

CAMPAIGN For TOBACCO-FREE Kids®

RESPONSES TO MISLEADING AND INACCURATE CIGARETTE COMPANY ARGUMENTS AGAINST STATE CIGARETTE TAX INCREASES

Whenever an increase to a state's cigarette tax rate is being seriously considered, a number of misleading or false arguments against the increase typically appear. The following list presents actual arguments made by cigarette companies, or their lobbyists and allies, in various states. Some were made publicly to policymakers or the media, and others were made only behind closed doors. As outlined below, however, none of these arguments holds water when confronted with the actual, relevant facts.

- I. *Cigarette Company Myth: Cigarette tax increases are regressive and hurt poor people.*
 - A. **The cigarette companies have it backwards: it is the harms from smoking that are regressive,** with lower-income communities already suffering disproportionately from smoking-caused disease, disability, death, and costs (thanks in no small part to cigarette company marketing tactics). Raising cigarette taxes, by getting more lower-income smokers to quit and cutback, will reduce those regressive harms and costs, not only helping lower-income smokers but reducing harms and costs to their families.
 - B. **Raising cigarette taxes helps lower-income communities the most because lower-income smokers are more likely to quit because of tax increases than higher income smokers.** That means that cigarette tax increases will reduce smoking-caused harms more sharply among lower-income families and communities – and that lower-income smokers are more likely than higher-income smokers to end up getting a big tax cut. Lower-income smokers who quit because of a tax increase not only stop paying any cigarette taxes at all but also stop spending any of the other amounts they previously paid for cigarettes, and lower-income smokers who cutback can also reduce their overall expenditures on cigarette taxes or cigarettes. Calculating the cigarette tax savings and total cigarette expenditure savings for a pack-a-day smoker in the state who quits (or a two-packs-a-day smoker who cuts back to one pack) can be quite revealing, with typical savings from reducing cigarette expenditures totaling considerably more than \$1,000 per year.
 - C. **Numerous polls show that there is strong support for tobacco tax increases among lower-income communities.** Nobody wants cheap cigarettes in their neighborhoods. [See, e.g., the TFK factsheet, Voters Across the Country Support Significant Increases in State Tobacco Taxes, <http://tobaccofreekids.org/research/factsheets/pdf/0167.pdf>.]
 - D. **Cigarette tax increases can be used to avert cuts to programs that benefit low-income communities or to fund new programs that will do so, including funding for tobacco prevention and cessation assistance.**
 - E. **By reducing smoking rates, cigarette tax increases will reduce the large amounts low-income and other state households are already paying in state and federal taxes to cover smoking-caused government expenditures.**
 - F. **See the Campaign for Tobacco-Free Kids (TFK) Factsheet *State Cigarette Tax Increases Benefit Lower-Income Residents*, <http://tobaccofreekids.org/research/factsheets/pdf/0147.pdf>.**
- II. *Cigarette Company Myth: Cigarette tax increases unfairly target smokers and make them shoulder the burden for statewide budget problems.*
 - A. **Total state income from cigarette taxes is currently far less than conservative estimates of state smoking-caused costs.** [For actual state-specific data to show comparisons, see TFK factsheets *State Tobacco-Related Costs & Revenues* and *State Tobacco-Prevention Spending vs. State Tobacco Revenues*, <http://tobaccofreekids.org/research/factsheets/pdf/0178.pdf> and <http://tobaccofreekids.org/research/factsheets/pdf/0219.pdf>.]

- B. **After any state cigarette tax increase, the state cigarette tax per pack, will still be far less than what the U.S. Centers for Disease Control & Prevention (CDC) estimates is the state's smoking-caused healthcare costs per pack (the national average is \$7.18 per pack).** [See the TFK factsheet *State Cigarette Tax Rates & Rank, Date of Last Increase And Related Data*, <http://tobaccofreekids.org/research/factsheets/pdf/0099.pdf>, for state health costs per pack.]
- C. **To make the tax increase exceedingly fair to smokers (and better for public health, and even more popular among voters), the state should allocate a portion of the new tax revenues to initiate or expand programs to help adult and youth smokers quit** (e.g., quit lines, public education, school-based programs, etc.). Better yet, the state should also use some of the new revenues to fund expanded efforts to prevent more kids from cigarette addiction. [And doing all that won't cost more than a few pennies per pack of the tax, while producing future reductions in state smoking-caused costs that will reduce economic burdens on all state residents, including smokers.]
- III. *Cigarette Company Myth: The state is already getting tons of tobacco money; seeking more is excessive.*
- A. **See IIA., above.**
- B. **While the state also gets tobacco settlement payments, those are to reimburse the state for its past and future costs caused by the cigarette companies illegal and wrongful acts prior to the tobacco settlement (and are far less than the total of those harms and costs).** [And those illegal and wrongful acts – marketing to kids, failing to disclose known dangers and harms caused by their products, interfering with scientific research and public awareness regarding product harms, etc. – have been fully established by court rulings and in internal industry documents disclosed in various lawsuits against the companies.]
- IV. *Cigarette Company Myth: The state (or federal, state, and local government) is already getting more per pack than the cigarette companies.*
- A. **Every state actually suffers a net loss for every pack sold within its borders but the cigarette companies make a net profit on every pack sale.** The cigarette companies comparison between their alleged profits per pack against total state or government revenues per pack is unfair and misleading. Company profits per pack equal what the companies gain, free and clear, after paying for all their costs associated with producing and marketing the cigarettes they sell. Similarly, the state's "profit" (or loss) per pack equals the state's cigarette tax revenues minus the state's cigarette-caused costs. Doing the math shows that every state has a per-pack loss. [Subtract CDC state smoking costs per pack from state's actual or proposed tax per pack. See above for TFK factsheets containing that data.] According to the *Tobacco International* trade journal, in 2004 Philip Morris had an average profit in the United States of 46 cents per pack sold (and Lorillard, which sells Newport, had an average profit of 59 cents per pack). That same year, Philip Morris's total U.S. revenues were \$1.87 per pack sold.
- B. **It is not fair or reasonable to include tobacco settlement payments when determining state revenues or profit/loss per pack. See IIIB., above.** But even if those payments are included, the state is still running at a loss. [Dividing current state settlement receipts by the number of packs sold will provide the state's per pack settlement revenue. See above for TFK factsheets containing that data.] It is also important to note that the cigarette companies are able to take a big "business expense" tax deduction for all of their tobacco settlement payments, which reduces their taxes by at least \$1.0 to \$1.5 billion per year (thereby increasing their per-pack profits, as well).¹
- C. **Similarly, it does not make sense to include state sales tax revenues on cigarette sales** since the sales tax applies to virtually all products sold in the state and is neither tobacco specific nor

¹ See, e.g., the Campaign for Tobacco-Free Kids (TFK) factsheet, *Cigarette Company Settlement-Related Price Hikes Are Excessive*, <http://tobaccofreekids.org/research/factsheets/pdf/0071.pdf>.

meant in any way shape or form to compensate the state for tobacco-caused harms. But even if tobacco product sales tax revenues are included, the state is still running at a loss.

- D. **Total state tobacco revenues per pack sold in the state are almost always less than the cigarette companies' total revenues per pack.** The major cigarette companies currently receive more than \$2.10 per pack in gross revenues. But each state currently receives only its current cigarette tax per pack in gross revenues – and only two states have tax rates of more than \$2.10 per pack (RI at \$2.46 & NJ at \$2.40). But both of those states still have a net loss per pack sold because of state smoking-caused costs -- while the big cigarette companies profit from each and every sale.]
- E. **The RJ Reynolds cigarette company, which has made this argument most aggressively, says that it has profits of only 10 cents per pack or less, but Wall Street Analysts and other experts say the major companies profits per pack are 28 to 46 cents per pack.**²
- F. **These analyses of cigarette company profits or revenues per pack do not even consider the fact that the whole tobacco industry's profits per pack are much larger than just the profits of the cigarette companies.** It is not only the cigarette manufacturers, such as Philip Morris and Reynolds American, that gain revenues and profits from cigarette sales but also cigarette distributors and retailers. Comparing state or government-wide cigarette revenues or net losses against cigarette industry-wide revenues or profits show that the cigarette industry, as a whole, is doing much, much better than the states per each pack sold.
- V. *Cigarette Company Myth: Cigarette tax increases do not provide a reliable source of future state revenue.*
- A. **After an increase, state cigarette tax revenues sharply increase and then slowly decline because of state smoking declines -- but those declines will be gradual and completely predictable.** There will be no surprises and the state can easily adapt.
- B. **State tobacco tax revenues are more predictable and stable than state income tax or corporate tax revenues,** which can decline sharply because of unexpected economic recessions. [State budget reports will provide useful examples.]
- C. **A state could easily compensate for the slow and predictable tobacco tax revenue declines by periodically increasing its tobacco tax rates, instituting an automatic inflation adjustment to its tobacco tax rates, and/or implanting automatic rate increases whenever revenues fall below an established floor.** The inflation adjustment, for example, could be based on the MSA inflation adjustment (i.e., an annual increase of 3% or the actual rate of inflation for the prior year, whichever is highest).
- D. **Along with the small, gradual declines in cigarette tax revenue caused by smoking declines, the state will also be accruing significant reductions to its smoking-caused costs.** Over time, these savings will more than make up for any cigarette tax revenue reductions.
- VI. *Cigarette Company Myth: Cigarette tax increases will promote cigarette smuggling, black markets, and smoker tax avoidance, which will eliminate state revenue gains.*
- A. **Every single state that has significantly increased its state cigarette tax rate has enjoyed substantial increases in state revenue** – despite the consumption declines prompted by the tax increase and despite any related tax avoidance. The increased new revenue the state receives on each pack sold in the state greatly outweighs the revenue losses from fewer packs being sold. [See

² Cigarette company profit sources include: "Tobacco Settlement Causes a Rise in Makers of Low-Price Cigarettes," *Wall Street Journal*, May 1, 2001 [citing Solomon Smith Barney tobacco analyst Martin Feldman re the major companies' profit was \$4.66 per carton (46.6 cents per pack)]; Donovan, D., "The Giant Tobacco Robbery," *Forbes Magazine*, January 22, 2001 [industry-wide profit 46 cents per pack], <http://www.forbes.com/forbes/2001/0122/062.html>; Adelman, D., *New York Times Magazine*, February 28, 1999 [Philip Morris's profit per pack on Marlboros sold in New York City was 28 cents].

the TFK factsheet *Raising State Tobacco Taxes Always Increases State Revenues & Always Reduces Tobacco Use*, <http://tobaccofreekids.org/research/factsheets/pdf/0098.pdf>.]

- B. **The smuggling/tax avoidance problem is a lot smaller than the cigarette companies and their allies say.** [See the same TFK factsheet mentioned in VI.A, above.]
- C. **There are simple, often low-cost, steps the state can take to minimize any loss of revenue from cigarette smuggling or smoker tax avoidance** -- and state support for comprehensive federal anti-smuggling and tobacco-internet legislation would further reduce any such revenue losses. [See the TFK factsheet outlining state-specific options for minimizing tax evasion and smuggling at <http://tobaccofreekids.org/research/factsheets/pdf/0274.pdf>. For guidance on possible state legislation to curtail Internet-based cigarette and other tobacco tax evasion, see the materials at <http://tobaccofreekids.org/research/factsheets/index.php?CategoryID=29>.]
- D. **States can take steps to maximize new cigarette tax revenues by minimizing pre-increase hoarding and related revenue problems.** First, state should be sure to apply the cigarette tax increase to all cigarettes held in wholesaler or retailer inventories on the effective date of the increases -- virtually all states and the federal government do this whenever they raise their cigarette tax rates but some states (e.g., Illinois and Alabama) have failed to do so in recent cigarette tax increases. Second, states should provide as little lead time as possible between the date the tax increase is passed and its actual effective date. Third, states should ensure that any wholesaler or distributor tax-stamp discounts based on a percentage of the state tax rate are adjusted to account for the increase.
- E. **There are very good models and formulas available for projecting state revenues from proposed cigarette tax increases that take full account of possible increases in tax evasion and smuggling.** These models show that states will still enjoy substantial additional new revenues from significant cigarette tax increases -- and states that use these conservative models can be assured that there will be no "lower-than-expected" problems with future state cigarette tax revenues following the increase. [For example, TFK's model and formulas for projecting state revenues from cigarette tax increases is quite conservative.]

VII. *Cigarette Company Myth: Cigarette tax increases do not reduce youth smoking (or any smoking).*

- A. **It is amazing that the cigarette companies' lobbyists and allies continue to make this argument with a straight face despite the absence of any facts to support it.** In fact, the cigarette companies have repeatedly asserted and acknowledged, both publicly and in internal company documents disclosed in tobacco lawsuits, that raising cigarette prices through state tobacco tax increases or other means significantly reduces smoking, especially among kids and lower-income communities. That fact is also well established by scientific research and by the actual experiences of states that have raised their tax. [See the TFK Factsheet *Raising Cigarette Taxes Reduces Smoking, Especially Among Kids (and the Cigarette Companies Know It)*, <http://tobaccofreekids.org/research/factsheets/pdf/0146.pdf>.]
- B. **The companies' fallback argument doesn't work, either.** A related new cigarette company argument is that tax evasion by current smokers after cigarette tax increases is now a much bigger problem than previously and that cigarette tax increases therefore do not produce the same smoking declines as they have in the past. It is important to note that this argument acknowledges that cigarette tax increases have and still do prevent and reduce smoking rates, but argues simply that the post-tax-increase smoking declines will not be as large as in past years. In addition, this cigarette company argument also ignores the fact that: a) the declines are still substantial; b) those smokers most likely to take steps to evade the higher cigarette tax rate are the heaviest and most powerfully addicted smokers, who were and are the least likely to quit and cutback anyway. Conversely, those smokers most likely to quit or cutback after cigarette tax increases -- such as youth smokers, those already trying or planning to quit, and light or occasional smokers -- are also the least likely to take any extra steps (other than quitting or cutting back) to try to evade the cigarette tax increase. And any rise in smoker tax evasion would not have any significant impact on

the ongoing power of cigarette tax increases to prevent kids from taking up smoking. [Also, see VI. C., above, on ways that states can reduce cigarette tax evasion, which will not only increase the amount of new revenue the state gets from its cigarette tax increase but also minimize any risk that tax evasion will reduce the power of the increase to cut current smoking levels.]

VIII. *Cigarette Company Myth: Cigarette tax increases will hurt the state's economy by reducing cigarette sales and related employment, retailer revenues, etc.*

- A. **Money spent on cigarette sales will not disappear when cigarette sales decline, it will simply shift to consumer expenditures on other products or to consumer savings or investments.** In other words, smokers who quit or cutback will spend or use the money they formerly spent on cigarettes in other ways – and those alternative uses are likely to produce more jobs and more productive economic activity. For example, cigarette manufacturing and distributing is very capital intensive and does not create a lot of jobs for people; and shifts from spending on a consumable (especially one with such large social costs) to saving or investing is always more economically productive. In addition, most states are exporting a large portion of its own consumers' expenditures on cigarettes to those tobacco states where cigarettes are manufactured and tobacco leaf is grown – which only helps the tobacco states' economies. Shifting consumer expenditures on cigarettes to other products tends to keep the money in the state, where it will generate new jobs and other beneficial economic activity.
- B. **Economic studies have found that even if smoking were entirely eliminated in the United States, the net economic effect on each state would be positive** (except in a few of the major tobacco states), with more jobs created as well as other increases in productive economic activity.³ Even in those states with the highest levels of tobacco farming and tobacco manufacturing, the economic consequences from the elimination of all U.S. smoking would be minimal – and the increasing diversification of those states' economies in recent years may have eliminated those net consequences altogether.
- C. **A study of retailer gross revenues by the State of Maryland's Comptroller after that state's recent cigarette tax increase found that "When all taxable sales throughout the entire study area for retailers typically selling cigarettes are examined, however, there is no evidence that the increase in tobacco taxes has had a direct and measurable impact on gross revenues."**⁴
- D. **State-specific economic impact studies in New Hampshire, Texas, and Virginia found that substantial cigarette tax increases in those states would actually increase total state employment** – and that reduced cigarette sales have, historically, been linked with increased state retail employment.⁵
- E. **The cigarette tax increase will reduce direct public and private smoking-caused costs, which will further strengthen and improve the state's economy** – especially since those savings will, overall, be shifted to much more productive uses.
- F. **CDC estimates that productivity losses caused by smoking amount to more than \$82 billion per year** – and that total does not even include business losses from cigarette breaks or from

³ Warner KE, et al., "Employment implications of declining tobacco product sales for the regional economies of the United States," *JAMA* 275(16):1241-6, April 24, 1996. Warner KE & GA Fulton, "The economic implications of tobacco product sales in a nontobacco state," *JAMA* 271(10):771-6, March 9, 1994. Warner KE, "Implications of a nicotine-free society," *Journal of Substance Abuse* 1(3):359-68, 1989.

⁴ Schafer, William Donald, Comptroller of the State of Maryland, Letter/Report to Thomas V. Miller, Senate President, and Michael E. Busch, Speaker of the House of Delegates, January 15, 2003.

⁵ Gottlob, B., *The Fiscal and Economic Impacts of Increasing the Cigarette Tax in New Hampshire*, PolEcon Research, March 2003. Gottlob, B., *The Fiscal and Economic Impacts of Increasing the Cigarette Tax in Texas*, PolEcon Research, in press. Gottlob, B., *The Fiscal and Economic Impacts of Increasing the Cigarette Tax in Virginia*, PolEcon Research, April 15, 2004, <http://tobaccofreekids.org/pressoffice/VACigTaxReport.pdf>.

workers being less productive when on the job because of smoking caused health problems.⁶ [CDC estimates of state productivity losses available from the TFK factsheet *State Tobacco-Related Costs & Revenue*, <http://tobaccofreekids.org/research/factsheets/pdf/0178.pdf>.]

- G. **Directing the new state government revenues generated by the cigarette tax increase to reduce state budget deficits or to fund economically productive programs or projects will further strengthen and improve the state's economy.**

IX. *Cigarette Company Myth: Cigarette tax increases will hurt the state's tobacco farmers.*

- A. **Even eliminating all smoking in any particular state would have only a very minor impact on the overall demand for American-grown tobacco leaf** – and the state cigarette tax increases being considered will not (unfortunately) even reduce smoking in the state by half. Smoking by U.S. citizens accounts for less than half of the total demand for U.S. tobacco leaf, which is also smoked worldwide in cigarettes exported from the U.S. and manufactured overseas. See <http://tobaccofreekids.org/research/factsheets/pdf/0150.pdf>, the TFK Factsheet *State Cigarette Tax Increases Will Not Hurt U.S. Tobacco Growers or Cigarette Factory Workers* [state-specific versions also available by request: factsheets@tobaccofreekids.org.]

X. *Cigarette Company Myth: Cigarette tax increases will reduce the state's tobacco settlement payments.*

- A. **There is no automatic offset that reduces tobacco settlement payments to the state if the state increases its cigarette taxes.** [There was such an offset for certain federal cigarette tax increases, but that provision expired in 2002.]
- B. **The “volume adjustment” in the state tobacco settlement agreements reduces settlement payments to the states based on reductions in the nationwide (not state) cigarette sales of the major cigarette companies.** The reduction in pack sales prompted by the cigarette tax increase proposed in the state would have only a miniscule impact on those nationwide sales, and an even smaller impact on the state's settlement payments.
- C. **See the TFK factsheet Effect of State Tobacco-Tax Increases on MSA and Phase II Payments to the States**, <http://tobaccofreekids.org/research/factsheets/pdf/0197.pdf>.

XI. *Cigarette Company Myth: Cigarette tax increases will reduce state revenues by eliminating or reducing state cigarette sales to smokers in other states (e.g., it will reduce cross border sales, reduce sales to interstate smugglers, eliminate state as source for internet sales).*

- A. **This argument applies only to very low-tax states or to states with cigarette tax rates significantly lower than neighboring states. But even in regard to those states, it fails.**
- B. **States will enjoy substantially more state revenues from increasing their state cigarette tax rate than they will lose from any corresponding reduction to their sales to cigarette smugglers, law-breaking internet sellers, or tax-avoiding shoppers from other states.** In many cases the new state revenues from the cigarette tax increase will not only exceed current state tax revenues from sales to out-of-state buyers but also exceed all retailer profits from those sales to out of state buyers.
- C. **States should not support the in-state sale of cigarettes to illegal smugglers, internet sellers, or tax-avoiding shoppers from other states.** By raising their cigarette tax rates, states can reduce or eliminate the illegal profit margins from these illegal activities, thereby reducing these illegal activities. More specifically, in some cases terrorist organizations have been raising revenues through cigarette smuggling from low-tax to high-tax jurisdictions. By raising their cigarette tax rates,

⁶ CDC, "Annual Smoking-Attributable Mortality, Years of Potential Life Lose, and Economic Costs -- United States 1995-1999," *MMWR*, April 11, 2002, www.cdc.gov/mmwr/preview/mmwrhtml/mm5114a2.htm.

low-tax states can not only increase their own revenues but also help to stop such terrorist fundraising activities by making it much less profitable.

XII. *Cigarette Company Myth: Cigarette tax increases will not save money because smokers dying early reduces state costs.*

A. **The average smoker actually has significantly higher total lifetime healthcare costs than the average nonsmoker, even though the average smoker dies a lot sooner than the average nonsmoker.**⁷

B. **See the TFK factsheet Immorality and Inaccuracy of the Death Benefit Argument, <http://tobaccofreekids.org/research/factsheets/pdf/0036.pdf>.**

XIII. *Cigarette Company Myth: What's next, raising taxes on fatty foods? Raising cigarette tax is just the first step in public health nazi's plan to tax everything that is bad for you.*

A. **There is absolutely no consumer product or category of consumer product other than cigarettes and tobacco products that, when used as directed, inevitably causes disease, disability, and death and enormous social and economic costs.**

B. **There is also no consumer product or category of consumer product other than cigarettes and tobacco products that, as actually used by consumers, directly causes as much disease, disability, and death and enormous social and economic costs** (as reflected in the fact that smoking kills many more people each year than alcohol, illegal drugs, murder, suicide, accidents, and AIDS, combined).

C. **While obesity is, according to some estimates, now responsible for an enormous number of deaths each year, that total is still considerably lower than the smoking-caused death toll.** In addition, the causes of obesity are numerous and diverse. The connection between fatty foods and obesity-related disease is nowhere near as direct and powerful as the causal relationship between smoking and lung cancer and numerous other diseases.

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For additional information on state cigarette taxes and the many benefits from increasing them, see the Campaign for Tobacco-Free Kids website at <http://tobaccofreekids.org/reports/prices> & <http://tobaccofreekids.org/research/factsheets/index.php?CategoryID=18>

Please send any comments, new response ideas, or new cigarette company anti-tax arguments to:

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⁷ See, e.g., Hodgson, T.A., Cigarette Smoking and Lifetime Medical Expenditures, *Milbank Quarterly* 70(1): 81-115 (1992). Nusselder, W.J., et al., "Smoking and the Compression of Morbidity," *Journal of Epidemiology and Community Health* 54(8): 566-74, August 2000. Warner, K.E., et al., "Medical Costs of Smoking in the United States: Estimates, Their Validity, and Their Implications," *Tobacco Control* 8(3): 290-300, Autumn 1999.