls: first with Mike Moore's group including (Moore, Scruggs, and Coale), the second with members of the public health group including Kessler, Koop, Myers, and leading health organizations such as the American

Heart Association, the American Medical Association, the American Cancer Society. These meetings will include the VP staff and HHS.

Finally, the DPC will hold specific meetings on legislative, communications, and rapid response issues as they arise.

Bruce N. Reed
09/22/97 06:14:11 PM

Record Type: Record

To: Thomas L. Freedman/OPD/EOP

cc: Elena Kagan/OPD/EOP
Subject: tobacco process

We need to write up a tobacco strategy/process memo for EB et al. Then we need to have zillions of mtgs on process, strategy, etc. Here are a few thoughts:

GOAL

Bipartisan bill by year-end

MEETINGS
1. Weekly Tobacco Strategy/Communications Meeting -- with key people from WH and agencies. DPC (EK, BR, TF, CJ, Lambrew, JRM), VP (Gips/Toby), OPL (Wooley), IGA (Emily), Toiv, Leg Affairs (Tate, Carey), Lindsey (optional), NEC, OMB, HHS (Tarplin, Skolfield, O'Hara), Treasury (Gruber), USDA, DOJ (Phillips). Tuesday is Tom's preference.

2. Weekly conference call with Mike Moore's group (Moore, Scruggs, Coale)

3. Weekly conference call/meeting with public health group (K-K, Myers/Novelli, AHA, AMA, ACS) -- include HHS, VP

LEGISLATIVE OUTREACH

1. Reed/Shalala rounds to key members on Hill over next 2 wks

2. Plan WH mtg with Leadership (schedule for early October)
-- Hilley/Bowles outreach to Lott/Gingrich

3. Continue policy development

COMMUNICATIONS

1. Schedule of events for rest of 97

Tobacco Policy and Public Health

TABLE OF CONTENTS

Introduction by the Co-chairs

On May 22, 1997, a bipartisan group of Members of Congress asked us to convene a committee on national tobacco policy. In response to this request, we formed the panel that has met as the Advisory Committee on Tobacco Policy and Public Health. This Committee is composed of representatives of some of the major public health groups that have been leaders in the debate on tobacco control. The selection of organizations to be represented was an especially difficult task, inasmuch as so many highly qualified groups with great expertise are involved in tobacco control; nevertheless, in order to make the Committee of manageable size, we made hard choices to limit the number of members and urged them to consult with a wide range of other organizations and experts.

The Committee has as its mission the development of a comprehensive and rational public health policy toward tobacco, containing clear goals and principles, in order to provide a benchmark against which future public and private activities can be measured.

The Committee has met three times, each time in open session, on June 5, June 18, and June 25. To conduct its work, the Committee resolved itself into five task forces on overlapping topics:

- Regulation of Nicotine and Tobacco Products (Chair: American Cancer Society)
- Youth and Tobacco (Chair: American Academy of Pediatrics)
- Performance Objectives Subgroup (Chair: Partnership for Prevention)
- Current Users of Tobacco Products (Chair: American Medical Association)
- Environmental Tobacco Smoke (Chair: American Lung Association)
- Future of the Tobacco Industry and Tobacco Control Efforts (Chair: Advocacy Institute)

These task forces conferred independently and made their preliminary reports to the Committee. Each report was discussed in open session and amendments were made. Revised reports were developed and summarized.

We believe that this final report speaks loudly for itself, but it is perhaps appropriate for us to note here what this report does not speak to. This is not a report on past actions of the tobacco industry or on the harm that it has done. It is not intended to recommend how tobacco litigation or compensation programs for past injury should be handled. It is not a report on liability for the past.

Rather, in keeping with the Congressional charge, this is a blueprint for the future of tobacco policy and public health. It is neither incremental nor utopian. The plans outlined are ambitious but they can be achieved within a short time.

Most of all, this report is a document intended to look forward, and to move the Nation from its past injuries to future good health. Its recommendations are to ensure complete ability for the FDA to regulate nicotine and tobacco products, to prevent our children from starting to smoke, to treat those already addicted to tobacco, and to protect nonsmokers from involuntary exposure to smoke. These are the goals for which all new policy should aim. Any approach that fails these goals fails the Nation and fails the future.

We fully recognize that there are billions of dollars at stake here in hospital bills, compensation, and liability costs. While these are important issues, we believe that this debate about the past should not distract us from solid plans for the future. Not one of those compensatory dollars will be well spent if our children repeat their elders' mistakes, if adults continue their addiction, or if we all have smoke in our faces. As the national debate about tobacco continues, we urge all sides to keep their eyes clearly on this extraordinary opportunity for change.

What follows is a summary of the major recommendations of each of the task forces. An appendix has been included that contains the full final report of each of the task forces.

We want to thank and acknowledge our colleagues who have joined us for this daunting task in such a brief amount of time. We appreciate the expertise, commitment, and labor that have been contributed. We are confident that our work together will change the debate for the better.

C. Everett Koop, M.D., Sc.D. David A. Kessler, M.D.

Summary of Major Recommendations of the Task Force on the Regulation of Nicotine and Tobacco Products

BACKGROUND

"[N]icotine in cigarettes and smokeless tobacco has the same pharmacological effects as other drugs that FDA has traditionally regulated."[1] Indeed, it is acknowledged that nicotine is extremely addictive and that "the vast majority of people who use nicotine-containing cigarettes and smokeless tobacco do so to satisfy their craving for the pharmacological effects of nicotine; that is, to satisfy their drug-dependence or addiction."[2] Many would argue, therefore, that the regulation of nicotine and its delivery is itself the most essential element of tobacco control activities.

Other components of tobacco smoke are also toxic. The tar, carbon monoxide, and additives contained therein are dangerous to the health of those using tobacco and those around them.

RECOMMENDATIONS

Regulatory Policy

- FDA should continue to have authority to regulate all areas of nicotine, as well as other constituents and ingredients, and that authority should be made completely explicit.
- FDA should continue to have the authority to phase out nicotine and remove ingredients that contribute to the initiation of smoking and dependence on cigarettes and other tobacco products (including smokeless tobacco, pipes, cigars, and roll-your-own tobacco), and that authority should be made completely explicit.
- There should be no limitations on or special exceptions to FDA authority to regulate nicotine, other constituents, and ingredients of tobacco products and such a no-limitations policy should be made completely explicit.
- The FDA should continue to have authority to regulate further nicotine, other constituents, and ingredients as the evidence suggests. The best science, information, and health policy (and not an arbitrary deadline) should drive FDA regulatory timing and that authority should be made completely explicit.
- The FDA should have the authority to test nicotine levels by brand, based on the best science and that authority should be made completely explicit.
- Regulation of non-tobacco nicotine delivery devices (e.g., nicotine patches, nicotine gum, nicotine inhalers, etc.) should be done in a manner that does not make the development and sale of less hazardous systems difficult and that encourages maximum overall reduction in disease.

Research Policy

- FDA should have the authority and funding to conduct research on nicotine and other components of tobacco products.
- International exchange and scientific conferences on nicotine and other components of tobacco products should be convened among private industry researchers and public researchers (such as those from the FDA, the CDC, the NIH, and the WHO).
- Research should be conducted on the effects of nicotine in children and adolescents.

Fiscal Policy

- FDA should be adequately funded to carry out its regulatory, enforcement, public

Attendees for 3 pm meeting Roosevelt Room on 7/16/97 as of 9:30 pm on 7-16

White House

Bruce Reed
Elena Kagan
Tom Freedman
Elizabeth Drye
Jerry Mande
Mary Smith

From Governor Hunt's office:

Governor James B. Hunt, Jr.
Debra M. Bryant
Fred Hartman
Trooper C.J. Stevens

USDA

Secretary Glickman
Charles Rawls, Executive Assistant to the Deputy Secretary
Dallas Smith, Acting Under Secretary for International Affairs and Commodity Programs

Farm Bureaus

Larry Wooten, Assistant to the President, North Carolina Farm Bureau

- He is the assistant to the President of the North Carolina Farm Bureau. He has grown tobacco for 20 years on an 140-acre farm. (The average acreage in NC is 35-40 acres.)

Larry McKenzie, South Carolina Farm Bureau

- He is the commodities director for the South Carolina Farm Bureau. Tobacco commodities is one of the primary areas in which he represents the South Carolina Farm Bureau. He is very familiar with tobacco marketing and production.

Wayne Ashworth, President, Virginia Farm Bureau

- He produces tobacco and is a life-long farmer.

Leslie Bryne
565-0099

Carl Loop, President, Florida Farm Bureau and Vice President of American Farm Bureau

- He is from the Jacksonville area. He is in the nursery business and represents the North Florida tobacco growers.

Wayne Dollar, President,Georgia Farm Bureau

- He is a tobacco farmer. He is very familiar with the tobacco program. (The tobacco grown in Georgia is primarily grown in south Georgia.)

Julius Johnson, Tennessee Farm Bureau

- He is the administrator of the Tennessee Farm Bureau. He is very familiar with the tobacco program, and he works with the burley growers in Tennessee.

Tim Cansler, Kentucky Farm Bureau

- He is the national affairs director for the Kentucky Farm Bureau. Burley tobacco is important to the economy in Kentucky. He deals in tobacco policy as it relates to burley tobacco.

Bill Sprague, President, Kentucky

- He was co-chair of the 1994 task force that worked with the USDA on some buyouts for tobacco farmers.

Peter Daniel, North Carolina Farm Bureau

- He is the assistant deputy commissioner of the North Carolina Department of Agriculture; he is very familiar with tobacco policy and tobacco's impact on the North Carolina economy. (North Carolina produces about 2/3 of the flue-cured tobacco.)

HHS

Secretary Shalala
William Corr
James O'Hara
Victor Zonana

Tom F.

67431

TOPIC: MEETING WITH CONGRESSIONAL LEADERS ON TOBACCO

DATE: OCTOBER 1, 1997

LOCATION: DIPLOMATIC RECEPTION ROOM

TIME: 11:15 a.m.

FROM: BRUCE REED
JOHN HILLEY

I. PURPOSE

The purpose of this meeting is to (1) set a bipartisan tone with Congress and (2) emphasize that tobacco legislation should be a top priority for the coming year.

II. BACKGROUND

The Administration is in a strong position to push tobacco legislation through Congress over the next year. Your announcement earlier this month united the public health community for the first time and attracted bipartisan support from the nation's attorneys general and many members of Congress.

Nevertheless, any tobacco bill will have to make its way through a tangle of overlapping committee jurisdictions and agendas. At least six committees in the Senate and four in the House can lay claim to some piece of this legislation, and dozens of members in both parties have a longstanding interest in tobacco from the standpoint of reducing teen smoking or protecting tobacco farmers. Republicans in particular recognize the political potency of ~~the President's~~ your plan, and are very nervous about being ~~trapped into the appearance of defending the industry~~ set up for failure in an election year.

The first step must therefore be to reassure the leadership and key committee chairs like Rep. Bliley that the Administration is indeed serious about passing a bipartisan bill, and not just looking to sandbag them in an election year. The meeting ~~with Congressional leaders, committee chairs, and ranking members~~ is ~~therefore~~ an important opportunity to set the right tone ~~from the outset~~: you are eager to work together to pass bipartisan legislation as early as possible next year, and we are ready to work in a collaborative fashion to get it done.

Our next step should be for representatives of the Administration (including the Vice-President, Erskine Bowles, Secretary Shalala, Secretary Glickman, John Hilley, and Bruce Reed) to meet with the key players in both parties over the remaining weeks of this session, to offer the Administration's expertise and to try to marshal bipartisan coalitions in both houses to prepare bills for introduction in January. It is too early to tell which members are in the best position to lead that effort. (Bliley is the key House Republican; Waxman and Fazio are important House Democrats; Hatch, Lugar, McCain, Jeffords, Mack, Campbell and several Republican moderates may be helpful in the Senate; Conrad, Lautenberg, Kennedy, and others are strong Senate Democrats). Ideally, we can lay the groundwork for a center-out coalition in the Senate, along the lines of Hatch-Kennedy or the Breaux-Chafee group, and work closely with Bliley, Waxman, and others in the House.

Senate committees have ~~already~~ held several hearings on tobacco over the past three months. Secretary Shalala testified before Jeffords' committee last week. The House may hold
hearings in November-December after adjournment.

The goal should be to forge a bipartisan vehicle you can endorse in January, and to make that the central focus of next year's State of the Union.

perhaps moving selected

Opponents of the legislation will make three types of arguments to slow it down. First, Nickles and others have criticized the Administration for failing to submit full legislative language to Congress and blamed the Administration for any delay in passage of a bill. Second, some will use the complexity of the issue as an excuse to go slow, ~~eventually permitting perhaps~~ only ~~restricted~~ portions of a bill to ~~advance following~~ lengthy hearings. Finally, opponents of legislation may focus on flashpoints such as farmers, restrictions on class action suits, or legal fees.

and that only

after

response

~~The Administration has a number of arguments to deploy in response to these expected attacks.~~ The strongest ~~argument~~ is to rise above partisan bickering, and stress the urgency of solutions that will protect America's children. ~~In addition, you have a~~ Your strong history of leadership on smoking issues ~~and can draw upon~~ public support in future disagreements with Congress.

any

III. PARTICIPANTS

To be Added by Leg. Affairs.

to these expected attacks

IV. PRESS PLAN

will allow you to deploy this strategy effectively and gain

The meeting is closed to the press. The members of Congress will have an opportunity to meet the press outside the White House following the event.

VI. REMARKS

Attached.

VI. REMARKS

* Thank you for coming to talk about this vital issue for America's future. (Acknowledge Gingrich, Gephardt, Nickles, Daschle, Bliley) This is an issue that touches on many aspects of American life -- our health, our economy, our laws, and our children -- and I want to acknowledge the hard work of so many of you in this room on this issue. In particular, I want to thank the Vice-President for his very important contribution. You are all here because of the critical role you will play as we work to pass legislation together. It is complicated, but I'm confident we can put politics aside and get this done.

* You and I are here because this is a crucial issue for America's future. Three thousand kids start smoking everyday, and it shortens the lives of one thousand of them. As I've said before, this is not about money, and it shouldn't be about politics. It should be about trying to reduce this problem of teen smoking.

not that

* Two weeks ago, I outlined the most significant elements I thought should be contained in a bill. ~~First, that~~ we ~~should~~ reduce teen smoking with tougher penalties, that we ~~shouldn't~~ hamstring FDA authority to regulate tobacco, that we make ~~there should be~~ some changes in the way tobacco is marketed, that we ~~need to~~ make more progress on other health goals like cancer research and second hand smoke. Finally, and this is very important to me, that we ~~need to~~ protect farmers and their communities. ~~This bill can't devastate those communities. They must be protected~~.

* This should not be a partisan issue. I'm going to put it at the top of my agenda for the next year, and I hope you will join me in making bipartisan legislation to reduce teen smoking a top priority for all of us in 1998.

* This bill will go through many committees and it affects many people and many states. It is not going to happen by fiat, but after you hold hearings, and work through the difficulties of legislation. And I'm sure we will have our differences. But this is too important for us not to get done. And it can't wait until we all agree on every word. We should work together and try to move ahead.

* I've said ~~in some detail~~ what I believe is ~~the~~ most important here. I've asked several members of my administration -- led by the Vice-President and my Chief of Staff Erskine Bowles, Secretary Shalala, Secretary Glickman, and Bruce Reed-- to work side by side with you along with ~~to~~ get this done.

* But I asked you here not just to tell you what I think about the issue but to hear what you think-- how we can work together, how we can get this done. So

I'll ask Vice-President Gore to give some of his thoughts, and I'd like to hear what directions you are going to take on tobacco legislation, where the problems might be and how we can work together.

QUESTIONS AND ANSWERS

Q. Why don't you submit legislation on tobacco?

A. We're happy to offer Congress our expertise and any other help in translating our principles into bipartisan legislation. I don't think there is any doubt where I stand. The five principles I set out in my plan are very clear. This is the first time I can remember Congress asking us to write the bill -- I recall a somewhat different reaction when we sent up legislation on health care. Members should introduce legislation, hold hearings and move for votes and I will play as constructive a role as possible.

Q. When should a bill pass?

A. It is at the top of my agenda for the coming year. There is nothing more important than saving thousands of children from taking up smoking. Three thousand are starting everyday.

Q. Will negotiations include industry?

A. The industry is a piece of this, but there isn't a need to negotiate with them.

Q. What is the role of the Vice-President?

A. The Vice-President will take a leadership role in the legislation and in building support for our plan.

Q. Will you support limits on liability?

A. I've said repeatedly that a cap on liability wouldn't be a deal breaker for us. But if we're going to do that, we should make sure we're passing a strong comprehensive plan to cut teen smoking.

Table S-7. TOBACCO LEGISLATION

(In millions of dollars)

	Estimate 1999	2000	2001	2002	2003	Total 1999–2003
USES OF RECEIPTS FROM TOBACCO LEGISLATION						
Federally-operated Programs:						
Research Fund for America	3,609	4,586	4,952	5,713	6,344	25,204
Food and Drug Administration Enforcement Activities	125	206	265	273	281	1,151
Health and Human Services/Centers for Disease Control Smoking Prevention	71	73	74	76	77	370
Medicare Beneficiaries' Cancer Clinical Trials Demonstration	200	250	300	....	....	750
Subtotal, Federally-operated programs	4,005	5,115	5,591	6,062	6,703	27,475
State-administered Programs:						
Child Care and Development Block Grant	1,155	1,280	1,400	1,600	2,065	7,500
Medicaid Child Outreach Reforms	110	150	210	210	220	900
Class Size Initiative	1,100	1,300	1,500	1,700	1,735	7,335
Subtotal, State-administered programs	2,365	2,730	3,110	3,510	4,020	15,735
Other Uses (Includes unrestricted funds for States, cessation programs, farmer assistance, etc.)	3,425	3,943	4,582	4,972	5,362	22,284
Total Uses	**9,795**	**11,787**	**13,283**	**14,544**	**16,085**	**65,494**
TOBACCO LEGISLATION RECEIPTS PROPOSED	**9,795**	**11,787**	**13,283**	**14,544**	**16,085**	**65,494**

10 12 13 14.5 16

Research 3.7 4.5 5 5.7 6.3

FDA

CDG

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OUTLINE FOR TOBACCO BRIEFING

I. Should the $1.50 increase be only from the settlement or other factors?

-- President said "up to $1.50."

-- Should be real settlement costs.

-- Industry estimates show non-settlement costs could easily eat up all but .62 of the 1.50 increase. Inflation is particularly important.

II. What are the effects of different levels of price increase on consumption? How does it effect industry profitability?

-- Starting at about $1 where teen smoking has diminished by 30%, rates drop by 5-6% every 25 cents up to $2.00. At $3 there is a 66% decrease.

-- Legislatively reduced prices lead (minus decrease ads and legal costs) to 10-17% lower profits.

-- FTC analysis shows that industry would increase prices above settlement costs. A 200% pass through of settlement costs to prices leads to a present value of after tax profits increases by about 78%.

-- Liability protection would lead to rising stock prices alone.

-- Tobacco farmers would suffer lower value quotas as cigarette prices rise.

-- Wholesalers/retailers suffer from reduced demand, possible penalties, loss of point of sale advertising.

-- Local/state excise taxes will diminish depending on the size of the excise tax.

III. Does the rate that prices increase make a difference?

-- This analysis didn't assume a sudden increase would have a different effect from an incremental one.

-- Arguably a sudden increase could have a shock effect, alternatively people may be better at adjusting their behavior over time.

-- Also sharp increases may lead to smuggling problems.

IV. Three possible approaches: (a) companies pay per pack into fund; (b) an excise tax, (c) public health user fee per pack, please discuss.

A. Antitrust exemption so that the tobacco companies can pay per pack increases into settlement fund is not warranted.

--even without an antitrust exemption, the cigarette manufacturers will raise prices to the amount of the settlement or greater than the settlement.

--FTC report concluded that there was insufficient justification for an antitrust exemption even unrelated to price such as achieving the goal of reducing youth smoking or as an exchange with the tobacco companies for the possibility that the settlements restrictions may be ruled unconstitutional.

B. A volume-adjusted penalty, excise tax, or per pack charge are effectively identical from a consumer point of view.

C. The current net stream of government revenue as envisioned by the settlement is substantially smaller than the face value contained in the settlement, and will decline over time.

--If objective is to fund public health programs, the payment should rise over time in line with the needs of the programs. By analogy, other entitlement programs have experienced rates of growth far in excess of inflation rates.

V. How big a price increase is necessary to achieve the youth smoking targets?

-- Price increases due to inflation alone will not help meet youth targets.

-- About $1.45 in fifth year to achieve 30% reduction; about $2.40 in seventh year to achieve 50% reduction; and about $3.00 per pack in tenth year to achieve 60% reduction (These estimates do not include any effect from non-price aspects such as access and advertising restrictions).

-- Comprehensive and <u>strongly enforced</u> restrictions on youth access to cigarettes could have significant effects on reducing underage use of cigarettes; might need incentives for communities to make compliance efforts; perhaps 20 to 40% reductions if strong enforcement of access restrictions.

-- Advertising restrictions are less clear on reducing youth smoking --the conclusions of several studies on advertising restrictions varies.

VI. How big a price increase to offset costs of smoking-related illnesses to the Federal government?

A. Medicare: costs of smoking-related illnesses are unclear because lower costs of healthier population are offset by increased life expectancies associated with reduced rates of smoking.

B. Medicaid, Veterans benefits, and FEHBP: costs unclear for the same reasons as for Medicare.

C. TRICARE for active-duty military (formerly known as CHAMPUS): more direct cost savings because this program serves a population under the age of 65.

VII. What are implications of $1.50 price increase for cigarette consumption, smoking rates, industry profitability, farmers, retailers, and wholesalers for different combinations of penalties and price increases?

-- President called for increase of up to $1.50 per pack.

-- Penalties will lead the industry to deter youth smoking (if it is able to do so) through non-price mechanisms if penalties are larger than the profits earned from youth smoking.

-- Tension between fighting smoking and having stable funding stream.

-- Administrative problems with relying solely on penalties as a means of raising settlement revenues. Issues re: reliability of youth smoking rates contained in surveys.

VIII. Ways to structure look-back penalties for missing youth smoking targets.

-- A mix of industry-wide and company-specific penalties would provide the best incentives; industry-wide penalties would promote efforts by all companies to reduce underage smoking; company-specific penalties would eliminate incentive for company to keep selling to youth and only pay part of penalty.

-- Substantial economic justification for de minimus exception assuming there is a "hard-core" group of youths that companies have no control over, regardless of the companies' actions.

-- One-time payment in year after target missed based on number of packs sold in previous year provides a known revenue vs. Per-pack taxes in year after target missed provides unknown revenue because level of sales is unknown when tax rate is instituted.

-- Difficulty in assessing different taxes on different brands.

-- Non-linear penalties provide the greatest incentives --i.e., penalties should increase as non-compliance rises.

OUTLINE FOR TOBACCO BRIEFING

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-- Comprehensive and <u>strongly enforced</u> restrictions on youth access to cigarettes could have significant effects on reducing underage use of cigarettes; might need incentives for communities to make compliance efforts; perhaps 20 to 40% reductions if strong enforcement of access restrictions.

-- Advertising restrictions are less clear on reducing youth smoking --the conclusions of several studies on advertising restrictions varies.

VI. How big a price increase to offset costs of smoking-related illnesses to the Federal government?

A. Medicare: costs of smoking-related illnesses are unclear because lower costs of healthier population are offset by increased life expectancies associated with reduced rates of smoking.

B. Medicaid, Veterans benefits, and FEHBP: costs unclear for the same reasons as for Medicare.

C. TRICARE for active-duty military (formerly known as CHAMPUS): more direct cost savings because this program serves a population under the age of 65.

VII. What are implications of $1.50 price increase for cigarette consumption, smoking rates, industry profitability, farmers, retailers, and wholesalers for different combinations of penalties and price increases?

-- President called for increase of up to $1.50 per pack.

-- Penalties will lead the industry to deter youth smoking (if it is able to do so) through non-price mechanisms if penalties are larger than the profits earned from youth smoking.

-- Tension between fighting smoking and having stable funding stream.

-- Administrative problems with relying solely on penalties as a means of raising settlement revenues. Issues re: reliability of youth smoking rates contained in surveys.

VIII. Ways to structure look-back penalties for missing youth smoking targets.

-- A mix of industry-wide and company-specific penalties would provide the best incentives; industry-wide penalties would promote efforts by all companies to reduce underage smoking; company-specific penalties would eliminate incentive for company to keep selling to youth and only pay part of penalty.

-- Substantial economic justification for de minimus exception assuming there is a "hard-core" group of youths that companies have no control over, regardless of the companies' actions.

-- One-time payment in year after target missed based on number of packs sold in previous year provides a known revenue vs. Per-pack taxes in year after target missed provides unknown revenue because level of sales is unknown when tax rate is instituted.

-- Difficulty in assessing different taxes on different brands.

-- Non-linear penalties provide the greatest incentives --i.e., penalties should increase as non-compliance rises.

OUTLINE FOR TOBACCO BRIEFING

I. Should the $1.50 increase be only from the settlement or other factors?

-- President said "up to $1.50."

-- Should be real settlement costs.

-- Industry estimates show non-settlement costs could easily eat up all but .62 of the 1.50 increase. Inflation is particularly important.

II. What are the effects of different levels of price increase on consumption? How does it effect industry profitability?

-- Starting at about $1 where teen smoking has diminished by 30%, rates drop by 5-6% every 25 cents up to $2.00. At $3 there is a 66% decrease.

-- Legislatively reduced prices lead (minus decrease ads and legal costs) to 10-17% lower profits.

-- FTC analysis shows that industry would increase prices above settlement costs. A 200% pass through of settlement costs to prices leads to a present value of after tax profits increases by about 78%.

-- Liability protection would lead to rising stock prices alone.

-- Tobacco farmers would suffer lower value quotas as cigarette prices rise.

-- Wholesalers/retailers suffer from reduced demand, possible penalties, loss of point of sale advertising.

-- Local/state excise taxes will diminish depending on the size of the excise tax.

III. Does the rate that prices increase make a difference?

-- This analysis didn't assume a sudden increase would have a different effect from an incremental one.

-- Arguably a sudden increase could have a shock effect, alternatively people may be better at adjusting their behavior over time.

-- Also sharp increases may lead to smuggling problems.

IV. Three possible approaches: (a) companies pay per pack into fund; (b) an excise tax, (c) public health user fee per pack, please discuss.

A. Antitrust exemption so that the tobacco companies can pay per pack increases into settlement fund is not warranted.

--even without an antitrust exemption, the cigarette manufacturers will raise prices to the amount of the settlement or greater than the settlement.

--FTC report concluded that there was insufficient justification for an antitrust exemption even unrelated to price such as achieving the goal of reducing youth smoking or as an exchange with the tobacco companies for the possibility that the settlements restrictions may be ruled unconstitutional.

B. A volume-adjusted penalty, excise tax, or per pack charge are effectively identical from a consumer point of view.

C. The current net stream of government revenue as envisioned by the settlement is substantially smaller than the face value contained in the settlement, and will decline over time.

--If objective is to fund public health programs, the payment should rise over time in line with the needs of the programs. By analogy, other entitlement programs have experienced rates of growth far in excess of inflation rates.

V. How big a price increase is necessary to achieve the youth smoking targets?

-- Price increases due to inflation alone will not help meet youth targets.

-- About $1.45 in fifth year to achieve 30% reduction; about $2.40 in seventh year to achieve 50% reduction; and about $3.00 per pack in tenth year to achieve 60% reduction (These estimates do not include any effect from non-price aspects such as access and advertising restrictions).

-- Comprehensive and <u>strongly enforced</u> restrictions on youth access to cigarettes could have significant effects on reducing underage use of cigarettes; might need incentives for communities to make compliance efforts; perhaps 20 to 40% reductions if strong enforcement of access restrictions.

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1. *The President has called for an increase in tobacco prices of $1.50 in a combination of price increases and penalties. The tobacco industry argues that a number of exogenous factors, including inflation, should be counted in determining the price increase. However, most economists believe that only real price increases, not nominal price increases, should be included in this calculation. As the Administration analyzes the effects of the price increases on tobacco consumption, the incidence of smoking, and the profitability of the tobacco industry and other industries in the tobacco supply chain, which price increases are relevant to the analysis? In particular, should inflation or exogenous price increases (for example, the ongoing trend of increased state and local sales and excise taxes) be taken into account, or should only those price increases directly attributable to the proposed settlement or comprehensive legislation be considered?*

- The President called for a "combination of industry payments and penalties to increase the price of cigarettes by *up to $1.50* a pack over the next decade as necessary to meet the youth smoking reduction targets."
- The intent of the statement was to call for a *real, settlement-induced* price rise of up to $1.50, which would amount to a more-than-doubling of the real industry payments called for the by settlement.
- The distinction between nominal and real prices is of critical importance, because it is the real price that matters for affecting the demand for cigarettes. Hence, the component of the price increase resulting solely from inflation will have no effect on demand. This is why the administration feels that substantial *real* price increases are required to meet the youth smoking targets.
- Unfortunately, the President's statement is being misinterpreted by the industry and Wall Street analysts. In particular, these parties are claiming that, even under the agreed-to settlement, prices would rise by more than $1.50 by the year 2007. The following table helps to show the different components of the industry's nominal price increase estimate:

Component	**Estimated Effect on Price per Pack**
Real Settlement Cost	$0.62
Inflation Effect	$0.78
Real Excise Tax Increase	$0.09
Other	$0.03

Total Nominal Increase	$1.52

- The tobacco industry projections show a *nominal* price increase of $1.52 by 2007 under the proposed settlement. Industry representatives point to that number as showing that the settlement already meets the President's goal of a price increase up to $1.50.

- But their estimate includes several things that cannot be directly attributed to the settlement: inflation, Federal and state excise tax changes, and increases in wholesale and retail markups.

- The most important difference is inflation as the distinction between the industry's *nominal* estimate and the President's *real* price amount becomes quite large 10 years out. *Over 85 percent* of the difference between the industry's projected $1.52 increase and the $0.62 real cost of the settlement is attributable to inflation. As a result, their real price increase is less than half as large as the price increase called for in the President's statement.

- The real excise tax increase of $0.09 (accounting for the $0.15 nominal increase and the inflation erosion on total Federal excise tax over time) will affect total use as well, but is *not part of the settlement*.

- Thus, in analyzing any legislation, only *real* price increases should be taken into account. Which real increases should be counted depends to some extent on the goal of the legislation:

  - If the goal is solely to reduce smoking, then all real price increases regardless of their source -- whether they result from settlement costs, excise taxes, or industry markups -- should be recognized as helping to reach that goal.

  - However, if a goal of the legislation is to provide funding for health programs, education, enforcement, etc., then the portion of the real price increase attributable to the real cost of the settlement becomes important.

2. *What are the implications of different levels of price increases on tobacco consumption, adult smoking rates, youth smoking rates, tobacco industry profitability and share prices, tobacco farmer profitability, tobacco wholesalers and retailers, and state and local tax revenues? For example, what would be the effects of the proposed settlement? What would be the effects of a 75 cent per pack increase? $1.00 per pack? $1.25 per pack? $1.50 per pack? $1.75 per pack? $2.00 per pack? $3.00 per pack?*

The following table shows our estimates of the reductions in total cigarette consumption, the number of adult smokers, and the number of teen smokers relative to a current law baseline for the various *real* price increases as described in the question.

Projected Smoking Reductions in the Sixth Year from Real Price Increases
(Percent Reductions from Current Law Baseline)

Real Price Increase	Total Cigarette Consumption	Adult Participation	Teen Participation	Range for Teen Particpation with Non-Price Effects*
$0.67--settlement	-15	-10	-20	-36 to -52
$1.00	-21	-13	-30	-44 to -58
$1.25	-26	-16	-36	-49 to -62
$1.50	-30	-19	-41	-53 to -65
$1.75	-34	-22	-46	-57 to -68
$2.00	-38	-24	-51	-61 to -71
$3.00	-51	-34	-66	-73 to -80

*Non-price effects of the settlement include fully enforced advertising and marketing restrictions, youth access restrictions, and counter-advertising.

The above estimates are based on Treasury methodology and estimation procedures. Estimates from other analysts -- including the JCT and the CBO -- could end up being different from what we have found.

It is also important to note that there is much more uncertainty about the non-price aspects of the settlement than about the price effects.

- The price effects are based on empirical research on the response of youth smoking to price changes.
- The non-price effects are based instead on our inference from several case studies in the literature. Moreover, these case studies suggest that these non-price effects will not emerge unless there is a very effective, coordinated, enforcement effort.

Effects on tobacco industry profitability and share prices: A large legislatively-induced real rise in prices would lead to a decline in profits for the tobacco industry, as sales volume would fall through the price effect noted above.

- On the other hand, to the extent that any legislation limited legal liability or advertising, as did the original settlement, it would offset this fall in revenues to some extent by lower legal and advertising costs

- After accounting for both of these factors, the original June 20 settlement was estimated to have lowered profits by 10-17%.

- But that estimate does not account for other possible changes. As shown in the FTC analysis (*Competition and the Financial Impact of the Proposed Tobacco Industry Settlement*), potential cooperative behavior by tobacco companies along with historical information indicate that companies could try to increase profits by raising prices in excess of the settlement costs. With a greater price increase, industry profits would rise as well, and the increase could be significant.

  - To the extent that the settlement facilitates cooperative price fixing (it has language calling for an antitrust exemption), discourages entry, reduces advertising, and raises the costs of output expansion, it could lead to price increases greater than the excise-tax equivalent of the industry payment.

  - A greater-than-1-for-1 pass through of the industry payment could actually lead to a *rise in industry profits,* which will be incrementally taxed at only 25 percent by this settlement.

  - The FTC analysis shows that, with a 200 percent pass-through of settlement costs to prices, the present value of after tax industry profits increases by about 78 percent.

- In any case, tobacco companies could gain from any legislation in this area *even if earnings were to decline*, if the legislation included the type of liability protection offered by the June 20 settlement. As a result, share prices could actually rise, as was suggested by many Wall Street analysts in the wake of the June 20 announcement, because of the reduced risk of high future liabilities.

  - Tobacco companies entered into the agreement for a very important reason: they were seeking protection from civil liabilities. That exemption is very valuable to the tobacco companies, due to the enormous uncertainty about the upside value of these future liabilities

- For this reason, most Wall Street analysts recommended the purchase of tobacco stocks in the wake of the settlement, and suggested that tobacco price/earning ratios could rise sharply due to this form of "insurance" that has been provided.

Effects on tobacco farmer profitability: Most of U.S. tobacco production has been under a price support and supply control program since the 1930s. Producers are guaranteed higher than market equilibrium prices in exchange for limiting marketings through marketing quotas. The quotas are based on intended purchases by cigarette manufacturers, export levels, and tobacco inflows needed to maintain specified reserve levels.

- Under the settlement, domestic use and marketings of tobacco would fall. As a result, the settlement likely would result in a decline in marketing quotas, as well as their value. Farmers would be adversely affected to the extent that the value of their production falls because of reduced quantities that could be marketed and because alternative crops that could be grown are not as profitable as tobacco. Generally, as cigarette prices rise and domestic tobacco use declines, the size and value of the marketing quota will decline.

Effects on tobacco wholesalers and retailers: Because of competitive market pressures, it is unlikely that wholesalers and retailers will be able to have an additional price markup beyond that of the manufacturers' markup. As a result, wholesalers and retailers will be affected by the reduction in the volume of demand for the product as a result of the price increase.

- As the volume of cigarette sales declines, the total revenues wholesalers and retailers receive from the sales will decline.

- In addition, retailers could face higher costs from meeting age-verification and point-of-sale advertising and access restrictions; these issues are discussed in detail in the FDA rule in the Federal Register (Vol. 61, no. 168, pp. 44426*ff*, 44577*ff*).

- Retailers would also face the higher potential costs from the monetary fines and criminal penalties that would be imposed for violating the laws relating to sales to minors.

Effects on state and local tax revenues: If state excise taxes grow only with inflation, then real State tax revenues from excise and sales taxes on tobacco products will decline as sales of tobacco products decline (from prices increases).

- For a state with a fixed real excise tax, the percentage decline in the real revenues that state receives would be equal to the percentage decline in the volume of sales in that state.

- Different levels of revenue effects will be realized because of differing volumes of sales and differing excise tax rates across states. For example, the states of Massachusetts, Michigan, and Washington have cigarette excise taxes of $0.75 per pack or more, while Kentucky, North Carolina, and Virginia have excise taxes of $0.05 per pack or less. The effects on state tax revenues from declining cigarette sales will obviously be greater in the states with the highest excise tax rates and lower in the states with the lowest excise tax rates.

3. *Some analysts suggest that sudden, dramatic price increases have a greater effect on smoking rates than a series of smaller price increases. How is the above analysis affected by the timing of the price increases?*

- Our analyses have not assumed any differential impact between a one-time real price increase or the same real price increase that is phased in over time. Generally, we have not experienced this type of change in the past and there is a large degree of uncertainty about this issue.

- There are factors on both sides of this issue, factors that could enhance or deter progress in reducing smoking.

  - On the beneficial side, a large one-time change could promote a sudden behavioral change that leads to reduced consumption, due to changing social norms about smoking in an environment of much higher prices.

  - Alternatively, individuals may be more successful over time in adjusting their behavior -- in this case, use of an addictive substance -- than over a very short time period.

- It's also possible that, because of difficulties of users to reduce consumption in the short-run, that a large one-time price increase may promote smuggling behavior more than a gradual change. Generally, black market activity will compromise the beneficial effects of price increases in reducing smoking.

4. *The proposed settlement envisions companies paying per pack amounts into a settlement fund, and covering these payments through an increase in the price of tobacco products. The settlement contains an anti-trust exemption, in part to ensure that companies raise prices in concert. Others have suggested that the price increase should be effectuated through an increase in the Federal excise tax or through a public health user fee imposed on a per pack basis. What are the pros and cons of these three approaches?*

The FTC report *Competition and the Financial Impact of the Proposed Tobacco Industry Settlement* (September 1997) specifically addresses the proposed antitrust exemption in an Appendix entitled "An Analysis of the Proposed Antitrust Immunity for Tobacco Product Manufacturers." The FTC addressed three arguments for having the tobacco companies receive some anti-trust immunity from the tobacco settlement:

- The tobacco settlement proposes shifting the cost of the settlement to consumers by allowing collusive pricing behavior by the companies.
- The settlement's restraints on advertising may be a violation of First Amendment rights of free speech.
- Achieving the targets for the reduction of youth smoking requires an ability to control, and possibly to sanction, retailers not cooperating in eliminating sales to underage smokers.

The FTC report concluded that even without shielding tobacco industry coordination from the antitrust laws, the proposed settlement would likely lead to price increases as large or greater than the cost of the settlement. There is little reason to believe competitive pressures would inhibit any company from passing on the (industry-wide) settlement costs fully.

- The greatest impact of anti-trust immunity with respect to price coordination would therefore be to open up the opportunity to raise prices by more than the settlement costs, and produce enhanced profits for the tobacco companies.
- On the basis of past experiences with increases in State tobacco excise taxes, the industry appears to be quite capable of increasing prices by the amount of the new taxes *without any grant of anti-trust immunity*. Recent cigarette price increases in relation to the Florida and Mississippi litigation provide support to the FTC's interpretation that the price increases will occur without the anti-trust exemptions.

The other arguments not related to price fall short as well:

- The proposed legislation already contains sufficient incentives for tobacco companies to individually sanction non-complying outlets. An antitrust exemption is therefore not needed to discipline outlets, and could be exploited for other anti-competitive purposes

- It is not necessary or advisable to confer broad anti-trust immunity up front to cover the speculative contingency that the governmental restrictions on advertising might be ruled unconstitutional. At the most, a very narrowly focused exemption, might be warranted.

Hence, the arguments presented above are not sufficient to support the settlement's call for tobacco manufacturers to be able to "jointly confer, coordinate or act in concert" in order "to achieve the goals of [the] Agreement and the Act relating to tobacco use by children and adolescents."

A volume-adjusted penalty, excise tax, or per pack charge are effectively identical. In terms of the price increase and the user response to the price increase, there is no real difference between a volume-adjusted penalty, an excise tax, and a per pack penalty.

- Under the proposed settlement, the volume adjustment for the annual payments effectively converts the payments into an excise tax equivalent: the total payment tracks the number of packs sold, so that the amount that is paid per pack sold remains constant
- As a result, this is identical to any other per pack charge, be it through a tax or through a per-pack "user fee".
- However, in terms of implementation, a difference could arise. For example, a per-pack fee imposed at the plant -- as opposed to an excise tax levied at point of sale, for example -- could aid in deterring efforts to circumvent the law, thereby keeping illegal marketing of cigarettes down.

This question highlights the problems of the settlement mechanism for rising revenues. The current net stream of government revenues envisioned by the settlement will be much smaller than the statutory value of payments, and will decline over time. But if one objective of the settlement is to provide adequate funding for public health programs (such as children's health initiatives), the payment should rise over time in line with the needs and costs of such programs.

- The actual annual payments will be substantially <u>smaller</u> than their $15 billion face value (to the extent that price increases and an underlying declining trend lead to less smoking) which in turn will reduce the payment through the quantity adjustment mechanism.
- Even the volume-adjusted payments are much larger than the net receipts to the government, due to offsets to other excise and income tax receipts and the costs to the government of a rise in the CPI.
- Although the annual payments are adjusted for general price inflation, many of the programs that may be funded are health and entitlement programs that have traditionally experienced rates of cost growth far in excess of overall inflation rates. Even non-entitlement spending can be expected to grow in real terms. As a result, the ability of the

industry payments to fund entitlement programs will shrink due to reduced purchasing power.

5. *If price were the only factor affecting smoking rates, how big a price increase would be required to achieve the youth smoking targets called for in the settlement? How much "credit" should be given for the non-price policy changes proposed in the settlement?*

First, it should be stated that price increases due to inflation will not help to meet the youth smoking targets; it requires *real* price increases to reduce youth smoking as well as total consumption.

- The settlement calls for phased-in targeted reductions in youth smoking from a base amount of 15.2 percent: a 30 percent reduction from base by the fifth year of the settlement; a 50 percent reduction by the seventh year; and a 60 percent reduction by the tenth year.

- Our estimates show that meeting the targeted reduction *through price increases alone* would require a *real* price increase of about $1.45 in the fifth year to achieve the 30 percent reduction; about $2.40 in the seventh year to achieve the 50 percent reduction; and about $3.00 per pack in the tenth year when the ultimate targeted reduction of 60 percent takes effect. These estimates do not include any effect from non-price aspects of the settlement, such as access and advertising restrictions.

The question of the effect of "non-price" aspects of the settlement is more difficult to answer.

- A review of the relevant studies and analyses indicates that comprehensive and enforced restrictions on youth access -- similar to what is proposed in the national tobacco settlement -- could have significant effects in reducing underage use of cigarettes and other tobacco products.

- To be effective, however, access and other restrictions would have to be strongly enforced. It is fairly clear to us that individual states and local communities will all have to make concerted efforts to assure compliance with efforts to reduce youth smoking. Some type of incentives for the local communities may be necessary in order to promote compliance efforts.

- The evidence on the role of advertising restrictions and counter-advertising is less clear. The FDA cites a number of studies and cases in which advertising restrictions or counter-advertising have led to reductions in underage or overall use of cigarettes. However, a significant number of other studies -- some funded by the tobacco industry -- presented contrary results showing that advertising restrictions or counter-advertising were not responsible or effective in initiating or retarding use of cigarettes; other factors, such as family and peer use, were the key factors in determining whether an underage individual would smoke.

- The above information suggests that a reduction in underage teen smoking could be accomplished by properly implemented and enforced access restrictions contained in the national tobacco settlement. An estimate for the general range of the effect suggests that perhaps as much as a 20 to 40 percent reduction from current levels of use could result from these types of restrictions. Without full enforcement, however, little or no effect on underage smoking should be expected.

- At a 40 percent reduction in use from the non-price aspects of the settlement, which is the upper end of our estimates, a real price increase of about $1.50 would be required to achieve the targeted reduction in youth use.

- But it is important to emphasize that the non-price estimates are considerably more uncertain than our estimates of price impacts.

  - The price effects are based on empirical research on the response of youth smoking to price changes.

  - The non-price effects are based instead on our inference from several case studies in the literature. Moreover, these case studies suggest that these non-price effects will not emerge unless there is a very effective, coordinated, enforcement effort.

6. How big a price increase would be required to offset the costs of smoking-related illnesses to the Federal government (including Medicare, Medicaid, veterans benefits, CHAMPUS and FEHBP) over the next 25 years?

Although a clear goal of public policy is to promote long and healthy lives, from a pure accounting perspective, there are offsetting effects for the role that cigarette smoking plays in terms of the cost to Federal health programs. Smoking-related illnesses directly raise the cost of health care costs because of the cost of service provided to ill individuals. However, because smoking reduces the life span of smokers, the cost of many programs is reduced over a longer horizon; hence, a settlement-induced reduction in smoking could boost costs from having longer life expectancy.

- *Medicare:* The cost of smoking-related illnesses to Medicare is, on balance, unclear, because the lower costs of a healthier population are offset by the increased life expectancies associated with reduced rates of smoking.
  - On the one hand, costs are higher because per person lifetime Medicare costs are higher for smokers, lowering both HI (Medicare Part A) and SMI (Medicare Part B) program expenditures. In addition non-smokers will contribute additional payroll tax revenue to the HI Trust Fund.
  - On the other hand, this will be offset to some extent by the lower lifetime costs of smokers due to the fact that they have shorter life expectancies and therefore collect fewer years of Medicare benefits after age 65.
  - Thus, raising the price of cigarettes has offsetting effects: it lowers spending on those former smokers who are alive, since they are healthier, but raises spending because former smokers live for more years.
- The effect on Medicaid is also problematic.
  - Annual per person Medicaid costs are higher for smokers. Further costs accrue from the fact that female smoking raises the incidence of very costly low birthweight babies.
  - However, raising cigarette prices would lead to increased Medicaid expenditures on the eligible elderly population, through increased Medicaid long term care payments for the now longer-lived population.
- Veterans benefits and the FEHBP would experience similar conflicting effects. For example, with reduced smoking under the settlement, over time the Veterans Health Administration would likely realize lower acute hospital care costs but higher nursing home care costs. Similarly, a reduction in the number of Federal employee smokers would

lead to lower costs of managing smoking-related illnesses, but Federal retirees would live longer, leading to higher medical costs over time.

- The effect on the Defense Health Program under TRICARE (formerly known as CHAMPUS), would be more direct because of its primary focus on active duty personnel, their dependents, and individuals under the age of 65. For this program, the benefit from the reduction in the direct costs of servicing smoking-related illnesses would be the primary effect.

7. *The President called for a $1.50 per pack increase in cigarette prices in a combination of price increases and penalties for missing the youth smoking targets. What are the implications for cigarette consumption, smoking rates, industry profitability, farmers, retailers and wholesalers of different combinations of price increases and penalties? For example, how do the effects of a $1.00 price increase and a 50 cent penalty differ from the effects of a 50 cent price increase and a $1.00 penalty? What about 75 cents each? Or a $1.25 price increase and 25 cent penalties?*

First, it should be stated that the President called for an increase in the price of cigarettes of *up to $1.50* if youth smoking reduction targets are not met.

There are three key issues for thinking about the difference between price increases and penalties.

The first is whether penalties for youth smoking actually lead the industry to actively deter youth smoking through non-price mechanisms (which they will have an incentive to do, so long as the penalties are larger than the profits earned from that youth smoker)

- If the tobacco industry has any ability to deter youth smoking, then youth penalties have an auxiliary benefit relative to price increases, since there is both a price and a non-price impact on youth smoking rates.
- In contrast, if the industry is completely unable to affect the youth smoking decision, then there would be little expected difference in results from equivalent per pack payments or penalties.
- In general, though, youth penalties would create the proper incentives, under which the industry's goals would align with the goals of the legislation.

The second issue is the potential tension that could arise between fighting smoking and having a stable funding stream.

- For example, with a reliance on youth penalties, if success is attained in reducing youth smoking, then the policy would be unsuccessful from the perspective of raising revenues. In contrast, if there were a lack of success in reducing youth use, then the policy would be successful in raising revenues.

The third issue is administrative difficulties that arise when we rely solely on youth penalties as a means of raising the settlement revenues:

- There are potential concerns about the reliability of youth smoking rates as measured through survey evidence, particularly as a basis for the determination of billions of dollars of penalty payments.

- Also, to the extent that the industry could simply shift from targeting underage youths to targeting young adults, even if success were attained in reducing underage use and penalty payments were low as a result, ultimate success in reducing adult smoking may not be attained.

8. *Look-back penalties for missing the youth smoking targets could be structured in several different ways. The following questions would help the task force understand the implications of some potential options for look-back penalties:*

8A. *What are the pros and cons of imposing penalties on an industry-wide, company-specific, or brand-specific basis? Would some combination of these approaches make more sense and why? If the penalties are imposed on a company- or brand-specific basis, is there justification for a de minimus exemption? Does this create a potential loophole?*

In order to provide the proper incentives, a mix of both industry-wide and company-specific penalties would probably be best. Industry-wide penalties would help to promote an effort on the part of all companies to encourage lower overall underage use of cigarettes. Company-specific penalties would provide incentives to *not* encourage use of their brands or even *discourage* underage use of their brands.

- Under the settlement, the smoking reduction targets are specified based on industry-wide underage usage. As a result, *individual* firms would have a monetary incentive to keep selling to youths because they would reap the full reward while bearing only part of the penalty. The advantage of specifying the fines on a *company by company basis* is that the fine would hit an individual firm's profits directly if it failed to reduce youth smoking of its brands.

- To be effective, any penalties must be a multiple of the expected profits deriving from a given youth smoking for the remainder of his/her life; otherwise, the penalty will not provide incentives for firms to reduce youth smoking.

- However, there are potential disadvantages to relying solely on company-specific fines. Relatively small differentials across companies in per pack penalties are sufficient to place individual companies at a severe competitive disadvantage. Also, data problems exist for a company-by-company approach that would have to be addressed before it could be implemented; there are no current national data collected on brand-specific smoking rates by youth.

Regarding the de minimus exemption: Substantial economic justification exists for a *de minimus* exemption. If companies or the industry have little control over "hard core" use, and are effectively unable to promote additional reduction in underage use beyond some low level, then penalties in that range will provide no incentive to the companies to try to reduce use. To create the proper incentives, and to attain the greatest reduction in use possible for a given fine, having higher penalties at higher levels of use -- where companies presumably could have an impact -- would be more effective.

8B: *What are the implications of collecting this penalty as a tax increase collected on each pack sold in the year following a year in which the youth smoking target was missed versus a one-time payment in the following year assessed on the basis of a per pack charge for each pack sold during the year in which the target was missed? If the former option were adopted, would there be administrative difficulties with assessing different per pack taxes on different brands or computing the size of the tax in time to impose the tax at the beginning of a calendar year?*

In the first case, which specifies the penalty as a tax on forthcoming sales will result in uncertain revenues, because the (1) tax increase will affect the level of sales and (2) the level of sales will be unknown when the tax rate is instituted. The latter case will provide a known amount of revenue because the volume of sales from the previous year will be known.

- If the tax were levied on a per-pack basis in the year following a missed target, it would be difficult to determine the proper per-pack tax level to generate a given level of payments because the quantity would not be known.
  - As the size of the per-pack tax is increased, the quantity likely would decline as price increases, and any such change could only be predicted with an error. As a result, the expected revenues would also be subject to uncertainty. In this case, the per-pack price increase from taxes would be known with certainty.
- The second case of a one-time payment assessed on the basis of the previous year's quantity of sales would yield exact revenue estimates as the per-pack penalty would be known with certainty and the quantity on which it would be based (last year's quantity) would also be known with certainty. In this case, however, the exact effect on the pack price would be uncertain, depending on how much of the penalty firms attempted to pass through to prices.

Concerning the assessment of different taxes on different brands: It would be very difficult to administer *brand-specific* taxes. Companies could shift costs from high-tax brands and spread them over other brands, reducing the price effect for the brand with the higher tax. Also, companies could reduce production of high-tax brands and increase production of lower-tax brands, or even introduce new brands. Company-specific penalties may be feasible, but brand-specific fines likely would be very difficult or impossible to implement successfully.

8C: *Penalties could be assessed as a flat fee or per pack charge that does not vary no matter how much the youth smoking target is missed, or it could be structured to ramp up steeply as the distance from the target increases. What are the pros and cons of different ways of graduating the penalty depending on the amount by which the target is missed?*

The penalty -- or some part of it -- for missing youth targets could be made "nonlinear" to maximize impact. For example, a ***non-abatable*** part of the surcharge could be structured to cost more per percentage point of youth use at higher levels than at lower levels. This would have the effect of increasing the penalty as the level of noncompliance rises. Another way of implementing this nonlinear penalty approach would be to have the abatement percentage increase as the level of teen smoking got closer to the reduction target.

- The escalating levels of fines presumably would represent increasing multiples of the present value of the profits a firm would expect to receive over the life of a teen smoker.
- If companies can take action to reduce smoking to some extent, but the ultimate level of success is uncertain, non-linear penalties would provide the greatest incentive in the range where they can make a difference.

11/13/97

NOTE: THIS IS A VERY PRELIMINARY ROUGH DRAFT -- AREAS WHERE AN INSUFFICIENT ANSWER HAS BEEN PROVIDED ARE MARKED WITH [**MORE HERE ...]. THOSE AREAS CAN BE FOUND IN WP BY SEARCHING ON THE ** SYMBOLS.

Questions from Sen. Conrad

1. *The President has called for an increase in tobacco prices of $1.50 in a combination of price increases and penalties. The tobacco industry argues that a number of exogenous factors, including inflation, should be counted in determining the price increase. However, most economists believe that only real price increases, not nominal price increases, should be included in this calculation. As the Administration analyzes the effects of the price increases on tobacco consumption, the incidence of smoking, and the profitability of the tobacco industry and other industries in the tobacco supply chain, which price increases are relevant to the analysis? In particular, should inflation or exogenous price increases (for example, the ongoing trend of increased state and local sales and excise taxes) be taken into account, or should only those price increases directly attributable to the proposed settlement or comprehensive legislation be considered?*

Private sector analysts have made estimates of the increases in cigarette prices that would occur over the next decade including the effects of the proposed national tobacco settlement. Their estimates show that the bulk of the increase in prices is attributable to inflation. In addition, most analysts' estimates of real settlement costs and the price markup relative to those settlement costs are very similar to those of the Administration. Hence, the differences in the price estimates in terms of the "public debate" are almost solely the result of inflation. Those who are arguing that prices would already be expected to increase by $1.50 are taking advantage of the fact that the President's statement did not clearly state that the price effects he was referring to were in real terms. *Even the Administration's estimates would show a price increase of about $1.62 for the basic settlement by 2007 when inflation is taken into account.*

A small survey of private analsyts' estimates show a *nominal* price increase by 2002 in the range of about $1.20 to $1.45. Roughly one-third of that increase can be attributed to inflation. In addition, most of the analysts assumed increases in real State taxes, accounting for about 3 to 5% of the overall price increase. After adjusting for inflation and real State and Federal tax increases, the range of estimates for the real price increase *resulting from the settlement* is about $0.64 to $0.79, representing a price markup ratio (analagous to the definition of the FTC report) in the range of of 100% to 133% relative to their estimated real settlement costs.

In 2007, the range of estimates for the price increase is $1.52 to $1.90, with about one-half of that increase attributable to inflation. The inflation- and tax-adjusted price increases are in the $0.59 to $0.62 range, representing a price markup ratio range of 100% or less. These estimates compare with internal Administration estimates which used an ultimate real settlement cost of about $0.63 per pack -- resulting from (1) $0.57 from the annual payment for cigarettes (smaller than the oft-cited $0.62 because part of the payment will be paid by non-cigarette tobacco products such as smokeless, cigars, etc.) and (2) about $0.06 from the youth lookback surcharge payments. We assumed no additional *real* markup by manufacturers, wholesalers or retailers, and that State excise taxes rose only with inflation -- yielding a markup ratio of 100%.

To the extent that State excise taxes are expected to increase in real terms, those real increases should be included in calculating the effect on the demand for cigarettes or the effect on adult or teen participation in smoking.

A comparison of the various private estimates indicates that most of the increase in prices can be attributed to factors other than the settlement -- inflation, the Federal excise tax increase from the 1997 budget legislation, and State and local excise tax increases. Aside from those factors, most analysts do not appear to expect large additional markups beyond the cost of the settlement.

Hence, the confusion that exists in the public discussion of the $1.50 price increase is almost solely over real vs. nominal prices. The $1.50 cited by the President is in real terms, just as the $368.5 billion settlement cost over 25 years is in real terms.

However, some of the confusion about real price increases also extends to the issue of the effects of price increases on demand for cigarettes. For example, one private analyst based an estimate of the effect on the volume of cigarette sales on the increase in nominal prices, while estimates in the economic literature for price effects on the demand for cigarettes are based on real, inflation-adjusted prices and not nominal prices.

2. *What are the implications of different levels of price increases on tobacco consumption, adult smoking rates, youth smoking rates, tobacco industry profitability and share prices, tobacco farmer profitability, tobacco wholesalers and retailers, and state and local tax revenues? For example, what would be the effects of the proposed settlement? What would be the effects of a 75 cent per pack increase? $1.00 per pack? $1.25 per pack? $1.50 per pack? $1.75 per pack? $2.00 per pack? $3.00 per pack?*

effects of prices

Statistical evidence suggests that the demand for cigarettes is price inelastic -- meaning that the percentage change in consumption is less than the percentage change in price. After a review of various studies, we chose to use a price elasticity of demand among adults of -0.47 in the current range of real prices, and an adult participation price elasticity of -0.26. Teenagers, who represent about 7 percent of all smokers (but consume fewer packs than adults per smoker), appear to be more responsive to price than adults, with an elasticity of participation of about -0.7 in the current range of real prices. We used a semi-logarithmic functional form in the demand equations for our analysis; the adult participation and total cigarette consumption equations included a term for a trend decline. The adult participation equation also included and adjustment factor to attempt to capture the contributory effect from reduced teen smokers as those teens become adults. One result of using the semi-logarithmic specification is that the arc elasticity of demand (the relationship over the total change in price from its initial starting point) declines gradually as the price increases.

If the volume-adjusted payments were passed on to consumers on a 1-for-1 basis, the average price of cigarettes would rise from about $1.90 currently to about $2.70 per pack (in real prices) by the sixth year; this increase includes the annual payments of the settlement, the youth look-back surcharge, and the $0.15 (nominal) excise tax increase from the BBA legislation. (Note that this case closely approximates the $0.75 increase discussed in the question above.)

- Overall cigarette consumption would decline by about 15 percent compared with what consumption would be under current law -- current law includes the additional Federal excise tax. Consumption would be 20 percent lower than current use levels.

- The number of adult smokers would decline by about 10 percent compared to current law and about 15 percent compared to current use levels. The number of teen smokers would fall by about 20 percent, for a reduction in the number of teen smokers by about 800,000 by 2003.

The following table shows estimates of the reductions in total cigarette consumption, the number of adult smokers, and the number of teen smokers relative to a current law baseline for the various *real* price increases as described in the question.

Projected Smoking Reductions in 2003 from Real Price Increases
(Percent Reductions from Current Law Baseline)

Real Price Increase	Total Cigarette Consumption	Adult Participation	Teen Participation
$0.67	-15	-10	-20
$1.00	-21	-13	-30
$1.25	-26	-16	-36
$1.50	-30	-19	-41
$1.75	-34	-22	-46
$2.00	-38	-24	-51
$3.00	-51	-34	-66

[**MORE HERE. TO FULLY ANSWER QUESTION, NEED DISCUSSION HERE ON THE FOLLOWING:

2a. EFFECTS ON TOBACCO INDUSTRY PROFITABILITY (discuss this with CEA and FTC) AND SHARE PRICES (general write-up will come from S. Lepper)

2b. EFFECTS ON TOBACCO FARMER PROFITABILITY (Most of U.S. tobacco production has been under a price support and supply control program since the 1930s. Producers are guaranteed higher than market equilibrium prices in exchange for limiting marketings through marketing quotas. The quotas are based on intended purchases by cigarette manufacturers, export levels, and tobacco inflows needed to maintain specified reserve levels. Under the settlement, domestic use and marketings of tobacco (flue-cured and burley) would fall. As a result, the settlement likely would result in a decline in marketing quotas, as well as their value. Farmers would be adversely affected to the extent that the value of their production falls because of reduced quantities that could be marketed. However, much of this would be made up by Federal payments at the loan rate. **CHECK THIS WITH AG]

2c. EFFECTS ON TOBACCO WHOLESALERS AND RETAILERS (Assuming no markup of tax at the wholesale and retail level, the wholesalers and retailers will be affected by the reduction in demand for the product as a result of the price increase. Retailers could face higher costs from meeting point-of-sale advertising restrictions. This last point is discussed in detail in the FDA rule in the Federal Register. **MORE

2d. EFFECTS ON STATE AND LOCAL TAX REVENUES (If State excise taxes grow only with inflation, then real State tax revenues from excise and sales taxes on tobacco products will decline as sales of tobacco products decline as prices increase. **MORE HERE, also note that relative comparisons could be made across States by size of existing excise tax rates by State]

3. *Some analysts suggest that sudden, dramatic price increases have a greater effect on smoking rates than a series of smaller price increases. How is the above analysis affected by the timing of the price increases?*

Our analysis does not assume any differential impact between a one-time real price increase or the same real price increase that is phased in over time. However, there is a large degree of uncertainty about this issue. In particular, a large one-time price increase may promote smuggling behavior more than a gradual change. Over time, individuals are more able to adjust their behavior -- in this case, use of an addictive substance -- than over a very short time period.

[**MORE HERE, calls into OTA and ATF]

4. *The proposed settlement envisions companies paying per pack amounts into a settlement fund, and covering these payments through an increase in the price of tobacco products. The settlement contains an anti-trust exemption, in part to ensure that companies raise prices in concert. Others have suggested that the price increase should be effectuated through an increase in the Federal excise tax or through a public health user fee imposed on a per pack basis. What are the pros and cons of these three approaches?*

Regarding the proposed anti-trust exemption, the FTC report *Competition and the Financial Impact of the Proposed Tobacco Industry Settlement* (September 1997) specifically addresses the proposed exemption in an Appendix entitled "An Analysis of the Proposed Antitrust Immunity for Tobacco Product Manufacturers."

Three arguments are presented for having the tobacco companies receive some anti-trust immunity from the Tobacco Settlement:

- The ability to shift the cost of the settlement to consumers, as desired by the Government, requires collusive pricing behavior by the companies prohibited by the anti-trust laws. Evidence suggests that although the tobacco industry is not very price competitive, prices for tobacco products remain well below the levels that coordinated pricing practices could produce. On the basis of past experiences with increases in State tobacco excise taxes, it appears the industry is quite capable of increasing prices by the amount of the new taxes *without any grant of anti-trust immunity.* Given the industry-wide cost increase inherent in the settlement, there is little reason to believe competitive pressures would inhibit any company from passing on those costs fully. The greatest impact of anti-trust immunity with respect to price coordination would therefore be to open up the opportunity to raise prices by more than the settlement costs, and produce enhanced profits for the firms in the industry.

- The settlement's restraints on advertising also require coordinated behavior and may be a violation of First Amendment rights of free speech. The argument is as follows. The tobacco companies apparently fear the agreement to limit billboard advertising and ads in selected magazines could be challenged by other affected interests (e.g., billboard companies, magazine publishers, etc.). If the courts were to rule against the tobacco companies, they could then be liable under the anti-trust laws for anti-competitive practices. There are strong precedents in the case of liquor and tobacco companies restraining from advertising on television at the present time. This argument is not sufficient grounds for granting anti-trust immunity in this area.

- Achieving the targets for the reduction of youth smoking requires an ability to control, and possibly to sanction, retailers not cooperating in eliminating sales to underage smokers. Retailers who can skirt the enforcement efforts designed to eliminate sales to minors have a profit incentive to sell to minors. Tobacco companies are concerned that, unless the companies are empowered to deny these outlets their tobacco products, the companies will be penalized for the youths smoking their brands while powerless to do anything to stop them. Regulators typically consider it to be undersirable to permit the exercise of marketing control by manufacturers, and it is feared the granting of such powers to the tobacco companies will be used for other anti-competitive practices (e.g., exclusive dealerships, etc.).

Of the three, only the last one appears to have any legitimacy.

Turning to the excise tax alternative, from an economic perspective and in terms of the price increase and the user response to the price increase, there is no real difference between an excise tax and a per pack penalty. Under the proposed settlement, the volume adjustment for the annual payments effectively converts the payments into an excise tax equivalent. ......[**THIS DISCUSSION PROBABLY NEEDS SOME REVISION]

Where the objective is to collect money from the companies (as compensation for past behavior, for example), a fixed payment is the best approach. This is because companies' pricing and output decisions should be the same irrespective of any fixed payment. In other words, a fixed payment will come out of a company's bottom line and affect its share price and earnings, but it will not translate into higher prices for cigarettes and other tobacco products.

But this point highlights the tension with another goal of the settlement: discouraging smoking. The alternative to a fixed payment is a per-pack payment, which is achieved by volume adjusting the stream of payments. This approach approximates an excise tax, and as such is directly passed through to the price of cigarettes with the resultant decline in smoking. But such an approach puts the burden on continuing smokers (and possibly marginal tobacco companies) rather than on large and profitable companies; since the payments are passed on to consumers, with constant marginal costs there is relatively little effect on the companies' bottom line. Moreover, the industry could become more collusive, which would raise profits.

This tension speaks to the bargaining strategy with the tobacco companies. Each dollar of fixed payments buys less public health benefits, but is much more painful to the companies themselves. This suggests that the ultimate bargain may not appreciably raise the fixed payments, but that the threat of higher fixed payments is an important negotiating tool along the way.

From the perspective of a public health user fee: The current stream of payments envisioned by the settlement will decline over time. But if one objective of the settlement is to provide adequate funding for public health programs (such as children's health initiatives), the payment should rise over time in line with the needs and costs of such programs. This could be accomplished, for example, by removing the volume adjustment and increasing the statutory payments by the health care CPI.

The problem with this approach, however, is that it penalizes efforts by the tobacco companies to lower smoking, because the per pack tax rises as volume falls (since the fixed payment is spread over fewer packs). That is, a non-volume adjusted payment has the unattractive feature that an innovation that lowers smoking actually raises the tax per pack. To the extent that the tobacco companies can control the level of smoking, this type of approach would reduce their incentive to exert that control, because they would be penalized by a higher (effective) excise tax.

5. *If price were the only factor affecting smoking rates, how big a price increase would be required to achieve the youth smoking targets called for in the settlement? How much "credit" should be given for the non-price policy changes proposed in the settlement?*

Price increases due to inflation will not help to meet the youth smoking targets; it requires real price increases to reduce youth smoking. The full targeted reduction of 60 percent from the base amount of 15.2 percent would be required by the tenth year of the settlement, which would be 2007 if legislation to implement it were passed in 1998. Our estimates show that meeting the targeted reduction through price increases alone would require a *real* price increase of about \$3.00 per pack. If expected inflation is taken into account, that translates into an expected nominal price increase of about \$5.00 per pack.

\$3.0 w/o ind. increases.

The question of the effect of "non-price" aspects of the settlement is more difficult to answer. A review of the relevant studies and analyses indicates that comprehensive and enforced restrictions on youth access -- similar to what is proposed in the national tobacco settlement -- could have significant effects in reducing underage use of cigarettes and other tobacco products. To be effective, however, access and other restrictions would have to be strongly enforced. The settlement provides funds for enforcement through the FDA, but it is unclear at this point how exactly that enforcement would occur.

The evidence on the role of advertising restrictions and counter-advertising is less clear cut. The FDA cites a number of studies and cases in which advertising restrictions or counter-advertising have led to reductions in underage or overall use of cigarettes. However, a significant number of other studies -- some funded by the tobacco industry -- presented contrary results showing that advertising restrictions or counter-advertising were not responsible or effective in initiating or retarding use of cigarettes; other factors, such as family and peer use, were the key factors in determining whether an underage individual would smoke.

At some point, for purposes of analyzing the settlement's effect in domestic markets, the exact magnitude of the effect of advertising restrictions and counter-advertising are not of critical importance. If restrictions on retail sales to minors are properly enforced, that effort combined with price increases could yield a significant decline in underage use; advertising restrictions and counter-advertising efforts would serve to reinforce the price effects and marketing restrictions, as well as provide an information role. The changes all should move in the same direction, so it isn't as if we would have to consider offsets to price or marketing restriction effects.

The studies, analyses and review suggest that a reduction in underage teen smoking could be accomplished by properly enforced access restrictions contained in the national tobacco settlement. A ballpark estimate would suggest that perhaps as much as a 20 to 40 percent reduction from current levels of use could result from properly implemented and enforced access restrictions and advertising restrictions and counter-advertising. Without full enforcement, however, little or no effect on underage smoking should be expected.

6. How big a price increase would be required to offset the costs of smoking-related illnesses to the Federal government (including Medicare, Medicaid, veterans benefits, CHAMPUS and FEHBP) over the next 25 years?

[**MORE HERE -- INFO FROM JOHN HAMBOR, OR OMB'S HEALTH GROUP, HHS??]

7. *The President called for a $1.50 per pack increase in cigarette prices in a combination of price increases and penaltiies for missing the youth smoking targets. What are the implications for cigarette consumption, smoking rates, industry profitability, farmers, retailers and wholesalers of different combinations of price increases and penalties? For example, how do the effects of a $1.00 price increase and a 50 cent penalty differ from the effects of a 50 cent price increase and a $1.00 penalty? What about 75 cents each? Or a $1.25 price increase and 25 cent penalties?*

On economic grounds, once the penalty on youth is greater than the expected profits that companies would receive from the youth smokers over time, there is no reason to load more on the youth target. It would be better to put it in the form of an overall penalty. The overall payment approach would yield a more stable funding stream and less room for measurement error that could result from use of the survey of high school cigarette smoking.

[**MORE HERE --]

8. *Look-back penalties for missing the youth smoking targets could be structured in several different ways. The following questions would help the task force understand the implications of some potential options for look-back penalties:*

8A. *What are the pros and cons of imposing penalties on an industry-wide, company-specific, or brand-specific basis? Would some combination of these approaches make more sense and why? If the penalties are imposed on a company- or brand-specific basis, is there justification for a de minimus exemption? Does this create a potential loophole?*

Want both

Some part of the fines for missing youth smoking reduction targets could be levied on a firm-by-firm basis to create the right incentives and to avoid "free-rider" problems. Because the smoking reduction targets are specified based on industry-wide underage usage, individual firms would have a monetary incentive to keep selling to youths because they reap the full reward while bearing only part of the penalty. This problem results from the fact that the look-back surcharge would be paid by all firms according to their total (primarily adult) market share. As each firm has this same incentive, in practice it is less likely that the reduction targets would be met. By specifying the fines on a company by company basis, the fine would hit an individual firm's profits directly if it failed to reduce youth smoking of its brands.

The key factor is that the fine companies face should be a multiple of the profits represented by the youth smoker. For example, the youth lookback surcharge of the proposed settlement was set equal to the present value of the expected profits from youth smoking. That approach would make firms indifferent between encouraging or discouraging youth smoking. To be effective, any penalties must be recognizably greater than the expected profits.

It should be recognized that there are data problems with a company-by-company approach that would have to be addressed before it could be implemented. Company-by-company fines would require that the Michigan Survey be expanded -- or an alternative survey created -- to ask underage tobacco users about their brand preferences and use. For example, base brand-use percentages would have to be established and the percentage reduction targets would be measured relative to those base brand-use percentages. The excess number of underage users of a specific brand would then be specified as the percentage point reduction shortfall times the number of underage users. Since, currently, it is not yet known what the base market share is for each company, then when the Michigan Survey were expanded for that purpose, firms would have an incentive to boost their sales to teens in the near term so as to establish an inflated baseline from which to attain reductions. Further, a mechanism would have to be developed to deal with reported use of more than one brand. Finally, implementation on a company-by-company basis would require that the fines be specified on a *per youth smoker* basis in order to make proper calculations. For example, base brand-use percentages would be established and the percentage reduction targets would be measured relative to those base brand-use percentages. The excess number of underage users of a specific brand would then be specified as the percentage point reduction shortfall times the number of underage users.
[**MORE HERE -- the *de minimus* issue -- the bang for the buck]

8B: *What are the implications of collecting this penalty as a tax increase collected on each pack sold in the year following a year in which the youth smoking target was missed versus a one-time payment in the following year assessed on the basis of a per pack charge for each pack sold during the year in which the target was missed? If the former option were adopted, would there be administrative difficulties with assessing different per pack taxes on different brands or computing the size of the tax in time to impose the tax at the beginning of a calendar year?*

[**MORE HERE --]

96 97

X - pack

97 per

8C: *Penalties could be assessed as a flat fee or per pack charge that does not vary no matter how much the youth smoking target is missed, or it could be structured to ramp up steeply as the distance from the target increases. What are the pros and cons of different ways of graduating the penalty depending on the amount by which the target is missed?*

The penalty (or some part of it) for missing youth targets could be made "nonlinear" to maximize impact. For example, the *non-abatable* part of the surcharge could be structured to cost more per percentage point of youth use at higher levels than at lower levels. This would have the effect of increasing the penalty as the level of noncompliance rises. Another way of implementing this nonlinear penalty approach would be to have the abatement percentage increase as the level of teen smoking got closer to the reduction target.

The escalating levels of fines presumably would represent increasing multiples of the present value of the profits a firm would expect to receive over the life of a teen smoker.

If companies can take action to reduce smoking to some extent, but that the ultimate level of success is uncertain, non-linear penalties would provide the greatest incentive in the range where they can make a difference.

Additional informal questions:

a. How much of a burden would the deal place on tobacco companies?

--should be subsumed into discussion of stock market effects in question 2. Make this a broader discussion of burden on companies. Key is to emphasize that effect of settlement/legislation should be evaluated relative to counterfactual of a world of legal uncertainty.

b. Are price increases or penalties more effective in deterring smoking?

This is subsumed in answering question 5

c. What can the tobacco companies live with; what is tough vs. what is fair?

This is subsumed in question 2 discussion referenced in (a). This is clearly going to be a critical part of the letter, and you should be careful that it is clearly delineated and doesn't get lost in large answer to question 2.

d. Do the various brands of smoking or potential court challenges create difficulties for attaining the reductions in youth smoking?

I don't understand this, and I think that you should blow it off.

e. How will black market activity affect the success of the settlement?

This is a critical question. My guess is that you should just discuss this in question 3, as per my comment above, highlight that it is an important issue, and say that we are looking into it.

f. Isn't the amount of money for counter-advertising insufficient when compared to the advertising and marketing budgets of the industry?

I think that we should add to the letter a general discussion of the restrictions on advertising. Chad did some work on this early on and you should contact him for help.

g) We should add discussion of incentives for new products, as per the overview memo
h) Excess profits -we need to discuss tension between wanting prices to rise and allowing > 100% pass-through, and how an excess profits tax is difficult to appropriately design. This may fit into the anti-trust discussion, or it may need to be separate.

i) Spending side -we need to somewhere make the point that the settlement should account for the fact that many of the activities on which money will be spent grow in real terms over time (e.g. health care spending), so that monies may need to grow as well.

j) Revenues -we need to make sure that letter points out revenue offset effects. They didn't explicitly ask for revenue estimates, presumably because they want these from JCT. But we should still find a way to incorporate the point that the revenues are a lot lower than you think. Perhaps this could be incorporated with the point immediately above somewhere.

k) When you are done, step back and reread the "overview" memo that we sent this summer. Be sure that this letter reflects all the main points that we tried to get across i