

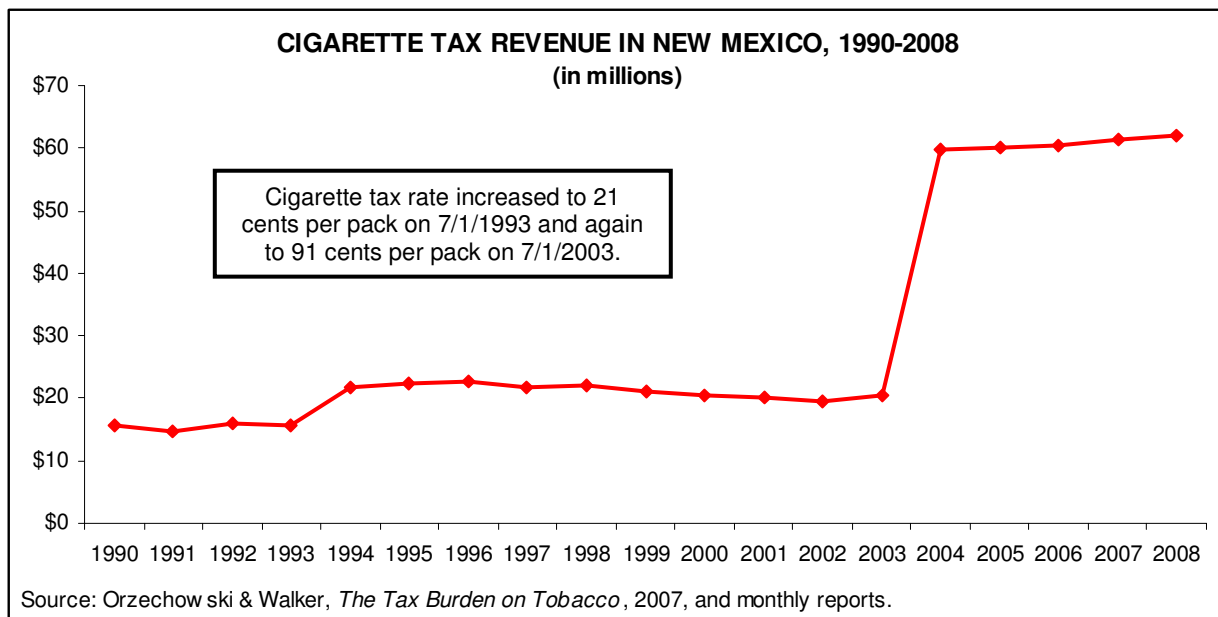


## TOBACCO TAX INCREASES ARE A RELIABLE SOURCE OF SUBSTANTIAL NEW STATE REVENUE

Opponents of state tobacco tax increases often claim, incorrectly, that tobacco taxes are unreliable sources of state revenue. In fact, state tobacco taxes are one of the most predictable sources of revenue that states receive. Any significant reductions to state tobacco tax revenues from ongoing smoking declines are dwarfed by the much larger reductions in government and private sector smoking-caused costs those smoking declines produce.

The success of effective tobacco control policies means that cigarette consumption will drop more rapidly than in the past – a trend that benefits public health, increases worker productivity, and lowers state health care costs. In fact, industry analysts now predict that national pack sales will decline by about four to five percent per year, on average, because of smokers quitting, cutting back, or switching to other tobacco products.<sup>1</sup> States with aggressive ongoing tobacco prevention efforts will likely see additional declines, but they would be offset by even larger reductions in smoking-caused costs. In addition, states can take a variety of actions to protect and maintain, or even increase, their tobacco tax revenues over time.

**Significant tobacco tax increases always produce substantial net new revenues.** In every single instance where a state has passed a significant cigarette tax increase, the state has enjoyed a substantial increase to its state cigarette tax revenues, well above what they would have received absent any rate increase. This occurs, despite significant declines in smoking rates and taxed pack sales, because the increased tax per pack brings in much more new revenue than is lost by the declines in the number of taxed packs.<sup>2</sup> The higher level of state tobacco tax revenues after a rate increase will decline over time as state smoking levels continue to shrink, but the revenue levels will remain much higher than they would have been without the rate increase. Moreover, the smoking-reduction revenue declines will occur at a gradual, predictable rate (as related savings grow), making related state budgeting quite easy. The following graph, presenting data from New Mexico, shows how state cigarette tax revenues do not decline sharply in the years following a significant cigarette tax increase.



**Tobacco tax revenues are much more predictable than many other state revenues.** Year to year, state tobacco tax revenues are more predictable and less volatile than many other state revenue sources, such as state income tax or corporate tax revenues, which can vary considerably each year because of nationwide recessions or state economic slowdowns. In sharp contrast, large drops in tobacco tax revenue from one year to the next are quite rare because of the addictive power of cigarettes.

Comprehensive tobacco prevention efforts are likely to reduce state smoking rates by roughly one or two percentage points each year, but those smoking declines reduce total state pack sales and revenues by much smaller amounts, proportionately, since the heaviest smokers who consume the most cigarettes (and pay the most taxes) are the most addicted and most resistant to quitting. It is also worth noting that smokers who quit or cutback typically use their savings from reduced cigarette purchases to buy various other goods and services in the state, thereby increasing other state tax revenues and helping to strengthen the state economy.

***Smoking declines produce enormous public and private sector savings that more than offset any state revenue reductions from fewer packs being sold.*** Although reductions to state smoking levels in the years after a cigarette tax increase will gradually erode state tobacco tax revenues (in the absence of any new state rate increases), those smoking declines will simultaneously lock in even bigger reductions in government and private sector smoking-caused costs. At the same time, the state would enjoy the even larger, rapidly growing cost savings from the sharper smoking declines prompted by the original cigarette tax increase.<sup>3</sup>

For example, cigarette tax increases work best to reduce smoking among youth, lower-income smokers and pregnant women – and those smoking declines directly reduce state Medicaid program expenditures. Similarly, decreasing smoking rates among workers directly reduces public and private sector employers' health insurance costs – while also reducing business productivity losses from smoking-caused job performance declines and work absences, and from losing productive workers to smoking-caused disease or disability. Among the many other savings from smoking reductions are reduced property losses from smoking-caused fires, and reduced cleaning and maintenance costs.

***States can implement numerous cost-effective strategies to maintain and increase their tobacco tax revenues.*** To increase and then stabilize total state tobacco product tax revenue, states should make sure their tax rates on other tobacco products parallel their cigarette tax rates. Establishing such tax parity will ensure that a state does not lose revenues when smokers switch from cigarettes to other tobacco products. This kind of switching has been quite pronounced lately – largely because of much lower state tax rates on cigars and smokeless tobacco compared to cigarettes. In just the first five months of 2008 compared to 2007, cigarette sales dropped by 4.5 percent nationwide while moist snuff sales increased by 5.6 percent and small cigar sales increased by 21.2 percent.<sup>4</sup>

States can also *increase* their tobacco tax revenues, *without* raising tax rates, by implementing cost-effective initiatives to prevent and reduce cigarette smuggling and other forms of tobacco tax evasion – such as switching to high-tech tax stamps; passing strict laws to prevent illegal Internet cigarette sales; or increasing enforcement efforts.<sup>5</sup> California, the first state with high-tech tax stamps, enjoyed a \$100 million increase in cigarette tax revenues in just the first 20 months after the new tax stamps were introduced.<sup>6</sup>

If gradually declining state tobacco tax revenues is still a concern – despite all the benefits and cost savings from the related smoking declines – a state could simply increase its tobacco tax rates both to offset the declines and bring in substantial more revenue. Alternatively, the state could implement legislation to allow the state treasurer or tax commissioner to increase state tobacco tax rates whenever state tobacco tax revenues (or total state tobacco revenues, including tobacco settlement payments) decline by more than a nominal amount compared to the prior year. Or the state could simply establish automatic, periodic adjustments to state cigarette tax rates to account for increases in inflation or cigarette prices, and maintain a comparable percentage-of-price tax on other tobacco products, which will automatically adjust for inflation, as well. But it is important to note that regular small increases to tobacco tax rates produce little or no public health benefits or cost savings compared to periodic larger lump-sum increases.

***Campaign for Tobacco-Free Kids, December 19, 2008 / Ann Boonn***

**More information on tobacco tax increases is available at**  
**[http://www.tobaccofreekids.org/facts\\_issues/fact\\_sheets/policies/tax/us\\_state\\_local/](http://www.tobaccofreekids.org/facts_issues/fact_sheets/policies/tax/us_state_local/).**

<sup>1</sup> Standard & Poor's, *Altria Group: Sub-Industry Outlook*, December 6, 2008.

<sup>2</sup> Campaign for Tobacco-Free Kids (TFK) Factsheet, *Raising State Cigarette Taxes Always Increases State Revenues (And Always Reduces Smoking)*, <http://tobaccofreekids.org/research/factsheets/pdf/0098.pdf>.

<sup>3</sup> State-specific factsheets are available upon request from [factsheets@tobaccofreekids.org](mailto:factsheets@tobaccofreekids.org).

<sup>4</sup> U.S. Alcohol and Tobacco Tax and Trade Bureau. See also, TFK Factsheet, *How to Make State Cigar Tax Rates Fair and Effective*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0335.pdf>, and *The Problem with Roll-Your-Own (RYO) Cigarettes*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0336.pdf>.

<sup>5</sup> See the TFK Factsheet, *State Options to Prevent and Reduce Cigarette Smuggling and to Block Other Illegal State Tobacco Tax Evasion*, <http://tobaccofreekids.org/research/factsheets/pdf/0274.pdf>.

<sup>6</sup> Halper, E, "States Tobacco Revenue Surges," *Los Angeles Times*, December 27, 2005. TFK Factsheet, *The Case for High-Tech Cigarette Tax Stamps*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0310.pdf>.