

NLWJC - Kagan

DPC - Box 047 - Folder-007

**Tobacco-Settlement: Lookback
Penalties**

**Comparison of Lookback Surcharges in
McCain Manager's Amendment and McCain as Amended by Durbin
(July 13, 1998)**

	McCain Manager's Amendment	McCain as Amended by Durbin
Lookback Surcharges -- Industry	<u>\$80 million</u> for each percentage point missed for the <u>first five points</u> missed, <u>\$160 million</u> for each percentage point missed (for <u>6-10 points</u> missed), <u>\$240 million</u> for each percentage point missed (for <u>11 points or more</u> missed). Penalties are capped at <u>\$4 billion</u> per year.	<u>\$40 million</u> for the <u>first five</u> percentage points by which the industry misses the youth smoking reduction target, and <u>\$120 million</u> for each point missed thereafter. Penalties are capped at <u>\$2 billion</u> .
Lookback Surcharges -- Company Specific	<u>\$1000 per teen</u> by which the company misses its youth smoking reduction target. This figure (which is equivalent to about <u>\$64 million</u> per percentage point) represents <u>twice the forgone profits</u> of hooking a teen. <u>No cap</u> on penalties.	<u>\$80 million</u> per percentage point for the first 5 percentage points, and <u>\$240 million</u> per percentage point thereafter. This figure represents approximately <u>2.5 times</u> the forgone profits for the <u>first five percentage points</u> , and about <u>7.5 times</u> the forgone profits for the <u>next 19 percentage points</u> . Penalties are capped at <u>\$5 billion</u> .
Youth Smoking Reduction Targets	Reduce youth smoking by 60% over 10 years.	Reduce youth smoking by 67% over 10 years.



Cynthia A. Rice

06/16/98 08:04:32 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP, Laura Emmett/WHO/EOP
cc: Cynthia Dailard/OPD/EOP
Subject: Technical Amendments re: Durbin lookback

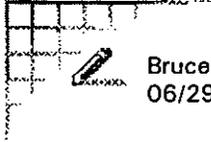
FYI -- Claxton have several technical amendments to the Durbin lookback amendment when we, OMB, and Treasury have scrutinized. I plan to call Tom Falletti and talk to him before sending them to Lloyd Ator. The amendments:

- 1) Make sure the lookback funds go to public health (since the Durbin section numbers are different, a reference in the spending title must be changed).
- 2) Clean up language regarding application to new manufacturers or manufacturers below the de minimus level.
- 3) Adds in several places "based on the annual performance survey" to make clear where the numbers will come from.

Tab-set - new legislative -
Hatch-Feinstein

and

Tab-set - lookbacks



Bruce N. Reed
06/29/98 03:19:13 PM

Record Type: Record

To: Elena Kagan/OPD/EOP

cc:

Subject: Estimated total increase in cost/pack

----- Forwarded by Bruce N. Reed/OPD/EOP on 06/29/98 03:23 PM -----

**JOSHUA
GOTBAUM**
06/26/98 02:29:32 PM



Record Type: Non-Record

To: Bruce N. Reed/OPD/EOP

cc: Cynthia A. Rice/OPD/EOP, Richard J. Turman/OMB/EOP

Subject: Estimated total increase in cost/pack

The figures below deal with the "peaks and valleys" problem with the lookback by using the 3-year average whose mid-point is the 10th year.

----- Forwarded by Joshua Gotbaum/OMB/EOP on 06/26/98 02:15 PM -----

Comparing Total Additional Cost Per Pack in Hatch & McCain in 2008

	Hatch	McCain
From base payment	.69	1.10
From surcharge*	.25	.19
total, per-pack	.94	1.29

* uses 3-year average for surcharge for both Hatch and McCain (sans Durbin).

JUN 25 1998

Tab - per - new legislative -
Hatch - Feinstein

and

Tab - per - look back penalties

Memo To: Bruce Reed
Elena Kagan
Cynthia Rice
Josh Gotbaum

From: Jon Gruber

Re: Hatch-Feinstein Lookback - Revised

Here is a more refined analysis of Hatch-Feinstein lookback, correcting some earlier mistakes, and containing a more detailed comparison to both old and new McCain.

Hatch-Feinstien Lookback Results

Targets: Same as AG settlement and McCain. But, uses daily smoking instead of monthly. Also, since use older Michigan surveys relying on lower teen smoking rate, targets are effectively harder to meet than McCain. That is, daily smoking rate today is 18.2%, but baseline daily smoking rate was 15.2%, so that a 30% reduction from baseline is really a 58% reduction from today's smoking rate.

Penalties: First five years of lookback: \$100 million per percentage point for 0-5; \$200 million for 6-10; \$300 million for 10+. Next five years: \$250 million per percentage point for 0-5; \$500 million per percentage point thereafter. **But there is a double-counting adjustment, as in AG settlement, that dramatically lowers the effective payments.**

Results:

Table 1 shows our base case estimates of the impact of the lookback provisions, using our youth elasticity model

- The actual reductions in teen smoking are substantially less than under McCain - in the out years, teen smoking falls by 42-43%, whereas with the Durbin lookback mechanism teen smoking was falling by almost 50% (all figures account for "feedback" effects of lookback surcharges themselves on youth smoking).
 - The reductions from "baseline" are very different for Hatch, however, since their baseline is the historical smoking measure. This leads to the lower numbers in the third column.
- The base penalty column presents the penalty payments if there were no adjustments. Note that all figures refer to the year for which the penalty is levied, not the year in which it is actually remitted to the government - this follows the Hatch tables. These are then adjusted in two ways.
- The first is a population change adjustment - the amounts are increased to account for growing teen population.
- The second is the double-counting adjustment - the amounts are decreased to account for teens for whom there was a surcharge in the previous year. It is unclear how to actually carry this out in practice. We approximate the exercise by:
 - Estimating penalty teens by age (13, 14, ..., 17)
 - Industry is always charged for penalty 13 year olds
 - Industry is then charged for net increase in penalty 14-17 year olds
 - Ratio of these "new" penalty teens to total penalty teens is the double-counting adjustment.

- The penalty amounts vary substantially over time with this double-counting adjustment. This is because when the targets "step down" over time, there are a larger number of "new teens" who are hit - that is, the double-counting adjustment knocks out fewer teens, since there are so many teens who weren't penalty teens in the previous year.
- The 25 year total payment under Hatch is almost \$80 billion. This is clearly dramatically lower than that reported in their propoganda. This is because they assume that the maximum lookback caps are hit in every year, whereas in fact they are only hit in one year, 2005.
 - Of much more minor consequence, they add in the lookback penalties for smokeless as well. We don't include those for our analysis, of either Hatch or McCain.

Comparison to McCain:

Table 2 provides comparable figures for the McCain bill, including the Durbin-ammdended lookback penalty. Note that this table is off by one year from the budget scoring tables I sent around on June 11, since I am following the Hatch table convention of reporting the penalties in the year for which they are levied, not the year in which they are actually paid.

- The total penalties under the ammended McCain bill over 25 years are almost \$94 billion, or about 18% higher than Hatch.
- This 25 year total is much lower than the \$235 billion figure in the Hatch propoganda.
- On the other hand, the ratio of this total to Hatch's total is very close to the ratio in the Hatch propoganda. Hatch says that his penalties are 86% as large as Durbin's ammendment to McCain; the truth is that his penalties are 85% as large.

Table 3 undertakes a similar exercise for the original McCain managers ammendment.

- The total penalties here are about \$59 billion, or about 26% lower than Hatch. Once again, the 25 year total is much lower than in Hatch propoganda
- This total is significantly closer to Hatch's total than in their propoganda. Their propoganda says that Hatch is 54% greater than original McCain. The truth is that Hatch is 36% greater than original McCain.

Adjustments: Two comments on the Hatch adjustments:

- The double-counting adjustment is horrible. It has at least three key disadvantages:
 - It is effectively unworkable. The approximation used here is just that - it doesn't account for the fact that some folks may have quit between ages 13 and 14 and

some new smokers may have taken their place, and that the firms should be charged for those new smokers. While double-counting adjustments sound good in theory, they are unworkable in practice without longitudinal data that follows the same teens over time.

- It leads to a strange pattern of penalties, which vary dramatically from year-year
- It makes the penalties sound a lot more severe than they are. Even in the very worst case, the penalties never hit the caps presented by Hatch-Feinstein.
- On the other hand, the adjustment for teen population change is a good idea if you use \$/percentage point (it obviously doesn't matter for \$/kid), and we should be trying to incorporate that into our suggested lookback.

TABLE 1: SECOND PASS HATCH ESTIMATES - BASE CASE

year	target reduction	actual reduction from '98	actual reduction from baseline	base penalty	pop change adjusted	dbl count adjusted	per pack equivalent
1998							
1999		0	26.4	11.5	0	0	0.00
2000		0	32.5	18.8	0	0	0.00
2001		0	35.3	22.2	0	0	0.00
2002		0	35.1	22.0	0	0	0.00
2003	30	36.0	23.1	884	977	977	0.05
2004	30	37.5	24.9	520	585	79	0.00
2005	50	37.6	24.9	6019	6873	5000	0.26
2006	50	39.8	27.7	5317	6124	1310	0.07
2007	50	39.9	27.8	5262	6074	1682	0.09
2008	60	40.5	28.5	14641	16793	8189	0.45
2009	60	41.6	29.8	13834	15731	3722	0.21
2010	60	42.6	31.0	13252	14946	3681	0.21
2011	60	43.4	32.0	12760	14358	3644	0.21
2012	60	41.8	30.0	13755	15444	5046	0.29
2013	60	42.3	30.6	13419	15032	3941	0.23
2014	60	42.5	30.8	13342	14913	4097	0.24
2015	60	42.6	31.1	13226	14749	4019	0.24
2016	60	42.3	30.6	13444	15061	4420	0.26
2017	60	42.5	30.9	13309	14977	4131	0.25
2018	60	42.5	30.9	13282	15013	4216	0.25
2019	60	42.7	31.1	13216	15005	4180	0.25
2020	60	42.6	31.0	13252	15113	4282	0.26
2021	60	42.7	31.1	13194	15212	4309	0.27
2022	60	42.8	31.2	13149	15326	4347	0.27
2023	60	42.9	31.3	13086	15416	4355	0.27

25 year total

79629.34101

TABLE 2: McCAIN COMPARISON - with Durbin Ammendment

year	Industry	Company	Total	Total, After-Tax
1998				
1999		0	0	0
2000		0	0	0
2001		0	0	0
2002		0	0	0
2003		0	0	0
2004		0	0	0
2005	647	1293	1940	2910
2006	499	998	1498	2246
2007	382	765	1147	1721
2008	1729	3459	5188	7783
2009	1497	2995	4492	6739
2010	1287	2575	3862	5793
2011	1099	2199	3298	4947
2012	1187	2375	3562	5343
2013	1221	2442	3662	5493
2014	1211	2422	3634	5451
2015	1170	2339	3509	5264
2016	1152	2303	3455	5182
2017	1143	2286	3428	5143
2018	1134	2268	3402	5102
2019	1119	2238	3357	5035
2020	1103	2207	3310	4966
2021	1089	2179	3268	4902
2022	1076	2152	3228	4842
2023	1062	2125	3187	4780

93641.90403

TABLE 3: McCAIN COMPARISON - Managers Ammendment (pre-Durbin)

year	Industry	Company	Total	Total, After-Tax
1998				
1999		0	0	0
2000		0	0	0
2001		0	0	0
2002		0	0	0
2003		0	0	0
2004		0	0	0
2005		341	273	614
2006		326	263	589
2007		311	251	562
2008		2091	880	2971
2009		1851	809	2660
2010		1641	747	2388
2011		1457	697	2154
2012		1530	715	2245
2013		1566	722	2289
2014		1572	722	2294
2015		1553	716	2269
2016		1546	717	2264
2017		1545	720	2265
2018		1544	723	2268
2019		1542	726	2267
2020		1538	728	2266
2021		1535	735	2270
2022		1532	742	2275
2023		1529	750	2279

58783.02414

Tab - sur - lookback

FROM : RCMASH COMMUNICATIONS
06/20/98 12:53PHONE NO. : 3015650804
HHS ASPE/HPJun. 20 1998 04:15PM P1
@001:001

President Clinton today announced that the Department of Health and Human Services is improving one of its major surveys collecting information on youth tobacco use -- the National Household Survey on Drug Abuse or NHSDA -- for 1999 to strengthen its accuracy and usefulness in understanding children's use of different tobacco products.

The NHSDA is an annual survey of the population supported and directed by the Office of Applied Studies in the Substance Abuse and Mental Health Services Administration. Conducted since the early 1970s, the survey is the primary source of information on illicit drug use in the general population and an important source of information on tobacco and alcohol use.

DHHS is improving the NHSDA in three important ways:

Collecting brand information. DHHS will be expanding the NHSDA in 1999 to collect information on youth tobacco use by brand. Currently the survey collects information on the percentage of children that use different types of tobacco products (e.g., cigarettes, smokeless), but does not collect information about which brands of these tobacco products children use most often. Collecting brand-specific information will allow public health officials to better understand how different tobacco marketing efforts (e.g. the Joe Camel campaign) affect teen tobacco use. This information also could permit tobacco manufacturers to improve effectiveness of their youth anti-smoking efforts.

Improved Precision. DHHS will be increasing the number of 12-17 year olds surveyed so that the survey's estimates of youth use of tobacco and other substances are more precise. The survey in 1999 will include 22,500 respondents ages 12-17, and will provide national estimates that will be able to measure the percentage of youth that use a particular brand of tobacco product within plus or minus 1% (with a 95 percent degree of confidence). These more precise estimates will better enable public health officials and policymakers to evaluate the effectiveness of tobacco-control efforts and to chart our progress in reducing youth tobacco use.

Introduction of Computer-Assisted Technology. Beginning in 1999, the NHSDA will incorporate a new, state of the art technology called "Audio Computer Assisted Self Interview" or ACASI to collect information from respondents. With ACASI respondents listen to questions through earphones and enter their responses by punching keys on a personal computer. The greater privacy and confidentiality afforded respondents through ACASI increases the truthfulness of survey responses, which improves the accuracy and usefulness of the results. For 1999, this technology will be used only for questions related to tobacco use. It will be incorporated for other questions during the 2000 and 2001 surveys.

PRESIDENT CLINTON CALLS FOR NEW DATA ON TEEN TOBACCO USE

June 22, 1998

Today, President Clinton announced that the Department of Health and Human Services will issue annual reports providing fuller and more accurate information on teen tobacco use than ever before, including information on teen tobacco use by brand. Noting that parents have a right to know which companies are marketing products to their children and that public health officials can use this information to reduce tobacco use among youth, the President reaffirmed his commitment to taking every step he can -- with or without the Congress -- to stop teen smoking. When the Congress once again takes up comprehensive tobacco legislation, these new data will form the basis for lookback surcharges that will ensure tobacco companies undertake meaningful efforts to reduce youth smoking. Today, one of every three teenagers smoke cigarettes and every day, 3,000 children become regular smokers.

The Expanded Survey will Provide Better Data on Teen Tobacco Use

To provide the information the President has called for, the Department of Health and Human Services will expand one of its major annual surveys, the National Household Survey on Drug Abuse (NHSDA), to collect new information on youth tobacco use. Conducted since the early 1970s, this survey is the primary source of information on illicit drug use in the general population and an important source of information on tobacco and alcohol use. The expanded survey will collect information on youth tobacco use by brand and will increase the number of young people surveyed and introduce computer assisted survey methods in order to improve the precision of the survey.

New Data will Help Parents and Public Health Officials Reduce Teen Smoking

The collection of data on youth tobacco use by brand will give parents new information and provide public health officials with new tools to address youth tobacco use. With this information, public health officials can determine how different kinds of tobacco marketing campaigns (e.g., the Joe Camel campaign) affect tobacco use, and they can target their tobacco control efforts accordingly. And when the Congress once again takes up comprehensive tobacco legislation, these new data will form the basis for lookback surcharges that will ensure tobacco companies undertake meaningful efforts to reduce youth smoking.

President Clinton is Committed to Bipartisan, Comprehensive Legislation

President Clinton also reaffirmed his commitment to passing bipartisan comprehensive legislation to reduce youth smoking that includes: a substantial increase in the price of cigarettes combined with additional surcharges on companies that continue to sell to kids; full authority for the Food and Drug Administration to regulate tobacco products; changes in the way the tobacco industry does business, including an end to marketing and promotion to kids; progress toward other public health goals, including biomedical and cancer research, a reduction in second-hand smoke, and smoking cessation programs; and protection for tobacco farmers and their communities. The President once again stated that he would not accept watered-down legislation that is designed to provide cover to politicians, rather than to bring about a dramatic reduction in youth smoking.

Tobacco Q&A
June 22, 1998

Q: What did the President announce today?

A: Today, President Clinton announced that the Department of Health and Human Services will issue annual reports providing fuller and more accurate information on teen tobacco use than ever before, including information on teen tobacco use by brand. Noting that parents have a right to know which companies are marketing products to their children and that public health officials can use this information to reduce tobacco use among youth, the President reaffirmed his commitment to taking every step he can -- with or without the Congress -- to stop teen smoking. When the Congress takes up comprehensive tobacco legislation, these new data will form the basis for lookback surcharges that will ensure tobacco companies undertake meaningful efforts to reduce youth smoking.

Q: How will these new data be used?

A: The collection of data on youth tobacco use by brand will give parents new information and provide public health officials with new tools to address youth tobacco use. With this information, public health officials can determine how different kinds of tobacco marketing campaigns (e.g., the Joe Camel campaign) affect tobacco use, and they can target their tobacco control efforts accordingly. And when the Congress once again takes up comprehensive tobacco legislation, these new data will form the basis for lookback surcharges that will ensure tobacco companies undertake meaningful efforts to reduce youth smoking.

Q: How will these new tobacco data be collected?

A: To provide the information the President has called for, the Department of Health and Human Services will expand one of its major annual surveys, the National Household Survey on Drug Abuse (NHSDA), conducted by the Office of Applied Studies in the Substance Abuse and Mental Health Services Administration. In particular, HHS will:

- **Expand the NHSDA to collect information on youth tobacco use by brand.** Currently the survey collects information on the percentage of children that use different types of tobacco products (e.g., cigarettes, smokeless), but does not collect information about which brands of these tobacco products children use.
- **Increase the number of teenagers surveyed.** HHS will increase the number of 12- to 17-year-olds surveyed to 22,500 to provide more precise estimates of youth use of tobacco, drugs, alcohol, and other substances.

- **Introduce Computer-Assisted Technology.** The survey will incorporate a new, state of the art technology called "Audio Computer Assisted Self Interview" or ACASI to collect information from respondents. With ACASI, respondents listen to questions through earphones and enter their responses by punching keys on a laptop computer. The greater privacy and confidentiality afforded respondents through ACASI increases the truthfulness of survey responses, which improves the accuracy and usefulness of the results. For 1999, this technology will be used only for questions related to tobacco use. It will be incorporated for other questions during the 2000 and 2001 surveys.

Q: By adding tobacco questions to the drug survey, isn't the President once again saying he thinks tobacco is a greater threat to our children than drugs?

A: In fact these changes will help us collect better information on both drug use and tobacco use. Expanding the number of 12- to 17-year-olds surveyed in the National Household Survey on Drug Abuse will give us more precise estimates of nationwide use and incorporating computer-assisted technology will improve the truthfulness of the responses.

Q: Does the President's action today mean that he has given up on Congress?

A: Not at all. The President will continue to fight for bipartisan comprehensive tobacco legislation in both the Senate and the House. But the President is determined to move forward to protect America's children from tobacco, with or without the Congress.

Draft 06/21/98 4:30pm
Jeff Shesol

PRESIDENT WILLIAM J. CLINTON
DEPARTURE STATEMENT ON TOBACCO LEGISLATION
THE WHITE HOUSE
June 22, 1998

In a few moments I will be leaving for the Vice President's Family Reunion Conference in Nashville, where I will speak about the health care concerns American families face. Before I depart, I want to make clear: one of the most important health issues our families face is youth smoking. 3,000 children a day start smoking, and 1,000 of them will die early because of it. That is why, three years ago, through the FDA, we began to act to end the practice of tobacco companies marketing to our children. And that is why, for the past year, we have been working to forge an honorable, bipartisan compromise that protects our children from the dangers of tobacco.

A majority of the Senate stands ready to join us in making progress; but last week, the Republican leadership placed partisan politics -- and tobacco companies -- above America's families. Their vote was not just pro-tobacco; it was anti-family. The bipartisan bill they blocked would not only protect families from tobacco advertising that targets children; it would also protect kids from drugs, and give low- and middle-income families a tax break by ending the marriage penalty. It would [improve child care and] make an important investment in cancer research.

The congressional leadership seems willing to walk away from its obligation to America's children. But this issue is too important to walk away. I will continue to do everything in my power to protect the health of our children. And while we wait for Congress to heed the call of America's families, I am today asking the Department of Health and Human Services to produce the first-ever annual survey on the brands of cigarette that teenagers smoke, and which companies are most responsible for this problem. Parents, quite simply, have a right to know. Public health officials can also use this new information to reduce youth smoking. Once this information becomes public, the tobacco companies will no longer be able to duck their responsibilities -- and neither will Congress. From now on, the new data will help to hold tobacco companies accountable for targeting our children.

Again, I urge Congress to pass a comprehensive, bipartisan bill -- rather than a watered-down bill, written by the tobacco lobby, that aims not to save the lives of children but to save the political lives of the congressional leadership. America's children deserve better than that, and I will continue to do everything I can to ensure that they receive it.

Tob - sur - lookback penalties.

Changing the fence from section 451(b)(2)(C) from 10% to 1%, and altering section 1991C(b). The language is altered to ensure authorization of additional surveys

Section 451(b)(2)(C)

"(C) Education and prevention. Of the total amounts allocated to this account, not less than 50 percent, but not more than 65 percent are to be used to carry out

(I) counter-advertising activities under section 1982 of the Public Health Service Act as amended by this Act;

(ii) smoking prevention activities under section 223;

(iii) surveys under section 1991C of the Public Health Service Act, as added by this act (but in no fiscal year may the amounts used to carry out ~~such~~ *the surveys required in section 204(a)* be less than 10 percent of the amounts available under this subsection); and"

Section 1991C(b)

"(b) ~~Youth~~ *Surveillance and Research* Systems. From amounts provided under Section 451(b), the Director of the Centers for Disease Control and Prevention shall provide for the use of youth surveillance systems to monitor the use of all tobacco products by individuals under the age of 18, including brands-used to enable determinations to be made of company-specific youth market share, *and research into product design and use, public health aspects of environmental tobacco smoke, trends in adult use of tobacco, cancer registries, and factors affecting youth tobacco use*"

TOL - no - lookback
penalties



U.S. SENATE COMMITTEE ON
Commerce, Science, and Transportation

JOHN McCAIN, Chairman

www.senate.gov/~commerce

FAX to
DAVID KASS
224-8525

To: Josh Gotbaum
Tom Oruber
Gary Claxton
Tom Perrelli

FAX

Attached is John's
counteroffer. Please let
me know what you
think ASAP.

TO: Elena Kasan

OFFICE: _____

FAX NO: _____

DATE: 6/1/98 TIME: 8:50

PAGE 1 OF: 2

FROM: John Rawdt (202) 224 - 1251

SUBJECT: _____

Elena

annually

(3) Survey Methodology Reviewed, Determined

The Secretary shall consult with the National Academy of Sciences on the survey methodology required by this subsection. A survey using the methodology required by this subsection is determined conclusively to be proper, correct, and accurate for purposes of this Act. ~~As part of such consultations,~~

~~The National Academy of Sciences shall annually review application of the survey methodology to assure such methodology and its application complies with subsection(d), and shall report to the Secretary and the appropriate Committees of Congress of its findings.~~

As part of such consultations,

The National Academy of Sciences may submit to the Secretary recommendations for modification to the methodology to improve survey accuracy.

John Raidt

Job - set - WashLach penalties

To replace 204(A)(3) on p. 106

(3) Scope of Review

~~(3)~~ A survey using the methodology required by this subsection shall be subject to judicial review only by the United States Court of Appeals for the District of Columbia Circuit, based on the standard set forth in 5 U.S.C. § 706(2)(A) of the Administrative Procedures Act.

Look-Back Surcharges are Critical to Reducing Youth Smoking

The purpose of the tobacco reduction lookback system is to ensure that the price of tobacco products increases sufficiently to achieve critically important reductions in youth smoking. The tobacco industry has been remarkably successful in addicting young people to tobacco because it is in their financial interest to do so. Tobacco companies must be given strong financial incentives to reverse their behavior and find ways to significantly lower underage use of their products.

Are individual manufacturer reduction targets and surcharges needed to discourage youth smoking?

The lookback surcharges act as insurance in case the initial increases in prices do not sufficiently reduce youth tobacco use. A combination of industry-wide and manufacturer-specific financial incentives are needed to ensure that each manufacturer makes its best efforts to discourage underage use of its tobacco brands. If reduction targets are missed on an industry-wide basis, assessing an industry-wide surcharge will cause the price of all tobacco products to increase, providing an additional deterrence to youth tobacco use. Company-specific surcharges provide a strong incentive for each tobacco company to make all efforts to discourage youth use of its brands.

Without company-specific surcharges, some companies could ignore the targets because other companies have met them. With company-specific surcharges, companies that fail to meet reduction targets are placed at a competitive disadvantage in the market, providing a strong incentive for each company to find ways to discourage youth use of its brands.

Should surcharges be assessed based on objective and/or subjective outcomes?

Any comprehensive tobacco legislation must achieve the paramount goal of significantly reducing youth smoking. Lookback surcharges are critically important because they ensure that the price of tobacco products will adjust if youth smoking targets are met. The surcharges will only be effective if they are tied to objective measures of youth smoking. The fairest way to hold companies accountable for reducing youth smoking is by measuring their actual results.

Requiring the government to show that tobacco companies engaged in “bad behavior” in addition to missing reduction targets – an element of some tobacco proposals – dilutes the potential effectiveness of the lookback system. Adding a subjective assessment about industry behavior to the objective test of whether or not targets are met shifts the focus of the lookback away from what matters – results. It also would necessitate much closer federal government review of all of the business and marketing practices of the industry in order to determine whether the industry or specific manufacturers substantially contributed to youth use above the

targets. Placing such a burden on the government would likely delay the imposition of surcharges and would leave the lookback system subject to endless litigation over industry behavior.

How can caps on surcharges be prevented from undermining financial incentives?

The low caps (e.g., \$2.0 - \$3.5 billion) on lookback surcharges contained in the tobacco settlement and in some tobacco proposals would essentially eviscerate the lookback system. For example, a \$3.5 billion cap on the maximum annual surcharge for failure to achieve the reduction targets is equivalent to less than 15 cents per pack, based on current sales of 24 billion packs per year. Even if tobacco use falls by 25 or 30 percent due to the passage of tobacco legislation, this cap would still be in the neighborhood of 30 cents per pack.

To ensure that tobacco companies have strong incentives to discourage youth tobacco use, any caps that are placed on youth lookback surcharges should be substantially higher than the levels currently included in tobacco proposals. The caps must be high enough so that strong financial incentives for tobacco companies to significantly reduce youth tobacco use remain. To ensure that appropriate incentives continue for both the industry and individual tobacco companies, establishing separate caps for industry-wide and company-specific surcharges should be considered.

Should the look-back system measure “past month use” or “daily use” of tobacco products?

Data on youth tobacco use indicates that a significant percentage of youth who are occasional users will become addicted users, some while they are still teens and others in early adulthood. For example, survey data shows that 31 percent of 12-17 year olds who smoked just 2-9 times in the previous 30 days had become everyday smokers 4 years later. If these youth are not captured in the measurement of youth tobacco users, tobacco companies would have little incentive to discourage occasional use. In fact, they might find it profitable to encourage occasional use by older teens on the assumption that these teens will not progress to daily use until after age 17.

The daily use measure also may omit other regular patterns of tobacco use that should be captured by a lookback system. For example, some youth use several different types of products on a routine basis, but none of them on a daily basis. Data indicate that past month youth users who have established a usual brand, even if they use other brands or products on an occasional basis, are likely to remain with their usual brand into the future. Failure to capture this data could omit important patterns of tobacco use from the lookback system.

Tob - nr - new legislati-
Waxman
and
Tob - nr - look back
penalties

1 **TITLE ____ — PERFORMANCE**
2 **OBJECTIVES**

3 **SEC. ____ . SHORT TITLE.**

4 This title may be cited as the "NO Tobacco for Kids
5 Act".

6 **SEC. ____ . CHILD TOBACCO USE SURVEYS.**

7 (a) **ANNUAL PERFORMANCE SURVEY.**—Within 1 year
8 after the date of the enactment of this title and annually
9 thereafter the Secretary shall conduct a survey to deter-
10 mine the percentage of children who use each manufactur-
11 er's tobacco products.

12 (b) **BASELINE LEVEL.**—The baseline level of each
13 manufacturer is the percentage of children determined to
14 use its tobacco products in the first annual performance
15 survey.

16 **SEC. ____ . PERFORMANCE OBJECTIVES.**

17 (a) **PERFORMANCE OBJECTIVES FOR EXISTING**
18 **MANUFACTURERS.**—Each existing manufacturer shall
19 have the following performance objectives:

20 (1) To reduce the percentage of children deter-
21 mined to use its tobacco products in the third and
22 fourth annual performance survey to a percentage
23 which is at least 33 percent below the manufactur-
24 er's baseline level.

Feb-26-98 10:17am From-

T-089 P.03/16 F-233

2

1 (2) To reduce the percentage of children deter-
2 mined to use its tobacco products in the fifth and
3 sixth annual performance survey to a percentage
4 which is at least 50 percent below the manufactur-
5 er's baseline level.

6 (3) To reduce the percentage of children deter-
7 mined to use its tobacco products in the seventh,
8 eighth, and ninth annual performance survey to a
9 percentage which is at least 67 percent below the
10 manufacturer's baseline level.

11 (4) To reduce the percentage of children deter-
12 mined to use its tobacco products in the tenth an-
13 nual performance survey and each annual perform-
14 ance survey conducted thereafter to a percentage
15 which is at least 80 percent below the manufactur-
16 er's baseline level.

17 (b) PERFORMANCE OBJECTIVES FOR NEW MANU-
18 FACTURERS.—Any new manufacturer shall have as its
19 performance objective to not increase above the de minimis
20 level the percentage of children determined to use its to-
21 bacco products in each annual performance survey.

22 (c) DE MINIMIS LEVEL.—

23 (1) GENERAL RULE.—The de minimis level is
24 _____ percentage of children.

1 (2) **ACHIEVEMENT BY EXISTING MANUFAC-**
2 **TURER.**—If the percentage of children determined to
3 use the tobacco products of an existing manufac-
4 turer in an annual performance survey is equal to or
5 less than the de minimis level, the manufacturer
6 shall be considered to have achieved the applicable
7 performance objective.

8 **SEC. ____ . ADDITIONAL MEASURES.**

9 (a) **SECRETARIAL DETERMINATION.**—Beginning at
10 the beginning of the third year after the date of the enact-
11 ment of this title and annually thereafter, the Secretary
12 shall, based on the annual performance survey conducted
13 under section ____, determine if each manufacturer has
14 achieved the applicable performance objective under sec-
15 tion ____.

16 (b) **MANDATORY PRICE INCREASE.**—

17 (1) **FIRST FAILURE.**—If the Secretary deter-
18 mines that a manufacturer has failed to achieve the
19 applicable performance objective, the manufacturer
20 shall increase the price it charges for each unit of
21 its tobacco products by \$1 multiplied by the non-
22 compliance factor.

23 (2) **CONSECUTIVE FAILURES.**—If the Secretary
24 determines that a manufacturer has failed to achieve
25 the applicable performance objective in 2 or more

1 consecutive annual surveys, the manufacturer shall
2 increase the price it charges for each unit of its to-
3 bacco products by \$1 multiplied by (A) the non-
4 compliance factor, and (B) the number of consecu-
5 tive failures.

6 (c) NONMONETARY MEASURES.—

7 (1) CARTON REQUIREMENT.—If the Secretary
8 determines that a manufacturer has failed to achieve
9 the applicable performance objective in 3 consecutive
10 annual performance surveys, no retailer may sell the
11 tobacco products of the manufacturer to consumers
12 in quantities smaller than a carton.

13 (2) GENERIC PACKAGING REQUIREMENT.—If
14 the Secretary determines that a manufacturer has
15 failed to achieve the applicable performance objective
16 in 4 consecutive annual performance surveys, the
17 manufacturer may sell its tobacco products only in
18 packages that bear only black text on a white back-
19 ground, except for warning labels that are required
20 to appear in a different format.

21 SEC. ____ . PROCEEDS OF MANDATORY PRICE INCREASES.

22 (a) TOBACCO ENFORCEMENT AND EDUCATION
23 FUND.—A manufacturer that is required to increase
24 prices under section ____ shall pay the proceeds of the
25 price increase into a Tobacco Enforcement and Education

1 Fund in the United States Treasury. The proceeds shall
2 be paid by a manufacturer on a quarterly basis. The first
3 quarter shall begin on the date the Secretary determines
4 that such manufacturer did not achieve the applicable per-
5 formance objective and the payments shall be due within
6 30 days after the end of each quarter.

7 (b) USE OF THE FUND.—Funds in the Tobacco En-
8 forcement and Education Fund shall be available to the
9 Secretary, without fiscal year limitation, to enforce this
10 title and other laws relating to tobacco use by children
11 and for public education and other initiatives designed to
12 discourage children from using tobacco products.

13 SEC. ____ JUDICIAL REVIEW.

14 (a) IN GENERAL.—An action of the Secretary under
15 this title is not subject to judicial review until the Sec-
16 retary has made or failed to make a compliance determina-
17 tion under section ____ that has adversely affected the
18 person seeking the review. An action for review may only
19 be brought in the United States District Court for the Dis-
20 trict of Columbia. In an action seeking review of a compli-
21 ance determination, the manufacturer may prevail only to
22 the extent that the manufacturer demonstrates that the
23 percentage of children using its tobacco products is dif-
24 ferent than the percentage the Secretary used in making
25 the compliance determination.

1 (b) NO STAY.—Section 705 of title 5, United States
2 Code, shall not apply with respect to any action under sub-
3 section (a).

4 (c) INTEREST.—If the judgment of a court in an ac-
5 tion under subsection (a) results in the reduction of a pay-
6 ment paid by a manufacturer under section ____, the
7 manufacturer shall be paid an amount equal to such re-
8 duction and interest on such amount. If the judgment of
9 a court in an action under subsection (a) results in the
10 increase of a payment paid by a manufacturer under sec-
11 tion ____, the manufacturer shall pay to the Tobacco En-
12 forcement and Education Fund an amount equal to such
13 increase and interest on such amount.

14 SEC. ____, GENERAL PROVISIONS.

15 (a) ENFORCEMENT.—Section 301 of the Federal
16 Food, Drug, and Cosmetic Act (21 U.S.C. 331) is amend-
17 ed by adding at the end the following:

18 “(x) The failure to comply with any requirement
19 under the NO Tobacco for Kids Act.”.

20 (b) REGULATIONS.—

21 (1) GENERAL RULE.—The Secretary may pro-
22 mulgate regulations for the implementation of this
23 title.

24 (2) ADDITIONAL AUTHORITY.—The Secretary
25 may by regulation establish performance objectives

1 and additional measures for cigars, little cigars, cig-
2 arette tobacco, and pipe tobacco.

3 (c) ADMINISTRATION OF SURVEYS.—

4 (1) STATISTICAL ACCURACY OF SURVEYS.—The
5 annual performance surveys conducted by the Sec-
6 retary under section ____ shall be designed to
7 achieve a 95 percent confidence interval of no great-
8 er than plus or minus 1 percent

9 (2) CONFIDENCE INTERVALS.—In determining
10 the baseline level of a manufacturer in the first an-
11 nual performance survey under section ____, the
12 Secretary shall use the upper bound of the 95 per-
13 cent confidence interval as the baseline level. In de-
14 termining whether a manufacturer has achieved an
15 applicable performance objective in an annual per-
16 formance survey, the Secretary shall use the lower
17 bound of the 95 percent confidence interval to deter-
18 mine the number of children who use its tobacco
19 products.

20 (3) CONDUCT OF THE SURVEYS.—The annual
21 performance surveys shall be household-based sur-
22 veys and shall not be subject to State or local regu-
23 lation.

24 (d) INFLATION ADJUSTMENT.—The amount of the
25 price increase required under section ____ shall be ad-

1 justed annually after the date of the enactment of this
2 title to reflect the changes in the Consumer Price Index
3 from such date.

4 **SEC. ____ DEFINITIONS.**

5 For purposes of this title:

6 (1) **CARTON.**—The term “carton” means a
7 package containing at least 10 units of a tobacco
8 product.

9 (2) **CHILDREN.**—The term “children” means
10 individuals under the age of 18 and above the age
11 of 13.

12 (3) **EXISTING MANUFACTURER.**—The term “ex-
13 isting manufacturer” means a manufacturer which
14 manufactured or imported a tobacco product on or
15 before the date of the enactment of this title.

16 (4) **MANUFACTURER.**—The term “manufac-
17 turer” means any person who manufactures or im-
18 ports a tobacco product.

19 (5) **NEW MANUFACTURER.**—The term “new
20 manufacturer” means a manufacturer which begins
21 to manufacture or import a tobacco product after
22 the date of the enactment of this title.

23 (6) **NONCOMPLIANCE FACTOR.**—

24 (A) **EXISTING MANUFACTURER.**—In the
25 case of an existing manufacturer—

Feb-26-88 10:18am From-

T-083 P.10/18 F-283

9

1 (i) when the percentage of children
2 determined to use its tobacco products is
3 at ~~the~~ its baseline level, the term "non-
4 compliance factor" means 1;

5 (ii) when the manufacturer has re-
6 duced the percentage of children deter-
7 mined to use its tobacco products below
8 ~~the~~ its baseline level, the term "noncompli-
9 ance factor" means 1 minus the fraction—

10 (I) the numerator of which is the
11 percentage reduction achieved by the
12 manufacturer; and

13 (II) the denominator of which is
14 the percentage reduction required to
15 be achieved;

16 (iii) when the manufacturer has in-
17 creased the percentage of children deter-
18 mined to use its tobacco products above
19 ~~the~~ its baseline level, the term "noncompli-
20 ance factor" means the fraction—

21 (I) the numerator of which is the
22 percentage of children determined to
23 use its tobacco products; and

1 (II) the denominator of which is
 2 the percentage of children at its base-
 3 line level; and

4 (B) NEW MANUFACTURER.—In the case of
 5 a new manufacturer, the term noncompliance
 6 factor means the fraction—

7 (i) the numerator of which is the per-
 8 centage of children determined to use its
 9 tobacco products; and

10 (ii) the denominator of which is the
 11 percentage of children in the de minimis
 12 level.

13 (7) TOBACCO PRODUCT.—The term “tobacco
 14 product” means a cigarette or smokeless tobacco.

15 (8) UNIT.—The term “unit” means 20 ciga-
 16 rettes in the case of cigarettes and a comparable
 17 amount as determined by the Secretary in the case
 18 of smokeless tobacco.

19 (9) USE.—A child shall be considered to use a
 20 manufacturer’s tobacco product if the manufactur-
 21 er’s tobacco product is the usual brand of tobacco
 22 product used by the child in the last 30 days.

Tob - set - lookback penalties

and
Tob - set - Document disclosure

United States Senate

COMMITTEE ON COMMERCE, SCIENCE,
AND TRANSPORTATION

WASHINGTON, DC 20510-8126

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April 16, 1998

Dan Mollohan, Director
Congressional Research Service
LM 203
Washington, DC 20540

Dear Mr. Mollohan:

As you may know, on April 1, 1998, the Senate Commerce Committee approved S. 1415 -- the National Tobacco Policy and Youth Smoking Reduction Act.

This bill is a comprehensive measure aimed at dramatically reducing youth smoking, and is based on the framework laid out in the proposed June 20th settlement agreement between various state attorneys general and the industry.

The measure, like the settlement, contemplates that the industry would consent to terms under the legislation by entering into a national protocol and state consent decrees. This would enable the provisions to be implemented without challenge or delay. While industry cooperation is desirable, it is not mandatory, and Congress is prepared to act with or without the industry's consent.

As you know, absent industry cooperation, it has been suggested that three titles of S. 1415, as approved by the Commerce Committee, raise constitutional concerns: advertising and marketing restrictions; the look-back penalties for non-attainment of youth smoking reduction targets; and the public disclosure of tobacco industry documents.

With respect to advertising, the Committee could address concerns by simply codifying the FDA's approach embodied in 21 CFR, Part 801. While these advertising restrictions are more narrow than what is contemplated in the legislation and by the attorneys general, they are presumptively constitutional.

The purpose of this letter, however, is to request the Congressional Research Service's recommendations regarding what changes, if any, must be made to provisions dealing with the look back penalties (Title II) and public disclosure of tobacco industry documents (Title IX), to address any constitutional or other legal deficiencies.

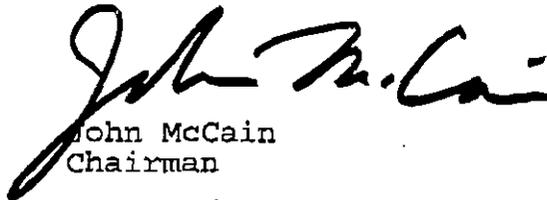
Your recommendations should include those modifications that are absolutely necessary, constitutionally and legally, absent industry consent. The suggestions should include alternatives Congress might consider to achieve the same purposes and goals without making itself unduly vulnerable to constitutional challenge.

Thank you for your assistance in this matter. If you have any questions regarding this request, please don't hesitate to contact me, or John Raidt, staff director of the Senate Commerce Committee at 224-1251.

As you know, the Senate intends to act on the tobacco bill prior to the Memorial Day recess. It would be very helpful if you would provide your recommendations no later than May 1, 1998.

Again, thank you for your help.

Sincerely,



John McCain
Chairman

JM/jr

5/4 Lookback penalties

1. Pen → surcharge

↳ it do this, still OK for it to be un-deductible?

2. Lookback - cost rationale

best rationale - in ind - pass thru to price + then pub health spending
less good the co-specific,

then, go w/
higher
number?
\$1,000 per.

but can make case that this works as a topper -
a way to address free-rider problem, so that ind
pens work.

could stack
then too - 3.
after you go
through ind.
penalties

Lookback policy

do per 10,000 bids - seem to manageable
units in survey

Options:

a) \$500 per bid - take profit out
(w/ ind. pens, actually does more)

b) transportation into millions per point:
(appetition by youth market share)

cap at
1 billion
(separate
from other)

20m per percentage point -- current appointment:
12m for PM
3m for RTR
etc.

c) more cap to 5 -
last billion based on youth market share

(ind. wide is based on adult market share)

so totally
screws
P. Murri -
doesn't wh
what their
plans have
been.

← this doesn't relate at all to increments from baseline
comes into effect after ind runs thru whole
ind. penalty (now at 20 per)

Essentially, a stacking of the caps.
DOT-OK w/ any OMB - 500 per bid
HHS - 500 per + ride-by-ride caps.

Contn: go to 5 b on industry
HHS agrees + 1 m co.

Everyone agrees! → Trees - same 1st choice
2nd choice: # per bid
stretched - two - wide -

April 21, 1998

MEMORANDUM FOR THE CHIEF OF STAFF

FROM: Bruce Reed

SUBJECT: Lookback Penalty Options

We have three concerns with the lookback penalties in the McCain bill:

1. **The overall cap of \$3.5 billion (which translates to about \$5 billion pre-tax, or roughly 30 cents a pack) needs to be raised.** Our concern is that under the McCain bill, the industry would hit the cap if it missed the youth smoking reduction targets (30% in 5, 50% in 7, 60% in 10) by just 20%. A 40% or 50% miss would produce the same penalty as a 20% miss. Ideally, we would like to see the cap raised to \$5 billion (which would be about 45 cents a pack). In any case, we need to raise the cap enough to include a company-specific penalty, as described below.

2. **We would like a company-specific penalty that gives individual companies an incentive to reduce youth smoking.** The current industry penalty, like the annual payments, is paid on the basis of adult market share (Phillip Morris 48%, RJR 24%, B&W 16%, Lorillard 9%). The youth market share is much different: PM 61%, RJR 15%, Lorillard 13%, B&W 1%. Without a company-specific penalty, a company could still theoretically profit from hooking kids. Companies hate company-specific penalties for the same reason the public health groups love them: If one company does well and another does poorly, the latter company may not be able to pass the penalty on to price, and will have to pay it directly out of profits.

Treasury estimates that the present value of lifetime profits from addicting a teen smoker at about \$500. By Treasury's estimate, the current industry penalty in McCain would reduce company profits by about \$150 per youth smoker. To remove the remaining profit, we would need a company-specific penalty of about \$350. Treasury and OMB would be more comfortable with a company-specific penalty of \$500. (To ease fears that we're trying to bankrupt the companies, we would place an overall cap on company-specific penalties of \$1 billion, with a subcap for each company based on its share of the youth market.)

The public health community is expecting considerably more than that. Conrad and Waxman's bills have astronomically higher company-specific penalties at levels (40 cents to \$1.00 a pack) that could easily bankrupt a company that does poorly. The Chafee-Harkin bill initially included a company-penalty of \$1500-3000 per youth smoker. Under pressure from Waxman, they switched to a cents-per-pack model that like Conrad and Waxman's provisions,

only PM
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would be impossible for companies to accept.

If McCain or others reject the idea of \$350-500 per youth smoker, we have developed two other possible approaches. Under the first alternative, we would assess a penalty of up to \$20 million a point (depending on the company's share of the youth market) for each percentage point by which a company missed its target. (For example, Philip Morris has 61% of the youth market, so it would pay \$12 million a point -- 61% times \$20 million.) This approach is more complicated to explain, but is the virtual equivalent of \$500 per youth smoker.

The second alternative would be to have the company-specific penalty kick in only after the industry had already hit the cap on industry-wide penalties. In other words, the first \$3.5 billion in penalties would be industry-wide. The next \$1 billion would be company-specific. Companies would pay the first \$3.5 billion on the basis of their adult market share, and the next \$1 billion based on their youth market share. This proposal addresses two of our concerns -- raising the cap and getting a company penalty -- in one fell swoop. Companies would only pay a company-specific penalty if the overall industry missed by more than 20 points. The public health groups and economists wouldn't like it as much, because the company-specific incentive and pain would not be as immediate.

3. Our other concern about McCain's penalty structure is the way they have drafted the link between youth smoking and liability caps. In its current form, it is meaningless, and should be rewritten or dropped.

1¢ if a pt to 20, ind wide

number of payments + pens - only 1.30

¢ 1¢ on both

1.5 on ind, non-d.

* 1¢ keep on going - past 20¢

Keep paying 45 a year, even if caps
kick up.

Sign on to ads even if fail to reduce
sub,

Can't be in it

miss by 30 pts

no sub

prices end up going down.

Tob - ser - look back
penalties

Comments on Proposed McCain Position

- ①) Cap on industry penalties should be in expressed real 1998 dollars, not nominal dollars.
- ②) Cap on liability should not completely come out of base payment \$23.6 billion. Rather, as with Chafee-Harkin, first \$4 billion comes out of base payment, with remainder as a copayment for the manufacturer. This is probably what is contemplated, but we should be sure.

3) We should continue to argue for a financial incentive at the company level. If there is a company-specific penalty, there should be a separate cap. If they insist on a low cap (e.g. \$1 billion), then we should likewise lower the incremental penalty, so that there is some bite at higher percentage misses. For example, with a \$1 billion cap and roughly 17 billion packs, then even at ½ cent per percentage point we only get a marginal incentive for the first 13 percentage points.

My guess is that they care about the cap more than the cents/pack. So, I think that we should push for the following options, in order of preference. Each option is designed to give bite for about the first 25 percentage points:

- a) \$4 billion cap: 1 cent per percentage point.
- b) \$2 billion cap: ½ cent per percentage point
- c) \$1 billion cap: 1/4 cent per percentage point

While 1/4 cent seems small, this still has some bite - it is still more than foregone profits per youth smoker, per example (e.g. still more than AG settlement figure, after adjusting for double-counting).

4) If they simply won't take a company-specific financial incentive, then we should try to get the company deterrent to kick in at an earlier level. Our models suggest that at their penalty levels you never get to a 20% miss. With a 1 cent per percentage point penalty on industry only, and a \$1.10 per pack price increase in out years, worst year has a miss of only 12.3%. And this is with a conservative 15% non-price effect.

Indeed, even if we lower our elasticity to 0.5, roughly the level for adults, the industry still misses by less than 20% in every year. And this is clearly a lower bound, since the elasticity for teens must be larger than that for adults.

5) Finally, if they simply won't take a company financial penalty, industry penalty could be made bigger. This could be done in one of two ways:

- a) Could simply make it more cents per percentage point, but that only helps if you raise the cap.
- b) Could tie this to liability, as with company penalty. This would work in the following way

(for example):

- Industry miss by 0-10%: \$4 billion from base in liability pool, with companies paying the remainder up to a cap of \$6.5 billion
- Industry miss by 10-20%: \$3.5 billion from base in liability pool, with companies paying the remainder up to a cap of \$6.5 billion
- Industry miss by 20%+: \$3 billion from base in liability pool, with companies paying the remainder up to \$6.5 billion.

This amounts to a contingent payment of 50 million per percentage point. This is roughly 0.3 cents per pack.

Tob - sur - lookback

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1 / 2 / 3 on industry and company

	legislative price increase	reduction target	actual reduction	%age point miss	number miss (000's)	LOOKBACK SURCHARGES				REAL PRICES		
						INDUSTRY		COMPANY		current law	effect of leg. w/o surcharge	effect of leg. with surcharge
						per-pack	Total (\$M)	per-pack	Total (\$M)			
1999	0.62	0	32.0	0.0	0	0.00	0	0.00	0	1.94	2.56	2.56
2000	0.80	0	38.5	0.0	0	0.00	0	0.00	0	2.04	2.84	2.84
2001	0.90	0	40.6	0.0	0	0.00	0	0.00	0	2.04	2.94	2.94
2002	1.00	0	43.7	0.0	0	0.00	0	0.00	0	2.09	3.09	3.09
2003	1.10	30	45.7	0.0	0	0.00	0	0.00	0	2.09	3.19	3.19
2004	1.10	30	45.7	0.0	0	0.00	0	0.00	0	2.09	3.19	3.19
2005	1.10	50	45.7	4.3	273	0.04	734	0.04	734	2.09	3.19	3.19
2006	1.10	50	46.6	3.4	222	0.03	583	0.03	583	2.09	3.19	3.23
2007	1.10	50	47.2	2.8	180	0.03	465	0.03	465	2.09	3.19	3.27
2008	1.10	60	47.7	12.3	787	0.29	4,787	0.15	2,393	2.09	3.19	3.29
2009	1.10	60	50.9	9.1	578	0.18	2,852	0.09	1,426	2.09	3.19	3.47
2010	1.10	60	52.7	7.3	462	0.15	2,230	0.07	1,115	2.09	3.19	3.57

surcharge doubles on industry after 3 consecutive years of non-compliance

1 cent penalty per percentage point miss on industry and company

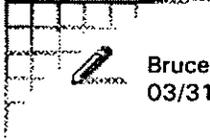
	legislative price increase	reduction target	actual reduction	%age point miss	number miss (000's)	LOOKBACK SURCHARGES				REAL PRICES		
						INDUSTRY		COMPANY		current law	effect of leg. w/o surcharge	effect of leg. with surcharge
						per-pack	Total (\$M)	per-pack	Total (\$M)			
1999	0.62	0	32.0	0.0	0	0.00	0	0.00	0	1.94	2.56	2.56
2000	0.80	0	38.5	0.0	0	0.00	0	0.00	0	2.04	2.84	2.84
2001	0.90	0	40.6	0.0	0	0.00	0	0.00	0	2.04	2.94	2.94
2002	1.00	0	43.7	0.0	0	0.00	0	0.00	0	2.09	3.09	3.09
2003	1.10	30	45.7	0.0	0	0.00	0	0.00	0	2.09	3.19	3.19
2004	1.10	30	45.7	0.0	0	0.00	0	0.00	0	2.09	3.19	3.19
2005	1.10	50	45.7	4.3	273	0.04	734	0.04	734	2.09	3.19	3.19
2006	1.10	50	46.6	3.4	222	0.03	583	0.03	583	2.09	3.19	3.23
2007	1.10	50	47.2	2.8	180	0.03	465	0.03	465	2.09	3.19	3.27
2008	1.10	60	47.7	12.3	787	0.12	2,021	0.12	2,021	2.09	3.19	3.29
2009	1.10	60	49.2	10.8	686	0.11	1,733	0.11	1,733	2.09	3.19	3.37
2010	1.10	60	50.5	9.5	597	0.09	1,485	0.09	1,485	2.09	3.19	3.45

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1 cent penalty per percentage point min on industry, zero on company
 ALL FIGURES IN 1998 \$

	legislative price increase	reduction legal	actual reduction	%age point min.	number min. (MTP-)	LOOKBACK SURCHARGES				REAL PRICES		
						INDUSTRY		COMPANY		normal law	effect of leg. rate surcharge	effect of leg. with surcharge
						per-pack	Total (\$M)	per-pack	Total (\$M)			
1998	0.65	0	32.7	0.0	0	0.00	0	0.00	0	1.94	2.59	2.59
2000	0.70	0	36.2	0.0	0	0.00	0	0.00	0	2.04	2.74	2.74
2001	0.80	0	38.5	0.0	0	0.00	0	0.00	0	2.04	2.84	2.84
2002	1.00	0	43.7	0.0	0	0.00	0	0.00	0	2.09	3.00	3.00
2003	1.10	30	45.7	0.0	0	0.00	0	0.00	0	2.09	3.19	3.19
2004	1.10	30	45.7	0.0	0	0.00	0	0.00	0	2.09	3.19	3.19
2005	1.10	50	45.7	4.3	273	0.04	734	0.00	0	2.09	3.19	3.19
2006	1.10	50	46.1	3.9	248	0.04	666	0.00	0	2.09	3.19	3.24
2007	1.10	50	46.5	3.5	225	0.03	586	0.00	0	2.09	3.19	3.23
2008	1.10	60	46.9	13.1	844	0.13	2,192	0.00	0	2.09	3.19	3.25
2009	1.10	60	47.7	12.3	793	0.12	2,018	0.00	0	2.09	3.19	3.29
2010	1.10	60	48.5	11.5	727	0.12	1,858	0.00	0	2.09	3.19	3.33

surcharge effects on price smoothed using three-year average
 new price path



Bruce N. Reed
03/31/98 03:41:41 PM

Record Type: Record

To: Cynthia A. Rice/OPD/EOP

cc: Elena Kagan/OPD/EOP, Laura Emmett/WHO/EOP, Cynthia Dailard/OPD/EOP

Subject: Re: For Review --- two pager on McCain--we need it COB to give to the Hill for tomorrow's markup



You can also include our "Reducing youth smoking is our bottom line. We must make it the tobacco industry's bottom line" -- but that's an argument for all penalties, not company-specific ones. We should argue strongly for company-specific penalties, and we'll get one. But we should never apologize for, or underestimate the impact of, industrywide penalties. The argument that they don't mean much because they can be passed along as price increases is just wrong. They will have a big impact on the companies' bottom line precisely because they force price increases, which reduce consumption and therefore profits. Teens are 2% of the market; adults are 98%. The industry would be crazy to risk big penalties that will drive down adult consumption just to hook kids. At \$240 million a point, non-deductible, the industrywide penalties in McCain are about 6 times the lifetime profit from addicting a given teen.

Effect of Options in 2008 (real 1998 \$)

1 / 2 / 3 cents per pack per %age point (industry), \$1,500 per kid (cc)

	Miss by	Industry Total (\$B)	Industry per pack	Company Avg. Total (\$B)	Company Avg. per pack
1 Year	10%	1.569	0.10	0.962	0.06
non-comp	20%	4.708	0.30	1.923	0.12
	30%	9.415	0.60	2.885	0.18

1 / 2 / 3 cents per pack per %age point (industry & company)

	Miss by	Industry Total (\$B)	Industry per pack	Company Avg. Total (\$B)	Company Avg. per pack
1 Year	10%	1.569	0.10	1.569	0.10
non-comp	20%	4.708	0.30	4.708	0.30
	30%	9.415	0.60	9.415	0.60

ToS - ser - lookback penalties

Office of Economic Policy

Department of the Treasury
Washington, D.C. 20220

FAX

Date: 3 / 30 / 98
Number of pages including cover sheet: 3

	Name	Fax Number	Phone Number
To:	Gary Cletton	401-7321	
	Josh Gottbaum	395-4995	
	Cynthia Rice	456-7431	
	Elena Kagan	456-2878	
From:	Jan Gruber	202-622-2633	202-622-

REMARKS: Urgent For your review Reply ASAP Please comment

Attached is our analysis of the new ^(McLain bill) swdcharge option (80 million per point, 1-5, etc.).

As you can see it ends up translating into slightly less per pack than the zero one/zero option from last week (attached).

80 / 160 / 240 million per percentage point miss on industry, zero on company
 ALL FIGURES IN 1998 \$

	legislative price increase	reduction target	actual reduction	%age point miss	number miss (000's)	LOOKBACK SURCHARGES				REAL PRICES		
						INDUSTRY		COMPANY		current law	effect of leg. w/o surcharge	effect of leg. with surcharge
						per-pack	Total (\$M)	per-pack	Total (\$M)			
1999	0.65	0	32.7	0.0	0	0.00	0	0.00	0	1.94	2.59	2.59
2000	0.70	0	36.2	0.0	0	0.00	0	0.00	0	2.04	2.74	2.74
2001	0.80	0	38.5	0.0	0	0.00	0	0.00	0	2.04	2.84	2.84
2002	1.00	0	43.7	0.0	0	0.00	0	0.00	0	2.09	3.09	3.09
2003	1.10	30	45.7	0.0	0	0.00	0	0.00	0	2.09	3.19	3.19
2004	1.10	30	45.7	0.0	0	0.00	0	0.00	0	2.09	3.19	3.19
2005	1.10	50	45.7	4.3	273	0.02	341	0.00	0	2.09	3.19	3.19
2006	1.10	50	45.9	4.1	263	0.02	326	0.00	0	2.09	3.19	3.20
2007	1.10	50	46.1	3.9	251	0.02	311	0.00	0	2.09	3.19	3.21
2008	1.10	60	46.3	13.7	880	0.12	2,091	0.00	0	2.09	3.19	3.22
2009	1.10	60	47.3	12.7	809	0.11	1,851	0.00	0	2.09	3.19	3.27
2010	1.10	60	48.2	11.8	747	0.10	1,641	0.00	0	2.09	3.19	3.32

surcharge effects on price smoothed using three-year average
 new price path

1 cent penalty per percentage point miss on industry, zero on company
ALL FIGURES IN 1998 \$

	legislative price increase	reduction target	actual reduction	%age point miss	number miss (000's)	LOOKBACK SURCHARGES				REAL PRICES		
						INDUSTRY		COMPANY		current law	effect of leg. w/o surcharge	effect of leg. with surcharge
						per-pack	Total (\$M)	per-pack	Total (\$M)			
1999	0.65	0	32.7	0.0	0	0.00	0	0.00	0	1.94	2.59	2.59
2000	0.70	0	36.2	0.0	0	0.00	0	0.00	0	2.04	2.74	2.74
2001	0.80	0	38.5	0.0	0	0.00	0	0.00	0	2.04	2.84	2.84
2002	1.00	0	43.7	0.0	0	0.00	0	0.00	0	2.09	3.09	3.09
2003	1.10	30	45.7	0.0	0	0.00	0	0.00	0	2.09	3.19	3.19
2004	1.10	30	45.7	0.0	0	0.00	0	0.00	0	2.09	3.19	3.19
2005	1.10	50	45.7	4.3	273	0.04	734	0.00	0	2.09	3.19	3.19
2006	1.10	50	46.1	3.9	248	0.04	656	0.00	0	2.09	3.19	3.21
2007	1.10	50	46.5	3.5	225	0.03	586	0.00	0	2.09	3.19	3.23
2008	1.10	60	46.9	13.1	844	0.13	2,192	0.00	0	2.09	3.19	3.25
2009	1.10	60	47.7	12.3	783	0.12	2,018	0.00	0	2.09	3.19	3.29
2010	1.10	60	48.5	11.5	727	0.12	1,858	0.00	0	2.09	3.19	3.33

surcharge effects on price smoothed using three-year average
 new price path

3-22 Lookback penalties

Assume 1.80 per pack

penny per pt. 10F ind = 1.56 loss across all cos.

penny per pt. 204 = 36.

- 25-year numbers
- mtg w/ industry

- due process provisions
in lookback?

Baird

DRAFT

Tobac - set - look back
penalties

Draft Specifications 3/6/98

Note: This follows the language of Conrad bill with some clarifications and some differences in policy.

PURPOSE.

The purpose of this title is to achieve reductions in the proportion of underage consumers of tobacco products through the imposition of financial deterrents relating to the use of tobacco products if certain underage tobacco-use reduction targets are not met.

CHILD TOBACCO USE SURVEYS.

Annual Performance Survey. Not later than 1 year after the date of the enactment of this Act and annually thereafter the Secretary shall conduct a survey to determine

- ▶ The percentage of all young individuals who used a type of tobacco product within the past 30 days; and
- ▶ the percentage young individuals who identify each brand of each type of tobacco product as the usual brand smoked or used within the past 30 days.

Young Individuals. For the purposes of this title, the term "young individuals" means individuals who are over 12 years of age and under 18 years of age.

Baseline Level. For the purposes of this title, the term "baseline level" is, with respect to each type of tobacco product, the percentage of young individuals determined to have used such tobacco product in the first annual performance survey for 1999.

Manufacturers Baseline Level. For the purposes of this title, the term "manufacturers baseline level" is, with respect to each type of tobacco product, the percentage of young individuals determined to have identified a brand of such tobacco product of such manufacturer as the usual brand smoked or used in the first annual performance survey for 1999.

Tobacco product. For the purposes of this title, the following are considered separate types of tobacco products: cigarettes, cigars, little cigars, smokeless tobacco, and roll-your-own tobacco.

Participation in survey. Notwithstanding any other provision of law, the Secretary may conduct a survey relating to tobacco use involving minors if the results of such survey with respect to such minors are kept confidential and are not disclosed.

REDUCTION IN UNDERAGE TOBACCO PRODUCT USAGE.

Annual Determination. The Secretary shall annually determine, based on the annual performance

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survey, whether the required percentage reductions in underage use of tobacco products for a year have been achieved for the year involved. Such determination shall be based on the average annual percentage prevalence of the use of tobacco products by young individuals (as determined by the surveys conducted by the Secretary) for the year involved as compared to the baseline levels.

Required Percentage Reduction in Underage Use of Tobacco Products. For purposes of this section, the required percentage reduction from the baseline level in the percentage underage use of tobacco products by young individuals with respect to each tobacco product shall be as follows:

- ▶ the percentage reduction in the percentage use shall be at least ___ percent for each of the calendar years 2001 and 2002;
- ▶ the percentage reduction in the percentage use shall be at least ___ percent for each of the calendar years 2003 and 2004;
- ▶ the percentage reduction in the percentage use shall be at least ___ percent for each of the calendar years 2005 through 2007; and
- ▶ the percentage reduction in the percentage use shall be at least ___ percent for calendar year 2008 and each subsequent calendar year.

Actual Percentage Reduction in Underage Use of Tobacco Products. For purposes of this section, "actual percentage reduction in underage use" means, for a type of tobacco product for a year, the percentage reduction, as determined by the Secretary through the annual performance survey, in the use of such tobacco product by young individuals measured from the baseline level for such tobacco product.

Application to Manufacturers. With respect to the average percentage prevalence of the use of each manufacturer's brands of tobacco product by young individuals (as determined on the basis of the annual performance survey conducted by the Secretary) for a year —

- ▶ Each manufacturer which manufactured a brand or brands of tobacco product on or before the date of the enactment of this Act shall reduce the percentage of young individuals who use such manufacturer's brand or brands as their usual brand in accordance with the percentage reductions described under (above).
- ▶ Each manufacturer of a tobacco product which begins to manufacture a tobacco product after the date of the enactment of this Act shall ensure that the percentage prevalence of young individuals who use the manufacturer's tobacco products as their usual brand is equal to or less than the de minimis level (for a firm).

Target Reduction Level for A Manufacturer. For purposes of this section, the target reduction level for each type of tobacco product for a year for a manufacturer is the product of the manufacturer's baseline level for such tobacco product and an amount that is equal to 100 minus

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the required percentage reduction for such tobacco product for such year.

NONCOMPLIANCE.

Industry-Wide Penalty. If, with respect to a year, the Secretary determines that the required percentage reduction in use of a type of tobacco product has not been achieved as required under section ___, the Secretary shall impose an industry-wide penalty on the manufacturers of such product which shall be applied to each unit of the tobacco product involved that is manufactured and distributed for consumer use in the year following the year in which the noncompliance occurs.

- ▶ **Penalty for noncompliance.** The amount of the industry-wide penalty for such type of tobacco product for a year shall be equal to [] for each percentage point by which the required percentage reduction in underage use for a type of tobacco product for a year exceeds the actual percentage reduction in underage use for such product for such year.
- ▶ **Increased penalty for at least [three consecutive years] of noncompliance.** If the Secretary determines that the required percentage reduction in use of a type of tobacco product has not been achieved as required under section ___ for at least three consecutive years but less than five consecutive years, the amount of the industry-wide penalty described (above) shall be [] instead of [].
- ▶ **Increased penalty for [five or more consecutive years] of noncompliance.** If the Secretary determines that the required percentage reduction in use of a type of tobacco product has not been achieved as required under section ___ for five or more consecutive years, the amount of the industry-wide penalty described (above) shall be [] instead of [].

De Minimis Rule. The Secretary shall not impose an industry-wide penalty with respect to a type of tobacco product for a year if the Secretary determines that the average percentage prevalence of young individuals using such tobacco product is less than [] percentage points.

Manufacturer-Specific Penalty. With respect to each manufacturer for a year, if the Secretary determines that the required percentage reduction in use of a type of tobacco product has not been achieved by such manufacturer, the Secretary shall impose a penalty on such manufacturer which shall be paid by such manufacturer within ___ days of assessment.

- ▶ **Penalty for noncompliance.** The amount of the manufacturer-specific penalty for a type of tobacco product for a year shall be equal to [] for each young individual for which such firm is in noncompliance with respect to its target reduction level.

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- ▶ The number of young individuals for which a manufacturer is in noncompliance for a year shall be determined by the Secretary from the annual performance survey and shall be calculated based on the estimated total number of young individuals in such year and the actual percentage prevalence of young individuals identifying a brand of such tobacco product of such manufacturer as the usual brand smoked or used in such year as compared to such manufacturer's target reduction level for the year.

De Minimis Rule. The Secretary shall not impose a penalty on a manufacturer for a type of tobacco product for a year if the Secretary determines that actual percentage prevalence of young individuals identifying a brand of such tobacco product of such manufacturer as the usual brand smoked or used for such year is less than __ percentage points.

Prohibition on Single-Pack Sales in Cases of Repeated Noncompliance. The Secretary shall establish regulations to prohibit the sale of single packs of a manufacturer's tobacco products in cases of repeated noncompliance with the reductions required under []. Such regulations shall require that, if a manufacturer fails to comply with such reductions in 4 or more consecutive years, the manufacturer's tobacco products may be sold in the following year only in packages containing not less than 10 units of the product per package (200 cigarettes per package in the case of cigarettes, and a corresponding package size for other tobacco products).

Required Generic Packaging in Severe Cases of Repeated Noncompliance. The Secretary shall establish regulations to require units and packages of a manufacturer's tobacco products to have generic packaging in severe cases of repeated noncompliance with the reductions required under []. Such regulations shall require that, if a manufacturer fails to comply with such reductions in 6 or more consecutive years, the manufacturer's tobacco products may be sold in the following year only in units and packages whose packaging contains no external images, logos, or text (other than any required labels), except that the brand name and the identifier 'tobacco' may appear on the packaging in block lettering in black type on a white background.

Procedures. In assessing penalties under this section, the Secretary may apply such statistical methods, including sampling, as may be appropriate to increase the accuracy of the estimates from the annual performance survey.

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Tobac - ser - lookback
penalties

Draft Specifications: Version 2

3/20/98

PURPOSE.

The purpose of this title is to achieve reductions in the proportion of underage consumers of tobacco products through the imposition of financial deterrents relating to the use of tobacco products if certain underage tobacco-use reduction targets are not met.

CHILD TOBACCO USE SURVEYS.

Annual Performance Survey. Not later than 1 year after the date of the enactment of this Act and annually thereafter the Secretary shall conduct a survey to determine

- ▶ The percentage of all young individuals who used a type of tobacco product within the past 30 days; and
- ▶ the percentage young individuals who identify each brand of each type of tobacco product as the usual brand smoked or used within the past 30 days.

Young Individuals. For the purposes of this title, the term "young individuals" means individuals who are over 12 years of age and under 18 years of age.

Baseline Level. For the purposes of this title, the term "baseline level" is, with respect to each type of tobacco product, the percentage of young individuals determined to have used such tobacco product in the first annual performance survey for 1999.

Manufacturers Baseline Level. For the purposes of this title, the term "manufacturers baseline level" is, with respect to each type of tobacco product, the percentage of young individuals determined to have identified a brand of such tobacco product of such manufacturer as the usual brand smoked or used in the first annual performance survey for 1999.

Tobacco product. For the purposes of this title, the following are considered separate types of tobacco products: cigarettes, cigars, little cigars, smokeless tobacco, and roll-your-own tobacco.

Participation in survey. Notwithstanding any other provision of law, the Secretary may conduct a survey relating to tobacco use involving minors if the results of such survey with respect to such minors are kept confidential and are not disclosed.

REDUCTION IN UNDERAGE TOBACCO PRODUCT USAGE.

Annual Determination. The Secretary shall annually determine, based on the annual performance survey, whether the required percentage reductions in underage use of tobacco products for a year

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Draft Specifications: Version 2

3/20/98

have been achieved for the year involved. Such determination shall be based on the average annual percentage prevalence of the use of tobacco products by young individuals (as determined by the surveys conducted by the Secretary) for the year involved as compared to the baseline levels.

Required Percentage Reduction in Underage Use of Tobacco Products. For purposes of this section, the required percentage reduction from the baseline level in the percentage underage use of tobacco products by young individuals with respect to each tobacco product shall be as follows:

- ▶ the percentage reduction in the percentage use shall be at least 15 percent for calendar year 2000;
- ▶ the percentage reduction in the percentage use shall be at least 20 percent for calendar year 2001;
- ▶ the percentage reduction in the percentage use shall be at least 25 percent for calendar year 2002;
- ▶ the percentage reduction in the percentage use shall be at least 30 percent for calendar year 2003;
- ▶ the percentage reduction in the percentage use shall be at least 40 percent for calendar year 2004;
- ▶ the percentage reduction in the percentage use shall be at least 50 percent for calendar year 2005;
- ▶ the percentage reduction in the percentage use shall be at least 55 percent for calendar year 2006;
- ▶ the percentage reduction in the percentage use shall be at least 60 percent for calendar year 2007;
- ▶ the percentage reduction in the percentage use shall be at least 65 percent for calendar years 2008 and beyond.

Actual Percentage Reduction in Underage Use of Tobacco Products. For purposes of this section, "actual percentage reduction in underage use" means, for a type of tobacco product for a year, the percentage reduction, as determined by the Secretary through the annual performance survey, in the use of such tobacco product by young individuals measured from the baseline level for such tobacco product.

Application to Manufacturers. With respect to the average percentage prevalence of the use of each manufacturer's brands of tobacco product by young individuals (as determined on the basis of the annual performance survey conducted by the Secretary) for a year —

- ▶ Each manufacturer which manufactured a brand or brands of tobacco product on or before the date of the enactment of this Act shall reduce the percentage of young individuals who use such manufacturer's brand or brands as their usual

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brand in accordance with the percentage reductions described under (above).

- ▶ Each manufacturer of a tobacco product which begins to manufacture a tobacco product after the date of the enactment of this Act shall ensure that the percentage prevalence of young individuals who use the manufacturer's tobacco products as their usual brand is equal to or less than the de minimis level.

Target Reduction Level for A Manufacturer. For purposes of this section, the target reduction level for each type of tobacco product for a year for a manufacturer is the product of the manufacturer's baseline level for such tobacco product and an amount that is equal to 100 minus the required percentage reduction in underage use for such tobacco product for such year.

NONCOMPLIANCE.

The Secretary shall assess a penalty on manufacturers in the case that required percentage reductions in underage use are not achieved, as specified in this section. The amounts of any manufacturer-specific and industry-wide penalty, as provided for in this ____, shall be additive with respect to any such manufacturer to which the penalties apply.

Manufacturer-specific Penalty. With respect to each manufacturer for a year, if the Secretary determines that the required percentage reduction in underage use of a type of tobacco product of such manufacturer has not been achieved as required under section ____, the Secretary shall impose a penalty on the tobacco products of such type of such manufacturer which shall be applied to each unit of the tobacco product involved that is manufactured and distributed for consumer use by such manufacturer in the year following the year in which the noncompliance occurs.

- ▶ **Penalty for noncompliance.** The amount of the penalty for such type of tobacco product for such a manufacturer for a year shall be equal to the amount specified in (below) with respect to each percentage point by which the required percentage reduction in underage use for a type of tobacco product of such manufacturer for a year exceeds the actual percentage reduction in underage use for such tobacco product of such manufacturer for such year.
- ▶ **Specified Amount.** The amount specified in (above) ____ for a type of tobacco product of a manufacturer for a year is :

For the first 10 percentage points by which the required percentage reduction in underage use exceeds the actual percentage reduction in underage use in such year, \$.01 for each such percentage point.

For each percentage point equal to or in excess of 11 and less than 21 by

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which the required percentage reduction in underage use exceeds the actual percentage reduction in underage use in such year, \$.02 for each such percentage point.

Subject to (following), For each percentage point equal to or in excess of 21 by which the required percentage reduction in underage use exceeds the actual percentage reduction in underage use in such year, \$.03 for each such percentage point.

If the Secretary determines that a manufacturer fails to meet the required percentage reduction in underage use of a type of tobacco product by at least 30 percentage points for a period of at least three consecutive years, the amount specified for each percentage point in excess of 30 by which the required percentage reduction in underage use exceeds the actual percentage reduction in underage use in such year is \$.06 for each such percentage point.

Industry-Wide Penalty. If, with respect to a year, the Secretary determines that the required percentage reduction in underage use of a type of tobacco product has not been achieved as required under section ____, the Secretary shall impose an industry-wide penalty on the manufacturers of such product which shall be applied to each unit of the tobacco product involved that is manufactured and distributed for consumer use in the year following the year in which the noncompliance occurs.

- ▶ **Penalty for noncompliance.** The amount of the penalty for such type of tobacco product for a year shall be equal to the amount specified in ____ (below) with respect to each percentage point by which the required percentage reduction in underage use for a type of tobacco product for a year exceeds the actual percentage reduction in underage use for such tobacco product for such year.
- ▶ **Specified Amount.** The amount specified in (above) ____ for a type of tobacco product for a year is :

For the first 10 percentage points by which the required percentage reduction in underage use exceeds the actual percentage reduction in underage use in such year , \$.01 for each such percentage point.

For each percentage point equal to or in excess of 11 and less than 21 by which the required percentage reduction in underage use exceeds the actual percentage reduction in underage use in such year, \$.02 for each such percentage point.

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For each percentage point equal to or in excess of 21 by which the required percentage reduction in underage use exceeds the actual percentage reduction in underage use in such year, \$.03 for each such percentage point.

- ▶ Increased penalty for at least three consecutive years of noncompliance. If the Secretary determines that the required percentage reduction in underage use of a type of tobacco product has not been achieved as required under section ___ for at least three consecutive years, the amounts described (above) shall be increased by a factor of 2.

Prohibition on Single-Pack Sales in Cases of Repeated Noncompliance. The Secretary shall establish regulations to prohibit the sale of single packs of a manufacturer's tobacco products in cases of repeated noncompliance with the reductions required under []. Such regulations shall require that, if a manufacturer fails to comply with such reductions in 4 or more consecutive years, the manufacturer's tobacco products may be sold in the following year only in packages containing not less than 10 units of the product per package (200 cigarettes per package in the case of cigarettes, and a corresponding package size for other tobacco products).

Required Generic Packaging in Severe Cases of Repeated Noncompliance. The Secretary shall establish regulations to require units and packages of a manufacturer's tobacco products to have generic packaging in severe cases of repeated noncompliance with the reductions required under []. Such regulations shall require that, if a manufacturer fails to comply with such reductions in 6 or more consecutive years, the manufacturer's tobacco products may be sold in the following year only in units and packages whose packaging contains no external images, logos, or text (other than any required labels), except that the brand name and the identifier 'tobacco' may appear on the packaging in block lettering in black type on a white background.

Procedures. In assessing penalties under this section, the Secretary may apply such statistical methods, including sampling, as may be appropriate to increase the accuracy of the estimates from the annual performance survey. In determining the industry-wide and manufacturer-specific penalties, the Secretary shall decide what confidence interval to use from the survey information made available from the annual performance survey.

Options On Youth Lookback

Current Administration Position

Targets: Rampdown to a 60-67% reduction

Industry Penalty: 3 cents price increase (2 cent fine if non-deductible) for each 1 percentage point shortfall of the youth targets. Ramp-up over time, to account for the fact that remaining smokers at sharper smoking reductions are less price sensitive. We had suggested 6 cents after 2 years, and 9 cents after 5 (or similar).

- We had suggested making these ramp up for years of consecutive misses on targets. In fact, the economic logic here would dictate increasing these regardless of whether industry makes its targets or not - the point is that the penalty should be higher on the margin in the future since targets are steeper.

Company Penalty: \$1500 per child for every teen by which the company misses its company-specific target.

Effect of 10% shortfall:

- Industry penalty would be 30 cents - 90 cents, depending on year
- Penalty on companies would vary by their market share. For Phillip Morris, penalty on order of 8-10 cents pack; half as large for RJR.

Alternative 1: Waxman-like large company penalties, no industry penalty

Targets: Could maintain, or go steeper (Kennedy is at 80%; Waxman wants 90%)

Industry Penalty: None

Company Penalty: Non-linear structure (non-deductible, so that price increase is roughly 50% bigger):

- 1 cents for each pp for 0-5 pp
- 2 cents for 5-10 pp
- 3 cents for 10-15 pp
- 4 cents for 15-20 pp
- 5 cents above 20 pp

Ramps up over time :

- Multiply by 2 for missing for two consecutive years
- Multiply by 3 for missing for five consecutive years

Effect of 10% shortfall

- 15 cents per pack in penalties - 23 cents increase in price - in first year
- Increasing to 30 cents penalties - 45 cents in price - in third year
- Increasing to 45 cents penalties - 68 cents in price - in sixth year

Pros:

- This would put us squarely in the Waxman camp and would please our Democratic constituency. They may prefer steeper targets or more ramping up over time, but should be very pleased with this as a new position
- This ensures that company-specific penalties are large enough that the effects of deviations from specific companies cannot easily be passed on to price.
- Cents/pack has political advantage relative to dollars/kid: can get large hits on the companies without large sounding penalties.

Cons:

- Cents per pack has three disadvantages relative to dollars per kid:
 - If all reductions are same, this is just an industry penalty. In the absence of an industry penalty, however, this is not necessarily a deadly disadvantage. Can think of this approach of combination of industry penalty imposed on amount of common shortfall by all firms, with firm-specific penalty on company-specific deviations from industry average.
 - Relatively easy on firms with disproportionately large youth share (Phillip Morris)
 - Makes the penalty for addicting youths dependent on the vagaries of adult smoking.
- Politically implausible, from the perspective of the endgame, to have penalties which are so large on companies with relatively small deviations from targets. This says that a company which has reduced its youth smoking more than in half (or even by up to 70-80% under Waxman) still can ultimately face a penalty of a 68 cent higher price than a competitor. And this is under a structure which is conservative relative to Waxman.
 - The flip side of the political attractiveness of small numbers argument is the huge effects of small numbers argument - it is really hard to construct a cents/pack penalty which multiplies over time and doesn't get enormously large.
- Substantial inequities and bizarre incentives from penalties on companies which multiply over time. Consider two companies that miss by 10%, one that has missed for 5 straight

l years and one that made it last year and bounced out because the price of its product dropped way down so kids shifted over (or some other random factor). These two companies would have a 45 cent difference in their tax/pack. And this is conservative - under Kennedy's proposal, they would have a \$1 difference in their tax/pack. Once again, this is inescapable with a company penalty that escalates over time.

- Moreover, there is little rationale for having the company penalty escalate over time. This is already such a huge multiple of foregone profits that companies have every incentive on the margin to reduce youth smoking.

Alternative 2: Compromise position (leaning towards us)

Targets: 60-67% reduction targets

Industry Penalty: As in original position

Company Penalty:

- 1 cent for each pp for 0-5 pp
- 2 cents for 5-10 pp
- 4 cents for 10-15 pp
- 7 cents for 15-20 pp
- 10 cents above 20 pp

Possible third tier: Market share surcharge after year 10, so that all companies have incentive to get to same absolute level of youth smoking. This could be 2 cents for each 5 percent of the youth market (24 cent surcharge on Phillip Morris if keep 60% of youth market).

Effect of 10% shortfall

- First year - 30 cents on industry, 15 cents in penalties (22.5 cents in price) on companies
- Third year - 60 cents on industry, 15 cents in penalties (22.5 cents in price) on companies
- Sixth year - 90 cents on industry, 15 cents in penalties (22.5 cents in price) on companies

Pros:

- Company-specific penalties are not arbitrarily large for very small misses from target, but get very large for large misses from target.
- Does not contain arbitrary ramping up over time on company penalties that leads to inequities across companies.
- Industry penalties in place that increase over time, in order to provide price insurance.

Cons:

- Unless you include market share adjustment, still have problems with Alternative 1
- Unlikely to please Waxman, who wants larger company-specific than industry-specific.

Options sheet 2

Tobac - set - look back penal Kes

Options On Youth Lookback***Administration recommendation to Chafee-Harkin*****Targets:** Rampdown to a 60-67% reduction**Industry Penalty:** 2 cents (3 cent price increase since non-deductible) for each 1 percentage point shortfall of the youth targets. Ramp-up over time, to account for the fact that remaining smokers at sharper smoking reductions are less price sensitive. We had suggested 4 cents after 2 years, and 6 cents after 5 (or similar).**Company Penalty:** \$1500-\$3000 per child for every teen by which the company misses its company-specific target.**Effect of 10% shortfall in price terms:**

- 30 cents on industry in first year - increasing to 60 cents in third year and 90 cents in sixth year
- Penalty on companies would vary by their market share, and over time as youth smoking responds to price increases from industry penalty. For Phillip Morris, penalty on the order of 15 cents/pack for \$1500, and 30 cents/pack for \$3000; half as large for RJR.

Alternative 1: Waxman-like large company penalties, no industry penalty**Targets:** Could maintain, or go steeper (Kennedy is at 80%; Waxman wants 90%)**Industry Penalty:** None**Company Penalty:** Non-linear structure (non-deductible, so that price increase is roughly 50% bigger):

- 2 cents for each percentage point for 0-10 percentage points
- 3 cents for each pp for 10-20 pp
- 4 cents for each pp for 20-30 pp
- 5 cents for each pp for 30+ pp

Ramps up over time :

- Multiply by 2 for missing for two consecutive years
- Multiply by 3 for missing for five consecutive years

Effect of 10% shortfall in price terms:

- 30 cents in first year
- 60 cents in third year

- 90 cents in sixth year

Pros:

- This would put us squarely in the Waxman camp and would please our Democratic constituency. They may prefer steeper targets or more ramping up over time, but should be very pleased with this as a new position
- This ensures that company-specific penalties are large enough that the effects of deviations from specific companies cannot easily be passed on to price.
- Cents/pack has political advantage relative to dollars/kid: can get large hits on the companies without large sounding penalties.

Cons:

- Cents per pack has three disadvantages relative to dollars per kid:
 - If all reductions are same, this is just an industry penalty. In the absence of an industry penalty, however, this is not necessarily a deadly disadvantage. Can think of this approach of combination of industry penalty imposed on amount of common shortfall by all firms, with firm-specific penalty on company-specific deviations from industry average.
 - Relatively easy on firms with disproportionately large youth share (Phillip Morris)
 - Makes the penalty for addicting youths dependent on the vagaries of adult smoking (this is basically a tax on adult smoking to penalize for youth smoking).
- Politically difficult, from the perspective of the endgame, to have penalties which are so large on companies with relatively small deviations from targets. This says that a company which has reduced its youth smoking more than in half (or even by up to 70-80% under Waxman) still can ultimately face a penalty of a 90 cent higher price than a competitor. And this is under a structure which is somewhat conservative relative to what (for example) Kennedy introduced.
 - The flip side of the "political attractiveness of small numbers" argument is the "huge effects of small numbers" argument - it is really hard to construct a cents/pack penalty which multiplies over time and doesn't get enormously large.
- Penalties on companies which multiply over time lead to substantial inequities and bizarre incentives. Consider two companies that miss by 10%, one that has missed for 5 straight years and one that made it last year and bounced out because the price of its product dropped way down so kids shifted over (or some other random factor). These two companies would have a 60 cent difference in their tax/pack. And this is

conservative - under Kennedy's proposal, they would have a \$1 difference in their tax/pack. Once again, this is inescapable with a company penalty that escalates over time.

Moreover, there is little rationale for having the company penalty escalate over time. This is already such a huge multiple of foregone profits that companies have every incentive on the margin to reduce youth smoking.

Alternative 2: Our industry penalty; their company penalty, fixed over time

Targets: 60-67% reduction targets

Industry Penalty: 2 cents (3 cent price increase since non-deductible) for each 1 percentage point shortfall of the youth targets. Ramp-up over time, to account for the fact that remaining smokers at sharper smoking reductions are less price sensitive. We had suggested 4 cents after 2 years, and 6 cents after 5 (or similar).

Company Penalty: Non-linear structure (non-deductible, so that price increase is roughly 50% bigger):

- 2 cents for each percentage point for 0-10 percentage points
- 3 cents for each pp for 10-20 pp
- 4 cents for each pp for 20-30 pp
- 5 cents for each pp for 30+ pp

Effect of 10% shortfall in price terms:

- First year - 30 cents on industry, 30 cents on companies
- Third year - 60 cents on industry, 30 cents on companies
- Sixth year - 90 cents on industry, 30 cents on companies

Pros:

- Company-specific penalties are not arbitrarily large for very small misses from target, but get very large for large misses from target (e.g. \$1.45 in price for 30% miss; \$2.10 in price for 40% miss)
- Does not contain arbitrary ramping up over time on company penalties that leads to inequities across companies.
- Industry penalties in place that increase over time, in order to provide price insurance.

Cons:

- Still have structural problems of moving away from \$/kid (NOTE: could address some of

these with \$million/percentage point, rather than cents/pack - but then introduce Waxman problem with large numbers).

- Unlikely to please Waxman, who wants larger company-specific than industry-specific, and wants company penalties to ramp up over time.
- May be seen as too complicated
- Penalties may still be too extreme for large deviations from target - is more than \$1/pack plausible?

Alternative 3: Parallel smaller industry and company penalties

Industry Penalty:

- 1 cent per pack for each percentage point missed, for 0-10 percentage points miss from target
- 2 cents/pack per percentage point for 11-20 percentage points miss
- 3 cents/pack per percentage point for more than 20 percentage points miss

Company Penalty

- 1 cent per pack for each percentage point missed, for 0-10 percentage points miss from target
- 2 cents/pack per percentage point for 11-20 percentage points miss
- 3 cents/pack per percentage point for more than 20 percentage points miss
- 6 cents/pack per percentage point for more than 30 percentage points miss, for firms that miss by at least 30% for three straight years.

Effect of 10% shortfall in price terms:

- 15 cents for industry
- 15 cents for companies

Pros:

- Company-specific penalties are small for small deviations, but once again get large for large deviations (e.g. 90 cents in price, for a 30% miss).
- While large, penalties never get huge - stay under \$1 unless egregious miss of target.
- Does not contain arbitrary ramping up over time on company penalties that leads to inequities across companies.

- Easy to explain.
- While penalties are smaller than Waxman would like, we are at least imposing company penalties of an equal magnitude to industry penalties.

Cons:

- Still have structural problems of moving away from \$/kid
- Still much smaller than Waxman would like, and doesn't have ramping up over time that he wants.

Final - for H/C

Tobacco - set - look back penalties

Draft Specifications 2/28/98

Note: This follows the language of Conrad bill with some clarifications and some differences in policy.

PURPOSE.

The purpose of this title is to achieve reductions in the proportion of *underage consumers* of tobacco products through the imposition of financial deterrents relating to the use of tobacco products if certain underage tobacco-use reduction targets are not met.

CHILD TOBACCO USE SURVEYS.

Annual Performance Survey. Not later than 1 year after the date of the enactment of this Act and annually thereafter the Secretary shall conduct a survey to determine

- ▶ The percentage of all young individuals who used a type of tobacco product within the past 30 days; and
- ▶ the percentage young individuals who identify each brand of each type of tobacco product as the usual brand smoked or used within the past 30 days.

Young Individuals. For the purposes of this title, the term "young individuals" means individuals who are over 12 years of age and under 18 years of age.

Baseline Level. For the purposes of this title, the term "baseline level" is, with respect to each type of tobacco product, the percentage of young individuals determined to have used such tobacco product in the first annual performance survey for 1999.

Manufacturers Baseline Level. For the purposes of this title, the term "manufacturers baseline level" is, with respect to each type of tobacco product, the percentage of young individuals determined to have identified a brand of such tobacco product of such manufacturer as the usual brand smoked or used in the first annual performance survey for 1999.

Tobacco product. For the purposes of this title, the following are considered separate types of tobacco products: cigarettes, cigars, little cigars, smokeless tobacco, and roll-your-own tobacco.

Participation in survey. Notwithstanding any other provision of law, the Secretary may conduct a survey relating to tobacco use involving minors if the results of such survey with respect to such minors are kept confidential and are not disclosed.

REDUCTION IN UNDERAGE TOBACCO PRODUCT USAGE.

Annual Determination. The Secretary shall annually determine, based on the annual performance survey, whether the required percentage reductions in underage use of tobacco products for a year has been achieved for the year involved. Such determination shall be based on the average

annual percentage prevalence of the use of tobacco products by young individuals (as determined by the surveys conducted by the Secretary) for the year involved as compared to the baseline levels.

Required Percentage Reduction in Underage Use of Tobacco Products. For purposes of this section, the required percentage reduction from the baseline level in the percentage underage use of tobacco products by young individuals with respect to each tobacco product shall be as follows:

- ▶ the percentage reduction in the percentage use shall be at least ___ percent for each of the calendar years 2001 and 2002;
- ▶ the percentage reduction in the percentage use shall be at least ___ percent for each of the calendar years 2003 and 2004;
- ▶ the percentage reduction in the percentage use shall be at least ___ percent for each of the calendar years 2005 through 2007; and
- ▶ the percentage reduction in the percentage use shall be at least ___ percent for calendar year 2008 and each subsequent calendar year.

Actual Percentage Reduction in Underage Use of Tobacco Products. For purposes of this section, "actual percentage reduction in underage use" means, for a type of tobacco product for a year, the percentage reduction, as determined by the Secretary through the annual performance survey, in the use of such tobacco product by young individuals measured from the baseline level for such tobacco product.

Application to Manufacturers. With respect to the average percentage prevalence of the use of each manufacturer's brands of tobacco product by young individuals (as determined on the basis of the annual performance survey conducted Secretary) for a year --

- ▶ Each manufacturer which manufactured a brand or brands of tobacco product on or before the date of the enactment of this Act shall reduce the percentage of young individuals who use such manufacturer's brand or brands as their usual brand in accordance with the percentage reductions described under (above).
- ▶ Each manufacturer of a tobacco product which begins to manufacture a tobacco product after the date of the enactment of this Act shall ensure that the percentage prevalence of young individuals who use the manufacturer's tobacco products as their usual brand is equal to or less than the de minimis level (for a firm).

Target Reduction Level for A Manufacturer. For purposes of this section, the target reduction level for each type of tobacco product for a year for a manufacturer is the product of the manufacturer's baseline level for such tobacco product and an amount that is equal to 100 minus the required percentage reduction for such tobacco product for such year.

NONCOMPLIANCE.

Industry-Wide Penalty. If, with respect to a year, the Secretary determines that the required percentage reduction in use of a type of tobacco product has not been achieved as required under section ____, the Secretary shall impose an industry-wide penalty on the manufacturers of such product which shall be applied to each unit of the tobacco product involved that is manufactured and distributed for consumer use in the year following the year in which the noncompliance occurs.

- ▶ **Penalty for noncompliance.** The amount of the industry-wide penalty for such type of tobacco product for a year shall be equal to [] for each percentage point by which the required percentage reduction in underage use for a type of tobacco product for a year exceeds the actual percentage reduction in underage use for such product for such year.
- ▶ **Increased penalty for at least three consecutive years of noncompliance.** If the Secretary determines that the required percentage reduction in use of a type of tobacco product has not been achieved as required under section ____ for at least three consecutive years but less than five consecutive , the amount of the industry-wide penalty described (above) shall be [] instead of [].
- ▶ **Increased penalty for more than five consecutive years of noncompliance.** If the Secretary determines that the required percentage reduction in use of a type of tobacco product has not been achieved as required under section ____ for five or more consecutive years, the amount of the industry-wide penalty described (above) shall be [] instead of [].

De Minimis Rule. The Secretary shall not impose an industry-wide penalty with respect to a type of tobacco product for a year if the Secretary determines that the average percentage prevalence of young individuals using such tobacco product is less than [] percentage points.

Manufacturer-Specific Penalty. With respect to each manufacturer for a year, if the Secretary determines that the required percentage reduction in use of a type of tobacco product has not been achieved by such manufacturer, the Secretary shall impose a penalty on such manufacturer which shall be paid by such manufacturer within ____ days of assessment.

- ▶ **Penalty for noncompliance.** The amount of the manufacturer-specific penalty for a type of tobacco product for a year shall be equal to [] for each young individual for which such firm is in noncompliance with respect to its target reduction level.
- ▶ **The number of young individuals for which a manufacturer is in noncompliance for a year shall be determined by the Secretary from the annual performance survey and shall be calculated based on the the estimated total number of young individuals in such year and the actual percentage prevalence of young individuals identifying a brand of such tobacco product of such manufacturer as the usual brand smoked or used in such year as compared to such manufacturer's target reduction level for the year.**

De Minimis Rule. The Secretary shall not impose a penalty on a manufacturer for a type of tobacco product for a year if the Secretary determines that actual percentage prevalence of young individuals identifying a brand of such tobacco product of such manufacturer as the usual brand smoked or used for such year is less than ___ percentage points.

Prohibition on Single-Pack Sales in Cases of Repeated Noncompliance. The Secretary shall establish regulations to prohibit the sale of single packs of a manufacturer's tobacco products in cases of repeated noncompliance with the reductions required under []. Such regulations shall require that, if a manufacturer fails to comply with such reductions in 4 or more consecutive years, the manufacturer's tobacco products may be sold in the following year only in packages containing not less than 10 units of the product per package (200 cigarettes per package in the case of cigarettes, and a corresponding package size for other tobacco products).

Required Generic Packaging in Severe Cases of Repeated Noncompliance. The Secretary shall establish regulations to require units and packages of a manufacturer's tobacco products to have generic packaging in severe cases of repeated noncompliance with the reductions required under []. Such regulations shall require that, if a manufacturer fails to comply with such reductions in 6 or more consecutive years, the manufacturer's tobacco products may be sold in the following year only in units and packages whose packaging contains no external images, logos, or text (other than any required labels), except that the brand name and the identifier 'tobacco' may appear on the packaging in block lettering in black type on a white background.

Procedures. In assessing penalties under this section, the Secretary may apply such statistical methods as may be appropriate to increase the accuracy of the estimates from the annual performance survey.

Draft: February 28, 1998

Talking Points on Lookback Penalty System

Purpose of Lookback

The purpose of a system of lookback penalties is to provide an incentive for tobacco companies to meet the youth reduction targets. The lookback penalties act as insurance in case fixed payments or excise taxes do not sufficiently reduce youth tobacco use.

Structure of Lookback System

A lookback system works by assessing additional payments on tobacco firms if the specified youth tobacco use reduction targets are not achieved. Penalties can be assessed on the industry as a whole, on specific firms that fail to reduce youth use of their brands, or a combination of industry and firm-specific penalties can be developed. A combination of these approaches would appear to provide the best guarantees that youth tobacco use reduction targets are achieved.

- ▶ Industry penalties would provide price insurance by increasing prices of tobacco products further if the fixed payments or excise taxes do not sufficiently reduce youth tobacco use. Industry-wide penalties should be fully passed on by each of the firms to consumers as higher prices, as has traditionally been the case with common charges to the entire industry.
- ▶ Firm-specific penalties would provide non-price insurance by inducing individual companies to reduce youth use of their brands. It would be difficult for a firm to pass on firm-specific penalties to consumers as higher prices because a large price increase on its brands relative to the brands of its competitors would make the firm less competitive. As a result, firm-specific penalties have a more direct effect on a firm's bottom line.

There are clear arguments for pursuing both types of insurance, price and non-price, through a mix of industry and company-specific penalties. While firm-specific penalties are better targeted to firms and brands that continue to be used by youth tobacco users, they will not necessarily result in the types of price increases that have shown to be effective in reducing youth smoking. Firm-specific penalties also present greater (but certainly manageable) difficulties in measuring compliance and may be difficult to apply if the composition of the tobacco industry changes significantly. At the same time, industry-wide penalties that can be passed through to price do not provide sufficient incentives for each individual tobacco firm to reduce youth use of its own brands. Without holding specific firms accountable for youth use of their products, achieving a real change in the behavior and culture of the industry will be very difficult. If specific firms are held accountable, it will cause them to take other actions to reduce youth use of their products.

Industry Penalties

- Industry-wide penalties would be best expressed as cents per unit of tobacco product per percentage point by which the target is missed.
- The amount of the penalty per product unit should be determined by the required price increase per percentage point of youth users to meet a given youth reduction target. A surcharge of about 3 cents per pack of cigarettes appears to be needed to reduce youth tobacco use by one percentage point, relative to baseline use.
- The penalty per unit could increase with each additional year in which the industry fails to meet reduction targets to account for declining price sensitivity as the number of youth tobacco users falls. The reduction in price sensitivity suggests that the appropriate penalties for very steep youth reduction targets should be 2-3 times as large as those for mild targets.
- There is no reason to make these penalties non-tax-deductible, since the direct goal is to have the penalties passed on to users in the form of higher prices. If penalties are not deductible, the cents per pack could be decreased by about 33% to achieve the same price impact.
- In the absence of a firm-specific penalty, it may be appropriate to increase the surcharge per unit as the industry misses the target by a larger amount in order to compound the penalty's punitive effect on the industry.
- It is not appropriate for either the industry or firm-specific penalties to include a "double-counting adjustment" of the type proposed by the June 20 settlement. This adjustment would be very difficult to carry out in practice and would reduce industry and firm incentives to meet the reduction targets. All of the figures noted for either the industry or firm-specific penalty assume no such adjustment.

Firm-specific Penalties

- Because industry penalties likely will be passed on fully to prices, individual companies may not have incentives to combat teen use of their specific products. Firm-specific penalties would provide incentives to companies to use their own resources to reduce underage use of their products.
- Firm-specific penalties should be based on a dollar amount per youth tobacco user in excess of the reduction targets. A penalty in the of \$2,000 appears to be appropriate. In developing a penalty amount, we should consider the expected lifetime profits that a firm would derive from hooking a youth smoker on its brand of tobacco product and assess a penalty per youth smoker that is well in excess of

anticipated profits to ensure that firms have strong incentives to discourage youth use.

- To maximize the effectiveness of the firm-specific penalty, this penalty could increase as the industry misses its target by a larger amount.
- The firm-specific penalty should be non-tax-deductible because firms should bear the costs of the penalty directly as lower after-tax profits. If the penalty is deductible, the penalty per youth should be increased by roughly one-third.
- This penalty should be uncapped because capping it would limit its effectiveness.
- Repeated failure to meet youth tobacco use reduction targets could trigger additional, noneconomic, penalties on a firm. For instance, repeated failure to meet targets could result in the firm being required to sell their products only by the carton (making the brands much less attractive to price sensitive youth) or being required to use generic packaging.
- An alternative approach would be to express the penalty as a cents per unit of tobacco product surcharge, based on the number of percentage points by which the reduction target is missed (paralleling the industry penalty). But this approach has three disadvantages in the context of the firm-specific penalty:
 - ▶ The relation of the penalty to foregone profits will actually change as total cigarette demand (primarily determined by adults) changes.
 - ▶ This approach will penalize relatively less those firms that have a relatively high share of the youth market; firms with a smaller share of the youth than adult market will pay disproportionately more of the penalty.
 - ▶ If all firms achieve the same percentage point reduction in youth smoking, this penalty can be passed on to price, since it will operate effectively as an industry penalty; this will minimize its impact on actual firm behavior.
- There should be a de minimis level of youth use of a firm's brands that does not trigger a penalty. Establishing such a level would recognize that there will always be some amount of youth tobacco use that no firm can prevent. A level of 0.5-1 percent of youth may be an appropriate level.

Measuring Youth Tobacco Use

To impose a lookback penalty, it is necessary to measure current levels of youth tobacco use and changes to those levels over time. If a portion or all of the penalty scheme is applied on a firm-

specific basis, then the measurements must be made by brand (and then aggregated to the firm level). These measurements would need to be made by surveying a sufficient number of youth to get reliable measures of youth tobacco use. Current surveys of youth smokers are not sufficient for this purpose for a variety of reasons, including insufficient sample size, failure to ask for brand-specific information, and failure to release methodology to the public.

A new survey that measures youth tobacco use would provide both point-in-time estimates of the prevalence of youth tobacco users (annually beginning with a base year of 1999) and estimates of the percent reduction in youth prevalence between the base year and later years (c.g., between the baseline in 1999 and 2003). In either case, confidence intervals of less than ± 1 percent could be obtained from a sample of 25,000 youths of age 12-17 in households. Given a sample of this size, very precise point estimates could be made down to a prevalence level of 0.5 percent (the confidence interval would be approximately ± 0.15 percent). An ongoing survey of this type would permit the determination of shortfalls in the reduction of prevalence rates at any point in time and could be used to develop smoothed and statistically more robust estimates in trends over time in the deviation from specified targets.

There are several specific issues involved in designing such a survey:

All Brands v. Usual Brand

Youth tobacco users often use more than one tobacco brand or product. A survey could attempt to identify all of the brands and types that each respondent uses or could focus on the usual brand used.

- Respondents would be better able to recall usual brand than all tobacco products used so the information on usual brand should be more reliable.
- Information on all types and brands may not be very useful without attempting to identify the quantity used of each identified brand and type. Information relating to quantity used is more difficult to obtain and may be less reliable.

Use in Past Month v. Daily Use

The most common methods of analyzing youth tobacco use are to measure (1) the percentage of youth who use tobacco products on a daily basis or (2) the percentage of youth who have used tobacco products [at least a specified number of times] within the past month. Each approach has advantages and disadvantages for use in a lookback penalty system.

- Basing measurements on daily tobacco use is likely to produce the most accurate information on brand use. Daily tobacco users are more likely than less frequent users to be able to accurately identify the brand of tobacco product they use most

often.

Daily use also may be a more defensible basis for a penalty system. Daily smokers are addicted smokers for which the tobacco industry and specific firms may surely be held accountable. The broader measure of minimum number of uses within a month would also bring in some respondents who are only experimenting with tobacco products, which may provide the industry with a basis to challenge the system.

The daily use measure, however, would omit valid information about tobacco use by youths that occurs regularly (e.g., 2-3 times per week) but that is less than daily use. Data on youth tobacco use indicate that a significant percentage of youths who are occasional users will become addicted smokers, some while they are still teens and others in early adulthood. For example, survey data shows that 31% of 12-17 year olds who smoked just 2-9 times in the previous 30 days had become everyday smokers 4 years later. If these youth are not captured in the measurement, tobacco companies would have little incentive to discourage experimentation and occasional use: in fact, they might find it profitable to encourage occasional use by older teens on the assumption that these teens will not progress to daily use until after age 17.

The daily use measure also may omit other patterns of tobacco use that should be captured by a penalty system. For example, it is possible that some tobacco products, such as cigars and smokeless tobacco, are used by some youth on a routine but not daily basis. There also are instances in which youth may use several different brands or types of products on a routine basis, but none of them on a daily basis. Data indicate that youth who have establish a usual brand, even if they use other brands or products on an occasional basis, are likely to remain with that brand into the future. Failure to capture this data could omit important patterns of tobacco use from the penalty system.

Tobacco firms may have an easier time complying with targets based on daily use than on targets based on minimum number of uses within a month. Although daily smokers are presumably more addicted, any movement from daily use to periodic use will count towards meeting a target based on daily use. To meet a target based on minimum number of uses within a month, firms must essentially discourage youth from any tobacco use.

Measuring change relating to targets based on minimum number of uses within a month can be done more accurately than change relating to targets based on daily use, because the baseline prevalence rates for minimum number of uses within a month are larger than those for daily use. Measuring change from higher prevalence levels can be done more accurately.

Capturing Information on Quantity

One option in measuring youth tobacco use is to attempt to measure the quantity of product that is actually used. This approach would more comprehensively determine each firm's share of the youth market because it asks about every product consumed and the amount of each product consumed in the past month. For example, a user who only smoked cigarettes would be asked to identify all the brands smoked in the past month and of each brand the number of cigarettes smoked. Surveys have not asked these questions in this way before, so work would have to be done to test whether or not a youth user could recall for the past month all the brands of all the tobacco products they used and the quantity of each used. For youth who switched brands often this might be particularly difficult to assess. Using a measure of quantity would delay the collection of baseline data until 2001.

February 18, 1997

The Appropriate Mix of Industry and Company-Specific Youth Lookback Penalties

The goal of youth lookback penalties is to provide *insurance*, in the case where the base payments (or excise tax equivalents) and other restrictions in comprehensive legislation do not sufficiently reduce youth smoking. As such, there is a clear case for having two types of youth lookback penalties:

- Industry penalties provide *price insurance*: they can be used to increase prices further in the event that the base payments (or excise tax equivalents) and other restrictions specified in the main part of the legislation fail to reduce teen smoking sufficiently;
- Company specific ^{penalties} provide *non-price insurance*: penalties can be established to provide incentives to individual companies to reduce youth use of their particular brands through non-price mechanisms.

Industry Penalties

The appropriate role for industry penalties is to increase prices to ensure that youth smoking targets are met. As such, the structure of industry penalties should be as follows:

- The penalties should be expressed as cents per pack of cigarettes, per percentage point by which the target is missed - clearly delineating the price rise that would occur if the target is missed.
- There is no reason not to make these industry penalties deductible, since the direct goal is simply to have the penalties passed on in the form of higher prices in any case.
- An appropriate level at which to set these penalties in this case would be 3 cents per pack, per percentage point by which the target is missed. This is roughly the price increase required to reduce youth smoking by one percentage point, at today's levels of smoking
- These penalties could then be capped at \$1 per pack, to ensure that there is not an excessive rise in prices through this mechanism.

Company Penalties

Industry penalties are useful for ensuring that prices rise further to deter youth smoking if we do not meet our youth targets. But, given the large youth reduction

targets contemplated by legislation in this area, price incentives may not be enough. What is needed is incentives *for the tobacco companies themselves to reduce teenage use of their product.*

But industry-level penalties do not provide that incentive. Since these penalties are imposed on all firms at once, they can be passed on to price, so that no individual company has any particular incentive to combat teen use of their product. What is required in this case is a *company-specific penalty* that can solve this "free rider" problem and incentivize tobacco companies to use their own resources to ensure that our youth targets are met. Several principles should guide the design of company-specific penalties:

- The advantage to specific companies of targeting youth smokers is that they potentially benefit from the loyalty of that smoker throughout their life. The appropriate penalty should therefore be determined by *the foregone future profit per youth smoker*. That is, a company that is deciding whether or not to target youth smokers will ask: is the payment sufficiently large that we should forgo the profits of attracting this teen?
- Our analysis points to a *break-even payment of \$454 per youth smoker* (with "youth smoker" defined by daily use of cigarettes, as measured in the youth surveys). Defining the payment as a dollar amount per youth smoker is the appropriate means of linking the penalty to foregone profits.
- These numbers were derived from a full analysis of the implied stream of profits over time that would be expected to be received from a teen smoker over the course of their lifetime. The analysis takes into account a variety of factors, including (1) per pack profits; (2) the likely number of packs of cigarettes smoked per day over different periods of the typical smoker's life, (3) the probability that a teen smoker that is kept from smoking as a teen will ultimately smoke as an adult anyway; (4) discounting to present value of future profits and payment streams; (5) the distribution of teen smokers by age within the teen smoking surveys; (6) the effect of not using a double-counting adjustment mechanism; (7) the responses of teen decisions to smoke to price increases, etc.
- For these penalties, there is no case for tax deductibility, since the notion is that firms would bear these costs in the form of lower profits. If tax deductibility were permitted, that amount would have to be increased to \$668 per youth smoker.
- A penalty that was exactly equal to the present value of profits would leave the company indifferent about reducing youth smoking. Therefore, to create a strong incentive for companies to reduce youth smoking, the penalty

should be specified as a *multiple* of the implied present value of profits.

- A sensible approach would be to assess “treble damages” (three times foregone profits) on companies that do not meet youth targets, doubling (to six time foregone profits) for those companies that grossly miss the targets (miss by more than 20 percentage points).
- But survey precision issues would mitigate a precise count of children smoking particular brands. A sensible pattern of payments could take the form:
 - \$15 million for every 10,000 children smoking that brand, if the brand falls short of its reduction target by 0-20%
 - \$30 million for every 10,000 children smoking that brand, if the brand falls short of its reduction target by more than 20%
- There is no need to cap these penalty payments, which will remain small in aggregate; doing so would limit their effectiveness at the very point where they are most needed.

DRAFT
A Revised Youth Look-Back Surcharge

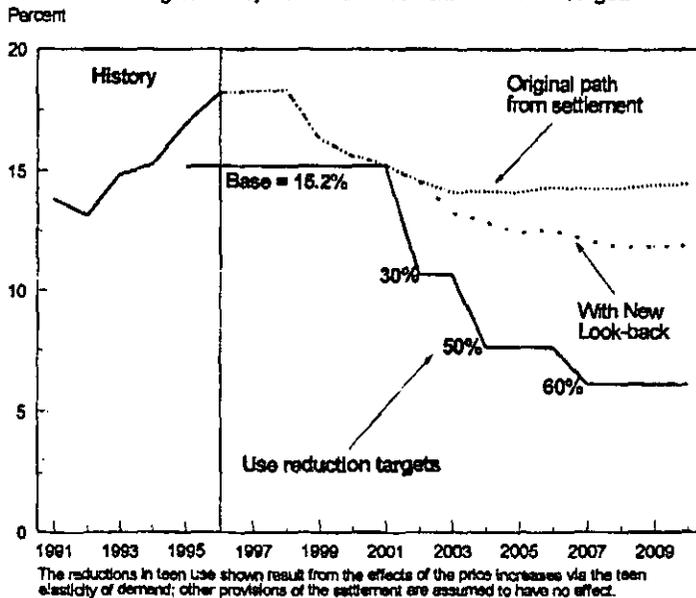
September 10, 1997

The proposed look-back surcharge of the Tobacco Settlement carries insufficient incentives to assure that tobacco firms will actively participate in reducing underage teen smoking. The following revised structure for the look-back surcharge addresses those shortcomings by establishing a two tier system with non-linear penalties related to the degree to which underage teen smoking remains in excess of the targeted reduction levels. One tier specifies *company-specific* fines determined by underage use of individual company brands. The second tier establishes penalties to be born by the industry as a whole (allocated by overall market share as would occur with the annual payments). The penalties of the second tier will be of significant magnitude and would likely boost the per pack price dramatically in the event underage use does not decline as targeted.

The new structure would maintain the broad features of the original proposed look-back surcharge, being based on the University of Michigan's High School Drug Use Survey and the phased reduction targets of 30% (year 5), 50% (year 7), and 60% (year 10). However, the survey would be expanded to determine the brands used by underage teens so company-specific information could be attained. Surcharge payments would be paid in the year following the survey year as specified in the settlement. However, there would be no abatement or double-count adjustment and payments would not qualify for tax deductibility.

The chart shows the projected paths for the underage teen smoking percentages for (1) the original settlement structure and (2) the settlement with the new look-back surcharge structure. Under the original settlement, the teen use percentage was projected to decline from the recent high levels of about 18 percent to about 14 to 15 percent. Under the new look-back structure, teen use is projected to decline to below 12 percent.

Underage Daily Cigarette Smoking Percentages and Targets
Michigan Survey Data and Settlement Look-Back Targets



The New Structure

Tier I -- Company-specific fines

The look-back structure in the settlement suffers from a potential free-rider problem in which individual firms would have the incentive to market to underage users when all other firms were

making efforts to reduce teen use. This problem results from the fact that the look-back surcharge would be paid by all firms according to their total (primarily adult) market share. To address that problem, company-specific penalties are specified as follows:

<u>% Points of Shortfall from Targeted Reduction</u>	<u>Penalty per underage user*</u>
0 to 30	\$840
>30 to 50	\$1280
> 50	\$1680

* As derived from the weighted average 13-17 year old user percentage from the Univ. of Michigan survey for teen use percentages as specified in the agreement. Per smoker present value of $\$1540 \times 2 \times .2727 = \840 , $\$1540 \times 3 \times .2727 = \1280 , and $\$1540 \times 4 \times .2727 = \1680 .

These escalating levels of fines represent increasing multiples of the present value of the profits a firm would expect to receive over the life of a teen smoker adjusted for the elimination of the double-counting provision (see note above).

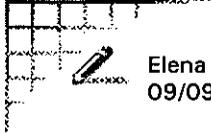
The High School Use survey would be expanded to ask questions to determine the primary brand of use for underage smokers. Base brand-use percentages would be established and the percentage reduction targets would be measured relative to those base brand-use percentages. The excess number of underage users of a specific brand would then be specified as the percentage point reduction shortfall times the number of underage users.

Tier II -- Industry Penalty Payments

To assure that the industry as a whole will not continue to profit in the event underage use continues unabated, a severe and escalating penalty structure is established. In the event that underage use did not decline, the penalties would lead to large cost and price increases that would deter underage as well as overall smoking.

<u>% Points of Shortfall from Targeted Reduction</u>	<u>Penalty per percentage point</u>
0 to 30	\$200 million
>30 to 50	\$400 million
> 50	\$600 million

The likely effects of these penalties would be to raise cigarette prices by about \$0.30 per pack at the top of the first level; at the top of the second level, by about \$0.70 per pack; and at the top of the third level by about \$1.00 per pack.



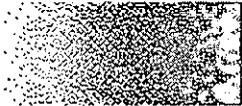
Elena Kagan
09/09/97 05:45:08 PM

Record Type: Record

To: Laura Emmett/WHO/EOP
cc:
Subject: Re: New lookback scenerios

could you print all this out? thanks.

----- Forwarded by Elena Kagan/OPD/EOP on 09/09/97 05:44 PM -----



Jerold R. Mande
09/09/97 12:55:15 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP
cc:
Subject: Re: New lookback scenerios

Here are the latest penalties scenerios that you requested.

----- Forwarded by Jerold R. Mande/OSTP/EOP on 09/09/97 12:53 PM -----

Patrick G. Locke

09/09/97 12:48:11 PM

Record Type: Record

To: Jerold R. Mande/OSTP/EOP
cc: joseph j. minarik/omb/eop, Hugh T. Connelly/OMB/EOP, Susanne D. Lind/OMB/EOP
Subject: Re: New lookback scenerios

Here are the new scenarios you asked for. All the scenarios assume that the BBA excise tax credit is repealed. For each of the three teen surcharge variants, I have run one version where teen consumption responds only to the deal's price increases, and a second version where the deal's nonprice provisions cause a 30% reduction in teen smoking on top of the price effect.]

Note that with tier 1 of the surcharge specified as nondeductible, there is now an increase in corporate income taxes in all the scenarios. The assumption is that in addition to passing through the surcharge, the companies tack on a further price increase that allows them to pay taxes on the surcharge payments and preserve the same profits as they would otherwise have booked.

I have not done any modeling of the "brand by brand" concept for the surcharge. Without more data on differential marketing to teens across firms, I have no way to model this right now.

Because the excise tax increases in tier 2 of the youth surcharge are buried in the spreadsheet files, I'm showing them in the table below. With a 30% nonprice effect, tier 2 of the surcharge doesn't kick in until year 10. Otherwise, you get fairly hefty excise taxes starting in year 5.

	<u>Year 5</u>	<u>Year 7</u>	<u>Year 10</u>
Noncumulative excise tax above 5/10/15			
Price effects only	21	31	35
30% nonprice effect	0	0	5
Cumulative excise tax above 5/10/15			
Price effects only	21	52	83
30% nonprice effect	0	0	5
Noncumulative excise tax above 10/10/10			
Price effects only	16	32	40
30% nonprice effect	0	0	10

Here are the files for the noncumulative excise tax above 5/10/15 percentage points. The first file (tobac13.wk4) is price effects only; the second file (tobac13n.wk4) has the 30% nonprice effect.

 
tobac13.wk tobac13n.wk

Here are the files for the cumulative excise tax above 5/10/15 percentage points.

 
tobac14.wk tobac14n.wk

Here are the files for the noncumulative excise tax above 10/10/10 percentage points.

 
tobac15.wk tobac15n.wk

**SUMMARY OF BUDGETARY EFFECTS OF PROPOSED SETTLEMENT
TWO TIER SURCHARGE WITH NONCUMULATIVE EXCISE TAX ABOVE 5/10/15 POINT SHORTFALL**

09/09/97

06:05 PM

(In billions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08	98-23
RECEIPTS														
Base Payment (inc. trust and up-front payment).....	10	9	10	12	14	15	15	15	15	15	15	69	144	369
Payments to Recoup Excise Tax Credit and/or Losses..	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult Sales Volume Adjustment.....	--	(1)	(1)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(4)	(9)	(26)	(84)
Credit for Personal Compensation Claims.....	--	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(4)	(4)	(11)	(29)	(84)
Inflation Adjustment.....	--	0	0	1	1	1	2	2	2	2	3	4	15	95
Credit for BBA Excise Taxes.....	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Look-Back Surcharge for Youth Consumption.....	--	--	--	--	--	1	0	1	0	0	1	1	3	13
Net Industry Settlement Payments.....	10	6	7	8	10	11	10	11	11	10	11	52	106	308
Tax Offsets														
Indirect Business Tax Offset.....	(3)	(2)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(13)	(27)	(77)
Corporate Income Tax on Look-Back Surcharge.....	--	--	--	--	--	0	0	0	0	0	0	0	2	7
Youth Excise Tax Trigger.....	--	--	--	--	--	3	3	4	4	4	5	3	24	96
Reduction in Existing Federal Excise Taxes.....	--	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(4)	(9)	(26)
Total Federal Tax Offsets.....	(3)	(2)	(2)	(3)	(3)	(1)	(1)	1	1	1	1	(13)	(10)	(1)
Net Additional Receipts to US Government.....	8	4	5	6	7	11	10	12	12	11	12	39	96	308
POTENTIAL USES/CHANGES														
State Attorneys General Proposals, Total.....	--	5	5	6	7	9	6	7	7	4	4	32	59	132
Offset Reduction in State Excise Taxes.....	--	1	1	1	1	1	1	2	2	2	2	5	13	44
Use of Youth Look-Back Surcharge (90% grants).....	--	--	--	--	--	1	0	1	0	0	1	1	3	13
Potential Increase in Federal Medicaid Match.....	1	2	2	2	2	3	3	3	3	3	3	12	25	76
Total Potential Uses.....	1	7	7	9	11	14	10	12	11	8	9	49	100	264
Memoranda:														
Ad Valorem Equivalent of Net Payments.....	17%	18%	22%	26%	36%	34%	39%	38%	38%	38%	40%			
Change in Total Cigarette Consumption.....	-7%	-8%	-10%	-12%	-16%	-15%	-17%	-17%	-17%	-17%	-17%			
Percentage Point Shortfall from Youth Target.....						26%	20%	41%	38%	40%	50%			

Potential Budgetary Impacts of Tobacco Agreement
Two Tier Surcharge With Noncumulative Excise Tax Above 5/10/15 Point Shortfall
(in billions of dollars)

09/09/97
06:05 PM
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	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08	98-23
Federal revenues:														
Industry payments:														
Up-front payment.....	10.0	—	—	—	—	—	—	—	—	—	—	10.0	10.0	10.0
Public health trust funds in bill.....	—	2.5	2.5	3.5	4.0	5.0	2.5	2.5	2.5	—	—	17.5	25.0	25.0
Base amounts in bill.....	—	6.0	7.0	8.0	10.0	10.0	12.5	12.5	12.5	15.0	15.0	41.0	108.5	333.5
Additional amounts to recover BBA97 credit.....	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Additional amounts to recover excise tax losses.....	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Adult sales volume adjustments.....	—	(0.7)	(1.1)	(1.6)	(2.4)	(3.2)	(3.1)	(3.5)	(3.4)	(3.4)	(3.6)	(9.0)	(26.0)	(83.8)
Credits for civil suits at cap.....	—	(1.8)	(2.0)	(2.3)	(2.7)	(2.6)	(3.3)	(3.2)	(3.2)	(3.8)	(3.8)	(11.5)	(28.7)	(83.9)
Inflation adjustments on above.....	—	0.2	0.4	0.7	1.1	1.5	1.7	1.9	2.2	2.4	2.6	3.9	14.7	94.6
Credit for BBA97 excise tax increase.....	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Look-back surcharge.....	—	—	—	—	—	0.6	0.0	0.8	0.3	0.4	0.8	0.6	2.8	13.0
User fees for nonparticipants.....	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Net penalties.....	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Subtotal, industry payments.....	10.0	6.1	6.7	8.3	10.0	11.2	10.3	11.1	10.9	10.5	11.1	52.4	106.3	308.4
Tax offset at 25% (IBT).....	(2.5)	(1.5)	(1.7)	(2.1)	(2.5)	(2.8)	(2.6)	(2.8)	(2.7)	(2.6)	(2.8)	(13.1)	(26.6)	(77.1)
Corporate income tax on look-back surcharge.....	—	—	—	—	—	0.3	0.0	0.4	0.1	0.2	0.4	0.3	1.5	7.0
Teen excise tax.....	—	—	—	—	—	3.0	3.0	4.4	4.4	4.4	4.9	3.0	24.1	95.5
Reduction in tobacco excise taxes (non-PAYGO).....	—	(0.3)	(0.5)	(0.6)	(0.9)	(1.2)	(1.1)	(1.2)	(1.2)	(1.2)	(1.2)	(3.5)	(9.5)	(26.2)
Total, Federal revenues.....	7.5	4.3	4.5	5.6	6.6	10.6	9.7	11.9	11.6	11.3	12.4	39.1	95.8	307.6
Federal outlays:														
Public health trust funds in bill.....	—	2.6	2.7	3.8	4.5	5.8	3.0	3.1	3.2	—	—	19.4	28.6	28.6
HHS direct programs and grants to States.....	—	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.3	9.0
FDA direct enforcement and grants to States.....	—	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	1.6	3.5	11.7
Grants to States for ASSIST-type programs.....	—	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.5	1.3	5.0
Direct Federal R&D to discourage tobacco use.....	—	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2	3.8
Payments to tobacco-sponsored events/teams.....	—	—	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8	0.9
Public educ. campaign run by non-profit board.....	—	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	2.7	5.9	18.8
HHS payments for tobacco use cessation programs.....	—	1.0	1.1	1.1	1.1	1.7	1.8	1.8	1.9	2.0	2.0	6.0	15.5	54.1
Spending of look-back surcharge (90% grants).....	—	—	—	—	—	0.6	0.0	0.8	0.3	0.4	0.8	0.6	2.8	13.0
Subtotal, specified spending in bill.....	—	4.7	5.0	6.2	7.1	9.6	6.4	7.3	7.0	4.1	4.6	32.6	62.0	144.9
Unspecified residual to reach total payments.....	10.0	1.5	1.8	2.1	2.9	1.6	3.9	3.7	3.9	6.4	6.5	19.8	44.3	163.5
Total, Federal outlays, excl. debt Service.....	10.0	6.1	6.7	8.3	10.0	11.2	10.3	11.1	10.9	10.5	11.1	52.4	106.3	308.4
Federal deficit:														
Revenues (deficit effect).....	(7.5)	(4.3)	(4.5)	(5.6)	(6.6)	(10.6)	(9.7)	(11.9)	(11.6)	(11.3)	(12.4)	(39.1)	(95.8)	(307.6)
Programmatic outlays.....	10.0	6.1	6.7	8.3	10.0	11.2	10.3	11.1	10.9	10.5	11.1	52.4	106.3	308.4
Debt service.....	0.1	0.2	0.3	0.4	0.5	0.7	0.9	1.1	1.3	1.5	1.8	2.1	8.6	128.7
Federal deficit.....	2.6	2.1	2.5	3.1	3.9	1.3	1.5	0.3	0.7	0.7	0.5	15.5	19.1	129.5
MEMORANDUM: PAYGO budget effects:														
Revenues (deficit effect).....	(7.5)	(4.6)	(5.0)	(6.3)	(7.5)	(11.7)	(10.8)	(13.1)	(12.7)	(12.4)	(13.6)	(42.6)	(105.3)	(333.8)
Outlays.....	10.0	6.1	6.7	8.3	10.0	11.2	10.3	11.1	10.9	10.5	11.1	52.4	106.3	308.4
Total PAYGO deficit effect.....	2.5	1.5	1.7	2.1	2.5	(0.5)	(0.5)	(2.0)	(1.8)	(2.0)	(2.5)	9.8	1.0	(25.4)
ADDENDA:														
Available (residual) spending if held to PAYGO neutrality	7.5	(0.1)	0.1	0.0	0.4	2.1	4.4	5.8	5.7	8.4	9.0	10.0	43.3	188.9
Available (residual) spending if held to budget neutrality..	7.5	(0.4)	(0.5)	(0.6)	(0.5)	0.9	3.3	4.5	4.5	7.2	7.8	6.5	33.8	162.7
Deficit impact of higher CPI (COLAs and indexation).....	—	0.5	1.5	2.5	3.4	3.9	4.2	4.4	4.5	4.6	4.6	11.9	34.3	—
Potential increase in Federal matching grants(lower end)	0.8	0.7	0.9	1.1	1.4	0.8	2.0	1.9	2.0	3.2	3.2	5.7	17.9	77.5
Potential increase in Federal matching grants(upper end)	1.0	1.5	1.7	2.1	2.5	2.8	2.6	2.8	2.7	2.6	2.8	11.6	25.1	75.6
Reduction in current law State excise tax revenues.....	—	(0.6)	(0.7)	(0.9)	(1.1)	(1.5)	(1.4)	(1.7)	(1.6)	(1.7)	(1.8)	(4.7)	(12.8)	(43.8)

See Footnotes Next Page.

1. Reduction in tobacco volume is assumed to result solely from price increases due to passthrough of industry payments.
Access restrictions, public education, and cessation programs are assumed to have no additional effect.
2. In scenarios where youth targets are met, change in youth smoking is assumed to have no effect on total consumption.
3. Civil liability settlements are assumed to be at cap (33% of industry basic payments). Cap is assumed to be a single 33% cap for suits based on past and future conduct.
4. Corporate income tax rate of 35% is assumed in scenarios where surcharge payments are nondeductible.
5. No manufacturers are assumed to qualify for 75% good faith surcharge abatement.
6. All manufacturers are assumed to participate in the settlement.
7. All manufacturers are assumed to meet compliance plan and corporate culture requirements.
8. Amounts are assumed to increase for inflation as follows: (a) industry payments increase for inflation beginning in 1999; (b) outlays increase for inflation beginning in 1999; (c) surcharge amount and cap increase for inflation beginning in 1997.
9. All industry payments are assumed to score as Federal indirect business taxes (excise tax receipts).
As indirect business taxes, industry payments are subject to a 25% income offset (BEA convention).
10. All payments are assumed to be spent as Federal outlays.
11. The credit for excise tax increases enacted as part of BBA '97 is assumed to be repealed.
12. States could use some portion of increased funds to increase matched grant spending, thereby generating a Federal match.
13. CPI effects shown as memorandum only because they at least partially overlap with the 25% income offset.

SUMMARY OF BUDGETARY EFFECTS OF PROPOSED SETTLEMENT
TWO TIER SURCHARGE W/NONCUM. EXCISE TAX ABOVE 5/10/15 POINTS AND 30% TEEN NONPRICE EFFECT
(In billions of dollars)

09/09/97

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	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08	98-23
RECEIPTS														
Base Payment (inc. trust and up-front payment).....	10	9	10	12	14	15	15	15	15	15	15	69	144	369
Payments to Recoup Excise Tax Credit and/or Losses..	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult Sales Volume Adjustment.....	--	(1)	(1)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(9)	(24)	(77)
Credit for Personal Compensation Claims.....	--	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(4)	(4)	(12)	(29)	(86)
Inflation Adjustment.....	--	0	0	1	1	2	2	2	2	2	3	4	15	97
Credit for BBA Excise Taxes.....	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Look-Back Surcharge for Youth Consumption.....	==	==	==	==	==	==	==	0	1	0	1	==	3	13
Net Industry Settlement Payments.....	10	6	7	8	10	11	11	11	12	11	12	52	108	316
Tax Offsets														
Indirect Business Tax Offset.....	(3)	(2)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(13)	(27)	(79)
Corporate Income Tax on Look-Back Surcharge.....	--	--	--	--	--	--	--	0	1	0	1	--	1	7
Youth Excise Tax Trigger.....	--	--	--	--	--	--	--	--	--	--	1	--	1	12
Reduction in Existing Federal Excise Taxes.....	(0)	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(4)	(9)	(24)
Total Federal Tax Offsets.....	(3)	(2)	(2)	(3)	(3)	(4)	(4)	(4)	(4)	(4)	(3)	(17)	(34)	(84)
Net Additional Receipts to US Government.....	7	4	4	6	7	7	7	7	8	7	9	36	75	231
POTENTIAL USES/CHANGES														
State Attorneys General Proposals, Total.....	--	5	5	6	7	9	6	7	7	4	4	32	59	132
Offset Reduction in State Excise Taxes.....	0	1	1	1	1	1	1	1	1	1	2	5	12	40
Use of Youth Look-Back Surcharge (90% grants).....	--	--	--	--	--	--	--	0	1	0	1	--	3	13
Potential Increase in Federal Medicaid Match.....	1	2	2	2	2	3	3	3	3	3	3	12	26	77
Total Potential Uses.....	1	7	7	9	11	13	10	11	12	8	10	48	99	262
Memoranda:														
Ad Valorem Equivalent of Net Payments.....	17%	18%	22%	26%	28%	28%	29%	32%	29%	34%				
Change in Total Cigarette Consumption.....	-8%	-9%	-11%	-13%	-14%	-14%	-14%	-15%	-14%	-16%				
Percentage Point Shortfall from Youth Target.....						-3%	-10%	10%	10%	8%	20%			

Potential Budgetary Impacts of Tobacco Agreement
Two Tier Surcharge w/Noncum. Excise Tax Above 5/10/15 Points and 30% Teen Nonprice Effect
(in billions of dollars)

09/09/97
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	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08	98-23
Federal revenues:														
Industry payments:														
Up-front payment.....	10.0	—	—	—	—	—	—	—	—	—	—	10.0	10.0	10.0
Public health trust funds in bill.....	—	2.5	2.5	3.5	4.0	5.0	2.5	2.5	2.5	—	—	17.5	25.0	25.0
Base amounts in bill.....	—	6.0	7.0	8.0	10.0	10.0	12.5	12.5	12.5	15.0	15.0	41.0	108.5	333.5
Additional amounts to recover BBA97 credit.....	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Additional amounts to recover excise tax losses.....	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Adult sales volume adjustments.....	—	(0.7)	(1.1)	(1.6)	(2.4)	(2.7)	(2.8)	(2.8)	(3.1)	(3.0)	(3.3)	(8.6)	(23.5)	(76.6)
Credits for civil suits at cap.....	—	(1.8)	(2.0)	(2.3)	(2.7)	(2.7)	(3.4)	(3.3)	(3.3)	(4.0)	(3.9)	(11.5)	(29.4)	(86.1)
Inflation adjustments on above.....	—	0.2	0.4	0.7	1.1	1.5	1.7	2.0	2.3	2.5	2.7	3.9	15.1	97.1
Credit for BBA97 excise tax increase.....	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Look-back surcharge.....	—	—	—	—	—	—	—	0.1	1.0	0.2	1.4	—	2.7	12.7
User fees for nonparticipants.....	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Net penalties.....	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Subtotal, industry payments.....	10.0	6.1	6.7	8.3	10.0	11.1	10.6	10.9	12.0	10.7	12.0	52.3	108.4	315.6
Tax offset at 25% (IBT).....	(2.5)	(1.5)	(1.7)	(2.1)	(2.5)	(2.8)	(2.6)	(2.7)	(3.0)	(2.7)	(3.0)	(13.1)	(27.1)	(78.9)
Corporate income tax on look-back surcharge.....	—	—	—	—	—	—	—	0.0	0.5	0.1	0.8	—	1.5	6.8
Teen excise tax.....	—	—	—	—	—	—	—	—	—	—	0.7	—	0.7	11.6
Reduction in tobacco excise taxes (non-PAYGO).....	(0.0)	(0.4)	(0.6)	(0.7)	(0.9)	(1.0)	(1.0)	(1.0)	(1.1)	(1.0)	(1.1)	(3.5)	(8.7)	(24.0)
Total, Federal revenues.....	7.5	4.2	4.5	5.6	6.6	7.3	6.9	7.2	8.5	7.1	9.3	35.7	74.8	231.1
Federal outlays:														
Public health trust funds in bill.....	—	2.6	2.7	3.8	4.5	5.8	3.0	3.1	3.2	—	—	19.4	28.6	28.6
HHS direct programs and grants to States.....	—	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.3	9.0
FDA direct enforcement and grants to States.....	—	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	1.6	3.5	11.7
Grants to States for ASSIST-type programs.....	—	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.5	1.3	5.0
Direct Federal R&D to discourage tobacco use.....	—	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2	3.8
Payments to tobacco-sponsored events/teams.....	—	—	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8	0.9
Public educ. campaign run by non-profit board.....	—	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	2.7	5.9	18.8
HHS payments for tobacco use cessation programs.....	—	1.0	1.1	1.1	1.1	1.7	1.8	1.8	1.9	2.0	2.0	6.0	15.5	54.1
Spending of look-back surcharge (90% grants).....	—	—	—	—	—	—	—	0.1	1.0	0.2	1.4	—	2.7	12.7
Subtotal, specified spending in bill.....	—	4.7	5.0	6.2	7.1	9.1	6.4	6.6	7.8	3.9	5.2	32.1	61.9	144.6
Unspecified residual to reach total payments.....	10.0	1.5	1.8	2.1	2.9	2.0	4.2	4.3	4.2	6.8	6.8	20.2	46.5	171.0
Total, Federal outlays, excl. debt Service.....	10.0	6.1	6.7	8.3	10.0	11.1	10.6	10.9	12.0	10.7	12.0	52.3	108.4	315.6
Federal deficit:														
Revenues (deficit effect).....	(7.5)	(4.2)	(4.5)	(5.6)	(6.6)	(7.3)	(6.9)	(7.2)	(8.5)	(7.1)	(9.3)	(35.7)	(74.8)	(231.1)
Programmatic outlays.....	10.0	6.1	6.7	8.3	10.0	11.1	10.6	10.9	12.0	10.7	12.0	52.3	108.4	315.6
Debt service.....	0.1	0.2	0.3	0.4	0.5	0.7	0.9	1.1	1.3	1.5	1.8	2.1	8.6	128.7
Federal deficit.....	2.6	2.1	2.5	3.1	3.9	4.4	4.5	4.8	4.8	5.1	4.4	18.7	42.3	213.2
MEMORANDUM: PAYGO budget effects:														
Revenues (deficit effect).....	(7.5)	(4.6)	(5.0)	(6.3)	(7.5)	(8.3)	(7.9)	(8.2)	(9.5)	(8.1)	(10.5)	(39.2)	(83.5)	(255.1)
Outlays.....	10.0	6.1	6.7	8.3	10.0	11.1	10.6	10.9	12.0	10.7	12.0	52.3	108.4	315.6
Total PAYGO deficit effect.....	2.5	1.5	1.7	2.1	2.5	2.8	2.6	2.7	2.4	2.6	1.5	13.1	24.9	60.5
ADDENDA:														
Available (residual) spending if held to PAYGO neutrality	7.5	(0.1)	0.1	0.0	0.4	(0.8)	1.6	1.6	1.8	4.3	5.3	7.1	21.6	110.5
Available (residual) spending if held to budget neutrality..	7.5	(0.4)	(0.5)	(0.7)	(0.6)	(1.7)	0.6	0.6	0.7	3.3	4.1	3.6	12.9	86.5
Deficit impact of higher CPI (COLAs and indexation).....	—	0.5	1.5	2.5	3.4	3.9	4.2	4.4	4.5	4.6	4.6	11.9	34.3	—
Potential increase in Federal matching grants(lower end)	0.8	0.7	0.9	1.1	1.4	1.0	2.1	2.1	2.1	3.4	3.4	5.9	19.0	81.3
Potential increase in Federal matching grants(upper end)	1.0	1.5	1.7	2.1	2.5	2.8	2.6	2.7	3.0	2.7	3.0	11.6	25.6	77.4
Reduction in current law State excise tax revenues.....	(0.0)	(0.7)	(0.7)	(0.9)	(1.1)	(1.2)	(1.3)	(1.3)	(1.5)	(1.4)	(1.6)	(4.7)	(11.8)	(40.1)

See Footnotes Next Page.

1. Reduction in tobacco volume is assumed to result solely from price increases due to passthrough of industry payments.
Access restrictions, public education, and cessation programs are assumed to have no additional effect.
2. In scenarios where youth targets are met, change in youth smoking is assumed to have no effect on total consumption.
3. Civil liability settlements are assumed to be at cap (33% of industry basic payments). Cap is assumed to be a single 33% cap for suits based on past and future conduct.
4. Corporate income tax rate of 35% is assumed in scenarios where surcharge payments are nondeductible.
5. No manufacturers are assumed to qualify for 75% good faith surcharge abatement.
6. All manufacturers are assumed to participate in the settlement.
7. All manufacturers are assumed to meet compliance plan and corporate culture requirements.
8. Amounts are assumed to increase for inflation as follows: (a) industry payments increase for inflation beginning in 1999;
(b) outlays increase for inflation beginning in 1999; (c) surcharge amount and cap increase for inflation beginning in 1997.
9. All industry payments are assumed to score as Federal indirect business taxes (excise tax receipts).
As indirect business taxes, industry payments are subject to a 25% income offset (BEA convention).
10. All payments are assumed to be spent as Federal outlays.
11. The credit for excise tax increases enacted as part of BBA '97 is assumed to be repealed.
12. States could use some portion of increased funds to increase matched grant spending, thereby generating a Federal match.
13. CPI effects shown as memorandum only because they at least partially overlap with the 25% income offset.

**SUMMARY OF BUDGETARY EFFECTS OF PROPOSED SETTLEMENT
TWO TIER SURCHARGE WITH CUMULATIVE EXCISE TAX ABOVE 5/10/15 POINT SHORTFALL**

09/09/97

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(In billions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08	98-23
RECEIPTS														
Base Payment (inc. trust and up-front payment).....	10	9	10	12	14	15	15	15	15	15	15	69	144	369
Payments to Recoup Excise Tax Credit and/or Losses..	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult Sales Volume Adjustment.....	--	(1)	(1)	(2)	(2)	(3)	(3)	(4)	(4)	(4)	(4)	(9)	(28)	(93)
Credit for Personal Compensation Claims.....	--	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(4)	(4)	(11)	(28)	(81)
Inflation Adjustment.....	--	0	0	1	1	1	2	2	2	2	2	4	14	91
Credit for BBA Excise Taxes.....	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Look-Back Surcharge for Youth Consumption.....	--	--	--	--	--	1	0	1	0	0	1	1	3	13
Net Industry Settlement Payments.....	10	6	7	8	10	11	10	11	11	10	11	52	105	298
Tax Offsets														
Indirect Business Tax Offset.....	(3)	(2)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(13)	(26)	(75)
Corporate Income Tax on Look-Back Surcharge.....	--	--	--	--	--	0	0	0	0	0	0	0	1	7
Youth Excise Tax Trigger.....	--	--	--	--	--	3	3	7	7	7	11	3	38	201
Reduction in Existing Federal Excise Taxes.....	--	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(2)	(4)	(10)	(31)
Total Federal Tax Offsets.....	(3)	(2)	(2)	(3)	(3)	(1)	(1)	3	3	3	7	(13)	3	102
Net Additional Receipts to US Government.....	8	4	5	6	7	11	10	14	14	14	18	39	108	400
POTENTIAL USES/CHANGES														
State Attorneys General Proposals, Total.....	--	5	5	6	7	9	6	7	7	4	4	32	59	132
Offset Reduction in State Excise Taxes.....	--	1	1	1	1	1	1	2	2	2	2	5	14	52
Use of Youth Look-Back Surcharge (90% grants).....	--	--	--	--	--	1	0	1	0	0	1	1	3	13
Potential Increase in Federal Medicaid Match.....	1	2	2	2	2	3	3	3	3	3	3	12	25	73
Total Potential Uses.....	1	7	7	9	11	14	10	12	11	9	10	49	101	270
Memoranda:														
Ad Valorem Equivalent of Net Payments.....	17%	18%	22%	26%	36%	34%	45%	43%	43%	43%	53%			
Change in Total Cigarette Consumption.....	-7%	-8%	-10%	-12%	-16%	-15%	-20%	-19%	-19%	-19%	-22%			
Percentage Point Shortfall from Youth Target.....						26%	20%	41%	34%	36%	46%			

Potential Budgetary Impacts of Tobacco Agreement
Two Tier Surcharge With Cumulative Excise Tax Above 5/10/15 Point Shortfall
(in billions of dollars)

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	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08	98-23
Federal revenues:														
Industry payments:														
Up-front payment.....	10.0	---	---	---	---	---	---	---	---	---	---	10.0	10.0	10.0
Public health trust funds in bill.....	---	2.5	2.5	3.5	4.0	5.0	2.5	2.5	2.5	---	---	17.5	25.0	25.0
Base amounts in bill.....	---	6.0	7.0	8.0	10.0	10.0	12.5	12.5	12.5	15.0	15.0	41.0	108.5	333.5
Additional amounts to recover BBA97 credit.....	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Additional amounts to recover excise tax losses.....	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Adult sales volume adjustments.....	---	(0.7)	(1.1)	(1.6)	(2.4)	(3.2)	(3.1)	(3.8)	(3.7)	(3.7)	(4.3)	(9.0)	(27.6)	(93.1)
Credits for civil suits at cap.....	---	(1.8)	(2.0)	(2.3)	(2.7)	(2.6)	(3.3)	(3.1)	(3.1)	(3.7)	(3.5)	(11.5)	(28.2)	(80.8)
Inflation adjustments on above.....	---	0.2	0.4	0.7	1.1	1.5	1.7	1.9	2.2	2.3	2.5	3.9	14.4	90.7
Credit for BBA97 excise tax increase.....	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Look-back surcharge.....	---	---	---	---	---	0.6	0.0	0.8	0.1	0.4	0.8	0.6	2.7	12.9
User fees for nonparticipants.....	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Net penalties.....	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Subtotal, industry payments.....	10.0	6.1	6.7	8.3	10.0	11.2	10.3	10.8	10.5	10.2	10.5	52.4	104.8	298.1
Tax offset at 25% (IBT).....	(2.5)	(1.5)	(1.7)	(2.1)	(2.5)	(2.8)	(2.6)	(2.7)	(2.6)	(2.6)	(2.6)	(13.1)	(26.2)	(74.5)
Corporate income tax on look-back surcharge.....	---	---	---	---	---	0.3	0.0	0.4	0.1	0.2	0.5	0.3	1.5	6.9
Teen excise tax.....	---	---	---	---	---	3.0	3.0	7.1	7.2	7.1	10.9	3.0	38.3	200.7
Reduction in tobacco excise taxes (non-PAYGO).....	---	(0.3)	(0.5)	(0.6)	(0.9)	(1.2)	(1.1)	(1.4)	(1.3)	(1.3)	(1.6)	(3.5)	(10.3)	(31.1)
Total, Federal revenues.....	7.5	4.3	4.5	5.6	6.6	10.6	9.7	14.2	13.8	13.7	17.7	39.1	108.1	400.0
Federal outlays:														
Public health trust funds in bill.....	---	2.6	2.7	3.8	4.5	5.8	3.0	3.1	3.2	---	---	19.4	28.6	28.6
HHS direct programs and grants to States.....	---	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.3	9.0
FDA direct enforcement and grants to States.....	---	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	1.6	3.5	11.7
Grants to States for ASSIST-type programs.....	---	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.5	1.3	5.0
Direct Federal R&D to discourage tobacco use.....	---	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2	3.8
Payments to tobacco-sponsored events/teams.....	---	---	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8	0.9
Public educ. campaign run by non-profit board.....	---	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	2.7	5.9	18.8
HHS payments for tobacco use cessation programs.....	---	1.0	1.1	1.1	1.1	1.7	1.8	1.8	1.9	2.0	2.0	6.0	15.5	54.1
Spending of look-back surcharge (90% grants).....	---	---	---	---	---	0.6	0.0	0.8	0.1	0.4	0.8	0.6	2.7	12.9
Subtotal, specified spending in bill.....	---	4.7	5.0	6.2	7.1	9.6	6.4	7.3	6.9	4.1	4.6	32.6	61.9	144.8
Unspecified residual to reach total payments.....	10.0	1.5	1.8	2.1	2.9	1.6	3.9	3.5	3.6	6.2	5.9	19.8	42.9	153.3
Total, Federal outlays, excl. debt Service.....	10.0	6.1	6.7	8.3	10.0	11.2	10.3	10.8	10.5	10.2	10.5	52.4	104.8	298.1
Federal deficit:														
Revenues (deficit effect).....	(7.5)	(4.3)	(4.5)	(5.6)	(6.6)	(10.6)	(9.7)	(14.2)	(13.8)	(13.7)	(17.7)	(39.1)	(108.1)	(400.0)
Programmatic outlays.....	10.0	6.1	6.7	8.3	10.0	11.2	10.3	10.8	10.5	10.2	10.5	52.4	104.8	298.1
Debt service.....	0.1	0.2	0.3	0.4	0.5	0.7	0.9	1.1	1.3	1.5	1.8	2.1	8.6	128.7
Federal deficit.....	2.6	2.1	2.5	3.1	3.9	1.3	1.5	(2.4)	(2.0)	(1.9)	(5.4)	15.5	5.3	26.7
MEMORANDUM: PAYGO budget effects:														
Revenues (deficit effect).....	(7.5)	(4.6)	(5.0)	(6.3)	(7.5)	(11.7)	(10.8)	(15.6)	(15.1)	(15.0)	(19.2)	(42.6)	(118.4)	(431.1)
Outlays.....	10.0	6.1	6.7	8.3	10.0	11.2	10.3	10.8	10.5	10.2	10.5	52.4	104.8	298.1
Total PAYGO deficit effect.....	2.5	1.5	1.7	2.1	2.5	(0.5)	(0.5)	(4.8)	(4.6)	(4.8)	(8.7)	9.8	(13.6)	(133.1)
ADDENDA:														
Available (residual) spending if held to PAYGO neutrality	7.5	(0.1)	0.1	0.0	0.4	2.1	4.4	8.3	8.3	10.9	14.6	10.0	56.5	286.4
Available (residual) spending if held to budget neutrality..	7.5	(0.4)	(0.5)	(0.6)	(0.5)	0.9	3.3	6.9	6.9	9.6	13.0	6.5	46.2	255.3
Deficit impact of higher CPI (COLAs and indexation).....	---	0.5	1.5	2.5	3.4	3.9	4.2	4.4	4.5	4.6	4.6	11.9	34.3	---
Potential increase in Federal matching grants(lower end)	0.8	0.7	0.9	1.1	1.4	0.8	2.0	1.7	1.8	3.1	2.9	5.7	17.2	72.4
Potential increase in Federal matching grants(upper end)	1.0	1.5	1.7	2.1	2.5	2.8	2.6	2.7	2.6	2.6	2.6	11.6	24.7	73.0
Reduction in current law State excise tax revenues.....	---	(0.6)	(0.7)	(0.9)	(1.1)	(1.5)	(1.4)	(1.9)	(1.8)	(1.9)	(2.3)	(4.7)	(14.0)	(52.3)

See Footnotes Next Page.

1. Reduction in tobacco volume is assumed to result solely from price increases due to passthrough of industry payments.
Access restrictions, public education, and cessation programs are assumed to have no additional effect.
2. In scenarios where youth targets are met, change in youth smoking is assumed to have no effect on total consumption.
3. Civil liability settlements are assumed to be at cap (33% of industry basic payments). Cap is assumed to be a single 33% cap for suits based on past and future conduct.
4. Corporate income tax rate of 35% is assumed in scenarios where surcharge payments are nondeductible.
5. No manufacturers are assumed to qualify for 75% good faith surcharge abatement.
6. All manufacturers are assumed to participate in the settlement.
7. All manufacturers are assumed to meet compliance plan and corporate culture requirements.
8. Amounts are assumed to increase for inflation as follows: (a) industry payments increase for inflation beginning in 1999;
(b) outlays increase for inflation beginning in 1999; (c) surcharge amount and cap increase for inflation beginning in 1997.
9. All industry payments are assumed to score as Federal indirect business taxes (excise tax receipts).
As indirect business taxes, industry payments are subject to a 25% income offset (BEA convention).
10. All payments are assumed to be spent as Federal outlays.
11. The credit for excise tax increases enacted as part of BBA '97 is assumed to be repealed.
12. States could use some portion of increased funds to increase matched grant spending, thereby generating a Federal match.
13. CPI effects shown as memorandum only because they at least partially overlap with the 25% income offset.

**SUMMARY OF BUDGETARY EFFECTS OF PROPOSED SETTLEMENT
TWO TIER SURCHARGE WITH CUMULATIVE EXCISE TAX ABOVE 5/10/15 POINT SHORTFALL**

09/09/97

06:05 PM

(In billions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08	98-23
RECEIPTS														
Base Payment (inc. trust and up-front payment).....	10	9	10	12	14	15	15	15	15	15	15	69	144	369
Payments to Recoup Excise Tax Credit and/or Losses..	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult Sales Volume Adjustment.....	--	(1)	(1)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(9)	(24)	(77)
Credit for Personal Compensation Claims.....	--	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(4)	(4)	(12)	(29)	(86)
Inflation Adjustment.....	--	0	0	1	1	2	2	2	2	2	3	4	15	97
Credit for BBA Excise Taxes.....	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Look-Back Surcharge for Youth Consumption.....	--	--	--	--	--	--	--	0	1	0	1	--	3	13
Net Industry Settlement Payments.....	10	6	7	8	10	11	11	11	12	11	12	52	108	316
Tax Offsets														
Indirect Business Tax Offset.....	(3)	(2)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(13)	(27)	(79)
Corporate Income Tax on Look-Back Surcharge.....	--	--	--	--	--	--	--	0	1	0	1	--	1	7
Youth Excise Tax Trigger.....	--	--	--	--	--	--	--	--	--	--	1	--	1	12
Reduction in Existing Federal Excise Taxes.....	(0)	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(4)	(9)	(24)
Total Federal Tax Offsets.....	(3)	(2)	(2)	(3)	(3)	(4)	(4)	(4)	(4)	(4)	(3)	(17)	(34)	(84)
Net Additional Receipts to US Government.....	7	4	4	6	7	7	7	7	8	7	9	36	75	231
POTENTIAL USES/CHANGES														
State Attorneys General Proposals, Total.....	--	5	5	6	7	9	6	7	7	4	4	32	59	132
Offset Reduction in State Excise Taxes.....	0	1	1	1	1	1	1	1	1	1	2	5	12	40
Use of Youth Look-Back Surcharge (90% grants).....	--	--	--	--	--	--	--	0	1	0	1	--	3	13
Potential Increase in Federal Medicaid Match.....	1	2	2	2	2	3	3	3	3	3	3	12	26	77
Total Potential Uses.....	1	7	7	9	11	13	10	11	12	8	10	48	99	262
Memoranda:														
Ad Valorem Equivalent of Net Payments.....	17%	18%	22%	26%	28%	28%	29%	32%	29%	34%				
Change In Total Cigarette Consumption.....	-8%	-9%	-11%	-13%	-14%	-14%	-14%	-15%	-14%	-16%				
Percentage Point Shortfall from Youth Target.....						-3%	-10%	10%	10%	8%	20%			

Potential Budgetary Impacts of Tobacco Agreement
Two Tier Surcharge With Cumulative Excise Tax Above 5/10/15 Point Shortfall
(in billions of dollars)

09/09/97
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	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08	98-23
Federal revenues:														
Industry payments:														
Up-front payment.....	10.0	---	---	---	---	---	---	---	---	---	---	10.0	10.0	10.0
Public health trust funds in bill.....	---	2.5	2.5	3.5	4.0	5.0	2.5	2.5	2.5	---	---	17.5	25.0	25.0
Base amounts in bill.....	---	6.0	7.0	8.0	10.0	10.0	12.5	12.5	12.5	15.0	15.0	41.0	108.5	333.5
Additional amounts to recover BBA97 credit.....	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Additional amounts to recover excise tax losses.....	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Adult sales volume adjustments.....	---	(0.7)	(1.1)	(1.6)	(2.4)	(2.7)	(2.8)	(2.8)	(3.1)	(3.0)	(3.3)	(8.6)	(23.5)	(76.6)
Credits for civil suits at cap.....	---	(1.8)	(2.0)	(2.3)	(2.7)	(2.7)	(3.4)	(3.3)	(3.3)	(4.0)	(3.9)	(11.5)	(29.4)	(86.1)
Inflation adjustments on above.....	---	0.2	0.4	0.7	1.1	1.5	1.7	2.0	2.3	2.5	2.7	3.9	15.1	97.1
Credit for BBA97 excise tax increase.....	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Look-back surcharge.....	---	---	---	---	---	---	---	0.1	1.0	0.2	1.4	---	2.7	12.7
User fees for nonparticipants.....	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Net penalties.....	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Subtotal, industry payments.....	10.0	6.1	6.7	8.3	10.0	11.1	10.6	10.9	12.0	10.7	12.0	52.3	108.4	315.6
Tax offset at 25% (IBT).....	(2.5)	(1.5)	(1.7)	(2.1)	(2.5)	(2.8)	(2.6)	(2.7)	(3.0)	(2.7)	(3.0)	(13.1)	(27.1)	(78.9)
Corporate income tax on look-back surcharge.....	---	---	---	---	---	---	---	0.0	0.5	0.1	0.8	---	1.5	6.8
Teen excise tax.....	---	---	---	---	---	---	---	---	---	---	0.7	---	0.7	11.6
Reduction in tobacco excise taxes (non-PAYGO).....	(0.0)	(0.4)	(0.6)	(0.7)	(0.9)	(1.0)	(1.0)	(1.0)	(1.1)	(1.0)	(1.1)	(3.5)	(8.7)	(24.0)
Total, Federal revenues.....	7.5	4.2	4.5	5.6	6.6	7.3	6.9	7.2	8.5	7.1	9.3	35.7	74.8	231.1
Federal outlays:														
Public health trust funds in bill.....	---	2.6	2.7	3.8	4.5	5.8	3.0	3.1	3.2	---	---	19.4	28.6	28.6
HHS direct programs and grants to States.....	---	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.3	9.0
FDA direct enforcement and grants to States.....	---	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	1.6	3.5	11.7
Grants to States for ASSIST-type programs.....	---	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.5	1.3	5.0
Direct Federal R&D to discourage tobacco use.....	---	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2	3.8
Payments to tobacco-sponsored events/teams.....	---	---	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8	0.9
Public educ. campaign run by non-profit board.....	---	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	2.7	5.9	18.8
HHS payments for tobacco use cessation programs.....	---	1.0	1.1	1.1	1.1	1.7	1.8	1.8	1.9	2.0	2.0	6.0	15.5	54.1
Spending of look-back surcharge (90% grants).....	---	---	---	---	---	---	---	0.1	1.0	0.2	1.4	---	2.7	12.7
Subtotal, specified spending in bill.....	---	4.7	5.0	6.2	7.1	9.1	6.4	6.6	7.8	3.9	5.2	32.1	61.9	144.6
Unspecified residual to reach total payments.....	10.0	1.5	1.8	2.1	2.9	2.0	4.2	4.3	4.2	6.8	6.8	20.2	46.5	171.0
Total, Federal outlays, excl. debt Service.....	10.0	6.1	6.7	8.3	10.0	11.1	10.6	10.9	12.0	10.7	12.0	52.3	108.4	315.6
Federal deficit:														
Revenues (deficit effect).....	(7.5)	(4.2)	(4.5)	(5.6)	(6.6)	(7.3)	(6.9)	(7.2)	(8.5)	(7.1)	(9.3)	(35.7)	(74.8)	(231.1)
Programmatic outlays.....	10.0	6.1	6.7	8.3	10.0	11.1	10.6	10.9	12.0	10.7	12.0	52.3	108.4	315.6
Debt service.....	0.1	0.2	0.3	0.4	0.5	0.7	0.9	1.1	1.3	1.5	1.8	2.1	8.6	128.7
Federal deficit.....	2.6	2.1	2.5	3.1	3.9	4.4	4.5	4.8	4.8	5.1	4.4	18.7	42.3	213.2
MEMORANDUM: PAYGO budget effects:														
Revenues (deficit effect).....	(7.5)	(4.6)	(5.0)	(6.3)	(7.5)	(8.3)	(7.9)	(8.2)	(9.5)	(8.1)	(10.5)	(39.2)	(83.5)	(255.1)
Outlays.....	10.0	6.1	6.7	8.3	10.0	11.1	10.6	10.9	12.0	10.7	12.0	52.3	108.4	315.6
Total PAYGO deficit effect.....	2.5	1.5	1.7	2.1	2.5	2.8	2.6	2.7	2.4	2.6	1.5	13.1	24.9	60.5
ADDENDA:														
Available (residual) spending if held to PAYGO neutrality	7.5	(0.1)	0.1	0.0	0.4	(0.8)	1.6	1.6	1.8	4.3	5.3	7.1	21.6	110.5
Available (residual) spending if held to budget neutrality..	7.5	(0.4)	(0.5)	(0.7)	(0.6)	(1.7)	0.6	0.6	0.7	3.3	4.1	3.6	12.9	86.5
Deficit impact of higher CPI (COLAs and indexation).....	---	0.5	1.5	2.5	3.4	3.9	4.2	4.4	4.5	4.6	4.6	11.9	34.3	---
Potential increase in Federal matching grants(lower end)	0.8	0.7	0.9	1.1	1.4	1.0	2.1	2.1	2.1	3.4	3.4	5.9	19.0	81.3
Potential increase in Federal matching grants(upper end)	1.0	1.5	1.7	2.1	2.5	2.8	2.6	2.7	3.0	2.7	3.0	11.6	25.6	77.4
Reduction in current law State excise tax revenues.....	(0.0)	(0.7)	(0.7)	(0.9)	(1.1)	(1.2)	(1.3)	(1.3)	(1.5)	(1.4)	(1.6)	(4.7)	(11.8)	(40.1)

See Footnotes Next Page.

1. Reduction in tobacco volume is assumed to result solely from price increases due to passthrough of industry payments.
Access restrictions, public education, and cessation programs are assumed to have no additional effect.
2. In scenarios where youth targets are met, change in youth smoking is assumed to have no effect on total consumption.
3. Civil liability settlements are assumed to be at cap (33% of industry basic payments). Cap is assumed to be a single 33% cap for suits based on past and future conduct.
4. Corporate income tax rate of 35% is assumed in scenarios where surcharge payments are nondeductible.
5. No manufacturers are assumed to qualify for 75% good faith surcharge abatement.
6. All manufacturers are assumed to participate in the settlement.
7. All manufacturers are assumed to meet compliance plan and corporate culture requirements.
8. Amounts are assumed to increase for inflation as follows: (a) industry payments increase for inflation beginning in 1999; (b) outlays increase for inflation beginning in 1999; (c) surcharge amount and cap increase for inflation beginning in 1997.
9. All industry payments are assumed to score as Federal indirect business taxes (excise tax receipts).
As indirect business taxes, industry payments are subject to a 25% income offset (BEA convention).
10. All payments are assumed to be spent as Federal outlays.
11. The credit for excise tax increases enacted as part of BBA '97 is assumed to be repealed.
12. States could use some portion of increased funds to increase matched grant spending, thereby generating a Federal match.
13. CPI effects shown as memorandum only because they at least partially overlap with the 25% income offset.

**SUMMARY OF BUDGETARY EFFECTS OF PROPOSED SETTLEMENT
TWO TIER SURCHARGE W/NONCUMULATIVE EXCISE TAX ABOVE 10 POINT SHORTFALL**

09/09/97

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(In billions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08	98-23
RECEIPTS														
Base Payment (inc. trust and up-front payment).....	10	9	10	12	14	15	15	15	15	15	15	69	144	369
Payments to Recoup Excise Tax Credit and/or Losses..	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult Sales Volume Adjustment.....	--	(1)	(1)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(4)	(9)	(26)	(84)
Credit for Personal Compensation Claims.....	--	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(4)	(4)	(11)	(29)	(84)
Inflation Adjustment.....	--	0	0	1	1	1	2	2	2	2	3	4	15	94
Credit for BBA Excise Taxes.....	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Look-Back Surcharge for Youth Consumption.....	--	--	--	--	--	1	0	1	0	0	1	1	3	10
Net Industry Settlement Payments.....	10	6	7	8	10	12	10	11	11	10	11	53	107	305
Tax Offsets														
Indirect Business Tax Offset.....	(3)	(2)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(13)	(27)	(76)
Corporate Income Tax on Look-Back Surcharge.....	--	--	--	--	--	1	0	0	0	0	0	1	2	5
Youth Excise Tax Trigger.....	--	--	--	--	--	2	2	5	5	5	6	2	24	105
Reduction in Existing Federal Excise Taxes.....	--	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(4)	(9)	(26)
Total Federal Tax Offsets.....	(3)	(2)	(2)	(3)	(3)	(1)	(1)	1	1	1	2	(14)	(11)	7
Net Additional Receipts to US Government.....	8	4	5	6	7	11	9	12	12	11	13	39	96	312
POTENTIAL USES/CHANGES														
State Attorneys General Proposals, Total.....	--	5	5	6	7	9	6	7	7	4	4	32	59	132
Offset Reduction in State Excise Taxes.....	--	1	1	1	1	1	1	2	2	2	2	5	13	44
Use of Youth Look-Back Surcharge (90% grants).....	--	--	--	--	--	1	0	1	0	0	1	1	3	10
Potential Increase in Federal Medicaid Match.....	1	2	2	2	2	3	3	3	3	3	3	12	25	75
Total Potential Uses.....	1	7	7	9	11	15	10	12	11	8	9	50	100	261
Memoranda:														
Ad Valorem Equivalent of Net Payments.....	17%	18%	22%	26%	36%	33%	40%	38%	38%	38%	40%			
Change in Total Cigarette Consumption.....	-7%	-8%	-10%	-12%	-16%	-15%	-17%	-17%	-17%	-17%	-18%			
Percentage Point Shortfall from Youth Target.....						26%	19%	42%	38%	40%	50%			

Potential Budgetary Impacts of Tobacco Agreement
Two Tier Surcharge w/Noncumulative Excise Tax Above 10 Point Shortfall
(in billions of dollars)

09/09/97
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	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08	98-23
Federal revenues:														
Industry payments:														
Up-front payment.....	10.0	---	---	---	---	---	---	---	---	---	---	10.0	10.0	10.0
Public health trust funds in bill.....	---	2.5	2.5	3.5	4.0	5.0	2.5	2.5	2.5	---	---	17.5	25.0	25.0
Base amounts in bill.....	---	6.0	7.0	8.0	10.0	10.0	12.5	12.5	12.5	15.0	15.0	41.0	108.5	333.5
Additional amounts to recover BBA97 credit.....	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Additional amounts to recover excise tax losses.....	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Adult sales volume adjustments.....	---	(0.7)	(1.1)	(1.6)	(2.4)	(3.2)	(3.0)	(3.5)	(3.4)	(3.5)	(3.6)	(9.0)	(26.0)	(84.2)
Credits for civil suits at cap.....	---	(1.8)	(2.0)	(2.3)	(2.7)	(2.6)	(3.3)	(3.2)	(3.2)	(3.8)	(3.8)	(11.5)	(28.7)	(83.7)
Inflation adjustments on above.....	---	0.2	0.4	0.7	1.1	1.5	1.7	1.9	2.2	2.4	2.6	3.9	14.7	94.4
Credit for BBA97 excise tax increase.....	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Look-back surcharge.....	---	---	---	---	---	1.1	0.0	0.8	0.2	0.4	0.6	1.1	3.1	9.9
User fees for nonparticipants.....	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Net penalties.....	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Subtotal, industry payments.....	10.0	6.1	6.7	8.3	10.0	11.8	10.4	11.1	10.9	10.5	10.8	53.0	106.6	304.9
Tax offset at 25% (IBT).....	(2.5)	(1.5)	(1.7)	(2.1)	(2.5)	(2.9)	(2.6)	(2.8)	(2.7)	(2.6)	(2.7)	(13.2)	(26.6)	(76.2)
Corporate income tax on look-back surcharge.....	---	---	---	---	---	0.6	0.0	0.4	0.1	0.2	0.3	0.6	1.7	5.3
Teen excise tax.....	---	---	---	---	---	2.3	2.3	4.5	4.5	4.5	5.5	2.3	23.7	104.8
Reduction in tobacco excise taxes (non-PAYGO).....	---	(0.3)	(0.5)	(0.6)	(0.9)	(1.2)	(1.1)	(1.3)	(1.2)	(1.2)	(1.2)	(3.6)	(9.5)	(26.4)
Total, Federal revenues.....	7.5	4.3	4.5	5.6	6.6	10.5	9.1	12.0	11.6	11.4	12.7	39.0	95.8	312.3
Federal outlays:														
Public health trust funds in bill.....	---	2.6	2.7	3.8	4.5	5.8	3.0	3.1	3.2	---	---	19.4	28.6	28.6
HHS direct programs and grants to States.....	---	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.3	9.0
FDA direct enforcement and grants to States.....	---	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	1.6	3.5	11.7
Grants to States for ASSIST-type programs.....	---	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.5	1.3	5.0
Direct Federal R&D to discourage tobacco use.....	---	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2	3.8
Payments to tobacco-sponsored events/teams.....	---	---	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8	0.9
Public educ. campaign run by non-profit board.....	---	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	2.7	5.9	18.8
HHS payments for tobacco use cessation programs.....	---	1.0	1.1	1.1	1.1	1.7	1.8	1.8	1.9	2.0	2.0	6.0	15.5	54.1
Spending of look-back surcharge (90% grants).....	---	---	---	---	---	1.1	0.0	0.8	0.2	0.4	0.6	1.1	3.1	9.9
Subtotal, specified spending in bill.....	---	4.7	5.0	6.2	7.1	10.2	6.4	7.4	7.0	4.1	4.3	33.2	62.3	141.8
Unspecified residual to reach total payments.....	10.0	1.5	1.8	2.1	2.9	1.6	4.0	3.7	3.9	6.4	6.4	19.8	44.3	163.1
Total, Federal outlays, excl. debt Service.....	10.0	6.1	6.7	8.3	10.0	11.8	10.4	11.1	10.9	10.5	10.8	53.0	106.6	304.9
Federal deficit:														
Revenues (deficit effect).....	(7.5)	(4.3)	(4.5)	(5.6)	(6.6)	(10.5)	(9.1)	(12.0)	(11.6)	(11.4)	(12.7)	(39.0)	(95.8)	(312.3)
Programmatic outlays.....	10.0	6.1	6.7	8.3	10.0	11.8	10.4	11.1	10.9	10.5	10.8	53.0	106.6	304.9
Debt service.....	0.1	0.2	0.3	0.4	0.5	0.7	0.9	1.1	1.3	1.5	1.8	2.1	8.6	128.7
Federal deficit.....	2.6	2.1	2.5	3.1	3.9	1.9	2.2	0.2	0.5	0.6	(0.1)	16.0	19.4	121.2
MEMORANDUM: PAYGO budget effects:														
Revenues (deficit effect).....	(7.5)	(4.6)	(5.0)	(6.3)	(7.5)	(11.7)	(10.1)	(13.3)	(12.8)	(12.6)	(13.9)	(42.6)	(105.3)	(338.8)
Outlays.....	10.0	6.1	6.7	8.3	10.0	11.8	10.4	11.1	10.9	10.5	10.8	53.0	106.6	304.9
Total PAYGO deficit effect.....	2.5	1.5	1.7	2.1	2.5	0.1	0.3	(2.2)	(1.9)	(2.1)	(3.1)	10.4	1.3	(33.9)
ADDENDA:														
Available (residual) spending if held to PAYGO neutrality	7.5	(0.1)	0.1	0.0	0.4	1.5	3.7	5.9	5.8	8.5	9.6	9.4	43.0	197.0
Available (residual) spending if held to budget neutrality..	7.5	(0.4)	(0.5)	(0.6)	(0.5)	0.4	2.7	4.7	4.7	7.3	8.3	5.9	33.5	170.5
Deficit impact of higher CPI (COLAs and indexation).....	---	0.5	1.5	2.5	3.4	3.9	4.2	4.4	4.5	4.6	4.6	11.9	34.3	---
Potential increase in Federal matching grants(lower end)	0.8	0.7	0.9	1.1	1.4	0.8	2.0	1.9	2.0	3.2	3.2	5.7	17.9	77.3
Potential increase in Federal matching grants(upper end)	1.0	1.5	1.7	2.1	2.5	2.9	2.6	2.8	2.7	2.6	2.7	11.7	25.1	74.7
Reduction in current law State excise tax revenues.....	---	(0.6)	(0.7)	(0.9)	(1.1)	(1.5)	(1.4)	(1.7)	(1.6)	(1.7)	(1.8)	(4.7)	(12.8)	(44.1)

See Footnotes Next Page.

1. Reduction in tobacco volume is assumed to result solely from price increases due to passthrough of industry payments.
Access restrictions, public education, and cessation programs are assumed to have no additional effect.
2. In scenarios where youth targets are met, change in youth smoking is assumed to have no effect on total consumption.
3. Civil liability settlements are assumed to be at cap (33% of industry basic payments). Cap is assumed to be a single 33% cap for suits based on past and future conduct.
4. Corporate income tax rate of 35% is assumed in scenarios where surcharge payments are nondeductible.
5. No manufacturers are assumed to qualify for 75% good faith surcharge abatement.
6. All manufacturers are assumed to participate in the settlement.
7. All manufacturers are assumed to meet compliance plan and corporate culture requirements.
8. Amounts are assumed to increase for inflation as follows: (a) industry payments increase for inflation beginning in 1999; (b) outlays increase for inflation beginning in 1999; (c) surcharge amount and cap increase for inflation beginning in 1997.
9. All industry payments are assumed to score as Federal indirect business taxes (excise tax receipts).
As indirect business taxes, industry payments are subject to a 25% income offset (BEA convention).
10. All payments are assumed to be spent as Federal outlays.
11. The credit for excise tax increases enacted as part of BBA '97 is assumed to be repealed.
12. States could use some portion of increased funds to increase matched grant spending, thereby generating a Federal match.
13. CPI effects shown as memorandum only because they at least partially overlap with the 25% income offset.

SUMMARY OF BUDGETARY EFFECTS OF PROPOSED SETTLEMENT
TWO TIER SURCHARGE W/NONCUM. EXCISE TAX ABOVE 10 POINTS AND 30% TEEN NONPRICE EFFECT
(In billions of dollars)

09/09/97
08:05 PM

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08	98-23
RECEIPTS														
Base Payment (inc. trust and up-front payment).....	10	9	10	12	14	15	15	15	15	15	15	69	144	369
Payments to Recoup Excise Tax Credit and/or Losses..	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult Sales Volume Adjustment.....	--	(1)	(1)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(9)	(24)	(77)
Credit for Personal Compensation Claims.....	--	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(4)	(4)	(12)	(29)	(86)
Inflation Adjustment.....	--	0	0	1	1	2	2	2	2	2	3	4	15	97
Credit for BBA Excise Taxes.....	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Look-Back Surcharge for Youth Consumption.....	==	==	==	==	==	==	==	0	1	0	1	==	2	9
Net Industry Settlement Payments.....	10	6	7	8	10	11	11	11	12	11	11	52	108	311
Tax Offsets														
Indirect Business Tax Offset.....	(3)	(2)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(13)	(27)	(78)
Corporate Income Tax on Look-Back Surcharge.....	--	--	--	--	--	--	--	0	1	0	1	--	1	5
Youth Excise Tax Trigger.....	--	--	--	--	--	--	--	--	--	--	1	--	1	23
Reduction in Existing Federal Excise Taxes.....	(0)	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(4)	(9)	(24)
Total Federal Tax Offsets.....	(3)	(2)	(2)	(3)	(3)	(4)	(4)	(4)	(4)	(4)	(2)	(17)	(33)	(75)
Net Additional Receipts to US Government.....	7	4	4	6	7	7	7	7	8	7	9	36	75	237
POTENTIAL USES/CHANGES														
State Attorneys General Proposals, Total.....	--	5	5	6	7	9	6	7	7	4	4	32	59	132
Offset Reduction in State Excise Taxes.....	0	1	1	1	1	1	1	1	1	1	2	5	12	41
Use of Youth Look-Back Surcharge (90% grants).....	--	--	--	--	--	--	--	0	1	0	1	--	2	9
Potential Increase in Federal Medicaid Match.....	1	2	2	2	2	3	3	3	3	3	3	12	25	76
Total Potential Uses.....	1	7	7	9	11	13	10	11	12	8	9	48	99	258
Memoranda:														
Ad Valorem Equivalent of Net Payments.....	17%	18%	22%	26%	28%	28%	29%	32%	29%	34%				
Change in Total Cigarette Consumption.....	-8%	-9%	-11%	-13%	-14%	-14%	-14%	-15%	-14%	-16%				
Percentage Point Shortfall from Youth Target.....						-3%	-10%	10%	10%	8%	20%			

Potential Budgetary Impacts of Tobacco Agreement
Two Tier Surcharge w/Noncum. Excise Tax Above 10 Points and 30% Teen Nonprice Effect
(in billions of dollars)

09/09/97
06:05 PM
CASTDATEMPTOBAC15

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08	98-23
Federal revenues:														
Industry payments:														
Up-front payment.....	10.0	--	--	--	--	--	--	--	--	--	--	10.0	10.0	10.0
Public health trust funds in bill.....	--	2.5	2.5	3.5	4.0	5.0	2.5	2.5	2.5	--	--	17.5	25.0	25.0
Base amounts in bill.....	--	6.0	7.0	8.0	10.0	10.0	12.5	12.5	12.5	15.0	15.0	41.0	108.5	333.5
Additional amounts to recover BBA97 credit.....	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Additional amounts to recover excise tax losses.....	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult sales volume adjustments.....	--	(0.7)	(1.1)	(1.6)	(2.4)	(2.7)	(2.8)	(2.8)	(3.1)	(3.0)	(3.3)	(8.6)	(23.5)	(77.0)
Credits for civil suits at cap.....	--	(1.8)	(2.0)	(2.3)	(2.7)	(2.7)	(3.4)	(3.3)	(3.3)	(4.0)	(3.9)	(11.5)	(29.4)	(86.0)
Inflation adjustments on above.....	--	0.2	0.4	0.7	1.1	1.5	1.7	2.0	2.3	2.5	2.7	3.9	15.1	97.0
Credit for BBA97 excise tax increase.....	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Look-back surcharge.....	--	--	--	--	--	--	--	0.1	1.0	0.2	0.9	--	2.2	8.9
User fees for nonparticipants.....	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Net penalties.....	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Subtotal, industry payments.....	10.0	6.1	6.7	8.3	10.0	11.1	10.6	10.9	12.0	10.7	11.5	52.3	107.9	311.3
Tax offset at 25% (IBT).....	(2.5)	(1.5)	(1.7)	(2.1)	(2.5)	(2.8)	(2.6)	(2.7)	(3.0)	(2.7)	(2.9)	(13.1)	(27.0)	(77.8)
Corporate income tax on look-back surcharge.....	--	--	--	--	--	--	--	0.0	0.5	0.1	0.5	--	1.2	4.8
Teen excise tax.....	--	--	--	--	--	--	--	--	--	--	1.4	--	1.4	22.6
Reduction in tobacco excise taxes (non-PAYGO).....	(0.0)	(0.4)	(0.6)	(0.7)	(0.9)	(1.0)	(1.0)	(1.0)	(1.1)	(1.0)	(1.1)	(3.5)	(8.7)	(24.2)
Total, Federal revenues.....	7.5	4.2	4.5	5.6	6.6	7.3	6.9	7.2	8.5	7.1	9.4	35.7	74.9	236.7
Federal outlays:														
Public health trust funds in bill.....	--	2.6	2.7	3.8	4.5	5.8	3.0	3.1	3.2	--	--	19.4	28.6	28.6
HHS direct programs and grants to States.....	--	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.3	9.0
FDA direct enforcement and grants to States.....	--	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	1.6	3.5	11.7
Grants to States for ASSIST-type programs.....	--	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.5	1.3	5.0
Direct Federal R&D to discourage tobacco use.....	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2	3.8
Payments to tobacco-sponsored events/teams.....	--	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8	0.9
Public educ. campaign run by non-profit board.....	--	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	2.7	5.9	18.8
HHS payments for tobacco use cessation programs.....	--	1.0	1.1	1.1	1.1	1.7	1.8	1.8	1.9	2.0	2.0	6.0	15.5	54.1
Spending of look-back surcharge (90% grants).....	--	--	--	--	--	--	--	0.1	1.0	0.2	0.9	--	2.2	8.9
Subtotal, specified spending in bill.....	--	4.7	5.0	6.2	7.1	9.1	6.4	6.6	7.8	3.9	4.7	32.1	61.4	140.8
Unspecified residual to reach total payments.....	10.0	1.5	1.8	2.1	2.9	2.0	4.2	4.3	4.2	6.8	6.8	20.2	46.5	170.5
Total, Federal outlays, excl. debt Service.....	10.0	6.1	6.7	8.3	10.0	11.1	10.6	10.9	12.0	10.7	11.5	52.3	107.9	311.3
Federal deficit:														
Revenues (deficit effect).....	(7.5)	(4.2)	(4.5)	(5.6)	(6.6)	(7.3)	(6.9)	(7.2)	(8.5)	(7.1)	(9.4)	(35.7)	(74.9)	(236.7)
Programmatic outlays.....	10.0	6.1	6.7	8.3	10.0	11.1	10.6	10.9	12.0	10.7	11.5	52.3	107.9	311.3
Debt service.....	0.1	0.2	0.3	0.4	0.5	0.7	0.9	1.1	1.3	1.5	1.8	2.1	8.6	128.7
Federal deficit.....	2.6	2.1	2.5	3.1	3.9	4.4	4.5	4.8	4.8	5.1	3.8	18.7	41.7	203.3
MEMORANDUM: PAYGO budget effects:														
Revenues (deficit effect).....	(7.5)	(4.6)	(5.0)	(6.3)	(7.5)	(8.3)	(7.9)	(8.2)	(9.5)	(8.1)	(10.6)	(39.2)	(83.6)	(260.9)
Outlays.....	10.0	6.1	6.7	8.3	10.0	11.1	10.6	10.9	12.0	10.7	11.5	52.3	107.9	311.3
Total PAYGO deficit effect.....	2.5	1.5	1.7	2.1	2.5	2.8	2.6	2.7	2.4	2.6	0.9	13.1	24.3	50.4
ADDENDA:														
Available (residual) spending if held to PAYGO neutrality	7.5	(0.1)	0.1	0.0	0.4	(0.8)	1.6	1.6	1.8	4.3	5.8	7.1	22.2	120.1
Available (residual) spending if held to budget neutrality..	7.5	(0.4)	(0.5)	(0.7)	(0.6)	(1.7)	0.6	0.6	0.7	3.3	4.7	3.6	13.5	95.9
Deficit impact of higher CPI (COLAs and indexation).....	--	0.5	1.5	2.5	3.4	3.9	4.2	4.4	4.5	4.6	4.6	11.9	34.3	--
Potential increase in Federal matching grants(lower end)	0.8	0.7	0.9	1.1	1.4	1.0	2.1	2.1	2.1	3.4	3.4	5.9	19.0	81.0
Potential increase in Federal matching grants(upper end)	1.0	1.5	1.7	2.1	2.5	2.8	2.6	2.7	3.0	2.7	2.9	11.6	25.5	76.3
Reduction in current law State excise tax revenues.....	(0.0)	(0.7)	(0.7)	(0.9)	(1.1)	(1.2)	(1.3)	(1.3)	(1.5)	(1.4)	(1.6)	(4.7)	(11.8)	(40.5)

See Footnotes Next Page.

1. Reduction in tobacco volume is assumed to result solely from price increases due to passthrough of industry payments.
Access restrictions, public education, and cessation programs are assumed to have no additional effect.
2. In scenarios where youth targets are met, change in youth smoking is assumed to have no effect on total consumption.
3. Civil liability settlements are assumed to be at cap (33% of industry basic payments). Cap is assumed to be a single 33% cap for suits based on past and future conduct.
4. Corporate income tax rate of 35% is assumed in scenarios where surcharge payments are nondeductible.
5. No manufacturers are assumed to qualify for 75% good faith surcharge abatement.
6. All manufacturers are assumed to participate in the settlement.
7. All manufacturers are assumed to meet compliance plan and corporate culture requirements.
8. Amounts are assumed to increase for inflation as follows: (a) industry payments increase for inflation beginning in 1999;
(b) outlays increase for inflation beginning in 1999; (c) surcharge amount and cap increase for inflation beginning in 1997.
9. All industry payments are assumed to score as Federal indirect business taxes (excise tax receipts).
As indirect business taxes, industry payments are subject to a 25% income offset (BEA convention).
10. All payments are assumed to be spent as Federal outlays.
11. The credit for excise tax increases enacted as part of BBA '97 is assumed to be repealed.
12. States could use some portion of increased funds to increase matched grant spending, thereby generating a Federal match.
13. CPI effects shown as memorandum only because they at least partially overlap with the 25% income offset.

Patrick G. Locke



09/02/97 08:34:56 PM

Record Type: Record

To: Jerold R. Mande/OSTP/EOP
cc: See the distribution list at the bottom of this message
Subject: Re: Tobacco penalty scenarios

The attached spreadsheets contain the variants on the youth lookback surcharge that you asked for last week. All of these spreadsheets are set up to print a summary table and a more detailed table.

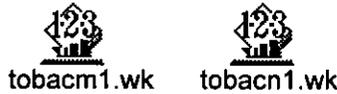
For each scenario, I have created two spreadsheets. The first estimates teen demand based on price effects only. This is consistent with Treasury's scenarios to date. The second spreadsheet for each scenario adds a 30% nonprice effect on top of the price effect. Even with this large nonprice effect, the teen smoking targets are generally not met, but the lower teen smoking does illustrate the sensitivity of the surcharge variants to teen smoking outcomes.

The scenarios are as follows:

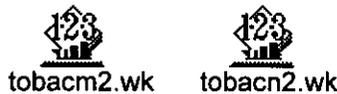
Base scenario -- \$80 million surcharge per percentage shortfall from the target. Surcharge is deductible by the industry. This scenario is in tobacco.wk4 (price only) and tobacn.wk4 (nonprice).



Uncapped, doubled surcharge -- \$160 million surcharge per percentage point, still deductible. No cap on surcharge payments. This scenario is in tobacm1.wk4 and tobacn1.wk4.



Nondeductible, uncapped surcharge -- \$80 million surcharge per percentage point, but not tax deductible. These scenarios assume that the industry will raise prices sufficiently to recoup the required penalty on an aftertax basis. As a result, the budget will gain increased receipts from the corporation income tax. The pretax cost to the companies is the sum of the surcharge and the increased corporation income tax. These scenarios are in tobacm2.wk4 and tobacn2.wk4.



Two tier, uncapped surcharge -- \$80 million deductible surcharge per percentage point up to 10 percentage points, followed by \$160 million nondeductible surcharge per percentage point for any shortfall above 10 percentage points. Again, any nondeductible surcharge results in higher

corporation income tax payments. These scenarios are in tobacm3.wk4 and tobacn3.wk4.



tobacm3.wk



tobacn3.wk

Excise tax trigger -- In addition to the surcharge in the settlement, an excise tax of 10 cent a pack in 2003, 20 cents in 2005, and 30 cents in 2008 if the youth targets are not met. These scenarios are in tobacm4.wk4 and tobacn4.wk4.



tobacm4.wk



tobacn4.wk

Message Copied To:

Hugh T. Connelly/OMB/EOP
Joseph J. Minarik/OMB/EOP
Randolph M. Lyon/OMB/EOP
Charles F. Stone/CEA/EOP
Elena Kagan/OPD/EOP

SUMMARY OF BUDGETARY EFFECTS OF PROPOSED SETTLEMENT

09/08/97

BASE SCENARIO

01:58 PM

(In billions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
RECEIPTS													
Base Payment (inc. trust and up-front payment).....	10	9	10	12	14	15	15	15	15	15	15	69	144
Payments to Recoup Excise Tax Credit and/or Losses..	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult Sales Volume Adjustment.....	--	(1)	(1)	(1)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(8)	(21)
Credit for Personal Compensation Claims.....	--	(1)	(2)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(9)	(24)
Inflation Adjustment.....	--	0	0	1	1	2	2	2	3	3	3	4	17
Credit for BBA Excise Taxes.....	--	--	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(11)	(27)
Look-Back Surcharge for Youth Consumption.....	=	=	=	=	=	3	2	3	2	1	3	3	13
Net Industry Settlement Payments.....	10	7	5	7	8	11	10	11	11	10	12	47	101
Tax Offsets													
Indirect Business Tax Offset.....	(3)	(2)	(1)	(2)	(2)	(3)	(2)	(3)	(3)	(3)	(3)	(12)	(25)
Corporate Income Tax on Look-Back Surcharge.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Youth Excise Tax Trigger.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Reduction in Existing Federal Excise Taxes.....	=	(0)	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(3)	(7)
Total Federal Tax Offsets.....	(3)	(2)	(2)	(2)	(3)	(4)	(3)	(4)	(4)	(3)	(4)	(15)	(32)
Net Additional Receipts to US Government.....	8	5	3	5	5	7	7	8	7	7	8	32	69
POTENTIAL USES/CHANGES													
State Attorneys General Proposals, Total.....	--	5	5	6	7	9	6	7	7	4	4	32	59
Offset Reduction in State Excise Taxes.....	--	1	1	1	1	1	1	1	1	1	1	4	10
Use of Youth Look-Back Surcharge (90% grants).....	--	--	--	--	--	3	2	3	2	1	3	3	13
Potential Increase in Federal Medicaid Match.....	1	2	1	2	2	3	2	3	3	3	3	10	24
Total Potential Uses.....	1	7	7	9	10	16	12	13	13	9	11	49	106
Memoranda:													
Ad Valorem Equivalent of Net Payments.....	17%	13%	17%	19%	27%	25%	27%	26%	25%	28%			
Change in Total Cigarette Consumption.....	-7%	-6%	-8%	-9%	-12%	-11%	-12%	-12%	-11%	-13%			
Percentage Point Shortfall from Youth Target.....						30%	26%	47%	46%	47%	58%		

Potential Budgetary Impacts of Tobacco Agreement
Base Scenario
(in billions of dollars)

09/08/97
01:58 PM
CASTD\TEMP\TOBAC

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
Federal revenues:													
Industry payments:													
Up-front payment.....	10.0	---	---	---	---	---	---	---	---	---	---	10.0	10.0
Public health trust funds in bill.....	---	2.5	2.5	3.5	4.0	5.0	2.5	2.5	2.5	---	---	17.5	25.0
Base amounts in bill.....	---	6.0	7.0	8.0	10.0	10.0	12.5	12.5	12.5	15.0	15.0	41.0	108.5
Additional amounts to recover BBA97 credit.....	---	---	---	---	---	---	---	---	---	---	---	---	---
Additional amounts to recover excise tax losses.....	---	---	---	---	---	---	---	---	---	---	---	---	---
Adult sales volume adjustments.....	---	(0.7)	(0.9)	(1.4)	(2.0)	(2.6)	(2.6)	(2.8)	(2.7)	(2.7)	(2.9)	(7.7)	(21.5)
Credits for civil suits at cap.....	---	(1.4)	(1.7)	(1.9)	(2.3)	(2.2)	(2.7)	(2.7)	(2.7)	(3.2)	(3.2)	(9.4)	(23.9)
Inflation adjustments on above.....	---	0.2	0.4	0.8	1.2	1.6	1.9	2.2	2.6	2.7	3.1	4.2	16.6
Credit for BBA97 excise tax increase.....	---	---	(2.4)	(2.3)	(3.4)	(3.2)	(3.3)	(3.2)	(3.2)	(3.2)	(3.2)	(11.3)	(27.3)
Look-back surcharge.....	---	---	---	---	---	2.6	1.6	2.7	2.0	1.5	3.0	2.6	13.4
User fees for nonparticipants.....	---	---	---	---	---	---	---	---	---	---	---	---	---
Net penalties.....	---	---	---	---	---	---	---	---	---	---	---	---	---
Subtotal, industry payments.....	10.0	6.5	5.0	6.7	7.6	11.1	9.9	11.2	10.9	10.0	11.7	46.9	100.7
Tax offset at 25% (IBT).....	(2.5)	(1.6)	(1.2)	(1.7)	(1.9)	(2.8)	(2.5)	(2.8)	(2.7)	(2.5)	(2.9)	(11.7)	(25.2)
Corporate income tax on look-back surcharge.....	---	---	---	---	---	---	---	---	---	---	---	---	---
Teen excise tax.....	---	---	---	---	---	---	---	---	---	---	---	---	---
Reduction in tobacco excise taxes (non-PAYGO).....	---	(0.3)	(0.4)	(0.5)	(0.7)	(0.9)	(0.8)	(0.9)	(0.8)	(0.8)	(0.9)	(2.8)	(7.1)
Total, Federal revenues.....	7.5	4.5	3.3	4.5	5.0	7.5	6.6	7.6	7.3	6.7	7.9	32.4	68.5
Federal outlays:													
Public health trust funds in bill.....	---	2.6	2.7	3.8	4.5	5.8	3.0	3.1	3.2	---	---	19.4	28.6
HHS direct programs and grants to States.....	---	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.3
FDA direct enforcement and grants to States.....	---	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	1.6	3.5
Grants to States for ASSIST-type programs.....	---	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.5	1.3
Direct Federal R&D to discourage tobacco use.....	---	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2
Payments to tobacco-sponsored events/teams.....	---	---	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8
Public educ. campaign run by non-profit board.....	---	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	2.7	5.9
HHS payments for tobacco use cessation programs.....	---	1.0	1.1	1.1	1.1	1.7	1.8	1.8	1.9	2.0	2.0	6.0	15.5
Spending of look-back surcharge (90% grants).....	---	---	---	---	---	2.6	1.6	2.7	2.0	1.5	3.0	2.6	13.4
Subtotal, specified spending in bill.....	---	4.7	5.0	6.2	7.1	11.6	8.0	9.3	8.7	5.2	6.8	34.6	72.6
Unspecified residual to reach total payments.....	10.0	1.8	(0.0)	0.5	0.5	(0.5)	1.9	2.0	2.1	4.9	5.0	12.3	28.2
Total, Federal outlays, excl. debt Service.....	10.0	6.5	5.0	6.7	7.6	11.1	9.9	11.2	10.9	10.0	11.7	46.9	100.7
Federal deficit:													
Revenues (deficit effect).....	(7.5)	(4.5)	(3.3)	(4.5)	(5.0)	(7.5)	(6.6)	(7.6)	(7.3)	(6.7)	(7.9)	(32.4)	(68.5)
Programmatic outlays.....	10.0	6.5	5.0	6.7	7.6	11.1	9.9	11.2	10.9	10.0	11.7	46.9	100.7
Debt service.....	0.1	0.2	0.3	0.4	0.5	0.7	0.9	1.1	1.3	1.5	1.8	2.1	8.6
Federal deficit.....	2.6	2.2	1.9	2.6	3.1	4.3	4.2	4.8	4.9	4.8	5.6	16.6	40.9
MEMORANDUM: PAYGO budget effects:													
Revenues (deficit effect).....	(7.5)	(4.9)	(3.7)	(5.0)	(5.7)	(8.4)	(7.5)	(8.4)	(8.2)	(7.5)	(8.8)	(35.2)	(75.6)
Outlays.....	10.0	6.5	5.0	6.7	7.6	11.1	9.9	11.2	10.9	10.0	11.7	46.9	100.7
Total PAYGO deficit effect.....	2.5	1.6	1.2	1.7	1.9	2.8	2.5	2.8	2.7	2.5	2.9	11.7	25.2
ADDENDA:													
Available (residual) spending if held to PAYGO neutrality	7.5	0.2	(1.2)	(1.2)	(1.4)	(3.3)	(0.5)	(0.8)	(0.6)	2.4	2.0	0.6	3.0
Available (residual) spending if held to budget neutrality..	7.5	(0.1)	(1.6)	(1.7)	(2.1)	(4.2)	(1.4)	(1.7)	(1.4)	1.5	1.1	(2.2)	(4.1)
Deficit impact of higher CPI (COLAs and indexation).....	---	0.5	1.5	2.5	3.4	3.9	4.2	4.4	4.5	4.6	4.6	11.9	34.3
Potential increase in Federal matching grants(lower end)	0.8	0.9	(0.0)	0.2	0.2	(0.3)	1.0	1.0	1.1	2.4	2.5	1.9	9.8
Potential increase in Federal matching grants(upper end)	1.0	1.6	1.2	1.7	1.9	2.8	2.5	2.8	2.7	2.5	2.9	10.2	23.7
Reduction in current law State excise tax revenues.....	---	(0.6)	(0.5)	(0.7)	(0.8)	(1.1)	(1.1)	(1.2)	(1.2)	(1.1)	(1.3)	(3.8)	(9.6)

See Footnotes Next Page.

1. Reduction in tobacco volume is assumed to result solely from price increases due to passthrough of industry payments.
Access restrictions, public education, and cessation programs are assumed to have no additional effect.
2. Civil liability settlements are assumed to be at cap (33% of industry basic payments). Cap is assumed to be a single 33% cap for suits based on past and future conduct.
3. Corporate income tax rate of 35% is assumed in scenarios where surcharge payments are nondeductible.
4. No manufacturers are assumed to qualify for 75% good faith surcharge abatement.
5. All manufacturers are assumed to participate in the settlement.
6. All manufacturers are assumed to meet compliance plan and corporate culture requirements.
7. Amounts are assumed to increase for inflation as follows: (a) industry payments increase for inflation beginning in 1999;
(b) outlays increase for inflation beginning in 1999; (c) surcharge amount and cap increase for inflation beginning in 1997.
8. All industry payments are assumed to score as Federal Indirect Business Taxes (excise tax receipts).
As Indirect Business Taxes, industry payments are subject to a 25% income offset (BEA convention).
9. All payments are assumed to be spent as Federal outlays.
10. Industry payments are reduced to provide a credit for excise tax increases enacted as part of BBA '97.
11. States could use some portion of increased funds to increase matched grant spending, thereby generating a Federal match.
12. CPI effects shown as memorandum only because they at least partially overlap with the 25% income offset.

**SUMMARY OF BUDGETARY EFFECTS OF PROPOSED SETTLEMENT
BASE SCENARIO WITH ADDITIONAL 30% NONPRICE REDUCTION IN TEEN SMOKING**

09/08/97

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(In billions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
RECEIPTS													
Base Payment (inc. trust and up-front payment).....	10	9	10	12	14	15	15	15	15	15	15	69	144
Payments to Recoup Excise Tax Credit and/or Losses..	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult Sales Volume Adjustment.....	--	(1)	(1)	(1)	(2)	(2)	(2)	(2)	(2)	(3)	(3)	(7)	(20)
Credit for Personal Compensation Claims.....	--	(1)	(2)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(10)	(24)
Inflation Adjustment.....	--	0	0	1	1	2	2	2	3	3	3	4	17
Credit for BBA Excise Taxes.....	--	--	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(11)	(28)
Look-Back Surcharge for Youth Consumption.....	=	=	=	=	=	0	=	1	1	0	2	0	4
Net Industry Settlement Payments.....	10	7	5	7	8	9	9	10	10	9	11	45	93
Tax Offsets													
Indirect Business Tax Offset.....	(3)	(2)	(1)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(3)	(11)	(23)
Corporate Income Tax on Look-Back Surcharge.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Youth Excise Tax Trigger.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Reduction in Existing Federal Excise Taxes.....	=	(0)	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(3)	(7)
Total Federal Tax Offsets.....	(3)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(4)	(14)	(30)
Net Additional Receipts to US Government.....	8	5	3	5	5	6	6	7	7	6	7	31	63
POTENTIAL USES/CHANGES													
State Attorneys General Proposals, Total.....	--	5	5	6	7	9	6	7	7	4	4	32	59
Offset Reduction in State Excise Taxes.....	--	1	1	1	1	1	1	1	1	1	1	4	9
Use of Youth Look-Back Surcharge (90% grants).....	--	--	--	--	--	0	--	1	1	0	2	0	4
Potential Increase in Federal Medicaid Match.....	1	2	1	2	2	2	2	2	2	2	3	10	22
Total Potential Uses.....	1	7	7	9	10	12	9	11	11	8	10	45	94
Memoranda:													
Ad Valorem Equivalent of Net Payments.....	17%	13%	17%	20%	22%	22%	24%	24%	24%	24%	27%		
Change in Total Cigarette Consumption.....	-7%	-6%	-8%	-9%	-10%	-10%	-11%	-11%	-11%	-11%	-12%		
Percentage Point Shortfall from Youth Target.....						1%	-6%	14%	13%	14%	24%		

Potential Budgetary Impacts of Tobacco Agreement
Base Scenario With Additional 30% Nonprice Reduction in Teen Smoking
(in billions of dollars)

09/08/97
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	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
Federal revenues:													
Industry payments:													
Up-front payment.....	10.0	---	---	---	---	---	---	---	---	---	---	10.0	10.0
Public health trust funds in bill.....	---	2.5	2.5	3.5	4.0	5.0	2.5	2.5	2.5	---	---	17.5	25.0
Base amounts in bill.....	---	6.0	7.0	8.0	10.0	10.0	12.5	12.5	12.5	15.0	15.0	41.0	108.5
Additional amounts to recover BBA97 credit.....	---	---	---	---	---	---	---	---	---	---	---	---	---
Additional amounts to recover excise tax losses.....	---	---	---	---	---	---	---	---	---	---	---	---	---
Adult sales volume adjustments.....	---	(0.7)	(0.9)	(1.3)	(1.9)	(2.2)	(2.3)	(2.5)	(2.5)	(2.5)	(2.7)	(7.1)	(19.6)
Credits for civil suits at cap.....	---	(1.5)	(1.7)	(1.9)	(2.3)	(2.2)	(2.8)	(2.8)	(2.8)	(3.3)	(3.2)	(9.5)	(24.4)
Inflation adjustments on above.....	---	0.2	0.4	0.8	1.2	1.7	1.9	2.2	2.6	2.8	3.1	4.3	17.0
Credit for BBA97 excise tax increase.....	---	---	(2.4)	(2.3)	(3.4)	(3.3)	(3.3)	(3.3)	(3.3)	(3.2)	(3.2)	(11.3)	(27.6)
Look-back surcharge.....	---	---	---	---	---	0.1	---	1.1	0.7	0.5	1.9	0.1	4.3
User fees for nonparticipants.....	---	---	---	---	---	---	---	---	---	---	---	---	---
Net penalties.....	---	---	---	---	---	---	---	---	---	---	---	---	---
Subtotal, industry payments.....	10.0	6.5	5.0	6.8	7.7	9.0	8.5	9.9	9.8	9.2	10.8	44.9	93.2
Tax offset at 25% (IBT).....	(2.5)	(1.6)	(1.2)	(1.7)	(1.9)	(2.2)	(2.1)	(2.5)	(2.5)	(2.3)	(2.7)	(11.2)	(23.3)
Corporate income tax on look-back surcharge.....	---	---	---	---	---	---	---	---	---	---	---	---	---
Teen excise tax.....	---	---	---	---	---	---	---	---	---	---	---	---	---
Reduction in tobacco excise taxes (non-PAYGO).....	---	(0.3)	(0.4)	(0.5)	(0.7)	(0.7)	(0.7)	(0.8)	(0.8)	(0.8)	(0.8)	(2.7)	(6.6)
Total, Federal revenues.....	7.5	4.5	3.3	4.6	5.1	6.0	5.7	6.6	6.6	6.2	7.3	31.0	63.3
Federal outlays:													
Public health trust funds in bill.....	---	2.6	2.7	3.8	4.5	5.8	3.0	3.1	3.2	---	---	19.4	28.6
HHS direct programs and grants to States.....	---	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.3
FDA direct enforcement and grants to States.....	---	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	1.6	3.5
Grants to States for ASSIST-type programs.....	---	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.5	1.3
Direct Federal R&D to discourage tobacco use.....	---	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2
Payments to tobacco-sponsored events/teams.....	---	---	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8
Public educ. campaign run by non-profit board.....	---	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	2.7	5.9
HHS payments for tobacco use cessation programs.....	---	1.0	1.1	1.1	1.1	1.7	1.8	1.8	1.9	2.0	2.0	6.0	15.5
Spending of look-back surcharge (90% grants).....	---	---	---	---	---	0.1	---	1.1	0.7	0.5	1.9	0.1	4.3
Subtotal, specified spending in bill.....	---	4.7	5.0	6.2	7.1	9.2	6.4	7.6	7.4	4.2	5.7	32.2	63.5
Unspecified residual to reach total payments.....	10.0	1.8	0.0	0.5	0.5	(0.2)	2.2	2.2	2.4	5.1	5.2	12.8	29.7
Total, Federal outlays, excl. debt Service.....	10.0	6.5	5.0	6.8	7.7	9.0	8.5	9.9	9.8	9.2	10.8	44.9	93.2
Federal deficit:													
Revenues (deficit effect).....	(7.5)	(4.5)	(3.3)	(4.6)	(5.1)	(6.0)	(5.7)	(6.6)	(6.6)	(6.2)	(7.3)	(31.0)	(63.3)
Programmatic outlays.....	10.0	6.5	5.0	6.8	7.7	9.0	8.5	9.9	9.8	9.2	10.8	44.9	93.2
Debt service.....	0.1	0.2	0.3	0.4	0.5	0.7	0.8	1.0	1.2	1.4	1.7	2.1	8.2
Federal deficit.....	2.6	2.2	1.9	2.6	3.1	3.6	3.7	4.3	4.4	4.5	5.2	16.0	38.1
MEMORANDUM: PAYGO budget effects:													
Revenues (deficit effect).....	(7.5)	(4.9)	(3.7)	(5.1)	(5.7)	(6.7)	(6.4)	(7.4)	(7.4)	(6.9)	(8.1)	(33.7)	(69.9)
Outlays.....	10.0	6.5	5.0	6.8	7.7	9.0	8.5	9.9	9.8	9.2	10.8	44.9	93.2
Total PAYGO deficit effect.....	2.5	1.6	1.2	1.7	1.9	2.2	2.1	2.5	2.5	2.3	2.7	11.2	23.3
ADDENDA:													
Available (residual) spending if held to PAYGO neutrality	7.5	0.2	(1.2)	(1.1)	(1.4)	(2.4)	0.0	(0.2)	(0.1)	2.7	2.4	1.5	6.4
Available (residual) spending if held to budget neutrality..	7.5	(0.1)	(1.6)	(1.7)	(2.0)	(3.2)	(0.7)	(1.0)	(0.9)	2.0	1.6	(1.1)	(0.2)
Deficit impact of higher CPI (COLAs and indexation).....	---	0.5	1.5	2.5	3.4	3.9	4.2	4.4	4.5	4.6	4.6	11.9	34.3
Potential increase in Federal matching grants(lower end)	0.8	0.9	0.0	0.3	0.3	(0.1)	1.1	1.1	1.2	2.5	2.6	2.1	10.6
Potential increase in Federal matching grants(upper end)	1.0	1.6	1.2	1.7	1.9	2.2	2.1	2.5	2.5	2.3	2.7	9.7	21.8
Reduction in current law State excise tax revenues.....	---	(0.6)	(0.5)	(0.7)	(0.8)	(0.9)	(0.9)	(1.1)	(1.1)	(1.1)	(1.2)	(3.6)	(9.0)

See Footnotes Next Page.

1. Reduction in tobacco volume is assumed to result solely from price increases due to passthrough of industry payments.
Access restrictions, public education, and cessation programs are assumed to have no additional effect.
2. Civil liability settlements are assumed to be at cap (33% of industry basic payments). Cap is assumed to be a single 33% cap for suits based on past and future conduct.
3. Corporate income tax rate of 35% is assumed in scenarios where surcharge payments are nondeductible.
4. No manufacturers are assumed to qualify for 75% good faith surcharge abatement.
5. All manufacturers are assumed to participate in the settlement.
6. All manufacturers are assumed to meet compliance plan and corporate culture requirements.
7. Amounts are assumed to increase for inflation as follows: (a) industry payments increase for inflation beginning in 1999; (b) outlays increase for inflation beginning in 1999; (c) surcharge amount and cap increase for inflation beginning in 1997.
8. All industry payments are assumed to score as Federal Indirect Business Taxes (excise tax receipts).
As Indirect Business Taxes, industry payments are subject to a 25% income offset (BEA convention).
9. All payments are assumed to be spent as Federal outlays.
10. Industry payments are reduced to provide a credit for excise tax increases enacted as part of BBA '97.
11. States could use some portion of increased funds to increase matched grant spending, thereby generating a Federal match.
12. CPI effects shown as memorandum only because they at least partially overlap with the 25% income offset.

**SUMMARY OF BUDGETARY EFFECTS OF PROPOSED SETTLEMENT
WITH UNCAPPED YOUTH SURCHARGE OF \$160 MILLION PER PERCENTAGE POINT**

09/08/97

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(In billions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
RECEIPTS													
Base Payment (inc. trust and up-front payment).....	10	9	10	12	14	15	15	15	15	15	15	69	144
Payments to Recoup Excise Tax Credit and/or Losses..	—	—	—	—	—	—	—	—	—	—	—	—	—
Adult Sales Volume Adjustment.....	—	(1)	(1)	(1)	(2)	(3)	(2)	(3)	(3)	(3)	(3)	(8)	(23)
Credit for Personal Compensation Claims.....	—	(1)	(2)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(9)	(24)
Inflation Adjustment.....	—	0	0	1	1	2	2	2	3	3	3	4	16
Credit for BBA Excise Taxes.....	—	—	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(11)	(27)
Look-Back Surcharge for Youth Consumption.....	—	—	—	—	—	7	—	8	1	4	5	7	26
Net Industry Settlement Payments.....	10	7	5	7	8	15	8	16	10	13	14	51	112
Tax Offsets													
Indirect Business Tax Offset.....	(3)	(2)	(1)	(2)	(2)	(4)	(2)	(4)	(3)	(3)	(3)	(13)	(28)
Corporate Income Tax on Look-Back Surcharge.....	—	—	—	—	—	—	—	—	—	—	—	—	—
Youth Excise Tax Trigger.....	—	—	—	—	—	—	—	—	—	—	—	—	—
Reduction in Existing Federal Excise Taxes.....	—	(0)	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(3)	(8)
Total Federal Tax Offsets.....	(3)	(2)	(2)	(2)	(3)	(5)	(3)	(5)	(3)	(4)	(4)	(16)	(36)
Net Additional Receipts to US Government.....	8	5	3	5	5	10	6	11	7	9	9	35	76
POTENTIAL USES/CHANGES													
State Attorneys General Proposals, Total.....	—	5	5	6	7	9	6	7	7	4	4	32	59
Offset Reduction in State Excise Taxes.....	—	1	1	1	1	1	1	2	1	1	1	4	11
Use of Youth Look-Back Surcharge (90% grants).....	—	—	—	—	—	7	—	8	1	4	5	7	26
Potential Increase in Federal Medicaid Match.....	1	2	1	2	2	4	2	4	3	3	3	11	27
Total Potential Uses.....	1	7	7	9	10	21	9	20	12	13	14	54	122
Memoranda:													
Ad Valorem Equivalent of Net Payments.....	17%	13%	17%	19%	35%	22%	38%	25%	31%	32%			
Change in Total Cigarette Consumption.....	-7%	-6%	-8%	-9%	-16%	-10%	-17%	-11%	-14%	-14%			
Percentage Point Shortfall from Youth Target.....						30%	20%	50%	39%	48%	55%		

Potential Budgetary Impacts of Tobacco Agreement
With Uncapped Youth Surcharge of \$160 Million Per Percentage Point
(in billions of dollars)

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	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
Federal revenues:													
Industry payments:													
Up-front payment.....	10.0	--	--	--	--	--	--	--	--	--	--	10.0	10.0
Public health trust funds in bill.....	--	2.5	2.5	3.5	4.0	5.0	2.5	2.5	2.5	--	--	17.5	25.0
Base amounts in bill.....	--	6.0	7.0	8.0	10.0	10.0	12.5	12.5	12.5	15.0	15.0	41.0	108.5
Additional amounts to recover BBA97 credit.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Additional amounts to recover excise tax losses.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult sales volume adjustments.....	--	(0.7)	(0.9)	(1.4)	(2.0)	(3.1)	(2.4)	(3.4)	(2.7)	(3.1)	(3.2)	(8.2)	(22.9)
Credits for civil suits at cap.....	--	(1.4)	(1.7)	(1.9)	(2.3)	(2.1)	(2.8)	(2.6)	(2.7)	(3.2)	(3.1)	(9.3)	(23.6)
Inflation adjustments on above.....	--	0.2	0.4	0.8	1.2	1.6	1.9	2.1	2.6	2.7	3.0	4.2	16.4
Credit for BBA97 excise tax increase.....	--	--	(2.4)	(2.3)	(3.4)	(3.1)	(3.3)	(3.0)	(3.2)	(3.1)	(3.1)	(11.1)	(27.0)
Look-back surcharge.....	--	--	--	--	--	6.7	--	8.1	1.5	4.4	5.1	6.7	25.8
User fees for nonparticipants.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Net penalties.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Subtotal, industry payments.....	10.0	6.5	5.0	6.7	7.6	14.9	8.4	16.2	10.4	12.8	13.7	50.7	112.1
Tax offset at 25% (IBT).....	(2.5)	(1.6)	(1.2)	(1.7)	(1.9)	(3.7)	(2.1)	(4.0)	(2.6)	(3.2)	(3.4)	(12.7)	(28.0)
Corporate income tax on look-back surcharge.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Teen excise tax.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Reduction in tobacco excise taxes (non-PAYGO).....	--	(0.3)	(0.4)	(0.5)	(0.7)	(1.1)	(0.7)	(1.2)	(0.8)	(1.0)	(1.0)	(3.1)	(7.8)
Total, Federal revenues.....	7.5	4.5	3.3	4.5	5.0	10.1	5.6	10.9	7.0	8.6	9.2	35.0	76.3
Federal outlays:													
Public health trust funds in bill.....	--	2.6	2.7	3.8	4.5	5.8	3.0	3.1	3.2	--	--	19.4	28.6
HHS direct programs and grants to States.....	--	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.3
FDA direct enforcement and grants to States.....	--	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	1.6	3.5
Grants to States for ASSIST-type programs.....	--	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.5	1.3
Direct Federal R&D to discourage tobacco use.....	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2
Payments to tobacco-sponsored events/teams.....	--	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8
Public educ. campaign run by non-profit board.....	--	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	2.7	5.9
HHS payments for tobacco use cessation programs.....	--	1.0	1.1	1.1	1.1	1.7	1.8	1.8	1.9	2.0	2.0	6.0	15.5
Spending of look-back surcharge (90% grants).....	--	--	--	--	--	6.7	--	8.1	1.5	4.4	5.1	6.7	25.8
Subtotal, specified spending in bill.....	--	4.7	5.0	6.2	7.1	15.8	6.4	14.6	8.2	8.1	8.9	38.8	84.9
Unspecified residual to reach total payments.....	10.0	1.8	(0.0)	0.5	0.5	(0.9)	2.1	1.5	2.2	4.6	4.8	11.9	27.2
Total, Federal outlays, excl. debt Service.....	10.0	6.5	5.0	6.7	7.6	14.9	8.4	16.2	10.4	12.8	13.7	50.7	112.1
Federal deficit:													
Revenues (deficit effect).....	(7.5)	(4.5)	(3.3)	(4.5)	(5.0)	(10.1)	(5.6)	(10.9)	(7.0)	(8.6)	(9.2)	(35.0)	(76.3)
Programmatic outlays.....	10.0	6.5	5.0	6.7	7.6	14.9	8.4	16.2	10.4	12.8	13.7	50.7	112.1
Debt service.....	0.1	0.2	0.3	0.4	0.5	0.7	0.9	1.1	1.3	1.5	1.8	2.1	8.6
Federal deficit.....	2.6	2.2	1.9	2.6	3.1	5.6	3.7	6.3	4.7	5.7	6.2	17.8	44.5
MEMORANDUM: PAYGO budget effects:													
Revenues (deficit effect).....	(7.5)	(4.9)	(3.7)	(5.0)	(5.7)	(11.2)	(6.3)	(12.1)	(7.8)	(9.6)	(10.2)	(38.0)	(84.1)
Outlays.....	10.0	6.5	5.0	6.7	7.6	14.9	8.4	16.2	10.4	12.8	13.7	50.7	112.1
Total PAYGO deficit effect.....	2.5	1.6	1.2	1.7	1.9	3.7	2.1	4.0	2.6	3.2	3.4	12.7	28.0
ADDENDA:													
Available (residual) spending if held to PAYGO neutrality	7.5	0.2	(1.2)	(1.2)	(1.4)	(4.6)	(0.0)	(2.5)	(0.4)	1.5	1.4	(0.7)	(0.8)
Available (residual) spending if held to budget neutrality..	7.5	(0.1)	(1.6)	(1.7)	(2.1)	(5.7)	(0.8)	(3.7)	(1.2)	0.5	0.4	(3.8)	(8.6)
Deficit impact of higher CPI (COLAs and indexation).....	--	0.5	1.5	2.5	3.4	3.9	4.2	4.4	4.5	4.6	4.6	11.9	34.3
Potential increase in Federal matching grants(lower end)	0.8	0.9	(0.0)	0.2	0.2	(0.4)	1.0	0.8	1.1	2.3	2.4	1.7	9.3
Potential increase in Federal matching grants(upper end)	1.0	1.6	1.2	1.7	1.9	3.7	2.1	4.0	2.6	3.2	3.4	11.2	26.5
Reduction in current law State excise tax revenues.....	--	(0.6)	(0.5)	(0.7)	(0.8)	(1.4)	(0.9)	(1.6)	(1.1)	(1.4)	(1.5)	(4.1)	(10.6)

See Footnotes Next Page.

1. Reduction in tobacco volume is assumed to result solely from price increases due to passthrough of industry payments.
Access restrictions, public education, and cessation programs are assumed to have no additional effect.
2. Civil liability settlements are assumed to be at cap (33% of industry basic payments). Cap is assumed to be a single 33% cap for suits based on past and future conduct.
3. Corporate income tax rate of 35% is assumed in scenarios where surcharge payments are nondeductible.
4. No manufacturers are assumed to qualify for 75% good faith surcharge abatement.
5. All manufacturers are assumed to participate in the settlement.
6. All manufacturers are assumed to meet compliance plan and corporate culture requirements.
7. Amounts are assumed to increase for inflation as follows: (a) industry payments increase for inflation beginning in 1999;
(b) outlays increase for inflation beginning in 1999; (c) surcharge amount and cap increase for inflation beginning in 1997.
8. All industry payments are assumed to score as Federal Indirect Business Taxes (excise tax receipts).
As Indirect Business Taxes, industry payments are subject to a 25% income offset (BEA convention).
9. All payments are assumed to be spent as Federal outlays.
10. Industry payments are reduced to provide a credit for excise tax increases enacted as part of BBA '97.
11. States could use some portion of increased funds to increase matched grant spending, thereby generating a Federal match.
12. CPI effects shown as memorandum only because they at least partially overlap with the 25% income offset.

**SUMMARY OF BUDGETARY EFFECTS OF PROPOSED SETTLEMENT
WITH UNCAPPED YOUTH SURCHARGE OF \$160M PER PERCENTAGE POINT AND 30% NONPRICE EFFECT**

09/08/97

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(In billions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
RECEIPTS													
Base Payment (inc. trust and up-front payment).....	10	9	10	12	14	15	15	15	15	15	15	69	144
Payments to Recoup Excise Tax Credit and/or Losses..	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult Sales Volume Adjustment.....	--	(1)	(1)	(1)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(7)	(20)
Credit for Personal Compensation Claims.....	--	(1)	(2)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(10)	(24)
Inflation Adjustment.....	--	0	0	1	1	2	2	2	3	3	3	4	17
Credit for BBA Excise Taxes.....	--	--	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(11)	(27)
Look-Back Surcharge for Youth Consumption.....	--	--	--	--	--	0	--	2	1	1	4	0	8
Net Industry Settlement Payments.....	10	7	5	7	8	9	9	11	10	10	12	45	97
Tax Offsets													
Indirect Business Tax Offset.....	(3)	(2)	(1)	(2)	(2)	(2)	(2)	(3)	(3)	(2)	(3)	(11)	(24)
Corporate Income Tax on Look-Back Surcharge.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Youth Excise Tax Trigger.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Reduction in Existing Federal Excise Taxes.....	--	(0)	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(3)	(7)
Total Federal Tax Offsets.....	(3)	(2)	(2)	(2)	(3)	(3)	(3)	(4)	(3)	(3)	(4)	(14)	(31)
Net Additional Receipts to US Government.....	8	5	3	5	5	6	6	7	7	7	8	31	66
POTENTIAL USES/CHANGES													
State Attorneys General Proposals, Total.....	--	5	5	6	7	9	6	7	7	4	4	32	59
Offset Reduction in State Excise Taxes.....	--	1	1	1	1	1	1	1	1	1	1	4	9
Use of Youth Look-Back Surcharge (90% grants).....	--	--	--	--	--	0	--	2	1	1	4	0	8
Potential Increase in Federal Medicaid Match.....	1	2	1	2	2	2	2	3	3	2	3	10	23
Total Potential Uses.....	1	7	7	9	10	13	9	13	11	8	12	46	99
Memoranda:													
Ad Valorem Equivalent of Net Payments.....		17%	13%	17%	20%	22%	22%	26%	25%	25%	30%		
Change in Total Cigarette Consumption.....		-7%	-6%	-8%	-9%	-10%	-10%	-12%	-11%	-11%	-13%		
Percentage Point Shortfall from Youth Target.....						1%	-6%	14%	12%	13%	23%		

Potential Budgetary Impacts of Tobacco Agreement
With Uncapped Youth Surcharge of \$160M Per Percentage Point and 30% Nonprice Effect
(in billions of dollars)

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	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
Federal revenues:													
Industry payments:													
Up-front payment.....	10.0	—	—	—	—	—	—	—	—	—	—	10.0	10.0
Public health trust funds in bill.....	—	2.5	2.5	3.5	4.0	5.0	2.5	2.5	2.5	—	—	17.5	25.0
Base amounts in bill.....	—	6.0	7.0	8.0	10.0	10.0	12.5	12.5	12.5	15.0	15.0	41.0	108.5
Additional amounts to recover BBA97 credit.....	—	—	—	—	—	—	—	—	—	—	—	—	—
Additional amounts to recover excise tax losses.....	—	—	—	—	—	—	—	—	—	—	—	—	—
Adult sales volume adjustments.....	—	(0.7)	(0.9)	(1.3)	(1.9)	(2.3)	(2.3)	(2.6)	(2.5)	(2.6)	(2.9)	(7.1)	(20.0)
Credits for civil suits at cap.....	—	(1.5)	(1.7)	(1.9)	(2.3)	(2.2)	(2.8)	(2.7)	(2.7)	(3.3)	(3.2)	(9.5)	(24.3)
Inflation adjustments on above.....	—	0.2	0.4	0.8	1.2	1.7	1.9	2.2	2.6	2.8	3.1	4.3	16.9
Credit for BBA97 excise tax increase.....	—	—	(2.4)	(2.3)	(3.4)	(3.3)	(3.3)	(3.2)	(3.2)	(3.2)	(3.1)	(11.3)	(27.5)
Look-back surcharge.....	—	—	—	—	—	0.2	—	2.1	1.1	1.1	3.6	0.2	8.2
User fees for nonparticipants.....	—	—	—	—	—	—	—	—	—	—	—	—	—
Net penalties.....	—	—	—	—	—	—	—	—	—	—	—	—	—
Subtotal, industry payments.....	10.0	6.5	5.0	6.8	7.7	9.1	8.5	10.8	10.1	9.8	12.5	45.0	96.8
Tax offset at 25% (IBT).....	(2.5)	(1.6)	(1.2)	(1.7)	(1.9)	(2.3)	(2.1)	(2.7)	(2.5)	(2.5)	(3.1)	(11.3)	(24.2)
Corporate income tax on look-back surcharge.....	—	—	—	—	—	—	—	—	—	—	—	—	—
Teen excise tax.....	—	—	—	—	—	—	—	—	—	—	—	—	—
Reduction in tobacco excise taxes (non-PAYGO).....	—	(0.3)	(0.4)	(0.5)	(0.7)	(0.7)	(0.7)	(0.9)	(0.8)	(0.8)	(0.9)	(2.7)	(6.8)
Total, Federal revenues.....	7.5	4.5	3.3	4.6	5.1	6.1	5.7	7.3	6.8	6.6	8.4	31.1	65.8
Federal outlays:													
Public health trust funds in bill.....	—	2.6	2.7	3.8	4.5	5.8	3.0	3.1	3.2	—	—	19.4	28.6
HHS direct programs and grants to States.....	—	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.3
FDA direct enforcement and grants to States.....	—	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	1.6	3.5
Grants to States for ASSIST-type programs.....	—	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.5	1.3
Direct Federal R&D to discourage tobacco use.....	—	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2
Payments to tobacco-sponsored events/teams.....	—	—	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8
Public educ. campaign run by non-profit board.....	—	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	2.7	5.9
HHS payments for tobacco use cessation programs.....	—	1.0	1.1	1.1	1.1	1.7	1.8	1.8	1.9	2.0	2.0	6.0	15.5
Spending of look-back surcharge (90% grants).....	—	—	—	—	—	0.2	—	2.1	1.1	1.1	3.6	0.2	8.2
Subtotal, specified spending in bill.....	—	4.7	5.0	6.2	7.1	9.3	6.4	8.7	7.8	4.8	7.4	32.3	67.4
Unspecified residual to reach total payments.....	10.0	1.8	0.0	0.5	0.5	(0.2)	2.2	2.1	2.3	5.0	5.0	12.8	29.4
Total, Federal outlays, excl. debt Service.....	10.0	6.5	5.0	6.8	7.7	9.1	8.5	10.8	10.1	9.8	12.5	45.0	96.8
Federal deficit:													
Revenues (deficit effect).....	(7.5)	(4.5)	(3.3)	(4.6)	(5.1)	(6.1)	(5.7)	(7.3)	(6.8)	(6.6)	(8.4)	(31.1)	(65.8)
Programmatic outlays.....	10.0	6.5	5.0	6.8	7.7	9.1	8.5	10.8	10.1	9.8	12.5	45.0	96.8
Debt service.....	0.1	0.2	0.3	0.4	0.5	0.7	0.8	1.0	1.2	1.4	1.7	2.1	8.3
Federal deficit.....	2.6	2.2	1.9	2.6	3.1	3.7	3.7	4.6	4.6	4.7	5.7	16.0	39.3
MEMORANDUM: PAYGO budget effects:													
Revenues (deficit effect).....	(7.5)	(4.9)	(3.7)	(5.1)	(5.7)	(6.8)	(6.4)	(8.1)	(7.6)	(7.4)	(9.3)	(33.8)	(72.6)
Outlays.....	10.0	6.5	5.0	6.8	7.7	9.1	8.5	10.8	10.1	9.8	12.5	45.0	96.8
Total PAYGO deficit effect.....	2.5	1.6	1.2	1.7	1.9	2.3	2.1	2.7	2.5	2.5	3.1	11.3	24.2
ADDENDA:													
Available (residual) spending if held to PAYGO neutrality	7.5	0.2	(1.2)	(1.1)	(1.4)	(2.5)	0.0	(0.6)	(0.2)	2.6	1.9	1.5	5.2
Available (residual) spending if held to budget neutrality..	7.5	(0.1)	(1.6)	(1.7)	(2.0)	(3.2)	(0.7)	(1.4)	(1.0)	1.7	1.0	(1.2)	(1.6)
Deficit impact of higher CPI (COLAs and indexation).....	—	0.5	1.5	2.5	3.4	3.9	4.2	4.4	4.5	4.6	4.6	11.9	34.3
Potential increase in Federal matching grants(lower end)	0.8	0.9	0.0	0.3	0.3	(0.1)	1.1	1.1	1.2	2.5	2.5	2.1	10.5
Potential increase in Federal matching grants(upper end)	1.0	1.6	1.2	1.7	1.9	2.3	2.1	2.7	2.5	2.5	3.1	9.8	22.7
Reduction in current law State excise tax revenues.....	—	(0.6)	(0.5)	(0.7)	(0.8)	(0.9)	(0.9)	(1.1)	(1.1)	(1.1)	(1.4)	(3.6)	(9.3)

See Footnotes Next Page.

1. Reduction in tobacco volume is assumed to result solely from price increases due to passthrough of industry payments.
Access restrictions, public education, and cessation programs are assumed to have no additional effect.
2. Civil liability settlements are assumed to be at cap (33% of industry basic payments). Cap is assumed to be a single 33% cap for suits based on past and future conduct.
3. Corporate income tax rate of 35% is assumed in scenarios where surcharge payments are nondeductible.
4. No manufacturers are assumed to qualify for 75% good faith surcharge abatement.
5. All manufacturers are assumed to participate in the settlement.
6. All manufacturers are assumed to meet compliance plan and corporate culture requirements.
7. Amounts are assumed to increase for inflation as follows: (a) industry payments increase for inflation beginning in 1999;
(b) outlays increase for inflation beginning in 1999; (c) surcharge amount and cap increase for inflation beginning in 1997.
8. All industry payments are assumed to score as Federal Indirect Business Taxes (excise tax receipts).
As Indirect Business Taxes, industry payments are subject to a 25% income offset (BEA convention).
9. All payments are assumed to be spent as Federal outlays.
10. Industry payments are reduced to provide a credit for excise tax increases enacted as part of BBA '97.
11. States could use some portion of increased funds to increase matched grant spending, thereby generating a Federal match.
12. CPI effects shown as memorandum only because they at least partially overlap with the 25% income offset.

**SUMMARY OF BUDGETARY EFFECTS OF PROPOSED SETTLEMENT
WITH UNCAPPED NONDEDUCTIBLE YOUTH SURCHARGE**

09/08/97

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(In billions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
RECEIPTS													
Base Payment (inc. trust and up-front payment).....	10	9	10	12	14	15	15	15	15	15	15	69	144
Payments to Recoup Excise Tax Credit and/or Losses..	—	—	—	—	—	—	—	—	—	—	—	—	—
Adult Sales Volume Adjustment.....	—	(1)	(1)	(1)	(2)	(3)	(2)	(3)	(3)	(3)	(3)	(8)	(22)
Credit for Personal Compensation Claims.....	—	(1)	(2)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(9)	(24)
Inflation Adjustment.....	—	0	0	1	1	2	2	2	3	3	3	4	16
Credit for BBA Excise Taxes.....	—	—	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(11)	(27)
Look-Back Surcharge for Youth Consumption.....	—	—	—	—	—	3	—	4	1	2	3	3	13
Net Industry Settlement Payments.....	10	7	5	7	8	12	8	12	10	10	11	47	100
Tax Offsets													
Indirect Business Tax Offset.....	(3)	(2)	(1)	(2)	(2)	(3)	(2)	(3)	(2)	(3)	(3)	(12)	(25)
Corporate Income Tax on Look-Back Surcharge.....	—	—	—	—	—	2	—	2	1	1	1	2	7
Youth Excise Tax Trigger.....	—	—	—	—	—	—	—	—	—	—	—	—	—
Reduction in Existing Federal Excise Taxes.....	—	(0)	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(3)	(7)
Total Federal Tax Offsets.....	(3)	(2)	(2)	(2)	(3)	(2)	(3)	(2)	(3)	(2)	(2)	(13)	(25)
Net Additional Receipts to US Government.....	8	5	3	5	5	10	6	10	7	8	9	34	75
POTENTIAL USES/CHANGES													
State Attorneys General Proposals, Total.....	—	5	5	6	7	9	6	7	7	4	4	32	59
Offset Reduction in State Excise Taxes.....	—	1	1	1	1	1	1	1	1	1	1	4	10
Use of Youth Look-Back Surcharge (90% grants).....	—	—	—	—	—	3	—	4	1	2	3	3	13
Potential Increase in Federal Medicaid Match.....	1	2	1	2	2	3	2	3	2	3	3	10	24
Total Potential Uses.....	1	7	7	9	10	17	9	15	11	10	11	50	106
Memoranda:													
Ad Valorem Equivalent of Net Payments.....	17%	13%	17%	19%	32%	22%	35%	25%	28%	31%			
Change in Total Cigarette Consumption.....	-7%	-6%	-8%	-9%	-15%	-10%	-16%	-11%	-13%	-14%			
Percentage Point Shortfall from Youth Target.....						30%	22%	50%	41%	48%	56%		

**Potential Budgetary Impacts of Tobacco Agreement
With Uncapped Nondeductible Youth Surcharge**
(in billions of dollars)

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	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
Federal revenues:													
Industry payments:													
Up-front payment.....	10.0	--	--	--	--	--	--	--	--	--	--	10.0	10.0
Public health trust funds in bill.....	--	2.5	2.5	3.5	4.0	5.0	2.5	2.5	2.5	--	--	17.5	25.0
Base amounts in bill.....	--	6.0	7.0	8.0	10.0	10.0	12.5	12.5	12.5	15.0	15.0	41.0	108.5
Additional amounts to recover BBA97 credit.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Additional amounts to recover excise tax losses.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult sales volume adjustments.....	--	(0.7)	(0.9)	(1.4)	(2.0)	(3.0)	(2.4)	(3.2)	(2.7)	(2.9)	(3.1)	(8.0)	(22.3)
Credits for civil suits at cap.....	--	(1.4)	(1.7)	(1.9)	(2.3)	(2.1)	(2.8)	(2.6)	(2.7)	(3.2)	(3.1)	(9.4)	(23.8)
Inflation adjustments on above.....	--	0.2	0.4	0.8	1.2	1.6	1.9	2.1	2.6	2.7	3.0	4.2	16.5
Credit for BBA97 excise tax increase.....	--	--	(2.4)	(2.3)	(3.4)	(3.2)	(3.3)	(3.1)	(3.2)	(3.2)	(3.1)	(11.2)	(27.1)
Look-back surcharge.....	--	--	--	--	--	3.4	--	4.2	0.9	2.0	2.8	3.4	13.3
User fees for nonparticipants.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Net penalties.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Subtotal, industry payments.....	10.0	6.5	5.0	6.7	7.6	11.7	8.4	12.4	9.9	10.4	11.4	47.5	100.1
Tax offset at 25% (IBT).....	(2.5)	(1.6)	(1.2)	(1.7)	(1.9)	(2.9)	(2.1)	(3.1)	(2.5)	(2.6)	(2.9)	(11.9)	(25.0)
Corporate income tax on look-back surcharge.....	--	--	--	--	--	1.8	--	2.3	0.5	1.1	1.5	1.8	7.1
Teen excise tax.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Reduction in tobacco excise taxes (non-PAYGO).....	--	(0.3)	(0.4)	(0.5)	(0.7)	(1.0)	(0.7)	(1.1)	(0.8)	(0.9)	(1.0)	(3.0)	(7.5)
Total, Federal revenues.....	7.5	4.5	3.3	4.5	5.0	9.6	5.6	10.5	7.1	8.0	9.1	34.5	74.7
Federal outlays:													
Public health trust funds in bill.....	--	2.6	2.7	3.8	4.5	5.8	3.0	3.1	3.2	--	--	19.4	28.6
HHS direct programs and grants to States.....	--	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.3
FDA direct enforcement and grants to States.....	--	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	1.6	3.5
Grants to States for ASSIST-type programs.....	--	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.5	1.3
Direct Federal R&D to discourage tobacco use.....	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2
Payments to tobacco-sponsored events/teams.....	--	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8
Public educ. campaign run by non-profit board.....	--	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	2.7	5.9
HHS payments for tobacco use cessation programs.....	--	1.0	1.1	1.1	1.1	1.7	1.8	1.8	1.9	2.0	2.0	6.0	15.5
Spending of look-back surcharge (90% grants).....	--	--	--	--	--	3.4	--	4.2	0.9	2.0	2.8	3.4	13.3
Subtotal, specified spending in bill.....	--	4.7	5.0	6.2	7.1	12.4	6.4	10.8	7.7	5.7	6.6	35.4	72.4
Unspecified residual to reach total payments.....	10.0	1.8	(0.0)	0.5	0.5	(0.7)	2.1	1.7	2.2	4.8	4.9	12.1	27.6
Total, Federal outlays, excl. debt Service.....	10.0	6.5	5.0	6.7	7.6	11.7	8.4	12.4	9.9	10.4	11.4	47.5	100.1
Federal deficit:													
Revenues (deficit effect).....	(7.5)	(4.5)	(3.3)	(4.5)	(5.0)	(9.6)	(5.6)	(10.5)	(7.1)	(8.0)	(9.1)	(34.5)	(74.7)
Programmatic outlays.....	10.0	6.5	5.0	6.7	7.6	11.7	8.4	12.4	9.9	10.4	11.4	47.5	100.1
Debt service.....	0.1	0.2	0.3	0.4	0.5	0.7	0.9	1.1	1.3	1.5	1.8	2.1	8.6
Federal deficit.....	2.6	2.2	1.9	2.6	3.1	2.8	3.7	3.0	4.1	4.0	4.1	15.1	34.0
MEMORANDUM: PAYGO budget effects:													
Revenues (deficit effect).....	(7.5)	(4.9)	(3.7)	(5.0)	(5.7)	(10.6)	(6.3)	(11.6)	(7.9)	(8.9)	(10.1)	(37.4)	(82.2)
Outlays.....	10.0	6.5	5.0	6.7	7.6	11.7	8.4	12.4	9.9	10.4	11.4	47.5	100.1
Total PAYGO deficit effect.....	2.5	1.6	1.2	1.7	1.9	1.1	2.1	0.8	2.0	1.5	1.4	10.1	17.9
ADDENDA:													
Available (residual) spending if held to PAYGO neutrality	7.5	0.2	(1.2)	(1.2)	(1.4)	(1.8)	(0.0)	0.8	0.2	3.2	3.5	2.0	9.7
Available (residual) spending if held to budget neutrality..	7.5	(0.1)	(1.6)	(1.7)	(2.1)	(2.9)	(0.8)	(0.3)	(0.6)	2.3	2.5	(1.0)	2.3
Deficit impact of higher CPI (COLAs and indexation).....	--	0.5	1.5	2.5	3.4	3.9	4.2	4.4	4.5	4.6	4.6	11.9	34.3
Potential increase in Federal matching grants(lower end)	0.8	0.9	(0.0)	0.2	0.2	(0.4)	1.0	0.8	1.1	2.4	2.4	1.8	9.6
Potential increase in Federal matching grants(upper end)	1.0	1.6	1.2	1.7	1.9	2.9	2.1	3.1	2.5	2.6	2.9	10.4	23.5
Reduction in current law State excise tax revenues.....	--	(0.6)	(0.5)	(0.7)	(0.8)	(1.3)	(0.9)	(1.5)	(1.1)	(1.3)	(1.4)	(4.0)	(10.1)

See Footnotes Next Page.

1. Reduction in tobacco volume is assumed to result solely from price increases due to passthrough of industry payments.
Access restrictions, public education, and cessation programs are assumed to have no additional effect.
2. Civil liability settlements are assumed to be at cap (33% of industry basic payments). Cap is assumed to be a single 33% cap for suits based on past and future conduct.
3. Corporate income tax rate of 35% is assumed in scenarios where surcharge payments are nondeductible.
4. No manufacturers are assumed to qualify for 75% good faith surcharge abatement.
5. All manufacturers are assumed to participate in the settlement.
6. All manufacturers are assumed to meet compliance plan and corporate culture requirements.
7. Amounts are assumed to increase for inflation as follows: (a) industry payments increase for inflation beginning in 1999;
(b) outlays increase for inflation beginning in 1999; (c) surcharge amount and cap increase for inflation beginning in 1997.
8. All industry payments are assumed to score as Federal Indirect Business Taxes (excise tax receipts).
As Indirect Business Taxes, industry payments are subject to a 25% income offset (BEA convention).
9. All payments are assumed to be spent as Federal outlays.
10. Industry payments are reduced to provide a credit for excise tax increases enacted as part of BBA '97.
11. States could use some portion of increased funds to increase matched grant spending, thereby generating a Federal match.
12. CPI effects shown as memorandum only because they at least partially overlap with the 25% income offset.

**SUMMARY OF BUDGETARY EFFECTS OF PROPOSED SETTLEMENT
WITH UNCAPPED NONDEDUCTIBLE YOUTH SURCHARGE AND 30% NONPRICE EFFECT**
(In billions of dollars)

09/08/97

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	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
RECEIPTS													
Base Payment (inc. trust and up-front payment).....	10	9	10	12	14	15	15	15	15	15	15	69	144
Payments to Recoup Excise Tax Credit and/or Losses..	—	—	—	—	—	—	—	—	—	—	—	—	—
Adult Sales Volume Adjustment.....	—	(1)	(1)	(1)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(7)	(20)
Credit for Personal Compensation Claims.....	—	(1)	(2)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(10)	(24)
Inflation Adjustment.....	—	0	0	1	1	2	2	2	3	3	3	4	17
Credit for BBA Excise Taxes.....	—	—	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(11)	(28)
Look-Back Surcharge for Youth Consumption.....	—	—	—	—	—	0	—	1	1	1	2	0	4
Net Industry Settlement Payments.....	10	7	5	7	8	9	9	10	10	9	11	45	93
Tax Offsets													
Indirect Business Tax Offset.....	(3)	(2)	(1)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(3)	(11)	(23)
Corporate Income Tax on Look-Back Surcharge.....	—	—	—	—	—	0	—	1	0	0	1	0	2
Youth Excise Tax Trigger.....	—	—	—	—	—	—	—	—	—	—	—	—	—
Reduction in Existing Federal Excise Taxes.....	—	(0)	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(3)	(7)
Total Federal Tax Offsets.....	(3)	(2)	(2)	(2)	(3)	(14)	(28)						
Net Additional Receipts to US Government.....	8	5	3	5	5	6	6	7	7	6	8	31	65
POTENTIAL USES/CHANGES													
State Attorneys General Proposals, Total.....	—	5	5	6	7	9	6	7	7	4	4	32	59
Offset Reduction in State Excise Taxes.....	—	1	1	1	1	1	1	1	1	1	1	4	9
Use of Youth Look-Back Surcharge (90% grants).....	—	—	—	—	—	0	—	1	1	1	2	0	4
Potential Increase in Federal Medicaid Match.....	1	2	1	2	2	2	2	2	2	2	3	10	22
Total Potential Uses.....	1	7	7	9	10	12	9	11	11	8	10	46	94
Memoranda:													
Ad Valorem Equivalent of Net Payments.....	17%	13%	17%	20%	22%	22%	26%	24%	24%	24%	28%		
Change in Total Cigarette Consumption.....	-7%	-6%	-8%	-9%	-10%	-10%	-12%	-11%	-11%	-11%	-13%		
Percentage Point Shortfall from Youth Target.....						1%	-6%	14%	12%	13%	24%		

Potential Budgetary Impacts of Tobacco Agreement
With Uncapped Nondeductible Youth Surcharge and 30% Nonprice Effect
(in billions of dollars)

09/08/97
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	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
Federal revenues:													
Industry payments:													
Up-front payment.....	10.0	--	--	--	--	--	--	--	--	--	--	10.0	10.0
Public health trust funds in bill.....	--	2.5	2.5	3.5	4.0	5.0	2.5	2.5	2.5	--	--	17.5	25.0
Base amounts in bill.....	--	6.0	7.0	8.0	10.0	10.0	12.5	12.5	12.5	15.0	15.0	41.0	108.5
Additional amounts to recover BBA97 credit.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Additional amounts to recover excise tax losses.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult sales volume adjustments.....	--	(0.7)	(0.9)	(1.3)	(1.9)	(2.2)	(2.3)	(2.5)	(2.5)	(2.6)	(2.8)	(7.1)	(19.8)
Credits for civil suits at cap.....	--	(1.5)	(1.7)	(1.9)	(2.3)	(2.2)	(2.8)	(2.7)	(2.7)	(3.3)	(3.2)	(9.5)	(24.3)
Inflation adjustments on above.....	--	0.2	0.4	0.8	1.2	1.7	1.9	2.2	2.6	2.8	3.1	4.3	16.9
Credit for BBA97 excise tax increase.....	--	--	(2.4)	(2.3)	(3.4)	(3.3)	(3.3)	(3.2)	(3.2)	(3.2)	(3.2)	(11.3)	(27.5)
Look-back surcharge.....	--	--	--	--	--	0.1	--	1.1	0.6	0.5	1.9	0.1	4.2
User fees for nonparticipants.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Net penalties.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Subtotal, industry payments.....	10.0	6.5	5.0	6.8	7.7	9.0	8.5	9.8	9.7	9.2	10.7	44.9	92.9
Tax offset at 25% (IBT).....	(2.5)	(1.6)	(1.2)	(1.7)	(1.9)	(2.2)	(2.1)	(2.4)	(2.4)	(2.3)	(2.7)	(11.2)	(23.2)
Corporate income tax on look-back surcharge.....	--	--	--	--	--	0.1	--	0.6	0.3	0.3	1.0	0.1	2.3
Teen excise tax.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Reduction in tobacco excise taxes (non-PAYGO).....	--	(0.3)	(0.4)	(0.5)	(0.7)	(0.7)	(0.7)	(0.8)	(0.8)	(0.8)	(0.9)	(2.7)	(6.7)
Total, Federal revenues.....	7.5	4.5	3.3	4.6	5.1	6.1	5.7	7.1	6.8	6.4	8.2	31.1	65.2
Federal outlays:													
Public health trust funds in bill.....	--	2.6	2.7	3.8	4.5	5.8	3.0	3.1	3.2	--	--	19.4	28.6
HHS direct programs and grants to States.....	--	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.3
FDA direct enforcement and grants to States.....	--	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	1.6	3.5
Grants to States for ASSIST-type programs.....	--	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.5	1.3
Direct Federal R&D to discourage tobacco use.....	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2
Payments to tobacco-sponsored events/teams.....	--	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8
Public educ. campaign run by non-profit board.....	--	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	2.7	5.9
HHS payments for tobacco use cessation programs.....	--	1.0	1.1	1.1	1.1	1.7	1.8	1.8	1.9	2.0	2.0	6.0	15.5
Spending of look-back surcharge (90% grants).....	--	--	--	--	--	0.1	--	1.1	0.6	0.5	1.9	0.1	4.2
Subtotal, specified spending in bill.....	--	4.7	5.0	6.2	7.1	9.2	6.4	7.6	7.4	4.2	5.7	32.2	63.4
Unspecified residual to reach total payments.....	10.0	1.8	0.0	0.5	0.5	(0.2)	2.2	2.2	2.3	5.0	5.1	12.8	29.6
Total, Federal outlays, excl. debt Service.....	10.0	6.5	5.0	6.8	7.7	9.0	8.5	9.8	9.7	9.2	10.7	44.9	92.9
Federal deficit:													
Revenues (deficit effect).....	(7.5)	(4.5)	(3.3)	(4.6)	(5.1)	(6.1)	(5.7)	(7.1)	(6.8)	(6.4)	(8.2)	(31.1)	(65.2)
Programmatic outlays.....	10.0	6.5	5.0	6.8	7.7	9.0	8.5	9.8	9.7	9.2	10.7	44.9	92.9
Debt service.....	0.1	0.2	0.3	0.4	0.5	0.7	0.8	1.0	1.2	1.4	1.6	2.1	8.0
Federal deficit.....	2.6	2.2	1.9	2.6	3.1	3.6	3.7	3.7	4.1	4.2	4.2	15.9	35.7
MEMORANDUM: PAYGO budget effects:													
Revenues (deficit effect).....	(7.5)	(4.9)	(3.7)	(5.1)	(5.7)	(6.8)	(6.4)	(7.9)	(7.6)	(7.2)	(9.1)	(33.8)	(72.0)
Outlays.....	10.0	6.5	5.0	6.8	7.7	9.0	8.5	9.8	9.7	9.2	10.7	44.9	92.9
Total PAYGO deficit effect.....	2.5	1.6	1.2	1.7	1.9	2.2	2.1	1.9	2.1	2.0	1.7	11.2	21.0
ADDENDA:													
Available (residual) spending if held to PAYGO neutrality	7.5	0.2	(1.2)	(1.1)	(1.4)	(2.4)	0.0	0.3	0.3	3.0	3.4	1.6	8.6
Available (residual) spending if held to budget neutrality..	7.5	(0.1)	(1.6)	(1.7)	(2.0)	(3.1)	(0.7)	(0.5)	(0.5)	2.2	2.5	(1.1)	1.9
Deficit impact of higher CPI (COLAs and indexation).....	--	0.5	1.5	2.5	3.4	3.9	4.2	4.4	4.5	4.6	4.6	11.9	34.3
Potential increase in Federal matching grants(lower end)	0.8	0.9	0.0	0.3	0.3	(0.1)	1.1	1.1	1.2	2.5	2.5	2.1	10.5
Potential increase in Federal matching grants(upper end)	1.0	1.6	1.2	1.7	1.9	2.2	2.1	2.4	2.4	2.3	2.7	9.7	21.7
Reduction in current law State excise tax revenues.....	--	(0.6)	(0.5)	(0.7)	(0.8)	(0.9)	(0.9)	(1.1)	(1.1)	(1.1)	(1.3)	(3.6)	(9.1)

See Footnotes Next Page.

1. Reduction in tobacco volume is assumed to result solely from price increases due to passthrough of industry payments.
Access restrictions, public education, and cessation programs are assumed to have no additional effect.
2. Civil liability settlements are assumed to be at cap (33% of industry basic payments). Cap is assumed to be a single 33% cap for suits based on past and future conduct.
3. Corporate income tax rate of 35% is assumed in scenarios where surcharge payments are nondeductible.
4. No manufacturers are assumed to qualify for 75% good faith surcharge abatement.
5. All manufacturers are assumed to participate in the settlement.
6. All manufacturers are assumed to meet compliance plan and corporate culture requirements.
7. Amounts are assumed to increase for inflation as follows: (a) industry payments increase for inflation beginning in 1999; (b) outlays increase for inflation beginning in 1999; (c) surcharge amount and cap increase for inflation beginning in 1997.
8. All industry payments are assumed to score as Federal Indirect Business Taxes (excise tax receipts).
As Indirect Business Taxes, industry payments are subject to a 25% income offset (BEA convention).
9. All payments are assumed to be spent as Federal outlays.
10. Industry payments are reduced to provide a credit for excise tax increases enacted as part of BBA '97.
11. States could use some portion of increased funds to increase matched grant spending, thereby generating a Federal match.
12. CPI effects shown as memorandum only because they at least partially overlap with the 25% income offset.

**SUMMARY OF BUDGETARY EFFECTS OF PROPOSED SETTLEMENT
WITH \$160 MILLION NONDEDUCTIBLE SURCHARGE ABOVE TEN PERCENTAGE POINT SHORTFALL**

09/08/97

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(In billions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
RECEIPTS													
Base Payment (inc. trust and up-front payment).....	10	9	10	12	14	15	15	15	15	15	15	69	144
Payments to Recoup Excise Tax Credit and/or Losses..	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult Sales Volume Adjustment.....	--	(1)	(1)	(1)	(2)	(3)	(2)	(4)	(3)	(3)	(3)	(8)	(24)
Credit for Personal Compensation Claims.....	--	(1)	(2)	(2)	(2)	(2)	(3)	(2)	(3)	(3)	(3)	(9)	(23)
Inflation Adjustment.....	--	0	0	1	1	2	2	2	3	3	3	4	16
Credit for BBA Excise Taxes.....	--	--	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(11)	(27)
Look-Back Surcharge for Youth Consumption.....	=	=	=	=	=	6	=	7	1	5	4	6	22
Net Industry Settlement Payments.....	10	7	5	7	8	14	8	15	10	13	12	49	108
Tax Offsets													
Indirect Business Tax Offset.....	(3)	(2)	(1)	(2)	(2)	(3)	(2)	(4)	(2)	(3)	(3)	(12)	(27)
Corporate Income Tax on Look-Back Surcharge.....	--	--	--	--	--	2	--	3	0	2	2	2	10
Youth Excise Tax Trigger.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Reduction in Existing Federal Excise Taxes.....	=	(0)	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(3)	(8)
Total Federal Tax Offsets.....	(3)	(2)	(2)	(2)	(3)	(2)	(3)	(2)	(3)	(2)	(2)	(13)	(25)
Net Additional Receipts to US Government.....	8	5	3	5	5	11	6	13	7	11	10	36	83
POTENTIAL USES/CHANGES													
State Attorneys General Proposals, Total.....	--	5	5	6	7	9	6	7	7	4	4	32	59
Offset Reduction in State Excise Taxes.....	--	1	1	1	1	2	1	2	1	2	1	4	11
Use of Youth Look-Back Surcharge (90% grants).....	--	--	--	--	--	1	--	1	0	1	0	1	3
Potential Increase in Federal Medicaid Match.....	1	2	1	2	2	3	2	4	2	3	3	11	25
Total Potential Uses.....	1	7	7	9	10	15	9	13	10	9	9	48	99
Memoranda:													
Ad Valorem Equivalent of Net Payments.....	17%	13%	17%	19%	38%	22%	43%	24%	36%	33%			
Change in Total Cigarette Consumption.....	-7%	-6%	-8%	-9%	-17%	-10%	-19%	-11%	-16%	-14%			
Percentage Point Shortfall from Youth Target.....						30%	18%	50%	36%	49%	51%		

Potential Budgetary Impacts of Tobacco Agreement
With \$160 Million Nondeductible Surcharge Above Ten Percentage Point Shortfall
(in billions of dollars)

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	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
Federal revenues:													
Industry payments:													
Up-front payment.....	10.0	--	--	--	--	--	--	--	--	--	--	10.0	10.0
Public health trust funds in bill.....	--	2.5	2.5	3.5	4.0	5.0	2.5	2.5	2.5	--	--	17.5	25.0
Base amounts in bill.....	--	6.0	7.0	8.0	10.0	10.0	12.5	12.5	12.5	15.0	15.0	41.0	108.5
Additional amounts to recover BBA97 credit.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Additional amounts to recover excise tax losses.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult sales volume adjustments.....	--	(0.7)	(0.9)	(1.4)	(2.0)	(3.3)	(2.4)	(3.7)	(2.6)	(3.3)	(3.2)	(8.4)	(23.6)
Credits for civil suits at cap.....	--	(1.4)	(1.7)	(1.9)	(2.3)	(2.1)	(2.8)	(2.5)	(2.7)	(3.1)	(3.1)	(9.3)	(23.5)
Inflation adjustments on above.....	--	0.2	0.4	0.8	1.2	1.5	1.9	2.0	2.6	2.6	3.0	4.1	16.2
Credit for BBA97 excise tax increase.....	--	--	(2.4)	(2.3)	(3.4)	(3.1)	(3.3)	(3.0)	(3.2)	(3.1)	(3.1)	(11.1)	(26.8)
Look-back surcharge.....	--	--	--	--	--	5.6	--	7.0	0.7	4.7	3.6	5.6	21.7
User fees for nonparticipants.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Net penalties.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Subtotal, industry payments.....	10.0	6.5	5.0	6.7	7.6	13.7	8.4	14.9	9.6	12.9	12.2	49.5	107.6
Tax offset at 25% (IBT).....	(2.5)	(1.6)	(1.2)	(1.7)	(1.9)	(3.4)	(2.1)	(3.7)	(2.4)	(3.2)	(3.1)	(12.4)	(26.9)
Corporate income tax on look-back surcharge.....	--	--	--	--	--	2.4	--	3.3	0.3	2.3	1.7	2.4	10.1
Teen excise tax.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Reduction in tobacco excise taxes (non-PAYGO).....	--	(0.3)	(0.4)	(0.5)	(0.7)	(1.2)	(0.7)	(1.3)	(0.8)	(1.1)	(1.0)	(3.1)	(8.2)
Total, Federal revenues.....	7.5	4.5	3.3	4.5	5.0	11.5	5.6	13.2	6.7	10.8	9.9	36.4	82.6
Federal outlays:													
Public health trust funds in bill.....	--	2.6	2.7	3.8	4.5	5.8	3.0	3.1	3.2	--	--	19.4	28.6
HHS direct programs and grants to States.....	--	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.3
FDA direct enforcement and grants to States.....	--	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	1.6	3.5
Grants to States for ASSIST-type programs.....	--	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.5	1.3
Direct Federal R&D to discourage tobacco use.....	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2
Payments to tobacco-sponsored events/teams.....	--	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8
Public educ. campaign run by non-profit board.....	--	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	2.7	5.9
HHS payments for tobacco use cessation programs.....	--	1.0	1.1	1.1	1.1	1.7	1.8	1.8	1.9	2.0	2.0	6.0	15.5
Spending of look-back surcharge (90% grants).....	--	--	--	--	--	1.1	--	0.8	0.1	0.5	0.4	1.1	2.9
Subtotal, specified spending in bill.....	--	4.7	5.0	6.2	7.1	10.2	6.4	7.3	6.9	4.2	4.2	33.2	62.1
Unspecified residual to reach total payments.....	10.0	1.8	(0.0)	0.5	0.5	3.6	2.1	7.6	2.8	8.7	8.0	16.3	45.4
Total, Federal outlays, excl. debt Service.....	10.0	6.5	5.0	6.7	7.6	13.7	8.4	14.9	9.6	12.9	12.2	49.5	107.6
Federal deficit:													
Revenues (deficit effect).....	(7.5)	(4.5)	(3.3)	(4.5)	(5.0)	(11.5)	(5.6)	(13.2)	(6.7)	(10.8)	(9.9)	(36.4)	(82.6)
Programmatic outlays.....	10.0	6.5	5.0	6.7	7.6	13.7	8.4	14.9	9.6	12.9	12.2	49.5	107.6
Debt service.....	0.1	0.2	0.3	0.4	0.5	0.6	0.8	0.9	1.1	1.3	1.4	2.1	7.6
Federal deficit.....	2.6	2.2	1.9	2.6	3.1	2.9	3.6	2.7	4.0	3.3	3.8	15.2	32.5
MEMORANDUM: PAYGO budget effects:													
Revenues (deficit effect).....	(7.5)	(4.9)	(3.7)	(5.0)	(5.7)	(12.7)	(6.3)	(14.5)	(7.5)	(11.9)	(10.9)	(39.6)	(90.7)
Outlays.....	10.0	6.5	5.0	6.7	7.6	13.7	8.4	14.9	9.6	12.9	12.2	49.5	107.6
Total PAYGO deficit effect.....	2.5	1.6	1.2	1.7	1.9	1.0	2.1	0.4	2.1	1.0	1.3	9.9	16.8
ADDENDA:													
Available (residual) spending if held to PAYGO neutrality	7.5	0.2	(1.2)	(1.2)	(1.4)	2.6	(0.0)	7.2	0.7	7.7	6.7	6.4	28.6
Available (residual) spending if held to budget neutrality..	7.5	(0.1)	(1.6)	(1.7)	(2.1)	1.3	(0.8)	5.8	(0.1)	6.6	5.7	3.2	20.5
Deficit impact of higher CPI (COLAs and indexation).....	--	0.5	1.5	2.5	3.4	3.9	4.2	4.4	4.5	4.6	4.6	11.9	34.3
Potential increase in Federal matching grants(lower end)	0.8	0.9	(0.0)	0.2	0.2	1.8	1.0	3.8	1.4	4.3	4.0	3.9	18.5
Potential increase in Federal matching grants(upper end)	1.0	1.6	1.2	1.7	1.9	3.4	2.1	3.7	2.4	3.2	3.1	10.9	25.4
Reduction in current law State excise tax revenues.....	--	(0.6)	(0.5)	(0.7)	(0.8)	(1.5)	(0.9)	(1.8)	(1.1)	(1.6)	(1.5)	(4.2)	(11.1)

See Footnotes Next Page.

1. Reduction in tobacco volume is assumed to result solely from price increases due to passthrough of industry payments.
Access restrictions, public education, and cessation programs are assumed to have no additional effect.
2. Civil liability settlements are assumed to be at cap (33% of industry basic payments). Cap is assumed to be a single 33% cap for suits based on past and future conduct.
3. Corporate income tax rate of 35% is assumed in scenarios where surcharge payments are nondeductible.
4. No manufacturers are assumed to qualify for 75% good faith surcharge abatement.
5. All manufacturers are assumed to participate in the settlement.
6. All manufacturers are assumed to meet compliance plan and corporate culture requirements.
7. Amounts are assumed to increase for inflation as follows: (a) industry payments increase for inflation beginning in 1999;
(b) outlays increase for inflation beginning in 1999; (c) surcharge amount and cap increase for inflation beginning in 1997.
8. All industry payments are assumed to score as Federal Indirect Business Taxes (excise tax receipts).
As Indirect Business Taxes, industry payments are subject to a 25% income offset (BEA convention).
9. All payments are assumed to be spent as Federal outlays.
10. Industry payments are reduced to provide a credit for excise tax increases enacted as part of BBA '97.
11. States could use some portion of increased funds to increase matched grant spending, thereby generating a Federal match.
12. CPI effects shown as memorandum only because they at least partially overlap with the 25% income offset.

**SUMMARY OF BUDGETARY EFFECTS OF PROPOSED SETTLEMENT
WITH TWO TIER NONDEDUCTIBLE SURCHARGE AND 30% NONPRICE EFFECT**

09/08/97

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(In billions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
RECEIPTS													
Base Payment (inc. trust and up-front payment).....	10	9	10	12	14	15	15	15	15	15	15	69	144
Payments to Recoup Excise Tax Credit and/or Losses..	—	—	—	—	—	—	—	—	—	—	—	—	—
Adult Sales Volume Adjustment.....	—	(1)	(1)	(1)	(2)	(2)	(2)	(3)	(2)	(3)	(3)	(7)	(20)
Credit for Personal Compensation Claims.....	—	(1)	(2)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(10)	(24)
Inflation Adjustment.....	—	0	0	1	1	2	2	2	3	3	3	4	17
Credit for BBA Excise Taxes.....	—	—	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(11)	(27)
Look-Back Surcharge for Youth Consumption.....	—	—	—	—	—	0	—	1	1	1	3	0	6
Net Industry Settlement Payments.....	10	7	5	7	8	9	9	10	10	9	12	45	94
Tax Offsets													
Indirect Business Tax Offset.....	(3)	(2)	(1)	(2)	(2)	(2)	(2)	(3)	(2)	(2)	(3)	(11)	(24)
Corporate Income Tax on Look-Back Surcharge.....	—	—	—	—	—	—	—	0	0	0	1	—	2
Youth Excise Tax Trigger.....	—	—	—	—	—	—	—	—	—	—	—	—	—
Reduction in Existing Federal Excise Taxes.....	—	(0)	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(3)	(7)
Total Federal Tax Offsets.....	(3)	(2)	(2)	(2)	(3)	(14)	(29)						
Net Additional Receipts to US Government.....	8	5	3	5	5	6	6	7	7	6	9	31	66
POTENTIAL USES/CHANGES													
State Attorneys General Proposals, Total.....	—	5	5	6	7	9	6	7	7	4	4	32	59
Offset Reduction in State Excise Taxes.....	—	1	1	1	1	1	1	1	1	1	1	4	9
Use of Youth Look-Back Surcharge (90% grants).....	—	—	—	—	—	0	—	1	0	0	1	0	3
Potential Increase in Federal Medicaid Match.....	1	2	1	2	2	2	2	3	2	2	3	10	22
Total Potential Uses.....	1	7	7	9	10	12	9	11	11	8	9	45	93
Memoranda:													
Ad Valorem Equivalent of Net Payments.....	17%	13%	17%	20%	22%	22%	26%	24%	25%	30%			
Change in Total Cigarette Consumption.....	-7%	-6%	-8%	-9%	-10%	-10%	-12%	-11%	-11%	-14%			
Percentage Point Shortfall from Youth Target.....						1%	-6%	14%	12%	14%	24%		

Potential Budgetary Impacts of Tobacco Agreement
With Two Tier Nondeductible Surcharge and 30% Nonprice Effect
(in billions of dollars)

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	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
Federal revenues:													
Industry payments:													
Up-front payment.....	10.0	--	--	--	--	--	--	--	--	--	--	10.0	10.0
Public health trust funds in bill.....	--	2.5	2.5	3.5	4.0	5.0	2.5	2.5	2.5	--	--	17.5	25.0
Base amounts in bill.....	--	6.0	7.0	8.0	10.0	10.0	12.5	12.5	12.5	15.0	15.0	41.0	108.5
Additional amounts to recover BBA97 credit.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Additional amounts to recover excise tax losses.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult sales volume adjustments.....	--	(0.7)	(0.9)	(1.3)	(1.9)	(2.2)	(2.3)	(2.5)	(2.5)	(2.6)	(2.9)	(7.1)	(19.9)
Credits for civil suits at cap.....	--	(1.5)	(1.7)	(1.9)	(2.3)	(2.2)	(2.8)	(2.7)	(2.8)	(3.3)	(3.2)	(9.5)	(24.3)
Inflation adjustments on above.....	--	0.2	0.4	0.8	1.2	1.7	1.9	2.2	2.6	2.8	3.1	4.3	16.9
Credit for BBA97 excise tax increase.....	--	--	(2.4)	(2.3)	(3.4)	(3.3)	(3.3)	(3.2)	(3.2)	(3.2)	(3.1)	(11.3)	(27.5)
Look-back surcharge.....	--	--	--	--	--	0.1	--	1.4	0.7	0.7	2.9	0.1	5.8
User fees for nonparticipants.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Net penalties.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Subtotal, industry payments.....	10.0	6.5	5.0	6.8	7.7	9.0	8.5	10.1	9.8	9.4	11.7	44.9	94.5
Tax offset at 25% (IBT).....	(2.5)	(1.6)	(1.2)	(1.7)	(1.9)	(2.2)	(2.1)	(2.5)	(2.4)	(2.4)	(2.9)	(11.2)	(23.6)
Corporate income tax on look-back surcharge.....	--	--	--	--	--	--	--	0.4	0.1	0.2	1.1	--	1.8
Teen excise tax.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Reduction in tobacco excise taxes (non-PAYGO).....	--	(0.3)	(0.4)	(0.5)	(0.7)	(0.7)	(0.7)	(0.8)	(0.8)	(0.8)	(1.0)	(2.7)	(6.8)
Total, Federal revenues.....	7.5	4.5	3.3	4.6	5.1	6.0	5.7	7.1	6.7	6.4	8.9	31.0	65.8
Federal outlays:													
Public health trust funds in bill.....	--	2.6	2.7	3.8	4.5	5.8	3.0	3.1	3.2	--	--	19.4	28.6
HHS direct programs and grants to States.....	--	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.3
FDA direct enforcement and grants to States.....	--	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	1.6	3.5
Grants to States for ASSIST-type programs.....	--	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.5	1.3
Direct Federal R&D to discourage tobacco use.....	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2
Payments to tobacco-sponsored events/teams.....	--	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8
Public educ. campaign run by non-profit board.....	--	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	2.7	5.9
HHS payments for tobacco use cessation programs.....	--	1.0	1.1	1.1	1.1	1.7	1.8	1.8	1.9	2.0	2.0	6.0	15.5
Spending of look-back surcharge (90% grants).....	--	--	--	--	--	0.1	--	0.8	0.5	0.4	0.8	0.1	2.5
Subtotal, specified spending in bill.....	--	4.7	5.0	6.2	7.1	9.2	6.4	7.3	7.2	4.1	4.6	32.2	61.7
Unspecified residual to reach total payments.....	10.0	1.8	0.0	0.5	0.5	(0.2)	2.2	2.8	2.6	5.3	7.1	12.8	32.8
Total, Federal outlays, excl. debt Service.....	10.0	6.5	5.0	6.8	7.7	9.0	8.5	10.1	9.8	9.4	11.7	44.9	94.5
Federal deficit:													
Revenues (deficit effect).....	(7.5)	(4.5)	(3.3)	(4.6)	(5.1)	(6.0)	(5.7)	(7.1)	(6.7)	(6.4)	(8.9)	(31.0)	(65.8)
Programmatic outlays.....	10.0	6.5	5.0	6.8	7.7	9.0	8.5	10.1	9.8	9.4	11.7	44.9	94.5
Debt service.....	0.1	0.2	0.3	0.4	0.5	0.7	0.8	1.0	1.2	1.4	1.6	2.1	8.2
Federal deficit.....	2.6	2.2	1.9	2.6	3.1	3.6	3.7	4.0	4.3	4.4	4.4	16.0	36.8
MEMORANDUM: PAYGO budget effects:													
Revenues (deficit effect).....	(7.5)	(4.9)	(3.7)	(5.1)	(5.7)	(6.7)	(6.4)	(8.0)	(7.5)	(7.2)	(9.9)	(33.7)	(72.6)
Outlays.....	10.0	6.5	5.0	6.8	7.7	9.0	8.5	10.1	9.8	9.4	11.7	44.9	94.5
Total PAYGO deficit effect.....	2.5	1.6	1.2	1.7	1.9	2.2	2.1	2.2	2.3	2.2	1.8	11.2	21.9
ADDENDA:													
Available (residual) spending if held to PAYGO neutrality	7.5	0.2	(1.2)	(1.1)	(1.4)	(2.4)	0.0	0.6	0.2	3.1	5.3	1.5	10.9
Available (residual) spending if held to budget neutrality..	7.5	(0.1)	(1.6)	(1.7)	(2.0)	(3.2)	(0.7)	(0.2)	(0.6)	2.3	4.4	(1.1)	4.1
Deficit impact of higher CPI (COLAs and indexation).....	--	0.5	1.5	2.5	3.4	3.9	4.2	4.4	4.5	4.6	4.6	11.9	34.3
Potential increase in Federal matching grants(lower end)	0.8	0.9	0.0	0.3	0.3	(0.1)	1.1	1.4	1.3	2.7	3.5	2.1	12.1
Potential increase in Federal matching grants(upper end)	1.0	1.6	1.2	1.7	1.9	2.2	2.1	2.5	2.4	2.4	2.9	9.7	22.1
Reduction in current law State excise tax revenues.....	--	(0.6)	(0.5)	(0.7)	(0.8)	(0.9)	(0.9)	(1.1)	(1.1)	(1.1)	(1.4)	(3.6)	(9.2)

See Footnotes Next Page.

1. Reduction in tobacco volume is assumed to result solely from price increases due to passthrough of industry payments.
Access restrictions, public education, and cessation programs are assumed to have no additional effect.
2. Civil liability settlements are assumed to be at cap (33% of industry basic payments). Cap is assumed to be a single 33% cap for suits based on past and future conduct.
3. Corporate income tax rate of 35% is assumed in scenarios where surcharge payments are nondeductible.
4. No manufacturers are assumed to qualify for 75% good faith surcharge abatement.
5. All manufacturers are assumed to participate in the settlement.
6. All manufacturers are assumed to meet compliance plan and corporate culture requirements.
7. Amounts are assumed to increase for inflation as follows: (a) industry payments increase for inflation beginning in 1999;
(b) outlays increase for inflation beginning in 1999; (c) surcharge amount and cap increase for inflation beginning in 1997.
8. All industry payments are assumed to score as Federal Indirect Business Taxes (excise tax receipts).
As Indirect Business Taxes, industry payments are subject to a 25% income offset (BEA convention).
9. All payments are assumed to be spent as Federal outlays.
10. Industry payments are reduced to provide a credit for excise tax increases enacted as part of BBA '97.
11. States could use some portion of increased funds to increase matched grant spending, thereby generating a Federal match.
12. CPI effects shown as memorandum only because they at least partially overlap with the 25% income offset.

**SUMMARY OF BUDGETARY EFFECTS OF PROPOSED SETTLEMENT
WITH EXCISE TAX TRIGGER WHEN YOUTH TARGETS NOT MET**

09/08/97

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(In billions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
RECEIPTS													
Base Payment (inc. trust and up-front payment).....	10	9	10	12	14	15	15	15	15	15	15	69	144
Payments to Recoup Excise Tax Credit and/or Losses..	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult Sales Volume Adjustment.....	--	(1)	(1)	(1)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(8)	(23)
Credit for Personal Compensation Claims.....	--	(1)	(2)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(9)	(24)
Inflation Adjustment.....	--	0	0	1	1	2	2	2	2	3	3	4	16
Credit for BBA Excise Taxes.....	--	--	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(11)	(27)
Look-Back Surcharge for Youth Consumption.....	=	=	=	=	=	3	1	3	2	1	3	3	13
Net Industry Settlement Payments.....	10	7	5	7	8	11	10	11	10	10	11	47	99
Tax Offsets													
Indirect Business Tax Offset.....	(3)	(2)	(1)	(2)	(2)	(3)	(2)	(3)	(3)	(2)	(3)	(12)	(25)
Corporate Income Tax on Look-Back Surcharge.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Youth Excise Tax Trigger.....	--	--	--	--	--	1	1	3	3	3	4	1	16
Reduction in Existing Federal Excise Taxes.....	=	(0)	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(3)	(8)
Total Federal Tax Offsets.....	(3)	(2)	(2)	(2)	(3)	(2)	(2)	(1)	(1)	(0)	0	(13)	(17)
Net Additional Receipts to US Government.....	8	5	3	5	5	9	8	10	10	9	12	34	82
POTENTIAL USES/CHANGES													
State Attorneys General Proposals, Total.....	--	5	5	6	7	9	6	7	7	4	4	32	59
Offset Reduction in State Excise Taxes.....	--	1	1	1	1	1	1	1	1	1	2	4	11
Use of Youth Look-Back Surcharge (90% grants).....	--	--	--	--	--	3	1	3	2	1	3	3	13
Potential Increase in Federal Medicaid Match.....	1	2	1	2	2	3	2	3	3	2	3	10	23
Total Potential Uses.....	1	7	7	9	10	16	11	13	12	9	11	49	106
Memoranda:													
Ad Valorem Equivalent of Net Payments.....	17%	13%	17%	19%	30%	27%	33%	31%	31%	36%			
Change in Total Cigarette Consumption.....	-7%	-6%	-8%	-9%	-14%	-13%	-15%	-14%	-14%	-16%			
Percentage Point Shortfall from Youth Target.....						30%	24%	46%	42%	44%	55%		

**Potential Budgetary Impacts of Tobacco Agreement
With Excise Tax Trigger when Youth Targets Not Met
(in billions of dollars)**

09/08/97
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	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
Federal revenues:													
Industry payments:													
Up-front payment.....	10.0	--	--	--	--	--	--	--	--	--	--	10.0	10.0
Public health trust funds in bill.....	--	2.5	2.5	3.5	4.0	5.0	2.5	2.5	2.5	--	--	17.5	25.0
Base amounts in bill.....	--	6.0	7.0	8.0	10.0	10.0	12.5	12.5	12.5	15.0	15.0	41.0	108.5
Additional amounts to recover BBA97 credit.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Additional amounts to recover excise tax losses.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult sales volume adjustments.....	--	(0.7)	(0.9)	(1.4)	(2.0)	(2.8)	(2.7)	(3.1)	(3.0)	(3.0)	(3.4)	(7.9)	(23.2)
Credits for civil suits at cap.....	--	(1.4)	(1.7)	(1.9)	(2.3)	(2.1)	(2.7)	(2.6)	(2.6)	(3.2)	(3.1)	(9.4)	(23.5)
Inflation adjustments on above.....	--	0.2	0.4	0.8	1.2	1.6	1.9	2.1	2.5	2.7	2.9	4.2	16.3
Credit for BBA97 excise tax increase.....	--	--	(2.4)	(2.3)	(3.4)	(3.2)	(3.2)	(3.1)	(3.1)	(3.1)	(3.0)	(11.2)	(26.9)
Look-back surcharge.....	--	--	--	--	--	2.6	1.4	2.7	1.6	1.4	3.0	2.6	12.7
User fees for nonparticipants.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Net penalties.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Subtotal, industry payments.....	10.0	6.5	5.0	6.7	7.6	11.0	9.6	11.0	10.3	9.8	11.4	46.8	98.9
Tax offset at 25% (IBT).....	(2.5)	(1.6)	(1.2)	(1.7)	(1.9)	(2.8)	(2.4)	(2.8)	(2.6)	(2.4)	(2.8)	(11.7)	(24.7)
Corporate income tax on look-back surcharge.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Teen excise tax.....	--	--	--	--	--	1.5	1.5	2.9	2.9	2.9	4.3	1.5	16.0
Reduction in tobacco excise taxes (non-PAYGO).....	--	(0.3)	(0.4)	(0.5)	(0.7)	(1.0)	(0.9)	(1.1)	(1.0)	(1.0)	(1.1)	(2.9)	(7.9)
Total, Federal revenues.....	7.5	4.5	3.3	4.5	5.0	8.8	7.8	10.1	9.7	9.3	11.7	33.7	82.2
Federal outlays:													
Public health trust funds in bill.....	--	2.6	2.7	3.8	4.5	5.8	3.0	3.1	3.2	--	--	19.4	28.6
HHS direct programs and grants to States.....	--	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.3
FDA direct enforcement and grants to States.....	--	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	1.6	3.5
Grants to States for ASSIST-type programs.....	--	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.5	1.3
Direct Federal R&D to discourage tobacco use.....	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2
Payments to tobacco-sponsored events/teams.....	--	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8
Public educ. campaign run by non-profit board.....	--	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	2.7	5.9
HHS payments for tobacco use cessation programs.....	--	1.0	1.1	1.1	1.1	1.7	1.8	1.8	1.9	2.0	2.0	6.0	15.5
Spending of look-back surcharge (90% grants).....	--	--	--	--	--	2.6	1.4	2.7	1.6	1.4	3.0	2.6	12.7
Subtotal, specified spending in bill.....	--	4.7	5.0	6.2	7.1	11.6	7.8	9.3	8.4	5.1	6.8	34.6	71.9
Unspecified residual to reach total payments.....	10.0	1.8	(0.0)	0.5	0.5	(0.6)	1.9	1.7	1.9	4.7	4.6	12.2	27.0
Total, Federal outlays, excl. debt Service.....	10.0	6.5	5.0	6.7	7.6	11.0	9.6	11.0	10.3	9.8	11.4	46.8	98.9
Federal deficit:													
Revenues (deficit effect).....	(7.5)	(4.5)	(3.3)	(4.5)	(5.0)	(8.8)	(7.8)	(10.1)	(9.7)	(9.3)	(11.7)	(33.7)	(82.2)
Programmatic outlays.....	10.0	6.5	5.0	6.7	7.6	11.0	9.6	11.0	10.3	9.8	11.4	46.8	98.9
Debt service.....	0.1	0.2	0.3	0.4	0.5	0.6	0.8	0.9	0.9	1.0	1.1	2.1	6.7
Federal deficit.....	2.6	2.2	1.9	2.6	3.1	2.9	2.6	1.8	1.6	1.5	0.8	15.2	23.4
MEMORANDUM: PAYGO budget effects:													
Revenues (deficit effect).....	(7.5)	(4.9)	(3.7)	(5.0)	(5.7)	(9.7)	(8.7)	(11.2)	(10.7)	(10.3)	(12.8)	(36.6)	(90.1)
Outlays.....	10.0	6.5	5.0	6.7	7.6	11.0	9.6	11.0	10.3	9.8	11.4	46.8	98.9
Total PAYGO deficit effect.....	2.5	1.6	1.2	1.7	1.9	1.3	0.9	(0.1)	(0.3)	(0.5)	(1.4)	10.2	8.7
ADDENDA:													
Available (residual) spending if held to PAYGO neutrality.....	7.5	0.2	(1.2)	(1.2)	(1.4)	(1.9)	0.9	1.9	2.3	5.1	6.0	1.9	18.3
Available (residual) spending if held to budget neutrality..	7.5	(0.1)	(1.6)	(1.7)	(2.1)	(2.9)	0.0	0.8	1.3	4.2	4.9	(0.9)	10.3
Deficit impact of higher CPI (COLAs and indexation).....	--	0.5	1.5	2.5	3.4	3.9	4.2	4.4	4.5	4.6	4.6	11.9	34.3
Potential increase in Federal matching grants(lower end)	0.8	0.9	(0.0)	0.2	0.2	(0.3)	0.9	0.9	1.0	2.3	2.3	1.8	9.2
Potential increase in Federal matching grants(upper end)	1.0	1.6	1.2	1.7	1.9	2.8	2.4	2.8	2.6	2.4	2.8	10.2	23.2
Reduction in current law State excise tax revenues.....	--	(0.6)	(0.5)	(0.7)	(0.8)	(1.2)	(1.2)	(1.4)	(1.4)	(1.4)	(1.6)	(3.9)	(10.8)

See Footnotes Next Page.

1. Reduction in tobacco volume is assumed to result solely from price increases due to passthrough of industry payments.
Access restrictions, public education, and cessation programs are assumed to have no additional effect.
2. Civil liability settlements are assumed to be at cap (33% of industry basic payments). Cap is assumed to be a single 33% cap for suits based on past and future conduct.
3. Corporate income tax rate of 35% is assumed in scenarios where surcharge payments are nondeductible.
4. No manufacturers are assumed to qualify for 75% good faith surcharge abatement.
5. All manufacturers are assumed to participate in the settlement.
6. All manufacturers are assumed to meet compliance plan and corporate culture requirements.
7. Amounts are assumed to increase for inflation as follows: (a) industry payments increase for inflation beginning in 1999;
(b) outlays increase for inflation beginning in 1999; (c) surcharge amount and cap increase for inflation beginning in 1997.
8. All industry payments are assumed to score as Federal Indirect Business Taxes (excise tax receipts).
As Indirect Business Taxes, industry payments are subject to a 25% income offset (BEA convention).
9. All payments are assumed to be spent as Federal outlays.
10. Industry payments are reduced to provide a credit for excise tax increases enacted as part of BBA '97.
11. States could use some portion of increased funds to increase matched grant spending, thereby generating a Federal match.
12. CPI effects shown as memorandum only because they at least partially overlap with the 25% income offset.

**SUMMARY OF BUDGETARY EFFECTS OF PROPOSED SETTLEMENT
WITH EXCISE TAX TRIGGER WHEN YOUTH TARGETS NOT MET AND 30% NONPRICE EFFECT**

09/08/97

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(In billions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
RECEIPTS													
Base Payment (inc. trust and up-front payment).....	10	9	10	12	14	15	15	15	15	15	15	69	144
Payments to Recoup Excise Tax Credit and/or Losses..	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult Sales Volume Adjustment.....	--	(1)	(1)	(1)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(7)	(21)
Credit for Personal Compensation Claims.....	--	(1)	(2)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(9)	(24)
Inflation Adjustment.....	--	0	0	1	1	2	2	2	3	3	3	4	17
Credit for BBA Excise Taxes.....	--	--	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(11)	(27)
Look-Back Surcharge for Youth Consumption.....	=	=	=	=	=	0	=	1	0	0	2	0	4
Net Industry Settlement Payments.....	10	7	5	7	8	9	9	9	9	9	10	45	91
Tax Offsets													
Indirect Business Tax Offset.....	(3)	(2)	(1)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(3)	(11)	(23)
Corporate Income Tax on Look-Back Surcharge.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Youth Excise Tax Trigger.....	--	--	--	--	--	2	--	3	3	3	4	2	15
Reduction in Existing Federal Excise Taxes.....	=	(0)	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(3)	(7)
Total Federal Tax Offsets.....	(3)	(2)	(2)	(2)	(3)	(2)	(3)	(0)	(0)	(0)	1	(12)	(16)
Net Additional Receipts to US Government.....	8	5	3	5	5	7	6	9	9	9	11	32	76
POTENTIAL USES/CHANGES													
State Attorneys General Proposals, Total.....	--	5	5	6	7	9	6	7	7	4	4	32	59
Offset Reduction in State Excise Taxes.....	--	1	1	1	1	1	1	1	1	1	2	4	10
Use of Youth Look-Back Surcharge (90% grants).....	--	--	--	--	--	0	--	1	0	0	2	0	4
Potential Increase in Federal Medicaid Match.....	1	2	1	2	2	2	2	2	2	2	3	10	21
Total Potential Uses.....	1	7	7	9	10	12	9	11	11	8	10	46	94
Memoranda:													
Ad Valorem Equivalent of Net Payments.....	17%	13%	17%	20%	25%	22%	30%	29%	29%	29%	34%		
Change in Total Cigarette Consumption.....	-7%	-6%	-8%	-9%	-12%	-10%	-13%	-13%	-13%	-13%	-15%		
Percentage Point Shortfall from Youth Target.....						1%	-8%	14%	9%	10%	20%		

Potential Budgetary Impacts of Tobacco Agreement
With Excise Tax Trigger when Youth Targets Not Met and 30% Nonprice Effect
(in billions of dollars)

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	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	98-03	98-08
Federal revenues:													
Industry payments:													
Up-front payment.....	10.0	--	--	--	--	--	--	--	--	--	--	10.0	10.0
Public health trust funds in bill.....	--	2.5	2.5	3.5	4.0	5.0	2.5	2.5	2.5	--	--	17.5	25.0
Base amounts in bill.....	--	6.0	7.0	8.0	10.0	10.0	12.5	12.5	12.5	15.0	15.0	41.0	108.5
Additional amounts to recover BBA97 credit.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Additional amounts to recover excise tax losses.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Adult sales volume adjustments.....	--	(0.7)	(0.9)	(1.3)	(1.9)	(2.4)	(2.3)	(2.8)	(2.8)	(2.8)	(3.2)	(7.3)	(21.1)
Credits for civil suits at cap.....	--	(1.5)	(1.7)	(1.9)	(2.3)	(2.2)	(2.8)	(2.7)	(2.7)	(3.2)	(3.1)	(9.5)	(24.0)
Inflation adjustments on above.....	--	0.2	0.4	0.8	1.2	1.7	1.9	2.2	2.5	2.7	3.0	4.3	16.7
Credit for BBA97 excise tax increase.....	--	--	(2.4)	(2.3)	(3.4)	(3.3)	(3.3)	(3.2)	(3.2)	(3.2)	(3.1)	(11.3)	(27.2)
Look-back surcharge.....	--	--	--	--	--	0.1	--	0.9	0.4	0.4	1.7	0.1	3.5
User fees for nonparticipants.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Net penalties.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Subtotal, industry payments.....	10.0	6.5	5.0	6.8	7.7	8.9	8.5	9.4	9.3	8.9	10.4	44.8	91.4
Tax offset at 25% (IBT).....	(2.5)	(1.6)	(1.2)	(1.7)	(1.9)	(2.2)	(2.1)	(2.4)	(2.3)	(2.2)	(2.6)	(11.2)	(22.8)
Corporate income tax on look-back surcharge.....	--	--	--	--	--	--	--	--	--	--	--	--	--
Teen excise tax.....	--	--	--	--	--	1.5	--	3.0	3.0	2.9	4.3	1.5	14.7
Reduction in tobacco excise taxes (non-PAYGO).....	--	(0.3)	(0.4)	(0.5)	(0.7)	(0.8)	(0.7)	(1.0)	(0.9)	(0.9)	(1.1)	(2.8)	(7.4)
Total, Federal revenues.....	7.5	4.5	3.3	4.6	5.1	7.3	5.7	9.1	9.0	8.7	11.0	32.4	75.8
Federal outlays:													
Public health trust funds in bill.....	--	2.6	2.7	3.8	4.5	5.8	3.0	3.1	3.2	--	--	19.4	28.6
HHS direct programs and grants to States.....	--	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.3
FDA direct enforcement and grants to States.....	--	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	1.6	3.5
Grants to States for ASSIST-type programs.....	--	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.5	1.3
Direct Federal R&D to discourage tobacco use.....	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2
Payments to tobacco-sponsored events/teams.....	--	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8
Public educ. campaign run by non-profit board.....	--	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	2.7	5.9
HHS payments for tobacco use cessation programs.....	--	1.0	1.1	1.1	1.1	1.7	1.8	1.8	1.9	2.0	2.0	6.0	15.5
Spending of look-back surcharge (90% grants).....	--	--	--	--	--	0.1	--	0.9	0.4	0.4	1.7	0.1	3.5
Subtotal, specified spending in bill.....	--	4.7	5.0	6.2	7.1	9.2	6.4	7.4	7.1	4.1	5.5	32.2	62.7
Unspecified residual to reach total payments.....	10.0	1.8	0.0	0.5	0.5	(0.3)	2.2	2.0	2.2	4.8	4.8	12.6	28.7
Total, Federal outlays, excl. debt Service.....	10.0	6.5	5.0	6.8	7.7	8.9	8.5	9.4	9.3	8.9	10.4	44.8	91.4
Federal deficit:													
Revenues (deficit effect).....	(7.5)	(4.5)	(3.3)	(4.6)	(5.1)	(7.3)	(5.7)	(9.1)	(9.0)	(8.7)	(11.0)	(32.4)	(75.8)
Programmatic outlays.....	10.0	6.5	5.0	6.8	7.7	8.9	8.5	9.4	9.3	8.9	10.4	44.8	91.4
Debt service.....	0.1	0.2	0.3	0.4	0.5	0.6	0.8	0.9	0.9	1.0	1.0	2.1	6.6
Federal deficit.....	2.6	2.2	1.9	2.6	3.1	2.2	3.6	1.2	1.2	1.2	0.4	14.5	22.2
MEMORANDUM: PAYGO budget effects:													
Revenues (deficit effect).....	(7.5)	(4.9)	(3.7)	(5.1)	(5.7)	(8.2)	(6.4)	(10.0)	(9.9)	(9.6)	(12.1)	(35.1)	(83.2)
Outlays.....	10.0	6.5	5.0	6.8	7.7	8.9	8.5	9.4	9.3	8.9	10.4	44.8	91.4
Total PAYGO deficit effect.....	2.5	1.6	1.2	1.7	1.9	0.7	2.1	(0.6)	(0.6)	(0.7)	(1.7)	9.7	8.2
ADDENDA:													
Available (residual) spending if held to PAYGO neutrality	7.5	0.2	(1.2)	(1.1)	(1.4)	(1.0)	0.0	2.6	2.8	5.6	6.5	3.0	20.5
Available (residual) spending if held to budget neutrality..	7.5	(0.1)	(1.6)	(1.7)	(2.0)	(1.8)	(0.7)	1.6	1.9	4.6	5.5	0.2	13.1
Deficit impact of higher CPI (COLAs and indexation).....	--	0.5	1.5	2.5	3.4	3.9	4.2	4.4	4.5	4.6	4.6	11.9	34.3
Potential increase in Federal matching grants(lower end)	0.8	0.9	0.0	0.3	0.3	(0.2)	1.1	1.0	1.1	2.4	2.4	2.1	10.1
Potential increase in Federal matching grants(upper end)	1.0	1.6	1.2	1.7	1.9	2.2	2.1	2.4	2.3	2.2	2.6	9.7	21.3
Reduction in current law State excise tax revenues.....	--	(0.6)	(0.5)	(0.7)	(0.8)	(1.0)	(0.9)	(1.3)	(1.3)	(1.3)	(1.6)	(3.7)	(10.1)

See Footnotes Next Page.

1. Reduction in tobacco volume is assumed to result solely from price increases due to passthrough of industry payments.
Access restrictions, public education, and cessation programs are assumed to have no additional effect.
2. Civil liability settlements are assumed to be at cap (33% of industry basic payments). Cap is assumed to be a single 33% cap for suits based on past and future conduct.
3. Corporate income tax rate of 35% is assumed in scenarios where surcharge payments are nondeductible.
4. No manufacturers are assumed to qualify for 75% good faith surcharge abatement.
5. All manufacturers are assumed to participate in the settlement.
6. All manufacturers are assumed to meet compliance plan and corporate culture requirements.
7. Amounts are assumed to increase for inflation as follows: (a) industry payments increase for inflation beginning in 1999;
(b) outlays increase for inflation beginning in 1999; (c) surcharge amount and cap increase for inflation beginning in 1997.
8. All industry payments are assumed to score as Federal Indirect Business Taxes (excise tax receipts).
As Indirect Business Taxes, industry payments are subject to a 25% income offset (BEA convention).
9. All payments are assumed to be spent as Federal outlays.
10. Industry payments are reduced to provide a credit for excise tax increases enacted as part of BBA '97.
11. States could use some portion of increased funds to increase matched grant spending, thereby generating a Federal match.
12. CPI effects shown as memorandum only because they at least partially overlap with the 25% income offset.