The Effect of Raising State and Federal Tobacco Taxes

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Cigarette smoking kills more people than any other preventable cause of death[1] and burdens the nation with over $68 billion a year in health care costs and lost productivity, $20.8 billion of which is in direct health care costs.[2,3] The Clinton administration has proposed a large tax on tobacco to raise revenues for the nation's new health plan. Politically, the time is right for such a move. Two thirds of American voters, including 65% of those in the six tobacco-producing states, favor a $2-per-pack tax increase on cigarettes.[4] Public support is especially high when tobacco tax funds are earmarked for health purposes.

A tax increase will reduce tobacco consumption because it increases the cost of the product. The law of downward sloping demand states that the quantity of a commodity purchased declines as the price for that commodity increases. This law has been found to hold true for cigarettes.[5] Therefore, the higher the price of a package of cigarettes, the fewer packages sold. Young people are most sensitive to increases in price and are less likely to start smoking when cigarette prices are high.

As tobacco taxes go up, fewer children will start smoking and more current smokers will quit. The health of the public will improve. The tobacco industry, which understands this chain of events, has recently cut the price of premium cigarette brands by 40 cents a package. Without a state or federal tax increase, cigarettes have thus become much more affordable. With a $2-per-pack tax increase, cigarette consumption would drop approximately 23%, 7 million fewer Americans would smoke, and about $20 billion of new federal revenues would be raised.

The actual federal tax increase that will be passed is unknown at this writing, but the 75 cents per-pack increase being considered by the Clinton administration would produce a 14% drop in cigarette consumption, reduce the number of Americans smoking by 4 million, and raise about $7.5 billion in federal revenues.

Decreased smoking and increased federal revenue make an attractive combination. However, as the higher federal tobacco tax causes an increase in the price of cigarettes and decreased sales in states, there will be decreased state tobacco excise tax revenue. In most states, the loss of tobacco tax revenue will be more than offset by the increase in sales tax revenue, with sales tax based on the new, higher cost of cigarettes. In 11 states, however, there is no sales tax, or the sales tax is not applied to tobacco products, or tobacco excise taxes are not included in the total to which the sales tax is applied (Figure). In these states (Alabama, Alaska, Colorado, Delaware, Georgia, Michigan, Missouri, Montana, New Hampshire, Oregon, and Wyoming), an increase in the federal tobacco excise tax will lead to a net loss of state revenue. All states should increase tobacco taxes to decrease smoking and increase revenue; these 11 states have the additional incentive of avoiding loss of revenue.

The prospects of enacting a significant tax hike on cigarettes through the routine legislative channels are remote in many states. Tobacco lobbies have loud voices in most state legislatures. While tobacco tax legislation should be pursued in states where there is some chance of passage, voter-initiated action should be considered in states where there is no chance of passage and the initiative process is a legitimate alternative.

For example, in 1988, after years of failed attempts to get the state legislature to pass tobacco tax legislation, the California divisions of the American Lung Association, American Cancer Society, American Heart Association, and other constituencies mounted a grass-roots movement to place an initiative on the November ballot that would increase the state excise tax on cigarettes from 10 cents to 35 cents per pack effective January 1, 1989, and raise approximately $600 million in state revenues the first year. The Coalition for a Healthy California raised approximately $1 million to support the initiative.

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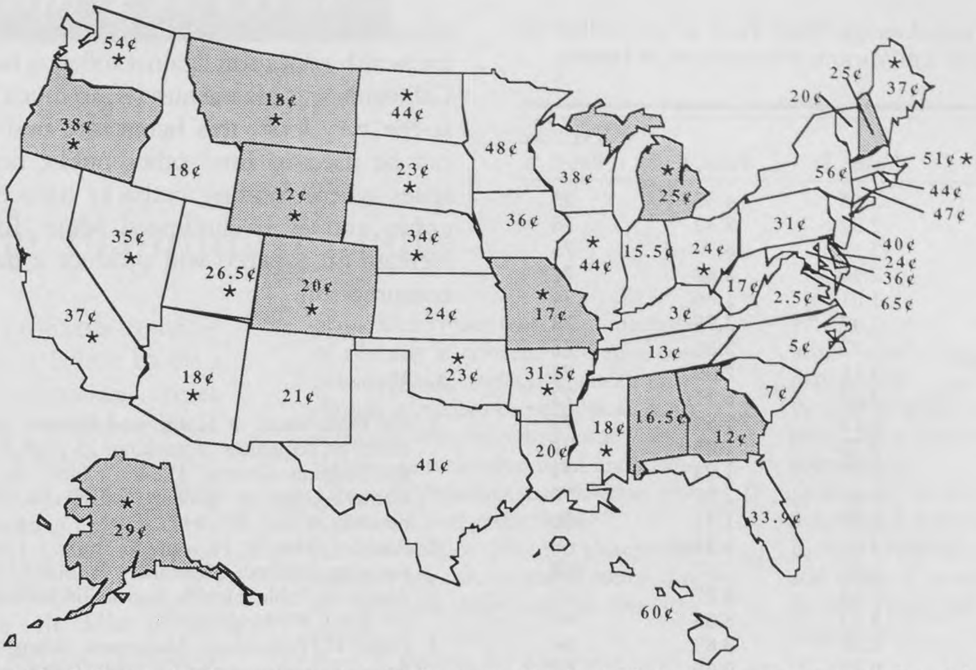

Figure. Eleven states (shaded on map) face revenue loss in the event of a rise in federal tobacco tax rates. Asterisk denotes states with tax initiative ability; cents sign, state cigarette excise tax rate cents-per-pack.

The tobacco industry responded predictably with a $24 million counterattack, which included a massive media campaign of disinformation. It was a tremendous victory for public health when the voters passed the initiative by a margin of 58% to 42%.[6]

The California Tobacco Tax Initiative included a provision that should be incorporated in other state initiatives. This provision set aside 20% of the revenues from the new tax (more than $100 million a year) in a Health Education Account which was to "only be available for appropriation for programs for the prevention and reduction of tobacco use."

After the passage of the initiative, the tobacco industry has made continuing efforts to divert the earmarked funds. State-funded tobacco prevention and control educational activities are a wooden stake through the heart of the tobacco industry. The tobacco industry has responded by product advertising and promotional activities and by vastly increasing its campaign contributions to state legislators. As a result, funding cuts or diversions over the years have chipped away over 30% of the educational program's funding base.

Even with these setbacks, the California program has had a measurable salutary effect. Since 1988, the rate of cigarette smoking among California adults has fallen from 26.7% to 20.4%—a 23.6% decrease. In fact, the 1992 smoking prevalence in California was 14.6% lower than it would have been had the 1974-through-1988 trend continued.[7] This reduction translates directly into better public health and billions of dollars saved in present and future health care costs and lost productivity in the state.

In 1992, Massachusetts became the second state to win a major tobacco tax increase through the initiative process. The Massachusetts initiative increased the tax on cigarettes from 26 cents per pack to 51 cents per pack and is expected to raise approximately $110 million the first year. As in California, a significant portion of the tax revenues will be used to support a health education program against tobacco use. Some other states have attempted to raise tobacco taxes through initiated act campaigns, but were unsuccessful, including Montana, Colorado, and Oregon in 1990[9] and Arkansas and Nebraska in 1992. Voter initiated campaigns are labor intensive and should be undertaken only with help from experienced political consultants.

There are at least two other reasons to raise tobacco taxes. First, tobacco excise taxes in most states have not kept pace with inflation and tobacco product price increases. In California, for example, the 2 cents per-pack increase of 1993 was the first to be enacted through the normal legislative process since 1966, when the California state excise tax on tobacco was raised from 3 to 10 cents per pack of cigarettes. Over the next 27 years, the share of the average retail price of a pack of cigarettes represented by the combined federal and state tobacco taxes on cigarettes shrank from 42% to less than 27%.[10] The record is similar in other states.

Second, US tobacco taxes are among the lowest of the developed countries in the world (Table).

Table. Total Taxes and Average Retail Price in US Dollars of a Pack of 20 Cigarettes in Various Countries as of January 4, 1993

Country	Taxes, $	Price, $	Tax/Price Ratio, %
Denmark	3.68	4.33	85
UK	2.52	3.32	76
Ireland	2.77	3.70	75
Finland	2.45	3.32	74
Portugal	1.01	1.36	74
Sweden	2.87	3.93	73
Belgium	1.72	2.35	73
Germany	2.11	2.90	73
Canada (highest)	3.69	5.11	72
Italy	1.11	1.54	72
Greece	0.75	1.06	71
France	1.37	1.93	71
Netherlands	1.45	2.07	70
Argentina	0.99	1.41	70
Canada (average)	3.01	4.34	69
New Zealand	1.81	2.67	68
Norway	3.33	4.87	68
Canada (lowest)	2.59	3.88	67
USA ($2 increase)	2.56	3.89	66
Spain	0.37	0.60	62
Korea	0.46	0.76	61
Japan	1.05	1.75	60
Australia	1.38	2.29	60
Hong Kong	1.37	2.65	52
Switzerland	1.05	2.10	50
USA ($0.75 increase)	1.31	2.64	50
USA (highest)	0.86	2.15	40
Kuwait	0.22	0.74	30
USA (average)	0.56	1.89	30
USA (lowest)	0.34	1.73	20

Source: Adapted from Non-Smokers Rights Association (Canada).

The benefits of raising tobacco taxes, with or without earmarking revenues for a health education program, are apparent: a reduction in smoking leading to improved health. If the federal government raises the tax on tobacco, 11 states will have an extra incentive to follow suit. In these states, if state tobacco excise taxes are not increased, there will be a net loss of revenue. In some states, initiated acts can and should be used to raise tobacco taxes. If the tax increase can be linked to support for health education against tobacco use, as was done in California and Massachusetts, so much the better. If not, at the very least, this heretofore undertapped resource can be used to fund other public health programs in states where funding cutbacks have eroded most programs and even eliminated some. In any case, a tax increase on tobacco will produce a decline in cigarette consumption.

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