



Budget Facts 2009

from the COMMONWEALTH FOUNDATION

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Cigarette Taxes

Pennsylvania faces a \$3 billion tax revenue shortfall in the state's General Fund Budget. Competing proposals from Gov. Ed Rendell and the Republican-led Senate differ on raising taxes and reducing/reprioritizing spending. This is the sixth in a series of fact sheets on the state budget.

BACKGROUND

- Governor Rendell has proposed raising the state cigarette tax an additional **10 cents per pack**, in hopes of raising an additional **\$61 million in revenue**.
- Cigarette taxes were first imposed in Pennsylvania as a **temporary emergency tax** in 1935.
- Pennsylvania's state cigarette tax is currently the **18th highest** among the 50 states at \$1.35 per pack.

STATE CIGARETTE TAX COLLECTIONS ARE DECLINING

- Pennsylvania is already experiencing declining revenues from cigarette taxes. After a 35 cent per pack increase in 2004, **revenue fell by \$72 million**, and tax revenues have remained below 2004 levels since then.
- In a 2009 study, Altria found **cigarette taxes are an inefficient method to increase revenue**.

Pennsylvania Cigarette Tax Revenue

Fiscal Year	Revenue (in thousands)	Growth	Tax Rate (per pack)
2001-02	\$266,795	-0.9%	\$0.31
2002-03	\$826,742	209.9%	\$1.00*
2003-04	\$856,442	3.6%	\$1.00/\$1.35**
2004-05	\$784,371	-8.4%	\$1.35
2005-06	\$792,124	1.0%	\$1.35
2006-07	\$778,582	-1.7%	\$1.35
2007-08	\$784,055	0.7%	\$1.35
2008-09 (est.)	\$782,000	-0.2%	\$1.35

⇒ Of 57 state excise taxes imposed from 2003 through 2007, only 16 were found to raise as much revenue as projected.

*The tax rate of \$1.00 per pack went into effect July 15, 2002.

**The tax rate of \$1.35 per pack went into effect January 7, 2004.

Source: Governor's Executive Budget

⇒ **Thirty-nine state tax increases fell short of estimate** by a range of 2% to 181%.

- Funding programs with declining revenue sources eventually requires cuts in programs and tax increases elsewhere.

FEDERAL CIGARETTE TAX INCREASE WILL IMPACT PENNSYLVANIA'S REVENUE

- President Obama and Congress recently enacted the single largest cigarette tax hike in U.S. his-

tory, bringing the federal tax rate to **\$1.01 per pack**.

- The recent federal tax increase of 39 cents per pack will negatively impact Pennsylvania's state tax revenue.
 - ⇒ A report from the Tax Foundation found that Pennsylvania residents will pay **an additional \$272 million in taxes** under the federal tax increase.
 - ⇒ However, **Pennsylvania will suffer a \$140 million loss in state revenue** as a result of the tax increase due mainly to an increase in unreported cigarette sales.

HIGHER CIGARETTE TAXES ENCOURAGE SMUGGLING

When any product is taxed to the point of inconvenience, consumers will use other means to attain it. This gives rise to smuggling cigarettes and other tobacco products across state, and even international, lines.

- Traditionally, tobacco holds a fairly inelastic demand, with an elasticity fluctuation of -0.3 to -0.5. In layman's terms, cigarette **consumption** is insensitive to price change.
- However, consumers will seek methods to avoid high taxes on cigarettes. The Mackinac Center reported the net rate of smuggling cigarettes in Pennsylvania to be at **14% of total sales in 2006**.
 - ⇒ This rate places Pennsylvania in the middle of the 50 states.
 - ⇒ Smuggling rates reaching 40% are suffered by states imposing the highest cigarette taxes, resulting in high losses of revenue.
 - ⇒ An estimated **20% of cigarettes sold in Pennsylvania were smuggled commercially**, but the state gained sales from casual smuggling across state lines, primarily as a result of higher tax rates in New York and New Jersey.

CIGARETTE TAXES HIT THE POOR HARDEST

Cigarette taxes are a regressive tax. The rate of cigarette smoking is highest among low-income households, who also spend a much greater percent of their income on tobacco products than those in higher income brackets.

- Smokers are not only the poorest group of taxpayers, but also the smallest, accounting for only 20% of the population. No other tax hurts the poor more than the cigarette tax.
- Tobacco taxes have increased three times faster than alcohol taxes (the next highest "sin tax") from 2000 to 2005.
- In a 2004, families with incomes in the bottom fifth of households **paid 21.6% of total cigarette taxes collected** (several times their share of income), while the highest quintile in household income paid 15% of tobacco taxes.

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