Tobacco Issues

and the

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TOBACCO ISSUES

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Cardinal

THE CASE AGAINST UNFAIR TOBACCO EXCISE TAXES

The Administration and some Members of Congress propose drastic increases in tobacco excise taxes to fund reform of the U.S. health care system. A solution to the nation's fiscal problems must be constructed on the basis of equity: All members of society should pay their fair share.

Raising tobacco excise taxes to help pay for health care reform would further burden low- and middle-income families already paying more than their fair share of taxes. Raising tobacco excise taxes is unfair and unwise fiscal policy.

- Consumer excise taxes are regressive, hitting hardest those people who are least able to pay -- low- and middle-income families. According to a March 1993 Peat Marwick study, 54 percent of American families earn less than $30,000 per year. These families account for only 19 percent of family income -- but they pay a staggering 54 percent of all tobacco excise taxes.

- A 1987 Congressional Budget Office (CBO) study states that excise taxes are among the most regressive of all taxes, and calls tobacco taxes the "most regressive of all." The CBO's study indicated that tobacco taxes, as a percentage of income, were 15 times greater for low-income persons compared with wealthy individuals.

- Rural Americans pay a significantly higher percentage of their income in consumer excise taxes than do residents in urban areas. Specifically, rural Americans shoulder a 44 percent higher tax burden in tobacco excises alone. (Ekelund and Long, Excise Taxes and the Rural Taxpayer: Losing Ground in the '80s and '90s?, commissioned by the American Agriculture Movement, March 1993.)

- Consumer excise taxes also hurt Blacks, Hispanics and other minorities as these groups have higher levels of poverty and unemployment, and thus are more vulnerable to regressive taxes.

- It is unfair to ask one group of taxpayers -- smokers -- to shoulder the burden health care reform. In a fair and progressive system, the tax burden should be borne by all, not just one group of taxpayers.

WHO PAYS CONSUMER EXCISE TAXES?

- Individuals -- not corporations -- pay consumer excise taxes.

- Anyone who buys gasoline, alcohol or tobacco products pays a consumer excise tax.

- A 1987 Congressional Budget Office study states that excise taxes are among the most regressive of all taxes, and calls tobacco taxes the "most regressive of all."

- Excise taxes are not levied based on one's ability to pay. Thus, they adversely impact poor and middle-income individuals as well as the elderly.

- Consumer excise taxes particularly hurt Blacks, Hispanics and other minorities as these groups have higher levels of poverty and unemployment, and thus are more vulnerable to regressive taxes.

- Rural Americans pay a significantly higher percentage of their income in consumer excise taxes than do residents in urban areas. Specifically, rural Americans shoulder a 44 percent higher tax burden in tobacco excises alone. (Ekelund and Long, Excise Taxes and the Rural Taxpayer: Losing Ground in the '80s and '90s?, commissioned by the American Agriculture Movement, March 1993.)

- Working women also bear a greater tax burden than others. With the rise in women joining the workforce, and rising number of families headed by women, increasing numbers of women pay more than their fair share of taxes. (Lyons and Colvin, Women and Children First: An Analysis of Trends in Federal Tax Policy, prepared for the Coalition of Labor Union Women, May 1990.)

FEDERAL REPORTS INDICATE SMOKERS PAY THEIR OWN WAY -- AND THEN SOME

Contrary to some assertions, smokers currently make enormous contributions to government health care financing -- in excise and sales taxes, personal income and Social Security taxes and other fees. Smokers appear already to be subsidizing nonsmokers in these programs, not the other way around as some antismokers claim.

- A recent Centers for Disease Control and Prevention (CDC) study claims smoking-related illnesses "cost" Americans $50 billion in direct medical expenses, or $2.06 per pack of cigarettes. CDC asserts that "[f]or each of the 25 billion packs of cigarettes sold in 1993, approximately $2.02 was spent on medical-care costs attributable to smoking. Of the $2.02, approximately $0.87 was paid for through public sources."

  Accepting CDC's assertion for the sake of argument, more than half of CDC's estimated medical expenses are expenses that are not borne by government but are paid by smokers through out-of-pocket spending and private health insurance. The balance -- about $22 billion -- is more than covered through $13.3 billion in excise and sales taxes on cigarettes (that smokers alone pay) and payroll contributions to Federal and state health plans (that smokers and nonsmokers make alike).

Other recently published economic analyses, from the Congressional Office of Technology Assessment (OTA) and the Congressional Research Service (CRS), conclude that the excise taxes paid by smokers exceed the "costs" of federal, state and local government funding of health care expenditures attributed to smoking-related illnesses.

- In a report released in May 1993, the OTA estimated that smokers "cost" federal, state and local governments $8.9 billion in health care expenditures because of illnesses viewed as "smoking-related." Assuming the validity of that estimate for the sake of discussion, smokers currently pay federal, state and local governments $11.3 billion in cigarette excise taxes and another $2 billion in sales taxes. The total tax collection of $13.3 billion is a tax that only smokers pay.

  Thus, the OTA data indicates that smokers currently pay $4.4 billion more to federal state and local governments than the $8.9 billion that OTA claims smokers "cost" all levels of government.

  The OTA further estimates the federal government's share of these governments' "costs" at $6.3 billion. This translates to $.24 per pack of cigarettes sold -- the current level of the federal excise tax on cigarettes.

- Newly released data from the CRS underscores the OTA estimates. In its March 1994 report to Congress, the CRS concluded:

  > "Mid-range estimates based upon likely assumptions suggest net external costs from smoking in the range of 33 cents per pack in 1995 prices, an amount that by itself is too small to justify either current cigarette taxes (averaging 50 cents per pack) or the proposed tax increase."

DEBUNKING THE "SOCIAL COSTS" OF SMOKING

Some people claim that smoking is not strictly a personal choice, but imposes external "social costs" on our nation, and that smokers should compensate by paying higher taxes.

- In economics, "social costs" are activities of one group of individuals that impose significant costs on another group. Environmental pollution, for example, in which a company discharges waste products into a community water supply, constitutes a "social cost."

  Private costs, in contrast, are activities on the part of one individual that do not, generally, impose costs on others. In these cases, the costs are borne by the individuals who undertake the activity directly. Smoking falls into this category.

- Almost one-third of medical expenses related to any illness or injury are private costs, paid directly by the individual. Private insurance companies and government-financed health care programs usually cover the rest. Health insurers who have established different premium rates for smokers and nonsmokers have done so without benefit of actuarial studies to support these rate differentials. The 1989 Surgeon General's Report acknowledged that "there is little supportive actuarial evidence that nonsmokers incur fewer claims."

- Funding for government programs such as Medicaid and Medicare comes from all taxpayers, smokers and nonsmokers alike. Contributing to such programs is considered beneficial for all participants and, like any social insurance program, the benefit to some taxpayers will be greater in value than their actual contribution.

  It is difficult to determine who gains and who loses under such a system -- so difficult, in fact, that even a staff report from the Office of Technology Assessment on the claimed "costs" of smoking declined to address this issue, calling it too "complex."

- However, if these government programs were being overused by smokers, as the American Medical Association has recently claimed, one could argue that smokers were creating additional costs for others. To the contrary, however, smokers as a group are very much underrepresented in the population groups served by these programs.

  Forty-five percent of those served by Medicaid, for example, are children; 15 percent of Medicaid beneficiaries and more than 90 percent of Medicare beneficiaries are over age 65 -- an age group in which only 16 percent are smokers.

- Nevertheless, an American Medical Association report released on February 23 claimed that smokers "cost" the health care system $22 billion annually. Of that

total, the AMA claims that the government spent $4.2 billion in the Medicaid and Medicare programs on tobacco-related illnesses.

- Smokers already pay $11.3 billion in federal, state and local cigarette excise taxes and another $2 billion in additional sales taxes, for a total of $13.3 billion.

  However, given the enormous contribution that smokers already make to government health care financing -- in excise and sales taxes, personal income and Social Security taxes and other fees, there is ample reason to suggest that smokers are subsidizing nonsmokers in these programs -- not the other way around.

THERE IS NO TOBACCO SUBSIDY
REPEALING THE PRICE SUPPORT PROGRAM CANNOT BE JUSTIFIED

Legislation is proposed in Congress nearly every year to repeal the tobacco price support program. Its critics wrongly call it a "subsidy" for tobacco growers and argue that the program conflicts with the federal government's efforts to discourage smoking. There is no government subsidy to tobacco farmers, however. The program is self-supporting. Furthermore, the price support and production control program actually limits the quantity of tobacco grown in the United States.

The tobacco price support and production control program guarantees farmers a minimum price for their tobacco in return for strict limits on production -- much as programs do for corn, rice, peanuts, cotton and several other commodities. To participate, tobacco growers agree to acreage and poundage allotments set annually by the U.S. Department of Agriculture, based on the amount the USDA estimates is necessary to meet the needs of the domestic tobacco industry, foreign buyers and inventory set by law.

The program sets a minimum price for tobacco sold at auction, which is especially important to the tens of thousands of farm families who grow tobacco on acreage so small that no other crop could support the family. If a grower's tobacco fails to bring an auction bid of at least one cent per pound over the minimum, and the grower meets USDA requirements, he is eligible for a government-backed loan based on the support price. The tobacco is taken as collateral by the grower's cooperative, processed and stored for future sale. When the cooperative sells the tobacco, the loan is repaid with interest.

Since 1982, tobacco growers have contributed to their cooperative fund to ensure loan repayment, making this program have "no net cost" to the American taxpayer. In the past, the Commodity Credit Corporation has incurred some expense in the program, for example, when changes in the prevailing interest rates caused gaps between the rate set by the CCC at the start of the year and the rate at which the CCC borrowed from the Treasury for producer loans later in the year. Variable rate loans, begun in 1981, now minimize this gap.

Also, the USDA incurs some administrative costs for agents who track allotments, marketing and other program operations, totalling about $15 million annually. In general, however, these costs are not separable from those incurred by work with other crop support programs.

As of 1992, the CCC books covering half a century of price supports showed a net loss of only $81.5 million on tobacco loans. By comparison, the corn and wheat price support programs each lost more than $3 billion, and cotton more than $2 billion. Furthermore, unlike corn, wheat and cotton, tobacco products generate federal, state and local excise tax revenues -- totalling more than $254 billion in that 50-year period.

THE IMPACT ON THE CONSUMER PRICE INDEX AND FEDERAL SPENDING OF A 75-CENT CIGARETTE EXCISE TAX INCREASE

There are various estimates of the additional revenues that would accrue to the federal government from a 75-cent increase in the cigarette excise tax. The most widely used estimate is $10.4 billion. This is an estimate of the net additional revenues from such a tax increase. Actual revenues would be considerably less than half this amount. This is why:

The tobacco component of the Consumer Price Index (CPI) is about two percent (1.7458 percent). Therefore, a 75-cent tax increase on cigarettes would translate into a one percent increase in the CPI, given the current price of cigarettes. A one percent increase in the CPI will lead to a one percent increase in all indexed spending at the federal level -- Social Security, food stamps, federal pension programs and so on. At 1993 spending levels, this would amount to $5.6 billion in additional obligated federal spending and loss of revenue from income tax indexing.

Various additional increases in federal spending would occur as tobacco workers are displaced by a cigarette tax increase, and as a result receive unemployment benefits and pay less income taxes. (There also would be less state excise tax revenue as cigarette consumption declines.) A reasonable estimate of these losses is $2.46 billion.

Therefore, actual federal revenues from a 75-cent cigarette tax increase would be: $10.4 billion - $8.06 billion = $2.34 billion. This is less than half of the estimated gross revenues.

There has been some discussion of taking tobacco products out of the CPI for the purpose of indexing federal programs. This makes no sense whatsoever. In fact, Patrick Jackman, the chief economist for the CPI division of the Bureau of Labor Statistics, recently indicated that the bureau is opposed to measures that would remove tobacco from the CPI. According to Jackman, "The CPI is supposed to represent expenditure patterns. You can't just unilaterally exclude something here if people are still spending their money on tobacco."

The marketbasket of goods for computing the CPI is longstanding and widely followed by the economics profession and financial markets as a reliable indication of inflation. Its administration has been consistent, professional and credible. Indeed, during the recent spate of cigarette price reductions, government officials proudly touted the fall in the Producer Price Index (PPI) as a result of a decline in cigarette prices. To include tobacco in the PPI when it produces good news and to exclude it when it produces bad news would be the height of hypocrisy and would politicize and seriously devalue an economically objective standard.

REJECT THE LAUTENBERG-HARKIN
MEDICARE AND MEDICAID THIRD PARTY LIABILITY ACT

S. 2245 has been introduced by Senators Lautenberg and Harkin to authorize the federal government to sue tobacco manufacturers to recover Medicare, Medicaid, veterans and other health care costs for illnesses "caused, in whole or in part, by the use of tobacco products." The legislation would allow a determination of liability to be made based on statistical association. Regardless of one's opinion on the use of tobacco products, this legislation should be rejected as an unsound means of financing health care, an inequitable manipulation of tort law, and a dangerous precedent for makers of other consumer products.

This legislation represents a frivolous approach to a serious issue: health care. Congress and the Administration have spent a year debating the best means for funding health care coverage. It would be irresponsible for duly elected representatives to abandon their decision-making to the uncertainties of the civil court system. Litigation is not the appropriate means of providing health care for the poor, the aged, and the nation's veterans.

Furthermore, it is illogical to raise tobacco taxes as part of broad health care reform and then specifically enact legislation aimed at destroying the American tobacco industry. Back-door attempts at Prohibition should not be cloaked in the guise of recouping Medicare and Medicaid costs.

This proposal sets up an unfair and inequitable process for determining the liability of one industry. First, it creates a new and suspect standard for liability "by statistical analysis or epidemiological evidence" applicable only to tobacco manufacturers. This would allow the federal government -- unlike any private party -- to escape the obligation of proving that the injury suffered was caused by the particular acts or omissions of the defendant.

Second, S. 2245 provides for broad class action lawsuits without any requirement for identification of the persons for whose treatment the claim is made. Similarly, the measure would provide for damages to be apportioned based on "market share theory." The entire question of liability becomes a matter of probability. It is grossly unfair to torture the civil justice system in such a way in order to attack a single industry.

This measure would open the door for future legislation authorizing lawsuits against manufacturers of virtually any consumer product or service. What would be next? Alcoholic beverages? Automobiles? Electrical utilities? Candy and sugared soft drinks? Artificially sweetened soft drinks? The list of potential targets for filling gaps in health care funding is endless.

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THE FOOD & DRUG ADMINISTRATION SHOULD NOT BE GIVEN NEW AUTHORITY TO REGULATE TOBACCO PRODUCTS

Bills have been introduced in Congress (S. 672 and H.R. 2147) to give the Food & Drug Administration new authority to regulate tobacco products. In the past, FDA has asserted jurisdiction over cigarettes as a "drug" under the Federal Food, Drug, and Cosmetic Act when health claims were made by vendors or manufacturers, and the courts have sustained the agency's assertions of jurisdiction. Cigarettes have been treated no differently from other products in this regard.

The proposals now being advanced, by contrast, would give FDA authority to regulate tobacco products as drugs regardless of whether they are marketed as drugs. Some of these proposals would give FDA broad power to regulate tobacco product design, sales, labeling and advertising -- subject only to the limitation that FDA not attempt to ban tobacco products outright.

But subjecting tobacco products to a regulatory regime designed for products marketed as drugs obviously would lead down the path to prohibition. To take just one example, the regulatory scheme for prescription drugs assumes a product for which therapeutic claims are made. Applying the requirement of that scheme to the labeling and advertising of a product for which therapeutic claims are not made produces absurd results. Under the requirements that apply to prescription drugs, tobacco advertising in outdoor and point-of-sale media would be practically impossible. The effect of such requirements might not be to ban tobacco products but certainly would restrict tobacco product advertising severely.

In recent testimony in the House, moreover, Commissioner Kessler made clear that his real interest lies in preventing young people from smoking. Representatives Waxman and Wyden have suggested that this is their principal object as well. As Dr. Kessler recognized, however, this goal does not automatically require FDA to regulate tobacco products. He indicated, for example, that this goal might be achieved by tightening restrictions on youth access to tobacco products.

FDA is ill-equipped to undertake major new regulatory responsibilities, especially in an area where it has no pertinent experience or expertise. The agency's staff already is stretched too thin. While its resources declined during the past decade, more than a dozen laws were enacted imposing new responsibilities on FDA. As a result, approval of new medicines and vaccines for life-threatening illnesses, such as AIDS, often is significantly delayed. Adding tobacco product regulation to FDA's agenda would further slow review and approvals of new drugs.

For all of these reasons, proposals to give FDA new authority to regulate tobacco products should be rejected.

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THE CASE AGAINST SMOKING BANS

Legislation currently pending in Congress would ban smoking in all federal, public and private buildings and even the outside entrances to those buildings. In addition, the federal Occupational Safety and Health Administration has proposed an indoor air quality standard that would virtually ban smoking in all workplaces, including, restaurants, bars, hotels and motels, and, in many instances, private residences. This activity is largely the result of the Environmental Protection Agency's January 1993 report which classified environmental tobacco smoke (ETS) as a "Group A" (known human) carcinogen.

- **The EPA report on ETS does not justify a national smoking ban.** The report is flawed and does not focus on workplace data. EPA based its conclusions on ETS and lung cancer on studies of spousal smoking in the home, not in the workplace. EPA manipulated and ignored data to achieve predetermined results. It achieved its results by lowering the statistical confidence interval, ignoring major ETS studies (including workplace smoking studies) that did not report a statistically significant overall increase in lung cancer risk, and discounting confounding factors.

- **In a March 1994 report, the Congressional Research Service (CRS) identified significant flaws in the EPA risk assessment of ETS.** In March 1994, the CRS issued a report entitled Cigarette Excise Taxes to Fund Health Care Reform: An Economic Analysis. The CRS criticized EPA for modifying its conventional standards in assessing ETS and for relying on studies within the home, not in the workplace or public places. In recent testimony before a Senate committee on the subject of ETS, the CRS stated that, based on its assessment of the evidence, "...the statistical evidence does not appear to support a conclusion that there are substantial health effects of passive smoking."

- **EPA's cost/benefit analysis of smoking ban legislation is fundamentally flawed.** Most of the costs attributed by EPA to ETS are private-sector, not government costs, and most of these are costs EPA attributes to heart disease which no federal agency has concluded is caused by ETS. Moreover, the CRS concluded that any costs to nonsmokers from ETS are trivially small. The CRS stressed that "the epidemiological evidence for passive smoking-related disease is weak."

- **Smoking bans are unreasonable and extreme.** Smoking is not a marginal or deviant behavior. Fifty million American adults smoke. Yet smoking would be banned in factories, office buildings and other workplaces, and virtually all public settings. The circumstances under which smoking could be permitted in most such places are so limited they are meaningless.

- **An overwhelming majority of Americans believe smokers and nonsmokers should be accommodated in workplace and public settings.** According to a recent CNN/USA Today poll, two-thirds of the respondents supported designated smoking areas in the workplace, seven in ten restaurant patrons believe that designated areas are preferable to outright smoking bans, and 78 percent opposed smoking bans in hotels and motels.

- **Smoking policies should be individual business decisions.** It is very clear that businesses are responding more than adequately to employee and customer demands. National surveys show that the majority of public and private sector employers in the United States already have workplace smoking policies. Each business selects the smoking policy that achieves the desired result for it at minimum cost. The system is working well. A "one-size-fits-all" approach will not work. Flexibility is key.

- **The proposed smoking ban legislation and regulations would threaten building owners, lessees and tenants who attempt to accommodate smokers and nonsmokers with endless legal harassment.** The merest whiff of smoke in a nonsmoking area could trigger a lawsuit. Under the OSHA proposal, a worker could make a complaint against an employer if exposed to smoke, for example, by a co-worker smoking outside a designated, specially ventilated smoking room. An employer could be in complete compliance and still be punished, because in real life situations, it is impossible for an employer to control the behavior of all workers at all times. The OSHA proposal would impose penalties on employers for violations ranging from $7000 to $70,000 for each violation.

- **Smoking bans are not required by the Americans with Disabilities Act.** The ADA does not mandate smoking bans to accommodate employees claiming hypersensitivity to ETS. As noted by an official of the U.S. Equal Opportunity Commission, "the ADA does not require employers to have a smoke-free environment or prevent it. It does not interfere one way or the other." Moreover, two federal district courts have rejected claims that the ADA mandates smoking bans in places of employment and public accommodation, and other federal courts have reached the same conclusion under the Rehabilitation Act.

- **Banning smoking will not solve overall indoor air quality.** Because of its visibility, ETS is often blamed for a variety of complaints associated with poor indoor air quality. However, studies of nearly 700 buildings worldwide by private ventilation experts demonstrate that inadequate ventilation is the leading cause of indoor air quality problems. The best way to improve indoor air quality is to require proper operation and maintenance of ventilation systems. Proper ventilation decreases levels of substances in indoor air regardless of the source. Current legislative and regulatory proposals, however, target ETS, thus ignoring the larger problems of poor indoor air quality on the false assumption that banning smoking in the workplace will solve a complex problem. Such an assumption will cheat American workers and the public of adequate indoor air quality.

Cardinal

DISALLOWING TAX DEDUCTIONS FOR TOBACCO ADVERTISING VIOLATES THE FIRST AMENDMENT AND SETS A PRECEDENT FOR OTHER PRODUCTS

Some policymakers in Washington propose legislation that would disallow tax deductions for tobacco product advertising and promotion expenses. Because such a proposal would target tobacco product advertising and promotion uniquely and exclusively, based solely on official disapproval of its expressive content or communicative impact, the proposal would violate the First Amendment.

- **By eliminating the tax deductions for tobacco advertising, the measure would effectively restrict speech on the basis of its content, thus violating the First Amendment.** Recently, the Supreme Court reaffirmed that "[a] statute is presumptively inconsistent with the First Amendment if it imposes a financial burden on speakers because of the content of their speech." Simon & Schuster, Inc. v. Members of the New York State Crime Victims Board, 112 S.Ct. 501 (1991).

- **Disallowing the tax deduction for advertising of tobacco products would set a dangerous precedent.** If we begin to use the tax code to penalize disapproved speech or to tax speech as an instrument of social policy, there is no logical stopping point. Proposals already have been introduced in previous sessions of Congress to disallow tax deductions for beverage alcohol advertising expenses and arms-sale promotion expenses, just to name two examples. What would stop Congress from deciding next year to remove the advertising exemption from wine or beer, red meat, sugared cereals or any other product that some segment of the population disapproves of?

- **Restricting information does not lead to better decisions, only controlled ones.** The proposal's basic flaw is that it would effectively suppress truthful speech concerning lawful products based on the paternalistic belief that the government should control the flow of commercial information.

- **The advertising deduction cannot be rationalized as a "subsidy."** The tax system is based on the premise that only net income should be taxed, with deductions permitted for costs reasonably incurred in producing that income. The deduction for advertising expenses simply implements the net income concept. It no more provides a "subsidy" for advertising than the deduction for payroll expenses provides a "subsidy" for hiring workers.

- **Any effort to limit commercial speech of a legal product, whether directly or indirectly, is a challenge to the First Amendment.** For this reason, previous attempts to disallow tax deductions for tobacco advertising have been opposed by groups as diverse as the American Civil Liberties Union, the Washington Legal Foundation, the Freedom to Advertise Coalition, the Association of National Advertisers and the American Association of Advertising Agencies.