The Science Behind Tobacco Taxation

Frank J. Chaloupka
University of Illinois at Chicago

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Fundamentals of Tobacco Tax Increases: Science, Methods, and Messaging
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Overview

- Overview of tobacco taxation
- Impact of taxes/prices on tobacco use, consequences of use
- Industry price marketing
- Earmarking tobacco tax revenues for tobacco control programs
- Counterarguments – Myths & Facts
Overview of Tobacco Taxation
Why Tax?

- **Efficient revenue generation**
  - Primary motive historically and still true in many countries today
  - Very efficient sources of revenue given:
    - Historically low share of tax in price in many countries
    - Few producers and few close substitutes
    - One of many goods/services that satisfies the “Ramsey Rule”
  - “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 on tobacco tax
Federal Cigarette Tax and Tax Revenues
Inflation Adjusted, 1955-2011

Source: Tax Burden on Tobacco and author’s calculations
Why Tax?

- **Promote public health**
  - Increasingly important motive for higher tobacco taxes in many high 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

- “… 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?

- **Cover the external costs of tobacco use**
  - “Pigouvian” tax
  - Less frequently used motive
  - Account for costs resulting from tobacco use imposed on non-users
    - Increased health care costs, lost productivity, caused by exposure to tobacco smoke among non-smokers
  - Can also include “internalities” that result from addiction, imperfect information, and time inconsistent preferences
Sources: CDC/SAMMEC, CTFK, Tax Burden on Tobacco, and author’s calculations
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
  – Specific excise tax in all states
  – Currently: 17.0 cents/pack (MO) to $4.35/pack (NY)
  – Average $1.49 per pack (48.5 cents in tobacco growing states; $1.63 in other states)

• Several proposing additional increases
State Tobacco Taxation

• State taxes on other tobacco products
  – All but PA tax other tobacco products
  – Mostly *ad valorem* taxes, but increasing movement towards specific 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
Local Taxation in the U.S.

• Many localities add additional cigarette tax
  – Typically a few cents/pack; some exceptions:
    » $1.50 in New York City
    » $2.68 in Chicago/Cook county

  – Sales tax applied to tobacco products in most states
    – Usually, but not always, applies to price inclusive of excise taxes
Cigarette Taxes & Prices
Inflation Adjusted, United States, 1954-2012

Source: *Burden on Tobacco* and author’s calculations
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
Cigarette Prices and Cigarette Sales
Inflation Adjusted, United States, 1970-2011

Source: Tax Burden on Tobacco and author’s calculations
Cigarette Prices and Adult Smoking Prevalence,
United States, 1970-2011, Inflation Adjusted

Source: NHIS, Tax Burden on Tobacco, 2009, and author’s calculations
Note: green data points for prevalence are interpolated assuming linear trend
Monthly Quit Line Calls, United States
11/04-11/09

- 4/1/09 Federal Tax Increase
- 1/1/08 WI Tax Increase
Cigarette Prices and Cessation
US States & DC, 2009

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

\[ y = 0.0283x + 43.083 \]

\[ R^2 = 0.371 \]

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

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

The graph shows a scatter plot with a trend line. The equation of the trend line is $y = -0.0129x + 25.34$ and the coefficient of determination ($R^2$) is 0.1721.
Cigarette Price and Youth Smoking Prevalence
Inflation Adjusted, United States, 1991-2011

Source: MTF, *Tax Burden on Tobacco*, and author's calculations
Taxes, Prices and Health: US, 1980-2005

- Cigarettes per adult per day
- Lung cancer death rates per 100,000 (divided by 4): men age 35–44
- Relative price

Source: Nat Rev Cancer © 2009 Nature Publishing Group
Industry Price Marketing
Cigarette Company Marketing Expenditures, by Type, 1975-2008

Source: author’s calculations from data reported in FTC (2011)
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
Earmarking Tobacco Tax Revenues for Tobacco Control
Tobacco Industry is Outspending Prevention Efforts 22:1 — FY2012

State Tobacco Revenue (taxes and settlement funds)
$25.6 billion

Tobacco Industry Marketing & Promotion Expenditures (2008)
$9.9 billion

Total CDC-Recommended Spending Level
$3.7 billion

State Tobacco Program Budgets
< $0.5 billion

Campaign for Tobacco Free Kids, Federal Trade Commission, American Heart Association, American Cancer Society, American Lung Association, SmokeLess States National Tobacco Policy Initiative
Comprehensive Programs

- Impact of state program funding
  - Increased funding associated with:
    - Reductions in overall cigarette sales
    - Lower youth smoking prevalence
    - Lower adult smoking prevalence
    - Increased interest in quitting, successful quitting
  - Much of impact results from large scale mass-media anti-smoking campaigns
State Tobacco Control Program Funding and Youth Smoking Prevalence

Source: ImpacTeen Project, UIC; YRBS
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

Tax Revenues (Millions)

Tax per Pack


Tax Revenues (Millions)

Tax per Pack
Positive Effect of Tax Increase on Revenue Results from:

Low share of tax in price:
- state taxes account for about 25% of price
- total taxes account for less than half of price
- 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 Increase on Revenues

Example – with significant tax avoidance

- Price $4.00, State tax $1.00, Sales 500 million packs
  - Revenues: = $500 million
- Double tax to $2.00; price rises to $5.00
  - 100% tax increase; 25% price increase
  - 25% price increase reduces sales by 20% (reduced consumption plus tax avoidance)
    - new sales 400 million packs
    - 80% of original sales at double the tax increases revenues by 60%
    - new revenues = $800 million
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 most states
Tax Avoidance

US Smokers, Last Purchase, November 2002-June 2011

Source, ITC project, US survey, Waves 1-8
Tax Avoidance & Evasion Do NOT Eliminate Health Impact of Higher Taxes

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

Source: Tax Burden on Tobacco, 2008 and BRFSS
Tax Avoidance & Evasion Do NOT Eliminate Revenue Impact of Higher Taxes

Cook County Cigarette Tax and Tax Revenues - FY01-FY06

Chicago tax rises from 16 to 48 cents

Chicago smoking ban, 1/16/06

Chicago tax up to 68 cents, 1/1/06

Revenue Impact of Higher Taxes
Combating Tax Evasion

- High-tech tax stamps
- Licensing of all involved in distribution and sale
- Strong enforcement
- Swift, severe penalties
- Focus on large scale, criminal activity
- Coordinated efforts
  - NAAG efforts targeting Internet
  - Agreements with tribes
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.
Impact on the Poor

- Concerns about the regressivity of higher tobacco taxes
  - Tobacco taxes are regressive, but tax increases can be progressive
    - Greater price sensitivity of poor – relatively large reductions in tobacco use among lowest income populations, small reductions among higher income populations
    - Health benefits that result from tax increase are progressive
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
Summary
Summary

- Tobacco tax increases have significantly reduced tobacco use in the US
  - Increased quitting
  - Prevented initiation
  - Reduced intensity

- Taxes generate significant revenues and revenues increase when tax increases
  - Added reductions in use/consequences when revenues earmarked for prevention/control efforts

- Adverse economic impact false or overstated
For more information:

www.bridgingthegapresearch.org

www.impacteen.org

fjc@uic.edu