CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

August 25, 2009

H.R. 1256
Family Smoking Prevention and Tobacco Control Act

As cleared by the Congress on June 12, 2009,
and signed by the President on June 22, 2009

SUMMARY

H.R. 1256 (enacted as Public Law 111-31) authorizes the Food and Drug Administration (FDA) to regulate tobacco products, and requires the agency to assess fees on manufacturers and importers of tobacco products to cover the cost of FDA's new regulatory activities authorized by the law. Starting in fiscal year 2010, such fees can be collected and made available for obligation only to the extent and in the amounts provided in advance in appropriation acts. H.R. 1256 also contains provisions that affect direct spending and revenues associated with federal retirement benefits. (Discretionary costs of implementing the act are not discussed here; this cost estimate addresses only the effects that H.R. 1256 will have on direct spending and revenues.)

CBO and the Joint Committee on Taxation (JCT) estimate that:

- H.R. 1256 will increase direct spending, on net, by $35 million over the 2009-2014 period and by $0.4 billion over the 2009-2019 period;

- Federal revenues will increase, on net, by $0.3 billion over the 2009-2014 period and by $1.5 billion over the 2009-2019 period; and

- Considering both the revenue and direct spending effects, H.R. 1256 will reduce budget deficits by a total of $0.3 billion over the 2009-2014 period and by $1.0 billion over the 2009-2019 period. (Those amounts exclude the effects that are subject to appropriation action.)

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 1256 is shown in the following table. The costs of this legislation fall primarily within budget functions 550 (health) and 600 (income security).

	By Fiscal Year, in Millions of Dollars												
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2009-2014	2009-2019
CHANGES IN DIRECT SPENDING													
Tobacco Provisions													
Medicaid													
Estimated Budget Authority	0	-1	-2	-4	-6	-8	-11	-13	-15	-17	-20	-21	-97
Estimated Outlays	0	-1	-2	-4	-6	-8	-11	-13	-15	-17	-20	-21	-97
Funds Covering the Start-up Period[a]													
Estimated Budget Authority	11	11	0	0	0	0	0	0	0	0	0	21	21
Estimated Outlays	2	14	5	0	0	0	0	0	0	0	0	21	21
Special Indemnity Allowance													
Estimated Budget Authority	0	0	0	0	0	35	71	167	225	0	0	35	498
Estimated Outlays	0	0	0	0	0	35	71	167	225	0	0	35	498
Total Changes in Direct Spending													
Estimated Budget Authority	11	10	-2	-4	-6	27	60	154	210	-17	-20	35	422
Estimated Outlays	2	13	3	-4	-6	27	60	154	210	-17	-20	35	422
CHANGES IN REVENUES													
Tobacco Provisions													
Excise Taxes and Fines	0	-15	-31	-44	-61	-82	-104	-129	-157	-189	-225	-233	-1,037
Collections of Fees Covering the Start-up Period[b]	8	8	0	0	0	0	0	0	0	0	0	16	16
Thrift Savings Plan Enhancement	0	53	87	111	138	176	222	282	362	463	592	565	2,486
Total Changes in Revenues	8	46	56	67	77	94	118	153	205	274	367	348	1,465
NET IMPACT FROM CHANGES IN DIRECT SPENDING AND REVENUES													
Estimated Deficit Impact[c]	-6	-33	-53	-71	-83	-67	-58	1	5	-291	-387	-313	-1,043

Note: Components may not sum to totals because of rounding.

a. Amounts reported here reflect spending of fees collected for fiscal year 2009 to cover the "start-up period" that ends on September 30, 2009. Spending on "start-up costs" made available through existing agency funds during that period are also included; such funds will be fully reimbursed through appropriated fees in fiscal year 2010.

b. Amounts reported here reflect net receipts to the Treasury arising from fees assessed prior to October 1, 2009.

c. Negative numbers indicate a reduction in the deficit; positive numbers indicate the opposite.

BASIS OF ESTIMATE

H.R. 1256 authorizes FDA to regulate tobacco products. Such authority includes:

- Setting national standards for tobacco products, including a ban on cigarettes that contain certain additives or flavors (other than tobacco or menthol) that are a characterizing flavor of the tobacco product or tobacco smoke;

- Implementing new restrictions on the sale, distribution, and marketing of tobacco products;

- Requiring manufacturers of certain tobacco products to submit a marketing application to FDA and requiring manufacturers of certain products that are "substantially equivalent" to ones already on the market before a particular date to notify FDA by submitting a report with specified information before entering the market;

- Directing manufacturers and importers of tobacco products to adhere to new labeling requirements and to submit specific information, including health-related research, to the FDA about their products;

- Mandating the annual registration of all establishments that manufacture, prepare, compound, or process tobacco products and specifying certain inspection, record-keeping and reporting requirements for manufacturers and importers; and

- Enforcing compliance with requirements specified in the law.

H.R. 1256 establishes the Center for Tobacco Products within the FDA. It also requires FDA to reinstate certain regulations issued in 1996 intended to limit tobacco sales and marketing, especially to children. (The Supreme Court ruled in 2000 that the FDA did not have the authority to issue such regulations.) The law explicitly prohibits FDA from banning certain tobacco products or requiring the reduction of nicotine yields of tobacco products to zero.

The law also requires FDA to issue new regulations relating to the testing and reporting of tobacco product information. Such regulations could also include requirements for public disclosure of that information. Among other things, H.R. 1256 requires the Secretary of Health and Human Services (HHS) to publish a list of the amounts of harmful and potentially harmful constituents of each tobacco product.

Use of Tobacco Products in the United States

At least partly as a result of efforts by the federal government, state governments, and the public health community, cigarette smoking has declined substantially over the past decade: in 2005, about 21 percent of adults in the United States were smokers, compared to about 25 percent in 1995. The recent increase in the federal excise tax on cigarettes as a result of the Children's Health Insurance Program Reauthorization Act (Public Law 111-3)—from $0.39 to $1.01 per pack—is likely to contribute to a continuing decline in smoking. CBO expects that consumption of tobacco products in the United States will further decline as a result of H.R. 1256.

The effect of regulatory activities authorized under H.R. 1256 on the use of tobacco products is uncertain because initiatives to reduce the use of tobacco products are expected to continue. In particular, public heath efforts by private entities and by federal, state, and local governments have contributed to a substantial reduction in underage smoking in recent years. For example, the proportion of 17-year-olds who smoke declined from 19 percent in 1995 to 10 percent in 2005. Significant efforts to reduce underage smoking (the group most directly targeted by many of the interventions envisioned under H.R. 1256) have been taken as a result of the Master Settlement Agreement (MSA) in 1998 between major tobacco manufacturers and settling states. States and localities continue to pursue public health initiatives independent of the MSA to reduce smoking and to limit health risks to the public associated with smoking. Ongoing public health efforts funded by federal programs and coverage of smoking cessation therapies also aim to reduce the use of tobacco.

The expected impact of the law on the use of tobacco products stems from a combination of regulatory and economic factors. The regulatory changes with the largest potential to reduce smoking include: restricting access to tobacco by youths, requiring certain tobacco packaging to include larger and pictorial warning labels, limiting certain marketing and advertising activities (especially those that target youths), and requiring FDA permission before manufacturers can market tobacco products that suggest reduced health risks or exposure to particular substances. For example, pursuant to a timeline specified in the law, descriptors on a tobacco product such as “low,” “light,” or “mild” will be prohibited and certain health-related claims not allowed unless manufacturers receive FDA’s permission to market the product that term or claim. In addition, tobacco consumption will decline because the assessment of new fees on manufacturers and importers of tobacco products will probably result in higher prices of tobacco products. (The costs for FDA to administer the new regulatory activities authorized under the legislation—$2.1 billion over the 2009-2014 period and $5.3 billion over the 2009-2019 period—will be covered by fees assessed on manufacturers and importers of tobacco products.)

Based on information from academic and other researchers, CBO estimates that H.R. 1256 will result in a further reduction in the number of underage tobacco users of about 11 percent by 2019. CBO also estimates that implementing H.R. 1256 will lead to a further decline in smoking by adults by about 2 percent after 10 years. CBO has incorporated these projected changes in U.S. tobacco consumption into its estimates of the impact of the law on Medicaid spending and on receipts from excise taxes on tobacco products.

Direct Spending

CBO estimates that H.R. 1256 will increase direct spending, on net, by $35 million over the 2009-2014 period and by $0.4 billion over the 2009-2019 period. That estimate primarily reflects three effects of the law:

- Authorizing FDA regulation of tobacco products and changes relating to such products required by the law will lower consumption of tobacco and will create savings for the Medicaid program;

- Generating the spending of fees collected to cover the start-up period that ends on September 30, 2009; and

- Increasing the monthly allowance paid to certain survivors of military retirees.

Estimating the Effect of Lower Use of Tobacco on Health Costs and Federal Spending. A decline in smoking could affect health care spending for certain medical conditions. For example, an individual who stops smoking is less likely to suffer a heart attack or stroke over a given period of time compared to one who continues to smoke, so a potential reduction in utilization of acute care services for those or other conditions could lead to cost savings. The magnitude and timing of such savings are uncertain, however. Also, a reduction in smoking may add to costs in many cases by increasing the lifespan of persons who would incur health care costs over longer periods. In those cases, government spending for other benefits such as Social Security and Medicare would also increase.

Many of those who will be affected by the law are under age 25, however, so the full effect on Social Security expenditures from individuals living longer and claiming more benefits will not be realized for many years. The effect on Medicare outlays is less clear. CBO expects that H.R. 1256 will eventually raise Medicare spending by increasing longevity; that is, people who otherwise would die early due to smoking-related illnesses could end up receiving Medicare benefits for more years than in the absence of this legislation. However, H.R. 1256 will also have cost-reducing effects. A decline in

smoking attributable to the law will improve individuals' health, reducing annual costs for some beneficiaries.

Private health care is likely to realize significant cost savings from reduced smoking, and lower premiums for employer-based health insurance could result in higher taxable earnings for workers generating higher receipts of federal revenue than would otherwise have occurred. Better health of Medicaid beneficiaries could lead to additional savings for that program, but greater longevity of nonsmokers and former smokers could lead to higher Medicaid outlays for long-term care services. CBO continues to examine the impact of smoking related legislation on public and private payers. This cost estimate does not include potential effects on federal spending other than the estimated impact on Medicaid of reduced smoking levels on pregnancies, as described below.

Impact of FDA Regulation of Tobacco on Medicaid. CBO anticipates that FDA's regulation of tobacco products will lead to a decline in smoking among pregnant women. That decline will reduce health care spending on pregnancies because women who refrain from smoking during pregnancy are less likely to give birth to children with low birth weights—such children have relatively high costs both at birth and afterwards—or experience other complications during pregnancy. Part of the savings from reduced complications is offset by costs associated with the additional live births resulting from a decline in miscarriages. CBO estimates federal spending for Medicaid will decrease by $97 million over the 2010-2019 period. (That savings is an estimated increment above savings previously estimated and credited to Public Law 111-3, which contains an increase in federal excise taxes on tobacco products.)

Funds Covering the "Start-up Period" for the Tobacco Program. H.R. 1256 establishes a program to assess fees to fund FDA's administrative costs for new regulatory activities relating to tobacco products authorized by the law. Starting in fiscal year 2010, authorized fees can be collected and made available for obligation only to the extent and in the amounts provided in advance in appropriation acts; thus, CBO assumes that such fees will be recorded in the federal budget as discretionary. However, the law explicitly authorizes the collection and spending of fees authorized for fiscal year 2009 to cover the "start-up period" that ends on September 30, 2009. (Such amounts will remain available for use by the agency until expended.) CBO assumes that the spending of fees authorized for fiscal year 2009 will be recorded as direct spending in the federal budget. We estimate that H.R. 1256 will increase direct spending by $21 million over the 2009-2011 period because of the spending of fees authorized for fiscal year 2009 and disbursed in future fiscal years.

In addition, during the start-up period, H.R. 1256 allows FDA to spend existing funds on start-up costs for the tobacco program to be fully reimbursed later through appropriated fees. CBO estimates that roughly $5 million will be spent on administrative activities

over the 2009-2010 period from such funds; however, because all amounts spent will be reimbursed by the end of fiscal year 2010, we estimate that there will be no net budgetary impact associated with the use of such funds over the 2009-2010 period.

Special Indemnity Allowance. The National Defense Authorization Act for Fiscal Year 2008 (Public Law 110-181) authorized a monthly allowance to be paid to those recipients of Survivor Benefit Plan payments who have their annuities reduced dollar-for-dollar by the amount of Dependency and Indemnity Compensation they receive from the Department of Veterans Affairs. The amount of that allowance is currently $50 per month and will increase by $10 each year until it reaches $100 per month in 2014. The allowance is scheduled to be terminated five months into fiscal year 2016. H.R. 1256 extends the allowance through fiscal year 2017. It also increases the monthly allowance to $150 beginning in 2014 and by additional amounts each year thereafter until it reaches $310 per month in 2017. Based on data from the Department of Defense's Office of the Actuary, CBO estimates that about 55,000 survivors will receive the increased allowance under this subtitle, which will increase direct spending for military survivor benefits by $0.5 billion over the 2010-2019 period (with no impact after 2017).

Revenues

CBO and JCT estimate that H.R. 1256 will increase federal revenues, on net, by $0.3 billion over the 2009-2014 period and by $1.5 billion over the 2009-2019 period.

That estimate reflects four effects of the law:

- Authorizing FDA oversight of tobacco products and changes relating to such products required by the law will lower consumption of tobacco and reduce receipts of federal excise taxes on those products;

- Collecting fines associated with violations of certain new requirements imposed by the law will be recorded as federal revenues;

- Collecting tobacco fees authorized for fiscal year 2009 to cover the "start-up period" that ends on September 30, 2009 will be recorded as federal revenues; and

- Establishing a Roth contribution program will increase tax revenues because of the tax treatment of employee's contributions.

Excise Taxes and Fines. As noted earlier, CBO expects that H.R. 1256 will reduce the consumption of tobacco products in the United States, which in turn will reduce the collection of federal excise taxes. As a result, CBO estimates that the law will reduce

federal revenues by $0.2 billion over the 2010-2014 period and by $1.0 billion over the 2010-2019 period, net of changes to income and payroll taxes. Over the 10-year period, the reduction in receipts will amount to less than 1 percent of receipts from excise taxes on tobacco expected before passage of this law.

In addition, CBO expects that H.R. 1256 will affect federal revenues through provisions that allow the Secretary of HHS to levy fines against sponsors of misbranded and adulterated tobacco products, sellers of tobacco to underage individuals, and for other violations. H.R. 1256 also allows the Federal Trade Commission to assess fines for certain violations of tobacco-related requirements enforced by the commission. We estimate that revenues from the collection of civil fines authorized under H.R. 1256 will be roughly $1 million annually.

Collection of Fees Covering the Start-up Period for the Tobacco Program. H.R. 1256 authorizes the maximum assessment of $85 million in aggregate fees for fiscal year 2009 and requires that such amount be prorated based on the number of days remaining in the fiscal year following the date of enactment. As discussed earlier, the law explicitly authorizes the collection and spending of fees authorized for fiscal year 2009 to cover the start-up period that ends on September 30, 2009. Because the assessment and collection of such fees are not subject to appropriation action, we assume that they will be recorded in the federal budget as revenues. CBO estimates that $21 million in fees will be assessed for fiscal year 2009 and we expect that is it equally likely that the receipts will be recorded by the Treasury in fiscal year 2009 or in early fiscal year 2010. However, CBO estimates that H.R. 1256 will increase net revenues overall by about $16 million over the 2009-2019 period because we expect that assessments would reduce income and payroll taxes by an estimated 25 percent of the gross assessments. (Excise taxes and other indirect business charges reduce the tax base of income and payroll taxes.)

Thrift Savings Plan Enhancement. CBO and JCT estimate that H.R. 1256 will increase revenues by an estimated $2.5 billion over the 2010-2019 period from provisions related to retirement of federal employees.

The law establishes a Roth contribution program (in which contributions to the retirement accounts will be made on an after-tax basis) and will result in some Thrift Savings Plan (TSP) participants electing to contribute after-tax income to their retirement plan rather than contributing pre-tax amounts. CBO and JCT estimate that the program will boost income tax revenues by an estimated $3.3 billion over the 2010-2019 period.

H.R. 1256 also requires that newly hired federal employees who are eligible for the TSP be automatically enrolled in that program, creating a greater and earlier participation rate of employees in the program. According to data from a 2006 survey conducted by the Federal Thrift Retirement Investment Board, 52 percent of employees enrolled in the

Federal Employees Retirement System voluntarily contribute to the TSP in their first year of eligibility, but 86 percent contribute by their sixth year. (Although federal employees covered by the Civil Service Retirement System are also eligible to participate in the TSP, they would not be affected by automatic enrollment.) Using information from that survey, CBO expects that under automatic enrollment more than 90 percent of eligible new entrants would contribute to the TSP in their first year and that a similar proportion would continue to contribute by their 10th year (some would opt out in the beginning and others would likely change their status in the future). Because income taxes are deferred on regular TSP contributions, the anticipated increase in participants' contributions from automatic enrollment will offset part of the revenue increase generated by the new Roth contribution program, reducing receipts by $0.8 billion over the 2010-2019 period.

Other Effects on Revenues and Direct Spending

Under H.R. 1256, FDA has the discretion to impose criminal fines on entities convicted of violating certain new requirements established by the law. Collections of criminal fines are recorded in the budget as revenues, deposited in the Crime Victims Fund, and later spent. Such expenditures are classified as direct spending. CBO expects that relatively few cases will result in such criminal fines. Therefore, CBO estimates that H.R. 1256 will not have a significant effect on revenues or direct spending from the collection of criminal fines over the 2010-2019 period.

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