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My Favorite Tax Hike, by G.O. Party

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A Republican Congress is working hard to pass a huge tax increase, and nobody seems to notice. President Clinton and his Democratic congressional allies strongly support the tax increase, even though it falls disproportionately on the poor and middle-income taxpayers, and nobody seems to notice. Even in Washington, this isn't business as usual. What are these people smoking?

Tobacco, of course. The central element of the tobacco settlement working its way through the Congress is \$65 billion in addi-

tractual agreement, there is a sense even among Republicans that this tax would be paid by "Big Tobacco." The implication, of course, is that a tax increase on big tobacco companies would be okay. What nonsense! There is nothing unique about the tobacco industry that exempts it from the basic rule that businesses don't pay taxes; people pay taxes.

The simple fact that seems to be roundly ignored is that the \$65 billion in additional federal revenues is a tax increase on smokers, not on the industry. As the companies involved have negotiated this amount, there is little point in questioning the propriety of raising this sort of tax revenue. What is curious, however, is that this tax increase violates basic Democratic and Republican principles, and yet neither side is objecting.

The Republicans proclaim themselves the party of lower taxes and smaller government. Indeed, a Republican consensus is developing around a \$30 billion income tax cut over the next five years. A big question is how to pay for this income tax cut. Senator Pete Domenici (R-NM), Chairman of the Senate Budget Committee, has indicated that this year's budget resolution "is not going to have tax cuts in it that use the Social Security surplus or the cigarette tax — the cigarette settlement."

Apparently, Senator Domenici doesn't want to call this revenue a tax. As the old saw goes, however, if it looks like a duck and it quacks like a duck, then it's probably a duck. Tobacco settlement revenues would come from higher cigarette prices, consumers would pay the higher prices, and the revenues would flow to the Treasury. It's a tax.

Combined with the tobacco settlement taxes, the Republicans' \$30 billion income tax cut nets out to \$35 billion tax hike. Apparently alone among Republican leaders Senator

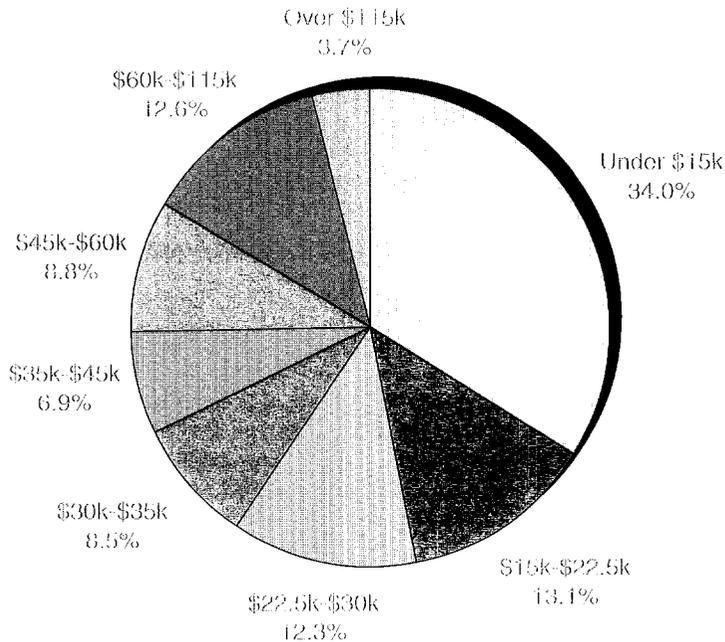
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tional federal revenues over the next five years. It is still unclear whether the tobacco companies will make these payments as part of a contractual settlement with the federal government, or whether Congress will raise the federal cigarette excise. Politically, the difference may be important. Economically, the difference is meaningless — tobacco prices will increase.

Indeed, higher tobacco prices are a basic goal of the government in reaching the settlement. Anti-tobacco forces want prices to increase to discourage tobacco use.

Perhaps because the tobacco industry negotiated the \$65 billion figure, or perhaps because the payments may be part of a con-

Cigarette Excise Tax Burden by Income Group



Source: Tax Foundation, Center for Disease Control.

Bill Roth (R-DE), Chairman of the Finance Committee, seems to understand this. In a March 13 letter Senator Roth called on the Budget Committee to allow any new revenue generated from the tobacco settlement to fund tax relief. "I would urge the Budget Committee to refrain from adopting any budget resolution that would directly or indirectly preclude the use of these funds for offsetting tax cuts." Thank you, Senator Roth.

Republicans are supposed to be the party of tax cuts. Well, if Senator Domenici gets his way, 1998 will be the exception. But how about smaller government? Forget it. The Republican leadership's strategy is to find ways to spend the money that are less objectionable than what the Democrats propose. Specifically, they want to dedicate the additional taxes to preserve Medicare. Preserving Medicare is laudable, but does it have to be done by raising taxes? Are there no efficiencies to be gained that would save money in the Medicare program? How about other spending cuts? On this issue it's hard to tell the "conservatives" from the "tax and spend liberals."

For their part, the Democrats also seem to have lost their moorings. Perhaps they are

beguiled at having new tax revenues to fund new programs for the poor and oppressed. But they seem to have forgotten what the table below makes clear: Cigarette taxes are paid predominantly by poor and middle-class tax payers. Based on data provided by the Center for Disease Control, the Tax Foundation calculates that over a third of this tax increase would be paid by individuals with incomes of less than \$15,000 annually. Over two-thirds would be paid by individuals with incomes of less than \$30,000 annually.

We have Republicans happily hiking taxes and spending the money. And we have Democrats supporting tax policies that hammer the poor. When matters are this confused, it's best to go back to first principles.

Principle one is that revenues collected under the tobacco settlement result from a tax hike paid by individuals. If Republicans want to cut taxes in 1998, the tax cut amount must be over and above the \$65 billion envisioned in the tobacco settlement. A \$30 billion net income tax cut thus requires a total \$95 billion income tax cut. Are Republicans for bigger government, or smaller government. Forget the rhetoric. Watch what do they do.

A second principle is that cigarette taxes fall most heavily on the poor and middle-class. Democrats have worked for years to achieve a more progressive tax system. They would be hypocrites to let such a huge tax hike pass without an all-out fight to direct all of the \$65 billion tobacco tax hike to income tax relief for low-and middle-income taxpayers.

Unless somebody derails this train, the tax hike is going to go through. Maybe nobody will notice until after the tobacco agreement takes effect. But then cigarette prices will rise rapidly. Smokers will notice. Then the press will notice — the Congress passed a whopper of a tax hike. And the Republicans and Democrats worked nicely together to bring it to you. Kinda makes you miss gridlock.

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