

**PREPARED ORAL TESTIMONY OF
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**SENATE JUDICIARY COMMITTEE HEARINGS ON
“The Proposed Global Tobacco Settlement: Who Benefits?”
Washington DC, July 30, 1997**

Mr. Chairman, my name is Jeffrey Harris. Thank you for inviting me to testify today. I am a primary-care doctor at the Massachusetts General Hospital in Boston and a member of the economics faculty at the Massachusetts Institute of Technology. The views I express today are mine; they are not necessarily endorsed by M.I.T., the Massachusetts General Hospital, or any other organization. While a tobacco industry global settlement is attractive in principle, the current draft proposal contains a number of provisions that warrant careful scrutiny.

First, the proposed global payments may cover the *future* smoking-related costs of the Medicaid program. But they will not recover the *past* costs incurred by Medicaid as a consequence of smoking-related illness. Nor will the proposed industry-wide payments recover the past or cover the future smoking-related health-care costs incurred by private parties or by other Federal programs including Medicare and the Veterans Administration.

The proposed settlement has been described as a plan to pay a total of \$368.5 billion over 25 years. I have calculated, however, that the payment plan's real market value is approximately \$195 billion. This total dollar amount may cover future smoking-related costs to the Medicaid program over the next 25 years, whose present value is, conservatively, \$178 billion.

But the proposed settlement payments would not recover past costs incurred by Medicaid as a result of smoking-related illness. For the fiscal years 1991–1995 alone, the past

Medicaid costs have a present value of approximately \$40 billion. Total past costs from smoking-related diseases since the inception of the Medicaid program in the last 1960's would run in the hundreds of billions of dollars. Neither does the proposed settlement cover *past* or *future* smoking-related Medicare costs. Future Medicare costs attributable to smoking, I conservatively estimate, have a current market value of another \$192 billion over the next 25 years.

Second, the draft settlement sets 5- and 10-year targets for the proportion of 13- to 17-year-olds who smoke cigarettes every day. While economic research shows that teenagers' smoking rates may be especially responsive to price, the increase in cigarette price anticipated from the proposed global settlement would be insufficient by itself to reach the specified targets.

I expect that cigarette manufacturers will pass the costs of the settlement along to their consumers by raising cigarette prices. By the fifth post-settlement year, the real price increase will be about 62 cents per pack. This increase in price will bring the percentage of 13- to 17-year-olds who smoke every day from its current level of 18.2 percent down to about 15 percent. The anticipated reduction in underage smoking, however, would go only about one-third of the way toward the five-year target rate of 10.6% that is implicit in the draft settlement's provisions. To reach the target teenage smoking rate, I calculate that the price of a pack of cigarettes would need to rise by \$1.50.

Third, the financial penalties (or "look back" surcharges) contained in the proposed global settlement do not provide sufficient incentives for tobacco manufacturers to reduce underage smoking.

The draft settlement specifically pegs the “look back” surcharge to the profit that manufacturers would attain for each new teenager who becomes a life-long tobacco consumer. Such a penalty, however, simply permits the tobacco industry to break even on teenage sales. If a “look back” surcharge is to provide adequate incentives for tobacco manufacturers to reduce underage use, then the financial penalty must *exceed* the profit attained from a new underage customer. That way, tobacco sellers will incur a net *loss* if their products are used by underage smokers.

Under the currently drafted “look back” provision, industry-wide payments are apportioned according to each firm’s *overall* market share, not according to each firm’s share of the teenage smokers. This means, for example, that Philip Morris Companies, with an *overall* 1996 market share of 47.8%, would pay nearly half of the surcharge regardless of its efforts to reduce teenagers’ use of its own brands.

To avoid these problems, it would be preferable to levy charges on individual manufacturers in direct proportion to the estimated number of packs of their brands that consumed by underage youth. Such a penalty, I suggest, would not be subject to the complex provisions of the current draft proposal. There would be no annual payment cap, no required complex profit calculations, and no need to make special mathematical provisions for double-counting of teenagers.

I thank you again, Mr. Chairman, for allowing me this opportunity to speak before the Judiciary Committee. I hope my comments have been constructive, and would be pleased to answer questions.