



## Plans to Increase State Revenue Could Go Up In Smoke

by Amy K. Frantz

Governor Vilsack's budget proposal for the upcoming fiscal year includes several tax increases, including an increase in the state's sales tax on cigarettes. The Governor's plan would increase the sales tax on a pack of cigarettes from 36 cents to 96 cents, an increase of 60 cents.

More than 30 states and the District of Columbia have increased their sales tax on cigarettes since 2000.<sup>1</sup> Smokers are an easy target for those looking to increase taxes, particularly if proponents claim the increased revenue will be used for education for our children or health care for the elderly. However, the results from a hike in the sales tax on cigarettes may not be as positive as promised.

Supporters of an increase in cigarette taxes often maintain that an added benefit of the tax increase will be that some smokers will quit rather than pay the higher tax to continue their habit. But the politicians always have a plan for the additional projected revenue from the increased cigarette tax. These two goals, then, seem in conflict with one another. If a significant number of smokers quit smoking due to the tax increase, the additional projected revenue would go up in smoke.

Fewer youth will start smoking if the cigarette tax is higher is another argument often advanced to justify an increase in the cigarette tax. The National Cancer Institute funded a recent study by economists at Cornell University to look into this assertion. The study found that increasing cigarette taxes does little to reduce the number of eighth through twelfth graders that begin smoking. The study did find that higher cigarette prices can reduce the number of cigarettes that young people smoke, but generally will not stop them from smoking entirely.<sup>2</sup>

An increase in the cigarette tax can impact more than the smokers themselves and the state's coffers. In 2002, the state of New York increased their sales tax on cigarettes to \$1.50 per pack. The City of New York also increased their cigarette tax to \$1.50 per pack that same year, resulting in a combined state and local cigarette tax of \$3.00 per pack for purchases in New York City.<sup>3</sup>

Instead of the projected increase in revenue for the city and state from the increase in the cigarette tax, the opposite occurred. In the four months following the tax hike, "sales of taxed cigarettes in the city fell by more than 50 percent compared with the same period the prior year."<sup>4</sup>

The Small Business Survival Committee commissioned a survey on the impact of the increase in the cigarette tax in New York City on the city's small businesses. Eighty-five percent of the small businesses surveyed reported decreased revenues, resulting in lower profits for those businesses and lost jobs.<sup>5</sup> The increase in the cigarette tax "has resulted in less than half the revenue increase projected for New York City."<sup>6</sup>

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The dramatic increase in the sales tax rate on cigarettes in New York has led to an increase in cigarette smuggling and black market sales of cigarettes. While Iowa will probably never see crime rates like that of New York City, cigarette smuggling on a smaller scale will surely occur, particularly by those living close to the state's border.

If the Iowa cigarette tax rate is increased to 96 cents per pack, that tax rate will be higher than that of Missouri (17 cents per pack), Minnesota (48 cents), Nebraska (64 cents), South Dakota (53 cents), and Wisconsin (77 cents) – states that border Iowa.<sup>7</sup> Iowa retailers near those states may lose some business as customers cross the border in search of tax savings. Stores in cities such as Burlington, that benefited when the cigarette tax was increased in Illinois, may now find their customers heading to Missouri instead.

Increasing the sales tax on a pack of cigarettes may seem like an easy means of raising revenue while discouraging smoking, but such a tax increase may not meet all of the expectations its proponents claim.

#### ENDNOTES:

<sup>1</sup>“Cigarette Tax Increases, 2000-2004 (table)” *Budget & Tax News*, The Heartland Institute, February 2004, p. 12.

<sup>2</sup>John Dunham, “Taxing Smokers: Will Cigarette Taxes Solve Pennsylvania’s Budget Crisis and Reduce Teen Smoking?,” *Commonwealth Policy Brief*, The Commonwealth Foundation, June 2002, p. 3.

<sup>3</sup>Patrick Fleenor, “Cigarette Taxes, Black Markets, and Crime: Lessons from New York’s 50-Year Losing Battle,” *Tax Foundation Policy Analysis No. 468*, February 6, 2003, p. 1.

<sup>4</sup>*Ibid.*, p. 13.

<sup>5</sup>Small Business Survival Committee, “How New York City’s High Tobacco Taxes Hurt Small Businesses, Taxpayers, and Consumers,” March 5, 2003, <[www.sbsc.org](http://www.sbsc.org)> (February 5, 2004).

<sup>6</sup>*Ibid.*

<sup>7</sup>“Education and Taxes,” *Iowa Legislative News Service Bulletin*, Volume 39, No. 9, January 27, 2004, p. 1.

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