

4 Reasons Obama's Plan to Raise Tobacco Taxes Is a Bad Idea

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Among the controversial items in the budget presented by the Obama Administration last week is a substantial increase in tobacco taxes, which is earmarked to fund an expansion of pre-school education. Whatever the merits of the education plan, here are four reasons to oppose paying for it with higher taxes on smokers.

1. Tobacco taxes are regressive.

In 2008, then-candidate Barack Obama made a "firm pledge" on taxes. "Under my plan, no family making less than \$250,000 a year will see any form of tax increase." Within a month of taking office, he signed the Children's Health Insurance Program Reauthorization Act (CHIPRA), imposing a more than doubling of the federal cigarette tax on smokers of every income.

Like most excise taxes, the financial burden of cigarette taxes falls to a greater degree on those with lower incomes. A widely reported study of American smokers surveyed from 2010 to 2011 found that smokers making less than \$30,000 per year spend 14 percent of their income on cigarettes. In New York, home to the highest cigarette taxes in the country, cigarettes consume nearly a quarter of their income. By comparison, smokers earning more than \$60,000 per year spend just 2 percent of their income on cigarettes.

President Obama's new proposal would nearly double the federal cigarette tax yet again, from the current \$1.01 per pack to \$1.95, then keep raising it indexed to inflation. One may make the paternalistic argument that the tax makes some low-income smokers better off by forcing them to quit, but many who continue to smoke will be among those who can least afford it.

2. Smokers already pay their way.

Popular perception holds that smokers impose costs on society by consuming extra medical care at public expense. This is part of what prompted the class-action lawsuits against tobacco companies in the 1990s, culminating in the Master Settlement Agreement of 1998. Yet the evidence is that smokers pay their way, both by contributing more in excise taxes and by collecting less in services in their later years -- since, to put it nicely, they're not around as long to collect.

Research at the time of the Master Settlement Agreement showed that smokers were already covering at least a significant portion of their external costs, and tobacco taxes have gone up substantially since then. A recent commentary published by the Congressional Budget Office in the New England Journal of Medicine projected the impact of a hypothetical federal cigarette tax hike. It concluded that in the long run, the health effects of reduced smoking would actually add to the deficit. Additional tax revenues would offset this, but either way, it's hard to make the case that smokers are a fiscal drain. That's why contemporary arguments for higher taxes tend to focus on the good of smokers -- not on their cost to society.

3. Pipes and cigars are already under threat.

Press coverage of tobacco taxes focuses on cigarettes, but other kinds of tobacco are affected too. One goal of the new proposal is to fix a disparity created by President Obama's first tobacco tax increase. Prior to 2009, pipe tobacco and roll-your-own tobacco were both

taxed at \$1.10 per pound. CHIPRA increased that to \$2.83 per pound for pipe tobacco and a whopping \$24.78 per pound for roll-your-own. Consumers, unsurprisingly, began substituting the former for the latter.

A similar dynamic occurred with low-end cigars, with some producers adding a little extra weight to their products to qualify as "large" cigars instead of "small" and thereby gaining favorable tax treatment. These changes are merely nominal; neither pipes nor premium cigars have seen a sudden explosion of new consumers. Yet the dramatic market distortions created by these taxes can be seen in this chart from a General Accounting Office report:

The GAO estimates that these shifts may have cost the Treasury up to \$1.1 billion in the first two fiscal years since CHIPRA, so it's understandable that the government would like to amend the law. The new taxes proposed by Obama would increase rates for cigars and end the disparity between pipe tobacco and roll-your-own by taxing both products at a high rate. But at what cost? The premium tobacco business is already beleaguered by ever more expansive smoking bans, state and local taxes, and the looming threat of costly and inefficient regulation by the FDA. It's a safe bet that Marlboro will still be around a few years from now, but premium cigars and pipe blends may not fare nearly as well. The combined effect of these changes could be enough to put consumers' favorite brands or local tobacconists out of business.

4. Broadly beneficial programs should be funded by broadly imposed taxes.

Funding programs that benefit children by raising taxes on the unpopular smoking minority can be a winning move politically, as demonstrated by Obama's first-term success with CHIPRA. He gives the strategy a second try in his second term, promising that his administration "will work with states to make high-quality preschool available to every child in America." And paying for it by taxing tobacco? "It's the right thing to do."

But is it? Smokers already pay considerable sums while getting little in return. According to the Centers for Disease Control, states will collect \$25.7 billion from tobacco taxes and legal settlements this year. Less than 2 percent of this will go toward tobacco-control programs.

Supporters of federally funded pre-school education presumably believe that the program will be beneficial for society as a whole. If that's the case, then the burden of funding it should not fall solely on the 19 percent of adults who smoke -- a percentage that will only get smaller if the taxes have their desired effect. The White House's own projections have tobacco tax revenues peaking in 2015. Sustainable funding of the program would require either a larger tax base or even higher tobacco taxes in the future.

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