Ta~~r~~x and Nicotine

Seeking any means available to raise revenue, southeastern states—like their counterparts across the nation—have been raising the tax rate on cigarettes, sometimes dramatically. But between smoking-cessation initiatives and the higher cost of lighting up, the number of smokers has been declining. In the long run, how reliable is this revenue stream for state governments?

Once Iowa levied the first state excise tax on cigarettes in 1921, 68 years passed before all 50 states had a similar tax in place. But just as there was no unanimity on the timeline for implementing a cigarette tax, no consensus exists today among states for setting the rate for that tax.

As political battles go, setting the tax rate on cigarettes is a conflict worthy of the proverbial smoke-filled room. Support for raising cigarette tax rates generally comes from lawmakers seeking to offset tobacco-related health costs as well as an array of health organizations hoping to reduce the smoking population. Opposition to taxing tobacco tends to come from lawmakers who vow to fight any new tax, reflecting the antitax fervor of the 2010 national elections. Opposition also comes from industries that stand to profit from tobacco sales, including growers, manufacturers, and retailers.

While each of these groups pursues its own end with the cigarette tax rate, one underlying question persists: What effect will each state's decision have on its bottom line?

Hurting for cash: where to turn?

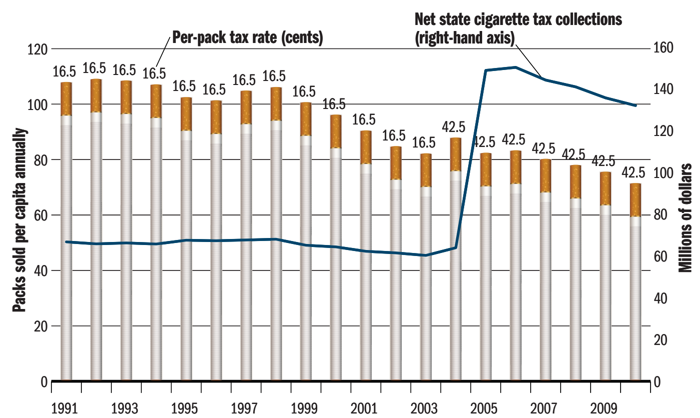
States have increasingly felt a budgetary pinch caused by smaller-than-forecast revenues in the wake of the recent recession and the shifting of funding for some programs from the federal government to the states. According to the Center on Budget and Policy Priorities (CBPP), a nonprofit policy organization, budget shortfalls for 2012 are the norm for the Southeast and the nation. Florida's forecast shortfall of $3.6 billion is equal to 14.9 percent of its 2011 budget. Louisiana has a $1.6 billion shortfall (20.7 percent of its 2011 budget) looming, Georgia faces a $1.3 billion shortfall (7.9 percent), Alabama has to close a $980 million budget gap (13.9 percent), and Mississippi's budget is staring at a $634 million shortfall (14.1 percent). Tennessee's projected 2012 shortfall is not available, but the state had a $1 billion shortfall in 2011, equal to 9.4 percent of its 2011 budget. CBPP forecasts the national average of 2012 shortfall to 2011 budget at 17.6 percent.

Raising tax rates on cigarettes to reduce the deficits is attractive for multiple reasons, according to Mark Robyn, an economist at the Tax Foundation in Washington, D.C.

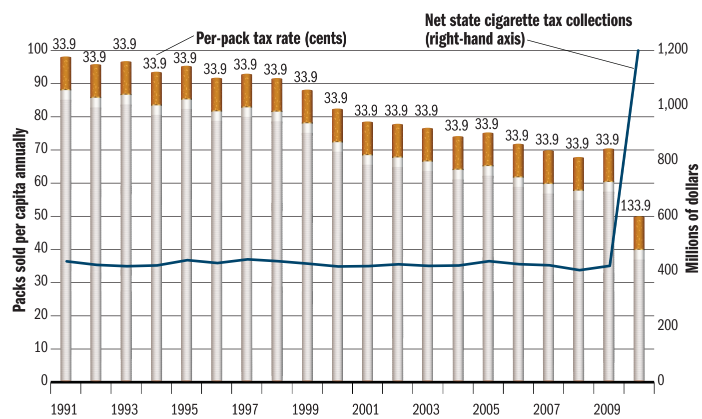
"[Raising cigarette taxes] is a target right now because it's aimed at a not politically favored group," Robyn said. "It's a minority of the population. It's not a very sympathetic group. Politically, it's just very easy." Whereas raising taxes—never a politically palatable undertaking—is especially difficult in a

Southeastern States' Tobacco Sales, Taxation, and Revenue

Alabama



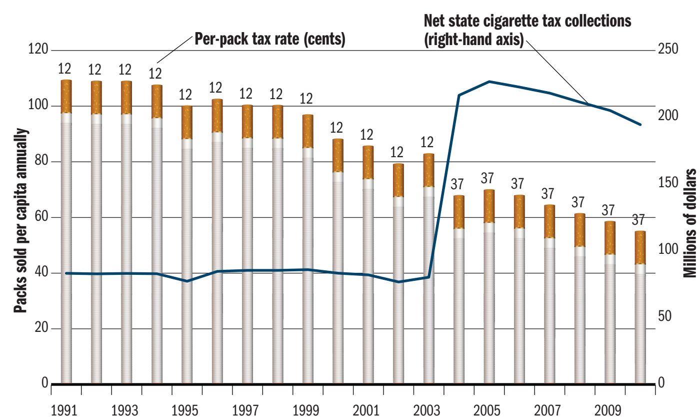
Florida



slow economy, raising the cigarette tax is one of the few taxes that is politically viable, Robyn added.

Tobacco has certainly been in the taxation crosshairs recently in the Southeast. The legislatures of Alabama (House Bill 457) and Louisiana (House Bill 63) have active bills under consideration. Georgia's legislative assembly ended its 2011 spring session without a bill reaching the floor, although Ron Stephens (R-Savannah), backed by a number of health and medical associations, tried to muster support for a tax increase of $1 per pack, raising the rate from $.037 to $1.37, according to WTOC-TV in Savannah. In 2010, Florida accomplished what Stephens sought, a $1 tax hike, from $0.34 to $1.34 per pack. Mississippi more than tripled its cigarette tax in 2009, jumping from $0.18 to $0.68 per pack. The year before, Tennessee enacted a slightly smaller increase, from $0.20 to $0.62 per pack.

Georgia



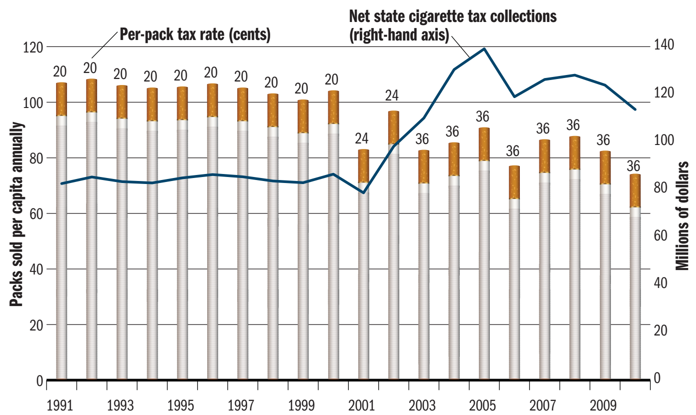
Building the cases

Defenders of these recent initiatives to hike cigarette taxes point to statistics from the Centers for Disease Control and Prevention (CDC) about the costs smokers have on a population. The total economic costs (direct medical costs along with lost productivity) associated with cigarette smoking are estimated at $10.47 per pack of cigarettes sold in the United States, the CDC says. From 2000 to 2004, cigarette smoking was estimated to be responsible for $193 billion in annual health-related economic losses in the United States ($96 billion in direct medical costs and approximately $97 billion in lost productivity), according to the CDC.

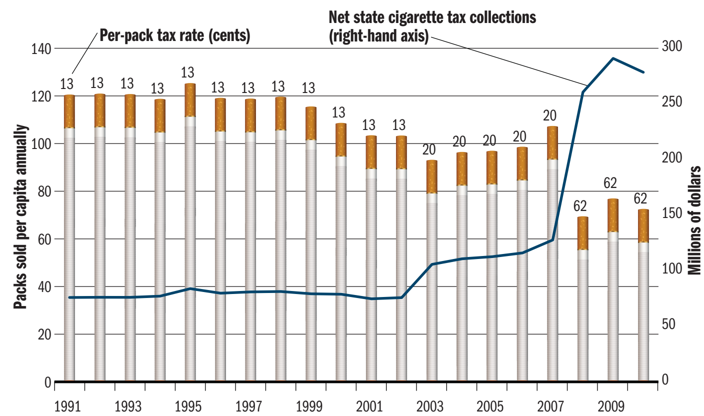
Armed with statistics like these, supporters of the two most recent legislative initiatives on cigarette taxes in the Southeast cited two objectives for a tax hike. On March 31, 2011, Baton Rouge's *Advocate* quoted Frank Hoffmann (R-West Monroe, Louisiana) as supporting the proposed Louisiana cigarette tax hike because the $178 million it would generate annually could be spent on health care. He also feels the hike could discourage young people from smoking. Patricia Todd (D-Birmingham), who proposed Alabama's tax hike, voiced similar reasons. Like Hoffman, she feels that the hike, in addition to providing an estimated $230 million a year for the state's health expenses, could deter young smokers. She described her proposal as a "win-win" in the *Birmingham News*.

Note: “Per capita sales” represents the number of cigarette packs purchased annually.
Source for all chart data: “Tax Burden on Tobacco” report from Orzechowski and Walker

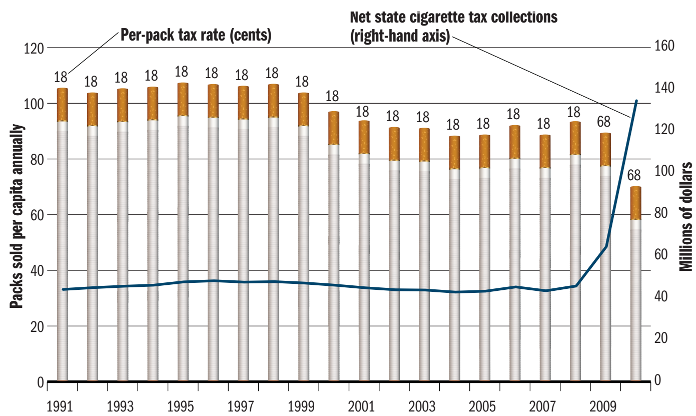
Louisiana



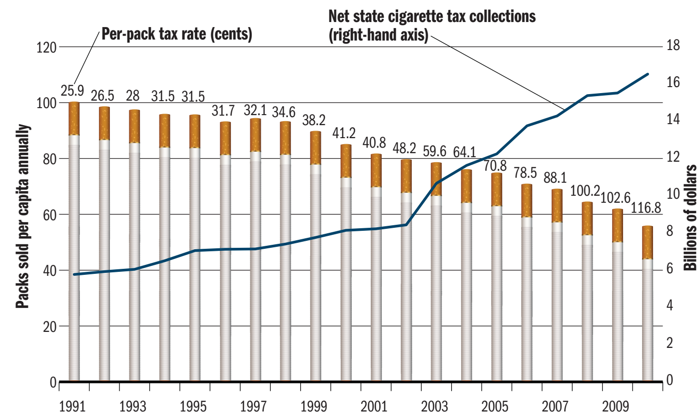
Tennessee



Mississippi



United States



Governors in both Louisiana and Alabama oppose the cigarette tax increase, and reports in the *Advocate* of Baton Rouge and the *Birmingham News* say passage of either is unlikely. Louisiana Gov. Bobby Jindal was quoted in the *Advocate* as saying he would veto any attempt to raise taxes. “Bottom line, we continue to oppose any and all tax increases,” Jindal said.

Higher rates, fewer smokers

The CDC’s Office of Smoking and Health contends that raising cigarette tax rates decreases consumption. The CDC estimates that a 10 percent increase in price reduces overall cigarette consumption among adolescents and young adults by about 4 percent. Data from southeastern states over the last 20 years are consistent with the CDC’s findings. In 1991, Tennessee had a relatively low cigarette tax rate at $0.13 per pack and the highest annual per capita sales at 120.6 packs, according to the *Tax Burden on Tobacco Report*, which quotes the U.S. Department of Treasury’s Alcohol and Tobacco Tax Trade Bureau and is funded primarily by the tobacco industry. Conversely, Florida had the highest rate at $0.34 per pack in 1991 and the lowest sales per capita at 98.2 packs a year. Nationally, the average cigarette tax was $0.26 a pack while per capita sales were 100 packs.

Fast forward to 2010, and the same link between tax rates and the size of the smoking population still existed. In the Southeast, Louisiana replaced Tennessee as having both the lowest cigarette tax, at $0.36 per pack, and highest per capita sales, at 74.3. At the other end of the spectrum, Florida still had both the highest tax rate, at $1.34 per pack, and lowest per capita sales, at 50. Florida's lead in these two categories was solidified in 2009 with a $1 per pack tax hike, which no doubt triggered a dramatic one-year drop in per capita sales, from 70.5 to 50.9 (see the charts).

Observers note that factors other than the cigarette tax rate affect per capita sales. The Tax Foundation's Robyn attributes an unknown portion of the drop to stop-smoking campaigns. Nationally, CDC data show the percentage of Americans who smoke dropped more than 5 percentage points, from 25.7 percent to 20.6 percent, between 1991 and 2009. Overall, the Southeast didn't quite parallel the national decline. While the percentage of smokers in Florida and Tennessee dropped 6.8 percent and 6.9 percent, respectively, two other states remained basically unchanged, with Mississippi's percentage of smokers dropping only 1.6 percent while Alabama's percentage only fell 0.4 percent.

Bruce Ely, a Birmingham attorney who worked with former Alabama Gov. Don Siegelman on tax issues for that state and also represented tobacco companies on excise tax disputes, notes that another factor in per capita sales is the tax rate in neighboring states. He said the states "that are so far behind and below the national average tend to become magnets" for illegal smuggling. "I wish there was a more balanced tax nationally to avoid some of the smuggling and tax evasion we're seeing, both in this state and in other states," he said. "It's just like with tax incentives. The states compete with each other to some extent on being a low-tax state."

A spike and a drop

While the connection between higher cigarette taxes and reduced consumption seems direct, the link between higher tax rates and the states' revenues is not as clear. One prominent trend is that following an increase in a cigarette tax rate, states see a short-term upward spike in revenue, but that spike is typically followed by a gradual reduction, according to data from the Tax Burden on Tobacco report.

After raising its tax per pack from $0.17 to $0.43 in 2004, Alabama's revenue from cigarette taxes peaked at around $150 million in 2005 and 2006. The succeeding years saw a decline each year, until revenue reached $132 million in 2010, a 12 percent drop. Georgia last raised its cigarette tax per pack from $0.12 to $0.37 in 2004. Cigarette tax revenue peaked in 2005 at $226 million. Since then, cigarette tax revenues have declined each year, falling to $194 million in 2010, a 14 percent drop. Louisiana's last cigarette tax rate increase in 2003 was from $0.24 to $0.36 per pack. Cigarette tax revenue in Louisiana peaked two years later in 2005 at $139 million but has dropped in all but one of the succeeding years, to $113 million in 2010, a 19 percent decline. Tennessee raised its cigarette tax rate from $0.20 to $0.62 per pack in 2008 and saw its cigarette tax revenue more than double from $127 million in 2007 to $260 million in 2008. However, after cigarette tax revenues reached $290 million in 2009, they dropped in 2010 to $277 million, a 4 percent decline.

The latest cigarette tax hikes in Florida and Mississippi reveal significant short-term spikes in revenue but are too recent for a post-spike downturn to appear. Mississippi raised its rate from $0.18 to $0.68 per pack in 2009 and saw its revenue more than double, from $65 million in 2009 to $134 million in 2010, while Florida, with an increase to $1.34 in 2010, saw its cigarette tax revenue nearly triple, jumping from $420 million to $1.2 billion.

New school of thought?

The trend of raising cigarette tax rates only to see overall revenue fall is changing the way some states are looking at the issue. The Associated Press reported in March that three states—New Hampshire, New Jersey, and Rhode Island—have considered reducing their cigarette tax rate in hopes of drawing smokers from other states and increasing revenue.

"When you raise rates, you may gain revenue in the short term and lose it in the long term," Robyn said. "The two goals of raising lots of revenue to balance state budgets and reducing smoking are sort of at odds with each other. You can take raising rates to the ultimate extreme, where the tax is $100 a pack. At that point, you're not going to have any smokers left or any smokers buying cigarettes legally. If states truly believe that they're reducing the number of smokers and that's their goal, they shouldn't be dependent on this revenue source because it's going to be dwindling."

So have states extracted as much as they can from cigarette taxation? According to Ely, it depends on the state. "In terms of the high-tax states, I think they're pretty well capped out," he said. "All they can do at this point are things like tax the Indian reservations [which do not pay taxes on cigarettes], tax Internet sales through the Jenkins Act, and try to stop smuggling into their states. Sometimes raising rates can be counterproductive." ∎

This article was written by Ed English, a staff writer for EconSouth.