CAMPAIGN for TOBACCO-FREE Kids®

FEDERAL CIGARETTE TAX INCREASES AND STATE TOBACCO REVENUES

Federal cigarette tax increases will have no direct or immediate effect on the amounts the states will receive from their own tobacco lawsuit settlements. Although a significant federal cigarette tax increase would reduce some state revenues by reducing cigarette consumption, any such declines would be gradual and predictable – and would also produce enormous state benefits and budget savings.

Federal Cigarette Tax Increases Need Not Trigger The Federal Offset Provision In The State Tobacco Settlements

The federal offset provision in the state tobacco settlements provides that the cigarette companies' settlement payments to the states will be reduced on a dollar-for-dollar basis if any new funds the federal government obtains from the cigarette companies through federal legislation enacted on or before November 30, 2002 are given to the states for unrestricted, public health, or tobacco control purposes. Accordingly, the federal offset provision cannot apply to any funds derived from the currently proposed increase to federal cigarette taxes unless Congress also votes to direct some of the new tax revenues to the states for unrestricted, health care, or tobacco control purposes.

But it would not make sense for Congress to give any of the new revenues to the states in such a way as to reduce the cigarette companies' state settlement payments. To avoid triggering the federal offset, Congress could simply: a) earmark any of the new revenues directed to the states for specific purposes other than tobacco control or public health; or b) not give any of the new revenue to the states (and provide any new funds to the states from other sources, instead).

Reduced Cigarette Sales From U.S. Cigarette Tax Increases Will Not Harm The States

A substantial federal cigarette tax increases would reduce smoking throughout the country, thereby reducing state cigarette tax revenues to the extent that the national cigarette sales decline is reflected in fewer packs being sold in each state. In addition, the state tobacco settlements include a volume adjustment that reduces the cigarette companies' payments to the states whenever the companies' U.S. cigarette sales decline below pre-settlement levels. As set forth below, however, there is no justifiable reason for any state to fear or oppose the possible state cigarette revenue reductions from any federal cigarette tax increase.

Any Reductions To State Tobacco Revenues Caused By A Federal Cigarette Tax Increase Will Be Gradual And Predictable. A federal tobacco tax increase would not create any sudden state budget shortfalls. Because of the addictive power of cigarettes, any reductions in state tobacco settlement and cigarette tax receipts caused by the federal tax increase are likely to be modest and gradual -- and they would not interfere with state efforts to budget their revenues prudently and effectively. Given the advance notice, states could also quickly make adjustments for the expected impact on consumption and state settlement and tax revenues.

Reducing Smoking Will Promote Major State Goals By Improving Public Health and Saving Lives. Given the enormous amount of human suffering caused by smoking, it is inconceivable that any state would oppose constructive actions to further prevent and reduce tobacco use, such as a federal tobacco tax increase, just to save money. Without substantial reductions in U.S. smoking levels, hundreds of thousands of adults will die every year from tobacco use and roughly five million kids who are alive today will die prematurely from smoking-caused disease.

Smoking Reductions Will Reduce State Costs. Any reductions in national cigarette consumption large enough to reduce state settlement or cigarette-tax revenues significantly would also produce enormous cost savings to the states (with those states with smoking declines above the national average enjoying disproportionately high economic and health savings). Currently, state governments spend roughly $7 billion per year just on the states' share of smoking-caused Medicaid costs, but those costs would go down if cigarette consumption declines.

Any Significant Reductions In Smoking Caused By A Federal Cigarette Tax Increase Will Include Even More Substantial Declines in The Number of Kids Who Smoke. It is well established that cigarette price increases reduce youth smoking much more powerfully than they reduce adult smoking. For example, if federal cigarette taxes were increased by 25 cents per pack, overall cigarette sales would decline by approximately three percent, but the number of youths who smoke would drop by more than 5.5 percent. In other words, a 25-cent federal cigarette tax increase would reduce state cigarette tax revenues by only about three percent and have an even smaller impact on state tobacco settlement revenues. But it would also reduce the number of current youth smokers by almost one million, thereby saving at least 300,000 kids who are currently alive today from dying prematurely from smoking while also reducing future public and private smoking-caused health care costs by at least $3.5 billion.

The Upward Inflation Adjustments To State Tobacco Settlement Payments Will Offset Any Reductions Caused By Consumption Declines. The states' scheduled settlement payments will be automatically adjusted upward by a minimum of three percent per year to account for inflation – which will largely offset any reductions to the settlement payments caused by consumption declines. For example, the tobacco settlement agreements state that the cigarette companies will pay the states about $240 billion through the year 2025, subject to adjustments. At a minimum, the inflation adjustment will automatically increase that amount to more than $320 billion before any downward adjustments based on declining cigarette consumption are made. In addition, the settlement agreement includes a provision that reduces any downward adjustment for consumption declines if the cigarette companies' profits increase despite declining sales; and because of their price increases some of the cigarette companies have recently been experiencing increased cigarette revenues despite declining sales.

States Can Offset Any Revenue Losses By Slightly Increasing Their Own Tobacco Tax Rates. States that wish to make up any lost revenues caused by reduced cigarette sales could simply increase their own tobacco tax rates by a few cents per pack. This strategy would especially make sense in the many states with cigarette tax rates that remain far below the national average of about 44 cents per pack. State cigarette tax increases do not trigger any offset to the tobacco settlement payments to the states. Moreover, while state cigarette tax increases will reduce smoking rates in the state, the volume adjustment to each state's settlement payments is based on nationwide (not state-specific) consumption declines.

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