

BRIEF ANALYSIS

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Taxing the Poor

In its haste to enact one of the largest tax increases in U.S. history, Congress has done precious little analysis of the social and economic impact of the proposed tobacco bill.

The \$1.10 per pack tax increase that the Senate Commerce Committee approved would be the most regressive in history. Its greatest impact would be on people with low incomes, racial minorities and those with little education, because higher percentages of these groups are smokers. According to the U.S. General Accounting Office, it also would significantly increase cigarette smuggling, reduce state tax revenues and diminish employment opportunities in some states.

There is far less evidence that raising the cigarette tax would appreciably reduce teen-age smoking, which is the purported purpose of the bill.

A Regressive Tax. People with low incomes buy a disproportionate percentage of all cigarettes sold. According to data from the U.S. Bureau of Labor Statistics [see Figure I]:

- Households with incomes of less than \$30,000 make about half of all tobacco purchases (47 percent).
- Households with incomes of \$30,000 to \$50,000 make 30 percent of all tobacco purchases.
- Households with incomes over \$50,000 make only 23 percent of purchases.

According to new data from the Joint Committee on Taxation (JCT), raising the cigarette tax by \$1.10 per pack would increase the federal tax burden on those earning less than \$10,000 per year by 44.6 percent by the year 2003. Sixty-one percent of all the new taxes would be paid by those with incomes under \$40,000. Meanwhile, those earning more than \$75,000 would see a tax increase of less than 1 percent. [See Figure II.]

Further, according to a new report from the U.S. Surgeon General, a higher percentage of blacks than whites smoke, and among both groups those with less than a high school education are twice as likely to smoke as those with a college education. Thus the impact of higher cigarette taxes would fall disproportionately on racial minorities and those with little education.

That impact could be far greater than the JCT estimates. According to financial analyst Gary Black of Sanford C. Bernstein & Co., the widely cited \$1.10 figure does not include all the provisions of the legislation. Add to it the likely effects of look-back penalties, liability costs, licensing fees and declining sales, and the \$1.10 figure rises to \$2.78 per pack. Other Wall Street analysts have made similar calculations.

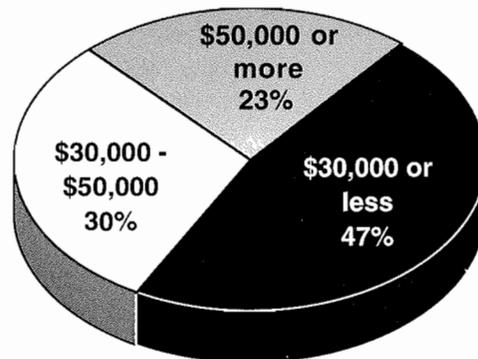
If these estimates are correct, they could dramatically change the political prospects of the tobacco bill. A new poll by the Tarrance Group and KRC Research found that a substantial majority of Americans oppose the tobacco bill if it raises cigarette prices by as much as \$2.50 per pack. The poll also indicates that Americans are

concerned that higher cigarette taxes could create a black market for cigarettes, destroy jobs and foster government bureaucracies.

The Black Market. The smuggling of cigarettes already is a \$1 billion a year problem in the U.S.

- Contraband cigarettes from Mexico hold as much as 23 percent of the market in California.
- New York state alone loses \$300 million per year in revenue due to smuggling from states with lower cigarette taxes.
- When Alaska recently raised its tax from 29 cents to \$1 per pack, cigarette sales at legitimate outlets virtually collapsed, despite no evidence of reduced smoking.

FIGURE I
Who Buys Tobacco
(Percent of Sales by Family Income, 1995)



Source: Bureau of Labor Statistics.

Understandably, law enforcement officials are apprehensive about the impact of the cigarette tax, fearing it not only will encourage the black market in cigarettes but also will give organized crime a new line of business.

A Way to Thwart Teen Use? Not. If the most important goal of the legislation is to prevent underage tobacco use, the huge tax hike will not accomplish it. An expanded black market would likely make cigarettes even easier for teen-agers to get, not to mention making them more enticing to young minds seeking adventure and excitement.

In all probability, high prices would encourage the smugglers who now market illegal drugs to target teen-agers. From the standpoint of parents, pushing the cigarette trade underground would make it even harder to keep cigarettes out of their children's hands.

Senator John McCain (R-Ariz.), author of a \$516 billion tobacco bill, claims the proposed legislation will stop 3,000 children a day from starting to smoke. Many experts warn such predictions are little more than wishful thinking that raises unreasonable expectations for lower rates of youth smoking. After the tobacco industry and 40 state attorneys general announced a settlement last year, the American Cancer Society talked in terms of a 60 percent decrease in youth smoking, but later acknowledged that figure was a goal and said it had performed no analysis to determine whether the goal could be reached.

Few studies have carefully analyzed how youths are affected by price increases. Any parent with a clothing-brand conscious teen can affirm that high prices are seldom a deterrent. But beyond casual social observa-

tion, there is other evidence to question the claim that raising the price is the best way to combat youth smoking.

In congressional testimony, Deputy Treasury Secretary Lawrence Summers cited studies that conclude every 10 percent hike in the price of a pack of cigarettes would produce up to a 7 percent reduction in the number of children who smoke. These studies argue that children are far more sensitive to price than adults.

But a recent Cornell University study, the results of

which were reported in *The New York Times*, challenged the methodology of the studies cited by Summers. The Cornell study found that states that increased tobacco taxes did not have significantly fewer children who started smoking than states that raised taxes more slowly or not at all. Further, a Cornell researcher noted, it is hard to predict how a \$1.10 or more per pack increase would affect smoking rates because there has never

been an increase of that magnitude in the United States, and there are so few studies on the correlation between youth smoking rates and prices that any estimate is a guess.

Everyone in the tobacco debate agrees that reducing youth smoking would be beneficial because nearly all long-term smokers start early. Yet the impact of the proposed legislation on teen smoking is questionable. The only certain thing is the unprecedented tax increase on people with low incomes.

This Brief Analysis was prepared by NCPA Senior Fellow Bruce Bartlett.

