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OFFICE OF THE DEPUTY SECRETARY
 DEPARTMENT OF THE TREASURY
 1500 PENNSYLVANIA AVENUE, NW
 WASHINGTON, D.C. 20220
 FACSIMILE COVER SHEET

July 1, 1997

FOR: Dr. Janet Yellen
Phone: 395-5042
Fax: 395-6958
TOTAL PAGES: 8
FROM: Lawrence Summers
PHONE: 202/622-1080
FAX: 202/622-0081

MESSAGE:

Please see attached - FYI.

To: Larry Summers
From: Jeremy Bulow
203-432-3721
203-389-0724

cc: Wdlin
Gribber
Yellin.

7 pages including this one.

Larry,
I'm also getting ahold of some
reports from three securities firms.
Hopefully I'll have those in another
day or two.

Jeremy

Jeremy's concerns

- lawyer fees still written into deal & negotiated as to total amt
- would prefer quantity restriction

The Tobacco Settlement

1. Economics of Cigarettes

Per Pack:

Retail Price	1.85
Fed. Tax	.24
State Taxes	.34
Distributors	.44
Wholesale	.83

Wholesale	.83
Marketing	.23
Legal	.025
Other	.25
Profits	.33

Industrywide:

Retail Sales	\$45 billion
Taxes	\$14 billion
Distributors	\$11 billion
Manufacturers	\$20 billion

Of which: \$5.5 billion marketing and advertising
\$600 million legal
\$8.4 billion operating profits

2. Industrial Organization

Premium cigarettes are about 30 cents more per pack at wholesale than discount cigarettes. Operating profits are much more closely related to premium cigarette sales than to overall sales. Economic profits may be thought of as proportional to premium sales.

Elasticity of demand is approximately -.4 or -.5.

Sales (Market Shares)

	Premium		Discount		Total	
Philip Morris	194.8	(56.3)	36.0	(26.2)	230.8	(47.8)
RJR Nabisco	75.0	(21.7)	44.1	(32.1)	119.1	(24.8)
BAT*	35.7	(10.3)	48.1	(35.1)	83.9	(17.3)
Lorillard	38.1	(11.0)	2.9	(1.7)	40.4	(8.4)
Liggett	2.4	(0.7)	6.7	(4.9)	9.0	(1.9)
Total	346.0	(71.8)	137.2	(28.4)	483.2	(100.0)

BAT (Brown & Williamson) information was calculated as a residual from industry information and the information available from the other companies' 10K reports.

Philip Morris has 2.43 billion shares outstanding at about \$42 per share, for a total market value of \$102 billion.

Philip Morris earns 1/3 of its profits in domestic tobacco and 1/3 in foreign tobacco. Foreign sales are about 660 billion vs. 230 billion domestically, but margins are much lower in foreign sales. However, the foreign business is growing while the sales of domestic cigarettes are following a long term trend of falling 1-2 percent per year.

3. Financial Terms of the Settlement

\$10 billion will be paid upfront, in proportion to market value. So Philip Morris will pay about \$6.5 billion. The agreement specifies that this amount will be tax deductible, meaning that the cost is equal to approximately 14 months' pretax profits for the industry. I don't know whether settlements in tort claims are normally deductible business expenses. These costs should be treated the same way as normal tort settlements for tax purposes.

The industry also agrees to pay an excise tax per pack of cigarettes sold. The pre pack figures given below are overstated by the fraction of the tax to be borne by smokeless tobacco. These taxes should be, and will be, deductible as ordinary business expenses.

- 1998 35 cents a pack.
- 1999 39 cents a pack.
- 2000 48 cents a pack.
- 2001 58 cents a pack.
- 2002 62 cents a pack.
- After 2002: 62 cents a pack.

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All taxes are to be adjusted for inflation, defined as the maximum of the CPI adjustment and 3%. If consumption remains unchanged, the tax will raise \$8.5 billion in 1998 and \$15 billion in 2002 and thereafter. Predictions based on the elasticity of demand is that consumption should fall 15% once the full tax is phased in, beyond the normal trend of 1-2% per year.

There is also an excess profits tax of 25% of the industry's real domestic tobacco profit growth, up to the point where the total tax bill would be the same as if there were no reduction from 1996 sales. I assume that this sum will also be paid through a further increase in the tax rate rather than by companies actually having to pay a portion of their profits.

The "Public Health Trust" receives \$2.5 billion the first two years, then \$3.5 billion, then \$4 billion, then \$5 billion, then \$2.5 billion. Among the mandated uses of the money is \$75 million for ten years to compensate events, teams, or participants (race car drivers) who lose tobacco sponsorship money.

No class action or punitive damage claims. In any event, total payments will not be more than \$2 billion per year for all tort claims. (Any excess is rolled over and queued up.) Any leftover money, if the \$2 billion is not reached, is distributed by a commission appointed by the President. Note the awful incentive problem. The tobacco companies are totally insured against all such judgements, and in fact would have no incentive to defend against them. However, the public health and government entities that would be the residual claimants on these funds would have an incentive to minimize payouts.

4. How to Value the Settlement

The 14 months' pretax profits that must fund the initial settlement may be worth about 14% of the domestic businesses of the companies. This assumes that real profits will decline by 2% a year, and should be discounted by 10% a year. This imputes a value to the business of roughly \$40 billion (for after tax profits of about \$5 billion), once the litigation is settled.

However, we must also consider the business lost because of the tax increase. One estimate would be that because business is supposed to drop 15% the long run value of the businesses will be 15% lower. There are arguments that can be made to raise (or lower) this number, principally based on whether prices will rise by more or less than 100% of the tax. You can have theoretical models that go either way. If the tax is passed on dollar for dollar, maybe the 15% number is right, and the companies are taking a 29% hit.

There is also the issue of how the lawyers are to be compensated. If that is additional money that does not come from the current agreement, then the total

cost to the companies may be substantially more. If the lawyers are to be paid an extra \$5 billion in expectation, for example, then (a) the total cost of the settlement to the companies rises to 35% and (b) we can be sure that the money comes from funds that otherwise would go to the states. More on lawyers later.

5. Youth Smoking

If youth smoking falls by less than 35% over the next 10 years, an additional tax of 8 cents per pack will be added to the price. However, if companies can show that they took appropriate measures to attempt to reduce such smoking, then the tax is reduced by 75 percent. If youth smoking is reduced by 35-60 percent the tax is reduced linearly.

Given the estimate that youth smoking has an elasticity of demand of perhaps -1, the 40 percent increase in initial prices combined with the secular fall in cigarette demand should make the youth smoking goal attainable. In any event, depending on how the requirements for receiving the tax reduction are enforced, the tax might be very small anyway.

A better approach might be to raise the age for smoking from 18 to 21, perhaps over a five year period. This would eliminate legal smoking by all high school students, and make it much less likely that the typical 15-17 year old would have close friends with easy, regular access to cigarettes. Presumably there is some data on this.

Using some of the money collected to pay a workmen's compensation program type program of disability payments to smokers who became disabled before normal retirement age might be a way to improve the incidence of the program. It would also be a good way of discriminating between young and old smokers, so that the young would face high prices while the old would suffer less from the incidence.

6. What makes the program a tax?

*Payments are (essentially) a fixed amount times number of packs sold.

*New entrants to the business, who are not liable for any past damages, would still be required to pay the same amount per pack.

7. Lawyers' Fees

The lawyers have managed to keep their fees out of the agreement. I think that it is essential that those fees be resolved as part of the agreement, and that they be related to the upfront payments rather than to the tax payments.

There are two kinds of lawyers involved. The class action lawyers will be paid based on the determinations of an arbitrator. The Wall St. Journal estimates that these lawyers may get \$1 billion. It is unclear that their clients will get anything, unless they subsequently file individual suits. The lawyers representing the states have varying agreements. Some have said that they will use the arbitrator. The Wall St. Journal estimated that these lawyers may try to get as much as 3% of the gross value of the next 25 years' tax revenues, or \$11 billion. Some of these lawyers have contingency fee arrangements that give them 25% of what the state collects.

It seems to me to be a very bad idea to let the lawyers get a percentage of the money that is raised by their facilitating a tax increase. States should be able to raise their cigarette taxes without having to turn over a portion of the revenue to their cigarette tort lawyers. Besides, we have had several tort suits where the customers have only been compensated with couponsin this case many of the "beneficiaries" are being compensated with negative coupons!!!

My recommendation is that the agreement follow these terms: Overall legal fees should be capped at some percentage of the amounts paid up front, ideally with a maximum of, say \$2 billion. An arbitrator can examine all claims, and if the claims approved are in excess of \$2 billion then claims of under \$1 million can be given first priority, claims between \$1-5 million next priority, etc. If the lawyers are paid in this way then we can rest assured that any final settlement will involve an adequate up-front payment by the companies.

8. Summary of Potential Improvements to the Tobacco Deal

- (i) Raise the smoking age to 21 over 5 years. This and the price increase should do more than telling kids not to smoke and strangling Joe Camel. 16 and 17 year olds will know less people who can buy legally, and no one in high school would be able to buy cigarettes legally.
- (ii) CAFÉ-style caps on the average level of tar and nicotine in a company's cigarettes. (Current deal limits tar and nicotine to 12 mgs/cigarette but says nothing about averages.)
- (iii) Incentivize the companies to fight tort lawsuits by individuals. As the proposal stands, the marginal cost of any tort settlements is borne by the government and health agencies who will not want to be put in the position of fighting these plaintiffs.
- (iv) To improve incidence, have most of the tort money put into a "no fault" type workmen's compensation fund that would pay medical bills and lost wages for smokers with lung cancer and emphysema. Could also be applied to smokers

who have died or become disabled in recent years. This enables the price of cigarettes to rise, cutting youth smoking, while reducing the regressiveness of the plan. It also helps with the incentive problem cited in (iii).

(v) Put a cap on legal fees in return for a larger lump sum payment. If legal fees are capped at 20% of the lump sum then the companies should be willing to pay a larger lump sum, assuming that the legal fees are not to come out of the tax revenues. Such a cap could help states negotiate claims with their lawyers, some of whom will undoubtedly try to claim contingency fees based on the amount of tax revenue raised rather than the amount of damages paid. With the legal fees made a percentage of the lump sum, we can be sure that the attorneys will negotiate a lump sum that is an appropriate punishment for the companies. Lawyer claims can be submitted to an arbitrator, but if the total of all claims approved exceeds 20% of the lump sum, then rationing can be used in a manner similar to that proposed for tort claimants if total approved payments exceed the cap.

(vi) Instead of raising taxes, institute a licensing system which sells the companies a fixed (and declining) quantity of cigarette stamps. By using quantity rather than price, and auctioning off the licenses, we will substantially reduce the incentive for the industry to recruit new customers. With a tax, once this bill is passed, the companies have a reduced incentive to go after underage smokers but every incentive to recruit new smokers age 18 or over. With licenses similar to the pollution licenses used in the Clean Air Act, we will get gradual, progressive, predictable reductions in smoking. Because there is a small number of companies in the industry it is likely that the auctions will not be fully competitive. To protect against collusion leading to excess profits, floor prices can be set on the licenses that gradually rise to 62 cents per pack.

*to be
- econ*

Memorandum

July 3, 1997

From: Chad Stone, CEA
Jon Gruber, Treasury
To: Elizabeth Drye, DPC
Subject: Progress Report on Economics Task Force, Domestic Issues

Attached are several undigested pieces of material that are part of what will feed into a draft report we hope to complete next week:

1. An outline/progress report of the tasks being undertaken
2. Preliminary fact sheets on the domestic industry (foreign stuff to come)
3. Preliminary set of working assumptions feeding into the analysis
4. Preliminary bibliography of key economic articles, etc. for estimating elasticities and other effects.
5. Memorandum from DOJ antitrust division assessing the settlement
6. Memorandum from USDA on effects on tobacco farmers.
7. Preliminary Treasury assessment of "lookback"

All of these are preliminary and many are undigested and not integrated into the analysis.

Outline/Progress Report - Industry and Financial Issues

The domestic industry task force is gathering information to describe the likely impact of the settlement on the domestic tobacco industry. How will economic and financial incentives be changed by the settlement and how will the evolution of the industry and other affected sectors be different from what would have happened in the absence of a settlement? The policy framework informing this assessment of the facts assumes the objective of the settlement is to reduce smoking by raising the price of cigarettes and other tobacco products, with special attention paid to reducing youth smoking. An additional objective is to prevent the tobacco industry from profiting unduly from the settlement in order that the "profits" from raising cigarette prices can be diverted to specified public health and other purposes.

Outline of tasks:

A) Fact Sheet on industry structure and performance

- Domestic
- International

B) Effect of settlement on prices

- Can view this as an excise tax
- How are excise taxes passed through to prices in the tobacco industry?

C) Effect of settlement on smoking

- Incorporate effect on prices and advertising restrictions
 - effect overall, and by age group
 - cohort projections

D) Impact on the industry

- Effects on prices and labor demand
- Two methods
 - primary analysis (back of the envelope calculations), based on FDA research
 - summary of market analysis, including stock price response
- Overall, and company-by-company

E) Spillover Effects

- Rough magnitudes of effects on other sectors, from FDA research
- USDA is computing specific effects on farmers

F) Health Effects

- FDA and CDC are computing mortality by group and cohort

G) Government revenue effects

- Treasury's Tax Policy group is computing revenue effects of settlement
 - how much is collected through this implicit excise tax
 - corporate tax receipt effects, accounting for deductibility
 - excise tax spillovers
- Estimate incidence of this implicit excise tax increase
- Compare properties to traditional excise tax change

H) Government spending effects

- Treasury's Economic Policy group is computing effects on
 - Social Security/SSI/DI
 - Medicare
 - Medicaid
- Effects on PBGC through bankruptcies of smaller tobacco firms - DoL
- Effects on other government spending - OMB

I) Incentive Effects

- Industry
 - product substitution
 - youth smoking incentives through lookback provisions
 - is the penalty set at an appropriate level?
- Consumers
 - product substitution
- Government/Legal system
 - legal incentives through structure of punitive damage pools
 - distribution of initial \$10 billion across parties

**FACT SHEET
ON THE U.S. TOBACCO INDUSTRY**

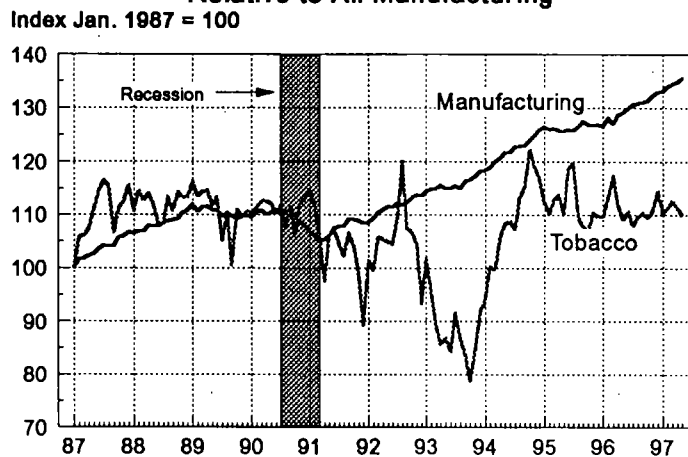
Production

- **The United States was the world's second largest tobacco producer** in 1994, accounting for about 9 percent of the estimated 6.44 million metric tons that were produced worldwide.

Top 10 Leaf Tobacco Producers		
		<u>Metric Tons</u>
1.	China	2,559,700
2.	United States	575,389
3.	India	524,500
4.	Brazil	398,000
5.	Turkey	219,983
6.	Zimbabwe	209,042
7.	Indonesia	171,400
8.	Greece	131,875
9.	Malawi	130,686
10.	Italy	130,400

- The U.S. **tobacco crop** in 1995 was worth almost \$2.3 billion, making it the seventh largest cash crop for the nation and representing approximately 2.7 percent of the total for all cash crops and farm commodities.
- The **manufacture of tobacco products** accounted for \$16.6 billion or 0.2 percent of gross domestic product in 1994, down from 0.6 percent in the early 1960's.
- **U.S. factories produced** 760 billion cigarettes in 1995, of which 234 billion (nearly one-third) were shipped abroad for foreign consumption.
- The manufacture of tobacco products **accounts for 1.2 percent of U.S. industrial output.**
- **Production slid from early 1991 through most of 1993** ... [will find out what was going on], but by mid-1994 returned to levels that prevailed in the late 1980's. (See chart on the next page.)

TOBACCO PRODUCTION Relative to All Manufacturing



Consumption

- **Per-capita cigarette consumption has been on a long-term decline** in the United States from a record high of 4,345 in 1963 (based on the population 18 years and over) to 2,515 in 1995 -- a drop of 42 percent. [Will try to get time series. Chart might be interesting.]
 - About **25 percent of all adults currently smoke.**
 - **Shares are generally even higher for older adolescents:** 30.4 percent of 10th graders, 34.0 percent of 12th graders report that they have smoked in the past 30 days, according to the Michigan survey. Smoking is much more highly concentrated among white than black teens (38.1 vs. 14.2 percent for 12th graders).
- **Consumers spent \$47.2 billion on tobacco products in 1995, or 1.0 percent of all consumer expenditures.**
- **93 percent of the money was spent on cigarettes.** U.S. consumption was divided as follows:
 - 487 billion cigarettes
 - 2.5 billion cigars and cigarillos
 - 14.2 million pounds of pipe and roll-your-own tobacco
 - 63.3 million pounds of chewing tobacco
 - 60 million pounds of snuff

- The **1995 consumer expenditure survey** shows that the average household spent \$269 that year on tobacco products and smoking supplies, with **households in the lowest income quintiles spending more of their budget on tobacco.**

Tobacco Expenditures by Income Quintile in 1995					
	Lowest 20%	Second 20%	Third 20%	Fourth 20%	Highest 20%
Tobacco	\$204	\$242	\$327	\$307	\$278
Share of total expenditures	1.4%	1.1%	1.1%	0.8%	0.4%

Employment and Wages

- **Tobacco manufacturing's contribution to payroll employment is minuscule.** In 1996, 41,000 workers were employed in the tobacco manufacturing industry (which includes processing of tobacco, as well as production of cigarettes, cigars, etc.), or only 0.03 percent of the 119.5 million workers on nonfarm payrolls. More than 100,000 workers (0.23 percent of nonfarm employment) had been employed in the industry in the early 1950's.

-- [Employment in major states to be added]

- **Production workers in the tobacco industry earned \$19.44 an hour last year,** 52 percent more than the average worker in manufacturing. Tobacco industry wages have climbed steadily from less than 75 percent of the average factory wage in the early 1950's. Few other industries can boast comparable wages (coal mining, steel, petroleum and coal product manufacturing also have earnings that top \$19 an hour).

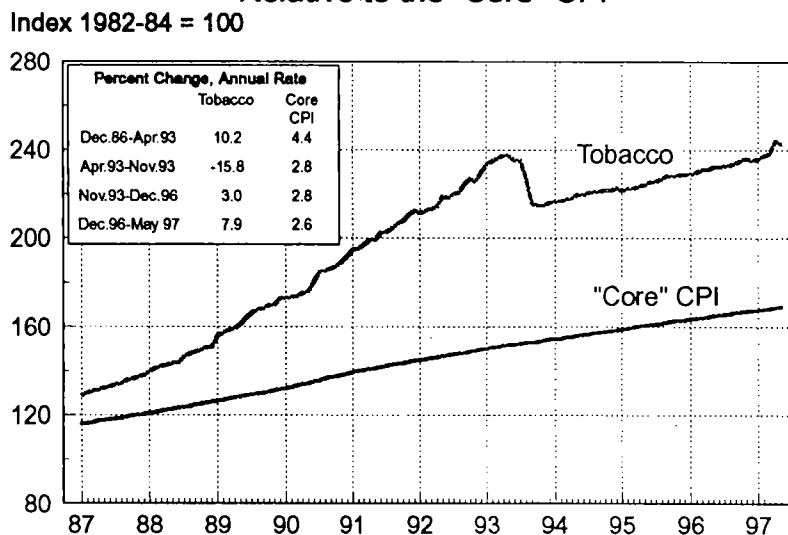
Average Hourly Earnings in 1996	
Private nonfarm	\$11.81
Manufacturing	12.77
Tobacco	19.44

- Of course, **agricultural jobs** are also provided in the cultivation of tobacco, which tends to be exceptionally labor-intensive, requiring 250 work hours per acre harvested compared to 3 hours for wheat. In 1995, 124,270 farms raised tobacco, harvesting 674,300 acres. A rough estimate would suggest that some 80,000 full-time equivalent jobs might be tied to raising tobacco.

Prices

- **Tobacco products have a weight of only 1.6 percent in the CPI.** Thus, it would take a change of 6.25 percent in tobacco prices to move the CPI by 0.1 percent.
 - **Over the past decade, tobacco prices have risen at a 6.3 percent annual rate, compared to 3.7 percent for "core" consumer prices** (excluding food and energy). Faster growth was mainly the result of a sharp uptrend prior to 1993. (See chart below.)
- **In 1993, there was a steep downward adjustment in prices ...**[am getting clarification on the reason], after which tobacco prices grew at about the same pace as the core.
- **This year, tobacco prices have sped up again, increasing at nearly an 8 percent annual rate through May.**

CONSUMER TOBACCO PRICES Relative to the "Core" CPI



Industry Composition

- **The market is dominated by Philip Morris,** which accounts for half of cigarette sales in the United States. (See table on the next page [need to find out from Jeremy Bulow just what these sales numbers represent].)

The Cigarette Market in 1996		
	Sales (Mil.\$[?])	Market Share (%)
Philip Morris	230.8	47.8
RJR Nabisco	119.1	24.6
BAT	83.9	17.3
Lorillard	40.4	8.4
Liggitt	9.0	1.9
TOTAL	483.2	100.0

Advertising Expenditures

- **Magazine advertising** for tobacco and related smoking materials accounted for \$285 million, or 3.4 percent, of the \$8.5 billion spent by all industries in 1994.

Prepared by
Treas./Econ.Policy/K.Hendershot

Parameters and Assumptions for Tobacco Settlement Calculations

Per Pack Cost of Cigarettes

Retail Price	1.85
Federal Tax	0.24
Average State Tax	0.32 (0.025 to 0.815)
Distributors	0.44
Wholesale	0.83
Marketing	0.23
Legal	0.025
Other	0.25
Profits	0.33

Cigarettes per pack: 20

Total packs of cigarettes sold in 1996 (U.S.): 24.4 billion

(Not surprisingly, multiplying the number of smokers by the average packs smoked give a lower total of 18.8 billion. This is probably due to under reporting and perhaps a few “nonsmokers” who bought a few packs.)

Total large cigars and cigarillos sold in 1996 (U.S.): 2.5 billion

(This is the total, I don't know how many per pack.)

Total pounds of pipe and roll-your-own tobacco sold in 1996 (U.S.): 14.2 million

Total Number of Adult Smokers: about 50.5 million

(based on 1987, 1991 rates)

Total Number of Underage Smokers: about 3.1 million (1994 Surgeon General's Report)

New Underage Smokers: about 1 million per year (FDA Analysis)

If about 25% of 17 year-olds smoke, about 925,000 smokers turn 18 every year. If the FDA's 1 million number is correct, these smokers who become adults are being more than replenished by new young smokers.

Average number of Packs Smoked (Adults): about 1 pack per day (18.2 cigarettes)

Distribution of packs smoked: 36.6% <15, 41.9% 15-24, and 21.5% 25+

Average Number of Packs Smoked (Underage): about ½ pack per day (For 1991, “teenage” cigarette consumption is estimated at about 516 million packs. Assuming that there are about 3.1

million teenage smokers -- these are from different studies so they may not really be comparable -- that translates to about ½ pack per day per smoker.)

Kids per Age Cohort: About 3.8 million

Youth Smoking Rates (“Daily” is used for the Lookback provisions)

Age	30-day	Daily	½ pack+/day	# of Daily
8th graders	21.0	10.4	4.3	395 thousand
10th graders	30.4	18.3	9.4	695 thousand
12th graders	34.0	22.3	13.0	847 thousand

Adult Smoking Rates

	Current	Former	Never
Adults 18+	25.7	24.1	50.2
18-24	22.9	7.7	69.3
25-44	30.4	19.4	50.2
45-64	26.9	32.9	40.2
65+	13.3	36.4	50.3

(Adult population is about 190 million.)

Adult “Quit” Rates

(percent of ever-smokers who are former smokers)

Adults 18+	48.5
18-24	25.2
25-44	38.9
45-64	55.1
65+	73.3

Spending on Tobacco by Income Level (CBO 1990)

Quintile	1990 Adj. Post-Tax Income	Average Expenditure	% of After-Tax Income	% of Expenditure
1st	8,228	327	4.0	1.6
2nd	18,101	380	2.1	1.5
3rd	27,314	426	1.6	1.4
4th	37,581	427	1.1	1.1
5th	77,622	383	0.5	0.7

Demand Elasticities: A consensus estimate for overall demand elasticity is -0.4. The following table from the Surgeon General's report gives elasticities by age (and is consistent with the literature):

Age Group	Total	Participation	Quantity per Smoker
12-17	-1.40	-1.20	-0.25
20-25	-0.89	-0.74	-0.20
26-35	-0.47	-0.44	-0.04
36-74	-0.45	-0.15	-0.15
All Adults (20-74)	-0.42	-0.26	-0.10
All Ages (12-74)	-0.47	-0.31	-0.11

Industrial Organization and prices: For now we are assuming a 1 to 1 pass through of any "tax" to prices, but a number of people are looking into the validity of this assumption. More to come soon.

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Aug-90 Congress of the United States

FROM

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Antitrust Division
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| ___ C&F, 616-8544 | ___ Support Services, 514-2200 |
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| ___ Fiscal, 514-6738 | ___ Telecommunications Task, 514-6381 |

FROM: Ken Hoyer, Antitrust Division

Comments: Here's the memo Doug Melamed had promised you.

Total Pages Transmitted: 12 (Including Transmittal Sheet)
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I. The settlement has 5 major goals:

- (A) Prevent youth smoking;
-highest priority because most smokers start before they are legal age
- (B) Get current smokers to quit or reduce smoking;
- (C) Make tobacco less hazardous for those that continue to smoke;
- (D) Avoid protracted litigation;
-it is expensive for all parties
- (E) Reduce involuntary exposure to smoking.

II. This memorandum focusses primarily on the key portions of the proposed Act that are designed to implement the first three goals.

III. A general observation about the settlement:

A slight familiarity with the details of the settlement would lead one to believe that the cigarette companies will be paying large sums of money out of their own pockets. In reality a large portion of the settlement will be borne by consumers. To the extent that one believes that the purpose of the settlement should be to punish the cigarette manufacturers, one would be disappointed to learn that consumers will be paying a large amount of the settlement. However, to the extent that one believes the most important objective of the settlement should be to reduce youth smoking, then having consumers pay for settlement, through higher prices, is preferable to having the money come from the tobacco companies.

IV. In this section we describe the two major economic proposals of the settlement.

- (A) The Base Annual Payments
 - there are annual payments specified for a period of 25 years
 - there is an inflation factor applied to the payments
 - when tobacco sales increase, the payment increases proportionately. When tobacco sales decrease, the payment declines if adult tobacco sales have declined relative to the base year. Under these circumstances, the payment declines proportionately to adult sales.

-if there is a reduction in the base payment, if industry profits increase above the industry's base year net operating profits, then the annual payment reduction will be reduced by 25%.

(B) The Surcharge

- is a penalty if the industry fails to meet certain targets for reducing youth smoking.
- the surcharge is \$80 million per percentage point the industry fails to meet the target. There is a \$2 Billion cap per year for the industry.
- the \$80 million may be reduced by up to 75% (the abatement) if firms meet youth marketing and other restrictions
- the \$80 million number will be adjusted proportionately for percentage increases or decreases compared to base year profit.
- Each tobacco firm pays its portion of the surcharge on the basis of its market share.

V. **Problems with the Actual Settlement Terms**

(A) Here's how the base payment scheme would actually work:

(1) If total volume of smoking increases, the settlement increases proportionately. In other words, for increases in total volume the payment scheme is equivalent to an excise tax per pack.¹ [While not strictly an excise tax (in the sense that a per pack tax is not tacked on at the sales register), tobacco companies will recognize that their total payment, when they come due, will be dependent on how many packs are sold. Thus, the economic effect is as if they were faced with an excise tax].

(2) If youth smoking declines and adult volume is

¹Here's an example: Suppose that total base volume is 200, 100 each for adult and youth, and the base payment is \$10. This can be thought of as a 5% excise tax. If total volume increases 25% to 250, the payment increases 25%, since the formula is

$$(\text{total volume}/\text{total base volume}) \times \$10 = (250/200) \times \$10 = \$12.50$$

Therefore, for increases in volume, the payment is a stable tax per pack.

unchanged, the "excise tax" per pack increases.²

(3) If adult smoking declines and youth smoking is unchanged, the "excise tax" per pack decreases.³

(4) If youth and adult smoking decline proportionately, the "excise tax" per pack is unchanged.⁴

²Here's an example that illustrates this point. Suppose that adult volume and youth volume are initially 100 each and that the base payment is \$10. Suppose that youth smoking declines to 70 while adult smoking stays at 100. Using the formula for the payment in case of a decline in total volume

(actual adult volume/actual adult base volume) x \$10 =

$$(100/100) \times \$10 = \$10$$

However, since the payment is made over a smaller total volume, 170, the excise tax rate is

$$\$10/170 = 5.9\%.$$

That is, the excise tax increases.

³Here's an example that illustrates this point. Suppose as before adult and youth volume are 100 each and the payment is \$10. Now suppose that youth smoking is unchanged, but that adult smoking declines to 70. Using the formula for the new payment, we have

$$(70/100) \times \$10 = \$7$$

To convert to an excise tax rate we divide the payment by total volume

$$\$7/170 = 4.1\%$$

Thus, when adult smoking declines and youth smoking is unchanged, the excise tax declines.

⁴Suppose the base numbers are as before. Now, suppose both adult and youth volume decline to 70. Using the formula for the new payment, we have

$$(70/100) \times \$10 = \$7$$

To convert to an excise tax, we divide the payment by total volume

(B) Comments on the base payment scheme:

(1) Why the asymmetry of (2) and (3) above? It's not clear from the language of the Settlement itself, however, as noted below, this could easily be rectified by having the actual payment be made equal to the base payment times actual volume over base volume.

(2) To the extent that Act is trying to reduce smoking, the fact that the base payment scheme operates as an excise tax rather than a lump sum payment is good. Excise taxes are a proven method of reducing smoking, especially for young smokers. Although true lump sum taxes penalize the tobacco companies, they do nothing to reduce smoking.

(3) Although the base payment scheme is basically an excise tax, which is good, there is an open question as to what is the correct level of the excise tax. While excise taxes can be an efficient method of forcing individuals to internalize any negative externalities produced by their behavior, a cursory view of the empirical literature on the subject is mixed on whether current cigarette prices (which already include substantial excise taxes) are high enough fully to internalize externalities from smoking.

(4) Higher taxes to reduce consumption, even if not justifiable on standard "externality" grounds, could perhaps be justified on grounds of paternalism towards addicted adults.

(C) Here's how the surcharge will actually work:

From the tobacco companies' perspective, the surcharge over and above "Base payments" due is essentially a tax per youth smoker. This is because every youth that keeps smoking costs the industry. How much? Assume there are 18 million people from ages 13 to 17 (the age groups in Apendix V, section A), of which 14.5% smoke on a daily basis [a rough, though not completely accurate, estimate taken from "Monitoring the Future"]--that's 2,520,000 teenage smokers. 1% of this number is 25,200. The tobacco companies pay 80 million for every 25,200 teenagers that do not quit - that's

\$7/140 = 5%

The excise tax rate is unchanged.

\$3,175 per youth smoker.

From the smoker's perspective the surcharge will work as an excise tax. Suppose that the industry has to pay the maximum tax: \$2 Billion. Sales of cigarettes approximate 25 Billion. That's 8 cents per pack...

However, the tax per youth smoker and the excise tax due to youth smoking are likely to be appreciably smaller:

First, it is plausible that the cigarette companies will work hard to do whatever it takes to meet the "no marketing to youth" and other restrictions in order to qualify for the 75% abatement from the maximum \$2 billion in surcharges. If this happens, then the tax per youth smoker drops to \$794, and the excise tax due to the surcharge drops to 2 cents a pack. Second, if profits in the cigarette industry fall, then the abatement falls proportionately. Experience shows that if companies are regulated on the basis of their profits in a particular line of business, they will find ways of lowering profits, such as taking profits in other lines of business and incurring higher costs. Suppose that due to the new incentives, industry profits drop by ¼. Then the per youth smoker drops to \$397 and the excise tax drops to 1 cent a pack.

We do not wish to suggest that these numbers above are highly accurate estimates. However, the above rough estimates do suggest that the youth surcharge may not have much economic punch, with the exception of incentivizing the tobacco companies to comply with the minimum specified restrictions on youth marketing, etc. that would enable them to qualify for the abatement.

(D) Problems with the Surcharge

- (1) The Free Rider Problem with respect to the penalty
 - Recall that each firm pays for its share of the surcharge according to its market share. This allocation lead to a free rider problem because a firm that recruits an underage smoker gets the full benefit of that smoker patronage, but the surcharge is split among its competitors based on their total market share, so a firm still has an incentive to attract underage smokers.
 - This may be a situation where antitrust immunity could enable the industry to overcome the free rider problem, however there are more direct ways

of dealing with this particular problem. In particular, basing each firm's surcharge on the change in its sales of cigarettes to youth

- (2) Problems with using profits
- As mentioned above, there is a strong reason to suspect that if the industry payment is tied to profits, that the tobacco companies will have an incentive to allocate profits to other non-tobacco lines of business and deviate from cost minimization by converting profits to higher salaries and waste.
 - The free rider problem may also be relevant here, since the Act uses industry average profit
- (3) Problem with using the abatement
- rewards meeting minimum standards rather than results (but note that there is no free rider issue here, since the abatement process looks at individual firm effort)
 - could be counterproductive, if all it does is encourage youth smoking by increasing the "forbidden fruit" aspect of smoking (almost certainly there must be public health studies that look at cross-state and cross-national variations of the effects of implementing laws making cigarettes more difficult for teenagers to buy and banning certain types of advertising. (Note: To the extent that cigarette advertising and marketing are simply a fight among firms for one another's existing customers, requirements to reduce these activities (and thereby qualify for the abatement) are profit-enhancing for tobacco companies, especially those that have relatively ineffective campaigns. In effect, banning certain of these activities may enhance industry profitability without much affecting total demand for their products.)

VI. Other Potential Problems with the Settlement

A. Disincentives for Desirable Innovations

- Mandatory cross-licensing could lessen the incentives of participating companies' to innovate reduced risk tobacco products.

One goal of the proposed legislation is to foster production of reduced risk tobacco products. The proposed legislation contains several elements designed to prompt such

innovation by the participating companies. We strongly suspect, however, that at least some of these claimed incentives to innovate may end up having precisely the opposite result. In particular,

Title I (E)(4) provides that:

The manufacturers will be required to notify FDA of any technology that they develop or acquire and that reduces the risk from tobacco products and, for a commercially reasonable fee, to cross license all such technology, but only to those companies also covered by the same obligations.

Title I (E)(4), Proposal at 14. Requiring cross-licensing of this technology may reduce research and development competition among tobacco companies because a firm with leading technology would not be able to benefit from its innovations to the exclusion of other firms with less valuable innovations. A rough, but useful, analogy might be to proposing a repeal of the patent laws (or property rights generally) and requiring mandatory licensing by firms or individuals that develop valuable innovations. The primary economic rationale for patent protection is, however, that rights to one's innovation provide the prospect of economic reward to the innovator, without which investment and innovation are far less likely to occur in the first place. If the participating tobacco companies are, in fact, the most likely source for new reduced risk technology, this cross-licensing mandate would seem to lessen the likelihood that the companies will allocate the research and development funds necessary to develop these reduced risk tobacco products, and therefore that they will not be developed at all. It therefore seems likely that incentives to innovate reduced risk tobacco technology would be increased--and the public health better served--if this provision were deleted from the proposed legislation.

B. Unclear Scope of Antitrust Exemption

Beyond the proposal to, in effect, raise cigarette prices through imposition of what would essentially be an additional "excise tax," the agreement goes further by proposing an exemption to the antitrust laws. The proposed antitrust exemption broadly states:

In order to achieve the goals of this agreement and the Act relating to tobacco use by children and adolescents, the tobacco product manufacturers may, notwithstanding the provisions of the Sherman Act, the Clayton Act, or any other federal or state antitrust law, act unilaterally, or may jointly confer, coordinate or act in concert, for this limited purpose.

Appendix IV (C)(2), Proposal at 50.

The agreement goes on to provide that the Department must approve any such "process or plan" that is to be exempt from the antitrust laws:

Manufacturers must obtain prior approval from the Department of Justice of any plan or process for taking action pursuant to this section; however, no approval shall be required for specific actions taken in accordance with an approved plan.

Appendix IV (C)(2), Proposal at 50. This draft provision provides no procedural guidance to the Department or to the participating companies regarding such approvals. The draft provision sets no standard for granting such approvals; it does not set a time limit for Departmental approval; and it does not provide for any remedy if companies act before the Department approves proposed activity. Most fundamentally, this proposal raises policy questions regarding the extent to which tobacco companies ought to be permitted to act in concert to raise prices. If (as seems likely) the monopoly price for cigarettes is above the price that would be produced by the annual payments-generated "excise tax," antitrust immunity would lead to a) higher prices (largely, one would expect, to already addicted (i.e., inelastic) smokers), b) reduced cigarette consumption (the precise reduction would depend on the demand elasticity for cigarettes in the relevant range), and c) higher profits to the cigarette companies.

One could make an economic case for raising prices and cutting cigarette consumption by the amounts implied by this proposal if there is good reason to believe that, at pre-collusion prices, cigarette smoking produces a combination of a) strong negative externalities (an issue on which, as noted below, the evidence seems to be mixed), and/or b) still too much smoking by youths who are probably too immature to make intelligent decisions about whether or not to smoke, c) paternalistic motives towards those who are already hooked⁵. Otherwise, the usual deadweight loss arguments for antitrust scrutiny of collusive behavior would seem to apply. If one were to expressly authorize monopoly pricing, there is an additional issue of who gets to keep the monopoly profits. The large

⁵It is worth noting an obvious tension between, on the one hand, seeking to help addicted smokers by getting them to cut back on cigarettes while at the same time charging them more money in the process. Insofar as a smoker quits, you may have done him a favor. Insofar as a smoker remains hooked, he is now not only suffering from cigarettes, he is poorer as well.

transfer of consumer surplus to tobacco companies could, if society wishes, be taxed away in some lump-sum fashion. One possibility might be to estimate in advance the profitability to the tobacco companies of colluding under the provisions of this settlement and impose a lump-sum tax of that size up front. Alternatively, one might adjust the terms of the settlement so as to raise the "excise tax" closer to that which would generate closer to monopoly pricing in the industry. This way more (though not necessarily all) of the monopoly rents would be handed back to the government.

VII. What might an "Ideal" settlement look like?

The answer depends on just what goals we are trying to achieve. The following identifies some of the goals implicit (or explicit) in the settlement, and describes very briefly proposed ways of achieving them most efficiently.

Goal(A): Reduce smoking generally

(1) insofar as smokers do not consider the costs of secondhand smoke and the higher expected health care costs they impose on society (assuming those costs exceed the pension benefits they lose due to their early deaths), they tend to smoke too much (i.e., the full cost of smoking includes those costs that smokers don't pay for, insofar as their smoking decisions do not take them fully into account, they smoke too much)

(2) solved by excise tax = costs they impose on society (with such a tax, a decision to smoke based only on the price of cigarettes and factors internal to the smoker would reflect the full costs of smoking)

(3) recent externality estimates range from 19 cents a pack to \$4.80 a pack (a range that's too broad to be of much use since it runs from a fraction of the current excise tax to a multiple of it and thus leaves us uncertain as to whether smokers impose costs on society or subsidize non-smokers)

(4) paternalism could be yet another appropriate motive for raising excise taxes by more than estimated negative externalities

Goal(B): reduce underage smoking

(1) underage smokers seem to act relatively myopically (Chaloupka JPE 1991 pp. 722-42 finds that smoking by older smokers supports the Becker-Murphy model for rational consumption of addictive goods, but smoking by younger smokers

does not)

(2) solved by an excise tax on underage smoking with each firm's tax based on number of kids smoking its brands

Goal(C): punish tobacco firms for fraud/deception

optimal fines are lump sum (otherwise cost passes through)

Goal(D): Get companies to accept settlement. This may require not punishing them severely.

VIII. Practical improvements in the settlement

(A) Have the base payment adjustment be more purely an excise tax. Instead of the formula described and critiqued above, make the payment equal to sales times a constant tax rate (i.e., make it simple and straightforward with incentives pointing in the right direction)

(B) Calculate each firm's surcharge on the basis of the change in its sales to kids to eliminate the free rider problem

(C) Base adjustments in the surcharge not on profits (which are hard to observe and easy to distort) but on revenue. This would help ensure that the surcharge is not avoided by accounting gimmicks and tobacco firms would have every incentive to minimize their costs.

(D) The 75% surcharge abatement makes the settlement for underage smoking 75% regulatory command and control and only 25% market incentives. Consider reducing the extent to which companies can get around the full surcharge by meeting criteria other than performance targets (i.e., reductions in number of kids hooked).

(E) If the externality evidence for adult smokers is weak, consider trading off some of the base payment for more surcharge

(F) Greater guidance needed on just what types of "industry cooperation" the antitrust authorities are to be approving. One possibility would be to have antitrust immunity attach only in certain limited circumstances; for example where, in the view of the antitrust authorities, the joint conduct of the participating companies will be primarily to reduce the sale to children and adolescents in the United States of tobacco products produced by the parties. No blanket exemption for cartel behavior across the board.

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Finally, consider fixing certain drafting problems in the proposed resolution. For example,

- 1) change p. 8 to a ban on tobacco companies distributing non-tobacco merchandise (rather than a ban on possession of such merchandise).
- (2) p. 19 should exempt cigarette papers from the ban on use of non-tobacco ingredients (since otherwise it would likely ban all manufacture of cigarettes).
- (3) p. 30 should exempt homes and private apartments from the ban on smoking (i.e., 10 people can be a big family or a weekly party).

Effects of the Tobacco Settlement on Tobacco Farmers and the USDA Price Support Program

The Tobacco Settlement between numerous States' Attorneys General and the Tobacco Industry on Friday June 20 is aimed at resolving issues relating to underage smoking and reimbursements to States for Medicaid expenditures related to tobacco-related illnesses. The Settlement also sets national standards controlling the manufacture of tobacco products, restricts advertising alternatives, and mandates a nationwide smoking cessation program. There are no immediate and direct implications for tobacco farmers or the USDA price support program. Nonetheless, there will be indirect effects resulting from the Settlement as the industry restructures in compliance with the 9 titles included in the Settlement.

Agriculture as Addressed by the Settlement

Direct mention of the USDA or tobacco farming occur in two instances within the agreement. The first simply states that tobacco farmers will not be subject to additional regulations over and above those existing for other producers of raw products. "Tobacco farmers will face no greater regulatory burden than the producers of other raw products regulated by the federal government." [Title I, Subtitle E. (See appendix)]

The second mention of agriculture addresses the issue of limitations on FDA regulatory jurisdiction and states: "-- Grower Limitation: FDA jurisdiction does not extend to the growing, cultivation or curing of raw tobacco (USDA has exclusive authority)." [Title V, Subtitle A. (See appendix)]

Indirect Implications of the Settlement for farmers

The primary implication of the Settlement for tobacco growers is added impetus to discourage consumption of tobacco products, reducing the demand for leaf tobacco used in domestic manufacturing.

Declining consumption due to reduced underage smoking

Currently, the proportion of total consumption attributable to underage smokers is not known with certainty. Estimates range from 3 to 5 percent. U.S. consumption in 1996 was 487 billion cigarettes of which between 15 to 24 billion could have been consumed by underage smokers. The Settlement seeks to reduce underage smoking significantly over the next decade and maintain the reduction thereafter:

Underage use of cigarette products must decline by at least 30% from estimated levels over the last decade by the fifth year after the legislation takes effect, by at least 50% from estimated levels over the last decade by the seventh year after the legislation

takes effect, by at least 60% from estimated levels over the last decade by the tenth year after the legislation takes effect, and remain at such reduced levels or below thereafter. [Title II]

If the Settlement reduces underage consumption by 30 percent by the fifth year, consumption will decline between 5 to 8 billion pieces, assuming underage consumption of 15 to 24 billion cigarettes annually. This is the equivalent of 5.7 to 9.2 million pounds of tobacco (farm sales weight), based on current domestic leaf use per cigarette. U.S. tobacco production in 1996 was 1,517 million pounds.

The Settlement also covers smokeless tobacco products in much the same terms as cigarettes. This increases the number of leaf types that may be affected.

Declining adult consumption may result if prices rise because of the Settlement.

At this point, it is difficult to tell how the Settlement will affect retail cigarette prices. Cigarette companies are liable for huge payments under the agreement, beginning with an up-front payment of \$10 billion at signing and \$8.5 billion due at the end of the first full calendar year following signing. The up-front penalty equals approximately 41 cents per pack (20 cigarettes) based on 1996 U.S. consumption and 26 cents per pack based on total output (including exports). Adding the first annual payment raises the amount to 76 cents per pack for domestic sales and 49 cents for total output. Retail cigarette prices averaged \$1.91 nationwide in 1996. Wholesale prices were 99 cents per pack for premium cigarettes, which make up about 72 percent of total output.

Given the imperfectly competitive structure of the cigarette industry and inelastic consumer demand, we would expect much of the additional costs to be transferred to consumers. However, in the past, the cigarette industry has reduced wholesale prices, such as in 1993 when the prices for premium cigarettes were slashed to regain market share from discount brands.

Some respected Wall Street analysts are forecasting a 50-cent per pack increase at the wholesale level, combined with a consumption decline of about 11-percent.

Using a commonly accepted price elasticity of demand for cigarettes, the following table illustrates potential changes in cigarette consumption with 4 levels of retail price increases. The change in cigarette consumption is converted to change in domestic leaf use for each price change. These estimates assume no change in the proportion of imported tobacco leaf used in U.S. manufactured cigarettes. A \$1.00 increase in the retail price of a pack of cigarettes results in a 20.9 percent decrease in cigarette consumption and a 116.7 million pound decrease in domestic leaf use, about 8 percent of U.S. production in 1996. Likewise, a 25 cent increase in the retail price results in a 5.2 percent decline in cigarette consumption and a 29.2 million pound decline in domestic tobacco use, about 2 percent of 1996 U.S. production.

Estimated effects of cigarette price increases

1996 average price per pack (\$)	1.91
1996 total U.S. consumption (billion cigarettes)	487
Price elasticity of demand	-0.40

price change cents	pct chng price percent	pct chng vol percent	quantity billions	domestic use per 1,000 cigarettes lbs.	domestic use mil. lbs.	pct chng	est chng mil. lbs.
25	13.1	-5.2	482	1.144	528	-5.2	-29.2
50	26.2	-10.5	438	1.144	499	-10.5	-68.3
75	39.3	-15.7	411	1.144	470	-15.7	-87.5
100	52.4	-20.9	385	1.144	440	-20.9	-118.7

The cigarette industry uses both domestically grown and imported tobacco leaf to manufacture cigarettes. In 1995, the most recent data available, U.S.-manufactured cigarettes contained about 35 percent foreign tobacco leaf. U.S. tobacco growers likewise supply both domestic cigarette manufacturers and the export market. In 1996, leaf exports accounted for about 33 percent of U.S. production. U.S.-manufactured cigarettes are consumed domestically and exported. In 1996, 32 percent of the cigarettes manufactured in the United States were shipped overseas.

The effects of changes in domestic consumption of cigarettes on tobacco growers are tempered by prospects for foreign demand for U.S. cigarettes and the proportion of foreign tobacco used by U.S. cigarette manufacturers. The impact of the Settlement and associated price changes on the mix of domestic and foreign leaf used by manufacturers, and the level of leaf imports, is difficult to determine. As manufacturers attempt to cut costs, use of lower-priced imported leaf may rise, accentuating downward price pressures on U.S. tobacco leaf. If, however, facing declining domestic consumption, manufacturers export more cigarettes, that could temper any downward price pressure on U.S. tobacco leaf. Currently tobacco leaf imports are limited by a tariff rate quota; however, in the past year, only about 68 percent of the quota was utilized. In addition, imported leaf which is used to manufacture cigarettes subsequently exported is subject to a duty drawback. If domestic consumption is relatively stable, manufacturers will likely continue using the same proportions of domestic and foreign leaf.

The increase in retail cigarette prices may be less than indicated by the size of the penalties to be paid by the manufacturers. The Settlement contains a provision (Title VI B. 5. (See appendix)) which rebates part of the penalty paid by manufacturers if adult consumption falls below the 1996 level. This provision should negate some of the price effect of the penalty by enabling manufacturers to use the rebate to lower prices and thus regain sales. In addition, the penalties are paid using pre-tax dollars, further lessening the financial burden of cigarette manufacturers and reducing amount prices might be increased. Advertising expenditures, which total about \$6 billion annually for the industry, are likely

to decline also.

Indirect Implications for the USDA Tobacco Program

The indirect implications for the USDA program are mainly political in nature. Congressional attention focused on the Settlement has already spawned tangential tobacco-related legislative proposals, such as the bill introduced by Senator Mitch McConnell to have cigarette manufacturers cover the costs of the Tobacco Program. In recent sessions of Congress, the Tobacco Program has come under attack and narrowly survived.

(Preliminary – NOT final)

THE “LOOK BACK” SURCHARGE

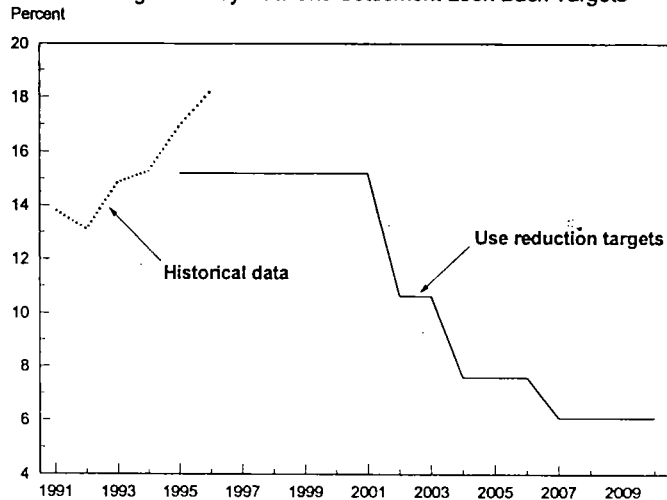
The settlement attempts to provide economic incentives to promote “dramatic and immediate reductions in the number of underage consumers of tobacco products.” Manufacturers would face surcharges if the tobacco-use reduction targets are not met. Surcharges will be imposed on the basis of a “look back” comparing actual teen tobacco use percentages to the targeted reduction percentages.

Will the surcharge be effective? No.

Our initial calculations indicate that the present value of the stream of profits from a higher percentage of teen tobacco use exceeds the cost of the surcharge by a factor in the range of 3 to 6 -- hence, the economic incentive to firms to reduce teen smoking will not be effective.

- The daily tobacco use percentage for underage teens in 1996 was 18.2 % -- well above the target base of 15.2 % (calculated from data over the past 11 years).
- The surcharge would be imposed beginning in the 5th year after enactment and every year thereafter based on the difference in the actual and targeted percentage reductions in underage use -- at the rate of \$80 million for each percentage point (adjusted for changes in the size of the relevant population and industry profits).
- For the case of no change in the level of teen daily use (staying at 18.2 %), the surcharge for the fifth year would be about \$660 million (in 1997 dollars). The present value of the future profit stream from the additional smokers above the target would be much higher at about \$3.6 billion -- *5-1/2 times greater than the cost of the surcharge.* (After-tax comparisons would yield the same ratio under the assumption that the profits tax rate remains unchanged through time.) Similar ratios apply to the surcharges in other years.
- If we assume that teen use declines because of higher cigarette prices from higher excise taxes, the use percentage falls to about 13-1/2 percent and the surcharge in the fifth year would be about \$400 billion and the present value of profits would be about \$1.4 billion for a ratio of about 3-1/2.

Underage Daily Tobacco Use Percentages and Targets
Michigan Survey Data and Settlement Look Back Targets



These results indicate that to be effective, the surcharge would have to be increased by a factor of about 3-1/2 to 5-1/2, or somewhere in the range of \$280 million to \$440 million per percentage point.

Some Assumptions:

Discount rate: 4.0 %

Profit per pack: \$0.30

Intensity of use: 1 pack a day

Survival probability: taken from FDA rule in Federal Register

Teen population: Census middle series

Teen price elasticity: -1.0 (second scenario assumes that % decline in use translates in to % decline in users)

to Yocco
— Economics

Memorandum

July 3, 1997

From: Chad Stone, CEA
Jon Gruber, Treasury
To: Elizabeth Drye, DPC
Subject: Progress Report on Economics Task Force, Domestic Issues

Attached are several undigested pieces of material that are part of what will feed into a draft report we hope to complete next week:

1. An outline/progress report of the tasks being undertaken
2. Preliminary fact sheets on the domestic industry (foreign stuff to come)
3. Preliminary set of working assumptions feeding into the analysis
4. Preliminary bibliography of key economic articles, etc. for estimating elasticities and other effects.
5. Memorandum from DOJ antitrust division assessing the settlement
6. Memorandum from USDA on effects on tobacco farmers.
7. Preliminary Treasury assessment of "lookback"

All of these are preliminary and many are undigested and not integrated into the analysis.

Why Tobacco Pact Won't Hurt Industry

Cigarette Makers Can Easily Raise Prices to Cover Payouts

By MICHAEL M. PHILLIPS
And SUEIN L. HWANG

Staff Reporters of THE WALL STREET JOURNAL

The sweeping tobacco settlement sounds like a huge burden for Big Tobacco: How can an industry with \$8.4 billion in annual pretax operating profits afford to pay out \$368.5 billion over 25 years, almost \$15 billion a year?

The fact is, it can. Tobacco will simply pass along the costs to millions of addicted customers and reap the rewards of higher stock prices, economists say. "The deal is a very good deal for the tobacco industry," says Gary Black, a tobacco analyst at investment firm Sanford C. Bernstein & Co.

The explanation for this seeming contradiction draws on the lessons of elementary economics, bringing from classroom to cash register classic textbook terms as supply and demand and present value. But perhaps the most important economic concept highlighted by the settlement is oligopoly. In short, a small number of companies hold the market in such a tight grip that they can easily jack up prices 30% or more as the settlement envisions without inducing new competitors to rush in, economists say.

"It has basically been an oligopoly with high barriers to entry for half a century," says Jeffrey E. Harris, an economics professor at the Massachusetts Institute of Technology and a physician at Massachusetts General Hospital. Dr. Harris served as an expert witness for Florida in its effort to extract Medicaid costs from the tobacco companies.

A handful of companies dominate the market — Philip Morris Cos., RJR Nabisco Holdings Corp., Loews Corp.'s Lorillard Tobacco Co., B.A.T. Industries Ltd.'s Brown & Williamson Tobacco Corp., Brooke Group Ltd.'s Liggett Group Inc. and UST Inc., a leader in smokeless tobacco. And there is virtually no threat that new contenders will challenge the oligopoly. Brand names are well established and start-up obstacles daunting.

That's not to say the industry is made up of equally strong players. Some in the industry fear the deal and its advertising restrictions will add to the No. 1 player's enormous clout, giving Philip Morris a nearly overwhelming edge at the expense of weaker rivals. That fear now is contributing to Washington delays in advancing the settlement, which still needs President Clinton's response and congressional approval for the industry to win broad liability protection.

Fueled by its super-hot Marlboro brand, Philip Morris controls half of the U.S. market, and shows no sign of slowing down world-wide. RJR Nabisco, an increasingly distant No. 2, is hobbled by aging, eroding brands such as Winston, a heavy reliance on the U.S. market (where its share is about 25%) and debt left from its 1989 leveraged buyout. Much-smaller Brown & Williamson and Lorillard rely heavily on menthol; Liggett, seller of discount cigarettes, is barely a blip on the screen.

All of which spells more wrangling in Washington, where policy makers insist the existing settlement is too favorable for cigarette companies yet the companies are reluctant to make more financial conces-

sions. Few believe the industry will walk away from the deal, although RJR's support seems the more fragile.

"Philip Morris is most on board," one person familiar with the matter says. If the deal does go through, economists say the industry as a whole will still do well. Among the reasons:

Tobacco demand is inelastic. Smokers don't cut their intake much even when prices rise. Frank J. Chaloupka, associate professor of economics at the University of Illinois in Chicago, figures adult cigarette-smoking declines only about 4% for every 10% cigarette-price increase (half from reduced intake, half from people quitting). "It's addictive behavior," says the professor, making an assertion long disputed by tobacco makers.

There aren't obvious substitutes. If orange juice prices soar, consumers can buy lemonade. Smokers have no such easy choice.

Prices will pick up the slack. Because every major producer has agreed to settle — tiny Liggett settled separately — it is unlikely any one company would undercut the others. In fact, the settlement proposal envisions an antitrust exemption to allow companies to raise prices jointly.

Both Dr. Harris and W. Kip Viscusi, a Harvard Law School economist and expert witness for the tobacco industry, believe the price of a pack of cigarettes will rise 62 cents on average within five years to provide the companies with enough revenue to pay off the plaintiffs. "This isn't a \$15 billion [a year] pure payment — this is a

Please Turn to Page A10, Column 1.

Continued From Page A2

62-cent-per-pack tax" in effect, says Bernstein's Mr. Black.

That's assuming cigarettes cover the whole amount. If smokeless-tobacco prices also rise, cigarettes could go up a little less than 60 cents a pack. Congress also recently approved a 15-cent-a-pack excise tax. After the industry settled suits filed by Florida and Mississippi, the companies recently boosted cigarette prices 7.6% — the right amount to cover that move, analysts believe.

Penalties seem survivable now. Teenagers are about three times as sensitive as adults to cigarette price boosts, Prof. Chaloupka says. The national settlement would limit advertising, boost minimum-age enforcement and provide \$500 million annually for antismoking publicity. But all that plus a 62-cent price increase isn't generally expected to reduce the number of teen smokers enough to meet targets included in the national agreement — a 60% cut in 10 years. Based upon price alone, cigarettes would have to double to about \$4 a pack to hit the target. Cigarette companies might balk at boosting prices that much but the currently proposed penalty for missing the target is at most \$2 billion. Possible penalties could change.

The horizon would clear. The settlement would simultaneously settle suits by 40 states that claim the industry should pay for tobacco-related Medicaid costs. It also would provide broad liability protection against future lawsuits.

For years, tobacco stocks have been hobbled by litigation fears. According to Smith Barney Inc.'s analyst Martin Feldman, RJR could jump as much as 34% to \$46 after the deal passes Congress. Philip Morris, he estimates, could jump 54% to \$65.

Some costs could shrink. Settlement payments fall if cigarette consumption

declines. Dr. Harris estimates U.S. cigarette sales, already dropping, could fall to 18.4 billion packs annually in 25 years from around 24.2 billion packs last year. So instead of paying \$15 billion, the companies would only have to pay \$11.4 billion in the fifth year. Over 25 years, Dr. Harris calculates the settlement would cost the industry perhaps \$304.3 billion, not the \$368.5 billion frequently cited.

And payments are deductible. "At year five, take a corporate tax rate of 40%; that means a \$15 billion payment results in tax savings of \$6 billion," says one person familiar with the industry's thinking.

Costs would spread over time. An amount paid over time is less costly than the same sum paid up front, a textbook concept economists call present discounted value. If the companies wanted to, economists say, they could spend about \$194.5 billion today to buy 7% bonds that would pay off \$304.3 billion over 25 years.

Because of new limits placed on advertising and store displays, the companies are also likely to save some of the \$6 billion they currently spend battling for market share. The industry's \$8.4 billion in annual pretax operating profit might shrink by just \$700 million to \$800 million, Mr. Black predicts, and if companies cut marketing sharply, they might avoid any profit decline at all.

When the industry says it cannot afford more money, "people in Washington laugh," Mr. Black says. But RJR isn't laughing. Some industry people expect volumes of more-profitable premium cigarettes to fade as smokers switch to cheaper, less-profitable brands. RJR would be among the most affected; its debt rating only recently was raised to so-called investment grade. With passage of the settlement, "RJR's upside isn't as clear as Philip Morris's," says one tobacco executive. "This is the cost of the LBO."

John's Economics

Leadership Woes Blamed by Army For Sex Scandals

By THOMAS E. RICKS

Staff Reporter of THE WALL STREET JOURNAL
WASHINGTON — The Army took a long look in the mirror and decided it didn't like what it saw.

In self-critiques commissioned in the wake of its Aberdeen sexual-abuse scandal and issued yesterday, two different Army reports concluded that many in the rank and file feel poorly led. Also, soldiers distrust the Army's system for handling sexual-harassment complaints. As a result, one study found, sexual discrimination and harassment are more widespread than the service's leadership had believed.

"Plain and simple, this is a leadership issue," said the Army's top officer, Gen. Dennis Reimer, in presenting the two reports that in many ways took aim at him and other top generals. "I think we need to place more emphasis on values." While the reports are harsh, they may have succeeded in helping the Army fend off an outside investigation of its handling of sexual-abuse problems. One of the Army's top priorities in responding to the Aberdeen sexual-abuse cases that became public last November has been to avoid being subjected to outside investigations. Congressional reaction to the reports was positive.

The Army's panel on sexual harassment, in an unprecedented survey of more than 30,000 soldiers conducted at 59 Army installations, concluded that "passive leadership" had permitted sexual harassment to persist across the Army. The panel, made up of four generals, two civilian defense officials, and a senior sergeant, generally was scathing about the poor quality of leadership in today's Army, identifying "a huge gap" between senior Army leaders and younger enlisted soldiers.

Many soldiers believe their officers don't care about them, and really are concerned "only about themselves and their careers," the panel reported. Both males and females agreed in their distrust of the way they are being led, with more than 40% of those surveyed saying their leaders are more interested in looking good than in being good.

Interestingly, both males and females perceived more racial or ethnic discrimination in their units (about 25% of females reported seeing it) than sexual harassment (which was perceived by 17% of females).

The complementary study by the Army's inspector general of sexual-harassment policies in boot camp came to similar conclusions.

Army Secretary Togo West insisted that the events at Aberdeen, the Army base in Maryland where several drill sergeants and a company commander were found guilty of charges ranging from rape to fraternization with female soldiers, were an "aberration." He indicated that the chain of command at that base failed to adequately supervise trainers there, and said that, among others, two lieutenant colonels, one colonel, and one general are receiving letters of reprimand for that failure. Such letters, which are placed in personnel files, are generally seen as ending a career.

Mr. West also said that the Army, spurred by complaints from some in Congress and the NAACP that the Aberdeen investigation disproportionately targeted black sergeants who had sex with white women, will review its conduct of that investigation.

Despite his insistence that the Aberdeen mess was a unique circumstance, the remedies Mr. West announced will be applied across the board, at all Army training installations. Among other things, he said that screening and supervision of drill sergeants will be tightened. Boot camp will be lengthened by a week to nine weeks, and the additional time will be used to place more emphasis on values, history and tradition.

Interestingly, this move comes about a year after the Marine Corps, which in recent years has placed enormous emphasis on values and tradition in its own two boot camps, decided to lengthen its recruit training to 12 weeks from 11. Most of all, Gen. Reimer indicated that the Army needed to renew its focus on teamwork, discipline and values. "We've got to get back to the basic fundamentals," he said. But Gen. Reimer insisted he had seen nothing to persuade him that the Army should follow another Marine method and train men and women separately in boot camp.

The officials also said that the Army will create a structure to monitor the implementation of these changes, and then in about a year conduct a full-scale review of its progress.

THE WALL STREET JOURNAL FRIDAY, SEPTEMBER 12, 1997

Tobacco
Economics

ANNUAL COSTS OF THESE PAYMENTS

1. **Annual cost of transition payments and quota compensation:** At the bottom of the page containing the tables is the summation of the cost of these purchases. Based on these calculations, it will cost \$411.725 million per year for each of the next 8 years to compensate farmers.
2. **Annual cost of transition payments, quota compensation, and retiring all tobacco quota after 8 years.** When this amount of a total quota buy-out after 8 years is counted in with the other two payments, it averages out to \$672.205 million per year for the next eight years.

Agreement - tobacco
anti-trust suit

Tobacco Economic

WB \$100 in last 5 years worldwide WHO → 1 mt

European Funds - private sector program

International Tobacco Fund

Early in the next century, tobacco will be the leading global cause of premature death and preventable illness. According to the World Health Organization (WHO), worldwide deaths from tobacco are likely to exceed ten million per year by 2025, with 70 percent of those deaths occurring in developing countries. While the proposed tobacco industry settlement addresses the industry's future in the United States, it is silent with regards to the overseas impact.

Tobacco consumption, and its deleterious effects, are a global problem which should not be ignored; the problem cannot simply be exported away. The United States Government should take the opportunity offered by the proposed settlement to take the lead mobilizing the international health community to reduce the consumption of tobacco products, particularly as it affects the health of children and youth. Such an undertaking will have many facets, but should leverage efforts already underway in bilateral and multilateral, official and non-governmental fora. However, resources that currently can be brought to bear are tiny in relation to both the scope of the problem and the resources that can be brought to bear by the tobacco industry.

B.I. U.S.G. w/ NGOs made to support 2/5

We can begin to address this imbalance through a creation of a new fund [with a portion of settlement proceeds] that will focus efforts in international public health and education efforts. These efforts include:

· **Bilateral Collaborations**, including cooperative agreements with key countries to promote the development of national and international tobacco control and prevention programs. Funds can be mobilized to deliver comprehensive technical assistance, including training, exchange of public health experts, organization of workshops and symposia, and exchange of publications and information related to tobacco control and prevention. The goal should be to promote globally consistent and reinforcing regulations that restrict tobacco advertising and minors' access to tobacco products, for example.

· **Regional and Multilateral Collaborations**, including working with UN agencies, the multilateral development banks (MDBs), and other development organizations to expand their tobacco use reduction efforts, and promoting efforts to expand or create regional alliances to facilitate and promote collaboration and cooperation on tobacco-related issues, such as the prevention of cigarette smuggling. Grants could be used to supplement MDB financing for existing activities and/or to establish new programs aimed at discouraging tobacco usage and production, as well as to help offset the medical costs of tobacco use. Other technical assistance can be provided through the MDBs, including policy advice they give to borrowing governments relating to regulatory issues (such as advertising bans); trade policies (to incorporate effective health and safety measures); and tax and fiscal policies (to help governments reduce reliance on revenues from tobacco sales).

· **Global Strategies**, such as increased support for the WHO's Tobacco or Health Plan of Action (1996-2000), which promotes comprehensive national tobacco programs, advocates strong tobacco control policies, and disseminates global and country-specific health data and tobacco prevention and control strategies. Increased funding can help to enhance staffing and

Issues for Industry/Economic Analysis

What is the counterfactual?

The central question for evaluating this settlement is a detailed understanding of the counterfactual: what would the world be like without a tobacco settlement? How much would the tobacco companies lose in this alternative world, and how much does the rest of society gain? This establishes the “threat point” of each of the parties to this settlement, and thereby the mutually acceptable range of agreement. This calculation consists of a number of components, some easier to compute than others. A number of these questions require probabilistic answers, both in terms of the economics and the politics:

- What would happen to FDA regulation of cigarettes in the absence of a deal, and what would that imply for cigarette sales/profits?
- How much could we raise through cigarette taxation in the absence of a deal, and what would that imply for sales/profits?
 - what is the political will for a tobacco tax rise instead?
 - does the settlement “crowd out” a tobacco tax increase?
 - does a collapse of the settlement make it hard to immediately raise taxes?
- What would be the net litigation costs to the tobacco companies and to the rest of society in the absence of a deal?
- What would happen to smoking in the absence of a deal
 - youth vs. adult tobacco use
 - public health costs

What is the cost of the settlement to the companies?

- Compute after-tax payment amount
- Compute post-settlement profit stream

What are the gains to settlement for the government?

- Compute net payments from tobacco settlement, incorporating tax deductibility, and “leakage” from existing excise taxation as prices rise
 - Divide these net payments into federal and state/local components
- Compute effects on social insurance programs - SS, Medicare, Medicaid

Market based analysis of the settlement

- Gather Wall Street paper on the settlement
- Event study analysis of settlement

*- possibility of changing behavior/
org. form to avoid payments*

Concerns with collusion

- Coordinate concerns with DOJ antitrust division
- Estimate effects of the agreement on pricing
- What would happen if we made payments conditional on past market share?
 - what about other restrictions on entry through advertising/marketing rules?

Understanding the details of the deal

- Explicit description of the uses of the settlement money

Concerns about parameters of the deal

Tax Issues

- Should the settlement be tax deductible?
- Are there sufficient protections against foreign spinoffs to avoid profit taxation?

Targeting & Penalties

- What is the correct share of incremental profits that should be retained by tobacco companies (currently 75%)?
- Should the lookback provisions apply company by company?
- What is the correct rule for determining future stream of payments - e.g. to what units should payments be tied, and how?
 - if you tie to unit sales, incentives to increase tar
 - if you tie just to cigarettes, incentives to move to other forms of smoking (roll-your-own or little cigars)
- Are the lookback penalties (roughly \$80 million for each percentage point shortfall of youth smoking target, with cap of \$2 billion) large enough, relative to stream of future profits lost from reduced youth smoking?
- What does state experience teach us about the most effective means of reducing youth smoking, and is that reflected in the parameters of the deal?
- Implications of using a quota, auctioned off across companies, rather than a tax?

Spillover effects

- Concerns about other sectors:
 - advertising
 - vending
 - sporting events
 - retail
 - hospitality
- Effect on farmers
- Effect on labor demand - employment and wages
 - tobacco directly (lots of "good jobs")
 - other sectors indirectly
- Smoking cessation sector will benefit - tobacco company ownership issues?

Other issues

- Why should we preclude future class action suits?
- Should we ignore the rest of the world?

- Are we tough enough/too tough on environmental (second-hand smoke) issues?
- Why are (effectively) tax dollars going to pay the cost of plaintiffs' attorneys?

Distribution of spending of settlement dollars

- Should we diversify beyond kids health?
- Should we compensate smokers who die before 65?
- Should we finance buy-in to Medicare (tied to smoking because benefits those who don't live until Medicare eligibility age)
- Should the federal government insist on 57% (federal Medicaid share) of the non-earmarked dollars (dollars not going to liability fund, smoking cessation, etc.)? (EP)

World Market Share (From WST)

Philip Morris	16.2%
BAT	12.8%
RJR	5.9%
Japan Tobacco	5.1%
Reckmans	4.2%

TITLE VI: Programs/Funding

TOTAL 25 YEAR PACKAGE FACE VALUE -- \$368.5 Billion

A. Up Front Commitment -- Lump Sum Cash Payment -- \$10 Billion

1. Payable on Statute Signing Date.

B. Base Annual Payments -- 25 Year Total Face Value is \$358.5 Billion (Figures Subject to Inflation Protection and Market Volume Adjustments)

1. Duration -- annual payments in perpetuity

2. Commencement -- 12/31 of first full year after statute signing

3. Face Amounts (includes payments from all industry sources):

Payment Year	1	2	3	4	5	6-8	9	→ ∞
Total Payments	\$8.5B	\$9.5B	\$11.5B	\$14B	\$15B	\$15B	\$15B	\$15B
Base Amount:	\$6B	\$7B	\$8B	\$10B	\$10B	\$12.5B	\$15B	\$15B
Public Health Trust	\$2.5B	\$2.5B	\$3.5B	\$4B	\$5B	\$2.5B		

4. Inflation Protection for Annual Payments

- Greater of 3% or CPI applied each year on previous year, beginning with first annual payment.

5. Adjustment for Volume Decrease (Adult Volume Only) or Total Volume Increase

- Beginning in year 1; payment made equal to scheduled annual payment times the ratio of actual relevant domestic tobacco product unit sales volume to relevant base volume. In the event of a decline in volume, relevant actual volume and relevant base volume are adult volume figures; in the event of an increase in volume, relevant actual volume and

relevant base volume are total volume figures. Base volume is 1996 volume.

- Any reduction in an annual payment will be reduced by 25% of any increase above the industry's base year net operating profits (after application of inflator discussed above) from domestic sales of tobacco products.

6. Payment Protection

- Provide for payment priority/continuation during bankruptcy/reorganization proceedings. Protocol cannot be rejected in bankruptcy. Obligation for annual payments responsibility only of entities selling into domestic market.

7. Pass-Through

- In order to promote maximum reduction in youth smoking, the statute would provide for the Annual Payments to be reflected in the prices manufacturers charge for tobacco products.

C. Applicability

1. Applicable to All Sellers of Tobacco Products

- Through protocol and statute to protocol signatories.
- Through alternative statutory provisions to non-signatories.

D. Tax Treatment

All payments pursuant to this Agreement (including those pursuant to Title II) shall be deemed ordinary and necessary business expenses for the year of payment, and no part thereof is either in settlement of an actual or potential liability for a fine or penalty (civil or criminal) or the cost of a tangible or intangible asset.

TITLE VII: Public Health Funds From Tobacco Settlement
As Recommended By The Attorneys General For Consideration
By The President And The Congress

BASED ON THE PREMISE OF \$ 1 BILLION FOR THE FIRST YEAR AND GRADUALLY INCREASING TO \$1.5 BILLION THEREAFTER, ADJUSTED FOR INFLATION AFTER THE FIRST YEAR.

BASED ON THE PREMISE OF \$1 BILLION FOR SMOKING CESSATION FOR THE FIRST 4 YEARS AND \$1.5 BILLION THEREAFTER, ADJUSTED FOR INFLATION.

(A) ALLOCATION OF GRANT MONIES AMONG PROGRAMS – The use of moneys under this Section shall be limited to programs established under this Section, shall be adjusted for inflation annually from the effective date, and shall be allocated among such programs as follows:

(1) \$125,000,000 for the first three years and \$225,000,000 annually thereafter to the Secretary of HHS to accomplish the purposes described in Paragraph (B) of this Section (Reduction in Tobacco Usage);

(2) \$300,000,000 annually for the FDA to carry out its obligations under and to enforce the terms of this Act, including for grants to the states to assist in the enforcement of the provisions of the Act;

(3) \$75,000,000 for the first two years, \$100,000,000 in the third year, and \$125,000,000 annually thereafter to fund state and local tobacco control community based efforts modeled on the ASSIST program, designed to encourage community involvement in reducing tobacco use and the enactment and implementation of policies designed to reduce the use of tobacco products;

(4) \$100,000,000 annually to fund research and the development of methods for how to discourage individuals from starting to use tobacco and how to help individuals to quit using tobacco;

(5) Beginning in the second year, \$75,000,000 annually for a period of ten (10) years to compensate events, teams or entries in such events, who lose sponsorship by the tobacco industry as a result of this Act, or who currently receive tobacco industry funding to sponsor events and elect to replace that

funding, provided that the event, team, or entry is otherwise unable to replace its tobacco industry sponsorship during those given years. Funds used for this purpose shall promote a Quit Tobacco Use theme. After a ten year period, no additional funds shall be used for this purpose and the funds previously allocated to this purpose shall be used as follows: 50% to supplement funding of the multi-media campaigns in paragraph (1) of this subsection; 25% to supplement the funding of the enforcement provisions of paragraph (2) of this subsection; and 25% to supplement the funding of community action programs in paragraph (3) of this subsection.

(B) ESTABLISHMENT OF PROGRAMS BY THE SECRETARY - The Secretary shall establish programs to accomplish the following purposes—

(1) the reduction of tobacco product usage, both by seeking to discourage the initiation of tobacco use by persons under the age of 18 and by encouraging current tobacco users to quit through media-based and non-media based education, prevention and cessation campaigns. The Secretary may make grants to state health departments to assist in carrying out the purposes of this provision.

(2) the research into and development and public dissemination of technologies and methods to reduce the risk of dependence and injury from tobacco product usage and exposure;

(3) the identification, testing and evaluation of the health effects of both tobacco and non-tobacco constituents of tobacco products;

(4) the promulgation of such other rules and regulations as are necessary and proper to carry out the provisions of this Act, as well as the development of such other programs as the Secretary determines are consistent with the goals of the Act.

(C) Public Education Campaign - \$500,000,000 shall be spent annually in such multi-media campaigns designed to discourage and de-glamorize the use to tobacco products. To carry out such efforts, an independent non-profit organization with a Board made up of prestigious individuals and the leaders of the major public health organizations shall be created which shall contract or make grants to non-profit private entities who are unaffiliated with tobacco manufacturers or tobacco importers, who have a demonstrated record of working effectively to reduce tobacco product use and expertise in multi-media communications campaigns. The independent body shall be authorized to contract with state health departments, where appropriate, to run campaigns for

their states and communities. In creating the program the Secretary or independent body shall also take into account the needs of particular populations. The goal shall be the reduction of tobacco product usage, both by seeking to discourage the initiation of tobacco use by persons under the age of 18 and by encouraging current tobacco users to quit.

(D) Tobacco Use Cessation - For the first 4 years, \$1 billion, and thereafter, \$1.5 billion of the total amount paid by the tobacco industry shall be paid into a Trust Fund to be used to assist individuals who want to quit using tobacco to do so. Within 12 months the Secretary shall promulgate regulations to govern (1) the establishment of criteria for and a procedure for the approval of cessation programs and devices for which payment may be made under the program, (2) the eligibility requirements for individuals seeking to use moneys from the trust to fund the tobacco cessation efforts, and (3) the procedures to govern the tobacco cessation program.

The goal of the tobacco cessation program shall to enable the most tobacco users possible to receive assistance in their effort to quit using tobacco by providing financial assistance and identifying the programs, techniques, and devices that have been shown to be safe and effective. Benefits to individuals should not be limited to a single effort, but should be tailored to the needs of individual smokers according to standards established by the Secretary using the best available scientific guidelines.

(E) Public Health Trust Fund Presidential Commission - A Presidential commission will be appointed to include representatives of the public health community, Attorneys General, Castano attorneys and others to determine the specific tobacco-related medical research for which the \$25 Billion Public Health Trust Fund will be used.

Tobacco Settlement Review

6/23/97

President has set 30-day time limit for review

Agreement incorporates up to \$368 B of spending
- idea is to see if the

~~Other~~ Working groups
Health investments
FDA review
Environment/workplace
Smoking cessation
Industry incentives
Liability litigation
Health effects

Package of health investments included in agreement is an important element in President's evaluation of the package

- should make sure this tobacco material complement & does not undermine budget negotiations

Estimated cost of setting up these funds is 50-75 cents per pack

Agreement is set up in perpetuity; assumes that payments are increased for 3%/yr CPI (though payments would be reduced if tobacco sales ↓)

Next mtg Monday 10^{am} (June 30)

could get 75% of its money back.

The way this works is that the industry, after paying its fine, can petition the FDA for a hearing. If the companies can establish they pursued all reasonably available measures to reduce youth smoking and did nothing to undermine the pact's goals, they get 75% of their money back. If the FDA turns them down, the companies can appeal the matter in court.

Health Consciousness

These provisions have been very well lawyered by the tobacco industry to thwart gains already made, charges former FDA Commissioner David Kessler, who launched the Clinton administration's war on youth smoking and has emerged as the settlement's most vocal opponent.

Even as the industry sells its conventional smokes, it is expected to start to peddle health-consciousness, too. With the threat of liability reduced and the FDA's role spelled out, companies are expected to introduce safer cigarettes and even smoking-cessation products. Smokers have overwhelmingly rejected the few such safe-cigarette products that have come to market so far, most notably Reynolds's no-smoke Premier.

Now, the settlement creates powerful incentives to make these products work. One big lure: Safer cigarettes would be exempt from the agreement's Draconian marketing curbs. Already, smaller rivals are gearing up. Star Tobacco, a tiny marketer of discount cigarettes in Petersburg, Va., has just filed papers seeking FDA approval for a new way of processing tobacco that eliminates nitrosamines, the most abundant carcinogens in cigarettes.

Success in safer cigarettes is particularly crucial to RJR. Pointing to its relatively small presence abroad and some aging brands, observers believe RJR hopes that research and development will now count for more than camels and cowboys. To the extent fewer marketing tools will be available, product attributes may become more of a selling feature, an RJR spokesman says.

Test Market

Already, Reynolds has spent more than \$1 billion working on Premier and, more recently, Eclipse, a low-smoke product that functions largely by heating tobacco, not burning it. Eclipse, being test-marketed in Tennessee, has taken about 0.5% of that market. While one person inside Reynolds describes it, in both taste and usability as probably like what Tab was to colas, he promises there will be more to come. (Philip Morris has been working on a cigarette that heats tobacco since the early 1990s.)

Even so, the settlement represents a high-stakes gamble for Reynolds, which had just begun to crawl out from under the huge debt load of its celebrated 1989 leveraged buyout. With an annual cash flow of just \$650 million a year, it may have to turn to banks or public markets to pay its share of the \$10 billion upfront payment.

One person involved in the talks recalls that at one point when antitobacco negotiators were pressing for \$15 billion, an RJR representative shot back: "If you want us bankrupt, go ahead." By the end of the talks, Mr. Goldstone was even more upset. Congress was also considering levying a 20-cents-per-pack excise tax. RJR declined to comment on the matter.

On the upside, with removal of the legal clouds, RJR shareholders—including Mr. Goldstone, an early supporter of settlement talks—stand to make a fortune by completing a long-contemplated spinoff of the company's Nabisco food operations. RJR management has feared that a spinoff could face a legal challenge on the ground that the company was shielding Nabisco from its tobacco liabilities.

Philip Morris's Outlook

The outlook is even rosier for Philip Morris, whose juggernaut Marlboro brand dominates the global tobacco market. Huge cash flow means the company can easily afford its settlement share. And its surging sales overseas make the fate of the U.S. market less important.

Because Philip Morris has so much to gain from a settlement, its rivals sniped throughout the talks that it was willing to give away the store. At one point, Philip Morris contemplated making billions of dollars worth of grants to restaurateurs for state-of-the-art ventilation to rid the last wisp of smoke from dining areas. Its competitors nixed the plan. A Philip Morris spokesman declined to comment.

The industry's astonishing gamble is predicated on legal calculations, too. Smokers likely will discover that their newfound knowledge of additives and nicotine will be of scant use in the courtroom. Under the settlement's terms, class-action and states lawsuits would be barred outright. Despite the industry's fears, there would probably be little economic incentive for smokers to bring individual suits. In the end, a number of plaintiffs' lawyers say, the industry has the immunity it was seeking all along.

These lawyers say that by banning class-action suits, the agreement strips plaintiffs of the economies of scale that make it possible to take on Big Tobacco, which spends \$600 million a year on its legal tab. Without the incentive of recouping punitive damages, pursuing individual claims for compensatory damages would be even more prohibitive. Another layer of complication involves the potentially explosive documents on smoking and health that the industry has agreed to release. The three-judge panel appointed to resolve document disputes with the industry will take away the decision from local judges handling the cases, making smoker litigation even more protracted.

Cottage Industry

But the industry's most potent legal weapon may be quite simply, the 68-page Proposed Resolution itself. The agreement contains scores of terms and definitions that are certain to create a new cottage industry for lawyers. Just one example: a requirement that companies give the FDA access to all records about their ingredients, with protection of proprietary information.

Says John Banzhaf, a George Washington University law professor and smoking foe: "This is going to be the Lawyers' Relief Act in terms of all these definitions."

Still, there are a couple of wild cards. Perhaps most worrisome for the industry is the possibility that developing countries, where cigarette sales are exploding, will one day decide to import the U.S. regulatory and liability scheme to their shores.

During the talks, no company was more vociferous in its objections to the FDA's encroachment than Brown & Williamson. The reason: Brown & Williamson's London parent is the most entrenched overseas. While B.A.T. controls only 17% of the U.S. market, it derives fully 75% of its tobacco volumes from developing markets like China, India and Eastern Europe.

Until now, though, antitobacco crusades in these countries have been embryonic, at best. Publicly, B.A.T.'s Mr. Broughton plays down the prospect that bureaucrats in other countries will clone the U.S. settlement.

For some, the proposed tobacco settlement will clearly yield an unprecedented windfall. All 50 states will reap 40% to 50% of the industry largess, negotiators say. The plaintiffs' lawyers who worked on the settlement are likely to pocket giant fees.

Even the FDA and the Department of Health and Human Services, among the settlement's most implacable foes, will collect more than \$1.5 billion a year for enforcement activities and other initiatives like research and a massive campaign aimed at youths.

There will be economic losers, too. Among them: magazines like Rolling Stone and Details that cater to young readers and enjoy streams of ad dollars from cigarette ads; the billboard industry; and the thousands of stores and supermarkets that will face onerous new restrictions on selling cigarettes.

For now, the landmark tobacco settlement faces a bruising fight in Congress, which it is expected to survive. But regardless of the outcome, the place of cigarettes in American culture and society will never again be the same.

"Cigarettes have always been associated with risk, menace and the intimation of mortality," says Richard Klein, author of "Smoking Is Sublime." "The more you interdict them, the more people enjoy the danger of transgressing."

But with the stripping away of the deception and manipulation that for four decades have marked the relationship between smokers and sellers, cigarettes, an enduring outlaw symbol, are on the verge of going respectable; they are about to become a regulated drug marketed with full disclosure of its risks. On paper at least, wringing every last shred of mystique out of the cigarette business promises to make for a more honest compact between buyer and seller. In the process of this catharsis, tobacco executives clearly hope to dispel their merchant-of-death image, too.

As Mr. Goldstone put it in his letter to RJR employees on Friday: "Most important, the agreement secures the tobacco industry's rightful place in the mainstream of legitimate U.S. commerce."

—Milo Gevelin
contributed to this article

THE WALL STREET JOURNAL

MONDAY, JUNE 23, 1997

Tobacco Pact's Limits —And Its Loopholes— Presage Fierce Debate

In the Fine Print Hurdles For FDA, and a Rebate To Firms if Smoking Falls

A Spur to 'Safer' Cigarettes

BY ALIX M. FREEDMAN
AND SUEIN L. HWANG

Staff Reporters of THE WALL STREET JOURNAL
Get ready for a scorching national debate over whether the cigarette industry came away from the historic tobacco settlement with too sweet a deal.

The pact announced Friday by a host of state attorneys general, plaintiffs' law

Ils, Ands and Butts

Congressional leaders and the White House will demand changes in the tobacco settlement, but in the end it's likely to make it into law. Article on page B1. In other coverage:

- Fees for plaintiffs' lawyers may total an obscene amount, B1
- Ad agencies are already thinking up new gimmicks to sell smokes, B1
- Kicking the habit takes more than a ban on billboards, B10
- Most analysts believe the long-term outlook for tobacco stocks is good, C1
- The smoking battle is just getting started overseas, A11

yers, public-health advocates and the nation's cigarette makers would place sweeping restrictions on America's most lethal consumer product. That would have been unimaginable as recently as a year ago.

If Congress blesses it, the industry could pay \$365 billion over the next 25 years and succumb to a ban on billboards, vending machines, sports promotions and ads with people and cartoon characters, such as Joe Camel and the Marlboro Man. It would yield to regulation by the Food and Drug Administration and print dire new warning labels such as "Smoking Can Kill You." And it would stop hiding what it knows about the deadly effects of smoking—for the first time, telling smokers just how much tar and nicotine they are really inhaling and disclosing the additives believed to make U.S. cigarettes among the world's most hazardous.

But the pact, banged together after nearly three months of fractious negotiations, could help the cigarette industry by spawning a potentially huge new market for "safer" cigarette designs that manufacturers previously shied away from for fear of waving a red flag to liability lawyers. And the settlement is pockmarked with loopholes that would probably let tobacco companies keep racking up huge profits from addicted smokers, while restricting legal redress in the courtroom.

Fewer Smokers

The industry is likely to pass along to smokers its massive settlement bill in the form of price increases of 35 to 50 cents a pack. The industry says that the one-time hit would probably cut the ranks of the nation's 45 million smokers by 15% during the next two years. But one mechanism in the proposed agreement could ensure that the industry won't lose too many smokers too quickly.

All sales of cigarettes purchased by adults drop below 1996 levels; companies would get a big rebate in their annual settlement payments, which, after an upfront \$10 billion payment, will begin at \$8.5 billion and ascend to \$15 billion in the fifth year of the agreement. That rebate, in turn, could let the industry lower prices and thus reignite sales.

In order to get the \$365 billion, we need to keep people smoking," says Attorney General Joseph Curran of Maryland, one of the 38 states that sued the industry. This is a real paradox that is very trou-

ble levels of nicotine in cigarettes—perhaps its tool for bringing smoking rates down. But don't hold your breath. Although a landmark federal-court ruling this year said the FDA has the power to regulate nicotine as a drug, the settlement creates a new set of hurdles before the agency can take that step.

Among them, the FDA would have to prove that ratcheting down nicotine in U.S. cigarettes would create significant demand for contraband. Regulators freely concede they don't have any idea how to prove that.

Shadowy Subject

The agreement also stipulates that the industry can take the agency to court to dispute its evidence, and orders judges to defer to the FDA's judgment only in areas where the agency has expertise. Nobody expects the FDA to claim expertise on the shadowy subject of contraband.

Indeed, some industry chieftains are already offering reassurances that the pact won't be a major disruption in the cigarette business.

After the shock of the 15% drop over the next couple of years, thereafter we'll be back to the normal trend," predicts Martin Broughton, chief executive of B.A.T. Industries PLC, whose Brown & Williamson Tobacco Corp. is the U.S.'s No. 3 cigarette supplier. This gives shareholders and employees more certainty and consumers a respite from the constant demonization of cigarettes.

In an interview, Mr. Broughton, who emerged as the most stiff-spined chief executive in the settlement talks, says he isn't worried about the FDA ever regulat-

Please Turn to Page A6, Column 1

Continued From First Page
ing nicotine. "It's an unlikely prospect," he says. "The contraband part gives me the most comfort."

And in a letter to employees the day the settlement was announced, Steven Goldstone, chief executive of No. 2 player RJR Nabisco Holdings Corp., said he had "every confidence" that the tobacco company will be able to "make critically important financial contributions" to the parent company. He added that RJR has already been operating in heavily regulated overseas markets, an area the cigarette makers are actively exploring, and "we don't see any reason to doubt the future of the domestic market under similar conditions."

Public Debate

Thus, as Congress and the White House launch a review of the agreement that is certain to be long and bruising, the pact thrusts the nation into a wrenching public debate over how to regulate its most controversial product ever.

The debate will be shaped by powerful crosscurrents running through America at the end of the century. On the one hand, thanks to a surging reverence for individual responsibility, there is a widely held belief that smokers should be accountable for their own behavior and don't need the FDA to wear them off nicotine. The cigarette industry has pressed this point successfully over and over to avoid courtroom losses and regulations it branded unduly paternalistic.

At the same time, the industry has until now maneuvered to be virtually untouched by the wave of consumer and environmental protection that has transformed so many other industries. The result: A product believed to be responsible for 425,000 deaths each year gets less government oversight of its contents and marketing than ice cream. And supporters of harsh regulation of cigarettes have made their cause hugely popular by focusing on the heavy toll on minors.

"We've reached a point in our political warfare in which public-health forces have the power and influence to counteract the tobacco lobby, but even among the most zealous of advocates there is a recognition of the right of consenting adults to commit smoking to their own home," says Michael Perlschuk, a former commissioner of the Federal Trade Commission and veteran antismoking advocate. "Finding the right balance will test the responsiveness of our democratic institutions and is going to be a challenge the nature of which we have never before faced in America."

instant criticism from the public. The advocates and lawmakers, who argued that negotiators gave away too much to an industry on the ropes. Nonetheless, inside the tobacco camp, some officials were shaken as they totted up the damage of a settlement that gave up far more than they ever imagined.

When the CEOs of RJR and industry leader Philip Morris Cos. kicked off negotiations on April 3, they intended to pay about \$200 billion in exchange for full protection from liability lawsuits. Instead they would be forced to pay almost double that amount for legal insulation that falls far short of what they had hoped.

There are about 600 individual liability suits pending against the tobacco industry that aren't erased by the agreement. (It affects only suits brought by 40 state governments and another group of state class-action suits.) Current and former smokers would remain free to press claims with no limits on compensatory damages.

Moreover, the tobacco industry fears those claims would be strengthened by internal industry documents on smoking and health that could become available to any U.S. citizen under the deal. The potential class of plaintiffs is still humongous, one negotiator says. "The upper-class plaintiffs bar will be less interested in representing plaintiffs because they can't hit a \$10 million home run, but a whole new bar will be created in America."

Warning Labels

The cigarette industry has a long history of shrewdly turning what appeared to be crushing defeat to its advantage. While the companies fought warning labels on cigarette packs when they were first mandated in 1965, they later used the little-read warnings as a shield against lawsuits.

In 1971, after voluntarily removing their ads from the airwaves to blunt increasingly effective antismoking spots, the companies simply shifted their brand imagery to frequently televised sporting events and lavish giveaways like Camel Cash and Marlboro Unlimited. They saved millions on TV-advertising expenses, and the TV ban made it hard for upstart brands to claim market share.

If the settlement goes through, regulators concede they have no plans to fiddle with cigarettes—partly because they have only begun to educate themselves about one of the most highly engineered products in the U.S. market. Under the terms of the agreement itself, reducing or purging cigarettes of nicotine and its nearly 600 additives would be virtually impossible.

Until now, FDA rulings couldn't be overturned unless a judge deemed them arbitrary and capricious. But under this settlement, the agency would have to provide substantial evidence to back up its assertions—a tough new standard that makes it far easier for the industry to block the FDA in court.

In addition, every time the FDA tried to modify cigarettes—either to reduce addictiveness or eliminate certain hazardous compounds—it would have to go through an intricate process called "formal rule-making," similar to a trial. How intricate? The last time the FDA recalls having used it was in the late 1960s, when it took almost 10 years to determine the percentage of peanuts that had to be in peanut butter.

One of the settlement's most touted provisions for reducing youth smoking is the "lookback." It is designed to guarantee that cigarette makers will drive down youth smoking rates by 30% in five years, 50% in seven years and 60% in 10 years by levying stiff penalties of as much as \$2 billion annually if those targets are missed. But here is the catch: The industry

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INDUSTRY TIMELINESS: 53 (of 95)

The Tobacco Industry has been a hot topic since our February review. Settlement talks between Big Tobacco and its foes, as well as developments on the litigation front, have fueled the fires raging around this group. Consequently, tobacco stocks have been more volatile than usual over the past three months.

The group's Timeliness rank has fallen below the median of the Value Line universe, owing largely to the decline in RJR Nabisco's rank (from 2 to 3). Philip Morris remains timely, and most of the tobacco stocks we track hold above-average long-term total-return prospects.

Settlement Talks

Last month, Philip Morris and RJR Nabisco began discussing a sweeping litigation settlement with anti-tobacco officials which include state attorneys general, plaintiffs' lawyers, and public health advocates. It was a landmark development because it was the first time a giant PM agreed to even acknowledge the possibility of a settlement. The initial proposed deal includes agreement by tobacco companies to accept strict marketing restrictions and to pay \$300 billion in damages over the next 25 years in exchange for protection from legal liabilities. But an eventual settlement, if any, may well look much different.

Big Tobacco is likely to demand complete immunity from all litigation, while many health advocates oppose the very idea of a deal. And many in the anti-tobacco camp have declared that \$300 billion is not a large enough payment. But if the monetary demands are too high, tobacco firms' incentive to settle would decrease. Too, a major settlement would require congressional approval, which would not come easily.

Litigation

Two recent legal decisions are particularly important for tobacco companies. First, the Hon. William I. Osteen ruled that the Food & Drug Administration may regulate tobacco as a drug. This had been a topic of negotiation in the settlement talks described above, but the federal judge's decision transformed the issue into law. Judge Osteen also ruled that the FDA lacks the authority to restrict tobacco firms' advertising and promotional practices. Notably, though, the Federal Trade Commission is now focusing more sharply on the industry's marketing techniques.

Second, RJR won the Connor v. RJ Reynolds case, in which the jury found that the company was not responsible for the death of a smoker who died of lung cancer. The victory replaces some of the negotiating leverage Big Tobacco lost in Judge Osteen's decision.

In the months ahead, the results of several other important legal cases may influence the settlement talks and investors' opinions of tobacco equities. Among the trials scheduled, the industry faces class-action suits involving nicotine addiction and second-hand smoke damages, as well as separate cases in which the states of Florida, Mississippi, and Texas are each suing for reimbursement of Medicaid payments made to treat illnesses allegedly related to tobacco.

Although it is clearly impossible to know or quantify the ultimate outcome of the settlement talks or lawsuits pending against tobacco companies, it appears that an industrywide tobacco settlement would help the stocks.

Operations

On a business-as-usual basis, tobacco firms appear to be in fine shape. Although U.S. tobacco consumption is basically flat, domestic consumers are generally buying more higher-margin premium cigarettes, helping to keep domestic profits at respectable levels. On the other hand, international earnings are growing at a strong double-digit pace. Improving economies and rising disposable incomes around the world are giving more consumers in foreign markets the wherewithal to buy tobacco products. In fact, the major multinational tobacco firms—PM, RJR, and B.A.T. Industries—are all expanding their global cigarette production capacity in order to keep up with demand.

Investment Guidelines

We expect tobacco stocks to continue trading rather erratically over the next three to six months. Rising speculation regarding an ultimate settlement between Big Tobacco and its foes, as well as a busy litigation calendar through August, will probably increase the volatility of the stocks in this group going forward. As such, conservative investors should avoid tobacco stocks for now.

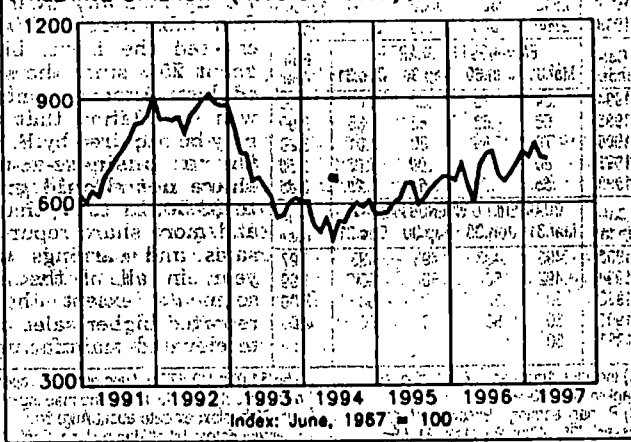
Nick Primavera

Composite Statistics: TOBACCO INDUSTRY

1993	1994	1995	1996	1997	1998	00-02	
132966	138308	142928	154096	160000	170000	220000	
14.1%	15.8%	16.9%	17.1%	18.0%	18.5%	20.0%	
3846.3	3989.8	3958.1	3971.8	4150	4200	5000	
6983.6	9067.7	10149	11467.3	13000	14000	20000	
38.3%	38.7%	39.2%	39.7%	40.0%	40.0%	40.0%	
5.3%	6.6%	7.1%	7.4%	8.0%	8.2%	9.1%	
1178.2	2513.9	3173.7	2258.8	2850	3000	4500	
34622	30325	29627	30857.1	30000	30000	30000	
36449	39427	41664	42499.4	45000	47000	65000	
12.0%	14.9%	16.2%	15.6%	17.5%	18.0%	21.0%	
19.2%	23.0%	24.4%	27.0%	28.0%	30.0%	30.5%	
8.1%	12.2%	11.5%	11.0%	11.5%	11.5%	15.0%	
60%	49%	55%	58%	60%	60%	60%	
14.1	11.0	11.4	11.5	Bold figures are Value Line estimates		12.0	
83	72	78	72	Value Line estimates		85	
4.1%	4.2%	4.7%	4.8%	Value Line estimates		5.0%	
						Avg Ann'l P/E Ratio	12.0
						Relative P/E Ratio	85
						Avg Ann'l Div'd Yield	5.0%

Tobacco

RELATIVE STRENGTH (Ratio of Industry to Value Line Comp.)



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A ERICAN BRANDS NYSE-AMB

RECENT PRICE: 54 P/E RATIO: 15.6 (Trailing: 16.4 Median: 11.0) RELATIVE P/E RATIO: 0.95 DIVD YLD: 3.7% VALUE LINE: 1576

TIMELINESS (Relative Price Performance since Next 12 Mos.)	High: 26.3	30.0	35.9	40.9	41.8	47.8	49.9	40.8	47.3	50.1	56.0	Target Price Range 2000: 2001: 2002:
SAFETY (Scale: 1 Highest to 5 Lowest)	Low: 15.7	18.3	21.1	30.6	30.9	35.6	39.0	28.5	36.8	39.9	47.8	
BETA 1.00 (1.00 = Market)	Cash Flow per Share											
2000-02 PROJECTIONS	Relative Price Strength											
In Insider Decisions	Options: ASE											
Institutional Decisions	Shaded area indicates recession											

1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	
29.83	29.48	32.27	31.75	33.37	38.55	41.57	64.13	62.24	68.78	68.97	72.19	68.31	65.34	63.81	67.89	72.75	78.15	78.15	78.15	78.15	78.15	78.15
2.06	2.01	2.14	2.26	2.35	2.67	2.85	3.95	4.29	4.90	5.26	5.82	4.92	4.83	4.49	4.88	5.25	5.65	5.65	5.65	5.65	5.65	5.65
1.67	1.64	1.69	1.80	1.84	2.09	2.21	2.72	3.26	3.78	3.91	4.29	3.39	3.06	2.90	3.20	3.50	3.85	3.85	3.85	3.85	3.85	3.85
.80	.88	.89	.93	.98	1.02	1.06	1.13	1.26	1.40	1.59	1.81	1.97	1.99	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
.74	.67	.62	.74	.77	1.16	.83	1.26	1.34	1.48	1.15	1.42	1.25	1.00	1.17	1.40	1.35	1.40	1.40	1.40	1.40	1.40	1.40
8.33	8.72	9.22	9.60	10.86	11.56	13.32	13.34	15.34	18.13	20.42	21.14	21.21	22.97	21.69	21.52	22.10	22.80	22.80	22.80	22.80	22.80	22.80
219.19	220.66	219.79	220.34	219.00	219.71	220.18	188.80	191.54	200.36	203.92	202.58	200.58	201.21	178.13	170.57	165.00	160.00	160.00	160.00	160.00	160.00	160.00
5.8	6.4	7.8	8.1	8.6	10.3	10.8	9.0	10.7	9.2	10.7	10.5	9.9	11.0	13.9	14.1	14.1	14.1	14.1	14.1	14.1	14.1	14.1
.70	.71	.64	.75	.70	.70	.72	.75	.81	.68	.68	.64	.58	.72	.95	.88	.88	.88	.88	.88	.88	.88	.88
8.3%	8.3%	8.9%	8.3%	6.2%	4.8%	4.4%	4.6%	3.6%	4.1%	3.8%	4.0%	5.9%	5.9%	5.0%	4.4%	4.4%	4.4%	4.4%	4.4%	4.4%	4.4%	4.4%

CAPITAL STRUCTURE as of 3/31/97	9152.9	11980	11921	13781	14064	14624	13701	13147	11367	11579	12000	12500	15000
Debt \$1548.1 mill. Due in 5 Yrs \$1000.0 mill.	10.8%	12.0%	12.8%	12.4%	12.6%	12.6%	13.5%	12.7%	11.8%	11.4%	11.9%	12.0%	12.5%
LT Debt \$1452.4 mill. LT Interest \$130.0 mill.	141.0	211.9	206.0	250.5	281.2	304.1	308.9	314.4	257.5	274.8	275	275	300
(LT Interest earned: 8.5x)	502.7	540.8	630.8	745.1	806.1	883.8	686.4	618.1	543.1	554.6	690	625	758
total interest coverage: 8.5x	41.2%	45.1%	40.6%	37.0%	34.9%	36.8%	37.9%	39.3%	39.2%	40.3%	40.0%	40.0%	40.0%
Common Stock 170,181,658 shares (72% of Cap'l)	5.5%	4.5%	5.3%	5.4%	5.7%	6.0%	5.0%	4.7%	4.8%	4.8%	4.9%	5.0%	5.0%
Pension Liability None	924.1	417.1	457.8	525.8	463.1	531.2	575.4	1555.4	752.7	178.1	200	250	300
Pfd Stock \$12.9 mill. Pfd Div'd \$1.2 mill.	1631.5	2359.2	1717.4	2433.8	2551.9	2406.8	2492.4	1512.1	1154.6	1598.3	1500	1500	1500
LT 444,012 shs. \$2.67 pfd (no par), each convertible into 4.08 com. shs. (less than 1% of Cap'l)	3103.9	2660.7	3101.5	3790.0	4318.0	4301.6	4271.4	4637.5	3877.2	3650	3650	3650	400
Common Stock 170,181,658 shares (72% of Cap'l)	11.9%	12.8%	15.2%	13.6%	13.3%	15.0%	11.6%	11.6%	12.2%	11.8%	12.5%	13.5%	15.0%
	16.2%	20.3%	20.3%	19.7%	18.7%	20.5%	18.1%	13.3%	14.0%	15.1%	16.0%	17.0%	20.0%
	8.7%	12.2%	12.9%	12.6%	11.3%	11.8%	6.8%	4.7%	4.3%	5.6%	7.0%	8.0%	10.0%
	4.9%	4.4%	4.0%	3.9%	4.2%	4.3%	5.8%	8.5%	7.0%	6.3%	6.0%	5.0%	6.0%

BUSINESS: American Brands is a diversified consumer products holding company. Product lines: International tobacco (59% of '96 revenues, 41% operating income) includes Gallaher Tobacco Ltd., the market leader in the U.K. with about a 39% market share; Office (11%, 10%); Hardware and home-improvement (12%, 18%); Distilled spirits (11%, 20%); and Golf & leisure (7%, 11%). Sold Franklin Life Ins., 1/95; U.S. tobacco ops., 12/94. Acq: Cobra Golf, 1/96. Employs about 28,000; has about 55,000 stockholders. Off. Dr. owned about 1.5% of common (3/97, Proxy). Chairman & CEO: Thomas C. Hays. President & COO: John T. Ludes, Inc. DE. Address: 1700 East Putnam Ave., Old Greenwich, CT 06870. Telephone: 203-698-5000. Web site: http://www.ambrands.com

American Brands is preparing to pass into history. In the coming weeks, the company plans to spin off its U.K.-based Gallaher tobacco division and rename its non-tobacco businesses Fortune Brands. (Note that our estimates and projections do not include the effect of the proposed spinoff.) AB shareholders would receive American Depository Receipts in Gallaher Tobacco (proposed symbol: GLH) and stock in Fortune Brands (proposed symbol: FO). As part of the spinoff, GLH will indemnify FO against any financial liability arising from tobacco-related issues. Investors have cheered the move, bidding AB stock up about 25% since the spinoff was announced last October. Contributing to the rise was speculation that a spun-off Gallaher may be acquired by B.A.T. Industries. On a business-as-usual basis, AB's share net should grow by about 10% to \$3.50; in 1997, thanks to higher profits and more share repurchases. First-quarter sales and earnings were up year over year, in all of the company's operating segments except the golf unit, which reported higher sales but lower profits due to elevated manufacturing costs related to Nick Primavera

new Cobra clubs: For the full year, each of AB's divisions will likely post higher sales and profits. AB is taking steps to improve future operations. It plans to merge the management of its hardware & home-improvement and office segments, which compose about half of what would become Fortune Brands. And AB is consolidating U.K. cigarette production in Northern Ireland, while expanding plant capacity in the former Soviet Union, where demand is very strong. The reorganization will be costly, but should significantly increase the long-term profitability of Fortune Brands and Gallaher Tobacco. We think investors should hold on to these unranked shares. Assuming the tobacco spinoff goes through, AB stockholders will realize an effective 15% dividend boost, thanks to U.K. tax refund, though conservative accounts would do well to exercise caution. Gallaher Tobacco stock will probably be volatile and not suitable for the

Calendar	Quarterly Revenues (\$ mil.)	Full Year
1994	3001, 3041, 3355, 3750	13147
1995	2792, 2595, 2895, 3085	11367
1996	2738, 2486, 2920, 3435	11579
1997	2845, 2600, 3055, 3500	12000
1998	2900, 2800, 3200, 3600	12500

Calendar	Earnings per Share	Full Year
1995	.84, .75, .65, 1.02	3.06
1996	.80, .63, .82, .85	2.90
1997	.70, .69, .80, 1.01	3.20
1998	.80, .76, .90, 1.05	3.50
1999	.85, .80, 1.00, 1.20	3.85

Calendar	Quarterly Dividends Paid	Full Year
1993	.493, .493, .493, .493	1.97
1994	.492, .50, .50, .50	1.99
1995	.50, .50, .50, .50	2.00
1996	.50, .50, .50, .50	2.00
1997	.50	2.00

B.A.T.I.

TIMELINESS (Relative Price Performance since Next 12 Mos.)

SAFETY (Scale: 1 Highest to 5 Lowest)

BETA 1.10

2000-02 PROJECTIONS

In Insider Decisions

Institutional Decisions

Options: ASE

U.S. Institut

CAPITAL STR

LT Debt

Current POS

ANNUAL RATE

Calendar

1994

1995

1996

1997

1998

1999

2000

2001

2002

Price

High 40

Low 30

NOT RE

1981

1982

1983

1984

1985

1986

1987

1988

1989

1990

1991

1992

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2001

2002

Revenues per sh

Cash Flow per sh

Earnings per sh

Div'ds Decl'd per sh

Cap'l Spending per sh

Book Value per sh

Common Shs Outstg

Avg Ann'l P/E Ratio

Relative P/E Ratio

Avg Ann'l Div'd Yield

Revenues (\$mill)

Operating Margin

Depreciation (\$mill)

Net Profit (\$mill)

Income Tax Rate

Net Profit Margin

Working Cap'l (\$mill)

Long-Term Debt (\$mill)

Net Worth (\$mill)

% Eamed Total Cap'l

% Eamed Net Worth

% Retained to Com Eq

% All Div'ds to Net Prof

15000

13.0%

300

758

40.0%

5.0%

200

1500

600

15.0%

20.0%

18.0%

6%

7802

8674

10055

10650

31

38

37

40

331

358

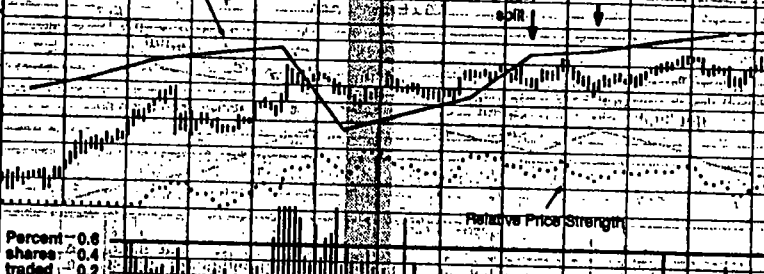
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1-800-833-0000

B.A.T INDUSTRIES (ADR) ASE-BT

RECENT PRICE 18 P/E RATIO 10.9 (Trading: 11.3 Median: 11.0) RELATIVE P/E RATIO 0.66 DIV YLD 6.4% VALUE LINE 1577

TIMELINESS (Relative Price Performance since Nov 12 '92)		SAFETY (Scale: 1-Highest to 5-Lowest)		BETA 1.10 (1.00 = Market)		2000-02 PROJECTIONS		Insider Deals		U.S. Institutional Decisions	
Average		Average						NOT REPORTED			
High: 7.0		High: 4.5		High: 1.0		Price Gain: 40 (-120%)		Ann'l Total Return: 26%		Percent shares traded: -0.6	
Low: 4.5		Low: 11.0		Low: 0.6		High: 40		Low: 30		Low: 14	
11.0		6.7		0.8		Ann'l Total Return: 26%		Low: 18%		Low: 19	
6.8		0.0		0.0		Low: 18%				Low: 13	
15.0		13.9		13.6		Low: 18%				Low: 10	
13.9		10.4		10.8		Low: 18%				Low: 8	
15.8		17.3		17.0		Low: 18%				Low: 4	
17.3		18.4		18.1		Low: 18%				Low: 2	
17.0		18.1		18.5		Low: 18%				Low: 1	
18.4		18.5		18.5		Low: 18%				Low: 0	
18.1		18.5		18.5		Low: 18%				Low: 0	
18.5		18.5		18.5		Low: 18%				Low: 0	



Year	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Price	12.17	12.74	11.76	12.18	11.43	11.67	11.89	11.81	11.81	11.93	11.70	11.83	20.53	20.99	23.44	27.12	27.75	29.16
Gain	65	70	55	63	59	61	63	61	62	62	75	91	149	156	175	183	205	215
Dividend	0.48	0.50	0.55	0.62	0.68	0.79	0.88	0.98	1.14	1.24	1.46	1.68	1.88	1.98	2.20	2.48	2.85	3.15
Yield	3.7	3.8	4.3	4.4	4.3	4.4	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5
EPS	2.91	3.01	3.15	3.36	3.61	4.15	4.99	4.29	4.85	5.77	6.78	8.12	9.26	10.33	11.36	12.48	13.65	14.85
Market Cap	1454.1	1454.5	1460.3	1476.9	1476.3	1488.3	1496.1	1520.9	1521.9	1473.2	1476.9	1448.9	1517.0	1540.5	1545.8	1543.0	1550.0	1550.0
Debt	3.6	4.3	4.3	5.2	6.2	7.6	9.0	6.8	9.0	25.3	22.6	19.8	12.2	11.5	10.8	9.8	8.8	8.8
Debt to Cap	4.4	4.7	3.6	4.8	5.0	5.2	6.0	5.6	6.8	1.88	1.44	1.20	0.72	0.75	0.71	0.62	0.63	0.63
Debt to EBITDA	6.4%	5.1%	5.0%	3.8%	4.4%	3.5%	3.6%	6.3%	5.7%	5.2%	6.3%	6.6%	5.2%	3.4%	5.4%	6.3%	6.3%	6.3%

Category	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Total Debt	27857	26678	29477	24799	25696	24097	31150	32338	36233	41847	43000	45000	43000	45000	43000	45000	43000	45000
LT Debt	454.0	445.0	441.0	225.8	342.2	320.0	383.0	390.2	430.9	395.0	450	500	430.9	395.0	450	500	430.9	395.0
LT Interest	1487.0	1718.0	1887.0	685.2	770.4	995.7	1891.1	2013.5	2281.6	2575.3	2750	2850	2281.6	2575.3	2750	2850	2281.6	2575.3
Interest Coverage	37.7%	36.7%	37.7%	54.6%	54.0%	41.5%	28.8%	25.4%	32.9%	34.2%	35.0%	35.0%	32.9%	34.2%	35.0%	35.0%	32.9%	34.2%
Leases	3814.0	606.0	1188.0	887.8	813.3	816.5	174.9	344.3	590.5	544.3	500	500	590.5	544.3	500	500	590.5	544.3
Stock	2334.0	3852.0	3874.0	3757.7	3833.5	4207.0	3548.9	3494.5	4553.9	5800.3	5000	5000	4553.9	5800.3	5000	5000	4553.9	5800.3
Common Stock	7458.0	6518.0	7540.0	5546.8	5589.4	5925.5	7500.0	7019.6	8571.5	8281.9	10000	11000	8571.5	8281.9	10000	11000	8571.5	8281.9
EPS	15.9%	17.2%	17.1%	9.0%	9.8%	11.3%	18.3%	20.7%	20.6%	18.8%	20.0%	20.0%	20.6%	18.8%	20.0%	20.0%	20.6%	18.8%
Debt to Cap	19.9%	26.4%	25.0%	12.4%	13.8%	16.7%	25.2%	28.7%	26.6%	27.7%	25.0%	25.0%	26.6%	27.7%	25.0%	25.0%	26.6%	27.7%
Debt to EBITDA	13.6%	18.1%	15.6%	NMF	NMF	NMF	14.1%	18.4%	11.1%	11.5%	12.0%	10.5%	11.1%	11.5%	12.0%	10.5%	11.1%	11.5%
Debt to Earnings	32%	31%	38%	NMF	NMF	NMF	44%	36%	58%	61%	65%	60%	58%	61%	65%	60%	58%	61%

CURRENT POSITION 1994 1995 12/31/96
 Cash Assets 1924.7 2216.5 2388.9
 Receivables 1941.6 1855.4 2250.4
 Inventory (Avg Cost) 3283.4 3382.1 3567.1
 Other 1924.7 2216.5 2388.9
 Current Assets 7149.7 7454.0 8208.4
 Debt Payable 426.9 454.2 501.2
 Acc't Due 2523.0 2941.9 3111.0
 Other 3855.5 3467.4 4249.9
 Current Liab. 6805.4 6883.5 7882.1

Year	1994	1995	1996	1997	1998
Quarterly Sales (\$ mil)	7802	7765	8415	8356	32338
Earnings per ADR	3.31	3.41	3.41	3.35	1.48
Gross Quarterly Div's Paid	331	353	362	362	362

B.A.T Industries stock has been extra volatile recently, owing to some noteworthy developments. Last month, Philip Morris and RJR Nabisco began negotiating a sweeping settlement on behalf of the industry with members of the anti-tobacco community. To a federal judge ruled that tobacco may be regulated as a drug by the FDA, and RJR gained an important victory in a very controversial lawsuit. It is clearly impossible to know or quantify the eventual ramifications of these recent events, although it appears that an industrywide tobacco settlement would help the stocks.

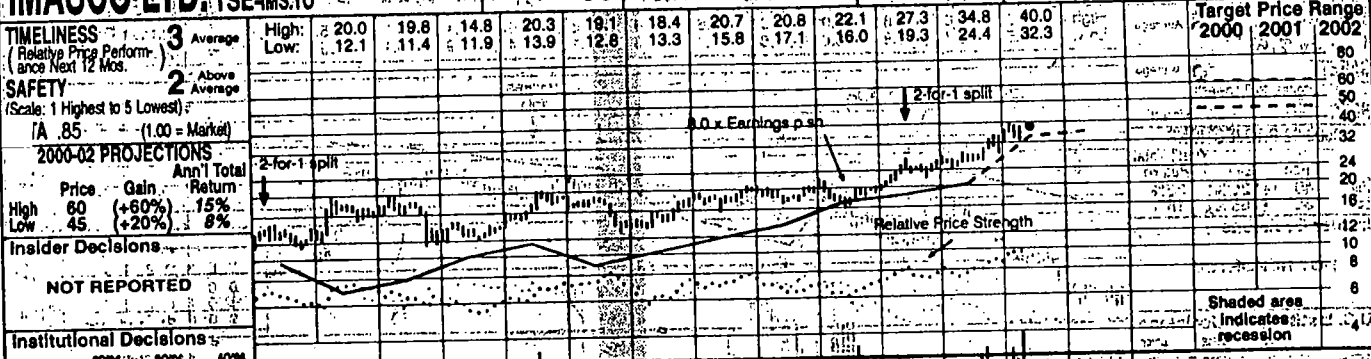
Neutrally ranked B.A.T. shares have a compelling valuation. Based on the company's present fundamentals, its U.S. tobacco unit seems to carry a negative valuation. Indeed, merely adjusting the division's weight to naught would likely increase this equity's share price by 10%-20%.

but only aggressive investors should consider a commitment here. We expect B.A.T. stock to continue to trade inconsistently over the next several months, owing to speculation regarding an ultimate tobacco settlement and a hectic U.S. litigation schedule through August. We have trimmed our 1997 share-net estimate by a nickel, to \$1.75, to reflect somewhat lower expectations for B.A.T.'s tobacco operations and a strong sterling. The company's financial services division has shown signs of improvement, most notably at U.S.-based Farmers Group, but the gains will probably be offset by slower growth in tobacco profits. We expect elevated legal and marketing costs in the U.S., where B.A.T.'s market share recently fell from 17.6% to 16.3%, to dampen the bottom line.

Earnings prospects through 2000-2002 remain bright. B.A.T. is well positioned in the global tobacco market, especially in emerging markets, where rising disposable incomes are permitting more consumers to purchase tobacco products. In fact, the company is substantially expanding its cigarette production capacity around the world to keep pace with the increasing demand. Our model calls for 5% average annual profit growth for the financial-services segment.

IMASCO LTD. TSE-IMS.TO

RECENT PRICE 38 P/E RATIO 14.3 (Trailing: 14.6, Median: 12.0) RELATIVE P/E RATIO 0.87 DIV'D YLD. 3.2% VALUE LINE 1578



Year	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
High	11.64	14.06	14.07	19.99	24.45	23.61	19.35	25.17	24.00	21.97	22.78	33.54	33.44	34.84	37.20	40.92	38.15	39.40	39.40	39.40	39.40	39.40
Low	3.8	1.12	1.29	1.59	1.82	1.48	1.48	1.92	2.09	1.78	1.98	2.80	3.07	3.67	3.82	4.11	4.25	4.50	4.50	4.50	4.50	4.50
Average	6.6	8.1	9.5	11.3	12.0	8.7	9.8	12.6	14.4	11.1	12.8	14.9	16.9	2.16	2.30	2.55	2.65	2.85	2.85	2.85	2.85	2.85
Gain	18	20	25	33	38	44	36	52	56	64	88	74	78	78	96	108	120	132	132	132	132	132
Return	57	59	51	93	85	98	100	127	98	87	50	49	63	47	144	105	110	115	115	115	115	115
Ann'l Total	3.12	4.23	4.81	6.06	6.94	7.96	8.56	8.62	9.45	9.92	10.48	11.34	12.35	13.71	13.47	14.65	15.85	17.10	17.10	17.10	17.10	17.10
Price	60	60	60	60	60	60	60	60	60	60	60	60	60	60	60	60	60	60	60	60	60	60
Gain	45	45	45	45	45	45	45	45	45	45	45	45	45	45	45	45	45	45	45	45	45	45

Year	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Revenues per sh	11.64	14.06	14.07	19.99	24.45	23.61	19.35	25.17	24.00	21.97	22.78	33.54	33.44	34.84	37.20	40.92	38.15	39.40	39.40	39.40	39.40	39.40
Cash Flow per sh	3.8	1.12	1.29	1.59	1.82	1.48	1.48	1.92	2.09	1.78	1.98	2.80	3.07	3.67	3.82	4.11	4.25	4.50	4.50	4.50	4.50	4.50
Earnings per sh	6.6	8.1	9.5	11.3	12.0	8.7	9.8	12.6	14.4	11.1	12.8	14.9	16.9	2.16	2.30	2.55	2.65	2.85	2.85	2.85	2.85	2.85
Div'ds Dec'd per sh	18	20	25	33	38	44	36	52	56	64	88	74	78	78	96	108	120	132	132	132	132	132
Cap'l Spending per sh	57	59	51	93	85	98	100	127	98	87	50	49	63	47	144	105	110	115	115	115	115	115
Book Value per sh	3.12	4.23	4.81	6.06	6.94	7.96	8.56	8.62	9.45	9.92	10.48	11.34	12.35	13.71	13.47	14.65	15.85	17.10	17.10	17.10	17.10	17.10
Common Shs Outst'g	188.22	193.01	204.22	217.80	217.82	238.25	238.38	238.38	238.49	238.23	238.49	238.20	238.37	233.48	232.29	230.61	228.00	228.00	228.00	228.00	228.00	228.00
Avg Ann'l P/E Ratio	7.1	7.9	8.9	9.7	11.0	20.0	15.9	10.6	12.1	15.2	11.9	12.5	11.2	8.7	10.2	11.1	11.1	11.1	11.1	11.1	11.1	11.1
Relative P/E Ratio	86	87	75	90	89	136	106	88	92	113	76	76	66	57	68	70	70	70	70	70	70	70
Avg Ann'l Div'd Yield	3.7%	3.1%	3.0%	3.0%	2.8%	2.5%	2.3%	3.9%	3.2%	3.8%	4.2%	3.7%	3.9%	4.1%	4.1%	3.8%	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%

Year	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Debt	4613.4	6000.6	5724.7	5234.0	5432.5	7989.8	7972.0	8134.0	8641.0	9436.0	8700	8900	8700	8900	8700	8900	8700	8900	8700	8900	8700	8900
LT Debt	10.6%	10.4%	11.8%	12.5%	12.1%	13.6%	14.5%	17.6%	16.9%	16.5%	18.5%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%
Incl. \$15.0 mill. capitalized leases	118.9	158.5	157.7	158.6	168.6	314.1	328.0	346.0	350.0	356.0	365	375	365	375	365	375	365	375	365	375	365	375
(LT interest earned: 8.0%)	245.0	314.3	366.1	291.4	331.8	380.4	424.0	521.0	546.0	601.0	610	655	610	655	610	655	610	655	610	655	610	655
Leases, Uncapitalized Annual rentals \$150.0 mill.	24.0%	19.5%	21.1%	23.7%	22.5%	30.6%	30.5%	37.7%	38.0%	39.3%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%
Pension Liability None	5.3%	5.2%	6.4%	5.6%	6.1%	4.8%	5.3%	6.4%	6.3%	6.4%	7.0%	7.4%	7.0%	7.4%	7.0%	7.4%	7.0%	7.4%	7.0%	7.4%	7.0%	7.4%
Prd Stock \$135.0 mill. Prd Div'd \$9.0 mill.	844.5	568.4	616.5	273.1	618.7	427.3	428.0	383.0	531.0	790	620	790	620	790	620	790	620	790	620	790	620	790
Incl. 270 shs. 6.9% Perpetual First Preference Shares Series D	2454.1	2143.6	1940.6	2072.3	1935.8	1958.9	1996.0	1927.0	1781.0	1966.0	1700	1450	1700	1450	1700	1450	1700	1450	1700	1450	1700	1450
Common Stock 230,814,624 shs. (62% of Cap'l)	2247.2	2281.0	2610.4	2719.9	2855.2	3057.8	3100.0	3337.0	3264.0	3514.0	3745	4005	3745	4005	3745	4005	3745	4005	3745	4005	3745	4005
Income Tax Rate	6.8%	8.7%	10.4%	8.2%	8.7%	8.4%	10.2%	11.5%	12.3%	12.5%	12.3%	12.5%	12.3%	12.5%	12.3%	12.5%	12.3%	12.5%	12.3%	12.5%	12.3%	12.5%
Net Profit Margin	10.9%	13.9%	14.0%	10.7%	11.6%	12.4%	13.7%	15.6%	16.7%	17.1%	16.5%	16.5%	16.5%	16.5%	16.5%	16.5%	16.5%	16.5%	16.5%	16.5%	16.5%	16.5%
Working Cap'l (\$mill)	7.2%	8.5%	9.2%	4.7%	6.1%	7.1%	7.7%	10.2%	10.0%	10.1%	10.1%	10.1%	10.1%	10.1%	10.1%	10.1%	10.1%	10.1%	10.1%	10.1%	10.1%	10.1%
Long-Term Debt (\$mill)	40%	44%	43%	62%	54%	50%	46%	38%	43%	43%	43%	43%	43%	43%	43%	43%	43%	43%	43%	43%	43%	43%
Net Worth (\$mill)	148	171	155	158	158	158	158	158	158	158	158	158	158	158	158	158	158	158	158	158	158	158
% Earned Total Cap'l	384	356	531	801	838	1158	801	838	1158	801	838	1158	801	838	1158	801	838	1158	801	838	1158	801
% Earned Net Worth	1333	1265	1704	680	683	899	680	683	899	680	683	899	680	683	899	680	683	899	680	683	899	680
% Retained to Com Eq	680	683	899	714	54	125	714	54	125	714	54	125	714	54	125	714	54	125	714	54	125	714
% All Div'ds to Net Prof	219	139	159	219	139	159	219	139	159	219	139	159	219	139	159	219	139	159	219	139	159	219

CAPITAL STRUCTURE as of 12/31/96
 Debt \$2091.0 mill. Due in 5 Yrs \$594.0 mill.
 LT Debt \$1968.0 mill. LT Interest \$150.0 mill.
 Incl. \$15.0 mill. capitalized leases.
 (LT interest earned: 8.0%) (36% of Cap'l)
 Leases, Uncapitalized Annual rentals \$150.0 mill.
 Pension Liability None
 Prd Stock \$135.0 mill. Prd Div'd \$9.0 mill.
 Incl. 270 shs. 6.9% Perpetual First Preference Shares Series D
 Common Stock 230,814,624 shs. (62% of Cap'l)

CURRENT POSITION
 1994 1995 12/31/96
 Cash Assets 148 171 15
 Receivables 384 356 531
 Inventory 801 838 1158
 Other 680 683 899
 Current Assets 1333 1265 1704
 Accts Payable 680 683 899
 Debt Due 714 54 125
 Other 219 139 159
 Current Liab. 970 888 1173

ANNUAL RATES
 Past 10 Yrs Past 5 Yrs Past 3 Yrs
 of change (per sh) 10 Yrs 5 Yrs 3 Yrs
 Revenues 5.0% 10.5% 30.0%
 Cash Flow 9.0% 14.5% 8.0%
 Earnings 8.0% 13.0% 10.5%
 Dividends 9.5% 19.0% 10.5%
 Value 7.0% 17.0% 8.5%

Year	1994	1995	1996	1997	1998	Full Year
Q1	1855	2081	2102	2096	2102	8134.0
Q2	2042	2232	2202	2165	2165	8641.0
Q3	2110	2375	2389	2562	2562	9436.0
Q4	2690	2000	2000	2010	2010	8700
Annual	2150	2200	2250	2300	2300	8900

QUARTERLY REVENUES (\$ mill.)
 1994 1855 2081 2102 2096 8134.0
 1995 2042 2232 2202 2165 8641.0
 1996 2110 2375 2389 2562 9436.0
 1997 2690 2000 2000 2010 8700
 1998 2150 2200 2250 2300 8900

QUARTERLY EARNINGS PER SHARE
 1994 1.30 1.59 1.64 1.63 2.18
 1995 1.41 1.61 1.65 1.63 2.30
 1996 1.47 1.67 1.71 1.70 2.55
 1997 1.63 1.70 1.72 1.70 2.65
 1998 1.65 1.75 1.78 1.77 2.85

QUARTERLY DIVIDENDS PAID
 1993 185 185 185 185 74
 1994 195 195 195 195 78
 1995 224 224 224 224 88
 1996 27 27 27 27 108
 1997 30 30 30 30 108

Business: Imasco Ltd. is a diversified Canadian company. Imasco's Federal of Rochester, 491. Sold Peoples Drug Stores, 9/90; UCS Group, 9/95; Roy Rogers, 8/96; First Federal, 3/97; Hardee's Food Systems, 4/97. '96 Deprec. rate: 14.2%. B.A.T. Inds. owns about 40% of common. Offices and Dirs. own less than 2% of common (96 annual). Pres. & C.E.O., Brian Levitt, Inc., Canada. Addr.: 600 de Maisonneuve Blvd., West, Montreal, H3A 3K7. Tel.: 514-982-9111.

Imasco has pared off a couple of non-pace of acquisitions, but only in its- strategic assets. The company divested established fields. Imasco purchased its U.S. financial subsidiary, First Federal, Meloche, Monnex, a Montreal-based prop- Savings of Rochester, for C\$928 million in- erty and casualty insurance business, for March. Imasco recorded a C\$246-million, \$142 million, in April. Merger mania has or C\$1.07-per-share, nonrecurring gain on, also hit the Canadian banking market; the sale in the first quarter. Although and the company will likely be required to First Federal has made a solid contribu- make further investments to compete ef- fectively down the road. In addition to ac- tion to the bottom line over the past, tively down the road. In addition to ac- several years, heavy consolidation within quitions, some of the proceeds from the the U.S. banking industry has recently, aforementioned sales will be utilized to placed the subsidiary at somewhat of a repurchase stock and reduce debt. competitive disadvantage. Imasco also sold Meanwhile, Imasco continues to build its Hardee's Food Systems last month for on its dominant position in the Can- dian cigarette market. The company approximately C\$457 million. Unlike First dian cigarette market. The company Federal, Hardee's has long been an al- now commands 67.3% of a Canadian batross around the company's neck, lower, cigarette sales, up from 66.2% the previous ing earnings by C\$10 million in 1996 year. However, a recently enacted Canadi- an law severely restricts the promotion of Hardee's sale will result in a write-off of tobacco products. Imasco is currently fight- ing the new legislation in court. Investors should do better elsewhere. The stock's 3- to 5-year appreciation potential is not too exciting. Moreover, the asco's looming battles on the tobacco front company may be subject to costly tobacco (see below), the divestiture is certainly litigation over the long haul. The equity is welcome news. The company will likely pick up the Perry H. Roth.

Company's Financial Strength: Imasco's stock price is stable, with a 5-year appreciation potential of 85%. Price Growth Persistence: Imasco's earnings growth is strong, with a 5-year average of 10.5%. Earnings Predictability: Imasco's earnings are predictable, with a 5-year average of 10.5%. To subscribe call 1-800-833-0016

PHILIP MORRIS NYSE:MO

RECENT PRICE 41 P/E RATIO 14.2 (Trailing: 15.4 Median: 12.0) RELATIVE P/E RATIO 0.86 DIV YLD 4.3% VALUE LINE 1579

TIMELINESS Reliable Price Perform. (Scale: 1 Highest to 5 Lowest)	2 Above Average	High: 6.5	10.4	8.5	15.3	17.3	27.3	28.9	25.9	21.5	31.5	39.7	48.8	Target Price Range 2000 2001 2002
SAFETY (Scale: 1 Highest to 5 Lowest)	3 Average	Low: 3.7	6.1	6.7	6.3	12.0	18.1	23.4	15.0	15.8	18.8	28.5	38.0	100 80 64 48 32 24 20 16 12 8 6 4 2 0
BETA 1.20 (1.00 = Market)														

2000-02 PROJECTIONS	Price	Gain	Ann'l Total Return
High	95	(+130%)	26%
Low	65	(+60%)	18%

Insider Decisions	J	J	A	S	O	N	D	J	F
To Buy	0	0	0	0	0	0	0	0	0
To Sell	0	1	1	0	0	0	0	0	0

1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	VALUE LINE PUB. INC. 00-02
3.82	3.88	4.33	4.74	5.57	8.90	9.75	11.45	16.07	18.42	20.48	21.07	23.15	25.45	26.50	28.46	30.63	34.80	Sales per sh
30	35	41	46	57	75	80	103	143	177	207	231	1.97	2.52	2.87	3.29	3.75	4.35	"Cash Flow" per sh
22	26	30	35	42	52	55	74	101	128	151	182	1.35	1.82	2.17	2.56	3.00	3.55	Earnings per sh
108	10	12	14	17	21	22	34	42	52	64	78	87	1.01	1.22	1.47	1.70	1.90	Div'ds Decl'd per sh
34	30	19	10	12	24	25	37	45	49	57	56	61	67	65	73	75	85	Book Value per sh
110	121	134	140	165	184	204	272	344	430	453	448	442	5.00	5.61	5.85	6.40	6.95	Cap'l Spending per sh
3009.6	3021.5	2999.6	2913.5	2864.4	2854.3	2839.5	2772.4	2785.6	2778.7	2759.6	2806.0	2631.3	2558.6	2493.5	2431.3	2400.00	2300.00	Common Shs Outst'g
9.3	8.4	8.8	8.5	8.2	10.6	11.8	10.3	11.7	11.6	14.8	14.4	13.5	10.3	11.4	12.6	12.6	12.6	Avg Ann'l P/E Ratio
11.3	9.3	7.4	7.9	6.7	7.2	7.9	8.6	8.9	8.6	9.5	8.7	8.0	6.8	7.6	7.9	7.9	7.9	Relative P/E Ratio
4.1%	4.6%	4.6%	4.7%	4.8%	3.8%	3.4%	4.5%	3.5%	3.5%	2.8%	3.0%	4.7%	5.4%	4.9%	4.5%	4.5%	4.5%	Avg Ann'l Div'd Yield

CAPITAL STRUCTURE as of 12/31/96	Total Debt \$13,933 mill. Due in 5 Yrs \$7,970 mill.	27695	31742	44759	51169	56458	59131	60901	65125	66071	69204	73500	80000	Sales (\$mill)
LT Debt \$11,827 mill. LT Interest \$945 mill.	(LT interest earned: 12.3%; total interest coverage: 10.0x)	17.0%	16.3%	17.2%	18.2%	18.7%	20.5%	16.1%	17.2%	18.5%	20.3%	21.0%	21.5%	Operating Margin
Pension Liability \$743 mill. in '96 vs. \$712 mill. in '94	(45% of Cap'l)	704.0	779.0	1194.0	1367.0	1487.0	1542.0	1619.0	1722.0	1671.0	1691.0	1750	1770	Depreciation (\$mill)
Pfd Stock None		1864.0	2064.0	2794.0	3540.0	4202.0	4939.0	3568.0	4725.0	5478.0	6303.0	7210	8170	Net Profit (\$mill)
Common Stock 2,431,348,191 shs. (55% of Cap'l) (Adjusted for 3-for-1 stock split paid 4/10/97)		44.3%	44.6%	41.8%	43.9%	43.4%	42.8%	42.4%	42.5%	41.4%	41.0%	42.0%	42.0%	Income Tax Rate
		6.7%	6.5%	6.2%	6.9%	7.4%	8.4%	5.9%	7.3%	8.3%	9.1%	9.8%	10.2%	Net Profit Margin
		1396.0	182.0	437.0	1007.0	770.0	643.0	6731.0	943.0	606.0	323.0	385	525	Working Cap'l (\$mill)
		5222.0	1588	13646	15285	13420	13407	14358	14085	12324	11827	12500	12500	Long-Term Debt (\$mill)
		6823.0	7679.0	9571.0	11947	12512	12563	11627	12786	13985	14218	15345	15970	Net Worth (\$mill)
		17.4%	10.2%	14.1%	15.3%	18.4%	21.5%	16.4%	19.9%	22.9%	26.0%	27.5%	30.5%	% Earned Total Cap'l
		27.3%	26.9%	29.2%	29.6%	33.6%	39.3%	30.7%	37.0%	39.2%	44.3%	47.0%	61.0%	% Earned Net Worth
		16.3%	15.2%	17.7%	18.3%	20.2%	23.2%	11.0%	17.5%	18.2%	20.0%	20.5%	22.5%	% Retained to Com Eq
		40%	43%	39%	38%	40%	41%	64%	53%	54%	55%	57%	56%	% All Div'ds to Net Prof

ANNUAL RATES	10 Yrs	5 Yrs	Est'd '94-'96 of change (per sh)
Sales	15.5%	8.0%	12.5%
"Cash Flow"	17.0%	10.5%	16.0%
Earnings	17.5%	11.5%	18.5%
Dividends	22.0%	18.5%	12.5%
Book Value	12.5%	6.0%	17.0%

QUARTERLY SALES (\$ mill)	Mar.31	Jun.30	Sep.30	Dec.31	Full Year
1994	15500	16414	16710	16501	65125
1995	16517	17129	16689	15736	66071
1996	17491	17509	17414	16790	69204
1997	18217	18483	18700	18100	73500
1998	19500	19800	20200	20500	80000

EARNINGS PER SHARE	Mar.31	Jun.30	Sep.30	Dec.31	Full Year
1994	45	47	47	43	1.82
1995	53	56	57	51	2.17
1996	63	66	67	60	2.56
1997	73	77	78	72	3.00
1998	88	91	90	86	3.55

QUARTERLY DIVIDENDS PAID	Mar.31	Jun.30	Sep.30	Dec.31	Full Year
1993	217	217	217	217	87
1994	217	231	231	275	95
1995	275	275	275	333	1.16
1996	333	334	40	40	1.47
1997	40	40			

BUSINESS: Philip Morris Companies Inc. is a leading consumer products company with four major segments: tobacco (53% of '96 revs., 67% of op. prof.), incl. Marlboro, Benson & Hedges, Merit, Virginia Slims; Lark food (40% of revs.), incl. coffee, Post cereals, and packaged foods (Jell-O, Kool-Aid, Oscar Mayer, Kraft, Velveeta, Miracle Whip); Miller beer (6%, 4%); and financial svcs./real est. (1%, 2%). Has a 50% share of U.S. industry shipments of cigarettes. Acq'd General Foods, 11/85; Kraft, 12/88; Suchard AG, 8/90; Frito, Marabou, 4/93. Has 151,000 employees; 144,400 stockholders. FMR Corp. owns 7.9% of stock; off/dir. less than 1% (397 proxy). Chmn: C.E.O. Geoffrey C. Bible; Inc. VA. Address: 120 Park Ave., New York, NY 10017. Tel: 212-880-5000.

Philip Morris is finally entertaining the prospect of a comprehensive tobacco litigation settlement. The company, along with its domestic tobacco peers, started preliminary discussions last month with White House aides and attorneys general from several states. More than 20 states are suing the tobacco industry for medical costs, and there are at least 15 additional class-action lawsuits pending. A recent court ruling has granted the FDA partial jurisdiction over tobacco, a move vigorously opposed by the industry. Mounting litigation and attorney fees have pushed Philip Morris to the bargaining table, but the world's leading tobacco firm will work hard to get favorable terms before signing on the dotted line.

R.J. Reynolds' recent court victory in Florida should provide some leverage for the industry. A Florida jury ruled that Reynolds was not culpable for Jean Connor's cancer. The plaintiff's lawyer had previously won a case against the industry last summer. Big Tobacco's first notable court defeat. Philip Morris and its competitors are seeking immunity from future lawsuits in exchange for payouts ranging from \$19.0 billion. (D) Incl. intangibles. '96: \$19.0 bill., \$7.81/sh. (E) In millions, adjusted for stock splits. (F) Excl. fin'l services and real estate subsidiary.

Company's Financial Strength
Price Stability 50
Price Growth Persistence 70
Earnings Predictability 70

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6.20
4.25
81.70
1.40
22.90
220.00
12.0
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10000
22.0%

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40.0%

9.5%

960
5170
15.0%

18.5%

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41%

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RJR NABISCO HLDGS NYSE-RN RECENT PRICE: **30** P/E RATIO: **10.5** (Trailing: 11.2 Median: NMF) RELATIVE P/E RATIO: **0.64** DIV'D YLD: **6.8%** VALUE LINE: **1580**

TIMELINESS (Relative Price Performance Next 12 Mos.)	3 Average	High: 275.6	355.6	472.5	491.9	0.0	65.0	58.1	46.3	40.0	34.6	35.3	38.9	Target Price Range	2000	2001	2002
SAFETY (Scale: 1 Highest to 5 Lowest)	3 Average	Low: 155.0	172.5	220.0	448.8	0.0	28.1	39.4	21.9	26.9	25.3	25.1	27.0				
2000-02 PROJECTIONS Price: 70 (+135%) Gain: 50 (+65%) Return: 28% 19%		Relative Price Strength 															
Insider Decisions J J A S O N D J F to Buy: 0 0 1 0 0 0 0 0 0 0 0 0 to Sell: 0 0 0 0 0 0 0 0 0 0 0 0		Institutional Decisions to Buy: 113 114 141 to Sell: 117 111 106 Net Buy: 187429 180522 221121 Percent 12.0% shares 8.0% traded 4.0%															

RJR Nabisco was taken private by Kohlberg Kravis Roberts & Co. in 1989. In Feb., 1991, RJR resumed public trading of its common stock at a price of about \$30 a share (adjusted for splits). On January 26, RJR completed an initial public offering of 19.5% of its Nabisco-food subsidiary at a price of \$24.50 a share. In March, 1995 KKR sold its remaining interest in RJR.	1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998	Sales per sh ^A 88.00 "Cash Flow" per sh 12.50 Earnings per sh ^B 5.00 Div'ds Decl'd per sh ^C 3.50 Cap'l Spending per sh 4.00 Book Value per sh ^D 48.00 Common Shs Outst'g ^E 250.00 Avg Annl' P/E Ratio 12.0 Relative P/E Ratio .85 Avg Annl' Div'd Yield 5.8%
CAPITAL STRUCTURE as of 12/31/98 Debt \$9,928 mill. Due in 5 Yrs \$4,735 mill. LT Debt \$9,256 mill. LT Interest \$850 mill. (Total interest coverage: 3.0x) (46% of Cap'l)	15766 18656 12764 13879 14989 15734 15104 15366 16008 17063 18000 19000	Sales (\$mill) ^A 22000 Operating Margin 25.0% Depreciation (\$mill) 1500 Net Profit (\$mill) 1600 Income Tax Rate 44.0% Net Profit Margin 7.3% Working Cap'l (\$mill) 500 Long-Term Debt (\$mill) 7000 Net Worth (\$mill) 12000 % Earned Total Cap'l 11.0% % Earned Net Worth 12.0% % Retained to Com Eq 5.0% % All Div'ds to Net Prof 70%
Common Stock 273.574 mill. shs. (326.502 mill. primary shs.) (47% of Cap'l)	18.92 25.31 8.47 3.67 2.05 2.29 2.70 2.46 2.73 2.71 3.30 3.10 122.05 128.95 20.08 21.50 35.96 35.35 33.26 34.55 35.87 35.13 42.45 44.25 49.47 45.13 61.62 116.00 224.33 226.93 227.60 272.33 272.81 273.57 265.00 260.00 12.0 8.7 8.1 3.10 1.10 1.03 1.03 1.03 1.03 1.03 1.03 1.03 .80 .81 3.1% 3.6% 5.2% 5.7%	Bold figures are Value Line estimates

BUSINESS: RJR Nabisco Holdings Corp. is a major tobacco and food concern. RJR Reynolds Tobacco is the second largest domestic producer (about 25% market share) of cigarettes. Brands include Winston, Salem, Camel, Doral, Vantage, & More. Nabisco is the largest U.S. maker of cookies (Oreo, Chips Ahoy!) and crackers (Ritz, Wheat Thins). Other products lines include Fleischmann's, Milk-Bone, Planters, Life Savers, SnackWells, and Parkay. Has about 79,700 employees. FMR Corp. owns 10.6% of common. Sanford C. Bernstein, 7.4%. Off. & Dir., less than 1% (3/97 proxy). Chairman, President: & C.E.O., Steven F. Goldstone, Inc., DE. Add.: 1301 Avenue of the Americas, New York, NY 10019. Tel.: 212-258-5600. Web site: http://www.rjnabisco.com

CURRENT POSITION 1994 1995 12/31/98 Cash Assets 423 234 252 Receivables 934 1334 1418 Inventory (LIFO) 2580 2489 2836 Other 426 503 445 Current Assets 4363 4560 4751 Acc'ts Payable 548 755 691 Debt Due 2266 418 672 Other 2780 2951 2943 Current Liab. 5594 4124 4308	L. RATES Past 10 Yrs. Past 5 Yrs. Est'd '94-'96 or change (per sh) 10 Yrs. '96-'02 Sales 14.0% 14.5% 7.0% "Cash Flow" 13.0% 12.0% Earnings 18.0% 15.0% Dividends 17.0% 15.0% Book Value 9.5% 6.5% 3.0%	QUARTERLY SALES (\$ mill) ANNUAL Full Year Mar.31 Jun.30 Sep.30 Dec.31 1994 3572 3784 3968 4044 15368 3540 4081 4063 4324 16008 3886 4203 4349 4625 17063 3779 4400 4821 5000 18000 4000 4500 5000 5500 19000	EARNINGS PER SHARE Full Year Mar.31 Jun.30 Sep.30 Dec.31 1994 1.60 1.55 1.55 1.40 2.10 1.51 1.58 1.61 1.60 2.30 1.57 1.64 1.68 1.73 2.62 1.62 1.70 1.80 1.89 3.00 1.75 1.80 1.95 1.90 3.60	QUARTERLY DIVIDENDS PAID Full Year Mar.31 Jun.30 Sep.30 Dec.31 1994 1.375 1.375 1.375 1.13 1.375 1.4625 1.4625 1.4625 1.76 1.4625 1.5125
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RJR Nabisco shares have been more volatile than usual as of late. In the past month, RJR and Philip Morris began discussing a sweeping litigation settlement with anti-tobacco forces, a federal judge ruled that the FDA may regulate tobacco as a drug, and RJR won a controversial lawsuit in which the jury found that the company was not responsible for the death of a smoker who died of lung cancer. It is clearly impossible to know or quantify the eventual ramifications of these developments, although it seems likely that an industrywide tobacco settlement would help the stocks. We expect neutrally ranked RJR stock to continue trading erratically over the short term. Indeed, speculation regarding an ultimate settlement between Big Tobacco and its foes, as well as a busy litigation calendar through August, will probably increase tobacco stocks' volatility going forward. Accordingly, risk-averse investors should avoid these shares. However, aggressive accounts may want to consider a commitment here, given that RJR stock's total-return prospects through 2000-2002 are above average.

RJR's first-quarter operating results included some potential concerns. The domestic and international tobacco units registered 5% and 11% volume declines, respectively, compared to the year-earlier period. And the Nabisco food division's year-over-year sales fell by 4%.

but 1997 share net should still rise, by about 15% to \$3.00, thanks to a lower tax rate, further cost-reduction measures, and continuing share repurchases. (RJR recently raised its dividend and announced that it is doubling its buyback program to \$200 million.) Domestic tobacco profits will likely be flatish, marked by higher sales and lower volumes, international tobacco earnings, which were hurt by a temporary importing problem in the former Soviet Union in the first quarter, should rebound nicely for the balance of the year, and food profits will probably trend higher as the unit's current reorganization progresses. For additional information on Nabisco Holdings, refer to our report on page 1488.

Earnings growth through 2002 should also approximate 15% per year.

Nick Primavera
May 16, 1997

(A) Excludes excise taxes. (B) Primary earnings. Excludes net int. rem. '94, (86c); '95, (77c); '94, (80c); '93, (50c); '92, (1.60c). Next earnings report late July. (C) Dividend reinstated 2/95. Next dividend meeting early August. Next ex date June 11th. Payment dates about the 1st of January, April, July, and October. (D) Includes intangibles. In '96, \$20.3 billion, \$74.20/sh. (E) In millions, adjusted for stock split.

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FAX

Date: 7/17/97
 Number of pages including cover sheet: 2

	Name	FAX Number	Phone Number
To:	<u>Mark Mazur</u>	<u>395-6809</u>	<u>395-5147</u>
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From:	<u>Jon Gruber</u>	<u>202-622-2633</u>	<u>622-0563</u>

REMARKS: Urgent For your review Reply ASAP Please comment

Question: Does deductibility reduce net revenue to the government from tobacco companies?

Answer: Yes. Revenue would be greater if the tobacco payment were not deductible. Nonetheless, focusing on the tobacco industry alone, the revenue loss to the government from deductibility is likely to be offset by a revenue gain from higher corporate receipts. To the extent that the settlement amount is fully reflected in increased spending on tobacco products (e.g., through an increase in the price of cigarettes), receipts will rise by the full amount of the settlement payment, and there will be no change in tobacco company's taxable income. The increase in receipts offsets the effect of the deductibility of the settlement payment by tobacco companies. In essence, deductibility allows the tobacco companies to serve as a "pass through" for collecting the settlement payment from consumers, without affecting their net tax liability.

Question: Since allowing tobacco settlement payments to be deductible reduces net revenues to governments from the agreement, should the payments be deductible?

Answer: Under present tax law, businesses are allowed to deduct in computing net income ordinary and necessary business expenses paid or incurred in carrying on a trade or business. Deductible amounts include amounts paid as compensatory or punitive damages if they arise in the ordinary course of a taxpayer's business. Absent a deduction for ordinary and necessary business expenses, income (and tax liability) would be overstated. On tax policy grounds, allowing a deduction for the settlement payments is appropriate.

7/18/17

Tobacco Settlement Economic analysis group

Inclined to believe that excise tax \uparrow would lead to price increase slightly higher than excise tax \uparrow

Gruber/Gotbaum will work on putting these figures in normal budget terms (by fiscal year) -- incorporating

Options for raising more money

(1) \$1 per pack excise tax \Rightarrow 295 B / yr

(2) get rid of volume requirement (lower volume of tobacco sales \Rightarrow lower payment by $\approx 1/4$)
-- doing this shifts some of the burden from smokers to shareholders

(3) auction quantity licenses for cigarette sales
- Larry makes analogy to climate change policy

Bova: Goals of this exercise are

(1) reduce smoking

(2) not allow companies to avoid obligations to reduce smoking

Larry: Industry gets insurance against being put into bankruptcy from damage awards;

Industry gets to administer its own excise tax as a way to fund payments for damages

Issue is what else Admin can get from this deal (b/c industry seems to be doing OK, based on the economics)

Lookback mechanism

Larry thinks it should not be formed like an excise tax

Could be done on company-by-company basis to make sure that each company makes serious efforts (no free rider)

Gruber: should ↑ size of lookback penalty (probably double) and also should eliminate the 75% abatement of penalty, based on "good efforts" to reduce smoking
Faith

That material is the secret Treasury

stuff designed to make Larry look good.

July 18, 1997

ON THE LOOK-BACK SURCHARGE

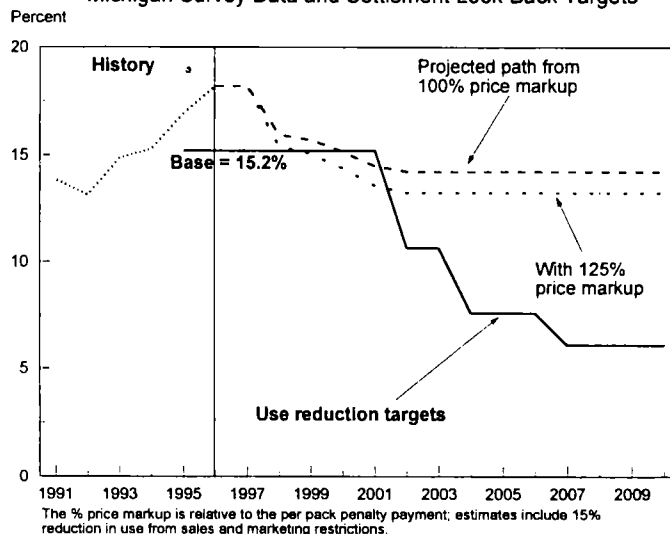
The settlement contains a "look-back" provision that attempts to provide economic incentives to tobacco firms to achieve "dramatic and immediate reductions in the number of underage consumers of tobacco products." Manufacturers would face a surcharge if tobacco-use reduction targets for underage users are not met. The surcharge would be imposed on the basis of a comparison between actual underage teen tobacco use percentages and specific youth smoking targets. The stated goal of the lookback surcharge was to "approximate the present value of the profit that the cigarette industry would earn over the life of underage smokers". Manufacturers could petition the FDA for partial abatement of the surcharge if they have acted in good faith and in full compliance with the Act.

PROBLEMS WITH THE CURRENT STRUCTURE OF THE LOOK-BACK

A number of problems exist with the current structure of the look-back surcharge:

- The lookback penalty -- \$80 million per percentage point of underage use in excess of the reduction target -- was determined as part of the negotiations between the Attorneys General and the industry. But our estimates indicate that the *present value to firms of the profit stream* from the underage smokers in excess of the reduction target is about *twice as large as the cost of the surcharge* as specified in the agreement. As a result, this surcharge amount offers little incentive for tobacco companies to reduce teen smoking, beyond the natural reductions that will occur due to higher cigarette prices. The accompanying figure compares projected teen smoking reductions due to price changes alone with the specified lookback targets¹
- If the specified surcharge is too low, so that youth smoking falls through the price effect only, our estimates suggest that the surcharge payments would begin at roughly \$100 million per year, and rise to roughly \$250 million per year after the final step down in the reduction targets.

Underage Daily Tobacco Use Percentages and Targets
Michigan Survey Data and Settlement Look Back Targets



¹The reductions shown in the chart are from price effects alone and do not account for the possible reduction in youth smoking that could result from the marketing restrictions and other components of the agreement intended to help reduce underage smoking.

- The partial abatement -- under which firms could receive up to 75% abatement of the surcharge -- would significantly erode the economic incentive of the surcharge. Many believe that it would be very easy for firms to qualify for the abatement. If firms did qualify for this abatement, then the lookback surcharge would only be *one-eighth* as large as the profit stream from increasing youth smoking.
- An additional difficulty is the “free rider” problem. Because the targets are specified for use of non-brand-specific tobacco, individual firms have the incentive to keep their sales to teens while others would bear the surcharge cost from that use. As each firm has these same incentives, in practice it is less likely that the reduction targets would be met.
- A stronger approach would advocate that the goal should be to *eliminate* underage tobacco use, not merely reach the targets specified in the agreement. Six percent of high school teens would continue to smoke cigarettes on a *daily* basis even if the ultimate teen reduction target (60% reduction in 10 years) was fully met.

OPTIONS THAT MORE EFFECTIVELY REDUCE YOUTH SMOKING

While maintaining the broad structure of the deal, adjustments could be made to attempt to make the look-back actually work to provide the incentive to reduce underage tobacco use.

- **Eliminate the surcharge abatement:** As a first principle, the partial abatement of the surcharge should be eliminated.
 - The industry likely would strongly oppose any effort to eliminate the abatement -- the industry claims that it does not have direct control over whether teens smoke or not and therefore should not be held directly accountable for all of their use.
 - The Attorneys General accepted the abatement provision in part because they viewed it as a vehicle to assure that firms would actually pay the surcharge without first challenging it in court and thereby delaying their payment and also because the hearing process would provide the opportunity for an annual public relations campaign against smoking.

Option 1: Increase the size of the surcharge

As noted above, our calculations indicate that *the base surcharge amount should be increased to at least \$160 million per percentage point*. An amount above this level would truly penalize the industry for not reducing youth smoking, and would as a result increase their incentives to do so.

- If youth smoking only falls through the price effect (that is, if even the increased penalty level does not impact youth smoking) the level of payments with a \$160 million base

surcharge would run in the range of about \$200 million initially, and roughly \$450 million when the steps down in the reduction targets occur.²

- If other settlement provisions or firm efforts succeed in reducing teen smoking below the levels shown in the chart, the level of surcharge payments would be lowered accordingly.

Option 2: Eliminate the double counting provision

- Under the agreement as negotiated, the surcharge is reduced to account for underage smokers on whom a surcharge was paid in earlier years.
- We see little justification for not repeatedly penalizing the companies for youths that do not quit. Under this so called “double counting” provision, once a youth has begun smoking (and the company has been fined), there is no remaining incentive for the industry to discourage continued smoking.
- Furthermore, given existing data constraints, the double counting provision is administratively unworkable. Without data that follows teens over time to assess whether they continue to smoke, the double counting adjustment will simply be a rough approximation based on the share of cohorts that do smoke.
- Our estimates indicate that by eliminating the double-counting provision, the current level of the surcharge (\$80 million) would provide an effective incentive to firms to reduce underage smoking.
 - Initially, there is no change in effectiveness because the double counting provision would not be in effect. In succeeding years, however, the present value of profits generally would be about ½ the size of the surcharge payment (rather than twice the size, as we estimate for the current settlement parameters).
- Once again, if even this increased penalty has no effect, the estimated levels of annual surcharge payments would begin at roughly \$250 million, and grow to \$500 to \$600 million annually.
 - But, as noted above, the level of payments would be lowered if there were greater success in reducing teen smoking.

²These amounts would be the equivalent of about 1 or 2 cents per pack.

Option 3: Look-back penalty based on *all* underage smoking

- An alternative approach is to have a goal of *eliminating* underage smoking, not merely reaching the reduction targets specified in the agreement. With such a goal, the level of industry payments under the look-back could be determined relative to total underage tobacco use.³
- In this option, the look-back penalty would operate in a fashion similar to that of the agreement, except the reduction targets would be respecified for the ultimate goal of eliminating underage smoking; also, there would be *no double-counting provision and no abatement*. The ultimate target would be for a weighted survey response of 1 percent or less -- the 1 percent to allow for possible survey error.
- Because it may be unreasonable to expect to get current teens who smoke to stop, the reduction targets would be reduced on an annual basis to account for the turnover in the 13 to 17 year-old age group of the survey. Current estimates show a weighted average of 18 percent of underage daily smokers. A path with immediate reduction targets would therefore be as follows⁴:

<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	<u>Year 6 and after</u>
16%	13%	10%	7%	4%	1%

- As in the no double-counting option presented above, a base surcharge level of about \$40 million per percentage point would be required to make the look-back effective. Based on the currently projected use levels without further reduction efforts, the level of payments would start out at zero in the first year and then rise steadily until the payments continued at about \$520 million each year.
 - Once again, the level of payments would be lowered if there were greater success in reducing teen smoking.
- Tobacco firms likely would strongly oppose this approach as being unnecessarily punishing and that they don't have that much control over underage users.

³The settlement's targets were based on the earlier FDA rule analysis that had a generally stated goal of cutting teen smoking in half.

⁴A path with a delayed or more gradual decline -- as in the settlement -- could be used, but the stated goal is "dramatic and immediate" reductions.

THREE REMAINING ISSUES

1. Free Rider Problem: As noted above, there is a significant free rider problem.

- One option would be to expand the Michigan Survey to ask the underage tobacco users about their brand preferences and use. Additional funding -- albeit small relative to the size of the agreement -- might be required to make changes to the survey and perhaps increase the survey size.⁵
- If firm- or brand-specific reduction targets were to be specified, however, the problem of the double counting would become even more severe and all the more difficult to calculate.

2. Reliance on Michigan Survey data: The use of the University of Michigan's High School Drug Use survey as the basis for determining actual teen use and the surcharge payment presents a number of problems:

- To our knowledge, no Federal expenditure or tax policy is based on private survey data. This deal, depending on how it is ultimately implemented, could establish such a precedent and that may be undesirable. One option would be to have the Federal government take over the survey.
- Errors in measurement in the survey could have profound effects on the amounts paid by tobacco firms.
- High school teens may end up having the incentive to misrepresent their true use status and lie on the survey -- if it became known that the cost of cigarettes and other tobacco products were affected by responses to the survey, teen smokers may recognize that admitting use on the survey would lead to higher prices for their habit. Careful attention would have to be paid to the design of the survey to deal with this issue.

3. How should the target be defined? It isn't clear what the best measure of underage use is.

- Health care professionals argue that the daily users are already "hooked" and that the better measure for attempted reduction is to target the 30-day user numbers. However, the current reduction targets wouldn't be effective until the fifth year, meaning an entirely new cohort of teens would be in place. Also, it likely would be more difficult to get reductions in the number of daily users -- thereby establishing a more difficult and more meaningful target to hit.

⁵At the current level of use, the survey would have to be about 5 times larger in order to be confident that the reported percentage use of a particular brand would be accurate to within plus or minus 1 percentage point.

- Another issue is whether the target measure should be in terms of the number of users -- as in the survey -- or in terms of number (volume) of cigarettes smoked by teens. The industry reportedly advocated using the volume rather than the number of smokers. The Attorneys General advocated the number of users under the pretext that they wanted to reduce the number of smokers and not just have the possibility of the same number of smokers but at, say, 1/4 a pack rather than 1/2 a pack a day.

July 18, 1997

OTHER ALTERNATIVES

Moving beyond the structure of the settlement, several other alternatives exist that could be used and that would boost government receipts:

1. Higher excise tax

One way to boost prices, reduce use, and capture additional government revenues is to impose a higher excise tax on cigarettes. It is widely accepted that teen smoking (and overall smoking as well) declines as the price increases -- yet total revenues would actually increase.

- Rough estimates indicate that a \$1 increase in the excise tax on cigarettes would generate about \$15 billion in additional tax revenue each year -- and at the same time generating a 38% decline in overall cigarette sales, and a 38% decline in the number of teen smokers.

2. No volume adjustment

- Josh Gotbaum says that going to a dollar revenue adjustment would be

- The current settlement uses a volume adjustment to adjust the size of the annual penalties ^{an} paid by firms -- ultimately \$25 billion per year before the volume adjustment. The ^{intermediate} volume adjustment would reduce the size of the penalty because of the decline in sales -- ^{goal} roughly 22% over ten years -- that will occur under current trends and with the price increases associated with the penalty payments.
- Eliminating the volume adjustment would guarantee a higher stream of payments that would not be eroded in the event that firms raise prices and the quantity of sales declines. In fact, under the current agreement, firms may have the incentive to boost prices in the effort to capture greater profits. This would occur because the penalty payments would decline with volume but firms would only have to pay 25% of any excess profits.
- While the existing structure of the settlement would raise \$197 billion over 25 years, with no volume adjustment, \$252 billion would be raised.

3. Auction quantity licences

A final alternative would be to target overall tobacco use and establish quantity restrictions (with reduced quantity over time) for tobacco sales. Such an approach could be implemented by auctioning the rights to sell a given quantity of tobacco products (perhaps defined in terms of tar and nicotine in the product).

- This approach has the desirable feature that it would guarantee the decline in tobacco use over time.
- The auction approach would rely on the private market to solve the rationing problem that accompanied the declining quantity.

04:28 PM

PRELIMINARY

07/16/97

Table 1
 Net Payments to all Governments from the Tobacco Settlement
 Payment Reflected in Price of All Products
 100% Pass Through
 (1996 \$'s Millions)

		PDV
Base Payment	368,500	231,910
Gross Volume Adjusted Payment	293,566	187,547
Federal Excise Tax Leakage	(13,397)	(9,025)
State Excise Tax Leakage	(18,151)	(12,227)
Total Gross Excise Tax Leakage	(31,548)	(21,252)
Net Volume Adjusted Payment (Pre-offset)	262,018	166,296
Income Tax Offset	(65,504)	(41,574)
Individual	(55,679)	(35,338)
Corporate	(9,826)	(6,236)
Net Volume Adjusted Payment (including offset)	196,513	124,722

Fixed
 GDP
 assumption

Department of the Treasury
 Office of Tax Analysis

Table 2
Sources of Net Yearly Payments to all Governments from the Tobacco Settlement
Payment Reflected in Price of All Products
100% Pass Through
(1996 \$'s Millions)

Year	Base Payment	Gross Volume Adjusted Payment	Net Volume Adjusted Payment	Net Payment Fixed GDP
1998	10,000	10,000	8,665	6,498
1999	8,500	7,601	6,497	4,873
2000	9,500	8,365	7,179	5,384
2001	11,500	9,867	8,495	6,372
2002	14,000	11,656	10,062	7,547
2003	15,000	12,298	10,657	7,993
2004	15,000	12,247	10,661	7,995
2005	15,000	12,198	10,664	7,998
2006	15,000	12,137	10,655	7,991
2007	15,000	12,072	10,641	7,981
2008	15,000	12,012	10,629	7,972
2009	15,000	11,951	10,616	7,962
2010	15,000	11,891	10,601	7,951
2011	15,000	11,832	10,586	7,939
2012	15,000	11,772	10,569	7,926
2013	15,000	11,713	10,550	7,913
2014	15,000	11,655	10,531	7,898
2015	15,000	11,596	10,511	7,883
2016	15,000	11,538	10,490	7,867
2017	15,000	11,480	10,468	7,851
2018	15,000	11,423	10,444	7,833
2019	15,000	11,365	10,421	7,815
2020	15,000	11,309	10,396	7,797
2021	15,000	11,252	10,370	7,778
2022	15,000	11,196	10,344	7,758
2023	15,000	11,140	10,317	7,738
Total	368,500	293,566	262,018	196,513

Department of the Treasury
Office of Tax Analysis

Table 3
 PDV of Sources of Net Yearly Payments to all Governments from the Tobacco Settlement
 Payment Reflected in Price of All Products
 100% Pass Through
 (1996 \$'s Millions)

Year	PDV Base Payment	PDV Gross Volume Adjusted Payment	PDV Net Volume Adjusted Payment	PDV Net Payment Fixed GDP
1998	10,000	10,000	8,665	6,498
1999	8,182	7,317	6,254	4,691
2000	8,803	7,751	6,652	4,989
2001	10,258	8,801	7,578	5,683
2002	12,021	10,008	8,640	6,480
2003	12,398	10,165	8,809	6,607
2004	11,935	9,744	8,482	6,362
2005	11,489	9,342	8,167	6,126
2006	11,059	8,948	7,855	5,892
2007	10,646	8,568	7,552	5,664
2008	10,248	8,206	7,262	5,446
2009	9,865	7,860	6,981	5,236
2010	9,496	7,528	6,711	5,033
2011	9,141	7,210	6,451	4,838
2012	8,799	6,906	6,200	4,650
2013	8,470	6,614	5,958	4,468
2014	8,154	6,335	5,724	4,293
2015	7,849	6,068	5,500	4,125
2016	7,555	5,812	5,284	3,963
2017	7,273	5,566	5,075	3,806
2018	7,001	5,331	4,875	3,656
2019	6,739	5,106	4,682	3,511
2020	6,487	4,891	4,496	3,372
2021	6,245	4,684	4,317	3,238
2022	6,011	4,487	4,145	3,109
2023	5,787	4,297	3,980	2,985
Total	231,910	187,547	166,296	124,722

Tobacco briefing for Bruce Reed

2/11/97

Deal is probably positive for tobacco industry

One concern raised is the language providing a sort-of antitrust immunity allowing industry to "collude" on anti-smoking activities, including making sure that price increases go through to consumers - stick -

- Justice Dept is worried b/c the antitrust immunity granted is vague & could be sweeping

Treasury estimates that revenues raised over 25 years would not be \$368B but only \$189B ~~---~~

Reasons:

- (1) lower smoking estimates in the future
- response to price ↑ (lower demand) and
also secular decline over time (1.6% per year)
- (2) current excise tax revenue ↓ (\$44B)
- (3) excise tax offset (\$60B) ↳ over 25 yrs

Treasury estimates that "youth smoking" penalty is only about half as large as the present value of getting another young person to be a smoker. Also, the penalty gets rebated if the company can show it made "good faith" effort to reduce youth smoking. So the penalty imposed would be only 1/3 to 1/2 as large as the PV of profits from getting a new smoker.

Single year revenue numbers when fully phased-in is probably \$7-10B (not \$15B, as advertised)

Bruce wants group to focus on how to modify "look back provisions" (youth smoking) that are perceived inadequate

Also think about reducing profits, advertising restrictions, + incentives to develop safer cigarettes.

From
CEA/Treasury

Economic Effects of the Tobacco Settlement
Discussion Agenda
July 11, 1997

I. Impact of the Settlement on the Tobacco Manufacturing Industry

- Overall the industry is in very good shape and could be made better by the settlement.
- A critical issue here is whether the settlement facilitates collusion that could lead to even higher prices than are implicit in the payment and higher industry profits; both FTC and DOJ expressed serious concern about the antitrust immunity.
- Wall Street analysts see tobacco stocks as a good buy if the settlement goes through. Uncertainty about whether it will go through probably explains the timid response in the market so far. In large part, the analysts' positive assessment reflects a negative view of tobacco company stocks in the absence of a settlement.
- The tobacco manufacturing industry represents a tiny piece of the labor market. It employs about 41,000 people, or only 0.03 percent of the 119.5 million workers on non-farm payrolls. By comparison, the economy generates between 100,000 and 200,000 new jobs every month.
- The companies with a large domestic market share and a strong overseas presence should do fine; Liggett was marginal to begin with and might be tipped over the edge by the settlement.

II. Impact on prices and smoking

- The industry payment will operate like an excise tax equivalent to about 62 cents per pack once the base value reaches \$15 billion per year.
- Other aspects of the settlement may increase the degree of non-competitive pricing so that the price rises by more than the amount of the implicit excise tax and industry profits increase. This could be especially serious with antitrust immunity.
- To the extent that the price goes up by more than the implicit excise tax, the discouraging effect on smoking will be larger.
- Large price increases will discourage smoking but increase the burden on continuing smokers (which would disproportionately affect those below the median income).
- The price increase should have an important impact on youth smoking because youth smoking is more responsive to price changes than adult smoking.
- The reduction in smoking would produce substantial positive health effects.

III. Impact on other sectors

- One study estimates job losses in tobacco and downstream industries might total about 6,500 after 8 years from an annual price increase of 2.1 percent, with most concentrated in the Southeast tobacco region. The price increase resulting from the settlement would probably be twice as large, so job losses could be larger as well.
- The overall impact on other sectors should be small.
- Although over 140,000 farms engage in tobacco farming, many engage in other activities as well (The average impact of reductions in demand due to a 62 cent rise in cigarette prices would be about \$885 a farm on a tobacco crop worth \$18,000 a farm)

IV. Budgetary Effects

- If the pass-through of the excise tax is only about 1-for-1, the actual amount of money collected will be less than the base value due to secular decline in demand and price-induced reductions. Reduced volume will also result in less other revenue, such as excise taxes, for the Federal government. Preliminary estimates suggest the actual payments could be half to two-thirds the full value of the base payments.
- A valuation of the settlement payments should be expressed on a present value basis, not simply as a cumulative sum over an arbitrary 25 years. This can take another third off the expressed value of the settlement (over and above the adjustment for reduced volume).
- The settlement will result in higher Federal budget outlays over time, primarily in Social Security because less smoking means people live longer.

V. The "look-back" and youth smoking

- The look back penalty for failing to meet targets for youth smoking reduction was meant to approximate the expected lifetime profits to the industry of hooking a young smoker.
- The penalty may be only half expected profits. But even if the penalty were about equal to expected profits, that would merely make the industry indifferent about attracting a youth smoker. To penalize them would require something like treble damages.
- The industry is likely to demonstrate "good faith" efforts to reduce smoking which gives them a rebate of much of the penalty even if they do not achieve their target.

VI. Important incentive effects

- The industry has little incentive to fight individual suits, which will largely be paid out of the settlement fund subject to a cap. As residual claimants to the settlement fund, States and the Federal government may not want to see successful lawsuits.
- The advertising ban does not cover important methods of advertising, creating an incentive to shift advertising into those areas.
- A free-rider problem exists for the look-back (individual companies pay only part of the cost but get all of the benefit when they attract an extra youth smoker because the penalty is based on industry performance).
- Consumers may have incentives to switch to higher tar cigarettes or smoke more intensively.
- Substitution of cross-licensing for patent and trademark protection reduces incentive to develop new safer products.

↳ Treasury estimates that $\approx 2\%$ ↑
in Soc Security costs in 75
years

↳ 75%

↳ 20% paid by industry

↳ about 1/2 of advertising
dollars
is covered
by ban
agreement

**FACT SHEET
ON THE U.S. TOBACCO INDUSTRY**

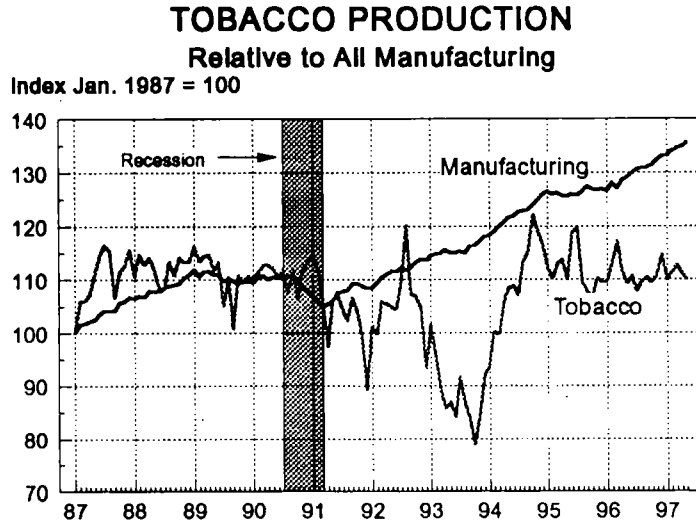
Production

- **The United States was the world's second largest producer of leaf tobacco** in 1995, accounting for about 9 percent of the estimated 14.0 billion pounds that were produced worldwide.

Top 10 Leaf Tobacco Producers - 1995			
		<u>Million Pounds</u>	<u>Share of Total (Pct.)</u>
1.	China	5,180	37
2.	United States	1,323	9
3.	India	1,156	8
4.	Brazil	877	6
5.	Turkey	464	3
6.	Zimbabwe	463	3
7.	Indonesia	375	3
8.	Italy	292	2
9.	Greece	291	2
10.	Malawi	240	2

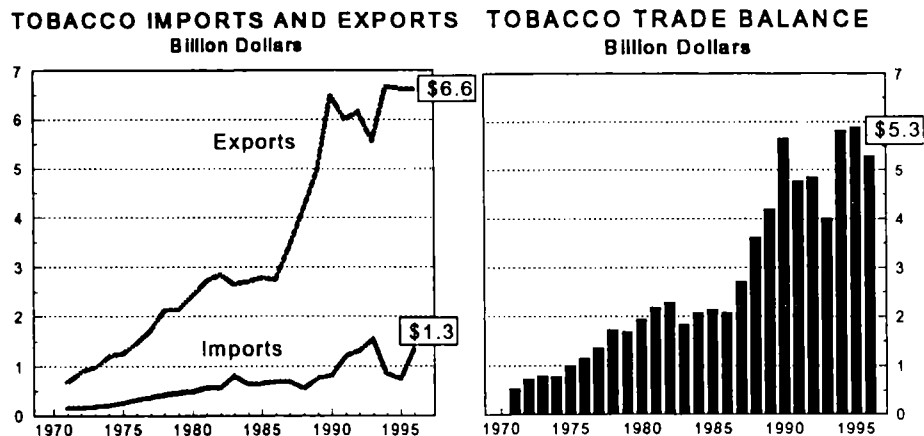
- **Some 124,000 farms in 16 states grow tobacco.** About three-quarters of these are actually classified as tobacco farms, meaning that tobacco comprises at least 50 percent of sales.
- **Six states account for 91 percent of production:** North Carolina and Kentucky originate 65 percent; Tennessee, Virginia, South Carolina, and Georgia produce another 26 percent.
- The U.S. **tobacco crop** in 1996 was worth \$2.5 billion, representing approximately 2.4 percent of the total for all cash crops and farm commodities.
- The **manufacture of tobacco products** accounted for \$16.6 billion or 0.2 percent of gross domestic product in 1994, down from 0.6 percent in the early 1960's.

- Tobacco manufacturing makes up 1.2 percent of **U.S. industrial output**.
- **Production slid from early 1991 through most of 1993**, but by mid-1994 returned to levels that prevailed in the late 1980's.



Trade

- **Exports of tobacco products** totaled \$6.6 billion in 1996, \$5.2 billion of which was in manufactured tobacco products and \$1.4 billion in unmanufactured (leaf) tobacco. The value of **tobacco imports** was \$1.3 billion last year, \$1.1 billion of which was in unmanufactured products.
- Exports rose rapidly from the mid-1980's through 1990 but have since been little changed and the trade balance has shown similar patterns.



- **U.S. factories produced** an estimated record of 760 billion cigarettes in 1996, of which about 36 percent were shipped abroad for foreign consumption.

Consumption

- **U.S. consumers spent** an estimated \$50.3 billion on tobacco products in 1996, or 1.0 percent of all consumer expenditures.

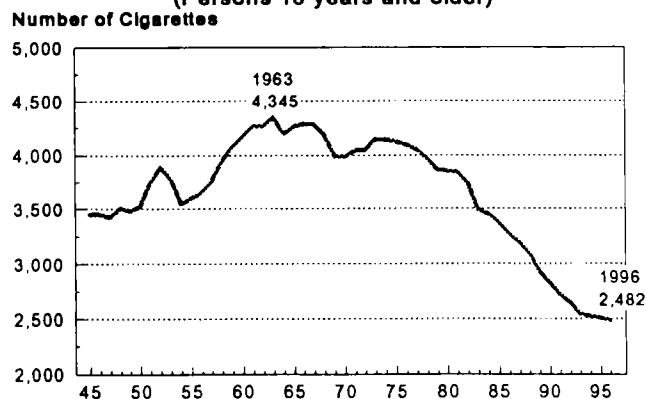
	<u>Billions</u>	<u>Percent of Total</u>
Total	\$50.3	100
Cigarettes	47.2	94
Cigars	1.0	2
Other (smoking tobacco, chewing tobacco, and snuff)	2.1	4

- The average household spent \$269 in 1995 on tobacco products and smoking supplies, with **households in the lowest income quintiles spending more of their budget on tobacco.**

	<u>Lowest 20%</u>	<u>Second 20%</u>	<u>Third 20%</u>	<u>Fourth 20%</u>	<u>Highest 20%</u>
Tobacco	\$204	\$242	\$327	\$307	\$278
Share of total expenditures	1.4%	1.1%	1.1%	0.8%	0.4%

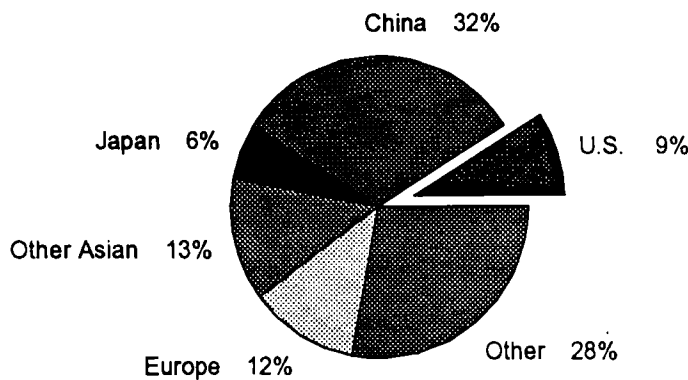
- **Per-capita cigarette consumption has been on a long-term decline in the United States** from a record high of 4,345 in 1963 (based on the population 18 years and over) to 2,482 in 1996 -- a drop of 43 percent.

PER CAPITA U.S. CIGARETTE CONSUMPTION
(Persons 18 years and older)



- **Cigar consumption**, while a tiny part of the total, rose 19 percent last year, to 32.7 per male 18 years and over, but was only about 3 percent above the 1987 level.
- More than offsetting the decline in the United States has been a **rise in foreign consumption of tobacco**, which has resulted in an increase in worldwide consumption of 1.2 to 1.5 percent annually.
 - **Foreign sales**, however, are said to be **much less profitable than domestic sales**.
- **China is the leading world cigarette market**, consuming 1.7 trillion cigarettes annually, or about 3-1/2 times as many as the 470 billion of the United States. (China's population is about 4-1/2 times that of the United States.)
 - **U.S. tobacco consumption is less than 10 percent of the world total.**

WORLDWIDE CIGARETTE CONSUMPTION
Total = 5.3 trillion cigarettes in 1996



Profile of Domestic Consumption

- There are estimated to be about **50.5 million adult smokers** (18 years and older) in the United States, or about 25 percent of the adult population. (See table on the next page.) These smokers consume an 18.2 cigarettes a day (almost a full pack) on average.

Adult Smoking Rates				Adult Quit Rates*
	<u>Current</u>	<u>Former</u>	<u>Never</u>	
Adults 18+	25.7	24.1	50.2	48.5
18-24	22.9	7.7	69.3	25.2
25-44	30.4	19.4	50.2	38.9
45-64	26.9	32.9	40.2	55.1
65+	13.3	36.4	50.3	73.3

* Percent of ever smokers who are former smokers

- There are about **3.1 million underage smokers** (younger than 18 years old). Their average consumption is about one-half a pack a day.
 - The FDA estimates that there are 1 million *new* underage smokers a year, which would roughly offset the number of 17-year-old smokers who turn 18 each year.
 - Youth smoking rates are shown below. (Note: "Daily" is used for the Lookback provisions.)

Youth Smoking Rates				
<u>Age</u>	<u>Have smoked in past 30-days</u>	<u>Daily</u>	<u>Have smoked 1/2 pack or more a day</u>	<u>Daily users</u>
	(------Percent-----)			(Number)
8 th graders	21.0	10.4	4.3	395,000
10 th graders	30.4	18.3	9.4	695,000
12 th graders	34.0	22.3	13.0	847,000

- **Demand Elasticities:** A consensus estimate for overall demand elasticity is -0.4, signifying that for every 1.0 percentage increase in price, demand would fall by 0.4 percent. The Surgeon General's report provides the following elasticities by age:

Demand Elasticities			
<u>Age Group</u>	<u>Total</u>	<u>Participation</u>	<u>Quantity per Smoker</u>
12-17	-1.40	-1.20	-0.25
20-25	-0.89	-0.74	-0.20
26-35	-0.47	-0.44	-0.04
36-74	-0.45	-0.15	-0.15
All Adults (20-74)	-0.42	-0.26	-0.10
All Ages (12-74)	-0.47	-0.31	-0.11

Employment and Wages

- **Tobacco manufacturing's contribution to payroll employment is minuscule.** In 1996, 41,400 workers were employed in the tobacco manufacturing industry (which includes processing of tobacco, as well as production of cigarettes, cigars, etc.), or only 0.03 percent of the 119.5 million workers on nonfarm payrolls. More than 100,000 workers (0.23 percent of nonfarm employment) had been employed in the industry in the early 1950's.
- **Five states and Puerto Rico account for nearly 85 percent of the jobs in tobacco manufacturing.** (Note: These are the only states that report employment separately for tobacco manufacturing and are presumably the most important for the industry.)

Jobs in Tobacco Manufacturing		
	<u>Number of Jobs</u>	<u>Share of State's Payroll Jobs</u> <u>(percent)</u>
North Carolina	16,830	0.47
Virginia	9,550	0.31
Kentucky	4,210	0.25
Florida	1,480	0.02
Tennessee	1,180	0.05
Puerto Rico	1,040	0.11

- **Production workers in the tobacco industry earned \$19.44 an hour** last year, 52 percent more than the average worker in manufacturing. Tobacco industry wages have climbed steadily from less than 75 percent of the average factory wage in the early 1950's. Few other industries can boast comparable wages (coal mining, steel, petroleum and coal product manufacturing also have earnings that top \$19 an hour).

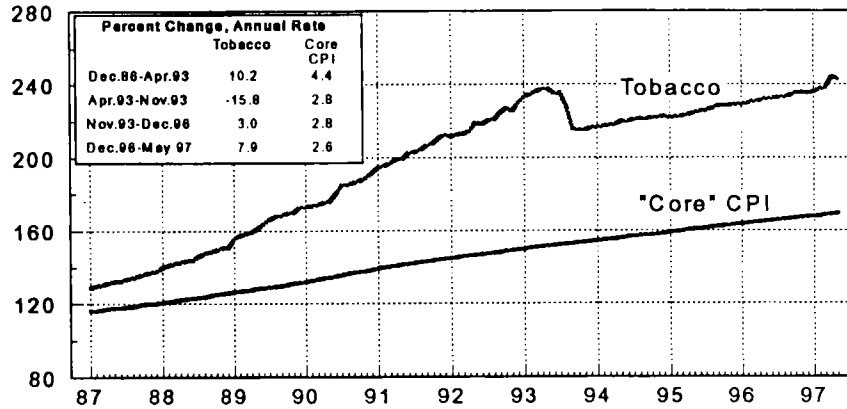
Average Hourly Earnings in 1996	
Private nonfarm	\$11.81
Manufacturing	12.77
Tobacco	19.44

Prices

- **Tobacco products have a weight of only 1.6 percent in the CPI.** Since cigarettes make up 94 percent of tobacco consumption, their weight would be 1.5 percent.
 - Current estimates of the impact of the tobacco settlement range suggest a \$0.35 a pack increase in cigarette prices for 1998 and \$0.62 by 2002. This amounts to a price hike between roughly 20 and 35 percent. **The impact on the CPI could be in the range of 0.3 to 0.5 percent**
- **Over the past decade, tobacco prices have risen at a 6.3 percent annual rate, compared to 3.7 percent for "core" consumer prices** (excluding food and energy). Faster growth was mainly the result of a sharp uptrend prior to 1993. (See chart on the next page.)
 - **In 1993, there was a steep downward adjustment in prices** as manufacturers of premium brands reduced prices to meet competition from the discount brands. Since 1993, tobacco prices grew at about the same pace as the core.
 - **This year, tobacco prices have sped up again,** increasing at nearly an 8 percent annual rate through May in part reflecting higher state taxes.

CONSUMER TOBACCO PRICES Relative to the "Core" CPI

Index 1982-84 = 100



Industry Composition

- The cigarette market is dominated by Philip Morris, which accounts for half of cigarette sales in the United States.

The Cigarette Market in 1997 (est.)		
	<u>Sales</u> (Bil.Cigarettes)	<u>Market</u> <u>Share (%)</u>
Philip Morris	233.4	49.2
RJR Nabisco	114.5	24.2
BAT	76.8	16.2
Lorillard	39.9	8.4
Liggitt	8.0	1.7
TOTAL	474.1	100.0

- Philip Morris has the **widest profit margins** (45 percent of revenues per pack), followed by Lorillard (40 percent). Liggitt is estimated to have a margin of only about 3 percent this year. (See table on the next page.)
 - Domestic producers devote 33 percent of revenues to marketing (advertising, promotion, selling).

Advertising and Promotional Expenditures

- U.S. domestic cigarette advertising and promotional expenditures averaged \$4.9 billion annually over the five years ended 1994.
 - **Conventional advertising** (point-of-sale, print media and outdoor and transit) accounted for only about \$1 billion, or 21 percent of the total.
 - The biggest advertising expenditures were point-of-sale (\$352 million). Outdoor and magazine advertising followed at \$306 million and \$266 million, respectively.
 - **Coupons, buy-one-get-one free promotions, etc** accounted for \$1.8 billion, or 37 percent of spending. **Promotional allowances** (volume discounts and incentives for priority shelf space) made up \$1.4 billion or 28 percent of spending.

<i>Domestic Cigarette Advertising and Promotional Spending, 1990-94 Averages</i>		
	<u>Billion Dollars</u>	<u>Percent</u>
TOTAL	\$4.929	100.0
Advertising	1.015	20.6
Newspapers	0.043	0.9
Magazines	0.266	5.4
Outdoor	0.306	6.2
Transit	0.048	1.0
Point-of-sale	0.352	7.1
Other promotional	3.915	79.4
Promotional allowances	1.386	28.1
Coupons and retail value added	1.810	36.7
Other	0.719	14.6

The Economics of the Proposed Tobacco Settlement

How does it work?

The proposed tobacco settlement has three provisions which could have economic impacts: 1) industry payments to the settlement fund, 2) restrictions on advertising, and 3) guidelines for FDA regulation of tobacco. Of these, the payments to the settlement fund are likely to have the most significant effects.

The Settlement Payments acts like an excise tax on tobacco. The Settlement language has the effect of making the annual industry Payment proportional to cigarette sales volume or a per-pack charge.¹ From the tobacco industry perspective, the Payments required by the settlement are equivalent to an excise tax of about 35 cents in the first couple years, rising to about 65 cents by the xth year, and remaining at that level thereafter. In fact, the effects of the Settlement Payment provisions could be replicated with an excise tax at the appropriate level and divided among States, the Federal government, and individuals (and allocated to particular uses, like smoking cessation, in some cases) in the manner set forth in the Agreement.

The economics of the Settlement Payments and an excise tax are similar; however, there are some important practical differences. Most important, an excise tax is straightforward: We know exactly what it is and have a lot of experience administering and enforcing excise taxes on tobacco. The Settlement would make the tobacco companies their own tax collectors, and some mechanism for oversight would need to be established, whereas, an additional excise tax could be easily administered Treasury Department. Additionally, the Settlement Payments are made to a Fund that is to be divided among States and individuals. The bulk of the payments to States are for damages to the Medicaid system. Under Medicaid statute, each State should give the Federal government a share of the Medicaid payments based on its Medicaid matching rate (after subtracting reasonable costs of bringing the suits). Of course, a Federal excise tax would go directly to the Federal government.

The settlement also provides for an "excess profits tax" of 25 percent. Because the tobacco industry is not competitive and the Settlement would provide some anti-trust exemptions, industry could restrict output and raise prices, increasing profits. (The economics of the industry is discussed more fully below.) This provision requires the tobacco industry to pay 25 percent of any profits above 1997 profits to the Settlement Fund. (It is not clear how these would be allocated among States, individuals, and the Federal government because these payments are not specifically for Medicaid damages.) Some worry that industry could find ways of "hiding" its profits to avoid this excess profits penalty. More specific rules and oversight are could help

¹If cigarette sales fall, the industry's Payment to the Settlement Fund is reduced by the ratio of that year's sales to 1996 sales; if sales rise, the Payment is increased by percent increase in sales to adults. The Settlement does not make clear how "adult volume" will be measured, but estimates indicate that adults consume more than 95 percent of cigarettes produced. Thus, the use of "adult volume" for an increase -- instead of "total volume" as for declines -- is of little consequence.

prevent this. Alternatively, the penalty could be related to a measure less prone to gaming, like revenues.

The advertising restrictions attempt to eliminate advertising targeted to children. These requirements are similar to those proposed (accepted?) in a recent FDA rule. The industry spends an estimate \$xx billion on advertising every year. These restrictions could save the industry billions of dollars, increasing profits (which would be subject to the excess profits provision if profits rise above 1997 levels). On the other hand, the industry could intensify advertising efforts not banned by the Agreement (advertising to adults) or look for new, creative marketing techniques such that their overall advertising budget is little affected by the Agreement. Because advertising expenses are fixed costs, these provisions are not expected to effect the per-pack price of cigarettes.

The provisions for FDA regulation limit the FDA's authority to regulate tobacco products compared to the status quo. Problems with these provisions have been widely discussed, particularly by Koop/Kessler.

How will the Settlement Effect Particular Objectives/Outcomes?

Effect on Youth Smoking and Current Smokers

Youth Smoking. Most of the "work" in reducing youth smoking is likely to happen through price increases for cigarettes. Among young people, the "participation rate" of smoking is very sensitive to price. The Settlement will increase the price of cigarettes considerably, by between x an x percent. This suggests that smoking rates for young people are expected to fall by x to x percent, or about xx to xx million 8th, 10th, and 12th graders. The number of packs that a young smoker consumes is also fairly sensitive to price, and the price increase is expected to reduce consumption for young people who do continue to smoke by about xx to xx percent. Advertising and access restrictions, as well as public health advertising, may also reduce youth smoking over the long term, although fewer studies address these issues. Some evidence suggests that access restrictions (enforcing age requirements and requiring face-to-face purchase) are effective in reducing youth smoking. Recent FDA regulations have already done a lot to strengthen access restrictions. (Is this true??) [Insert assessment of advertising restrictions and public health ads.]

The "lookback" provision does not give the tobacco industry an incentive to reduce youth smoking. The Settlement requires industry to pay a penalty if targets for the reduction in youth smoking are not met, capped at \$2 billion. If the industry can show the FDA that they have made a "good faith" effort, 75 percent of the penalty would be refunded. The amount of the penalty was selected to equal the present discounted value of profits for a new smoker. In other words, the penalty is by design financially neutral from the tobacco industry perspective. (Our calculations are consistent with this.) Depending on how "a good faith effort" is interpreted, the penalty could be significantly less than the expected profits from a new smoker. Furthermore, once the \$2 billion cap is met, there is no marginal penalty for addicting new smokers. If the lookback provision is really meant to punish the industry for failing to reduce youth smoking, triple damages (or more) would be a more appropriate penalty. However, most of the work in

reducing youth smoking is likely to be done by other aspects of the settlement: price increases, advertising and access restriction, and FDA regulation.

Adult Smokers. Adults smokers are significantly less sensitive to increases in the price of cigarettes, so the reductions in adult smoking will be smaller. The evidence suggests that the number of adult smokers could fall by between xx and xx percent, and the packs smoker per smoker could fall by about xx to xx percent. Smokers are disproportionately lower-income, so as with a tax on cigarettes, the Settlement will be regressive. Analyses of recent cigarette tax proposals suggest that [insert table].

The estimates of the number of adults who quit smoking could be understated if smoking cessation techniques become better and/or cheaper. The Settlement provides some funding to subsidize smoking cessation programs. The Settlement also creates an incentive for the development of alternative nicotine delivery systems. There is essentially no evidence on the potential for this type of substitution: Any estimation of its scope would be highly speculative. The settlement also attempts to encourage the development of safer, lower-nicotine cigarettes, which would provide alternative for current adult smokers (although this may be undermined by other provisions discussed below). There is some evidence, however, that when lower-tar cigarettes were introduced, smokers often consumed more of these cigarettes. This might also be the case for lower-nicotine cigarettes.

Impact on the Tobacco and Related Industries

Does the Settlement "Punish" the Tobacco Industry? While putting the tobacco industry out of business is not the goal of this Settlement, the damages are, in part, punitive. The tobacco industry can clearly absorb the payments required by this settlement. (In fact, it is required that they be largely passed along to consumers in the form of higher prices.) [Checking into possibility that one or more smaller co's could be put out of business.]

[Insert Christian's industry paragraph.]

The impact on employment and farmers is likely to be small. [Insert Chad paragraph.]

Effects on related industries are likely to be small and temporary. [Insert Chad summary of FDA analysis.]

Potential for-Side Effects and "Red Flags"

The incentive to develop safer cigarettes is greatly curtailed. The Agreement essentially eliminates intellectual property rights for tobacco-related innovations by requiring companies to notify FDA of any risk-reducing technologies that they develop or acquire and cross-licence them for a "reasonable" fee. In addition, the advertising restrictions could make it difficult to introduce a new product onto the market.

The Settlement limits industry's incentive to fight lawsuits and could encourage the government to limit lawsuits even more than the Settlement. The Agreement would eliminate class-action

suits and punitive damages for past harm. Individuals could still sue for damages (just not punitive damages), and 80 percent of any awards in these suits would be paid from the Settlement Fund (subject to an annual limit, excess claims are carried over to the next year). This means that the industry has little incentive to fight these cases and that the States and the Federal government -- who are the residual claimants to the Settlement Fund -- might like to discourage lawsuits.

What this lawyers would get form the settlement is not specified in the Agreement. We do not know specifically what agreements attorney's have with States for payment, but many may have contingency agreements which could give them up to a third of the settlement. (How this would work in practice is not clear.) Similarly, under Medicaid statute, the States are allowed to deduct reasonable costs of litigation up to 50 percent of the settlement before splitting it with the Federal government. These issues should be explicitly worked out in the Settlement to ensure that payments to lawyers are not excessive.

Draft -- Not for Distribution

Impact of Proposed Resolution on Cigarette Prices and Industry Profits

Can the Settlement be thought of as an excise tax?

Yes. The key to understanding the payments as effectively being an excise tax on cigarettes is the volume adjustment provision found in Title VI, B.5 of the settlement, entitled "Adjustment for Volume Decrease (Adult Volume Only) or Total Volume Increase."

For any given year, let X_0 denote the scheduled payment. Let q represent the actual unit volume of cigarette sales, and q^* denote the base volume in 1996. Then the volume adjusted payment would be $X_0(q/q^*)$, which can be rewritten as $(X_0/q^*)q$. This is the same as writing the volume adjusted payment as tq , where the "tax" $t = (X_0/q^*)$. This is just like an equivalent unit tax on cigarettes. As an example consider year 10 in which the base payment $X_0 = \$15$ billion. Since the actual number of cigarettes sold in 1996 was $q^* = 24.4$ billion, the effective tax per pack is equal to $t = (X_0/q^*) = \$15 / 24.4 = 61.5$ cents.

What will be the impact of the effective excise tax on prices of cigarettes?

According to the economic literature and historical evidence, the price of a pack of cigarettes will probably go up by at least as much as the tax, and probably more. Prominent analysts of the cigarette industry conclude that previous excise tax increases may have served as a focal point for coordinating oligopoly price increases by sellers. As a result we expect there to be two effects, 1) a direct price response to the increase in costs due to the effective excise tax, and 2) a further price increase as a result of opportune coordination on the part of sellers. The combined effect would raise prices by more than the increase in the excise tax. The range of the price increase expected starts from a conservative 100 percent of the tax to a high of 200 percent of the tax.

Will the advertising restrictions result in windfall profits for the industry?

The restrictions on advertising and marketing imposed by the settlement (Title I, A and Appendix VII), will not increase profits very much because of the expected substitution into non-restricted forms of advertising. Moreover, marketing innovations are expected as a result of the restrictions further increasing costs. Because the most important components of current cigarette advertising and marketing, promotional allowances (28% of total advertising expenditures) and coupons and retail value added (37%), are not barred by the Proposed Resolution, we expect these to increase in intensity. Furthermore, we expect there to be an increase in conventional media advertising. The bottom line then is that advertising expenditures may fall by about \$ 500 million to \$1 billion. This is equivalent to savings of less than 5 cent per pack (compared to the 62 cent effective excise tax starting in year 5).

What is the impact of increased prices on the tobacco industry's profits?

Corporate profits are expected to go up as part of the settlement. There are three components to the change in corporate profits:

- Fixed cost savings of at most 5 cents per pack due to decreased advertising expenditures
- Lost revenues of 33 cents per pack on those not sold due to the reduction in cigarette sales (on the order of 2 - 6 billion)
- Increased revenues of 10 to 16 cents per pack on remaining cigarettes due to new higher price (on the order of 18 - 22 billion)

It is clear that the combination of all three components would lead to higher industry profits.

Real Net Revenue From Tobacco Settlement

Attached are preliminary estimates of the net revenue from the tobacco settlement. They include revenue effects at federal, state and local levels. One set of calculations assumes that the payments are reflected in the price of all tobacco products, while the other assumes that the payments are reflected only in the price of cigarettes. These estimates are in real terms, measured in 1996 dollars.

We find that, considering all tobacco products, the real net revenue from the tobacco settlement is likely to be about \$189 billion in total, if summed over the first 25 years of the agreement. We obtain essentially the same estimate in our cigarette only calculation.

Two reasons explain why our \$189 billion net revenue estimate is substantially lower than the \$368.5 billion figure cited in the report. First, the \$368.5 billion figure in the report ignores the sales adjustment feature of the settlement. As sales fall, whether as a result of the long-term secular trend which has historically characterized the tobacco market, or as a result of the features of this agreement, the size of the payment falls proportionately. Adjusting for the fall in sales reduces the net revenue estimate by about 19%, to \$298 billion.

Second, the \$368.5 billion figure does not adjust for the reduction in revenue from existing excise, income, and employment taxes. Considering federal income and employment taxes, and federal, state and local excise taxes, this adjustment can reduce net revenue by an additional \$109 billion, or by 32% of the \$368.5 billion cited in the report. In total, then, we estimate that the actual increase in net government receipts will be about \$189 billion, or 51%, of the \$368.5 billion payment cited in the report.

—The \$368.5 billion figure also is misleading because it is a simple sum of (real inflation adjusted) payments which flow in over time. Proper measurement of the value of the payment flow would discount to reflect the (real) time value of money. As shown in the table, discounting the payment stream by a 3.7% real discount rate will reduce its sum from \$189 billion to \$123 billion, or by about 18% of the original \$368.5 billion dollar figure cited in the report. A higher (lower) discount rate would lower (raise) the discounted present value of the payment stream, relative to our \$123 billion figure.

Our modeling focuses on the basics of the payment plan outlined in the agreement. We do not include the effects of the special penalty imposed if profits increase, nor do we model the look-back provisions that impose a penalty if sales to minors fail to fall to specified target levels. By way of justification, we note that it seems unlikely that domestic profits will increase as a result of this agreement, so neglecting the profits tax seems reasonable in this preliminary estimate. For two reasons, the look-back also seems unlikely to have a major revenue effect. First, it seems likely that the agreement will be effective in significantly reducing under-age smoking, and so any penalty would likely be much lower than the \$2 billion annual maximum. Second, any assessed penalty can be reduced by 75% as long as the manufactures can show that they made a "good-faith" effort to comply with the agreement.

One detail that we do incorporate is the inflation indexation of the payments. Without such indexing, the real value of the annual proscribed payments would fall below their published level, thereby reducing the real net-revenue to the government. Our approach implicitly assumes that inflation indexing is complete, so that the real value of each year's annual payment is completely unaffected by inflation.

While this is not an official revenue estimate, our modeling approach does rely on some standard revenue estimating conventions. In particular, our estimate is based on a fixed GDP assumption, which has a number of important implications. First is an income and employment tax offset, reflecting the fact that the tobacco payments are "taken-off the top", and so reduce the base of the income and employment taxes by lowering national income. These offsets capture reductions in personal income, corporate income, and employment taxes at the federal level.

Second, some features of the agreement, which may have important effects for particular firms, or for the tobacco industry as a whole, have no effect at all in our model. In particular, the fixed GDP assumption means that the settlement's restrictions on advertising, even if effective, would have no direct effect on revenue; all else constant, the tobacco industry's reduced spending on advertising leads to a reduction in taxable income in the rest of the economy (e.g., in the advertising sector) which approximately offsets the tobacco industry's increase in taxable income.

The advertising restrictions, if effective, also might reduce net revenue indirectly by reducing tobacco sales. We have ignored this for two reasons. First, it is likely that much tobacco advertising is spent in intra-industry fights over the distribution of a fixed pool of smokers, rather than in an attempt to increase the number of smokers in the pool. Mandated reductions in this type of advertising would have no effect on industry wide sales. Second, the advertising restriction's bark may be worse than its bite because they are loosely worded, and because they do not apply to some major categories of promotional expenses.

An alternative to holding GDP fixed would be to let it rise by the full amount of the increase in the price of tobacco products. In that case, income tax receipts would not fall, so that net revenue to the government would be \$252 billion over 25 years. While net revenue seemingly is higher than in the fixed GDP case, in purchasing power terms it really is the same, as the rise in GDP reduces the purchasing power of government tax revenue.

David Richardson and James Mackie
U.S. Treasury, Office of Tax Analysis
OTA
7/10/97

05:59 PM

PRELIMINARY

07/10/97

Net Payments to all Governments from the Tobacco Settlement
 Payment Reflected in All Products
 100% Passthrough
 (\$'s Millions)

		PDV
Base Payment	368,500	231,910
Gross Payment	284,399	182,735
Federal Excise Tax Leakage	(18,537)	(11,836)
State Excise Tax Leakage	(25,113)	(16,077)
Total Gross Excise Tax Leakage	(43,650)	(27,913)
Net Payment (Pre-Offset)	240,749	154,822
Income Tax Offset	(60,187)	(38,705)
Individual	(51,159)	(32,900)
Corporate	(9,028)	(5,806)
Net Payment including offset	180,561	116,116

Department of the Treasury
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PRELIMINARY

07/10/97

Net Yearly Payments to all Governments from the Tobacco Settlement
 Payment Reflected in All Products
 100% Passthrough
 (\$'s Millions)

Year	Volume Adjusted	PDV	Volume Adjusted Fixed GDP	PDV Fixed GDP
1998	8,677	8,677	6,508	6,507
1999	6,404	6,163	4,803	4,623
2000	7,039	6,522	5,279	4,891
2001	8,288	7,392	6,216	5,544
2002	9,766	8,384	7,324	6,288
2003	10,295	8,508	7,721	6,381
2004	10,249	8,154	7,687	6,115
2005	10,207	7,817	7,655	5,863
2006	10,158	7,488	7,618	5,616
2007	10,104	7,170	7,578	5,378
2008	10,019	6,844	7,514	5,133
2009	9,925	6,526	7,444	4,895
2010	9,833	6,224	7,375	4,668
2011	9,741	5,935	7,306	4,451
2012	9,650	5,660	7,237	4,245
2013	9,560	5,397	7,170	4,048
2014	9,471	5,147	7,103	3,860
2015	9,382	4,909	7,037	3,681
2016	9,295	4,681	6,971	3,511
2017	9,208	4,464	6,906	3,348
2018	9,122	4,257	6,842	3,193
2019	9,037	4,060	6,778	3,045
2020	8,953	3,872	6,715	2,904
2021	8,870	3,692	6,652	2,769
2022	8,787	3,521	6,591	2,641
2023	8,706	3,358	6,529	2,518
Total	240,749	154,822	180,561	116,116

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PRELIMINARY

07/10/97

Net Payments to all Governments from the Tobacco Settlement
 Payment Reflected in All Products
 125% Passthrough
 (\$'s Millions)

		PDV
Base Payment	368,500	231,910
Gross Payment	274,466	176,584
Federal Excise Tax Leakage	(22,760)	(14,545)
State Excise Tax Leakage	(30,835)	(19,747)
Total Gross Excise Tax Leakage	(53,594)	(34,292)
Net Payment (Pre-Offset)	220,872	142,292
Income Tax Offset	(55,218)	(35,573)
Individual	(46,935)	(30,237)
Corporate	(8,283)	(5,336)
Net Payment including offset	165,654	106,719

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PRELIMINARY

07/10/97

Net Yearly Payments to all Governments from the Tobacco Settlement
 Payment Reflected in All Products
 125% Passthrough
 (\$'s Millions)

Year	Volume Adjusted	PDV	Volume Adjusted Fixed GDP	PDV Fixed GDP
1998	8,367	8,367	6,275	6,275
1999	5,976	5,752	4,482	4,314
2000	6,548	6,067	4,911	4,550
2001	7,662	6,833	5,746	5,125
2002	8,956	7,689	6,717	5,767
2003	9,411	7,778	7,059	5,833
2004	9,370	7,454	7,027	5,590
2005	9,331	7,146	6,998	5,359
2006	9,286	6,845	6,965	5,134
2007	9,237	6,555	6,928	4,916
2008	9,159	6,257	6,869	4,692
2009	9,074	5,966	6,805	4,475
2010	8,989	5,690	6,742	4,267
2011	8,905	5,426	6,679	4,069
2012	8,822	5,174	6,616	3,881
2013	8,740	4,934	6,555	3,701
2014	8,658	4,706	6,494	3,529
2015	8,577	4,487	6,433	3,366
2016	8,497	4,279	6,373	3,210
2017	8,418	4,081	6,314	3,061
2018	8,340	3,892	6,255	2,919
2019	8,262	3,711	6,197	2,784
2020	8,185	3,539	6,139	2,655
2021	8,109	3,375	6,082	2,532
2022	8,034	3,219	6,025	2,414
2023	7,959	3,070	5,969	2,302
Total	220,872	142,292	165,654	106,719

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