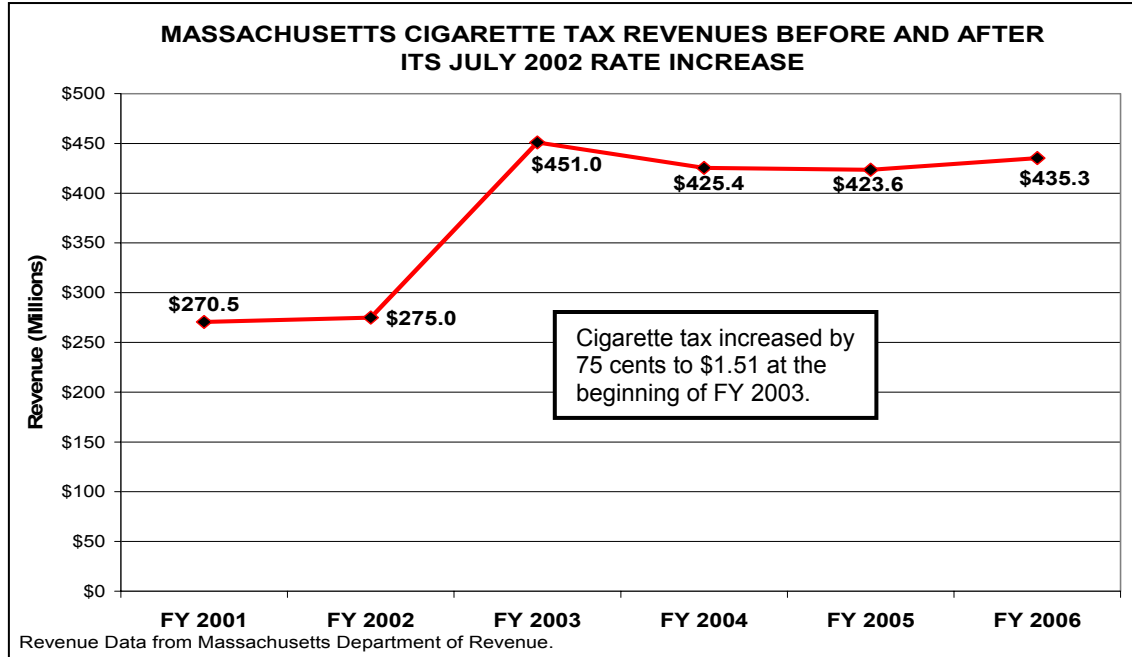




TOBACCO TAX INCREASES ARE A RELIABLE SOURCE OF SUBSTANTIAL NEW STATE REVENUE

The big cigarette companies and their allies often oppose state tobacco tax increases by making the curious claim that tobacco taxes are somehow not reliable sources of state revenue. In fact, state tobacco tax revenues are among the most predictable, steady, and reliable revenues that states receive. Moreover, any of the gradual reductions to state 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, state tobacco tax revenues typically decline by only about two percent per year, on average, because of smoking declines. States with aggressive ongoing tobacco prevention efforts will likely see larger declines, but they would be offset by even larger related reductions in smoking-caused costs. In addition, there are a variety of actions states can take to protect and maintain, or even increase, their tobacco tax revenues over time.

Significant tobacco tax increases always produce substantial net new revenues that last. In every single instance where a state has passed a significant cigarette tax increase, the state has enjoyed a substantial, sustained increase to its state cigarette tax revenues. 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 packs sold and taxed. In every case documented, states have seen both sharp reductions in total packs sold and large increases in total net new revenues in the full fiscal year after the rate increase, compared to the first full fiscal year before it.¹ The higher level of new state tobacco tax revenues after a rate increase will subsequently decline slowly as state smoking levels continue to shrink, but these declines will be gradual and predictable, making related state budgeting quite easy. The following graph, presenting data from Massachusetts, 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 and stable 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, for example, are likely to reduce state smoking rates by roughly one or two percentage point 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 continuing reductions to state smoking levels in the out 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 along with the declines immediately following the original cigarette tax increase will simultaneously produce much larger reductions in government and private sector smoking-caused expenditures.²

More specifically, smoking reductions among pregnant women and lower income households translate directly into reduced smoking-caused expenditures by state Medicaid programs. 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. Among the many other savings from smoking reductions are reduced property losses from smoking-caused fires, and reduced cleaning and maintenance costs caused by smoking.

States can implement numerous cost-effective strategies to maintain and increase their tobacco tax revenues. If gradually declining state tobacco tax revenues is a problem for a state – despite all the benefits and cost savings from the related smoking declines – the state can 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.

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 new, high-tech tax stamps; passing strict laws to prevent illegal Internet cigarette sales; or increasing enforcement efforts.³ 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.⁴

Campaign for Tobacco-Free Kids, February 15, 2007 / Eric Lindblom

Additional Information

- *Raising State Cigarette Taxes Always Increases State Revenues and Always Reduces Smoking*, <http://tobaccofreekids.org/research/factsheets/pdf/0098.pdf>.
- *Responses to Misleading and Inaccurate Cigarette Company Arguments Against State Tobacco Tax Increases*, <http://tobaccofreekids.org/research/factsheets/pdf/0227.pdf>.
- *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> [e.g., how to increase revenues without raising taxes].

¹ 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>.

² TFK has state-specific factsheets that show the many *Benefits & Savings From Each One Percentage Point Decline in Smoking Rates*. Versions for each state are available upon request from factsheets@tobaccofreekids.org.

³ 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>.

⁴ Halper, E, "States Tobacco Revenue Surges," *Los Angeles Times*, December 27, 2005. TFK Factsheet, *The Case for High-Tech Cigarette Tax Stamps*, <http://tobaccofreekids.org/research/factsheets/pdf/0287.pdf>.