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Increased Cigarette Taxes Rarely Produce Promised Revenue

By Michael W. Thompson

1/15/2018 -- The Thomas Jefferson Institute for Public Policy recently released a new study showing the impact of cigarette tax increases on local government budgets.

The study, *The Impact of Cigarette Tax Increases on Local Government Budgets* (here), uses budget data published by local jurisdictions as part of the budget process. This is the second year this report has been issued by the Jefferson Institute. Among its findings –

- Revenues from cigarette taxes continue to decline, despite repeated rate increases. Virginia's local governments collected 19.7 percent less in real cigarette tax revenue from FY 2010 to FY 2014 (the latest data available), even though individual local governments raised these taxes more than 50 times over the same period. Last year's study found that local governments collected 16.3 percent less in cigarette taxes between FY '10 and FY '13.
- Cigarette tax rate increases raise less tax revenue collections than budget projections or that the percentage rate would imply.
- Between 2010 and 2015, the number of localities that chose to levy a new tax on cigarettes grew from 80 to 106 – a one-third increase in just five years.
- The tax increases are changing consumption patterns as consumers seek alternative markets with lower taxes and lower prices.

Cigarette taxes rarely produce the revenue expected by local governments. Fairly consistently, the tax increases produce a decrease in revenue, don't meet expectations, miss budget projections or simply produce mixed results and often turn flat or negative in the years following a tax increase.

For instance, in the Town of Vinton, which doubled its cigarette tax in 2014, saw its revenues plunge by more than 44 percent between 2013 and 2016, as smokers drove elsewhere to make purchases. These new taxes caused two retailers to close and a new cigarette outlet to open just outside of Town limits, driving a further loss of reduced sales taxes.

This happens in both large and small jurisdictions. Bluefield raised cigarette taxes by 67 percent in FY 2012 and tax revenues fell 14 percent. Virginia Beach raised the cigarette tax three times between 2010 and 2016, and revenues remain below the level prior to the tax increases.

We expect to see this happen again in Petersburg where the cigarette tax was raised from 10 cents to 90 cents a pack. While it's too early to have final numbers, what we do know is that the number of cigarette tax stamps purchased by stores has declined by nearly 30 percent, as consumers likely crossed the city line to purchase products elsewhere.

And we see the reverse is true as well. In FY 2016, Portsmouth cut its cigarette tax rate by 33 percent. The budget for that year anticipated revenues would fall, but in fact revenues increased slightly. The tax cut brought in more revenue, not less.

These numbers are a real world example that tax impacts on the economy are not static. You cannot raise taxes by a certain percent and expect, automatically, that tax revenues will increase by that same percent. Indeed, just as our high school economics teacher explained to us, taxes impact the way people spend and invest. In this case, it seems that raising cigarette taxes likely encourages smokers to drive outside their own city or county seeking less expensive tobacco products. And, as studies show and retailers testify at local government hearings, these smokers also buy others products when they find a store in a lower taxed area.

As municipalities begin the process of developing their budgets for the coming fiscal year that begins on July 1, instead of raising cigarette taxes with only a temporary of even negative impact, they would be better off seeking efficiencies in their government operations or relying on a general, broader-based tax to fund public expenditures. Of course, efficiencies are the better course of action.

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