

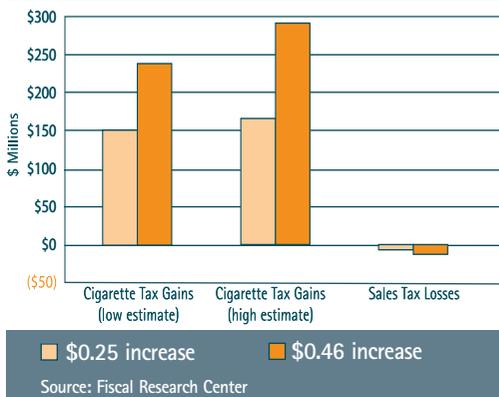


HealthVoices

Economic and Health Benefits of Tobacco Taxes for Georgians

Spring 2004

Georgia's Tobacco Tax Revenue Gains



"An independent economic analysis shows that the 2003 increase in Georgia's tobacco taxes – the first in 32 years – will deter Georgians from smoking and will generate substantial revenue. If Georgia enacted an additional tax increase of 21 cents per pack, it would have significant economic and health benefits as well."

As a catalyst for better health and health care in Georgia, Healthcare Georgia Foundation helped support an *independent economic analysis of the 2003 tobacco tax increase* by the Fiscal Research Center (FRC) of the Andrew Young School of Policy Studies at Georgia State University.¹ Because Georgia continues to have a revenue shortfall and the 2003 tax increase was less than the amount originally recommended, the FRC also examined the merits of an additional increase in Georgia's tobacco taxes.

The 2003 increase in Georgia's tobacco taxes – the first in 32 years – will both deter Georgians from smoking and will generate substantial revenue for the state. If the state enacted an additional cigarette tax increase of 21 cents per pack (for a total of 58 cents), it would have significant economic and health benefits as well.

Georgia enacted these changes in 2003:

- Increased the state excise tax on cigarettes from 12 cents to 37 cents per pack.
- Increased the state ad valorem tax on cigars from 10 percent to 23 percent.
- Established a tax on smokeless tobacco products of 10 percent.

Until last year Georgia's cigarette tax was 12 cents per pack; when adjusted for inflation, this is the equivalent of only 2.7 cents in 1971 dollars. Had this tax been adjusted annually to match the rate of inflation since 1971, the current tax rate would be 53.3 cents

per pack, 44 percent higher than the rate that became effective in July 2003. Georgia ranks 36th in state cigarette excise taxes at 37 cents per pack, with New Jersey having the highest tax (\$2.05 per pack) and Virginia having the lowest tax (2.5 cents per pack).

During deliberations by the 2003 Georgia General Assembly of the proposed tobacco tax legislation, public health and health care advocates made several statements on behalf of the tax increase.² These arguments related to the size of the revenue forecast and the economic and health benefits. However, there was no independent economic analysis to validate these assumptions. If legislation is proposed to raise tobacco taxes again, there is likely to be further debate about the merits of a tax increase. To prepare for this debate, we asked the critical question: *Are the common assumptions used to support tobacco tax increases really valid?* The independent economic analysis conducted by the Fiscal Research Center suggests that they are.



Independent Analysis of 2003 Tobacco Tax Increase

Independent Analysis

The Findings

Proponents of higher tobacco taxes frequently point to economic and health benefits to support their case. The purpose of FRC's analysis was to determine the factual basis for these claims, particularly for Georgia. The findings below summarize FRC's analysis of five issues addressed during the debate on the 2003 tobacco tax increase.

Raising tobacco taxes will increase state revenues.

Proponents of higher tobacco taxes stated that raising the state excise tax on cigarettes by 25 cents would increase state revenues by a significant amount. Their estimates were as high as \$180 million per year.

FRC's analysis shows the first-year increase in tobacco tax revenues from the 25 cent cigarette tax increase (bringing the tax to 37 cents) is estimated to range between \$149 million and \$163.9 million. FRC projected that an additional tax increase of 21 cents, to 58 cents per pack, (accomplishing Governor Perdue's original proposal) would generate an additional \$85.5 million to \$123.7 million in tax revenues in the first fiscal year.

Higher tobacco taxes will reduce smoking and improve health.

Tobacco tax proponents have pointed to a wide variety of health benefits, especially among young people, that can be expected to result from a reduction in smoking brought about by higher taxes.

Since measurement of health effects requires long-term research, no independent effort was made by FRC to verify all health claims made by the proponents. However, the FRC study did confirm that a sizeable portion of the drop in projected cigarette sales in Georgia following the 25 cent tax hike (i.e. 36.44 million packs in the first year), was likely to result from genuine declines in smoking vs. increased cross-border shopping in lower tax states. FRC's analysis found that the actual estimated decline in the number of packs smoked tends to confirm the findings from other states: higher taxes reduce smoking.

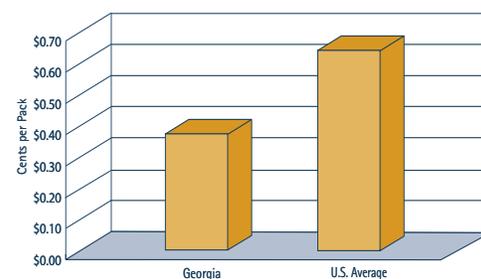
State sales tax and lottery revenue losses from lower tobacco sales will be minor.

Proponents have suggested that any short-term revenue losses linked to declining tobacco sales, including general sales tax and lottery revenue, would be relatively minor. FRC's analysis confirmed that any loss of sales tax revenues would be modest compared to state revenues from the tobacco tax increase. The offsetting loss of sales tax revenues after the 25 cent increase was estimated at \$3.85 million when linked to a 36.44 million-unit decline in annual cigarette packs consumed, which is less than 3 percent of the estimated revenue increase. Had the tax increased by 46 cents, projected losses are \$7.1 million in sales tax revenues from 66.98 million fewer cigarettes packs consumed.

Job losses will be minimal in tobacco-related industries.

Proponents have stated that any job losses in the state's tobacco growing and cigarette manufacturing sectors would be relatively

Georgia's 2003 Tax Rate Remains Well Below the U.S. Average

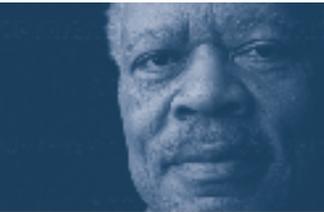


Georgia: \$0.37/pack U.S. Average: \$0.70/pack
Source: National Center for Tobacco-Free Kids

small since Georgia tobacco consumers are a small percentage of the global market for tobacco products. While tobacco tax proponents recognize that retail distribution job losses may occur, they suggest these would be short term and geographically limited. FRC's analysis suggests higher tobacco taxes pose no threat of a major job loss in either the tobacco growing or cigarette manufacturing sectors in Georgia. Tobacco production in Georgia would decline by less than 0.07 percent. The decision by Brown and Williamson to close its cigarette manufacturing plant in Macon is related to larger economic issues for the company, not the modest increase in Georgia's tobacco taxes. In the tobacco retail distribution sector, FRC concluded that the loss of 635 jobs projected by the American Economics Group overstated the likely job loss.³

Low-income smokers will gain the largest health benefits.

Proponents recognize that raising tobacco taxes imposes a relatively greater burden on low-income households. Based on an analysis of Georgia smoking prevalence



HealthVoices

data, such price impacts disproportionately affect three groups: young adults, those with a high-school or lower education and Hispanics. However, this "unfair" distributional effect is small and is partially outweighed by the response to higher taxes by low-income tobacco users. FRC cites studies that show that lower-income smokers reduce their smoking at a greater rate than high-income smokers when faced with tax-induced price increases.

FRC's analysis confirms that although tobacco excise taxes are regressive, this effect is partially mitigated by evidence that lower-income smokers reduce their smoking rate more than high-income users when taxes cause cigarette prices to rise.

In Summary

The independent analysis conducted by the Fiscal Research Center largely confirms both the economic and the health arguments made by Georgians who support higher tobacco taxes. Higher tobacco taxes promise both a measurable increase in revenue and substantial improvements in the health and quality of life of many Georgians. Over

20,000 Georgians will quit smoking and 9,200 of Georgia's children will be saved from premature death caused by smoking.

Conclusions

Governor Perdue and the Georgia General Assembly took a significant step in 2003 by enacting the state's first tobacco tax increase in 32 years. It will improve the health of Georgians while generating \$149 to \$163.9 million in new revenues that can be used to address critical needs in the state.

A number of other states have implemented additional tax increases in years following the initial tax increase.⁴ Georgia might also consider modifications to its tobacco taxes, including adding an automatic increase tied to increases in prices.

In light of potential deliberations in Georgia, it is important to know that further increases in these taxes, for example, raising the cigarette tax another 21 cents per pack to a total of 58 cents, would have significant economic and health benefits.

1 Seaman, B.A., *The Economics of Cigarette Taxation: Lessons for Georgia*, Fiscal Research Center, Andrew Young School of Policy Studies, Georgia State University, December 2003. Available at http://frp.aysps.gsu.edu/frp/frpreports/Report_89/index.htm.

2 *Benefits from a Cigarette Tax Increase in Georgia*, National Center for Tobacco-Free Kids. April 20, 2002. Available at www.tobaccofreekids.org.

3 *The Economic Impact of a 75 Cent Cigarette Tax Increase in Georgia*, Brown and Williamson, Macon, GA, 2003.

4 *State Cigarette Tax Rates & Rank, Date of Last Increase, Annual Pack Sales & Revenues, and Related Data*, National Center for Tobacco-Free Kids. Available at www.tobaccofreekids.org.

Prepared by:

Bruce A. Seaman, Ph.D., Associate Professor of Economics and Senior Associate in the Fiscal Research Center

David L. Sjoquist, Ph.D., Professor of Economics, holder of the Dan E. Sweat Distinguished Scholar Chair in Educational and Community Policy, and Director of the Fiscal Research Center

Estimated benefits to Georgians from the 2003 cigarette tax:

- 9,200 children will be saved from premature smoking-caused death
- 28,740 children will not become smokers
- 21.2 million fewer packs of cigarettes smoked
- 20,333 adult smokers will quit



Research Methods

The Fiscal Research Center in the Andrew Young School of Policy Studies of Georgia State University reviewed the existing body of academic and policy research to revisit five essential assumptions about Georgia's tobacco tax increases. Research was conducted to determine the degree to which these assumptions are supported by conceptual analysis and empirical evidence. The economic methods applied include modeling the price elasticity of demand and the elasticity of revenue with respect to tax rates and other econometric models.

Are tobacco tax assumptions accurate, or are they vulnerable in the face of further tax hikes? This analysis of research on consumption patterns, smoking rates, and revenue issues ranging from tax avoidance to tax regressivity to the magnitude of possible adverse economic effects offers lessons that will assist future policy decisions. The full report is available at http://frp.aysps.gsu.edu/frp/frpreports/Report_89/index.htm.

Healthcare Georgia Foundation is a statewide, private independent foundation whose mission is to advance the health of all Georgians and to expand access to affordable, quality healthcare for underserved individuals and communities.

Healthcare Georgia Foundation is a catalyst for better health and health care in Georgia. Through strategic grantmaking, Healthcare Georgia Foundation supports organizations that drive positive change; promotes programs that improve health and health care among underserved individuals and communities; and connects people, partners, and resources across Georgia.

HealthVoices is published periodically by Healthcare Georgia Foundation as an educational service to Georgians interested in health policy.

HealthVoices is available online at www.healthcaregeorgia.org. For further information, please contact Martha Katz, Director of Health Policy, 404.653.0990 or mkatz@healthcaregeorgia.org.

