



TOBACCO TAX INCREASES ARE A RELIABLE SOURCE OF SUBSTANTIAL NEW FEDERAL REVENUE

Cigarette companies and their allies often oppose tobacco tax increases by making the claim that tobacco taxes are not a reliable source of revenue. In fact, tobacco tax revenues are among the most predictable, steady, and reliable revenues that the federal government receives. Moreover, any of the gradual reductions to tobacco tax revenues from ongoing smoking declines are dwarfed by the massive reductions in public and private sector smoking-caused costs those smoking declines produce. Once the dust has settled after a major cigarette tax increase, cigarette tax revenues typically decline by only about two percent per year, on average, because of ongoing smoking declines (but some other tobacco tax revenues have lately been increasing).¹ Increased tobacco prevention efforts could produce larger annual declines in cigarette or total tobacco tax revenues, but any such decline would still be relatively modest, because of the addictive power of nicotine, and would be more than offset by even larger related reductions in public and private smoking-caused costs.

Significant tobacco tax increases always produce substantial net new revenues that last. A significant federal cigarette tax increase would produce the same results that have been seen in every state and locality that has passed a significant cigarette tax increase: a substantial, sustained increase to cigarette tax revenues.² Such revenue increases occur, despite the declines in smoking rates and taxed pack sales caused by the cigarette tax increase, because the increased tax per pack brings in much more new revenue than is lost by the declines in the number of packs sold and taxed. The new, much higher level of cigarette tax revenues produced by a cigarette tax rate increase would gradually decline if nationwide smoking levels continue to go down. But because of the addictive power of cigarettes, any such revenue declines (just like the underlying smoking declines) would be slow and predictable.

The last two increases to federal tobacco tax rates of 10 cents per pack in January 2000 and another five cents in January 2002 increased federal tobacco tax revenues by about \$1.6 billion per year. Since then, total federal tobacco tax revenues have remained quite stable with no significant declines. During that same period, both adult and youth smoking rates declined (by eight percent and 19.3 percent, respectively), and total cigarette consumption dropped by 11 percent (or just over two percent per year).³ Despite this gradual decline in cigarette consumption, however, total federal tobacco tax revenues remained much more stable because of some offsetting increases in smokeless tobacco use and cigar smoking and related federal tobacco tax revenues.*

Tobacco tax revenues are much more predictable and stable than many other revenues. Year to year, tobacco tax revenues are more predictable and less volatile than many other revenue sources, such as income tax or corporate tax revenues, which can vary considerably each year because of nationwide recessions or economic slowdowns. In sharp contrast, large drops in tobacco tax revenue from one year to the next are rare because of the addictive power of cigarettes. For instance, it is very difficult to predict corporate income tax revenues from year to year. Between 1999 and 2005, the corporate income tax collections fluctuated dramatically each year while tobacco tax revenues remained stable. For example, without any changes to the tax rate or structure between 2002 and 2003, corporate income tax revenues declined by eight percent (\$17.3 billion), whereas tobacco tax revenues stayed relatively constant (actually increasing by \$66 million).⁴ Moreover, changes in other federal revenues can be much more disruptive to federal budgeting than changes to tobacco tax revenues (which account for only a small part of total federal revenues). A highly unlikely five percent decline in tobacco tax revenues, for example, would reduce federal revenue collections by less than \$400 million, but a more probable five percent decline in corporate income tax revenues would cut federal revenues by \$19.1 billion.

* Cigarette sales make up roughly 95% of total tobacco product sales nationwide. Nevertheless, to maximize revenue increases (and maximize public health benefits and associated savings), it is important that the tax rates on all other tobacco products be increased along with any increases to the cigarette tax.

Tobacco prevention efforts only marginally reduce tobacco tax revenues – and produce enormous related cost savings. Ongoing smoking declines and other factors are projected to reduce taxable pack sales by about two percent per year. Because of the addictive power of cigarettes, even with greatly expanded public and private tobacco prevention efforts, nationwide smoking rates would, at most, decline by about one or two percentage points each year. But even if that happened, those smoking declines would reduce total pack sales and federal cigarette tax revenues by much smaller percentages because the heaviest smokers who consume the most cigarettes (and pay the most taxes) are the most addicted and most resistant to quitting. At the same time, smokers who quit or cutback typically spend their savings from reduced cigarette purchases on various other goods and services, which not only helps to strengthen the economy, but can also increase other tax revenues.

Moreover, any pack sale declines caused by smoking reductions translate directly into improved public health and stronger worker productivity, as well as growing reductions to government and private sector smoking-caused expenditures.⁵ More specifically, smoking reductions among pregnant women and lower income households translate directly into significant reductions to smoking-caused Medicaid expenditures. Decreasing smoking rates among workers directly reduces public and private sector employers' health insurance costs – while also reducing worker productivity losses from smoking-caused job performance declines, work absences, and early retirement.

Restoring the current federal cigarette tax rate to its historical levels would bring in significant amounts of new revenue. Controlling for general inflation or cigarette price increases, the current federal cigarette tax rate is much lower than when it first went into effect in 1960.⁶ It is also much smaller as a percentage of the average state cigarette tax, or compared with cigarette tax rates in other modern, industrialized nations. Restoring the value of federal cigarette tax to its 1960 levels would require an increase of as much as \$1.12 per pack or more.⁷ For instance, in 1960 the federal cigarette tax of 8 cents per pack made up more than 30 percent of the average total retail price for a pack of cigarettes. But today's 39-cent federal cigarette tax accounts for less than 10 percent of the total average retail price of a pack. Closing that gap through a 95 cent cigarette tax increase would produce \$13.9 billion in net new federal revenues (while also reducing youth smoking by 14.4 percent and saving more than 1.4 million lives from being ended by smoking-caused death). Even a much more modest increase to bring the federal cigarette tax rate to just \$1.00 per pack would produce more than \$9.4 billion in new revenue (reducing youth smoking by 9.2 percent and saving more than 900,000 lives).[†]

Parallel increases in federal tax rates on other tobacco products would produce even more revenue. Increasing the federal excise tax rates on all tobacco products at the same time as the cigarette tax rate increase would ensure even larger, more stable revenues for the government. A tax increase solely on cigarettes would render less revenue per amount of tobacco sold. In addition, some smokers would switch to the other tobacco products with substantially lower tax rates, thereby diverting additional revenues from the government.⁸ But raising rates across the board would ensure that all ongoing tobacco users would pay similar tax rates, which increases total net new revenues (despite increasing the number of tobacco users who quit or cutback).

Increasing the federal cigarette tax rate will not create a black market in the United States. A federal cigarette tax increase to \$1.00 per pack (along with parallel increases to other tobacco product tax rates) would not generate enough increased smuggling or other tobacco tax evasion to significantly reduce the amount of net new revenues received by the federal government. Such smuggling and tax evasion has not been a major problem in states that have passed significant cigarette tax rate increases. International smuggling and other activities to evade the federal tax are much more difficult than state-based smuggling or tax evasion. It is, for example, much easier to smuggle cigarettes across state or state-Tribal borders than over international borders into the United States. In addition, smokers cannot evade the federal tax (which is collected at the factory) when they go to a lower-tax state or onto Tribal lands to evade their own state's cigarette tax. Furthermore, the U.S. government could take a number of

[†] These projected revenue estimates are only for increased federal cigarette excise tax revenues; parallel increases to the federal tax rates on other tobacco products would bring in additional new revenues. These cigarette excise tax revenue increase projections are similar to those made by the Joint Committee on Taxation; but the Joint Committee also assumes a corresponding decrease in other federal tax revenues (e.g., payroll and income taxes) equal to 25 percent of the cigarette excise tax revenue increase.

specific cost-effective steps to reduce any smuggling and tax evasion that does occur, thereby boosting net new revenues even further.⁹

More information on Federal tobacco tax increases is available at
http://www.tobaccofreekids.org/facts_issues/fact_sheets/policies/tax/us_federal/.

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¹ USDA Economic Research Service, Table 1, Cigarettes: U.S. output, removals, and consumption, 1996-2006, April 2007.

² See, e.g., 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>.

³ National Center for Health Statistics, National Health Interview Survey. National Youth Risk Behavior Survey (YRBS). USDA ERS, Table 1.

⁴ US Internal Revenue Service, Table 6 in IRS Databook, Fiscal Year 2006, March 2007, <http://www.irs.gov/taxstats/article/0,,id=168593,00.html>.

⁵ For more details, see TFK Factsheet, *Benefits & Savings from Each One Percentage Point Decline in Adult and Youth Smoking Rates in the United States*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0235.pdf>.

⁶ For more details, see TFK Factsheet, *The Federal Cigarette Tax is Much Lower Than Historical Levels*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0092.pdf>.

⁷ See TFK Factsheet, *The Federal Cigarette Tax is Much Lower Than Historical Levels*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0092.pdf>.

⁸ See, e.g., Chaloupka, F & Warner, K, "Section 2.4: Econometric studies of the demand for other tobacco products," *Economics of Smoking*: 36-37, January 12, 1999; HHS, *Preventing Tobacco Use Among Young People: A Report to the Surgeon General*, 1994, http://www.cdc.gov/tobacco/data_statistics/sgr/1994/index.htm. See also, TFK Factsheet and the references cited therein, *Benefits from Increasing Smokeless Tobacco Tax Rates*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0180.pdf>.

⁹ For more policies to reduce cigarette smuggling, see TFK Factsheet, *Proposed Federal Measures to Reduce Cigarette Smuggling and Protect Federal and State Tobacco Tax Revenues*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0226.pdf>.