

**Written Testimony Before the  
Senate Committee on Agriculture, Nutrition, and Forestry  
Hearings on the  
Tobacco Settlement and the Future of the Tobacco Industry**

**Jeffrey E. Harris M.D. Ph.D<sup>1</sup>**

**106 Dirksen Senate Office Building  
Washington, D.C.**

**September 11, 1997**

Mr. Chairman, my name is Jeffrey Harris. I thank you for inviting me to testify today. I am a primary-care physician at the Massachusetts General Hospital in Boston and a tenured member of the economics faculty at the Massachusetts Institute of Technology. For your reference, I have attached a short biographical sketch to my testimony.

Under the Proposed Resolution of June 20, 1997,<sup>2</sup> tobacco manufacturers would be required to make continuing annual payments whose face value has been reported to be \$368.5 billion over 25 years. Today, I address three questions concerning the magnitude of the proposed tobacco-industry payments.

- 1. How much money would the tobacco industry actually pay over the next 25 years? What is the current market value of such payments?**
- 2. How does the size of tobacco industry payments compare with the public and private costs of illness and disability caused by tobacco use? Who will be compensated for tobacco-related injuries, and who will not?**
- 3. What is the monetary value of the industry-wide settlement to the tobacco industry? How much would the industry be willing to pay?**

My comments today, while critical of Proposed Resolution, are intended to be constructive.

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<sup>1</sup> The opinions expressed in my testimony today do not necessarily represent those of the Massachusetts General Hospital, Massachusetts Institute of Technology, or any other organization.

<sup>2</sup> "Proposed Resolution: For Settlement Discussion Purposes Only. 6/20/97, 3:00 p.m. DRAFT."  
68pp.

Tobacco Industry Payments: Volume Adjustments, Present Market Value

The Proposed Resolution contains a little-noted but important provision that pegs annual industry payments directly to the volume of tobacco products sold.<sup>3</sup> This “volume adjustment” provision was explicitly written into the industry’s recent settlements with both the state of Mississippi<sup>4</sup> and the state of Florida.<sup>5</sup> In particular, if domestic tobacco sales go down, then tobacco-industry payments go down, too.

Tobacco manufacturers are expected to finance the required payments by raising prices.<sup>6,7</sup> By the fifth post-settlement year, the required price increase on cigarettes will amount to approximately \$0.62 per pack in real (that is, inflation-adjusted)

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<sup>3</sup> Title VI, B.5 of the *Proposed Resolution* (pp. 34-35) states:

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

“<sup>co</sup> Beginning in year 1; payment made equal to scheduled annual payment times the ratio of actual relevant domestic tobacco product unit sales volume to relevant base volume. In the event of a decline in volume, relevant actual volume and relevant base volume are adult volume figures; in the event of an increase in volume, relevant actual volume and relevant base volume are total volume figures. Base volume is 1996 volume.”

<sup>4</sup> Memorandum of Understanding. *In Re Mike Moore, Attorney General ex rel, State of Mississippi Tobacco Litigation. Cause No. 94-1429. In the Chancery Court of Jackson County, Mississippi.* Washington, D.C., July 2, 1997. Paragraph 3 (pp. 4-5) states: “The above payments will also be decreased or increased, as the case may be, in accordance with decreases or increases in volume of domestic tobacco product volume sales as provided in Paragraph B.5 on pages 34-35 of the June 20, 1997 Proposed Resolution.”

<sup>5</sup> Settlement Agreement. *The State of Florida, et al. v. The American Tobacco Company, et al. Civil Action No. 95-1466 AH. Circuit Court of the Fifteenth Judicial Circuit, In and For Palm Beach County, Florida.* August 25, 1997, 11:20. The section entitled “B. Monetary Provisions. 3. Annual Payments” (p. 9) states: “Such payments will also be decreased or increased, as the case may be, in accordance with decreases or increases in volume of domestic tobacco product volume sales as provided in Paragraph B.5 on pages 34-35 of the Proposed Resolution.”

<sup>6</sup> The *Proposed Resolution* explicitly provides that the annual industry payments be passed on to consumers in the form of higher prices. Title VI, B.7 (page 35) states: “B.7 Pass-Through. In order to promote maximum reduction in youth smoking, the statute would provide for the Annual Payments to be reflected in the prices manufacturers charge for tobacco products.”

<sup>7</sup> Cigarette manufacturers have already raised prices, possibly in anticipation of settlement payments. Wholesale prices on premium- and discount-brand cigarettes rose by \$2.50 per 1,000 during March-April, 1997, and by \$3.50 per 1,000 in September, 1997 (Tom Capehart, USDA Economic Research Service: personal communication). The combined price increase, which amounts to 12 cents per pack, is expected to raise an additional \$2.8 billion annually.

dollars.<sup>8</sup> This increase in price will in turn cause a 14% reduction in smoking, which, through the volume adjustment provision, will result in 14% lower industry payments. Hence, the industry will actually pay \$12.9 billion in that year, and not the oft-cited face amount of \$15 billion. As a result of the volume adjustment provision, the total face value of tobacco industry payments over 25 years will actually be \$304.3 billion, rather than the oft-quoted total of \$368.5 billion.<sup>9</sup> My calculations are detailed in Appendix Table 1.

While tobacco manufacturers will directly make the annual payments prescribed by the *Proposed Resolution*, nearly all of the money will come indirectly from continuing current smokers, as well as future tobacco users. Over 25 years, I estimate that tobacco consumers will pay a cumulative face value of \$272.0 billion,

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<sup>8</sup> By the fifth post-settlement year, the face value of total payments is \$15 billion. (See *Proposed Resolution*, Title VI. B.3. Face Amounts. p. 34.) The 1996 base volume of cigarettes sold was 24.165 billion packs. (See John C. Maxwell, "Market Up: Philip Morris and Lorillard report 1996 growth in U.S. cigarette market." *Tobacco Reporter*, April 1997, p. 22.) If industry payments were financed entirely through cigarette revenues, then the required price increase would be: \$15 billion ÷ 24.165 billion packs = \$0.62 per pack. The *Proposed Resolution* does not specify what portion of total industry payments would be paid by United States Tobacco Co., which sells primarily smokeless tobacco, not cigarettes. If UST paid 5.1 percent (its share of total domestic tobacco revenues in 1996, as detailed below) and the other four participant cigarette manufacturers (Philip Morris, RJ Reynolds, Brown & Williamson, Lorillard) paid 94.9 percent, then cigarette prices would rise by 59 cents per pack. The table below shows participant firms' sales revenues from domestic tobacco for 1996, as derived from their annual reports. (The estimate for Brown & Williamson is based on the assumption that domestic sales accounted for 73% of 1996 net sales revenue of \$4,248.5 million. See pie chart on page 3 of *Brown & Williamson Tobacco Corporation Annual Review 1996*.)

Participant Firm	1996 Revenues (\$billions)	Percent of Total
Philip Morris	12,462	53.0%
RJ Reynolds	4,551	19.3%
Brown & Williamson	3,101	13.2%
Lorillard	2,217	9.4%
US Tobacco	1,195	5.1%
Total	23,526	100.0%

<sup>9</sup> See also Harris JE. *Comments on Proposed Tobacco Industry-Wide Resolution*, Commissioned by the American Cancer Society, June 26, 1997, esp. Table 2. The calculations in Appendix Table 1 assume that the revenues from federal excise tax increases of 10 cents per pack, scheduled for the year 2000, and an additional 5 cents per pack, scheduled for the year 2002, will be credited toward total industry payments, as provided in current law.

while the remaining \$32.3 billion will come from foregone tobacco industry profits. (See Appendix Table 1.)<sup>10</sup>

Money to be paid in the future is worth less than money in hand right now. Accordingly, I used current long-term interest rates to compute the real present market value of future industry payments, often called its “presented discounted value” by economists. In essence, I asked: If the tobacco industry had to raise the required payments over the next 25 years by issuing long-term corporate bonds, what would be the market value of those bonds today? Put differently: How much money would the tobacco industry need to invest today in long-term US Treasury bonds to have enough money to make the 25 years of payments?

As delineated in Appendix Table 1, I have estimated the present market value of industry payments over the first 25 post-settlement years to be \$194.5 billion. Of this amount, \$175.3 would be paid by consumers through higher prices, while \$19.3 billion would derive from lost profits.

Costs of Tobacco-Related Illness and Disability: Who is Compensated?

Under the *Proposed Resolution*, one-third of the tobacco industry’s annual “base payments” are to be allocated to a fund to pay for judgments and settlements against participating companies. The contributions to this fund are to constitute an annual aggregate cap on judgments and settlements against the participating manufacturers. The size of this annual liability cap is also subject to the same “volume adjustment” provision as total industry payments.<sup>11</sup>

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<sup>10</sup> Some commentators have noted that the tax treatment of industry payments as ordinary business expenses (*Proposed Resolution*, Title VI, D. Tax Treatment, p. 35) will cost state and federal governments billions in foregone income tax revenues. This observation, while plausible, is not entirely accurate. If industry payments were not tax-deductible, then I would expect the retail price of cigarettes to rise even higher in order to pay the additional costs. For example, if combined federal and state corporate tax rate were 42%, then the price increase required to cover industry payments would have to be multiplied by a factor of  $1/(1-0.42) = 1.72$ . As a result, the retail price of cigarettes would rise by \$1.07 per pack, rather than by the currently estimated \$0.62 per pack. Over 25 years, the total face value of industry payments, after volume adjustment, would be \$476.2 billion, of which \$431.6 billion would come from smokers and \$44.6 billion would come from lost profits.

<sup>11</sup> The *Proposed Resolution* (Title VIII: Civil Liability. B.9. Annual aggregate cap for judgments/settlements, p. 40) provides that 33% of “base annual industry payment (including any reductions for volume decline)” be allocated for judgment/settlements. In the event that the annual cap is not exceeded in a given year, the unused funds are to be disbursed by a Presidential Commission (B.10, at p. 41).

Based upon these and other provisions in the *Proposed Resolution*, I estimate that the total volume-adjusted industry payments of \$304.3 billion over 25 years will be allocated as: \$89.9 billion in contributions to the aggregate liability cap; \$162.8 billion to the states; and the remaining \$51.6 billion for administrative costs and public health purposes.<sup>12</sup> Similarly, the \$194.5 billion present market value of industry payments over 25 years will be apportioned as: \$54.8 billion toward the aggregate liability cap; \$104.8 billion to the states; and the remaining \$34.9 billion for administrative costs and public health purposes.

While these aggregate payments may appear substantial, they are dwarfed by the total costs of tobacco-related illness and disability imposed upon the public and private sectors of our economy. In recent testimony before the Senate Judiciary Committee, which I attach to this written testimony, I estimated the present discounted value of *future* smoking-related costs to the Medicaid program over the next 25 years conservatively to be \$178.3 billion. This estimate does not include the present value of *past* smoking-related costs to the Medicaid program, which, during fiscal years 1991-1995 alone, amounted to \$40.4 billion. Total past smoking-attributable costs since the inception of the Medicaid program in the 1960's, I estimated, would amount to hundreds of billions of dollars.

Based upon a very conservative estimate, I further testified that, over a 25-year period, the present discounted value of smoking-attributable Medicare expenditures would come to \$192.3 billion. This estimate did not include the past costs to the Medicare program that resulted from smoking-related illness.

The illness and injury caused by tobacco use result not only in increased spending on medical care, but also in disability and lost productivity. Higher rates of disability mean higher rates of eligibility for Medicaid, Medicare, and other federal entitlement programs including the compensation program administered the Veterans Benefits Administration.

In testimony before the House Ways and Means Committee in November, 1993, I estimated that in the year 1995 alone, the adverse health effects of cigarette smoking would be responsible for \$88 billion in health-care spending.<sup>13</sup> A large

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<sup>12</sup> Both the Florida and Mississippi settlements (cited in text footnotes 4 and 5 above) give the face value of aggregate payments to states as: \$4 billion in year 1; \$4.5 billion in year 2; \$5 billion in year 3; \$6.5 billion in years 4 and 5; and \$8 billion from the sixth post-settlement year onward. My estimates of state payments are based on the this schedule of payments, subject to the same volume adjustments that I used in Appendix Table 1.

<sup>13</sup> Harris JE, *Testimony Before the Committee on Ways and Means, U.S. House of Representatives, In Public Hearings on the Financing Provisions Of the Administration's Health Security Act*. Washington DC, November 18, 1993.  
(cont'd)

fraction of these costs are borne by private parties, including insurance companies, charitable institutions, and other benefit plans.

How Much Could the Tobacco Industry Pay?

Appendix Table 2 shows my calculations of the profits of the major tobacco manufacturers for 1996, which are based upon my analysis of company annual reports. I estimate that the total pre-tax domestic operating profits of the five major U.S. cigarette manufacturers were \$7.175 billion in 1996. With total 1996 domestic cigarette sales volume at 24.165 billion packs, the average operating profit per pack would be \$0.30. These calculations do not include the profits of UST, Inc., which sells primarily moist smokeless tobacco products, and not cigarettes. If I include UST, Inc., then total pre-tax domestic operating profits would be \$7.926 billion in 1996. The combined corporate-wide pre-tax profits of all major tobacco producers amounted to \$15.781 billion in 1996.

It might appear that the industry-wide operating profit of \$7.9 billion on domestic tobacco sales should be taken as a practical upper limit on its ability to pay. If not, then perhaps total pre-tax corporate profits of nearly \$16 billion should constitute an effective ceiling. These conclusions are unwarranted, however, because they incorrectly assume that tobacco manufacturers will not or cannot raise prices in order to finance settlement payments.

In reality, the cigarette industry's ability to pay damages is bounded by the maximum amount of money it could extract from smokers if the price of cigarettes were set at its full, monopoly profit-maximizing level. In a recent article,<sup>14</sup> I calculated that the full monopoly, profit-maximizing price of cigarettes in the United States in 1995 was approximately \$4.08 per pack. By contrast, the nation-wide average price of cigarettes in 1995 was about \$1.88 per pack. Accordingly, any increase in price up to \$2.20 per pack would generate additional profits for manufacturers or revenues for governments. A \$2.20-per-pack increase, I calculated, would generate over 32 billion dollars annually, which could be divided between liability payments and industry profits. That would mean, for example, that \$27 billion could be allocated to a global industry-wide resolution, while the industry would retain \$5 billion in pre-tax profits.

As many commentators have noted, the *Proposed Resolution* makes sweeping changes in our current system of civil liability with respect to tobacco and health.

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<sup>14</sup> Harris JE. American cigarette manufacturers' ability to pay damages: overview and a rough calculation. *Tobacco Control*, Winter 1996, Vol. 5, pp. 292-294.

Punitive damages for all pending and future claims are barred, so long as they are based solely on past industry conduct (p. 39). Future law suits can only take the form of individual trials. Class actions and other consolidations are eliminated (p. 39). After June 9, 1997, third-party payors can only file suit based on subrogation of individual claims (p. 40). The development of "reduced risk" tobacco products cannot be used as evidence in court of liability for past actions (p. 40). As I have already noted, there is an aggregate liability cap whose total value goes down as tobacco sales fall.

How much would the enactment of these sweeping legal changes be worth to tobacco manufacturers? Market analysts have suggested that tobacco stock prices have been depressed as much as 50% by the cloud of legal liability hanging over the industry.<sup>15</sup> I believe, however, that the traditional estimate of a 50% litigation discount should now be considered too low. During the past 2 years, the new wave of litigation aimed at the tobacco industry has been propelled not only by state attorneys general, but by private law firms with substantial resources who have been willing to accept high-risk contingency fee arrangements.<sup>16</sup> In addition to law suits filed by state and local governments, class actions have been brought by groups ranging from airline flight attendants to workers' health and welfare funds. Without the legislative changes contemplated by the *Proposed Resolution*, this wave of litigation is likely to swell further. As more cases proceed toward trial, more

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<sup>15</sup> See, for example, France M. Big Tobacco may be ready to deal. *Business Week* 1996 Oct 7: 150, 152 (citing estimates from Smith Barney and Salomon Bros).

<sup>16</sup> In the Mississippi Memorandum of Understanding, cited in text footnote 4 above, settling defendants agreed to pay the Attorney General \$2.5 million for the best estimate of costs and expenses attributable to his office and other appropriate state agencies, while \$12.5 million was to be paid to plaintiffs' private counsel for their best estimate of their costs and expenses. (See Mississippi Memorandum of Understanding, pp. 3-4.) In the Florida Settlement Agreement, cited in text footnote 5 above, settling defendants agreed to pay the Attorney General \$10 million and private counsel \$12 million for costs and expenses. See Florida Settlement Agreement, p. 13.

documents concerning possible egregious conduct of tobacco manufacturers may become available. Litigation costs to successive plaintiffs may fall as each litigant learns from the previous cases.

Based upon these economic considerations, I believe that the financial value to the tobacco industry of the proposed legal reforms substantially exceeds the aggregate amount of payments mandated under the current industry-wide resolution. I would not be surprised to learn that legal and economic experts advising the industry have reached a similar conclusion.



**Appendix Table 1. Estimated Cigarette Industry Payments During the First 25 Post-Settlement Years**

Payment Year	Face Amount of Total Payments (billions) <sup>1</sup>	Price Increase (real dollars per pack) <sup>2</sup>	Retail Price (real dollars per pack) <sup>3</sup>	Predicted Domestic Consumption (bill. packs) <sup>4</sup>	Real Volume-Adjusted Total Payments (\$billions) <sup>5</sup>	Real Volume-Adjusted Lost Profits (\$billions) <sup>6</sup>	Real Present Discounted Value of Total Payments (\$billions) <sup>7</sup>	Real Present Discounted Value of Lost Profits (\$billions) <sup>7</sup>
0	10.0	0.41	2.46	22.3	10.0	0.6	10.0	0.6
1	8.5	0.35	2.40	22.4	7.9	0.5	7.6	0.5
2	9.5	0.39	2.44	22.1	8.7	0.6	8.1	0.6
3	11.5	0.48	2.53	21.6	10.3	0.8	9.2	0.7
4	14.0	0.58	2.63	21.1	12.2	0.9	10.5	0.8
5	15.0	0.62	2.67	20.8	12.9	1.0	10.7	0.8
6	15.0	0.62	2.67	20.7	12.8	1.1	10.2	0.8
7	15.0	0.62	2.67	20.5	12.7	1.1	9.8	0.8
8	15.0	0.62	2.67	20.4	12.7	1.1	9.3	0.8
9	15.0	0.62	2.67	20.3	12.6	1.2	8.9	0.8
10	15.0	0.62	2.67	20.2	12.5	1.2	8.6	0.8
11	15.0	0.62	2.67	20.0	12.4	1.2	8.2	0.8
12	15.0	0.62	2.67	19.9	12.4	1.3	7.8	0.8
13	15.0	0.62	2.67	19.8	12.3	1.3	7.5	0.8
14	15.0	0.62	2.67	19.7	12.2	1.3	7.2	0.8
15	15.0	0.62	2.67	19.6	12.1	1.4	6.9	0.8
16	15.0	0.62	2.67	19.4	12.1	1.4	6.6	0.8
17	15.0	0.62	2.67	19.3	12.0	1.4	6.3	0.8
18	15.0	0.62	2.67	19.2	11.9	1.5	6.0	0.7
19	15.0	0.62	2.67	19.1	11.9	1.5	5.7	0.7
20	15.0	0.62	2.67	19.0	11.8	1.6	5.5	0.7
21	15.0	0.62	2.67	18.9	11.7	1.6	5.3	0.7
22	15.0	0.62	2.67	18.8	11.6	1.6	5.0	0.7
23	15.0	0.62	2.67	18.6	11.6	1.7	4.8	0.7
24	15.0	0.62	2.67	18.5	11.5	1.7	4.6	0.7
25	15.0	0.62	2.67	18.4	11.4	1.7	4.4	0.7
<b>Total</b>	<b>368.5</b>				<b>304.3</b>	<b>32.3</b>	<b>194.5</b>	<b>19.3</b>

Notes to Appendix Table 1:

1. Face value of total payments, as specified in Title VI of the *Proposed Resolution*. Surcharges under the "Look Back" provision (Appendix V of the *Proposed Resolution*) not included.
2. The price increase was computed as  $t = X_0/q_0$ , where  $X_0$  = Face Value of Total Payments and  $q_0$  = 24.165 billion packs shipped in 1996, as reported by Maxwell, *op. cit.*, text footnote 8.
3. Retail price was computed as  $p = t + 2.05$ , where the base price was estimated to be \$2.05/pack. The based price was derived as the ratio of total consumer spending to total cigarette consumption for 1996. Total consumer spending (inclusive of state sales taxes) was \$49,334 million in 1996 (T. Capehart, USDA Economic Research Service: personal communication).
4. Total domestic tobacco consumption was predicted from the equation:

$$q = \exp(3.5849 - 0.1951p - 0.006T),$$

where  $p$  is real price per pack and  $T$  is year of payment, based on model reported in Harris JE, "A Working Model for Predicting the Consumption and Revenue Impacts of Large Increases in the U.S. Federal Cigarette Excise Tax," Cambridge MA: National Bureau of Economic Research, July 1994. See (Internet) <http://web.mit.edu/jeffrey/harris/workingmodel.html>.

5. Total payments were computed as  $R = tq$ , where  $t$  = real price increase and  $q$  = number of packs.
6. Face value of lost profits was computed as  $L = m*(q_0 - q)$ , where  $m = \$0.30$  is the industry-wide average pre-tax profit margin per pack,  $q_0$  is base volume in 1996, as  $q$  is projected domestic tobacco consumption.
7. The real present discounted value of total payments was computed as  $R*(1.03/1.07)^T$ , where  $T$  is year of payment. An annual inflation rate of 3% was used (*Proposed Resolution*, Title V, B.4 Inflation Protection for Annual Payments, p. 34); and a long-term interest rate of 7% was used, based upon the Merrill Lynch Corporate Index, the Lehman Bros. T-Bond Index, and the 30-year Treasury Bond rate.
8. The real present discounted value of lost profits was computed as  $L*(1.03/1.07)^T$ . See previous note.

**Appendix Table 2. U.S. Tobacco Manufacturers' Pre- and Post-Tax Income, 1996**

Compiled by Jeffrey E. Harris MD PhD

Tobacco Manufacturer	Operating Companies Pre-Tax Income (\$millions)				All Operating Companies	Corporate-Wide	Corporate-Wide
	U.S. Domestic Tobacco	International Tobacco	Total Tobacco	Total Non-Tobacco		Pre-Tax Income (\$millions)	After-Tax Income (\$millions)
Philip Morris (1)	4,206	4,078	8,284	4,521	12,805	10,683	6,303
RJR Nabisco (2)	1,450	803	2,253	1,063	3,316	1,196	611
Loews (3)	722	-	722	2,100	2,822	1,701	1,384
Brown & Williamson (4)	791	198	988	-	973	1,476	891
Liggett (5)	7	-	7	-	7	(18)	(18)
<b>Cigarette Subtotal</b>	<b>7,175</b>	<b>5,079</b>	<b>12,254</b>	<b>7,684</b>	<b>19,923</b>	<b>15,037</b>	<b>9,170</b>
UST (6)	751	-	751	19	770	745	464
<b>Tobacco Total</b>	<b>7,926</b>	<b>5,079</b>	<b>13,005</b>	<b>7,704</b>	<b>20,694</b>	<b>15,781</b>	<b>9,634</b>

NOTES:

1. Source: *Philip Morris Companies, Inc. 1996 Annual Report*, pp. 1, 24, 30. Operating companies' income is income before amortization of goodwill, unallocated corporate expenses and interest and other debt expense, net. Corporate-wide income reflects deductions for these categories, including \$1,086 million interest and other debt expense, net. See p. 30. Non-tobacco operations include: food, beer, financial services and real estate.
2. Source: *RJR Nabisco Annual Report 1996*, pp. 2, 8, 29-30. Operating company contributions equal operating income before amortization of trademarks and goodwill and exclusive of restructuring expenses and interest and debt expenses. Corporate-wide income reflects deductions for these categories, including \$927 million interest and debt expense. Minority interest in Nabisco Holdings (\$3 million) also excluded from corporate income. See pp. 29-30. Non-tobacco operations include: food (Nabisco).
3. Source: *Loews Corporation 1996 Annual Report*, pp. 3, 27, 73-74. All operating companies income is income before minority interest and allocation of interest expense and corporate expense. Corporate-wide income reflects these categories. See note (e) p. 74. Non-tobacco operations include: insurance, hotels, drilling, watches and clocks.
4. Source: *Brown & Williamson Tobacco Corporation Annual Review 1996*, pp. 3, 5, 7, 9. Total tobacco income includes cigarette sales in U.S., Japan, Korea and Mexico, as well as export leaf tobacco. U.S. domestic tobacco income estimated as 80% of total tobacco income based on 73% of unit volume (p. 3) and 50% higher profit margin. Corporate-wide pre- and after-tax income based on parent BAT Industries income, reported in *BAT Industries Annual Review and Summary Financial Statement 1996*. Pre-tax and after-tax profits of BAT Industries were £2,495 and £1,506 million, respectively. Computed incomes based on 10a.m. 12/30/96 midpoint exchange rate of 1.6908 reported by Federal Reserve Bank of New York. See Internet FTP site: <ftp://ftp.frb.org/forex/10am/1996/DEC/10A1230.96>.
5. Source: *Liggett Group, Inc. Securities and Exchange Commission Form 10-K/A No. 1, for the fiscal year ended December 31, 1996*. Corporate-wide income includes interest expense and extraordinary item, including settlement of certain tobacco litigation. See pp. 12 and 22-23.
6. Source: *UST 1996 Annual Report*, pp. 1, 24-32. Tobacco segment includes only domestic smokeless products. "Non-tobacco" segment includes wine and "Other" (moist smokeless tobacco sales to Canada and Mexico, cigars, and Cabin Fever Entertainment). See p. 18.

JEFFREY E. HARRIS: Biographical Sketch

Jeffrey Harris, M.D., Ph.D. is a physician and an economist. He is a primary-care internist at Massachusetts General Hospital and a professor at M.I.T, where he teaches health economics and a freshman seminar entitled "AIDS in the 21st Century."

Dr. Harris has testified before the House Ways & Means Committee on financing health-care reform (1993), the Massachusetts legislature on public disclosure of cigarette ingredients (1995), and the Senate Judiciary Committee on the proposed global tobacco settlement (1997). He has advised numerous public and private agencies on health-care policy and health economics, including the Department of Veterans Affairs, Consumer Product Safety Commission, Centers for Disease Control, National Cancer Institute, Congressional Budget Office, American Cancer Society, Federal Trade Commission, and the Massachusetts Department of Public Health. He has served on National Academy of Sciences committees on AIDS, low birthweight, diesel emissions, and risk characterization. He was on the National Advisory Research Resources Council at the National Institutes of Health.

Dr. Harris wrote the seminal chapter in the 1989 *Surgeon General's Report*, in which he estimated that smoking caused nearly 400,000 deaths annually. In a 1990 article in the *Journal of the American Medical Association*, Dr. Harris was one of the first researchers to document that AIDS victims were surviving longer. He authored *Deadly Choices: Coping with Health Risks in Everyday Life* (1993). Last year, he published an evaluation of the impact of the Massachusetts anti-smoking campaign. He is now starting work on a new textbook on health economics and health policy.

JEFFREY E. HARRIS:  
Recent Presentations and Publications Concerning the Tobacco Industry

( Available via Internet at <http://web.mit.edu/jeffrey/harris> )

*Written Testimony Before the Senate Judiciary Committee Hearings on the  
"Proposed Global Tobacco Settlement: Who Benefits?" July 30, 1997*

*Prepared Remarks at the American Cancer Society's Press Conference on the  
Proposed Tobacco Industry-Wide Resolution, Washington DC, July 24, 1997*

*Comments on Proposed Tobacco Industry-Wide Resolution, Commissioned by  
the American Cancer Society, June 26, 1997*

*What Can the Cigarette Industry Afford? Structuring a Long-Term Settlement.*  
Remarks at the 12th Annual Conference of the Tobacco Products Liability Project,  
Northeastern University School of Law, Boston, May 11, 1997

*Estimates of Smoking-Attributable Medicaid Expenditures in Florida. Expert  
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"American cigarette manufacturers' ability to pay damages: overview and a rough  
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Campaign – Massachusetts, 1990-1996," *Morbidity and Mortality Weekly Report*  
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*Testimony Before the Mass. Dept. of Public Health Concerning Proposed  
Regulations to Implement Massachusetts General Laws chapt. 94, section  
307A (Cigarette Ingredient Disclosure), Boston, January 30, 1997.*

*A Working Model for Predicting the Consumption and Revenue Impacts of Large  
Increases in the U.S. Federal Cigarette Excise Tax.* National Bureau of Economic  
Research, Cambridge MA, July 1, 1994.

*Testimony Before the Committee on Ways and Means, U.S. House of  
Representatives, In Public Hearings on the Financing Provisions Of the  
Administration's Health Security Act.* Washington DC, November 18, 1993.

1 EXAMINATION OF IMPLICATIONS OF THE

2 PROPOSED TOBACCO SETTLEMENT

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4 THURSDAY, SEPTEMBER 11, 1997

5 United States Senate,

6 Committee on Agriculture, Nutrition, and Forestry,

7 Washington, D.C.

8 The committee met, pursuant to notice, at 9:00 a.m., in  
9 Room SD-106, Dirksen Senate Office Building, Hon. Richard G.  
10 Lugar (Chairman of the committee) presiding.

11 Present or submitting a statement: Senators Lugar,  
12 Helms, McConnell, Coverdell, Gramm, Craig, Harkin, Conrad,  
13 and Baucus.

1           STATEMENT OF JEFFREY E. HARRIS, M.D.,  
2           MASSACHUSETTS GENERAL HOSPITAL, BOSTON,  
3           MASSACHUSETTS

4           Dr. Harris. Mr. Chairman, my name is Jeffrey Harris.  
5 Thank you for inviting me to testify today. I am a primary  
6 care doctor at the Massachusetts General Hospital in Boston  
7 and a member of the economics faculty at the Massachusetts  
8 Institute of Technology. The views I express today are  
9 mine. They are not necessarily endorsed by MIT, the  
10 Massachusetts General Hospital, or any organization.

11           Today I address three questions concerning the  
12 magnitude of tobacco industry payments under the proposed  
13 global settlement. First, how much money will the industry  
14 actually pay? Second, how does the size of industry  
15 payments compare with the public and private costs of  
16 illness and disability caused by tobacco use? And third,  
17 what is the maximum amount that the industry could or would  
18 be willing to pay?

19           Although tobacco companies will reportedly pay a total  
20 face value of \$368.5 billion over 25 years, the real present  
21 value of the industry's actual payments will be much less.  
22 First, the draft global settlement contains a little noted,  
23 but important provision whereby industry payments are  
24 proportionately adjusted for changes in the volume of  
25 tobacco sales.

1           To finance the required payments, tobacco companies  
2 will raise prices which will cause consumption to drop by an  
3 average of 17 percent over the next 25 years. Under the  
4 settlement's volume adjustment provision, that would bring  
5 the face value of industry payments down to \$304 billion by  
6 itself.

7           Second, money paid in the future is worth less than  
8 money in hand now. By my estimate, the real present market  
9 value of the first 25 years of payments is \$195 billion.  
10 That is, the tobacco would need to invest \$195 billion today  
11 in long term U.S. Treasury bonds to have enough money to  
12 make the payments scheduled for the next 25 years. Put  
13 differently, a portfolio of corporate bonds promising the  
14 scheduled payments over the next 25 years would be worth  
15 \$195 billion today on the bond market.

16           Of the \$195 billion real market value of industry  
17 payments, \$105 billion I estimate will go to the States, \$55  
18 billion will go toward a fund to pay for judgments and  
19 settlements against participating companies, and the  
20 remaining \$35 billion will be devoted to administrative  
21 costs and public health purposes.

22           While these magnitudes appear substantial, they are  
23 dwarfed by the total costs of tobacco-related illness and  
24 disability on the public and private sectors of our economy.  
25 The present value of future smoking-related costs to the



1 Medicaid program over the next 25 years I conservatively  
2 estimate is \$178 billion. This estimate does not count the  
3 past costs incurred by Medicaid as a result of smoking-  
4 related illness which would run in the hundreds of billions  
5 of dollars since the beginning of the program in the last  
6 1960s.

7 Neither does it count past or future smoking related  
8 costs to the Medicare program. Future Medicare costs  
9 attributable to smoking, I conservatively estimate, have a  
10 current market value of another \$192 billion over the next  
11 25 years. Nor do these estimates cover the costs of smoking  
12 related disability as they might be incurred by the  
13 entitlement program administered by the Bureau of Veterans  
14 Affairs.

15 In 1996 tobacco companies participating in the proposed  
16 settlement earned \$7.9 billion before taxes on domestic  
17 tobacco sales and an additional \$5.1 billion on  
18 international tobacco sales. In total, the combined pre-tax  
19 profits of the parent companies from all lines of business  
20 was \$15.9 billion.

21 The quantities, however, should not be taken as a  
22 ceiling on tobacco manufacturers' ability to pay because  
23 manufacturers can and will raise prices to finance  
24 settlement payments.

25 Under the current proposal, cigarette companies would

1 be expected ultimately to raise prices by 62 cents per pack.  
2 As a result, 90 percent of the real market value of  
3 settlement payments would actually be paid by continuing and  
4 new consumers of tobacco products while the remaining 10  
5 percent would be derived from lost company profits. But 62  
6 cents per pack is not the limit. In fact, an increase in  
7 cigarette prices by more than \$2 per pack would continue to  
8 bring in substantial revenues, over \$30 billion, that could  
9 be allocated to settlement payments or retained as industry  
10 profits.

11 The proposed settlement entails sweeping changes in our  
12 current system of civil liability in relation to tobacco and  
13 health. In the absence of Congressionally sanctioned  
14 protections, tobacco manufacturers would face a mounting  
15 wave of potentially damaging lawsuits not only from State  
16 and local Governments, but from private parties ranging from  
17 airline attendants to workers health and safety funds.

18 The value of avoidance of the potential damages from  
19 such actions may be much higher, perhaps twice as high, to  
20 the tobacco companies as that of the current settlement.

21 Mr. Chairman, again, I thank you. I hope my comments  
22 have been constructive.

23 [The prepared statement of Dr. Harris follows:]

1           The Chairman. Thank you very much, Dr. Harris. Your  
2 testimony includes remarkable footnotes and calculations  
3 which are backup for your assertions and this is of  
4 tremendous value to members of the committee as we attempt  
5 to think through the three points that you have tried to  
6 make.

7           Mr. Ballin, you have suggested--and in fact, you did  
8 too, Mr. Sinclair--the need for a study along the lines that  
9 Dr. Koop mentioned earlier. I was impressed with his  
10 thought that we perhaps do not know enough--even as a  
11 committee on agriculture, people deeply interested in the  
12 subject--about how many tobacco farms there are in the  
13 country, how many people are actually farming tobacco as  
14 opposed to renting those rights to others and what the  
15 implications are in the lives of those persons and  
16 communities that are affected.

17           Likewise, about alternative crops, and you have  
18 mentioned, Mr. Ballin, that attempts have been made already  
19 to try to think through and many have been receptive in the  
20 tobacco community to potential alternatives. That the  
21 infrastructure of markets for these crops, of ways in which  
22 the farmers might have some reasonable hope of compensation,  
23 some form of income, appear to be very deficient. The whole  
24 idea of infrastructure, this enormous adjustment that would  
25 have to be made in many counties and many States, has barely

1 been contemplated.

2       Rather we have proceeded in American agriculture to a  
3 reduction of farms from 500-some thousand, as you pointed  
4 out, to something over 120,000 now, without regard to these  
5 families or to the infrastructure or to the communities. We  
6 have simply noted that these sorts of things have been  
7 occurring.

8       I want to know with regard, once again, to the blue  
9 ribbon committee idea, what is the urgency of this? I ask  
10 this as I asked Attorney General Norton, in the event that  
11 we are moving toward a Congressional piece of legislation  
12 incorporating the settlement there is a lot of unfinished  
13 business to do with regard to these growers, the  
14 communities, the community development, all of the things by  
15 and large most members today and most witnesses have agreed  
16 need to be done.

17       How much time is this going to take? Who, in the  
18 field, already has done some of this research and what sort  
19 of resources could we call upon?

20       Mr. Ballin. Senator, I think that the creation of the  
21 commission can go forward as settlement talks and  
22 discussions go forward because I think that no matter what  
23 allocation of money is going to be given to the farmers, we  
24 are still going to have to do some fact-finding as to how  
25 that money is going to be allocated. What is the best use

1 of that money?

2       There are some studies going on and some pilot projects  
3 being done in North Carolina and Kentucky to look at  
4 alternatives and supplementation to crops. There are some  
5 studies that have come out of the University of North  
6 Carolina of surveys of farmers to get a better perspective  
7 of what they see their future being.

8       That information is out there. But I think that a blue  
9 ribbon panel that will look at not only the agricultural  
10 aspects of this issue but also looking at non-agricultural  
11 aspects in those communities really needs to be done and it  
12 needs to be done with experts in investments, small farmers.  
13 There is a commission that has been established by the  
14 Secretary of Agriculture on small farms. It is meeting in  
15 Washington the last couple of days and it is holding  
16 regional hearings.

17       I think that kind of information from them, but also  
18 going into the tobacco communities and hearing from the  
19 farmers is going to be essential as we move forward over the  
20 next several years and into the next couple decades.

21       The Chairman. I would ask, Mr. Ballin, that you make  
22 available to the staff of this committee lists of studies  
23 that you and your organization might have. The staff  
24 already may be appraised of these, but at the same time I  
25 see some urgency in our proceeding with as comprehensive a

1 knowledge of who has done some work.

2 Mr. Ballin. We would be happy to do that and also put  
3 you in touch with others in North Carolina, Virginia,  
4 Tennessee and elsewhere who are doing these things because I  
5 think talking to them and finding out where they are headed  
6 and the work they have done is going to be very useful for  
7 the directions you head.

8 The Chairman. That would be very helpful.

9 Dr. Harris, in my opening statement, I suggested a more  
10 effective route toward reduction of teenage smoking or first  
11 smokers might well be the adoption of a \$2 per pack Federal  
12 excise tax. What is your judgment, or have you done  
13 modeling, as to what kind of reduction in terms of teenage  
14 smoking might occur if a \$2 per pack tax were to be  
15 assessed?

16 Dr. Harris. I have, in fact, looked at that.  
17 Currently, at least in the most recent 1996 survey, about 18  
18 percent of 13 to 17-year-olds smoked cigarettes every day.  
19 Historically, the 10 year average was closer to about 15  
20 percent. The settlement target is based on a 30 percent  
21 reduction from the historical average. That is the first  
22 five years will set a target of a 10 percent rate of teenage  
23 smoking.

24 To get from the current value of 18 percent down to the  
25 target of 10 percent of 13 to 17-year-olds smoking would

1 require by itself a price increase of \$1.50 per pack. The  
2 current 62 cent increase embodied within the settlement  
3 would get, by my calculations, the teenage smoking rate by  
4 itself about a third of the way there.

5 It is possible that some other provision within the  
6 proposed global resolution, such as the removal of  
7 billboards under certain circumstances and other actions,  
8 may independently have an effect on teenage smoking. But  
9 having looked at the experience of Massachusetts and  
10 California, which have such programs, I find it unlikely  
11 that that by itself will reach the target. Even  
12 optimistically giving credit for such programs I suspect  
13 that at least \$1.10 or \$1.15 tax increase, indexed to  
14 inflation, would be required to reach the target.

15 The Chairman. I think that is critically important  
16 testimony. Let me just reiterate from my own understanding,  
17 the goal now of the settlement is to move from an 18 percent  
18 usage of cigarettes by persons 13 to 17 down to 10 percent.  
19 And that is the goal of the settlement?

20 Dr. Harris. That is the five year goal. There is also  
21 a more stringent longer term goal.

22 The Chairman. Your testimony is that in order to get  
23 from 18 percent to 10 percent, a per pack tax of \$1.50 would  
24 be required?

25 Dr. Harris. Yes.

1           The Chairman. Your testimony is also that the amount  
2 of increase per pack now in the global settlement of 60-some  
3 cents might get a third of the way? That is maybe you get  
4 from 18 percent to 15 percent?

5           Dr. Harris. Correct.

6           The Chairman. But not 10. So that essentially, if  
7 your data, your modeling, is correct on the face of it the  
8 global settlement is bound to come up short so that the  
9 penalties that are instituted for failure to arrive at that  
10 are almost bound to be assessed?

11          Dr. Harris. If, in fact, the penalties are imposed,  
12 subject to other provisions currently in the lookback  
13 agreement, but yes.

14          The Chairman. In fact, however, your projection is  
15 that the global settlement misses by a whole lot. In other  
16 words, there is a big difference between 18, 15 and 10 over  
17 this large segment of the American population ages 13 to 17.  
18 So if we were to take Mr. Kessler, Dr. Kessler's testimony  
19 seriously, that he was saying today he is not really sure  
20 about the merits of the global settlement.

21          But if it brought about the reductions in teenage  
22 smoking, then he is prepared really to take another look at  
23 this, put the past behind this. But if Dr. Kessler were to  
24 hear your testimony he perhaps would be skeptical as to  
25 whether currently we are at that point without sizeable



1 changes in the global settlement.

2 This is why I underline it about three or four  
3 different ways. I think that this is the heart of the  
4 matter, which led me to suggest a \$2 per pack tax as a  
5 certain way of getting the job done, if this is, in fact, a  
6 major objective of American health policy.

7 Now the implications of that I also acknowledged. That  
8 is the reduction of the amount of tobacco grown in this  
9 country, reduction in the number of livelihoods, is going to  
10 be substantial. And therefore the need to think through  
11 alternative crops, a freedom to farm program, buy-out  
12 settlements, a whole lot of things that are absolutely  
13 necessary in transition if this health goal is to be arrived  
14 at, because there are other goals, too, in American life,  
15 the health of communities, of these individual people who  
16 are now involved in this, without a whole lot of thought  
17 having been given to them.

18 But I appreciate very much your testimony. Obviously,  
19 as people understand what you are saying, you may  
20 challenged. Perhaps you have been before. But I think that  
21 your testimony is very, very important to all of this.

22 Mr. Sinclair, with regard to this evolution, you have  
23 talked about that from your own experience. Are you  
24 optimistic that such an evolution of alternative crops, buy-  
25 outs, community development can make a difference? And over

1 what time frame is it practical that farmers and communities  
2 could make such a very large adjustment?

3 Mr. Sinclair. I think it is practical. It is hard to  
4 address the time frame perspective because we are so early  
5 in the process. I think one of the things that makes it  
6 most practical is that there is a change of attitude. I  
7 think historically, the tobacco growers saw the tobacco  
8 companies as their friends and their supporters and their  
9 protectors, and there is a change in that attitude. There  
10 is a concern about the reduction of the number of farms.  
11 There is a concern about the reduction in the amount of  
12 monies they are receiving out of tobacco products. There is  
13 a concern about the health issues, quite frankly.

14 As they realize those, and as they work with public  
15 health groups and other groups, and realize we are not out  
16 to put them out of business we are out to help them  
17 diversify. With the desire to do so, and with the expertise  
18 that is developing, I do believe it is practical and it is a  
19 reality and it can be done.

20 The Chairman. Thank you very much. Senator Conrad?

21 Senator Conrad. Thank you, Mr. Chairman.

22 I think the Chairman has engaged in a line of  
23 questioning that was very important with Dr. Harris. I  
24 really had intended to pursue much of that same questioning  
25 myself, but I very much appreciate the Chairman doing it,

1 because I think that really is right at the heart of this  
2 question.

3       What is it going to take to actually meet the goals for  
4 the reduction of teen smoking that are in this proposed  
5 settlement? The evidence that Dr. Harris has brought to  
6 this committee is that the proposed settlement falls short,  
7 that the increase in price required by this settlement will  
8 be insufficient--in fact, dramatically so--of actually  
9 reaching the goals called for in the settlement for reducing  
10 teen smoking.

11       Dr. Harris, I can tell you I have spent a good deal of  
12 time reading your work. I am glad to be able to meet you  
13 today because I have been reading your calculations and the  
14 way you have thought through these problems and I appreciate  
15 very much the effort and the energy that you have brought to  
16 this.

17       Dr. Harris. Thank you.

18       Senator Conrad. I would like to take you back to the  
19 testimony you provided with respect to the net present value  
20 of what the industry would be paying in comparison to the  
21 costs in just the Medicare and Medicaid program, because I  
22 want to make certain that I have it correctly in my mind.

23       As I hear you testify, you are saying that the net  
24 present value of what the industry would pay over the next  
25 25 years is roughly \$190 billion; is that correct?

1 Dr. Harris. Yes, \$194.5 billion.

2 Senator Conrad. \$194.5 billion. And as I hear your  
3 testimony, you are telling us that the net present value of  
4 the cost to the Medicaid program over that same period of  
5 time would be roughly \$178 billion; is that correct?

6 Dr. Harris. That is correct.

7 Senator Conrad. And that the cost to the Medicare  
8 program over that same period of time would be roughly \$192  
9 billion; is that correct?

10 Dr. Harris. Conservatively, yes.

11 Senator Conrad. Conservatively. And you have not done  
12 a calculation, as I understand it, for the cost to the  
13 veterans health program?

14 Dr. Harris. I have.

15 Senator Conrad. You have? What would be the amount of  
16 that?

17 Dr. Harris. At this point, I have looked not at the  
18 costs of health care but at the costs of the entitlement  
19 payments. That is, the disability compensation payments  
20 that might be required under a recent ruling--not recent,  
21 but within the last few years--of the General Counsel of the  
22 Veterans Administration, that tobacco related disabilities  
23 that resulted from the use of tobacco during military  
24 service would be compensable under current law.

25 Senator Conrad. What does that calculation disclose?

1           Dr. Harris. The current backlog of veterans, of our 25  
2 million U.S. veterans, of whom about 20 million are over the  
3 age of 45 currently, is that the potential backlog taking  
4 into account that some veterans did not start smoking during  
5 the military and that many may not file claims, would still  
6 run in the billions of dollars, approximately \$5 billion  
7 with a range somewhere from about \$1 billion to \$11 billion.

8           I can provide the committee with more accurate figures.  
9 I did not come prepared with that today.

10          Senator Conrad. I appreciate that very much and I  
11 would be interested in any further calculation you have.

12          Let us take the--the most likely, I take it, is a  
13 calculation of \$5 billion?

14          Dr. Harris. That would be the current backlog, yes.  
15 Under the assumption that only half of the veterans will  
16 file claims and that only, also in turn, about half of the  
17 veterans will actually be eligible for having started in the  
18 military service.

19          Senator Conrad. So the potential liability would  
20 actually be something higher than this, but you are making  
21 estimates on how many would actually file for claims?

22          Dr. Harris. The potential liability of the backlog  
23 could be \$20 billion if everyone filed a claim.

24          Senator Conrad. Well, as I add this up, \$178 billion  
25 for Medicaid, \$192 billion conservatively for Medicare, \$5

1 billion in this just one component of veterans possible  
2 costs, we are talking \$375 billion net present value,  
3 compared to the industry putting up \$190 billion.

4 So just in these areas, which of course does not count  
5 other health care costs to our society. It does not count  
6 lost work time, lost productivity, payments by other payors,  
7 for example private insurance companies. Have you made any  
8 calculations of the cost to those concerns?

9 Dr. Harris. I am in the process of giving that. I did  
10 testify in front of the House Ways and Means Committee a few  
11 years ago about the aggregate costs and I am in the process  
12 now of revising those. I do not have them for the committee  
13 now.

14 Senator Conrad. When you have those, if you could make  
15 those available we would certainly appreciate. Because it  
16 seems to me, Mr. Chairman, what we are finding out here is  
17 on two key tests that this settlement falls well short.  
18 Number one, in terms of covering costs to Federal and State  
19 taxpayers for these programs, that this settlement falls  
20 very short of meeting those needs.

21 After all, not all of the \$192 billion would be  
22 available to address the costs to Federal and State  
23 taxpayers. Is that not the case, Mr. Harris.

24 Dr. Harris. As I understand it, and I think I gave  
25 some numbers in my testimony, out of \$195 billion, I think

1 it was approximately \$105 billion by my estimate--let us  
2 see, \$105 billion would go back to the States. That is  
3 based on a schedule of State payments that I took from both  
4 the Florida State and Mississippi State settlements with the  
5 tobacco industry.

6 \$55 billion would go toward a fund for judgments and  
7 settlements against participating companies. Such a fund,  
8 if not used, would be subject to allocation by an appointed  
9 presidential commission, as I understand it. And the  
10 finally, the remaining \$35 billion in net present value  
11 would then go to public health purposes, some of which are  
12 recommended within the proposed resolution, and others would  
13 go to, as I understand it, toward administrative costs of  
14 the Food and Drug Administration.

15 Senator Conrad. So actually, according to your  
16 calculations, this settlement would provide less than one-  
17 third of the money necessary to meet the cost just in  
18 Medicare and Medicaid programs over the next 25 years from  
19 the industry itself. \$105 billion is significantly less  
20 than one-third of the \$375 billion you calculate would be  
21 the cost to Medicaid, Medicare and veterans programs.

22 Dr. Harris. That is correct.

23 Senator Conrad. And your calculation, as you just  
24 indicated to Senator Lugar, in terms of meeting the goals of  
25 reducing teen smoking is about one-third of what is

1 necessary to achieve the goals that are set out in this  
2 settlement.

3 Dr. Harris. That is correct.

4 Senator Conrad. So on both those tests, Mr. Chairman,  
5 it would seem to me the record, based on the analysis done  
6 by Dr. Harris, is well short of meeting the requirements  
7 that we face.

8 I would hope, Mr. Chairman, that--I wish Mr. Carlton  
9 were still here, because I think this word needs to go back  
10 to the industry that, I think, if one is trying to be  
11 objective here on reaching a conclusion that this settlement  
12 is well short of what is required to cover just some of the  
13 costs, and of meeting one of the key goals which is to  
14 reduce the level of teen smoking.

15 And I want to raise, if I could, one final point, Mr.  
16 Chairman. And I appreciate very much the Chairman's  
17 indulgence and patience.

18 When I asked Mr. Carlton about this ad, he indicated  
19 this ad would be out under the terms of this settlement. I  
20 do not believe that is the case. He indicated they would be  
21 limited to black and white advertising.

22 As I understand the settlement, the black and white  
23 advertising restriction applies to magazines that go to  
24 children. Adult magazines can have ads other than black and  
25 white.



1           My own view is this meets the test under this new  
2 standard. And if it does, frankly, I think that is a pretty  
3 effective ad. I am not so sure how effective these  
4 advertising restrictions are really going to be.

5           That is not to say that they are not welcome and they  
6 move in the right direction, because I believe they do. But  
7 I do not think they are going to be terribly effective at  
8 contributing to the reduction in teen smoking, which I think  
9 should be the overarching public health goal.

10          So with that, Mr. Chairman, I again want to thank you  
11 for really an excellent hearing and excellent panelists and  
12 thank the witnesses, as well.

13          Mr. Ballin. Mr. Chairman, could I beg your indulgence  
14 for one second? Matthew Myers of the National Center is  
15 here and he would like to just make a comment about that ad,  
16 if that is okay?

17          The Chairman. Mr. Myers, would you come to the table  
18 and make a comment?

19          Mr. Myers. I would just like to see if I can help  
20 clarify the questions about that ad and the advertising  
21 restrictions, since I was both involved and have studied  
22 those.

23          Mr. Carlton would correct. That ad would not be  
24 allowed in Sports Illustrated, nor would that ad be allowed  
25 in any youth-oriented publication. The definition of a

1 youth-oriented publication was taken from what Dr. Kessler  
2 did when he was at the Food and Drug Administration. That  
3 is any newspaper or magazine with regular youth readership  
4 of 15 percent or more than 2 million. Sports Illustrated  
5 would fail under both tests.

6 Senator Conrad. But would this be permitted in an  
7 adult magazine?

8 Mr. Myers. That ad would be permitted in a magazine  
9 like Newsweek. It would not be permitted in any of the  
10 normal sports magazines, any of the sort of--Field and  
11 Stream Magazine. It would not be permitted in outdoor  
12 advertising.

13 The examples of Malaysia that you gave earlier were all  
14 studied by the Food and Drug Administration and incorporated  
15 into the agreement. None of the types of abuses that you  
16 saw in Malaysia would have been permitted under the FDA  
17 rule, had it been adopted. Nor would it be permitted under  
18 this.

19 That is why the agreement is not a total ban, as you  
20 have correctly said. It would eliminate the sort of abuses  
21 we found that the tobacco industry has done in every other  
22 country in the world. It would prevent you from having a  
23 Marlboro Travel Agency. It would prevent sports sponsorship  
24 and the other things.

25 Senator Conrad. That is very helpful. You are

1 indicating that this ad would not be permitted in Sports  
2 Illustrated but it would be permitted in a Time or a  
3 Newsweek or Fortune?

4 Mr. Myers. I will give you the exact data, if you do  
5 not mind.

6 Senator Conrad. Could you, please?

7 Mr. Myers. Because it is in the Food and Drug  
8 Administration rule. I looked at Newsweek, just the data on  
9 Newsweek. I know it would be permitted in Newsweek. I do  
10 not remember Time for sure.

11 Senator Conrad. Probably not much different.

12 Mr. Myers. I think that is probably right. But some  
13 of the magazines are surprising.

14 The other point I would make about that, because it is  
15 important I think to understand in terms of the youth  
16 reduction, when Dr. Kessler promulgated the Food and Drug  
17 Administration rule, he said that there were three prongs in  
18 his mind at that time to reducing tobacco use among kids,  
19 restricting youth access, restricting advertising that makes  
20 tobacco products appealing to kids, and public education.

21 He said that if you did all three of those he thought  
22 you could reduce tobacco use among kids by 50 percent in  
23 seven years without regard to price increases. It was upon  
24 Dr. Kessler's evaluation and the Food and Drug  
25 Administration's evaluation that the negotiators relied in

1 determining that a proper balance of restricting youth  
2 access, eliminating the forms of advertising that have the  
3 greatest impact on kids, and coming up with a public  
4 education campaign that we could not otherwise come up with--  
5 -in this case, in terms of \$500 million a year--that it  
6 would contribute significantly to a reduction of tobacco  
7 use. And that when you combined that with the price  
8 increase, you would have a comprehensive that did not do one  
9 or the other because the problem with a tax increase is it  
10 is the change that brings out the reduction.

11 I agree with Professor Harris, who I have known a long  
12 time, that a tax increase is the quickest way to get an  
13 immediate reduction. The question is how you get a  
14 sustained, long-term change in behavior and reduction. It  
15 has got to be a combination of the two, price--and price has  
16 got to steadily change, otherwise it will wear off. Many  
17 European countries have, as you know, very high taxes and  
18 very high smoking rates among kids.

19 Senator Conrad. They get an initial reduction and then  
20 it comes right back.

21 Mr. Myers. That is right.

22 Senator Conrad. At least among adults, as I understand  
23 it.

24 Mr. Myers. That is exactly right. That is why a one  
25 time drop, no matter how strong, is not--there is no magic

1 bullet here, and that is the key. What we need to do is  
2 have a price increase large enough to drive down smoking  
3 rates, combined with all of the other things that Dr.  
4 Kessler when he promulgated the FDA rule said we needed.

5 The agreement is a balance trying to do that. As we  
6 look at the whole thing, it would be a mistake to say there  
7 is a magic bullet either in terms of eliminating advertising  
8 or public education or tax decreases. We have got to do  
9 them in tandem.

10 Senator Conrad. Combination strategy.

11 Mr. Myers. We have got to do them in tandem if we are  
12 going to succeed.

13 The Chairman. Thank you very much, Senator Conrad.

14 Let me make three comments. We have received a  
15 statement and questions from Senator Paul Coverdell, our  
16 colleague, and those will be included in the record  
17 requesting submission to the relevant witnesses.

18 [The prepared statement and questions of Senator  
19 Coverdell follows:]

1           The Chairman. The committee will met again in this  
2 room at nine o'clock next Thursday morning, September the  
3 18th with the testimony largely on the tobacco grower  
4 issues, which were of course a large part of our testimony  
5 today.

6           Finally, I just wanted to underline Senator Conrad's  
7 analysis which fits my own. We have identified at least a  
8 number of problems that are Federal problems, Medicare,  
9 Medicaid, Federal veterans programs. Dr. Harris has  
10 furnished his estimates of how much cost would be involved  
11 in meeting the Federal obligations with known persons in  
12 America today, and at least has asserted that those amounts  
13 are substantially more than the present discounted value of  
14 the settlement. Quite a bit more.

15           We have identified potential grower costs and community  
16 development which also must be incorporated at some point in  
17 all of this. And there have been doubts raised as to the  
18 strategy of meeting the teen smoking objectives, although  
19 all of the testimony has been developed toward meeting that  
20 there can certainly be differences of opinion of methodology  
21 questioning how you get there through taxes, through  
22 advertising, through strategies in the conference  
23 settlement.

24           I would just state, because in balance, Attorney  
25 General Norton also pointed out that in the real world

1 litigation is going on. Some cases may be won or lost,  
2 maybe all of them by one side or all of them by another,  
3 probably a mixed bag as a third suggestion that she made.  
4 And these aspects we all have to calculate in terms of the  
5 best public policy.

6 I appreciate your testimony, that of all of the  
7 witnesses today and vigorous participation by senators in  
8 what has been somewhat more than a four hour hearing, but  
9 you have held up well and, at this moment, the meeting is  
10 adjourned and we will meet again next Thursday.

11 [Whereupon, at 1:02 p.m., the hearing was adjourned.]

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