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Options for Funding SCHIP Expansion: Cigarette Taxes Least Defensible Alternative

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Fiscal Fact No. 92

This past week, Senate negotiators agreed on a bill that would increase the federal cigarette tax by 156 percent (from 39 cents to \$1.00) in order to raise \$35 billion for the popular SCHIP program that gives federal money to states for children's health insurance. SCHIP is set to expire at the end of fiscal year 2007 (Sept. 30).

Unfortunately, this proposal is an abuse of sound tax and fiscal policy. A politically popular, expensive program should never be funded by a small, low-income minority like cigarette smokers, even though smokers are politically unpopular.

As Table 1 shows, no other federal tax hurts the poor more than the cigarette tax. Other taxes the federal government could use to raise \$35 billion are displayed by income class.

Table 1
Cigarette Taxes Are the Most Anti-Poor Method of Funding S-CHIP

Household Income Quintile	Taxes that Could Be Used to Raise \$35 Billion to Fund S-CHIP Expansion (Average Tax Increase per Household in Quintile)						
	Cigarette Tax Increase	Alcohol Tax Increase	Gas Tax Increase	Air Transport Tax Increase	Corporate Income Tax Increase	Payroll Tax Increase	Individual Income Tax Increase
All Households	\$309	\$309	\$309	\$309	\$309	\$309	\$309
Bottom 20 Percent	\$249	\$142	\$100	\$62	\$39	\$41	\$7
Second 20 Percent	\$330	\$214	\$199	\$148	\$143	\$160	\$62
Middle 20 Percent	\$359	\$312	\$294	\$236	\$248	\$297	\$163
Fourth 20 Percent	\$336	\$423	\$414	\$423	\$414	\$469	\$348
Top 20 Percent	\$291	\$589	\$713	\$901	\$944	\$806	\$1,277

Source: Andrew Chamberlain and Gerald Prante, "Who Pays Taxes and Who Receives Government Spending? An Analysis of Federal, State and Local Tax and Spending Distributions, 1991 - 2004," *Tax Foundation Working Paper*, No 1.

Not only are the payers of cigarette taxes poorer as a group than the payers of these other taxes, but there are fewer of them. In fact, the burden of the proposed cigarette tax hike on the lowest-earning 20 percent of households is 37 times heavier than it would be if the government raised the money with the federal income tax. Put another way, the proposed cigarette tax hike would hit the poor with the same force as cutting the Earned Income Tax Credit (EITC) by one-fourth.

Why Are Smokers Taxed Again and Again?

Taxes on tobacco products have soared in recent years. As Table 2 shows, in just a five-year period from 2000 through 2005, tobacco tax collections rose 45 percent, according to the Department of Commerce. Not even property taxes have grown that fast, despite a housing bubble that pushed property taxes up at a historically rapid pace, starting a nationwide flurry of property tax relief measures. For more on how cigarette taxes have risen dramatically over the past five years, see *Tax Foundation Fiscal Fact*, No. 93, "State Tobacco Tax Rates Have Skyrocketed Since Last Federal Tax Increase."

Table 2
Tobacco Taxes are a Fast-Growing Source of Government Revenue

Tax Category (BEA)	Percent Change in Collections from 2000 to 2005
Special Assessments	79.5%
Severance Taxes	69.8%
Taxes on Insurance Receipts	55.1%
Taxes on Corporate Income	50.8%
Tobacco Taxes	44.7%
Property Taxes	37.6%
Air Transport Taxes	26.3%
Payroll Taxes	25.3%
General Sales Taxes	22.7%
Customs Duties	19.9%
Motor Vehicle Licenses	17.9%
Alcohol Taxes	13.4%
Gasoline (and Diesel Fuel) Taxes	13.3%
Personal Income Taxes	- 3.1%

Source: Tax Foundation calculations based on data from the Bureau of Economic Analysis, Dept. of Commerce

Taxes on tobacco products increased three times faster than alcohol taxes, the other major "sin tax," from 2000 to 2005. The most likely reason for the disparity is that a majority of citizens enjoys alcohol while smokers are a minority, about 20 percent of the population nationwide.

Powerful special interest groups pushing "public health" have been able to bring the non-smoking majority along with their campaign to tax smokers. John Stuart Mill would call it a tyranny of the majority: politicians have identified an unpopular minority and forced punitive taxes on them.

These advocates of higher taxes on tobacco, regardless of the impact on the poor, are frequently accused of being modern-day temperance workers who busy themselves telling other people how to live.

In addition to campaigning for high tobacco taxes, they often advocate special taxes on other unhealthy products like soda, candy, alcohol, etc. What's next, tanning beds? Extreme mountain climbing? Bacon cheeseburgers? Tony Blair has labeled such policies as representing a "nanny state."

Perhaps growing government revenue is as important as health to these nanny-statists. If they really believed these products to be so deadly, they would advocate banning them, not just taxing them. However, taxes are rising on tobacco to the point that for low-income people, they are tantamount to a legal prohibition, and a huge underground economy filled with violent crime and smuggling has sprung up.

All this is not to say that cigarette taxes should be zero. Cigarettes do impose costs on society that are not borne by smokers, and so, despite the low-income profile of smokers, some tax per pack is justified. However, most empirical studies of these costs conclude that the current combined tax (federal and state/local) are already more than enough.¹

Conclusion

Taxing only cigarettes to finance higher spending on SCHIP has absolutely no justification in sound tax policy. Excise taxes on cigarettes should be used to compensate for the costs they impose on society. Taxes levied above and beyond that point may be politically expedient because smokers are unpopular, but they only serve to make the federal tax system less principled and more regressive.

Notes

1. See, for example, Patrick Fleenor, "Who Bears the Ancillary Cost of Tobacco Use?," *Tax Foundation Background Paper*, No. 36 (January 2001), available at <http://www.taxfoundation.org/research/show/121.html>.