

Best Practices in Tobacco Taxation

**Frank J. Chaloupka
University of Illinois at Chicago**

**Change – Challenge - Progress
Tobacco Free Nebraska State Conference
Lincoln, NE, April 20, 2011**

Overview

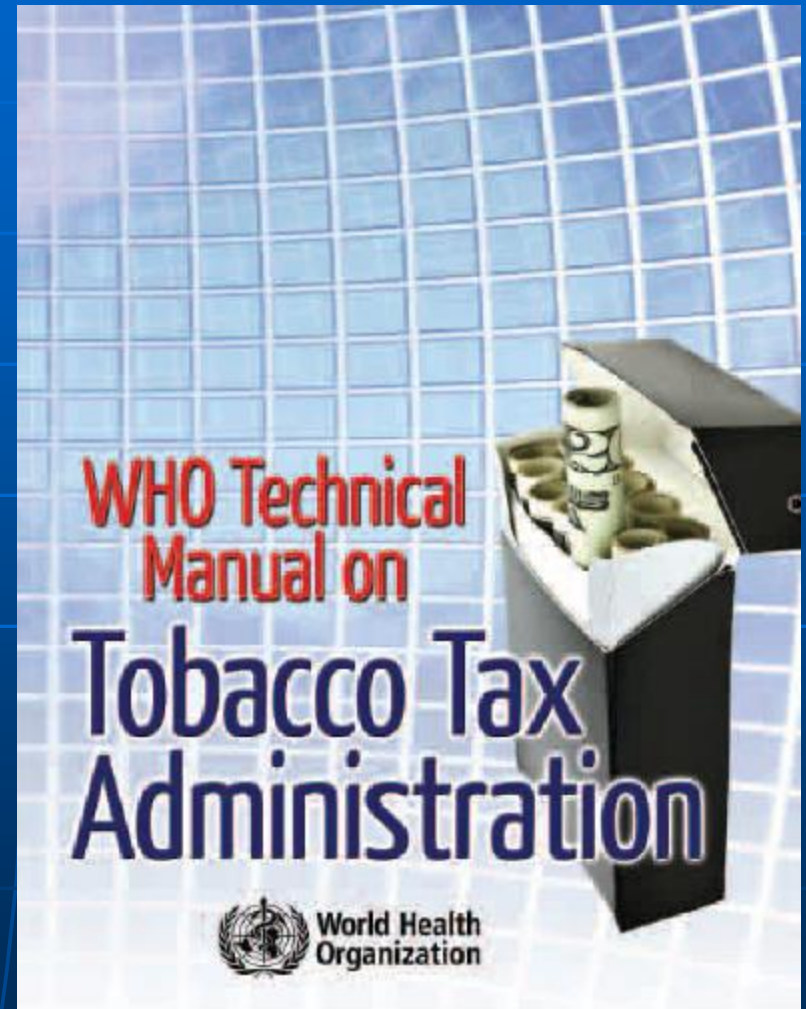
- Overview of tobacco taxation
- Impact of taxes/prices on tobacco use
- Earmarking revenues for tobacco control
- Industry price marketing
 - Marketing restrictions
 - Minimum pricing policies
- Counterarguments – Myths & Facts
- Summary and impact of a tax increase in Nebraska

WHO 'Best Practices'

WHO
Collaborating
Centre on The
Economics of
Tobacco and
Tobacco Control

Frank Chaloupka
Director

*UIC Health Policy
Center*



Overview of Tobacco Taxation

Why Tax Tobacco?

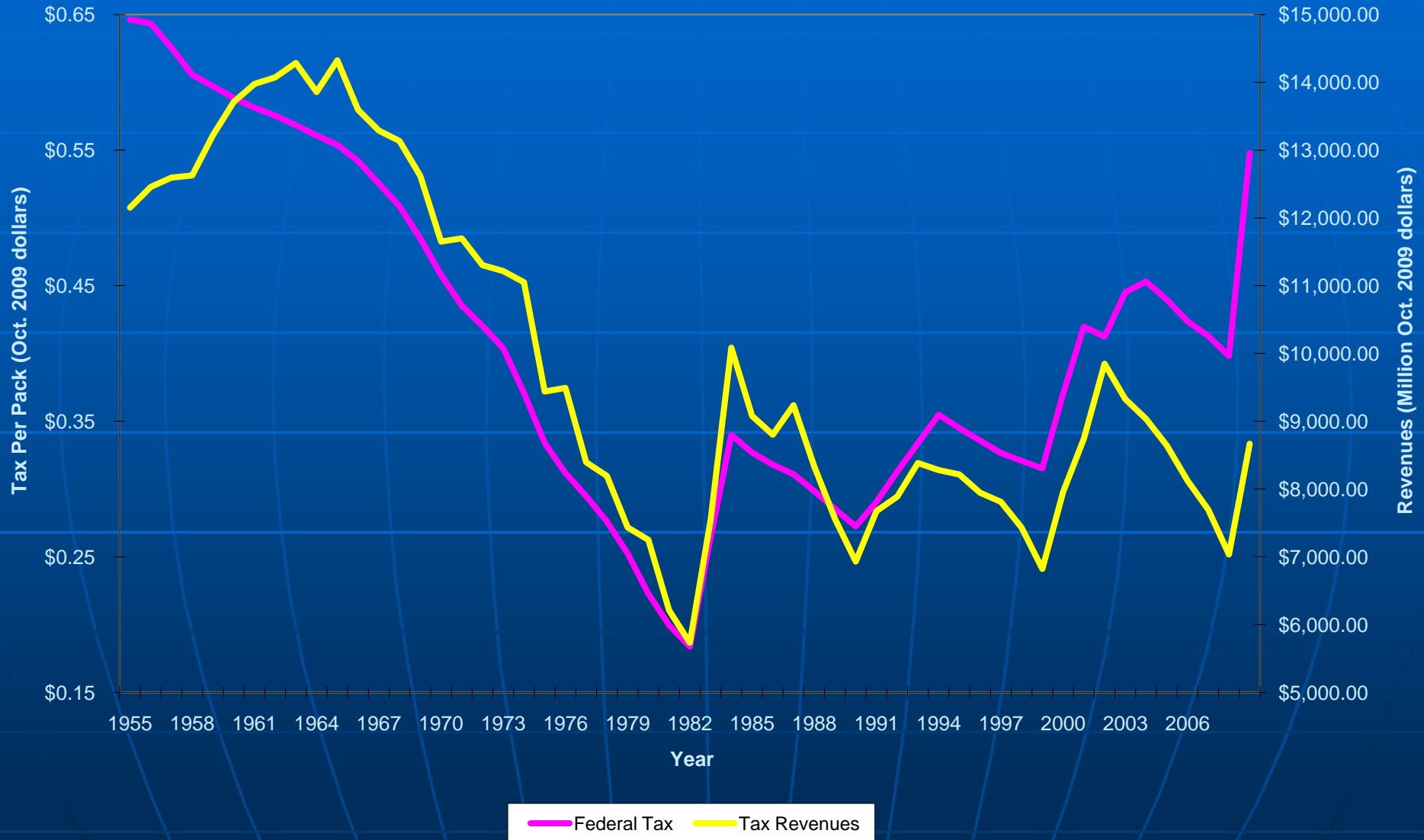
*"Sugar, rum, and **tobacco**, are commodities which are no where necessaries of life, which are become objects of almost universal consumption, and which are therefore extremely proper subjects of taxation."*

*Adam Smith, *An Inquiry into the Nature and Causes of The Wealth of Nations*, 1776*

Why Tax Tobacco?

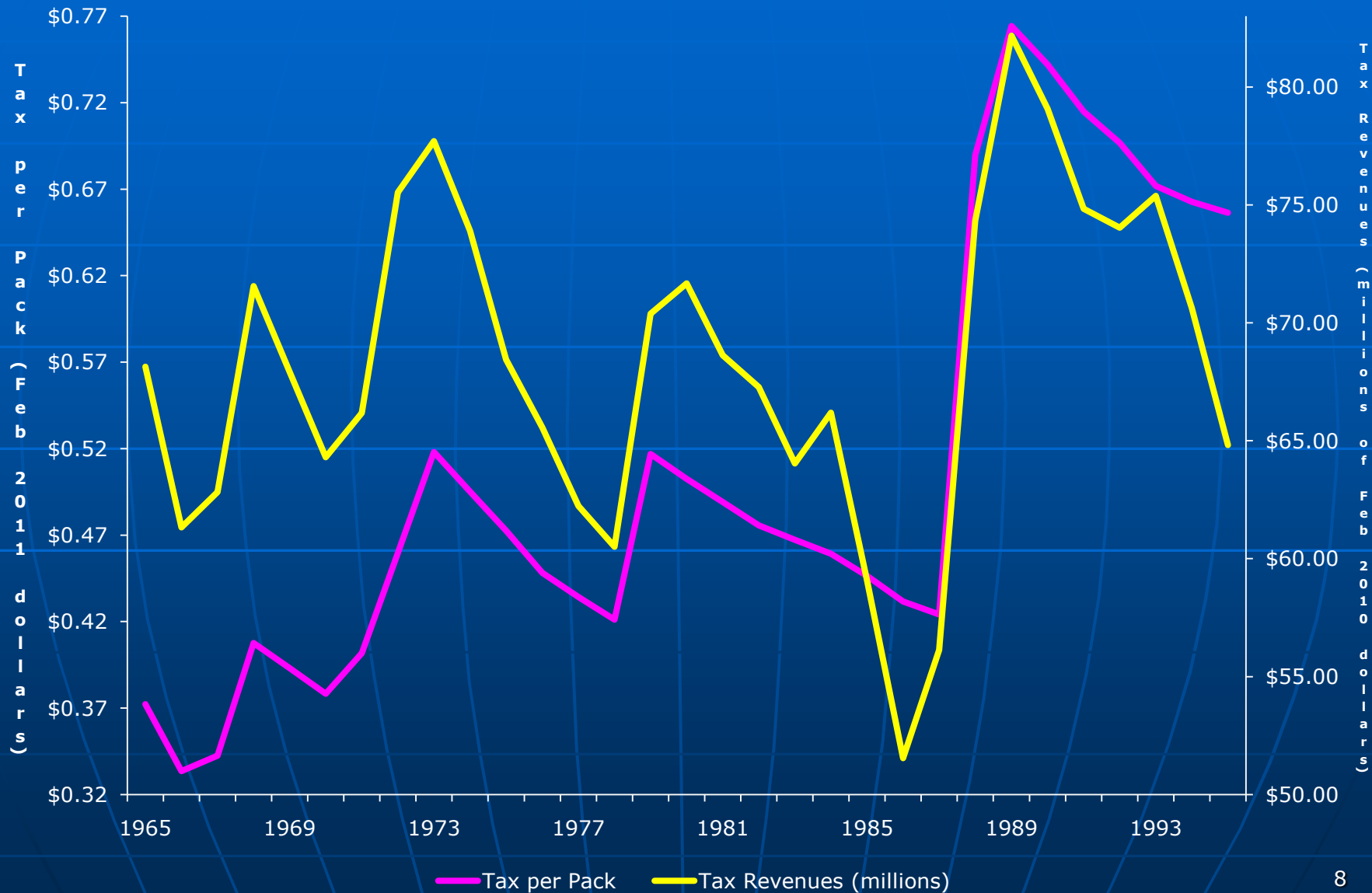
- **Efficient revenue generation**
 - Primary motive historically and still true in many countries today
 - Very efficient source of revenue given:
 - Historically low share of tax in price in many countries
 - Relatively inelastic demand for tobacco products
 - Few producers and few close substitutes
 - Makes tobacco one of many goods and services that satisfies the “Ramsey Rule”

Federal Cigarette Tax and Tax Revenues Inflation Adjusted, 1955-2009



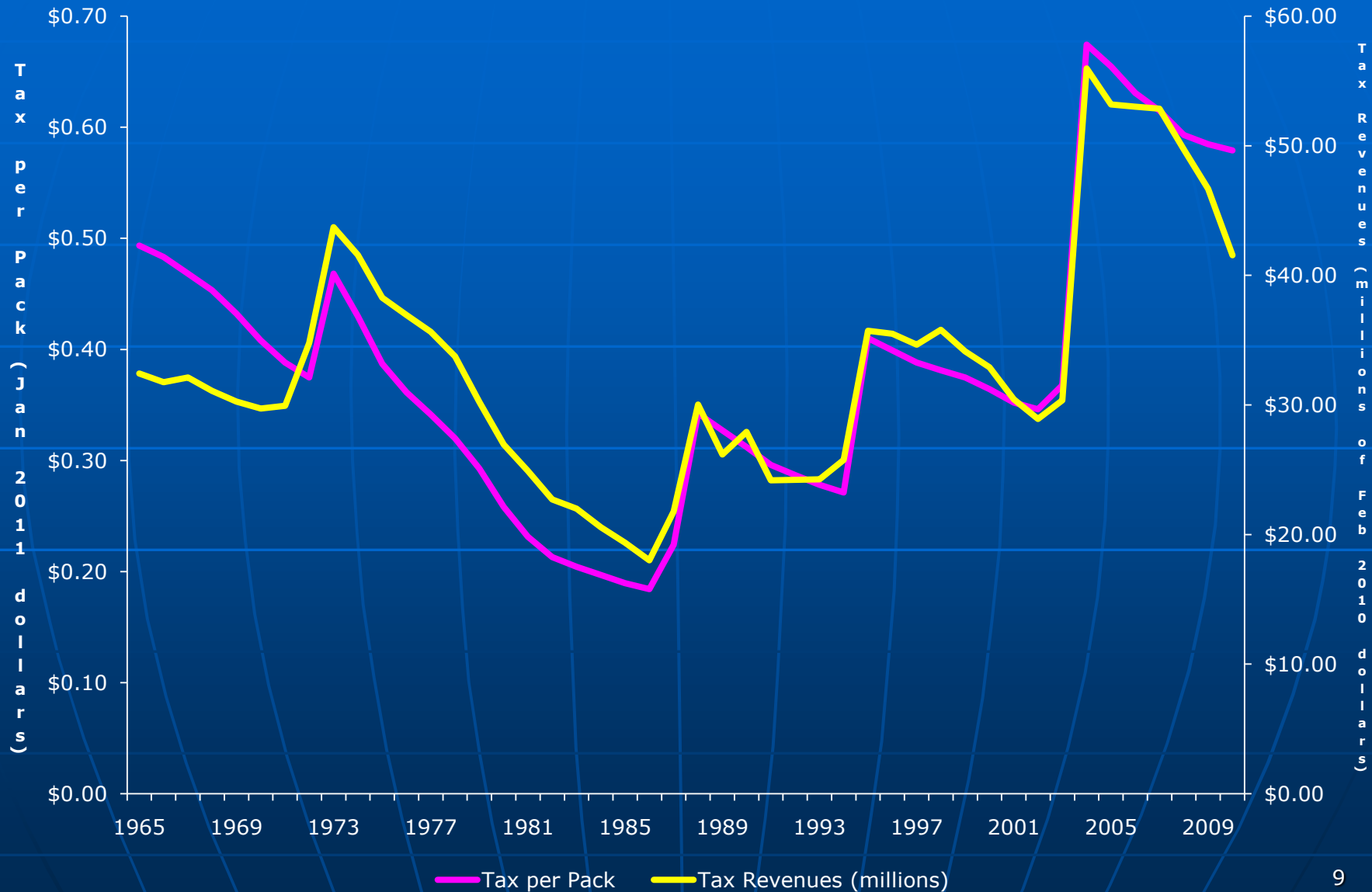
Source: *Tax Burden on Tobacco*, 2010, and author's calculations

Cigarette Tax and Tax Revenues Inflation Adjusted, Nebraska, 1980-2010



Source: *Tax Burden on Tobacco*, 2011, and author's calculations

Cigarette Tax and Tax Revenues Inflation Adjusted, Idaho, 1965-2010



Source: *Tax Burden on Tobacco*, 2011, and author's calculations

Why Tax Tobacco?

- **Efficient revenue generation**

“This vice brings in one hundred million francs in taxes every year. I will certainly forbid it at once – as soon as you can name a virtue that brings in as much revenue”

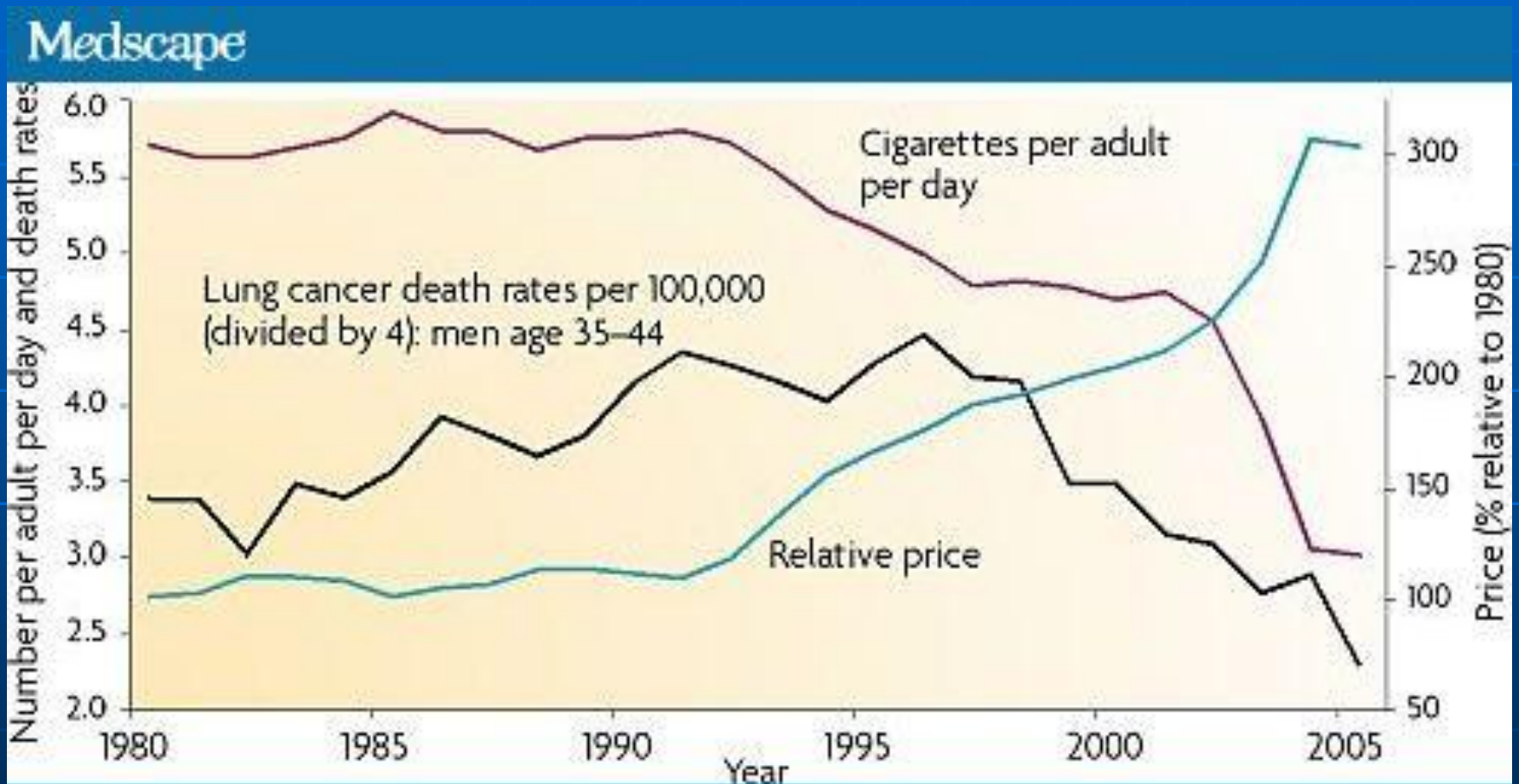
Napoleon III

Why Tax Tobacco?

■ **Promote public health**

- Increasingly important motive for higher tobacco taxes in many high income countries
 - Emerging as important factor in some low and middle income countries
- Based on substantial and growing evidence on the effects of tobacco taxes and prices on tobacco use
 - Particularly among young, less educated, and low income populations

Taxes, Prices and Health: US, 1980-2005



Source: Nat Rev Cancer © 2009 Nature Publishing Group

Why Tax Tobacco?

- **Promote public health**

*"... We [] have a package of six policy measures, known as MPOWER, that can help countries implement the provisions in the Convention. All six measures have a proven ability to reduce tobacco use in any resource setting. **But tobacco taxes are by far the most effective.**"*

Director General Dr. Margaret Chan, WHO, 2008

Why Tax Tobacco?

- **Cover the external costs of tobacco**
 - “Pigouvian” tax
 - Less frequently used motive
 - Account for costs resulting from tobacco use imposed on non-users
 - Increased health care costs, lost productivity from diseases/death caused by exposure to tobacco smoke
 - Increased financial costs from publicly financed health care to treat diseases caused by tobacco use
 - Can also include “internalities” that result from addiction, imperfect information, and time inconsistent preferences

Economic Costs of Smoking & Cigarette Tax Revenues, Nebraska Inflation Adjusted



Source: CDC/SAMMEC, Tax Burden on Tobacco 2010, and author's calculations

WHO's Best Practices in Tobacco Taxation

- Use tobacco excise tax increases to achieve the public health goal of reducing the death and disease caused by tobacco use
 - As called for in Article 6 of the WHO FCTC
 - Additional benefit of generating significant increases in tobacco tax revenues in short to medium term

Types of Taxes

■ **Variety of tobacco**

- Taxes on value of tobacco crop
- Customs duties on tobacco leaf, tobacco products imports and/or exports
- Sales taxes/Value added taxes
- Implicit taxes when government monopolizes production and/or distribution
- Excise Taxes
 - Excise taxes are of most interest given specificity to tobacco products
 - Specific (per unit, volume, weight) and *ad valorem* (based on price) excises

Federal Tobacco Taxes

- Federal cigarette tax
 - Specific (per unit) excise tax
 - initially adopted in 1864
 - Raised during war time/lowered during peace time
 - Set at 8 cents per pack in 1951
 - Doubled to 16 cents per pack in 1983
 - Eventually raised to 39 cents per pack in 2002
 - Less than 60% of inflation adjusted value of 1951 tax
 - Significant increase – 61.66 cents – April 1, 2009
 - Earmarked for S-CHIP expansion

Federal Tobacco Taxes

- Specific federal excise taxes on most other tobacco products, including
 - cigars: \$1.0066 per pack on small cigars; 52.75% of price for low priced cigars; cap of 40.26 cents per cigar for high priced cigars
 - chewing tobacco: 3.1 cents per ounce
 - moist snuff: \$1.51 per pound
 - roll-your-own tobacco \$24.78 per pound
 - pipe tobacco: \$2.83 per pound
 - rolling papers: 1.26 cents per pack
- Until latest increases, most were lower than cigarette tax; more equivalent now
- Similarly infrequent increases in taxes

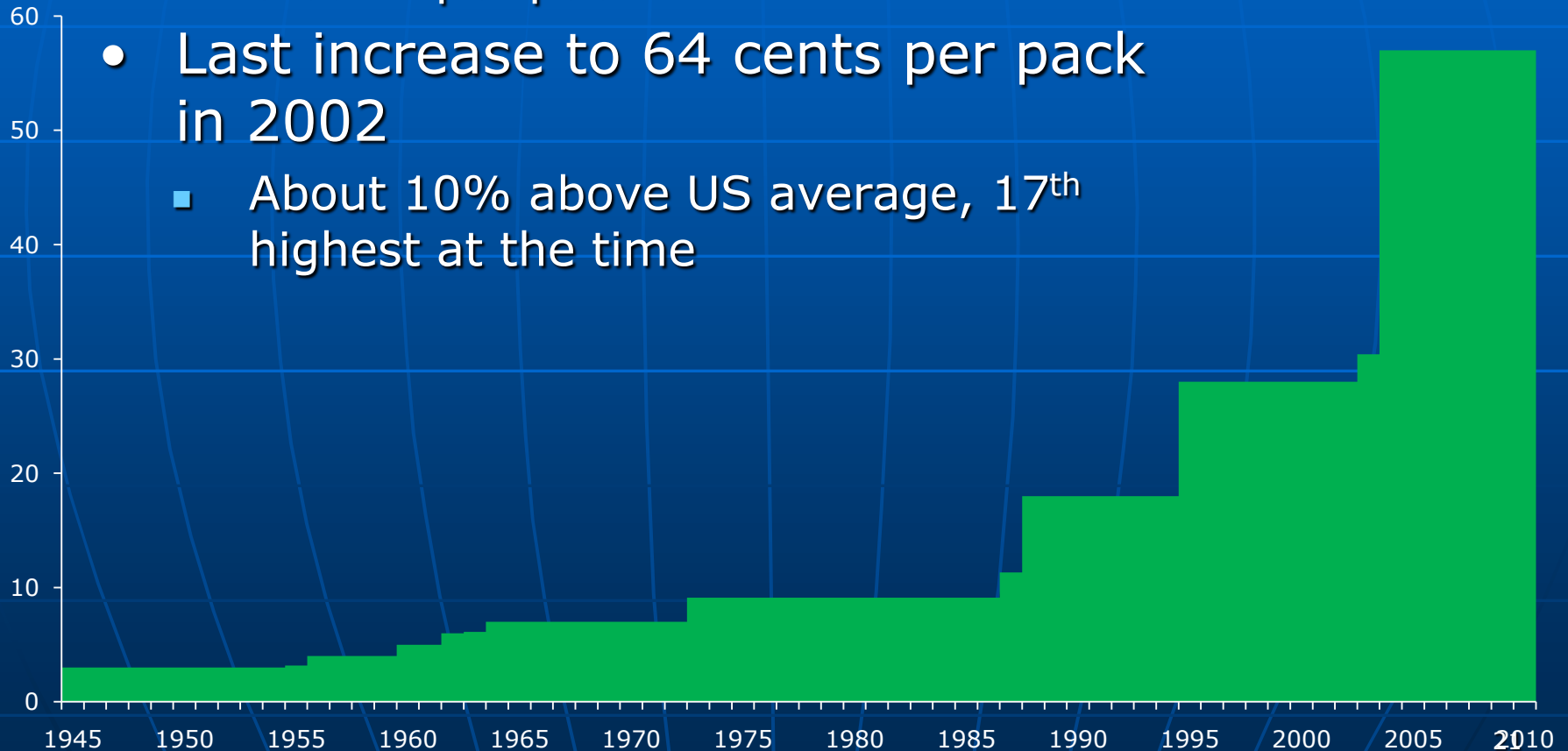
State Tobacco Taxation

- State cigarette taxes

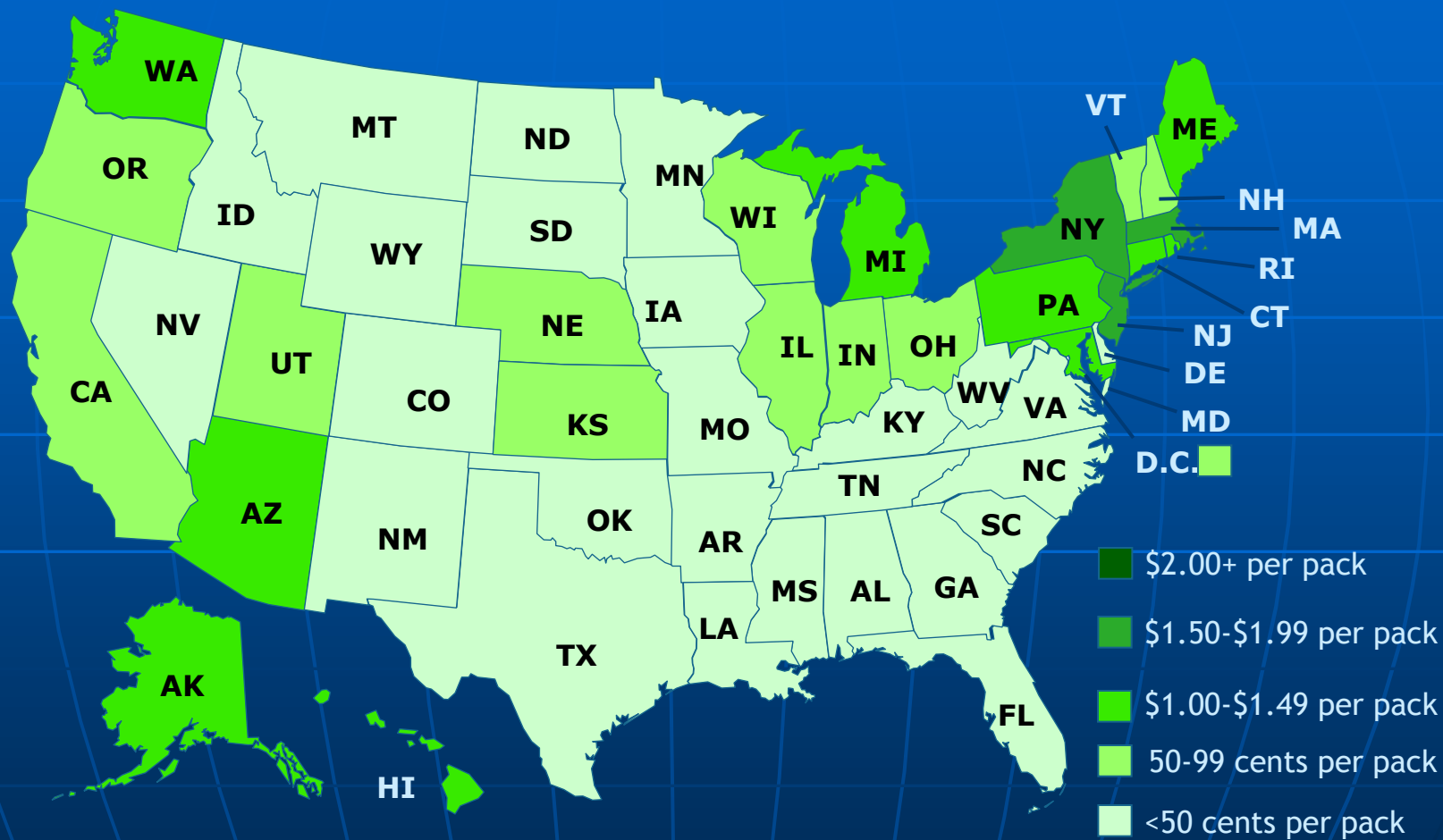
- First adopted by IA in 1921; NC last to adopt in 1969
- Currently: 17.0 cents/pack (MO) to \$4.35/pack (NY)
- Average \$1.45 per pack (48.5 cents in tobacco growing states; \$1.57 in other states)
- Many considering increases

Cigarette Taxation in NE

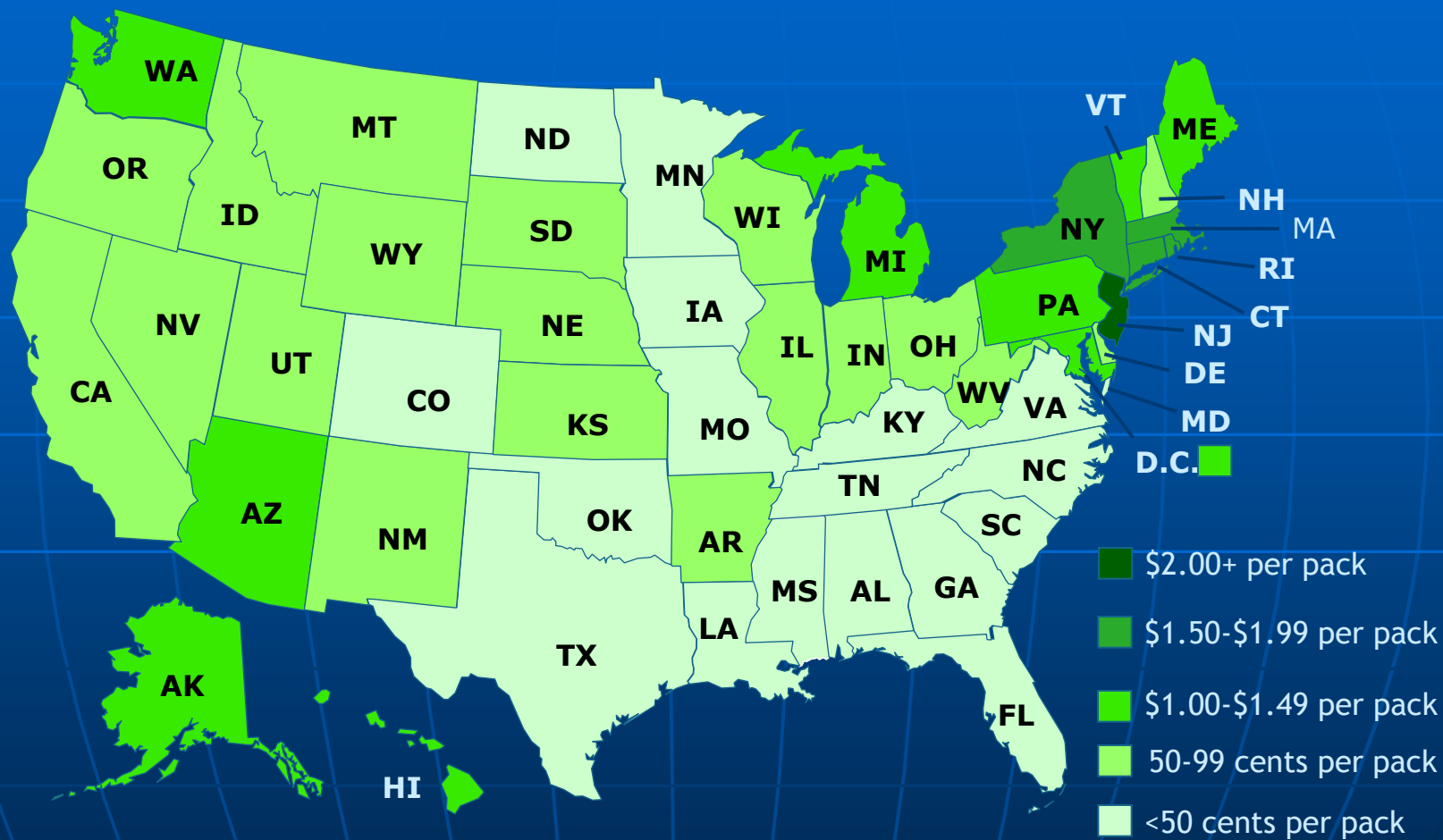
- Nebraska first adopted cigarette tax in 1947
 - 3 cents per pack
- Last increase to 64 cents per pack in 2002
 - About 10% above US average, 17th highest at the time



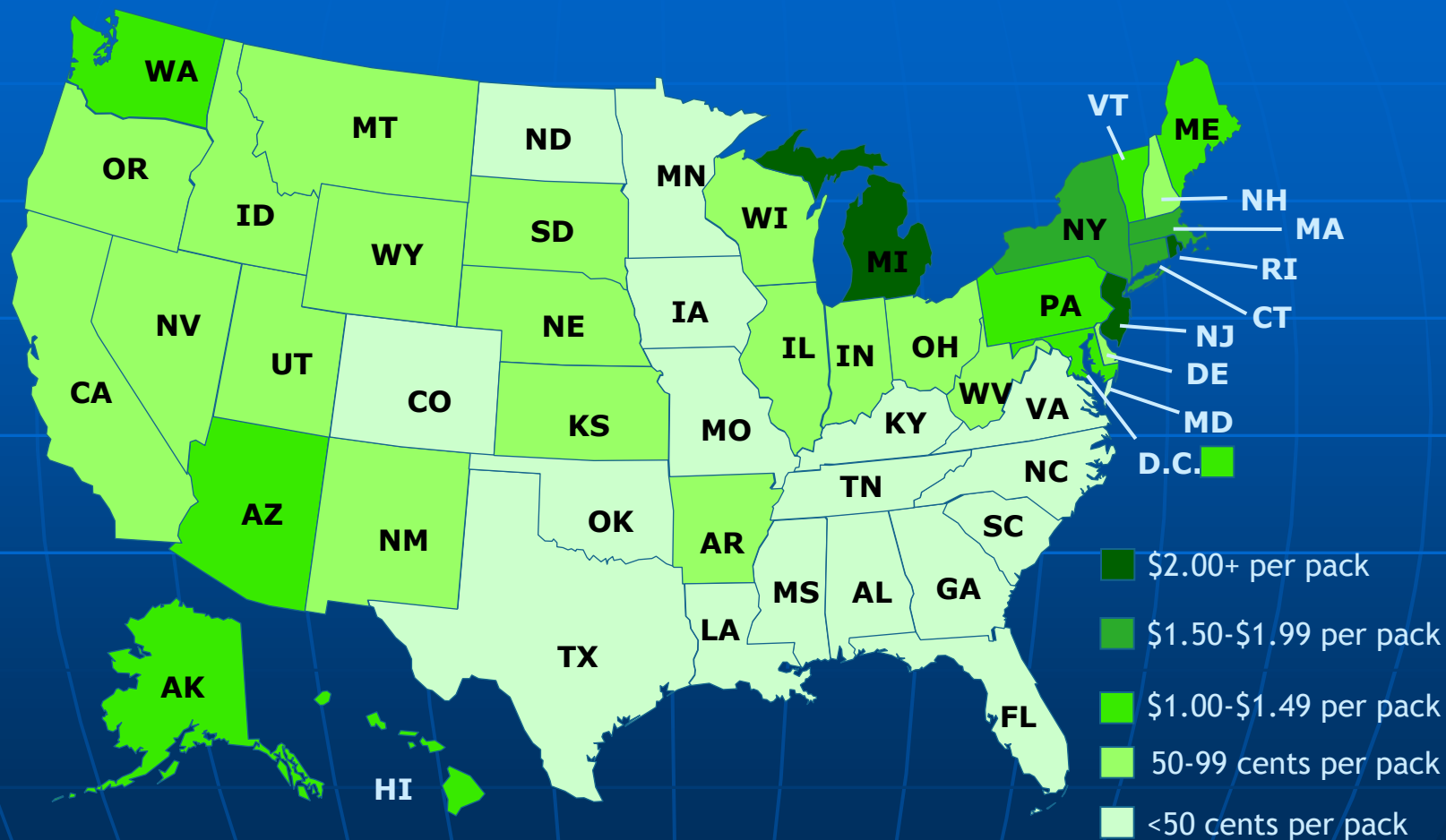
State Cigarette Excise Tax Rates – 2002



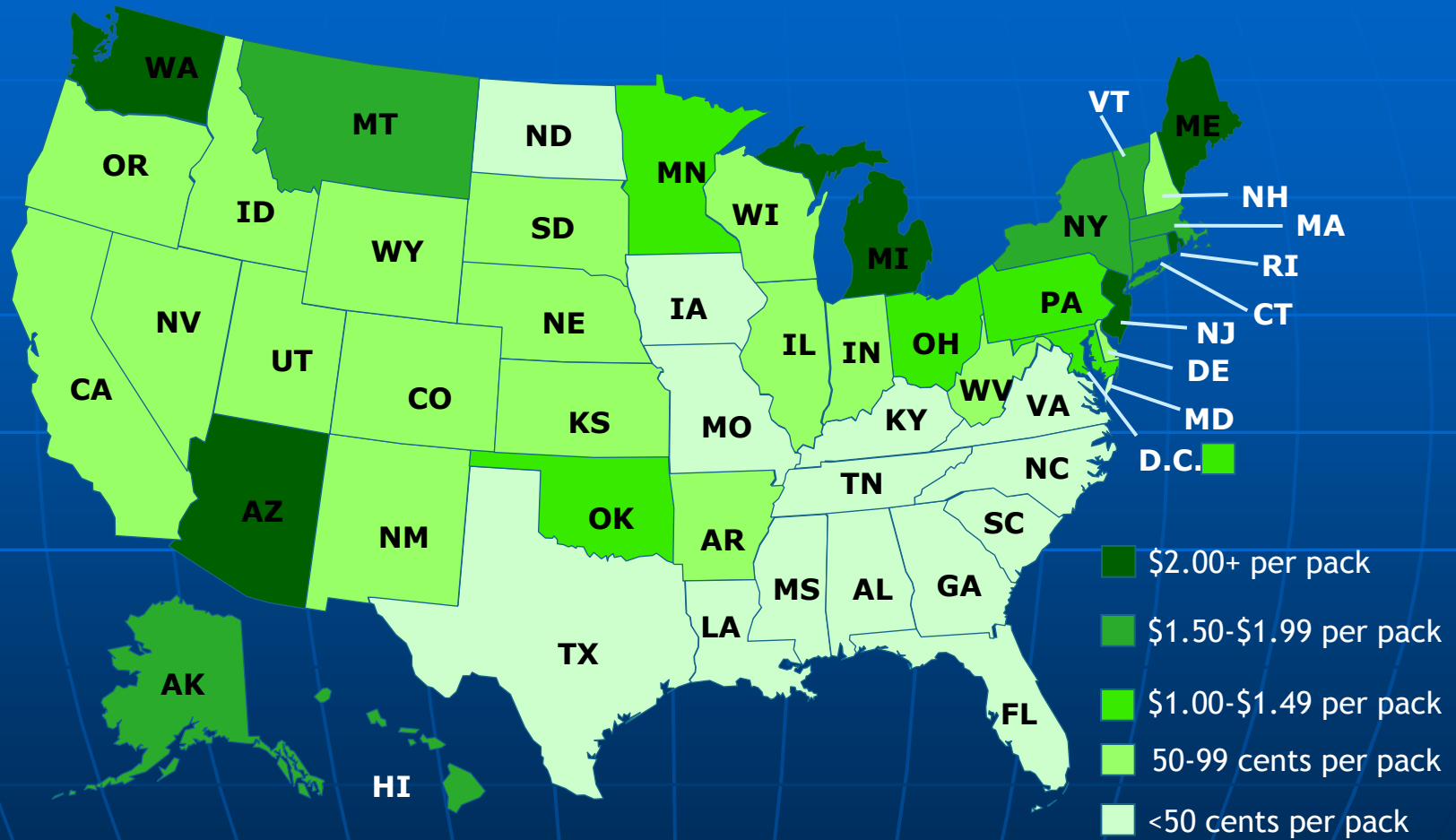
State Cigarette Excise Tax Rates – 2003



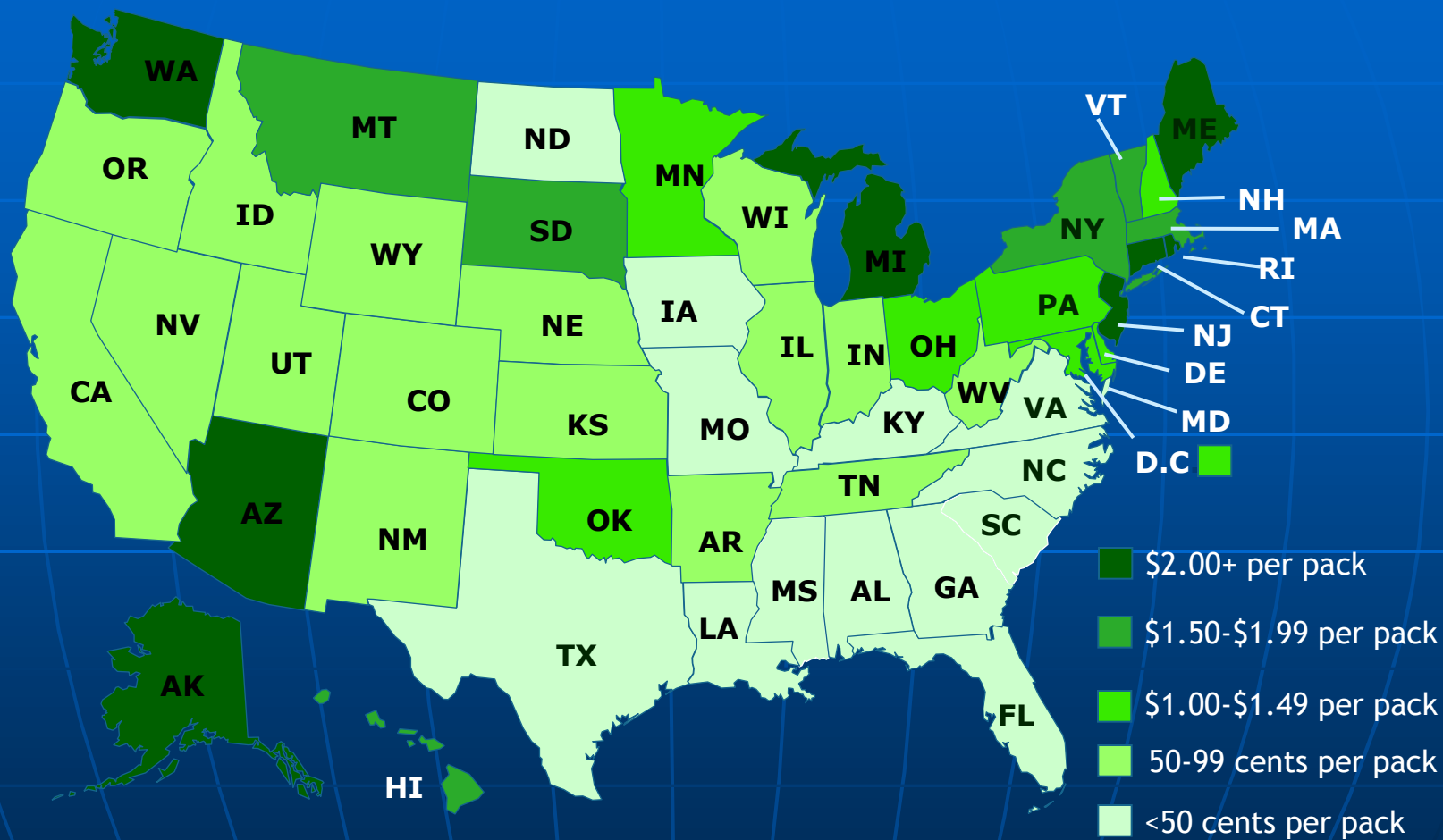
State Cigarette Excise Tax Rates – 2004



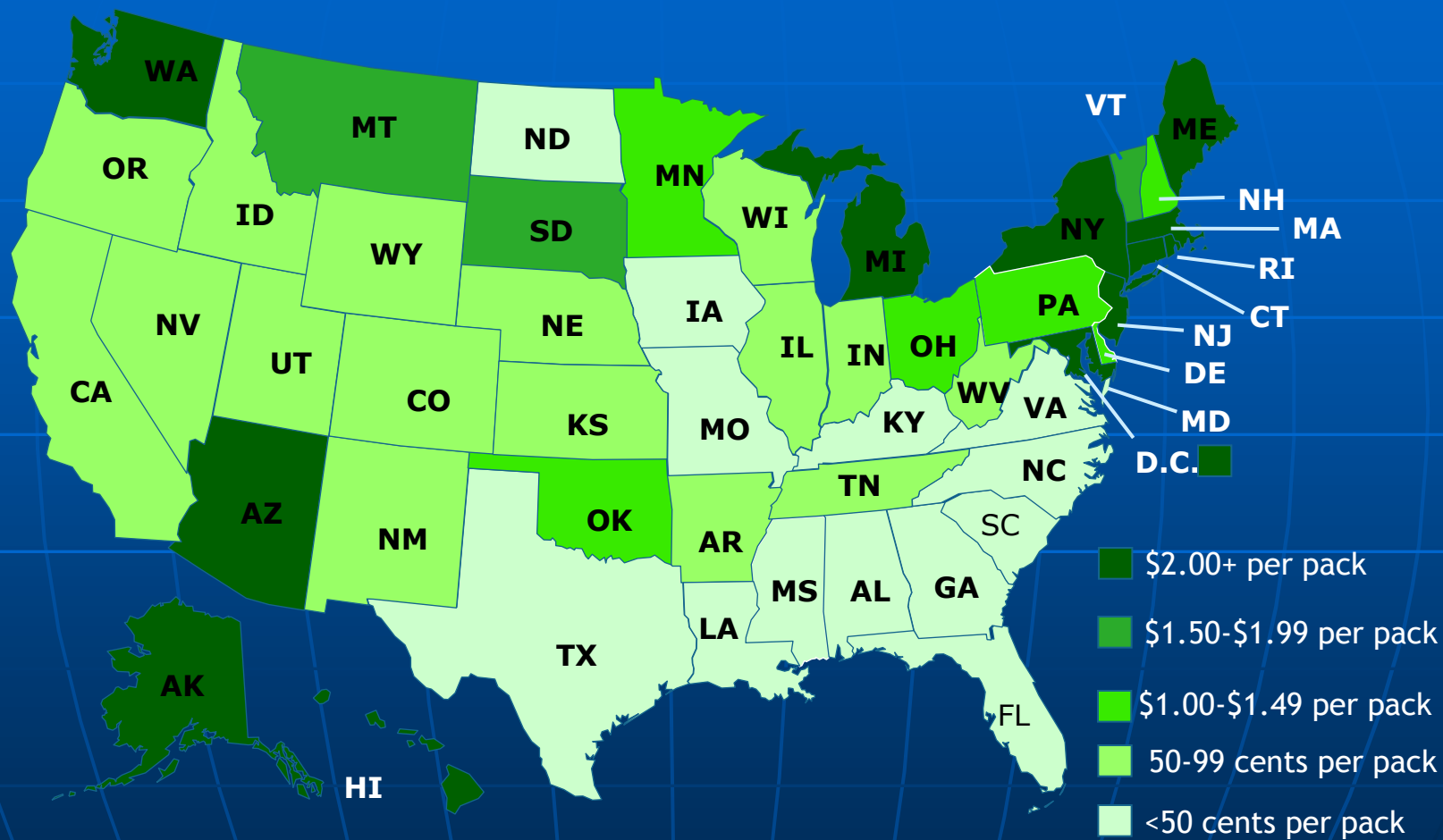
State Cigarette Excise Tax Rates – 2006



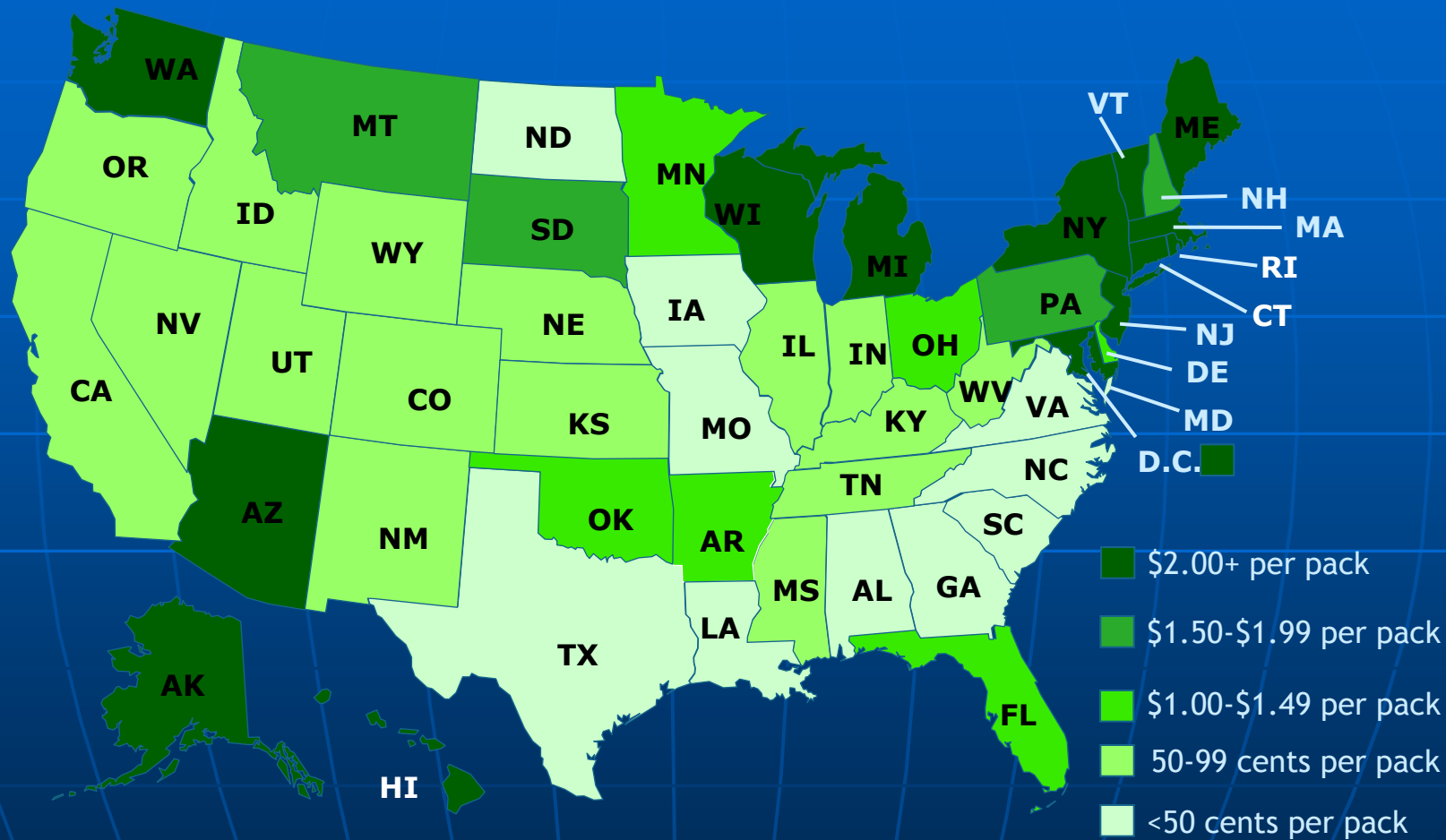
State Cigarette Excise Tax Rates – 2007



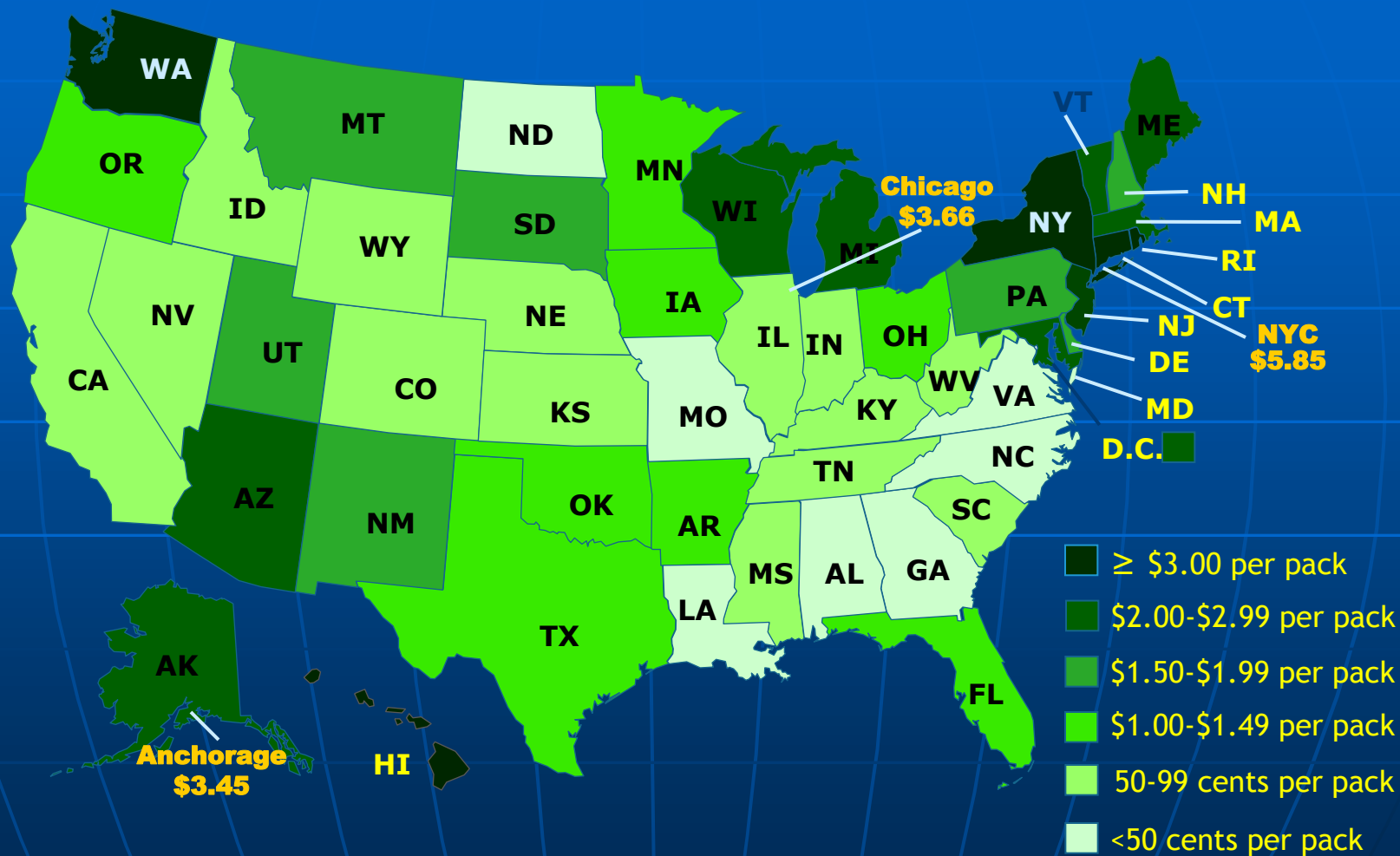
State Cigarette Excise Tax Rates – 2008



State Cigarette Excise Tax Rates – 2009



State Cigarette Excise Tax Rates – 2010

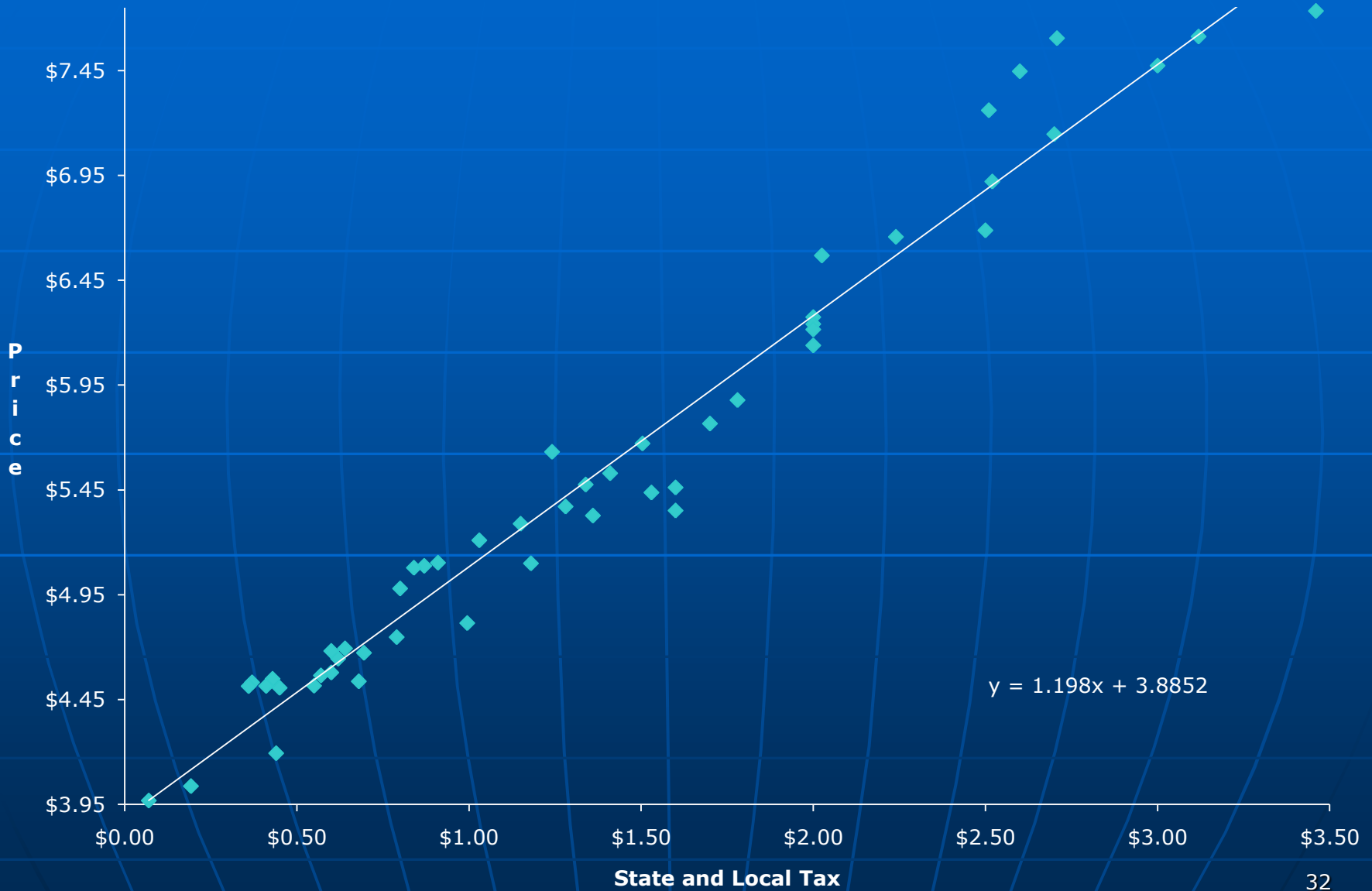


CDC, Office on Smoking and Health. State Tobacco Activities Tracking and Evaluation (STATE) System.

State Tobacco Taxation

- State taxes on other tobacco products
 - All but PA tax other tobacco products
 - Mostly *ad valorem* taxes
 - Typically applied to wholesaler/distributor price
 - Highest taxes include:
 - Wisconsin – 100%; Washington - 95%
 - Lowest taxes include:
 - South Carolina – 5%; Tennessee 6.6%
 - Average about 35%
 - Generally below equivalent rate on cigarettes
 - NE: 20% of wholesale price for chewing tobacco; \$0.44 per ounce for moist snuff

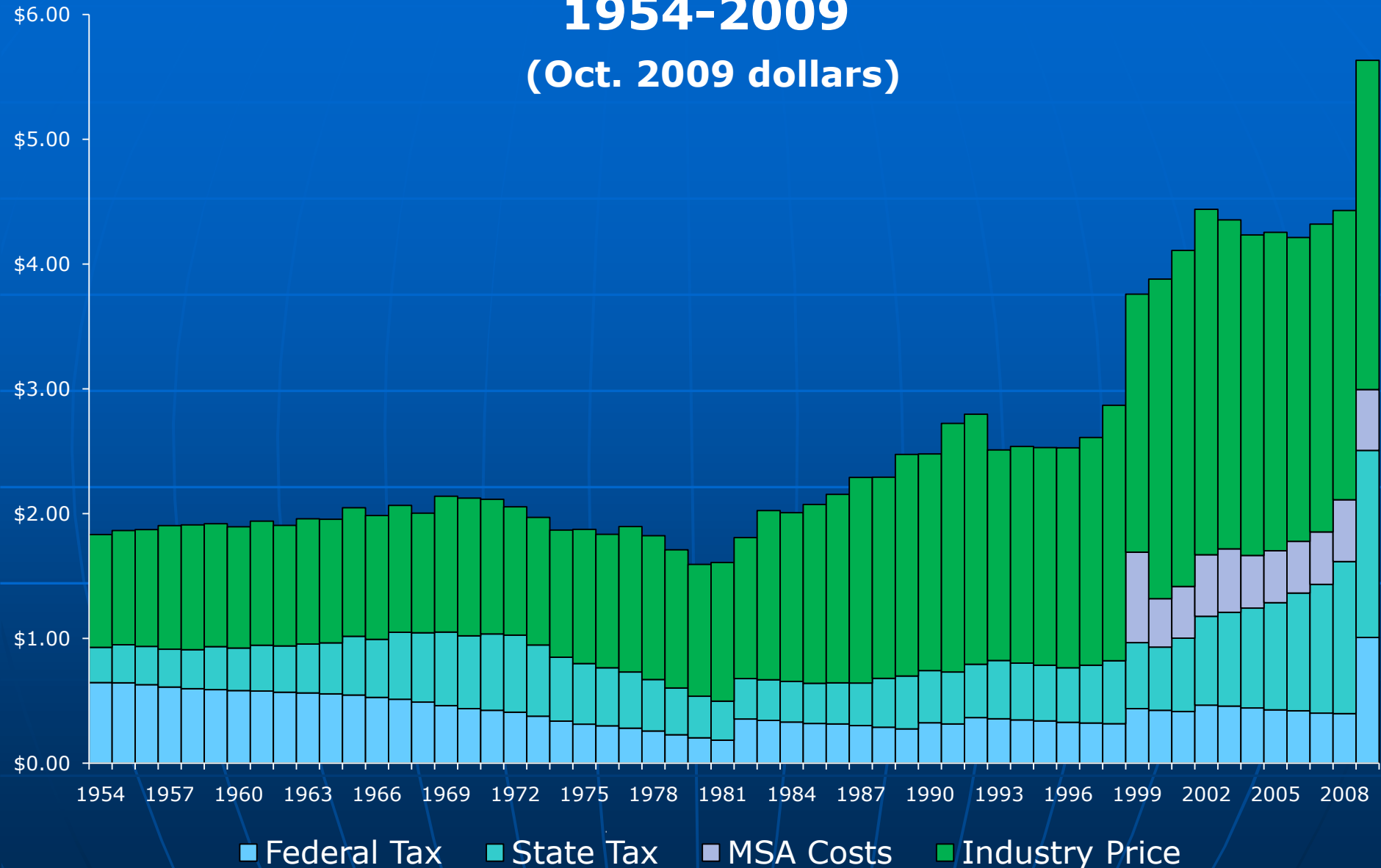
State and Local Cigarette Taxes and Average Price per Pack, 11/1/09



Source: *Tax Burden on Tobacco*, 2010, and author's calculations

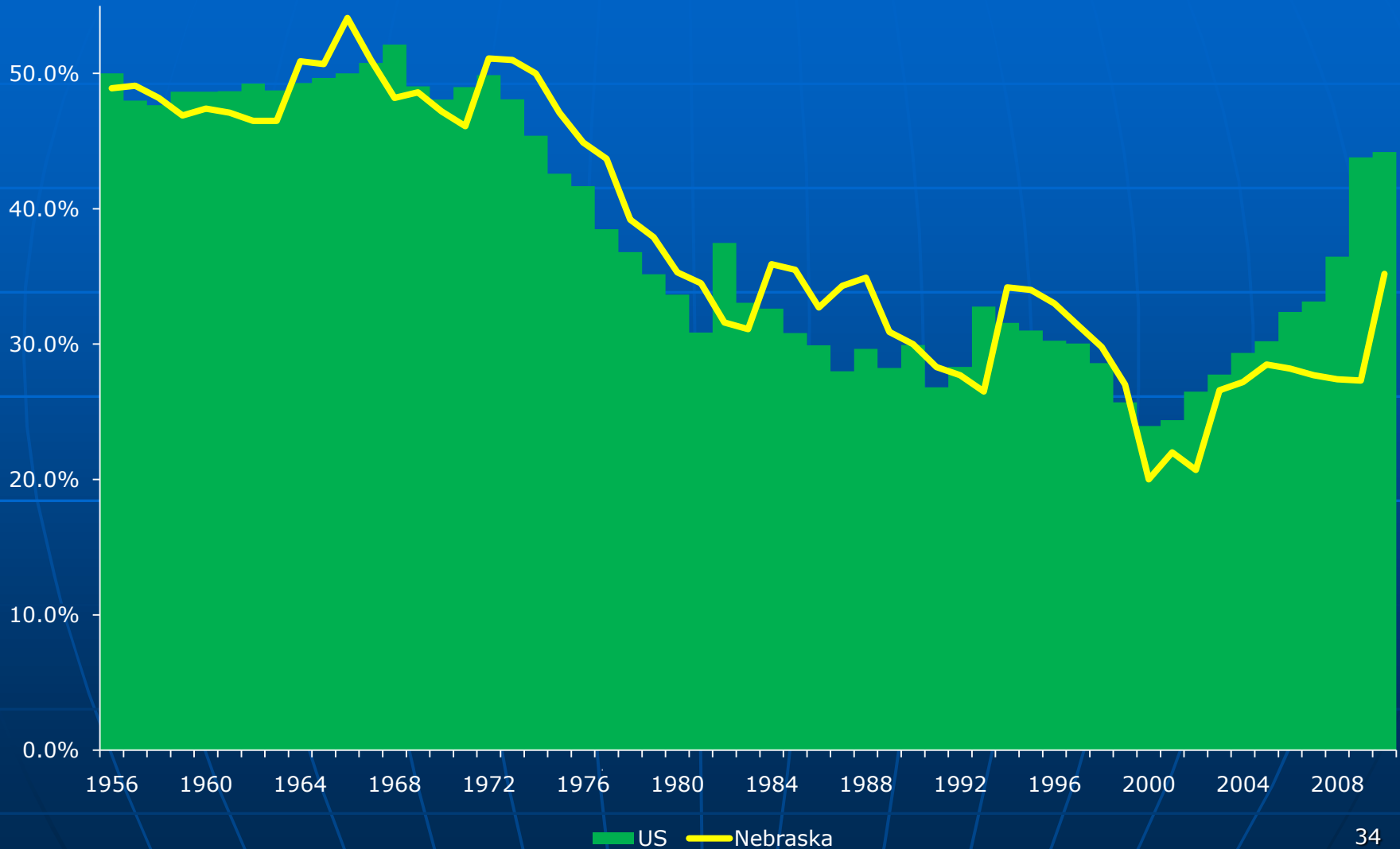
Cigarette Taxes & Prices, United States, 1954-2009

(Oct. 2009 dollars)



Source: *Tax Burden on Tobacco*, 2009, and author's calculations

Tax as Percent of Price, Nebraska & US, 1956-2010

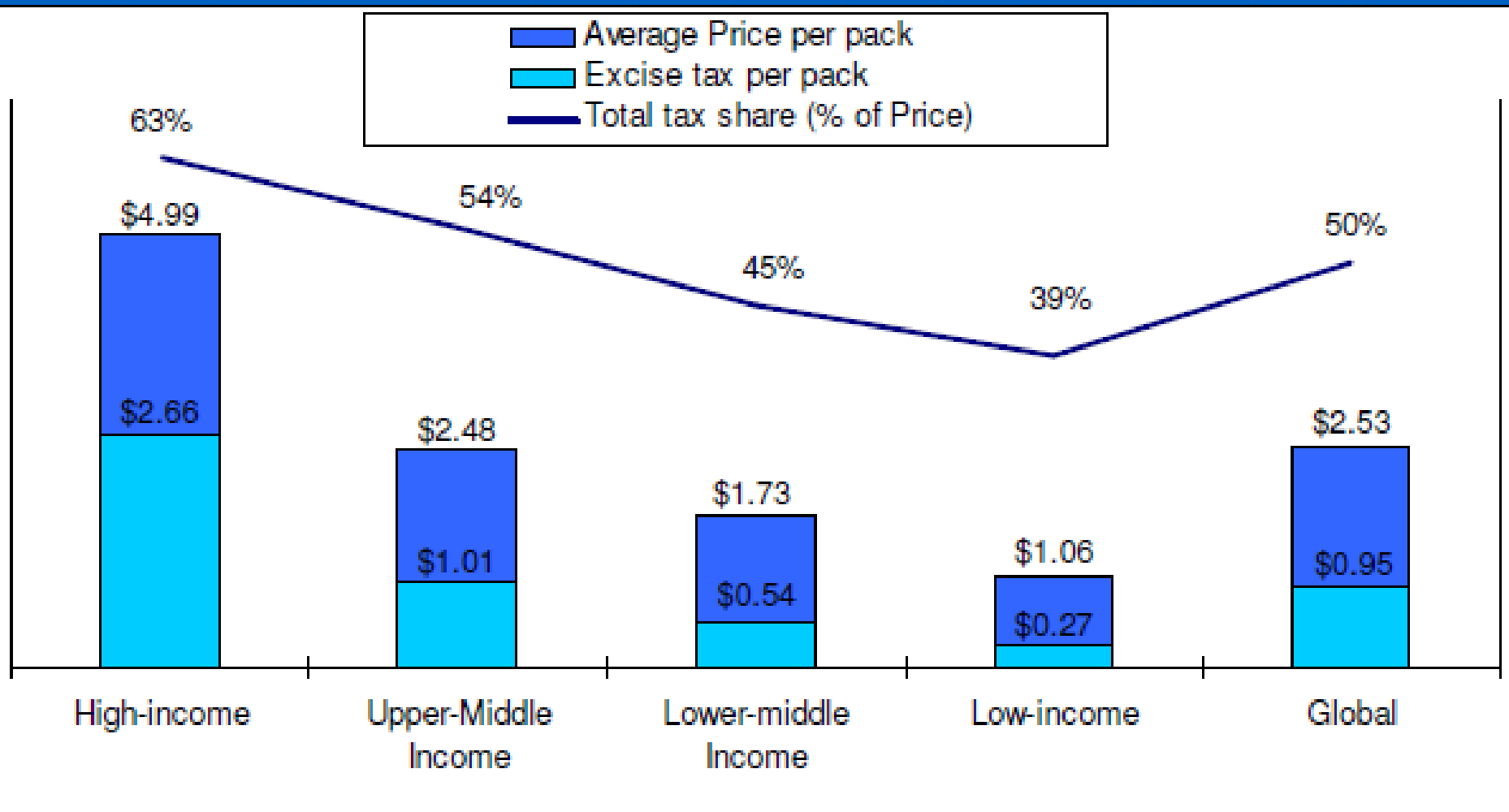


Source: *Tax Burden on Tobacco*, 2011, and author's calculations

Taxes and Tobacco Product Prices Globally

- Tax levels and prices, vary widely across countries

Price and Tax by Income Level, 2008

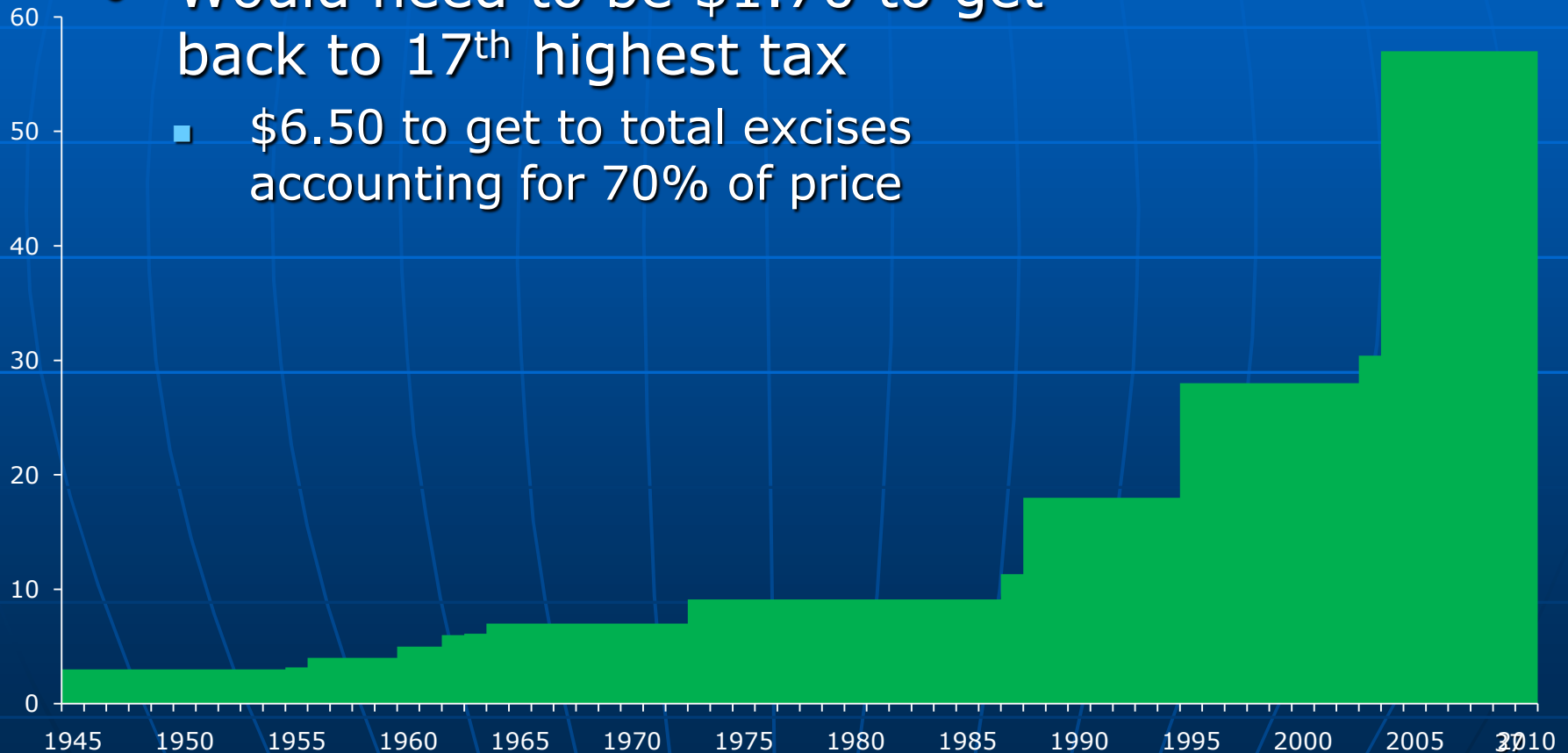


WHO's Best Practices in Tobacco Taxation

- Set tobacco excise tax levels so that they account for at least 70 percent of the retail prices for tobacco products
 - Update of World Bank 'yardstick' of any taxes accounting for 2/3 to 4/5 of retail prices
 - Well above where most countries are currently
 - Further increases in countries that do reach this target

Cigarette Taxation in NE

- Currently 38th highest state tax
 - Less than ½ of average
- Would need to be \$1.70 to get back to 17th highest tax
 - \$6.50 to get to total excises accounting for 70% of price



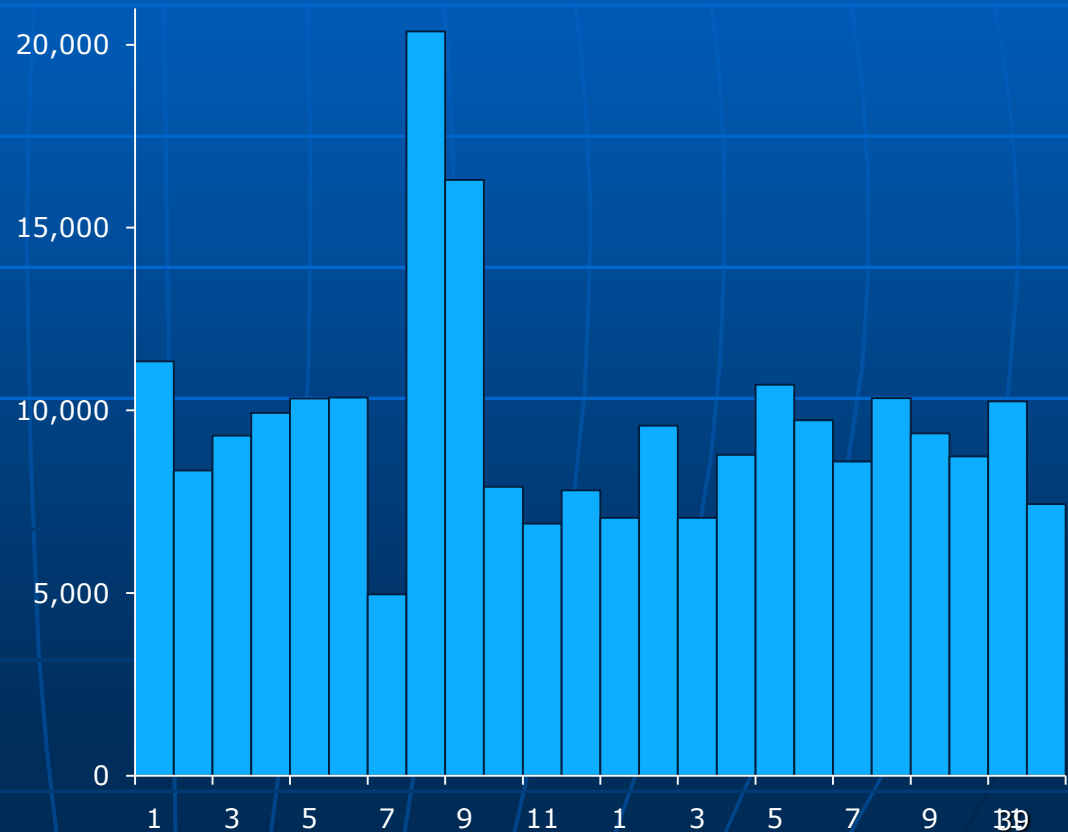
Other Issues when Increasing Tobacco Taxes

- Adopt equivalent taxes on other tobacco products
 - Minimize substitution to other products in response to cigarette tax increase
 - Maximize revenue and health impact of tax increases
- Currently almost equivalent in NE
 - 22% of wholesale price for cigarettes vs. 20% for other tobacco products

Other Issues when Increasing Tobacco Taxes

- “Inventory” or “Floor” tax
 - Collect increase in taxed on products in inventory taxed under old tax rate to avoid stockpiling in anticipation of tax increase

Monthly Cigarette Shipments, Nebraska, 2002-2003



Other Issues when Increasing Tobacco Taxes

- Adjust “discount” or “rebate” provided to stampers
 - Avoids windfall for distributors who apply stamps; revenues go to state instead

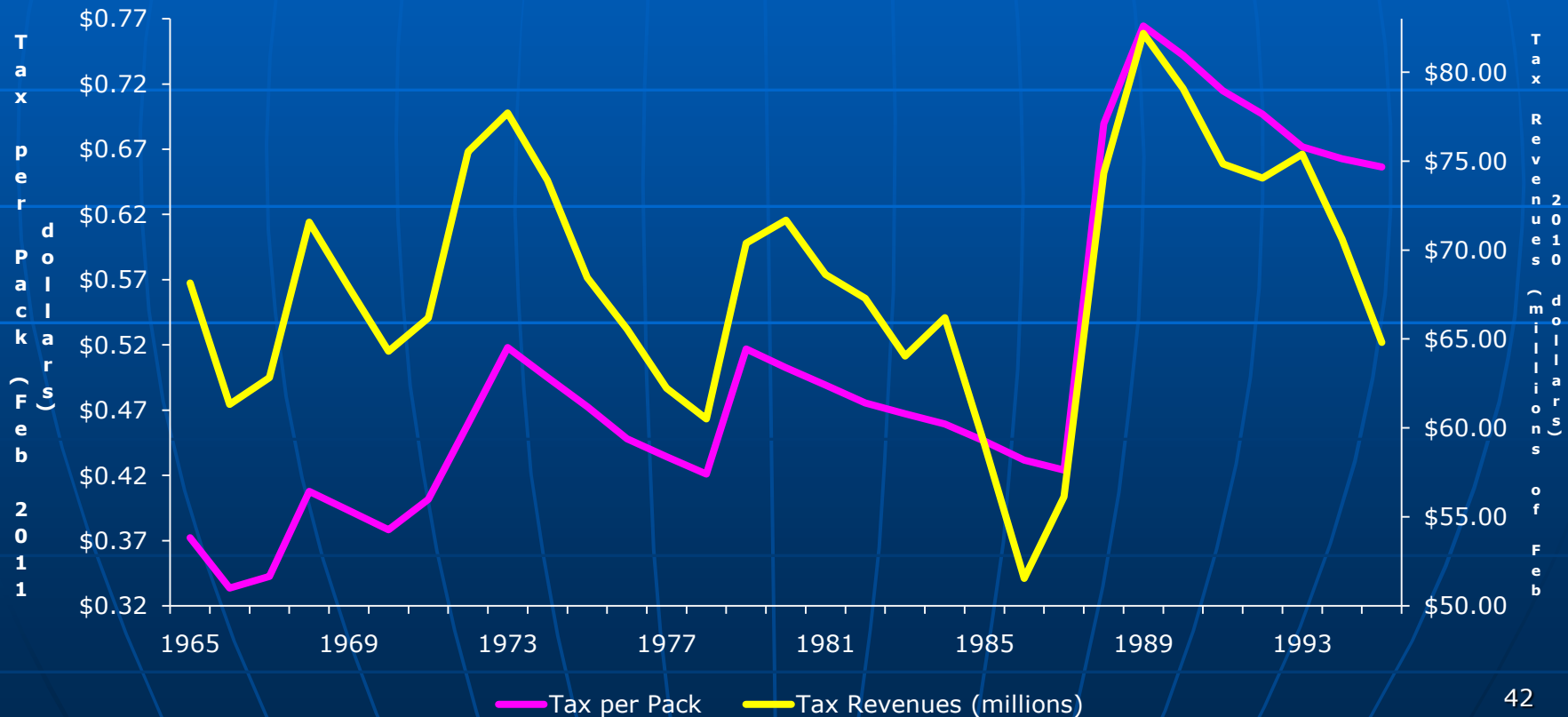
Other Issues when Increasing Tobacco Taxes

- Adopt high tech tax stamp and enforce
 - Reduces tax evasion
 - More than pays for itself with increases in revenues



Other Issues when Increasing Tobacco Taxes

- Automatically adjust for inflation
 - Could be 1st state to do so



Impact of Tax and Price on Tobacco Use

Prices and Tobacco Use

- **Increases in tobacco product prices:**
 - Induce current users to try to quit
 - Many will be successful in long term
 - Keep former users from restarting
 - Prevent potential users from starting
 - Particularly effective in preventing transition from experimentation to regular use
 - Reduce consumption among those who continue to use
 - Lead to other changes in tobacco use behavior, including substitution to cheaper products or brands, changes in buying behavior, and compensation

Prices and Tobacco Use

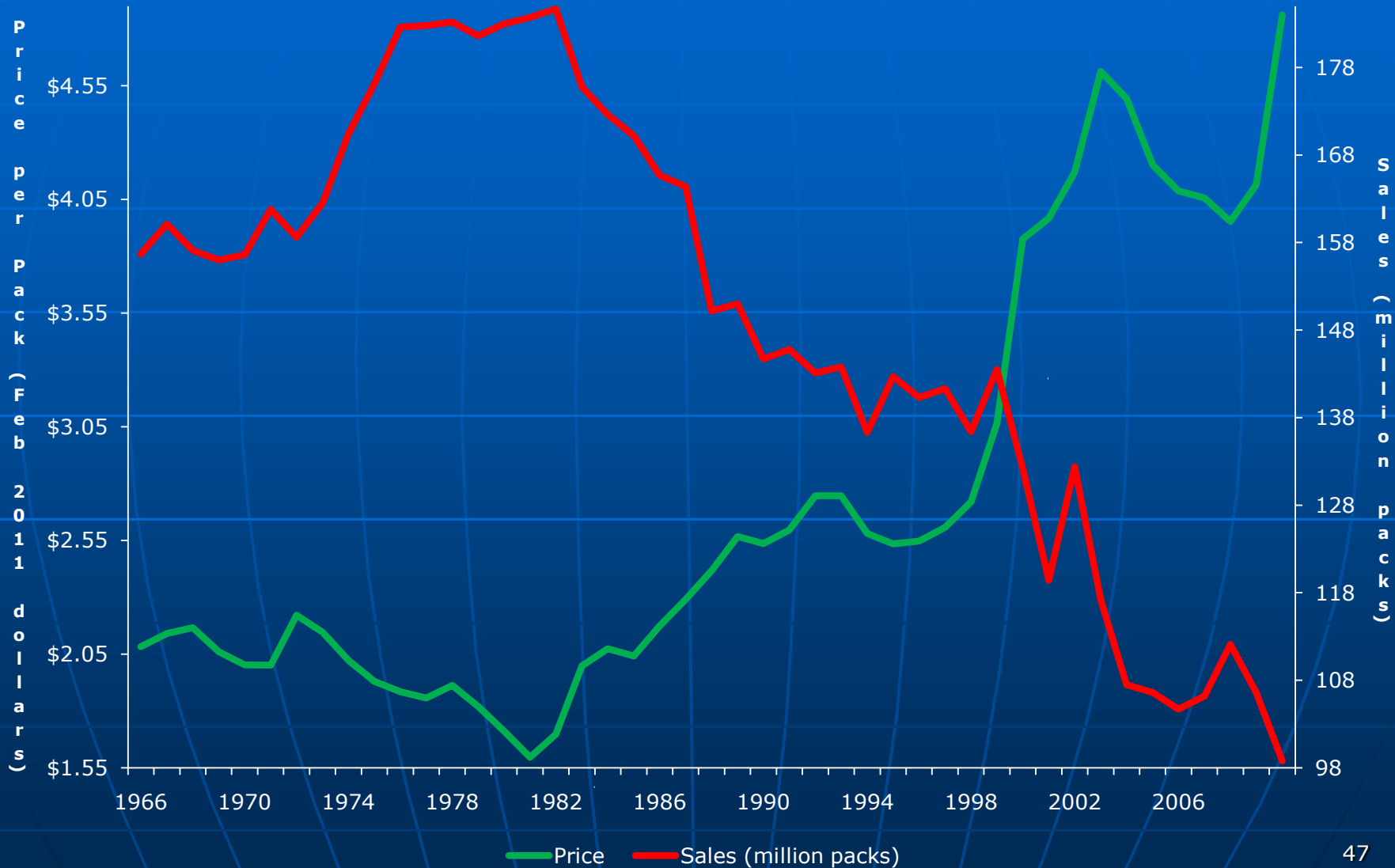
- **Increases in tobacco product prices:**
 - 10% price increase reduces consumption by 4%

Cigarette Prices and Cigarette Sales, United States, 1970-2009



Source: *Tax Burden on Tobacco*, 2009, and author's calculations

Price (Inflation Adjusted) and Cigarette Sales, Nebraska, 1966-2010

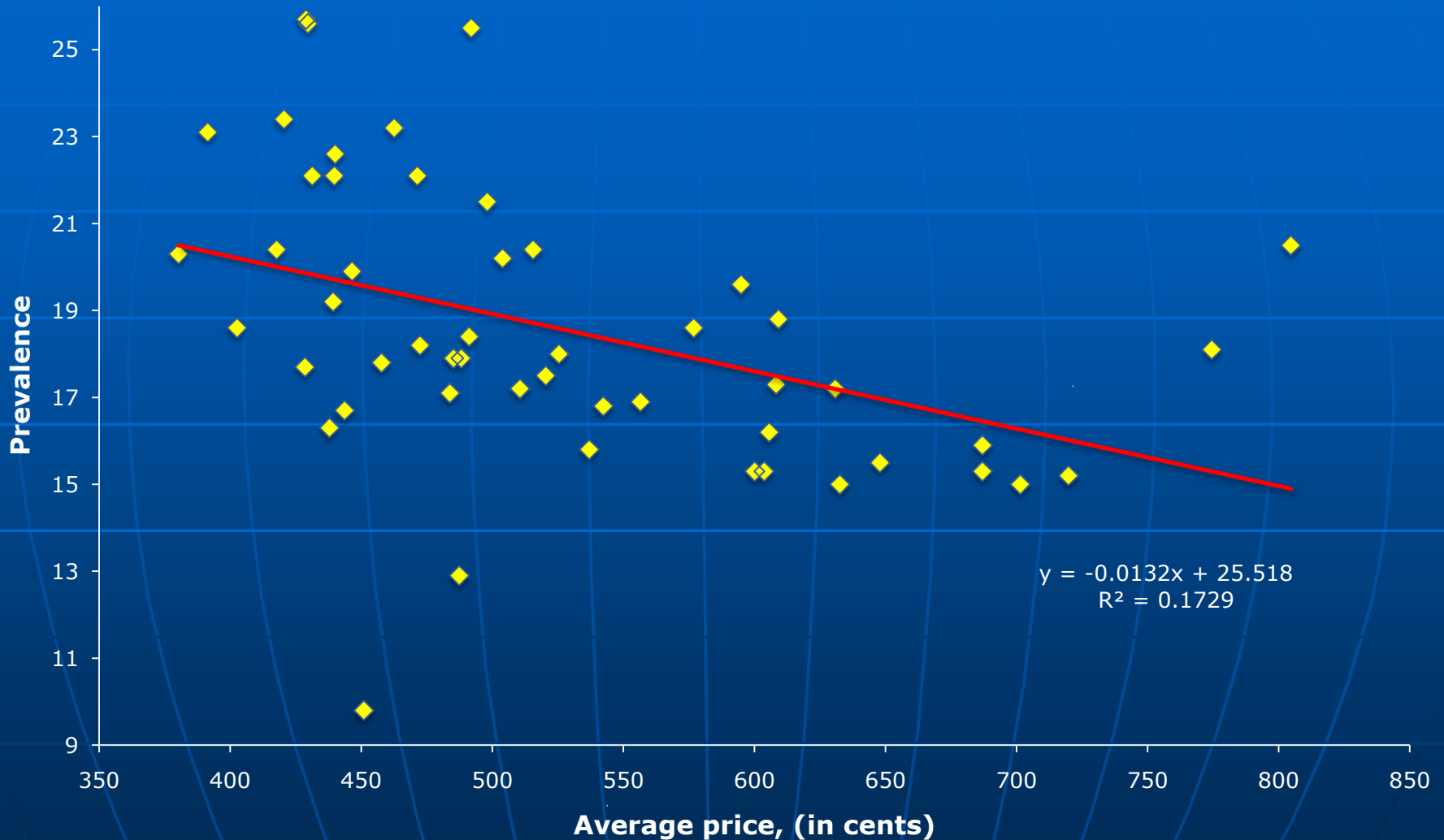


Source: *Tax Burden on Tobacco, 2011*, and author's calculations

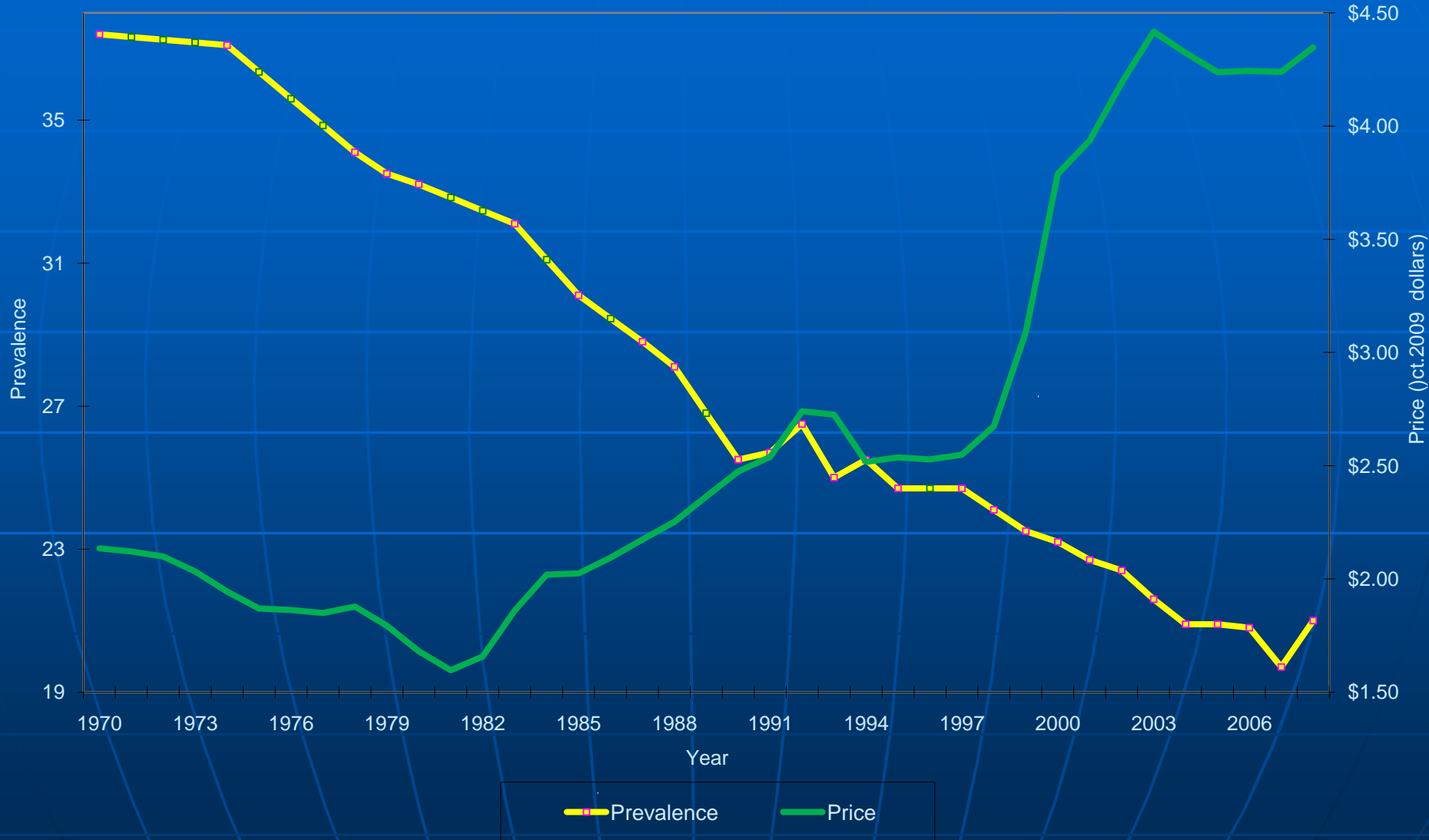
Prices and Tobacco Use

- **Increases in tobacco product prices:**
 - About half of impact on smoking prevalence
 - 10% price increase reduces prevalence by 2%

Cigarette and Adult Smoking Prevalence US States & DC, 2009

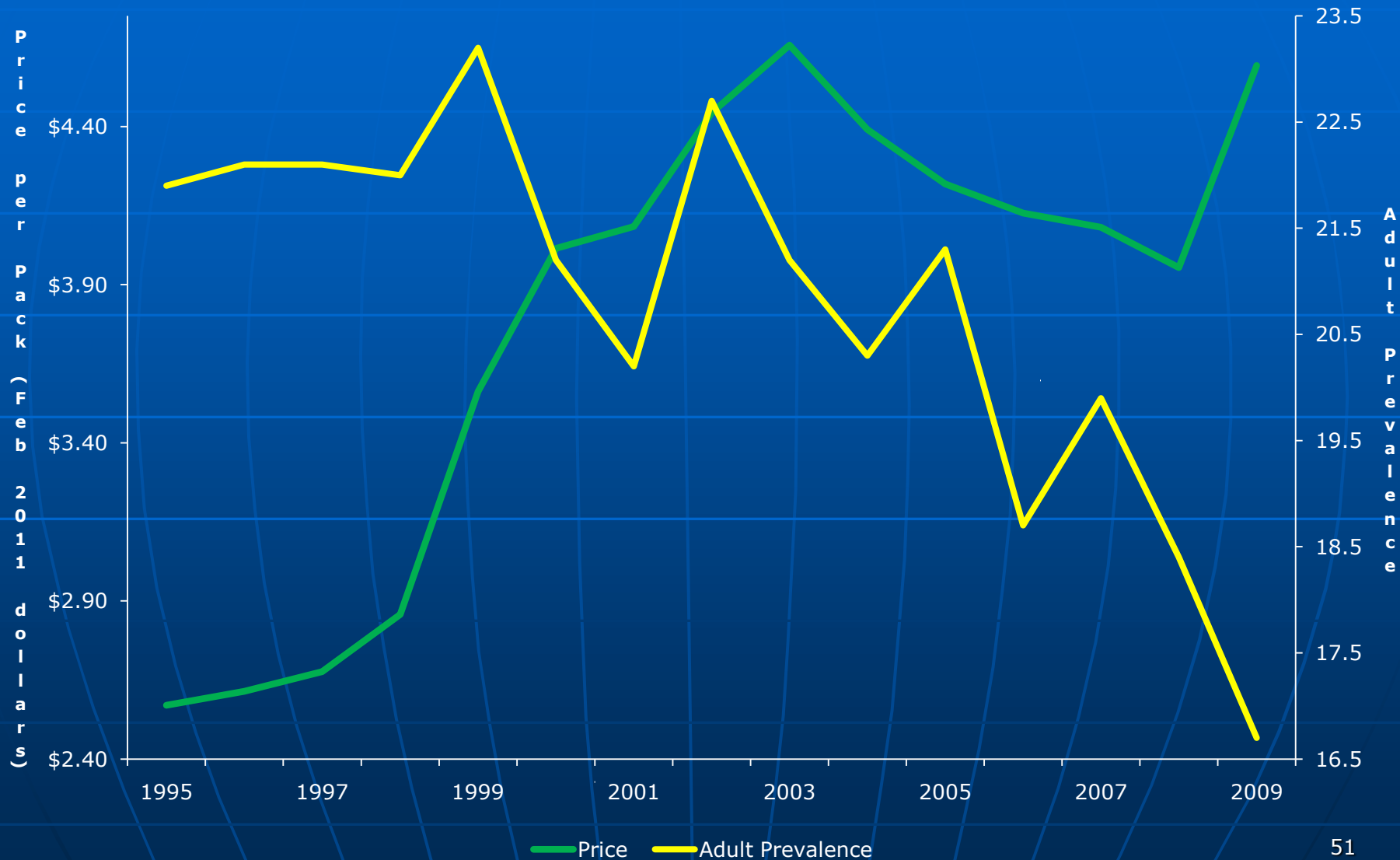


Cigarette Prices and Adult Smoking Prevalence, United States, 1970-2008



Source: NHIS, *Tax Burden on Tobacco*, 2009, and author's calculations
 Note: green data points for prevalence are interpolated assuming linear trend

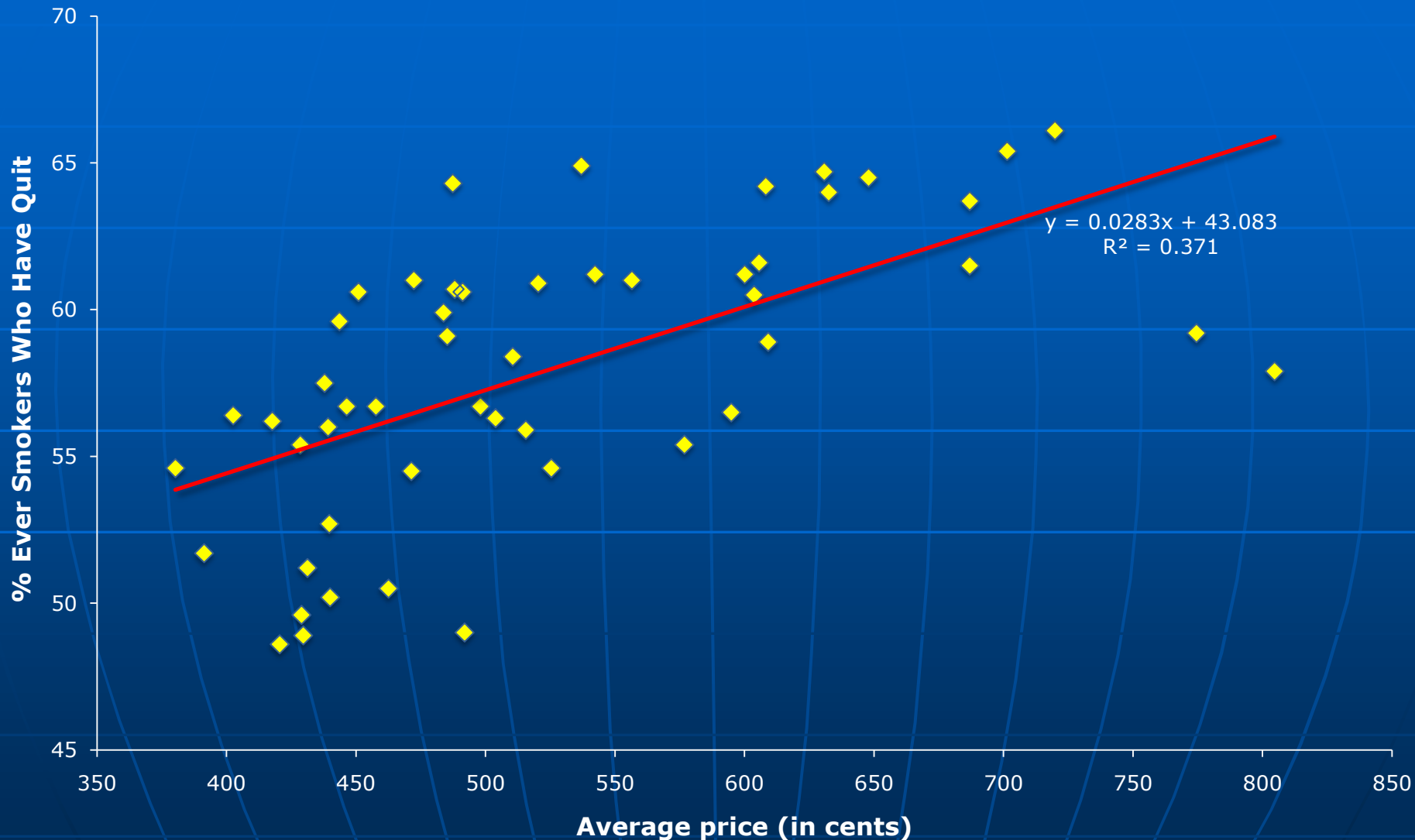
Price (Inflation Adjusted) and Adult Smoking Prevalence, NE, 1995-2009



Prices and Tobacco Use

- **Increases in tobacco product prices:**
 - Prevalence reductions result of adult users quitting
 - 10% price increase leads about 10% of smokers to try to quit
 - About 1 in 5 successfully quit

Cigarette Prices and Cessation US States & DC, 2009

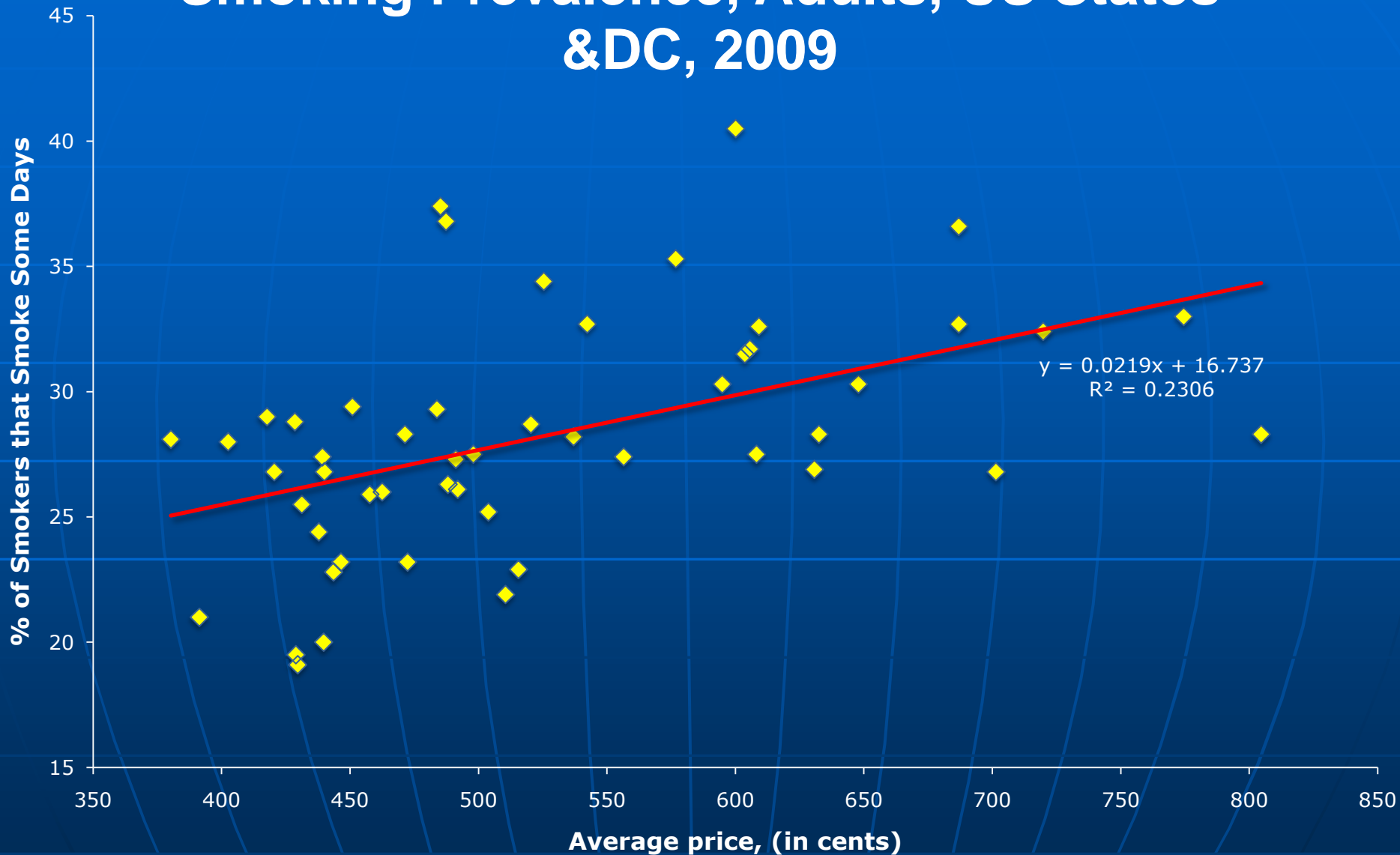


Source: BRFSS, *Tax Burden on Tobacco*, 2010, and author's calculations

Prices and Tobacco Use

- **Increases in tobacco product prices:**
 - Reductions in smoking intensity among those who continue to smoke
 - Smoke fewer days
 - Smoke fewer cigarettes on smoking days

Cigarette Price and Less than Daily Smoking Prevalence, Adults, US States & DC, 2009

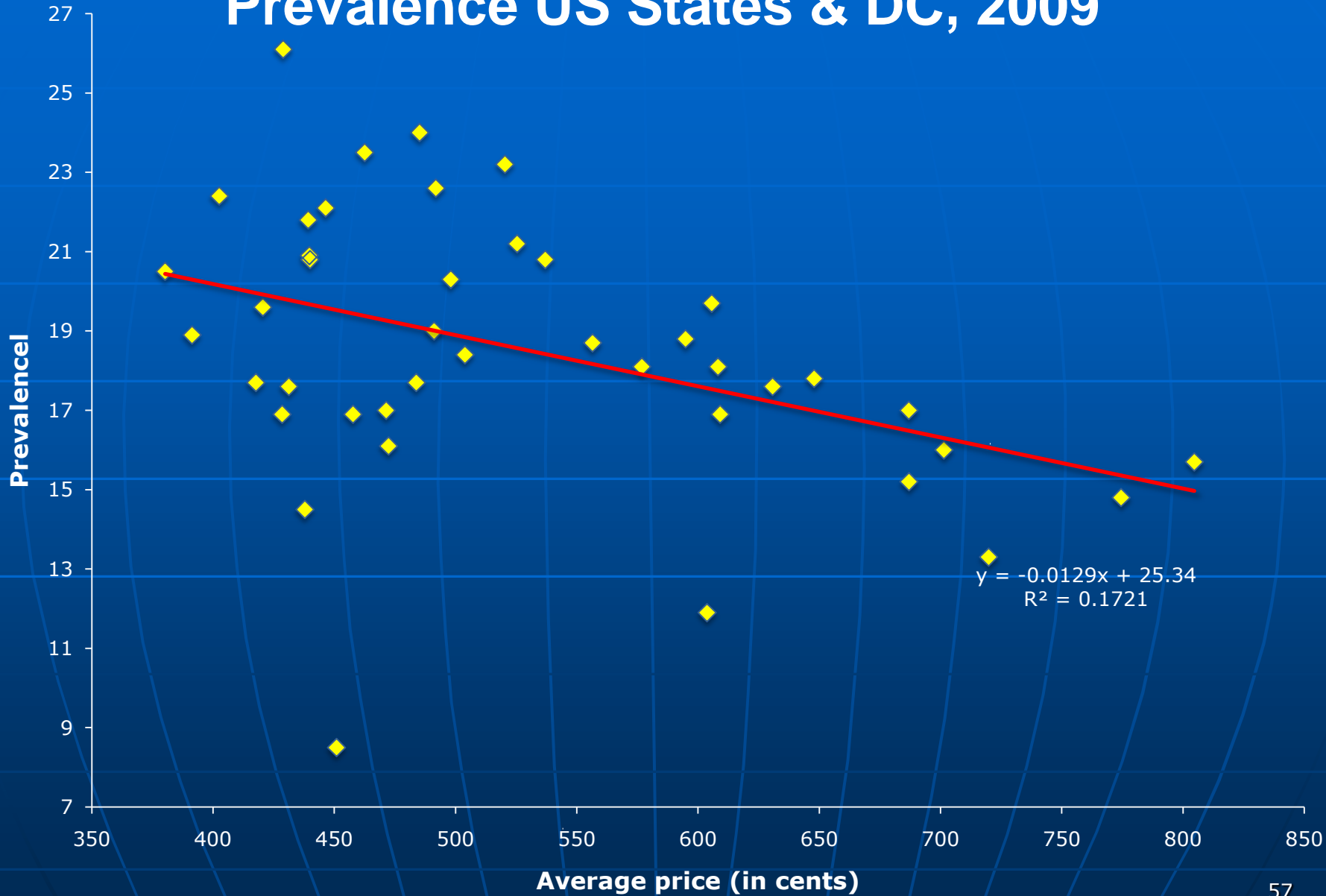


Source: BRFSS, *Tax Burden on Tobacco*, 2010, and author's calculations

Prices and Tobacco Use

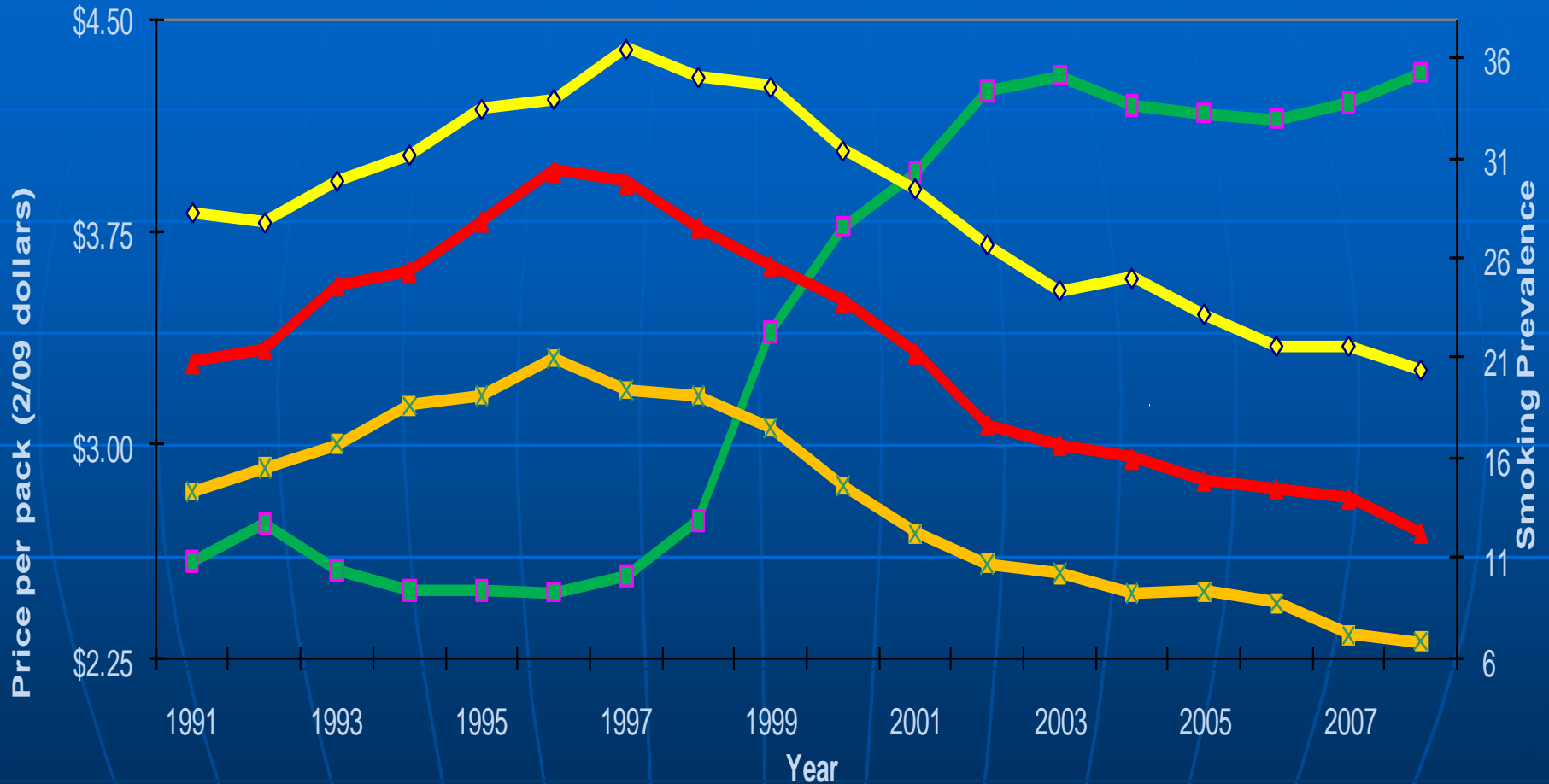
- **Increases in tobacco product prices:**
 - Prevent youth from taking up tobacco use
 - Youth 2-3 times more responsive to price than adults
 - Lower incomes, peer influences, shorter smoking histories, greater emphasis on present costs
 - Greatest impact in preventing youth from moving beyond experimentation into more regular smoking

Cigarette Prices and Youth Smoking Prevalence US States & DC, 2009



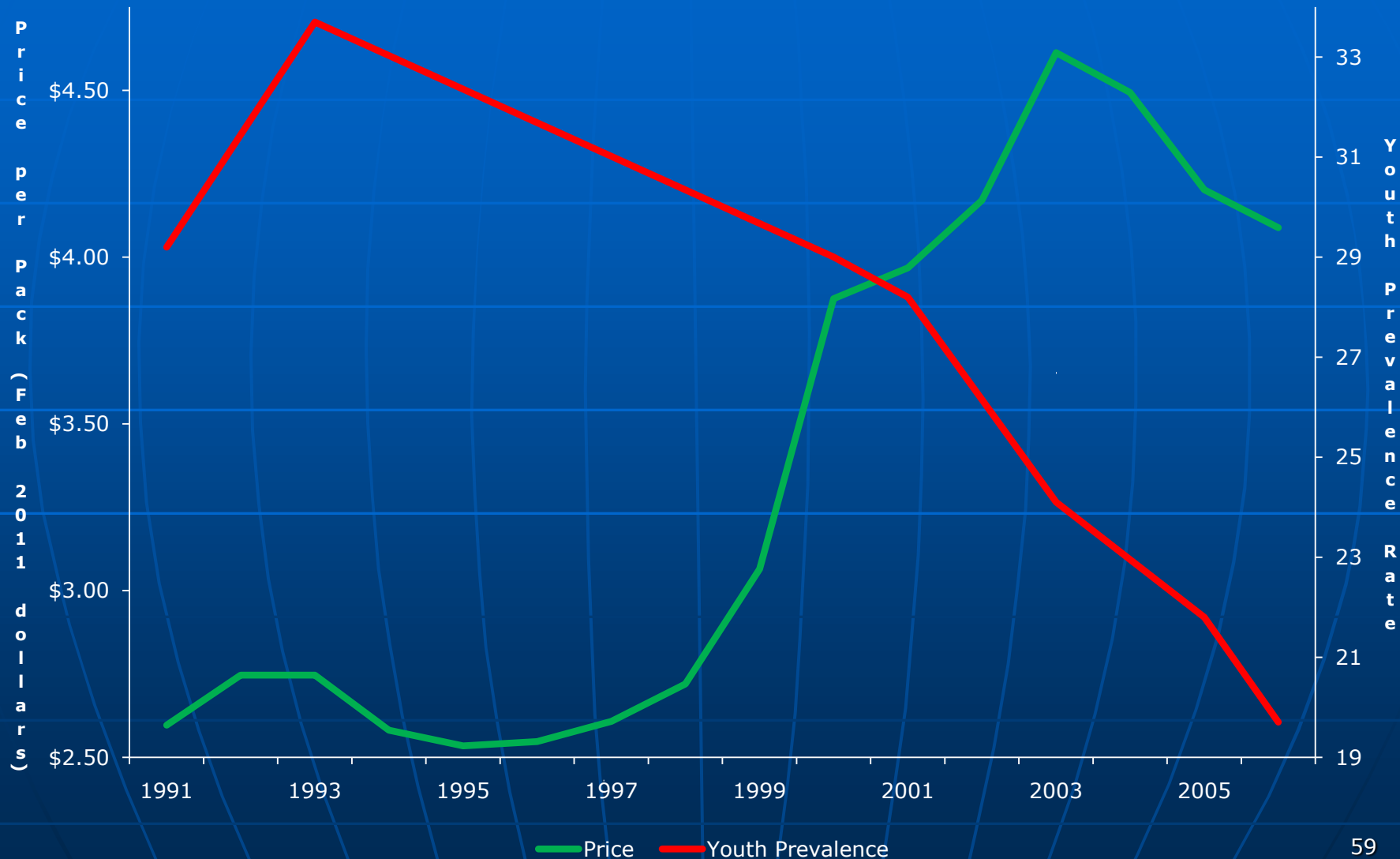
Source: YRBS, *Tax Burden on Tobacco*, 2010, and author's calculations

Cigarette Price and Youth Smoking Prevalence, United States, 1991-2008



■ Cigarette Price
 ◆ 12th grade prevalence
 ▲ 10th grade prevalence
 × 8th grade prevalence

Price (Inflation Adjusted) and Youth Smoking Prevalence, NE, 1991-2006

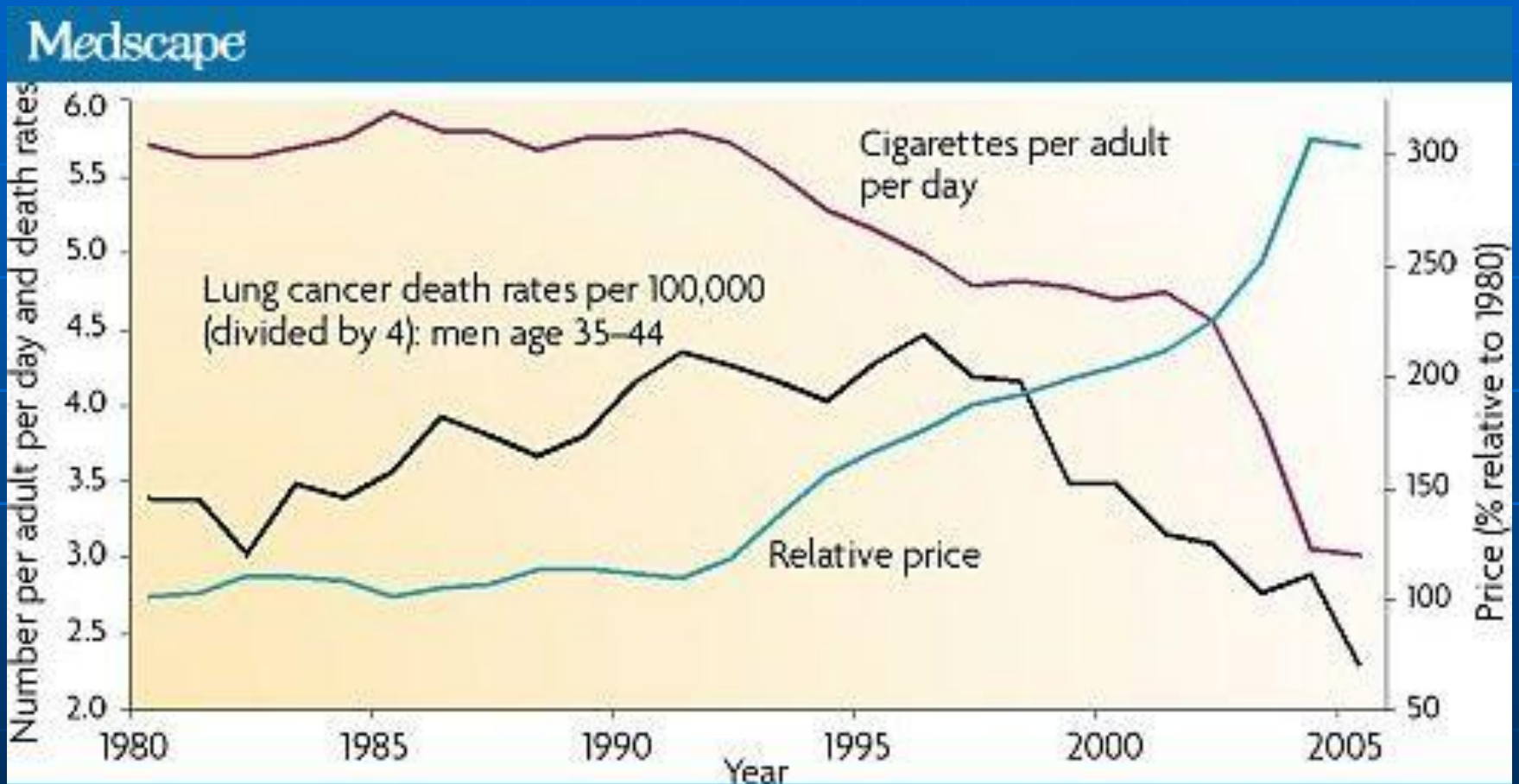


Source: NE YTS and YRBS, *Tax Burden on Tobacco*, 2011, and author's calculations

Prices and Tobacco Use

- **Increases in tobacco product prices:**
 - Reduce death and disease caused by tobacco use

Taxes, Prices and Health: US, 1980-2005



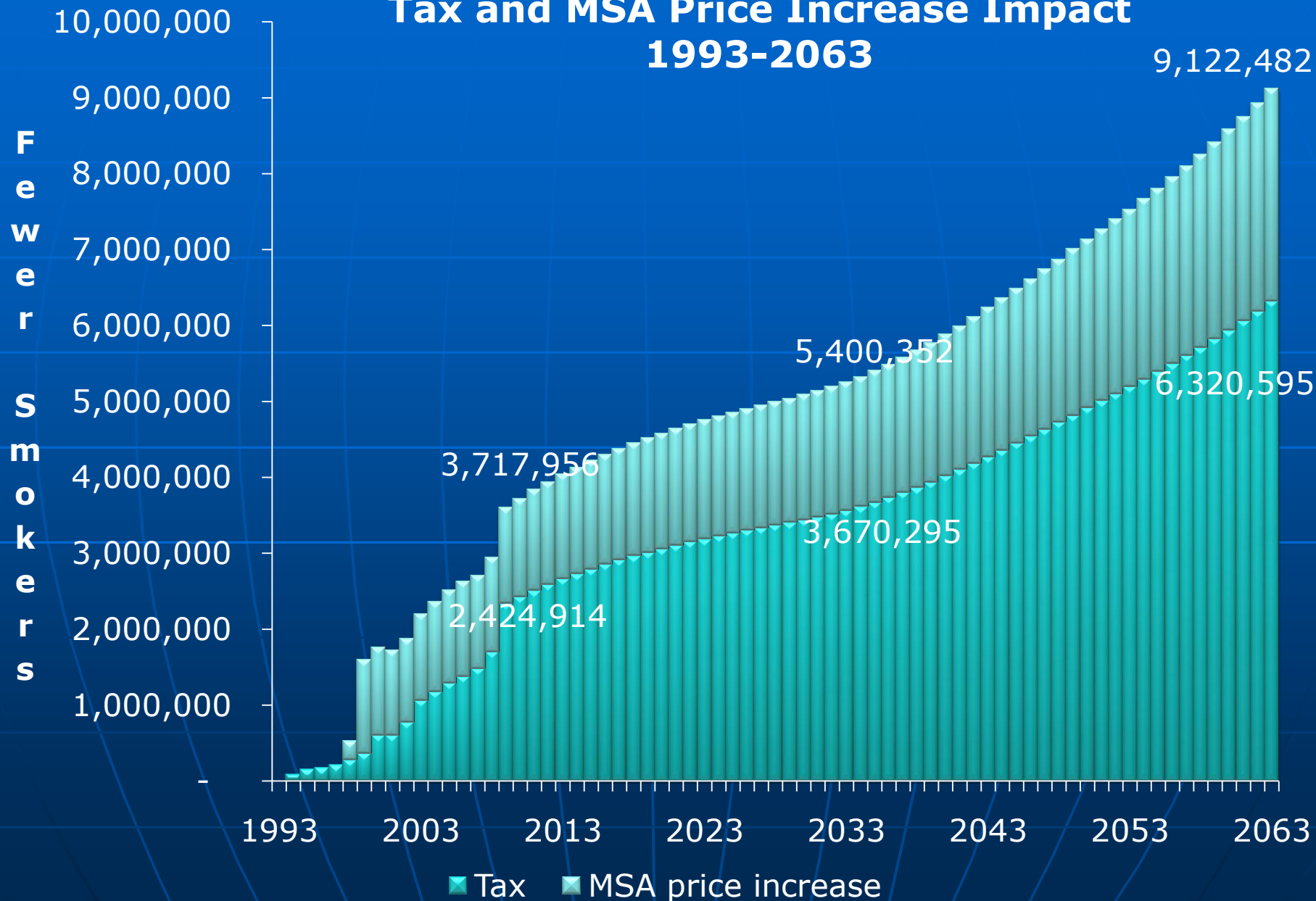
Source: Nat Rev Cancer © 2009 Nature Publishing Group

Health Impact of Tax Increases

Result from:

- Increased cessation following tax increase
 - strong evidence that cessation improves health outcomes
- Deterred initiation resulting from tax increase
 - avoids all health consequences caused by tobacco use
- Additional benefits from reduced health care spending on tobacco-caused diseases

Reduction in Number of Smokers Tax and MSA Price Increase Impact 1993-2063



Reduction in Deaths Caused by Smoking Tax and MSA Price Increase Impact 1993-2063

F
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D
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a
t
h
s

1,400,000

1,200,000

1,000,000

800,000

600,000

400,000

200,000

1993

2003

2013

2023

2033

2043

2053

2063

37,982

16,714

438,936

259,326

1,420,875

893,824



Popular Support for Tobacco Taxes

Popular with Voters

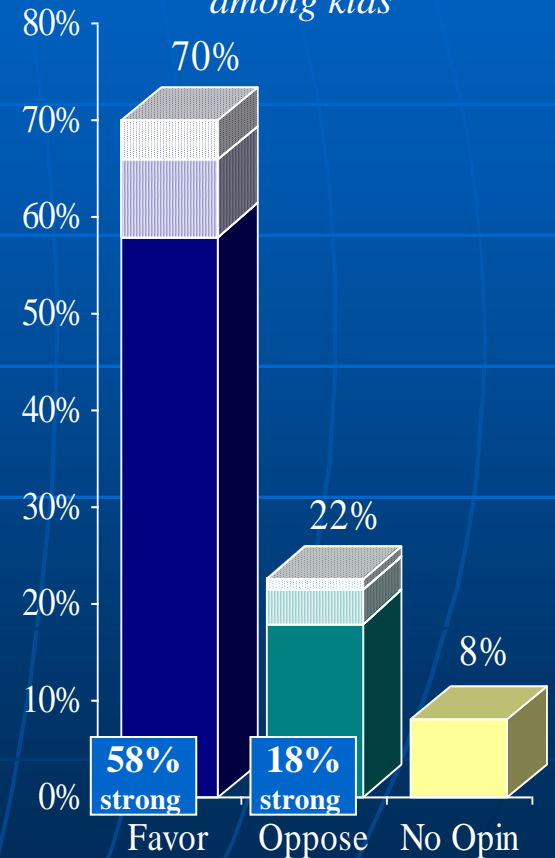
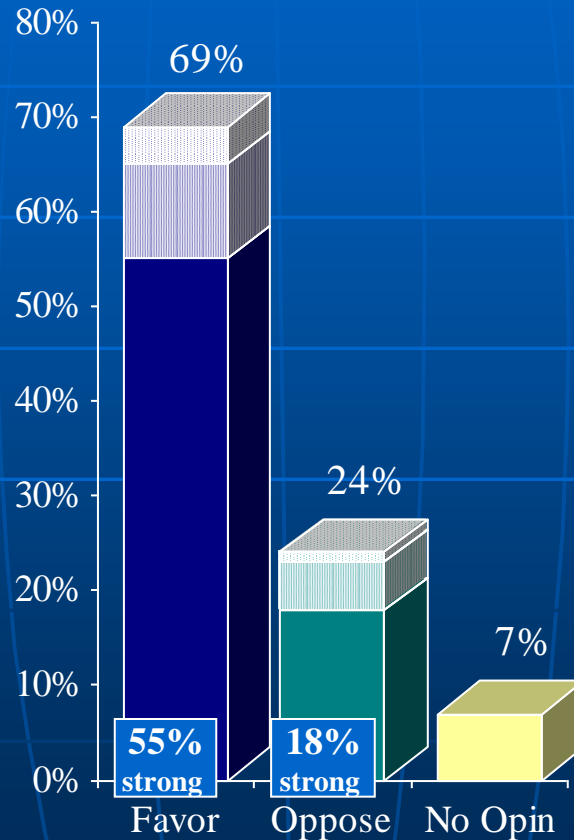
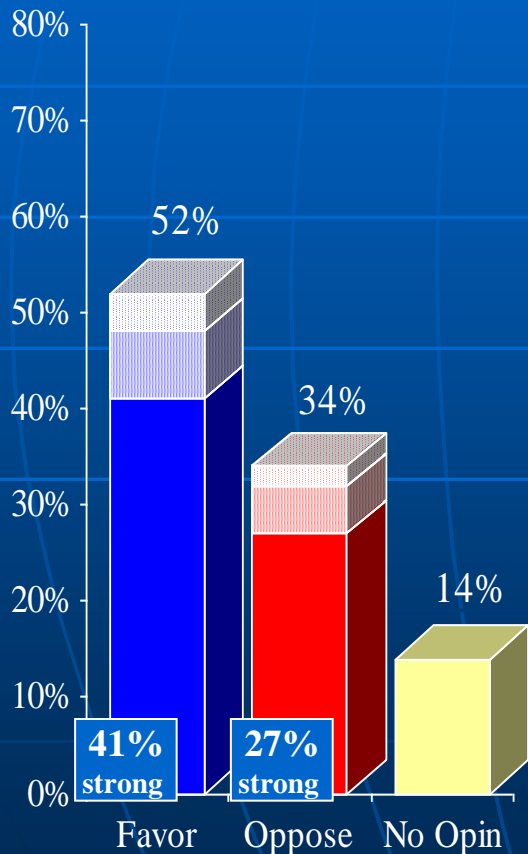
- Tobacco Excise Tax Increases:
 - *Generally supported by voters*
 - *Supported by those likely to vote for either party*
 - *More support when framed in terms of impact on youth tobacco use*
 - *More support when some of new revenues are used to support tobacco control and/or other health-related activities*
 - Comprehensive state tobacco control programs
 - Expanded public health insurance programs (e.g. S-CHIP; Arkansas)
 - *Greater support than for other revenue sources*

Earmarking for Youth Smoking Prevention Increases Support For Tobacco Tax Hikes

Would you favor or oppose an increase in the state tobacco tax?

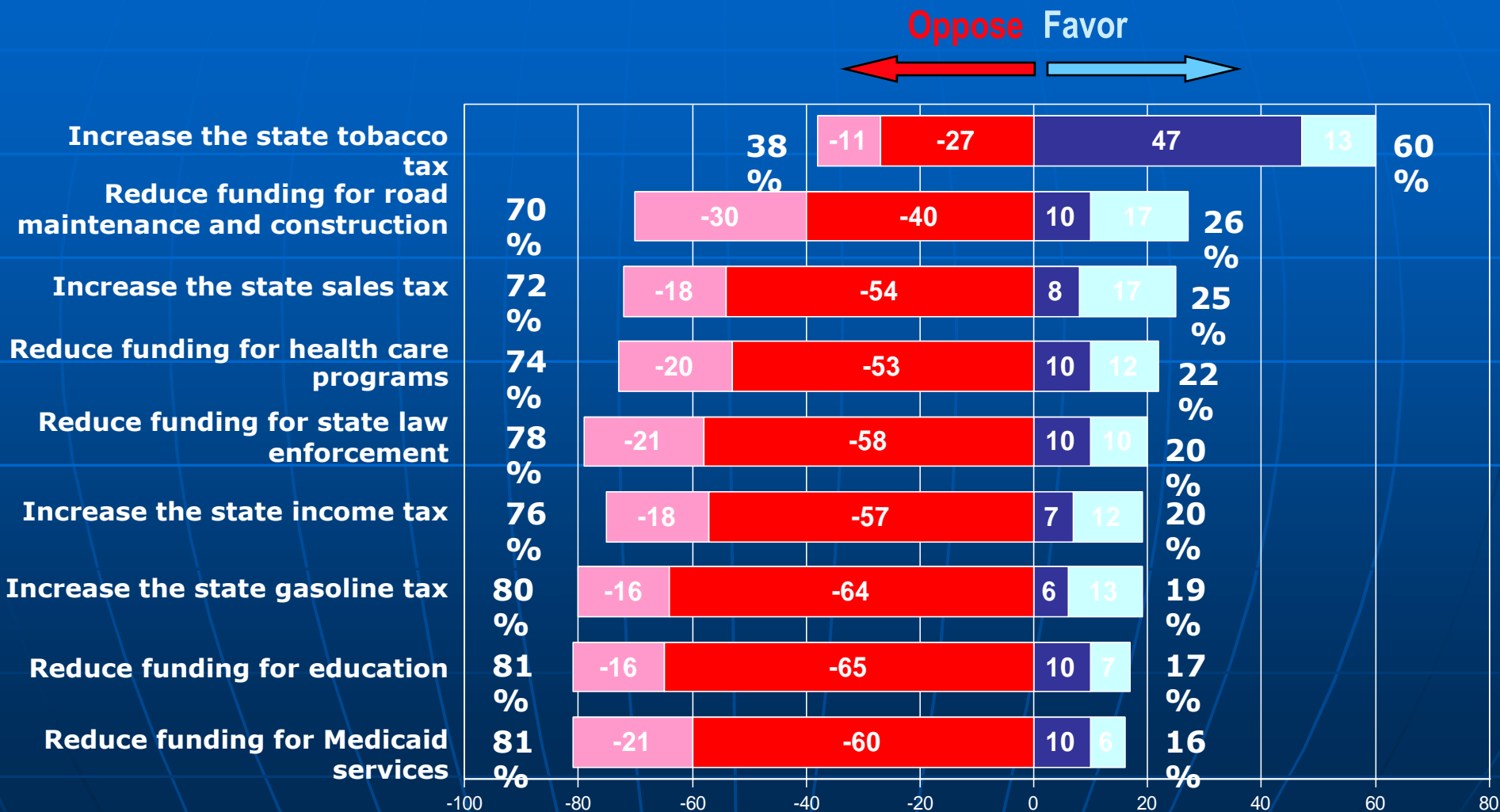
... as part of an effort to help reduce smoking, particularly among kids

...if part of the money is used to fund programs to reduce tobacco use, particularly among kids



Increasing The Tobacco Tax Supported as Way To Address State Budget Deficits

As you may have heard, virtually all states are currently facing severe budget deficits. I am going to read you a list of proposals that have been suggested as a way to address the state budget deficit. After I read each one, please tell me if you FAVOR or OPPOSE that proposal.



Total numbers are rounded
Darker shading indicates stronger intensity

International Communications Research Survey
January 2010; from McGoldrick 2010

Industry Price Marketing

Industry Strategies

- **Industry understands importance of tobacco taxes**

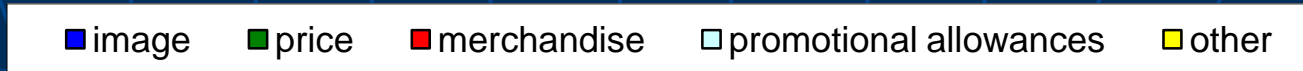
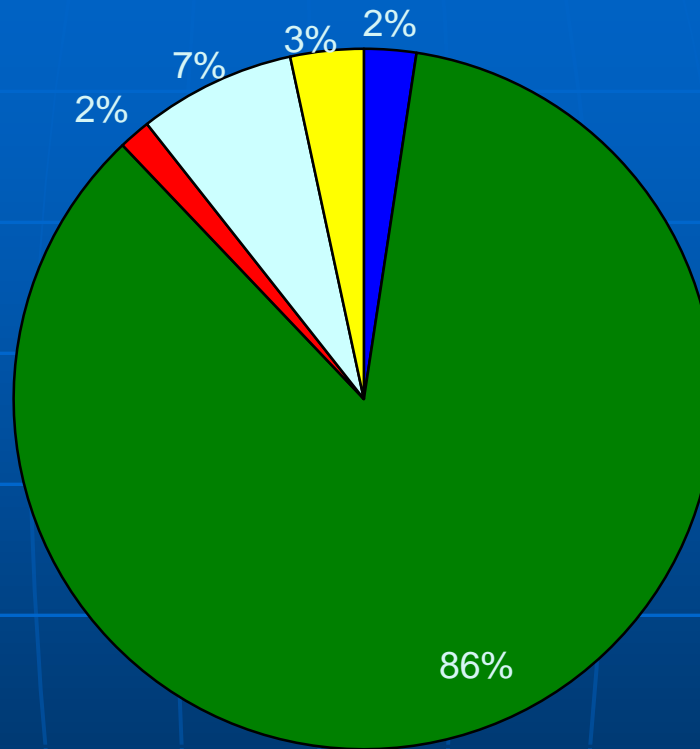
"With regard to taxation, it is clear that in the US, and in most countries in which we operate, tax is becoming a major threat to our existence."

"Of all the concerns, there is one - taxation - that alarms us the most. While marketing restrictions and public and passive smoking (restrictions) do depress volume, in our experience taxation depresses it much more severely. Our concern for taxation is, therefore, central to our thinking...."

Tobacco Marketing

- Marketing Strategies – the 4 P's:
 - Product – design, packaging
 - Price – including price promotions
 - Place – availability, accessibility
 - Promotion – advertising, sponsorship, etc.
- Most effective campaigns are well-integrated across different dimensions of marketing

2006 Cigarette Marketing Expenditures by Category, United States



Price-Related Marketing:

SAVE \$1.00 ON WINSTON \$1.00
MANUFACTURER COUPON 04/28/90
GOOD ON 1 CARTON OF WINSTON
ANY STYLE, ANY LENGTH
02314 479335147
REDEEM BY APRIL 28, 1990
LIMIT ONE COUPON PER CARTON

SAVE \$1.00 ON WINSTON \$1.00
MANUFACTURER COUPON 05/19/90
GOOD ON 1 CARTON OF WINSTON
ANY STYLE, ANY LENGTH
02317 479335147
REDEEM BY MAY 19, 1990
LIMIT ONE COUPON PER CARTON

KOMBO
FREE when you buy a pack.
bottle opener <- lighter
KOOL
CLASSIC 2 MENTHOL
KOOL
Mildes Genuss

Special Offer
65¢ off
Per Pack

Marlboro
PARLIAMENT

THE BEST THINGS IN LIFE ARE BASIC

CIGARETTES (100'S) & MENTHOL
SUGAR FREE

CAMEL
TURKISH GOLD

CAMEL
TURKISH GOLD

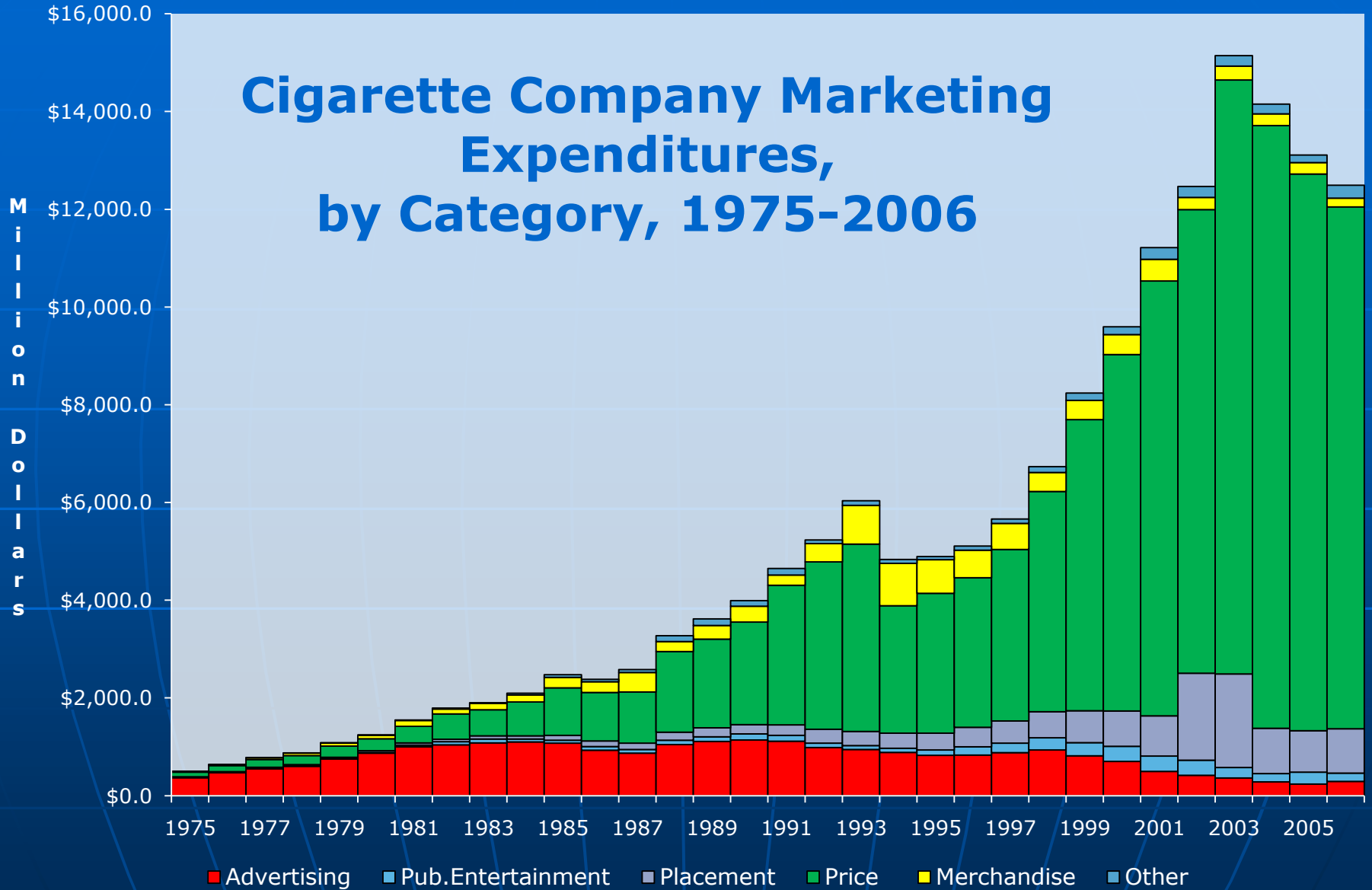
Buy 2 Packs
Get 1 Free!

PLEASURE
TO
BURN

Get a **FREE TIN**
of cold, fresh Snus

CAMEL
SNUS

Cigarette Company Marketing Expenditures, by Category, 1975-2006



Tobacco Industry Efforts to Offset Tax Increase

On February 4th, 2009, the Federal Government enacted legislation to fund the expansion of the State Children's Health Insurance Program (SCHIP) that increases excise taxes on cigarettes by 158%.

As a result, you will see the price of all cigarettes, including ours, increase in retail stores.

We know times are tough, so we'd like to help. We invite you to register at Marlboro.com to become eligible for cigarette coupons and special offers using this code: **MAR1558**

Thank You,

Philip Morris USA

Price-Related Cigarette Marketing and Tobacco Control

- Greater price-related marketing since the Master Settlement Agreement and related price increases (Ruel, et al., 2004; Loomis et al., 2006; FTC, 2007)
- More price-related marketing in states with greater spending on comprehensive tobacco control programs (Loomis, et al., 2006; Slater et al., 2001)
- Growing use of point-of-sale ads to highlight sales promotions (e.g. special price, special offer, cents off, reduced price, multi-pack special) (Feighery et al., 2008)

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STRATEGIC RESEARCH REPORT

TO: Mr. G. H. Long
Mr. M. L. Orlowsky
Mr. H. J. Lees

FROM: Feb

YOUNGER ADULT SMOKERS:
STRATEGIES AND OPPORTUNITIES

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R.J. REYNOLDS TOBACCO COMPANY, WINSTON-SALEM, N.C.

With respect to greater price sensitivity of young people:

"Tactically, extended periods of closely targeted pack promotions (B1G1F (buy-one-get-one-free), sampling) in selected sites (e.g., convenience stores, military exchanges, special events) could lead to brand loyalty from repeated trials. **This should be considered an investment program.**"

With respect to greater price sensitivity of young people:

"The major factor contributing to CAMEL's dramatic growth among Mid-West 18-24 year old males appears to be the increased level of Mid-West promotional support, and in particular, CAMEL's targeted promotions (which were implemented the same time as the boost in CAMEL's share and completed just prior to the downward trend)."



2010

July 23, 1986

Caufield

Lighton

WITH AMONG MALES 18-24 YEARS OLD IN THE MID-WEST

to thirteen month period beginning in March 1985 and continuing 1986, CAMEL's share in the Mid-West of 18-24 year old male smokers has increased dramatically. From a previously flat to declining share performance among these target smokers grew approximately 10 to 14% (from 3% to 14%). Growth accelerated during the fourth quarter in February/March of 1986 and has since declined. First quarter target share is 6.8% (versus 5.6% first half, 1985).

Provides a comprehensive analysis of CAMEL's performance in the Mid-West and identifies those factors which might explain the reasons behind the dramatic performance among Mid-West 18-24 year old male smokers.

Factor contributing to CAMEL's dramatic growth among Mid-West 18-24 year old male smokers appears to be the increased level of Mid-West promotional support, and in particular, CAMEL's targeted promotions (which were implemented the same time as the boost in CAMEL's share and completed just prior to the downward trend).

The Mid-West is a high opportunity area for CAMEL (based on CAMEL's record in the Pacific/Mountain area), total media and brand controlled promotional support in the Mid-West sales area was increased significantly in 1985 from \$15.8MM in 1984 to \$21.8MM in 1985. In addition, CAMEL's promotional strategy placed more emphasis than previous years on adult male smokers. Changes included increased OOH support (from 6 to 10 months) and more frequent target retail and media promotional events (such as B3G3F, "Six Pack" and CAMEL T-shirt).

Mid-West sales area spending increase in 1985 brought it to about equal to total promotional spending as the Pacific/Mountain sales area (\$9.6MM PMSA). However, the Mid-West actually exceeded the Pacific/Mountain in spending support in 1985 in terms of the ratio of promotional support to population size (17% PMSA; 20% PMSA) as well as to total volume base (17% PMSA; 29% PMSA). This difference in real terms may explain the additional growth achieved in the Mid-West among target smokers and among total smokers (relative to the Pacific/Mountain).

50572 7418

Sufficient Evidence that:

Tobacco industry price discounting strategies, price-reducing marketing activities, and lobbying efforts mitigate the impact of tobacco excise tax increases.

IARC HANDBOOKS OF CANCER PREVENTION

Tobacco Control



International Agency for Research on Cancer
World Health Organization

Volume 14

**Effectiveness of Tax and Price
Policies for Tobacco Control**

IARC
2011



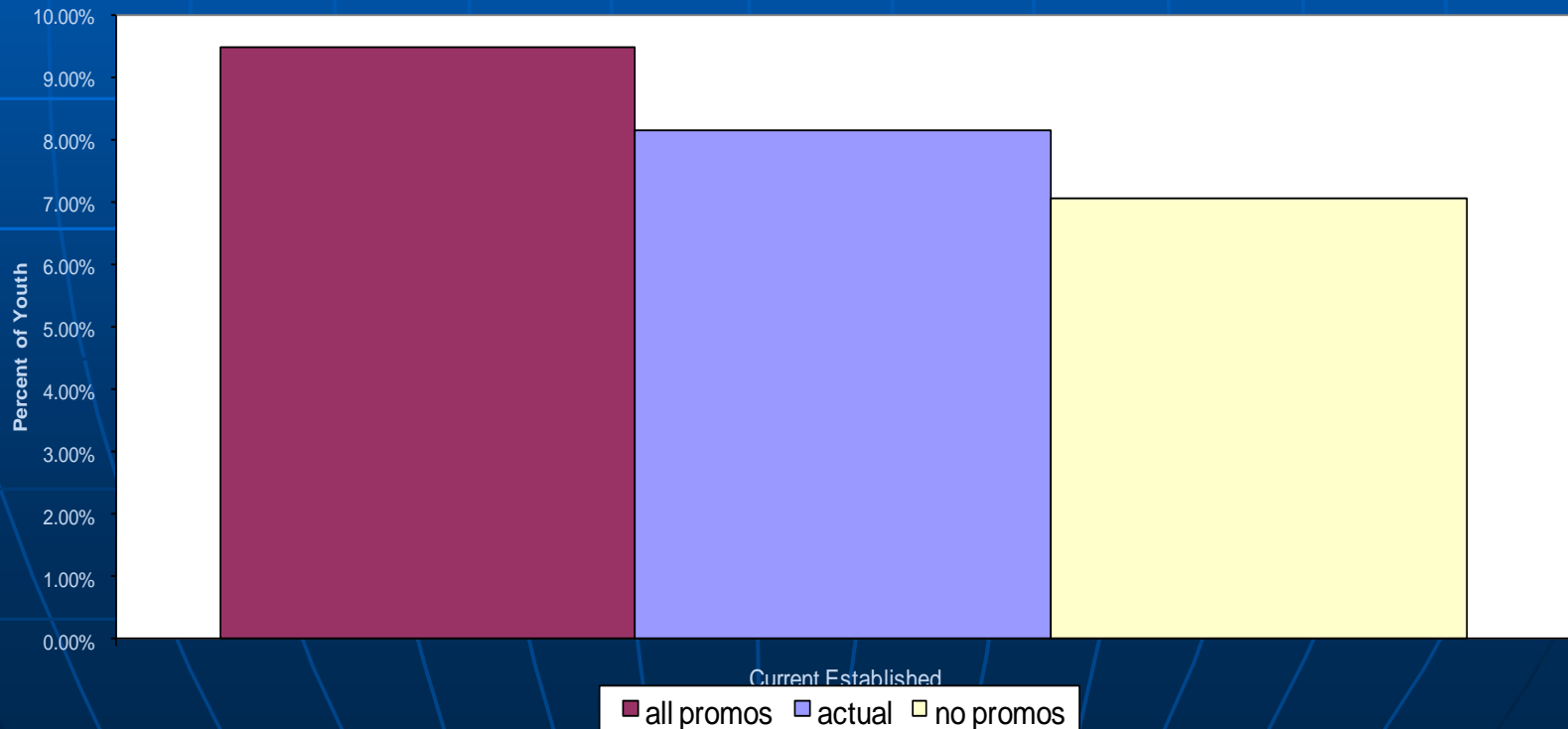
This Handbook was produced within
the EC-funded grant (HEALTH-F2-
2009-223323): Pricing Policies and
Control of Tobacco in Europe
(PPACTE)



POS Marketing and Youth Uptake

- Significant impact of promotions on later stages of uptake
 - effect rises as move to later stages of uptake
 - If all stores had no promotions, estimate that prevalence of current established smoking would fall by over 13%

Promotions and Youth Smoking Uptake Simulations

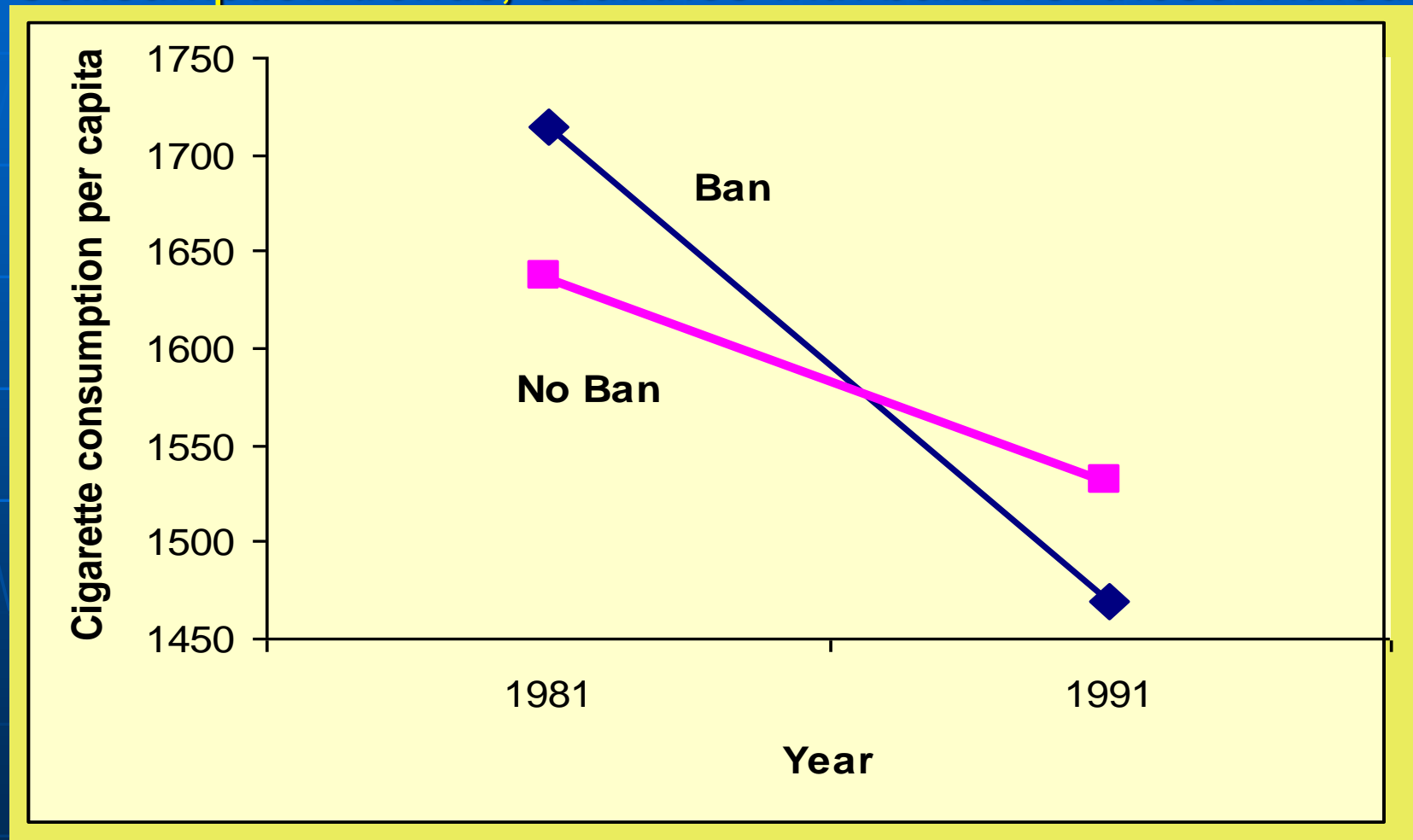


Restricting Marketing?

- Family Smoking Prevention and Tobacco Control Act, 2009
 - Eliminates federal pre-emption of stronger state, local restrictions on tobacco company marketing
 - Allows limits on time, place or manner of tobacco company marketing
 - Comprehensive state and/or local marketing bans possible?

Comprehensive advertising bans reduce cigarette consumption

Consumption trends, countries with bans vs. those without



Source: Saffer, 2000

Minimum Pricing Policies

- 25 states with minimum pricing policies
 - Including Nebraska
- Typically mix of minimum markups to wholesale and retail prices
 - Median wholesale markup 4% (4.75% in NE)
 - Median retail markup 8% (8% in NE)
- 7 states prohibit use of price promotions in minimum price calculation
 - Including Nebraska
- Little impact on actual retail prices
 - Greater impact where promotions excluded

Common Oppositional Arguments

Myths & Facts

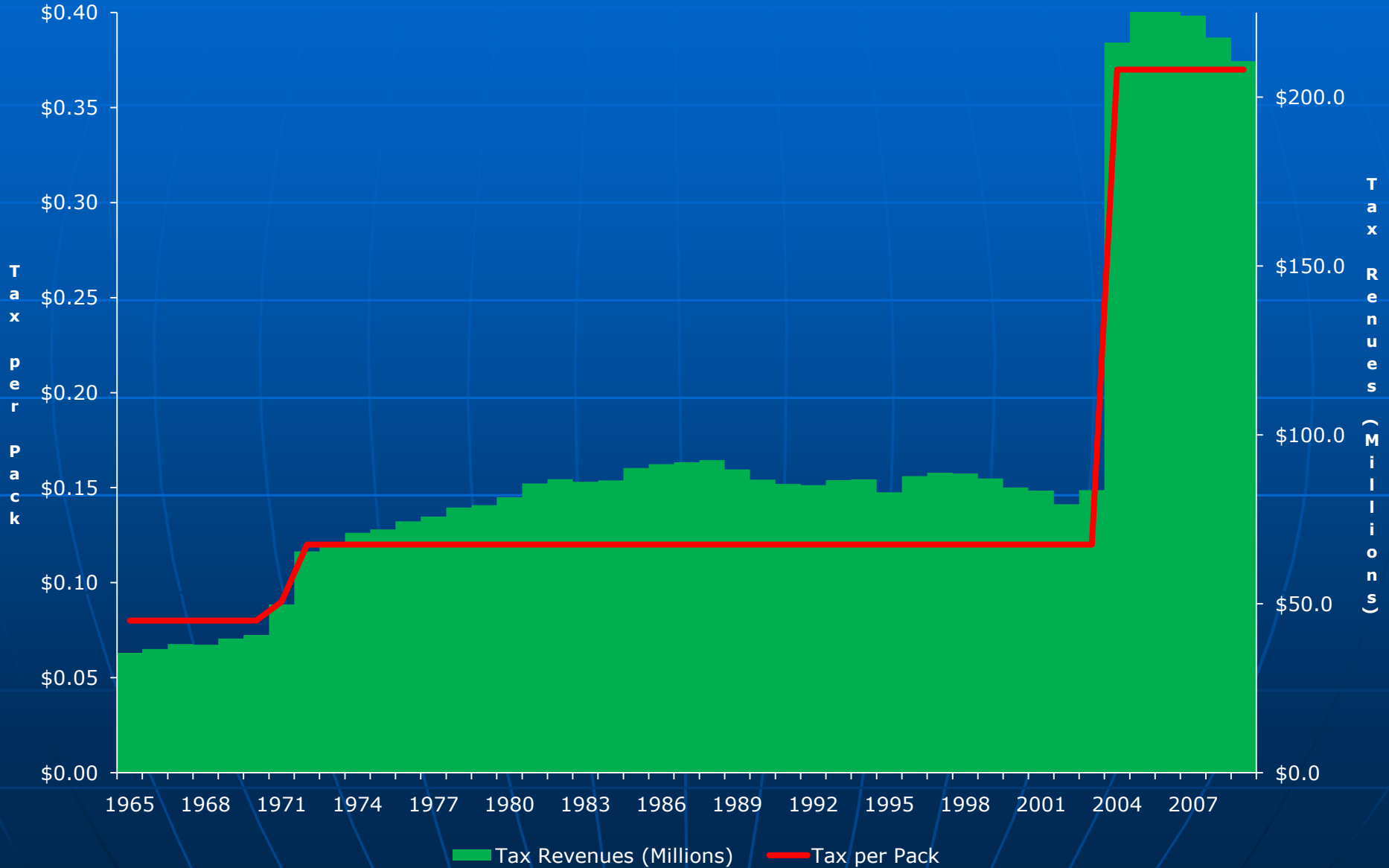
Impact on Revenues

By *J Scott Moody*, 4/2/08, from an AP story:

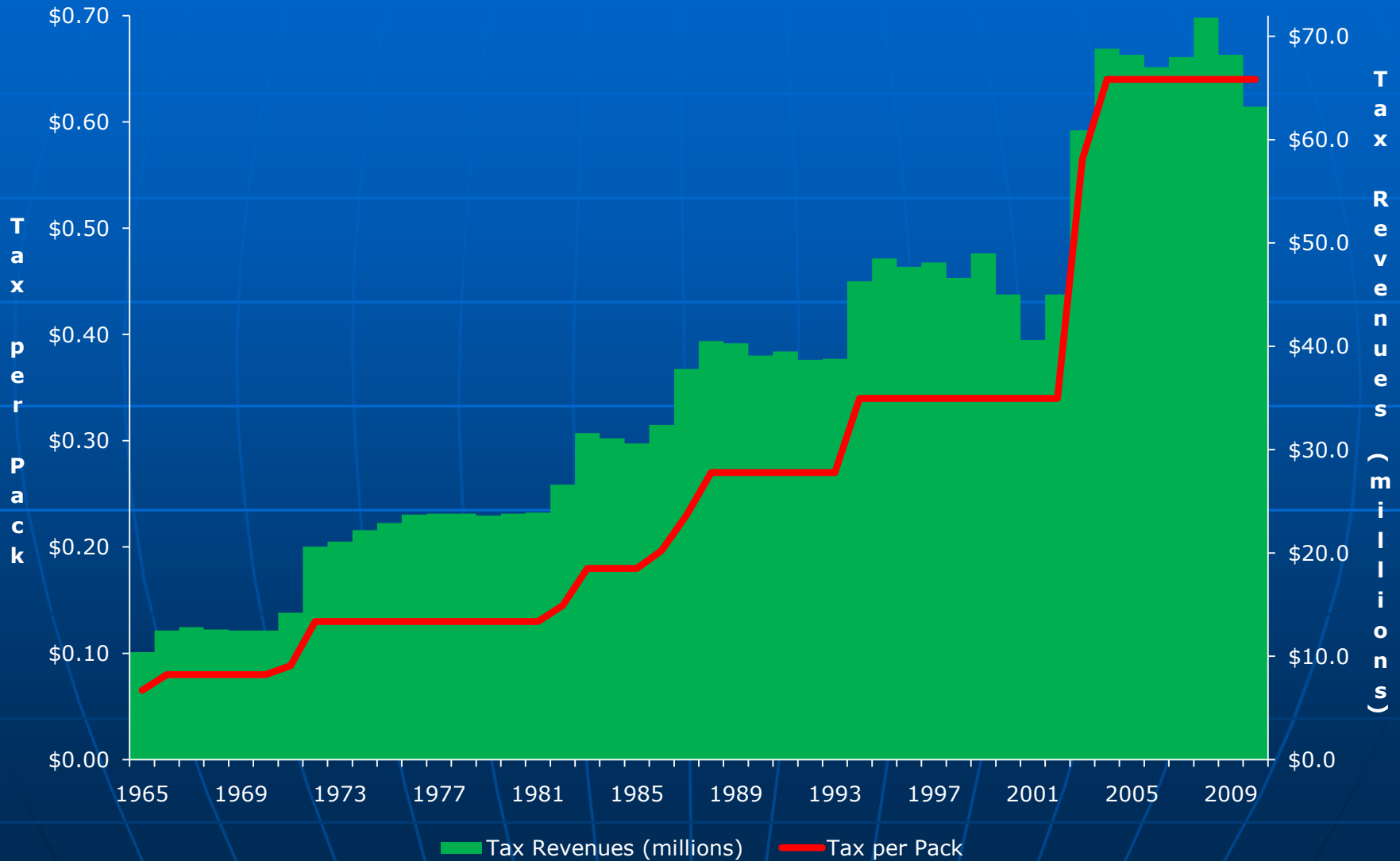
AUGUSTA — “A coalition of health groups today urged lawmakers to increase the cigarette tax by a \$1 per pack, saying the increase will encourage more people to quit smoking and generate more money for health programs.

Translation: Fewer people smoking equals more cigarette tax revenue? Someone needs a math lesson.”

Cigarette Tax and Tax Revenues Georgia, 1965-2009



Cigarette Tax and Tax Revenues Nebraska, 1965-2010



Positive Effect of Tax Increases on Revenues Results from:

Low share of tax in price:

- In US, state taxes account for about 25% of price on average
- total taxes account for less than half of price, on average
- *Implies large tax increase has much smaller impact on price*

Less than proportionate decline in consumption:

- 10% price increase reduces consumption by 4%

Positive Effect of Tax Increases on Revenues

Example

- Price \$4.00, State tax \$1.00, Sales 500 million packs
 - Revenues: = \$500 million
- Doubling of tax to \$2.00 per pack raises price to \$5.00
 - 100% increase in tax; 25% increase in price
- 25% price increase reduces sales by 10%
 - new sales 450 million packs
 - *90% of original sales at double the tax increases revenues by 80%*
 - new revenues = \$900 million

Positive Effect of Tax Increases on Revenues

Example – with significant tax avoidance

- Price \$4.00, State tax \$1.00, Sales 500 million packs
 - Revenues: = \$500 million
- Doubling of tax to \$2.00 per pack raises price to \$5.00
 - 100% increase in tax; 25% increase in price
- 25% price increase reduces sales by 20% (reduced consumption plus equivalent tax avoidance)
 - new sales 400 million packs
 - *80% of original sales at double the tax increases revenues by 60%*
 - new revenues = \$800 million

Sustainability of Cigarette Tax Revenues

Some suggest increases in revenues won't be sustained over time

- Looked at significant state tax increases over past 20 years where increase was maintained for at least 5 years
 - Separately for states with major tobacco control programs

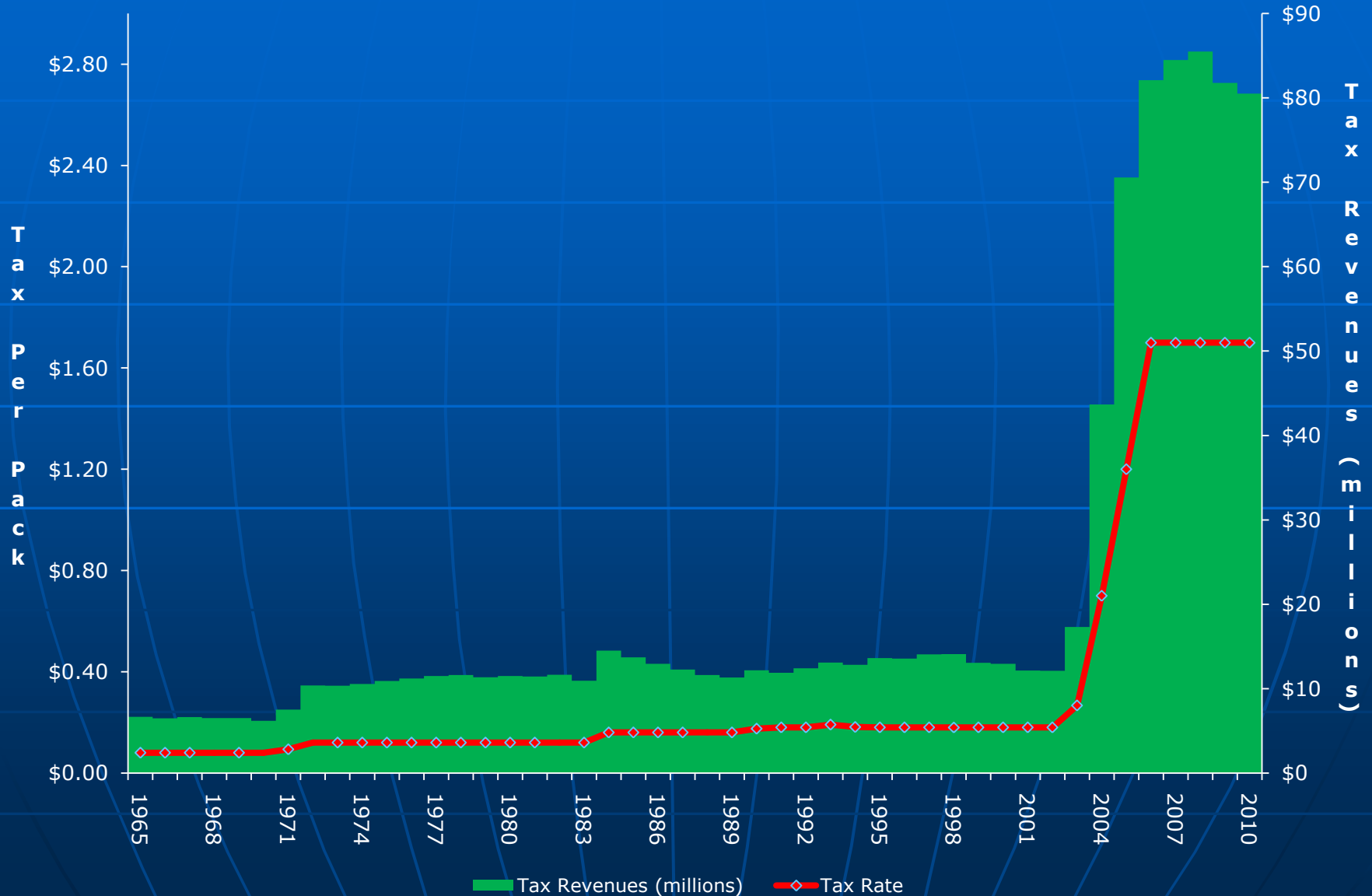
Sustainability of Cigarette Tax Revenues

- *Conclusions:*

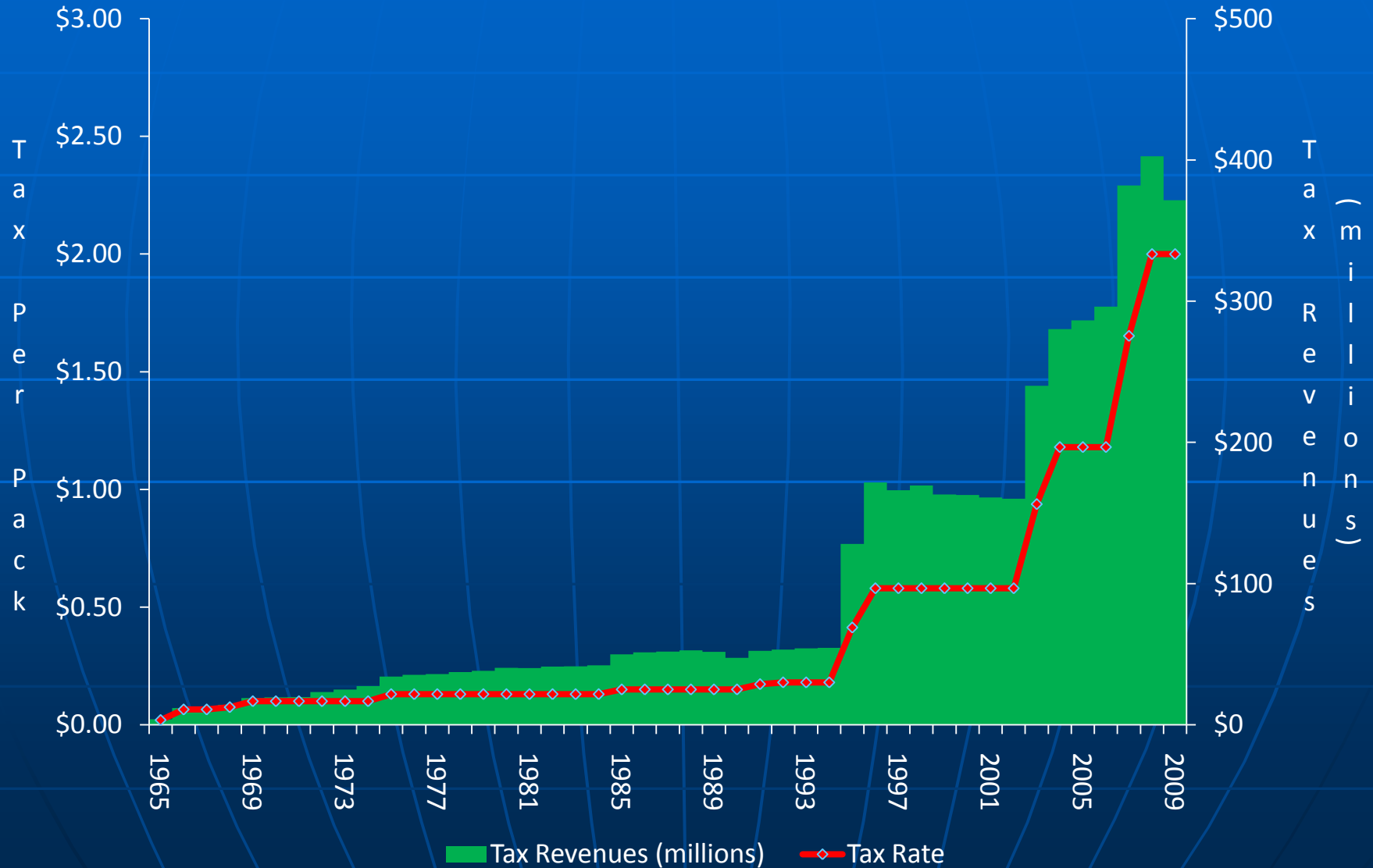
- All significant state tax increases resulted in significant increases in state tax revenues

- Nominal increases in revenues sustained over time in states without tobacco control programs
- Nominal revenues decline in states with tobacco control programs, but are significantly higher than before tax increase
- Tobacco tax revenues more predictable than other revenues

Cigarette Tax and Tax Revenues, Montana, 1965-2010



Cigarette Tax and Tax Revenues, Arizona, 1965-2009



WHO “Best Practices” for Tobacco Excise Taxes

- ***Earmark a portion of tobacco tax revenues for related/other tobacco control and/or health promotion efforts***
 - Maximizes the health impact of tobacco tax increases
 - Increases public support for tax increases

Impact on Jobs

JULY, 14, 2010 – The Associated Press

- RICHMOND, Va. — The tobacco industry is running a full-court press ahead of a federal scientific panel's meeting to discuss how to regulate menthol cigarettes, a still-growing part of the shrinking cigarette market.
- The union representing nearly 4,000 tobacco workers sent a letter to the Food and Drug Administration committee examining the public health effects of the minty smokes, warning that a ban could lead to "severe jobs loss" and black market cigarettes.

Impact on Jobs

- Tobacco excise tax will lead to decreased consumption of tobacco products
 - Small loss of jobs in tobacco sector
- Money not spent on tobacco products will be spent on other goods and services
 - Gains in jobs in other sectors
- Increase in tax revenues will be spent by government
 - Additional job gains in other sectors
- Net increase in jobs in states like Nebraska

Impact on Businesses

- More recent argument that higher taxes will harm convenience stores
- New analysis
 - Number of convenience stores (convenience only, gas stations, both), by state, 1997-2009
 - State cigarette tax rates and smoke-free air policies
 - Economic conditions (income, unemployment, gas prices)
 - Multivariate, fixed effects econometric models

Impact on Businesses

■ Results:

- Positive association between state cigarette tax and number of convenience stores
 - “overshifting” of cigarette tax in retail price
 - Substitution of spending on cigarettes to spending on other products
 - \$1.00 tax increase associated with increase of 11 stores per million population
- No impact of smoke-free policies
- Robust to alternative specifications and empirical methods

WHO “Best Practices” for Tobacco Excise Taxes

- ***Do not allow concerns about employment impact to prevent tobacco tax increases***
 - Tobacco employment often declining even where tobacco product consumption rising
 - Reductions in tobacco-dependent employment are offset by increases in other sectors
 - Where concerns are significant, use tax revenues to support transition from tobacco farming/manufacturing to other activities

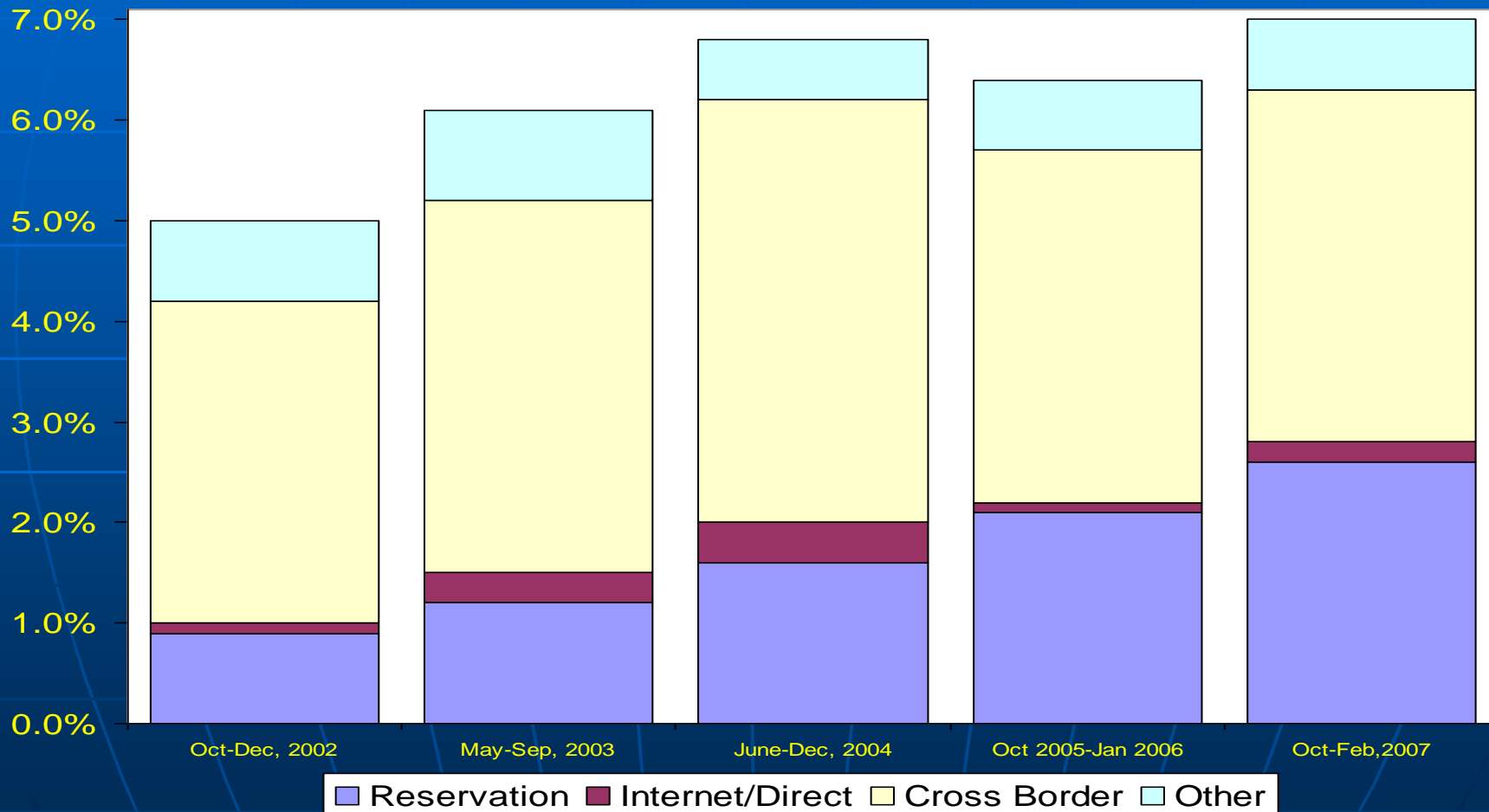
Tax Avoidance & Evasion

April 1, 2008 – New York Sun

- A pack of premium cigarettes in New York City now costs \$7 or \$8; prices would rise to above \$9. Opponents of the tax increase argue that **higher prices would drive smokers to seek ways to evade the law and purchase cheaper cigarettes from smugglers or in neighboring states, blunting potential revenue gains for the state.** "It's a **black market gold mine,**" a senior fellow at the Manhattan Institute, E.J. McMahon, said of the proposed tax.

Tax Avoidance

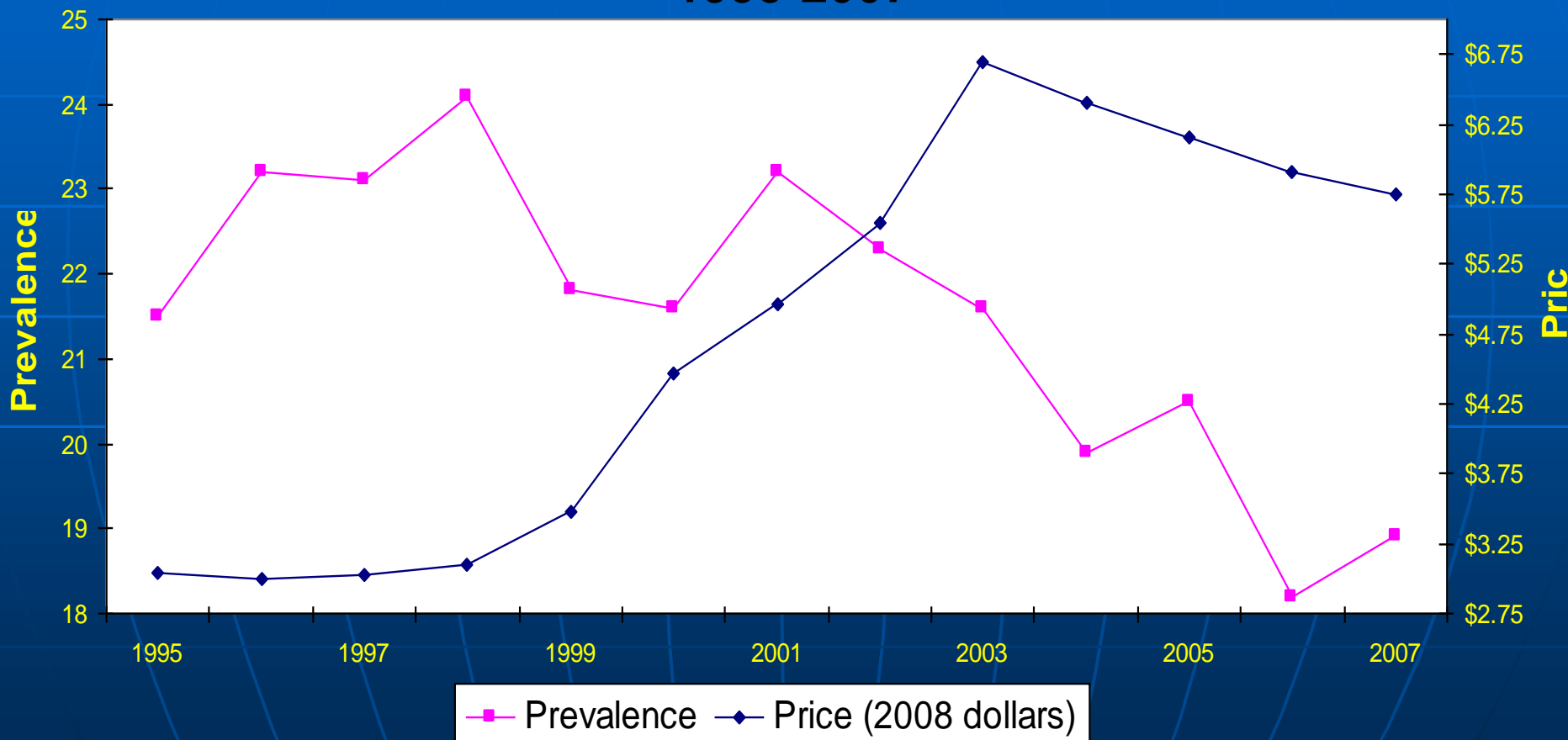
US Smokers' Tax Avoidance, Last Purchase, 2002-2007



Source, ITC project, US survey, Waves 1-5

Illicit Trade Does NOT Eliminate Health and Revenue Impact of Higher Taxes

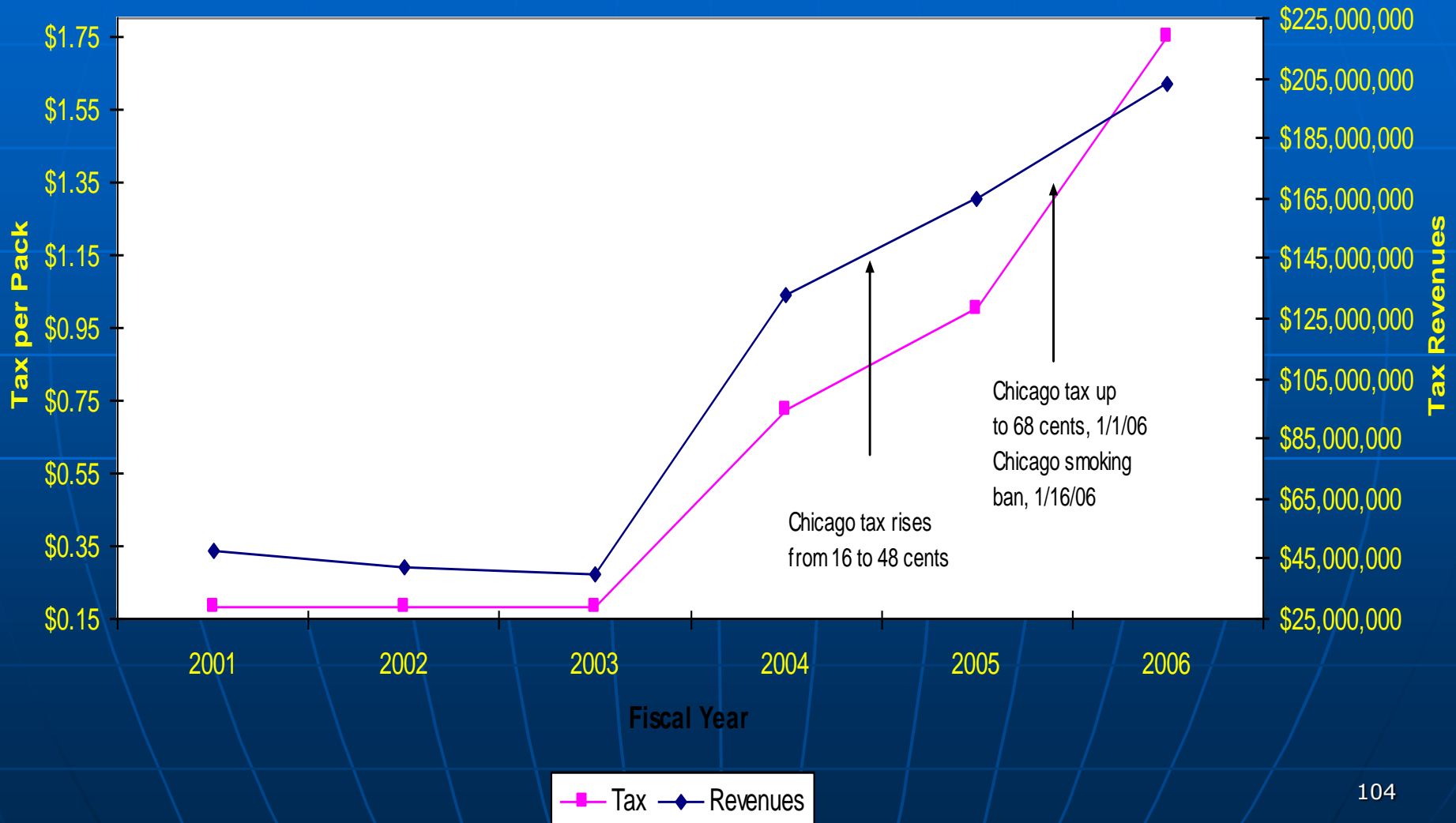
Cigarette Prices and Adult Prevalence, New York, 1995-2007



Source: Tax Burden on Tobacco, 2008 and BRFSS

Tax Increases and Tax Avoidance

Cook County Cigarette Tax and Tax Revenues - FY01-FY06



Combating Tax Evasion

- California's high-tech tax stamp
 - Adopted 2002; fully implemented 2005
 - Coupled with better licensing standards
 - Examined with hand-held scanners
 - Thousands of compliance checks, hundreds of citations
 - Generated over \$124 million in revenues during 20 month period (mid-2004 through late 2005)



Efforts to Curb Tax Avoidance

Many US efforts focused on Internet, phone and mail order sales:

- Outright ban on direct sales (e.g. New York)
- Major shipping companies (e.g. UPS, Federal Express) agree not to ship cigarettes to consumers
 - USPS finally adopted similar policy last year
- Major credit card companies agree to ban use of credit cards for direct cigarette purchases
- States apply Jenkins Act to identify direct purchasers and to collect taxes due
 - Effective based on early data from several states
 - e.g. MA collected over \$4.6 million in FY07

Efforts to Curb Tax Avoidance

Reservation sales similar focus in some states

- Some states (e.g. MN) impose tax on reservation sales with refund to reservation residents
- Other states (e.g. WA) enter into “compacts” with tribes that result in comparable taxes imposed on reservation sales with most/all of revenues kept by tribe
- Others apply different tax stamps for cigarettes sold to residents and non-residents of reservations
 - Quota on distributor sales to reservation outlets to reflect expected resident consumption (e.g. NY)

WHO's Best Practices in Tobacco Taxation

- Adopt new technologies to strengthen tobacco tax administration and minimize tax avoidance and evasion
 - Sophisticated tax stamps
 - Tracking and tracing technologies
 - Production monitoring technologies

WHO's Best Practices in Tobacco Taxation

- Strengthen tobacco tax administrators' capacity by licensing all involved in tobacco product manufacturing and distribution
 - Facilitates identification of those engaged in illegal trade
 - Enhances ability to penalize those engaged in illegal trade
 - License suspension, revocation

WHO's Best Practices in Tobacco Taxation

- Ensure certain, swift and severe penalties for those caught engaging in illicit trade in tobacco products
 - Increased the expected costs of engaging in illicit trade
 - Administrative sanctions coupled with licensing

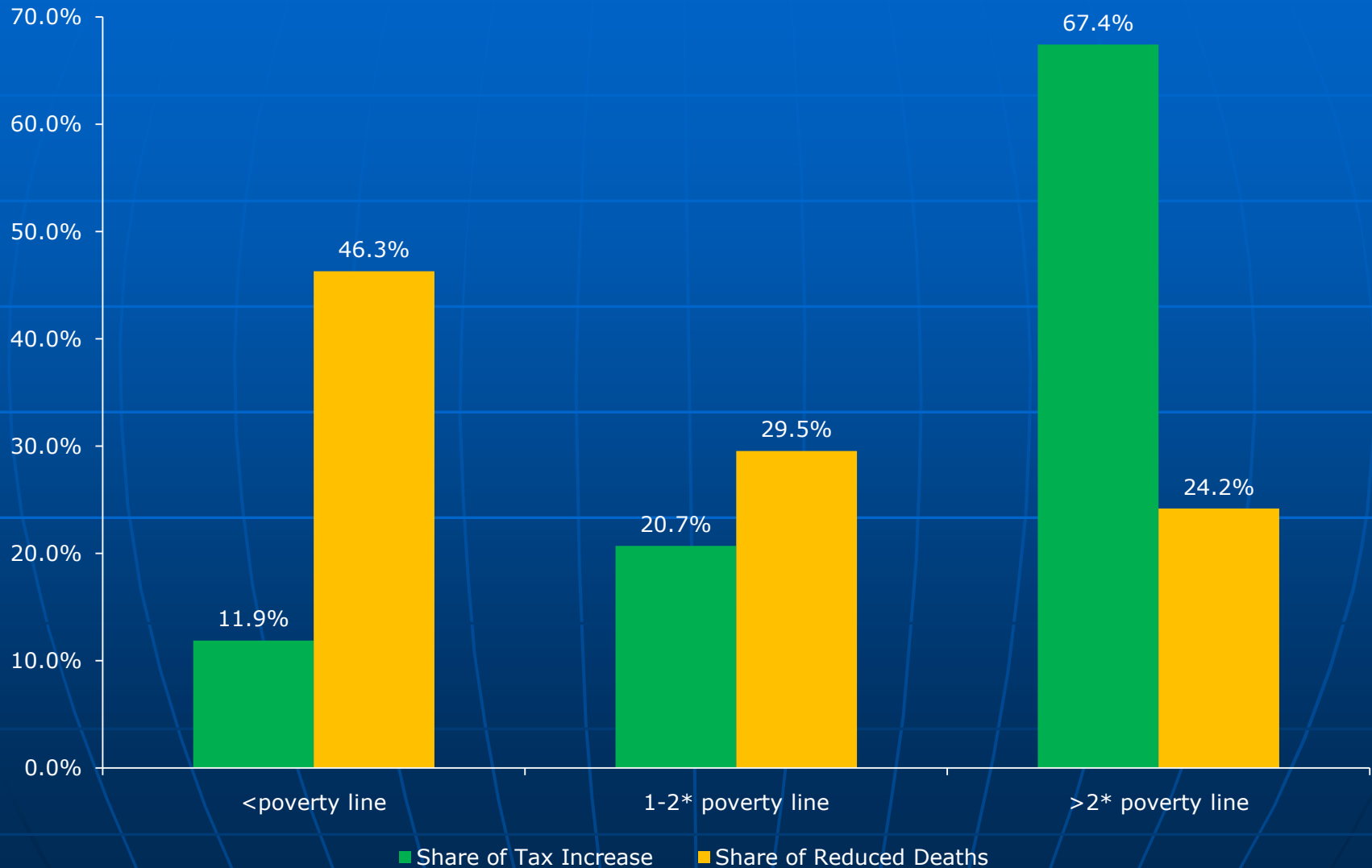
Impact on the Poor

July 23, 2010 – San Francisco Examiner

- “Democrats are relying more heavily in their midterm 2010 election message that Republicans care nothing about the poor. Conveniently absent from this analysis is Republican opposition to President Barack Obama’s cigarette tax increase..... **While higher cigarette taxes do discourage smoking, they are highly regressive.** Analyzing a slightly less severe proposal in 2007, the Tax Foundation noted that **‘no other tax hurts the poor more than the cigarette tax.’**” Peyton R. Miller, special to the Examiner.

Who Pays & Who Benefits

Impact of Federal Tax Increase, U.S., 2009



Source: Chaloupka et al., in progress; assumes higher income smokers smoke more expensive brands

Impact on the Poor

- Need to consider overall fiscal system
 - Key issue with tobacco taxes is what's done with the revenues generated by the tax
 - Greater public support for tobacco tax increases when revenues are used for tobacco control and/or other health programs
 - Net financial impact on low income households can be positive when taxes are used to support programs targeting the poor
 - Concerns about regressivity offset by use of revenues for programs directed to poor

WHO “Best Practices” for Tobacco Excise Taxes

- ***Do not view low taxes and prices for some tobacco products as a “pro-poor” policy***
- ***Do not allow concerns about the regressivity of higher tobacco taxes to prevent tobacco tax increases***
 - High tobacco taxes on all tobacco products will result in greater reductions in tobacco use among the poor
 - Results in a progressive distribution of the health and economic benefits that result – a truly “pro-poor” policy

Summary and Impact of a Tax Increase in Nebraska

Summary

- Increases in tobacco prices lead to significant reductions in tobacco use
- Higher tobacco taxes are most direct option for increasing prices
- Restricting price-reducing marketing would add to impact of tax increases
- Claims of negative economic impact of tax and price increases false or greatly exaggerated

Tobacco Taxation in NE

- Impact of raising the state cigarette excise tax by \$1.35
 - Would be 15th highest state tax
 - Somewhat higher than average tax in non-tobacco growing/manufacturing states
- If raised to \$1.99:
 - Over \$90 million in additional tax revenues in first full year
 - Almost \$10 million more if other tobacco product tax rate increased to same level
 - Sustained increases in revenues over time

Tobacco Taxation in NE

- Impact of raising the state cigarette excise tax by \$1.35
 - Nearly 10,000 adult smokers would quit
 - Almost 19,500 fewer kids would take up smoking
 - Prevent about 8,800 premature deaths from smoking among current population
 - Reduce the \$738 million spent to treat diseases caused by smoking
 - \$214 million through Medicaid

For more information:

www.bridgingthegapresearch.org

www.impactteen.org

fjc@uic.edu