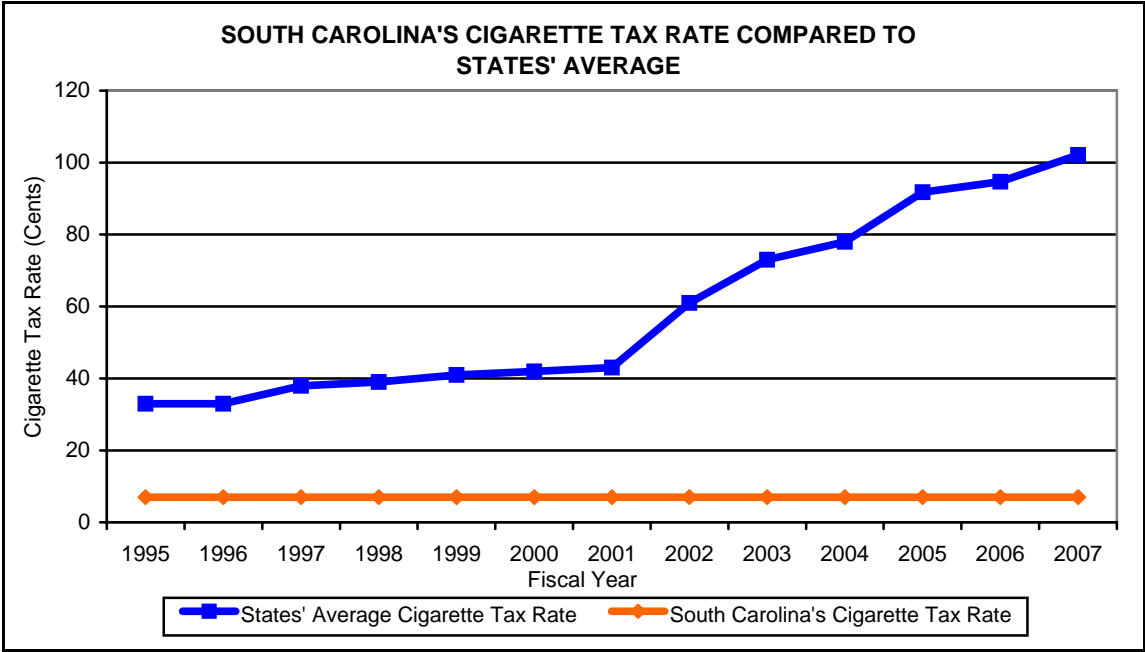


# TOBACCO TAX CHOICES FOR SOUTH CAROLINA

## CONTINUE SUBSIDIZING SMOKING OR REDUCE SMOKING, SAVE LIVES, AND CUT COSTS?

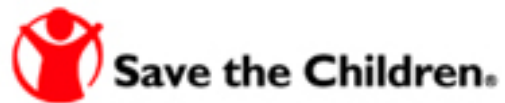
**South Carolina is Failing to Keep Up with the Rest of the States  
In Using the State Cigarette Tax to Save Lives, Improve  
Public Health, Raise Revenue and Reduce Government  
and Private Sector Costs**



**A Special Report By The Campaign for Tobacco-Free Kids  
April 2007**

*The Campaign for Tobacco-Free Kids is an independent, nonprofit organization dedicated to preventing and reducing tobacco use and its harms, especially among youth. The Campaign does not receive or accept any government funding, nor does it receive or accept any funding from the tobacco industry. To save lives and protect the public health, the Campaign has been supporting efforts to increase state and local tobacco tax rates throughout the country in order to reduce smoking, save lives, and reduce smoking-caused harms and costs. For more information, see [www.tobaccofreekids.org](http://www.tobaccofreekids.org).*

This report is endorsed by the following organizations:



**TOBACCO TAX CHOICES FOR SOUTH CAROLINA:  
CONTINUE SUBSIDIZING SMOKING  
OR REDUCE SMOKING, SAVE LIVES AND CUT COSTS?**

**Introduction & Executive Summary**

***Raising South Carolina’s cigarette tax rate would quickly produce massive economic and public health benefits.*** Increasing South Carolina’s cigarette tax by 93 cents to just one dollar per pack would bring the state’s rate closer to the nationwide average and produce enormous benefits to the state and its residents, including:

- Producing more than \$220 million in additional new annual state revenue
- Preventing more than 60,000 kids from growing up to become addicted adult smokers
- Prompting more than 31,000 current adult smokers to quit for good
- Saving more than 27,000 South Carolina citizens from dying prematurely from smoking
- Improving worker productivity throughout the state
- Reducing smoking-caused state Medicaid program costs by more than \$250 million
- Cutting total future smoking-caused health costs by more than \$1.3 billion.

***Small cigarette tax increases produce much smaller benefits.*** In addition to the fact that cigarette companies can and will easily override small tax increases with their own price reductions, a rate increase 30 cents or less would fail to take full advantage of the power of tobacco tax increases to benefit the state, its businesses, and its residents. For example, the currently proposed 30-cent increase would not produce anything close to the public health benefits, reductions in future smoking-caused health care and other costs, and additional new annual revenues that a 93-cent increase would provide.

<b>Cigarette Tax Increase</b>	<b>New Annual State Revenues</b>	<b>Kids Stopped From Smoking</b>	<b>Adult Smokers Who Quit</b>	<b>People Saved From Smoking Deaths</b>	<b>Reduced Future Health Costs</b>
30 Cents	\$92 million	19,500	10,200	8,900	\$438 million
93 Cents	\$220 million	60,700	31,800	27,800	\$1.3 billion
<b><i>Extra Benefits from 93¢</i></b>	<b><i>\$128 million</i></b>	<b><i>41,200</i></b>	<b><i>21,600</i></b>	<b><i>18,900</i></b>	<b><i>\$926 million</i></b>

A 93-cent increase would also reduce the smoking-caused expenditures of the state Medicaid program by \$9.3 million in just the next five years (compared to a mere \$3.0 million reduction from a 30-cent increase) and would reduce total future Medicaid smoking-caused costs over the next generation by \$252.1 million (\$171.1 million more than a 30-cent increase). By sharply reducing smoking among workers, a 93-cent increase would also do much more than 30-cents to cut smoking-caused productivity losses. It would also do more to reduce other smoking-caused costs, increase employment, and otherwise strengthen the state’s economy.

***South Carolina has the lowest cigarette tax rate in the country.*** South Carolina’s cigarette tax of only seven cents per pack is considerably lower than the growing average state rate of \$1.02 per pack. Twenty-two states now have cigarette tax rates of \$1.00 or higher, with the current highest state rate in New Jersey at \$2.57.5 per pack. Various cities and counties have even higher combined state-local cigarette tax rates, such as \$3.00 per pack in New York City and \$3.66 per pack in Chicago. The other tobacco-producing states also have substantially higher cigarette tax rates than South Carolina, with neighboring North Carolina at 35 cents per pack and the top state-local rates in Virginia going as high as 95 cents per pack.

***Smoking is taking a terrible toll on South Carolina.*** The U.S. Centers for Disease Control and Prevention (CDC) estimates that smoking-caused health costs and productivity losses in

South Carolina total more than \$7.66 per pack sold in the state. Indeed, the toll of tobacco use in South Carolina remains quite high, with 5,900 adults dying each year from their own smoking, 6,500 more kids becoming addicted daily smokers each year, and total smoking-caused health costs in the state totaling more than \$1.09 billion.

***Invest in Comprehensive Tobacco Prevention Programs.*** Investing just a small portion of the extra new revenue from a rate increase to fully fund the state tobacco prevention program will maximize the public health benefits by more effectively and powerfully preventing and reducing tobacco use and its harms in the state. Just 9 cents of the proposed 93-cent cigarette tax increase would generate enough revenue for South Carolina to fully subsidize the state tobacco prevention program at the CDC recommended minimum of \$23.9 million. Comprehensive tobacco prevention efforts reduce state smoking rates by roughly one or two percentage points each year.

***Public support for a large state cigarette tax is strong.*** Support for a substantial increase to the state's cigarette tax is high among a diverse cross-section of South Carolina adults and, especially, voters. There is bipartisan support for a 93-cent rate increase – in fact, more Republicans support the increase than Democrats. More voters strongly favor a higher rate increase (93 cents) compared to those strongly favoring a smaller rate increase (53 cents). And, voters are more likely to vote for candidates who support a 93-cent cigarette tax increase.

***Tobacco tax increases are a predictable and stable source of substantial state revenues.*** Year to year, state cigarette tax revenues are more predictable and less volatile than many other state revenue sources, such as state income tax or corporate tax revenues, which can vary considerably year to year because of nationwide recessions or state economic slowdowns. Every single state that has significantly raised its cigarette tax rate has enjoyed substantial increases to state revenues, despite the related declines in state smoking levels and despite any related increases in cigarette smuggling or cigarette tax avoidance. Once the dust has settled after a major cigarette tax increase, state tobacco tax revenues typically decline by only about two percent per year, on average, because of reductions in smoking rates.

***Lower-income households will benefit the most.*** Because more lower-income than higher-income smokers will quit in response to a substantial cigarette tax increase, both proportionately and in total numbers, lower-income families in South Carolina would be some of the largest beneficiaries from a 93-cent increase. Indeed, low-income families currently suffer disproportionately from smoking and smoking-caused disease and costs, and a 93-cent cigarette tax increase would directly and substantially reduce that burden.

***Raising the state cigarette tax rate will fight crime.*** By substantially raising its cigarette tax and establishing a tax stamp, South Carolina could also get out of the business of supplying criminal syndicates and terrorist organizations that raise illegal revenue through buying cigarettes in South Carolina to smuggle and sell in higher-tax states. On the other hand, by simply increasing its cigarette tax to the nationwide state average, South Carolina would not, itself, become a target for cigarette smuggling or contraband sales – and there are numerous simple steps the state could take to minimize any efforts by smokers to evade the higher rate through cross-border or Internet purchases.

***Increasing state tax rates on other tobacco products would maximize benefits.*** A parallel increase to the state's tax rate on smokeless tobacco and other tobacco products – from 5 to 44 percent of wholesale price – would bring South Carolina another \$34 million in new revenues each year, with parallel reductions to tobacco use and related harms and costs.

The following full report details the numerous and long-lasting benefits to South Carolina from raising the state cigarette tax to just one dollar per pack. Investing some of the revenues to expand state tobacco prevention efforts will produce even larger public health benefits and savings. Anything less is just a tax.

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**A 93-Cent State Cigarette Tax Increase Does Much More Good Than a 30-Cent Increase**

Recently, South Carolina legislators proposed raising the cigarette tax rate by 30 cents per pack. At the same time, public health groups and others proposed a 93-cent increase – bringing state’s cigarette tax rate to \$1.00 per pack – in order to earn more new state revenues, more sharply reduce smoking-caused costs in the state, and produce much larger smoking declines and related public health benefits.

Raising the state’s cigarette tax by 93 cents per pack, instead of only 30 cents, would produce \$128.8 million more per year in additional new revenue, save 18,900 more lives, prompt 21,600 more current adult smokers in the state to quit, prevent 41,200 more kids in the state from becoming addicted adult smokers, and reduce future state smoking-caused health costs by \$926.2 million.\*

***Bigger Declines in State Smoking and Related Harms.*** Tobacco tax increases are one of the most effective ways to change these trends. They sharply reduce smoking and other tobacco use, especially among youths, pregnant women, and low-income smokers. Studies have shown that for every 10 percent increase in the price of cigarettes, youth smoking drops by approximately 6.5 percent and overall consumption declines by three to five percent.<sup>1</sup> Even the cigarette companies have repeatedly asserted and acknowledged, both publicly and in internal company documents disclosed in tobacco lawsuits, that raising cigarette prices through state tobacco tax increases significantly reduces smoking, especially among kids. That fact is also well established by scientific research and by the actual experiences of states that have raised their tax.<sup>†</sup>

<b>Cigarette Tax Increases</b>	<b>Kids Alive Today Stopped From Smoking</b>	<b>Kids Saved From Dying From Smoking</b>	<b>Adult Smokers Who Quit</b>	<b>Adults Saved From Dying From Smoking</b>
30 Cents	19,500	6,200	10,200	2,700
93 Cents	60,700	19,400	31,800	8,400
<b><i>Added Benefits from 93-Cent Increase</i></b>	<b><i>41,200</i></b>	<b><i>13,200</i></b>	<b><i>21,600</i></b>	<b><i>5,700</i></b>

As the chart above shows, South Carolina would certainly obtain some benefits from a 30-cent cigarette tax increase, which would save 19,400 kids from addiction. But a 93-cent tax increase would stop an additional 41,200 kids from becoming addicted smokers. Likewise, a 30-cent tax increase would save 8,900 South Carolinians from a smoking-caused death, while a 93-cent tax increase would save 18,900 more South Carolina lives. Other data indicates that a 93-cent increase would also, each year, stop 10,600 South Carolina kids from becoming new regular, daily smokers (annually saving an extra 7,200 kids from tobacco addiction compared to just a 30-cent increase).<sup>‡</sup> If South Carolina does not need the revenues from a higher rate increase to balance its budget, the state can put the money towards tobacco prevention programs that would further contribute to smoking rate declines.

\* For a full list of benefits to South Carolina from a 93-cent cigarette tax increase, see Appendix B. For detailed information and references, regarding how these projections were made, see Appendix D.

† See TFK Factsheet, *Raising Cigarette Taxes Reduces Smoking, Especially Among Kids (And the Cigarette Companies Know It)*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0146.pdf>.

‡ For a full list of benefits to South Carolina from a 93-cent cigarette tax increase, see Appendix B. For detailed information and references, regarding how these projections were made, see Appendix D.

The public health benefits and cost reductions from any cigarette tax increase less than 30 cents are far from secure and much less certain than those obtained from larger rate increases. Faced with relatively small cigarette tax increases, big cigarette companies can fairly easily mute or eliminate any related smoking declines and public health benefits by temporarily reducing their own prices and activating a range of temporary retailer-based discounts and promotions. Recent studies show that cigarette companies have increased the amount of product discounting (such as buy-one-get-one promotions) and the level of spending on such promotions after cigarette tax increases or even their own self-imposed price increases.<sup>2</sup> As a result, any public health benefits due to higher prices of cigarettes, including lower levels of initiation by youth and higher quit rates, are limited or nonexistent. In contrast, a larger cigarette tax increase (e.g., 50 cents or more) is simply too large for the cigarette companies to handle or offset effectively.

**Additional New State Revenues.** Massive amounts of economic research and state experiences have firmly established that significantly raising state cigarette tax rates will always substantially increase state revenues – despite the smoking declines – thereby reducing the number of people who suffer from smoking-caused disease or die prematurely from their smoking or other tobacco use.<sup>\*</sup> Put simply, the additional revenues the state receives per pack sold after a cigarette tax increase brings in far more revenue than the state loses from the declines in pack sales prompted by the increase. These funds have helped states balance budgets and fund essential services like health care, education, and tobacco prevention programs. Although opponents of the rate increase insist that South Carolina’s treasury does not currently need additional revenue, the money raised from a cigarette tax increase can provide funding for a much-needed tobacco prevention program, which currently does not receive the adequate funding as recommended by the CDC.

Every single state that has significantly raised its cigarette tax rate has enjoyed substantial increases to state revenues, despite the related declines in state smoking levels and despite any related increases in cigarette smuggling or cigarette tax avoidance.<sup>†</sup> Those declines are dwarfed by the massive reductions in public and private sector smoking-caused costs those smoking declines produce. After a major cigarette tax increase, state tobacco tax revenues typically decline by only about two percent per year, on average, because of reductions in smoking rates. States with aggressive continuing tobacco prevention efforts will likely see larger declines, but they would be offset by even larger related reductions in smoking-caused costs. In addition, there are a variety of actions states can take to protect and maintain, or even increase, their cigarette tax revenues over time.

Year to year, state cigarette tax revenues are more predictable and less volatile than many other state revenue sources, such as state income tax or corporate tax revenues, which can vary considerably year to year because of nationwide recessions or state economic slowdowns. In sharp contrast, large drops in cigarette tax revenue from one year to the next are quite rare because of the addictive power of cigarettes – the heaviest smokers, who are the most addicted and most resistant to quitting, cause total state pack sales and revenues to decline by smaller amounts, proportionately.<sup>‡</sup>

Although ongoing reductions in state smoking levels in the years after a cigarette tax increase will gradually erode state cigarette tax revenues (in the absence of any new rate increases),

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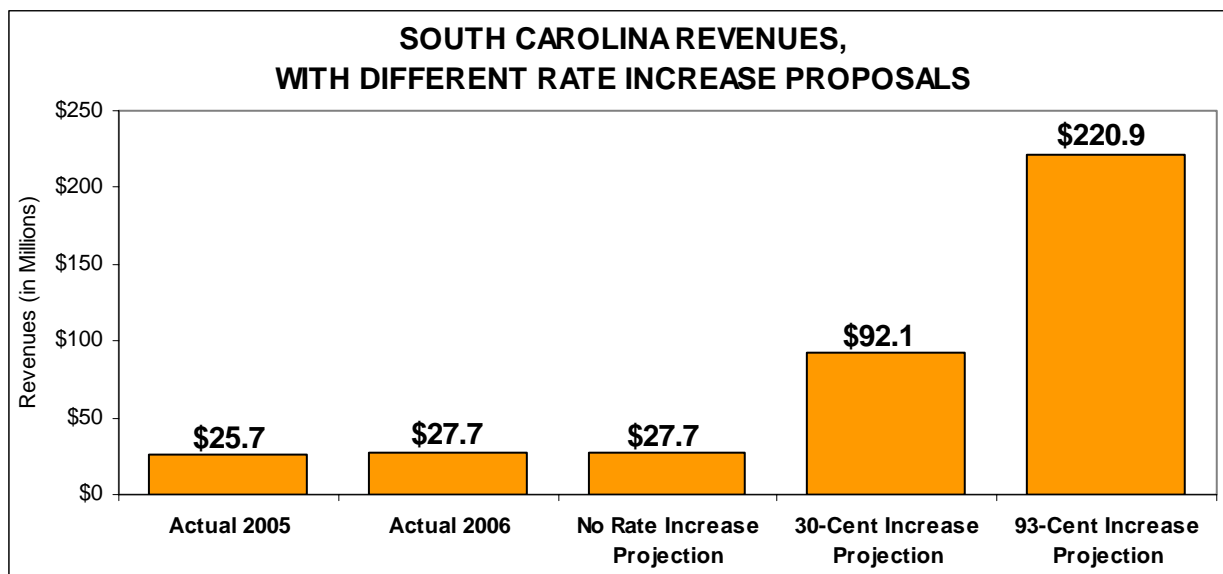
<sup>\*</sup> See TFK Factsheets, *Raising State Cigarette Taxes Always Increases State Revenues (And Always Reduces Smoking)*, and references cited therein, <http://www.tobaccofreekids.org/research/factsheets/pdf/0098.pdf>, and *Raising Cigarette Taxes Reduces Smoking, Especially Among Kids (And the Cigarette Companies Know It)*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0146.pdf>.

<sup>†</sup> See TFK Factsheet, *Raising State Cigarette Taxes Always Increases State Revenues (And Always Reduces Smoking)*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0098.pdf>.

<sup>‡</sup> See TFK Factsheet, *Tobacco Tax Increases are a Reliable Source of Substantial New State Revenue*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0303.pdf>.

those smoking declines along with the declines immediately following the original cigarette tax increase will simultaneously produce much larger reductions in government and private sector smoking-caused expenditures.\* Indeed, while the savings and benefits from these smoking declines will start small they will also grow exponentially, overwhelming any related reductions to state cigarette tax revenues.<sup>3</sup>

As detailed in the graph below, conservative estimates show that, with a 30-cent increase, South Carolina could expect to collect \$92.1 million in new revenue, but by increasing the cigarette tax by a full 93 cents, South Carolina could expect an *additional* \$128.8 million in new revenue – or about \$220.9 million in annual new revenues.<sup>†</sup>



South Carolina’s annual cigarette tax revenues are expected to remain the same from 2006 to 2007 without a state cigarette tax increase, because it is a source state for criminal cigarette smugglers, whose business counteracts the usual negligible revenue declines associated with decreases in smoking rates. Even if state pack sales decline by 1.5 percent per year, above and beyond the declines prompted by the cigarette tax increase itself, the 93-cent increase will bring the state more than \$965 million in additional new revenues over the next ten years compared to a 30-cent rate increase, while also preventing illegal cigarette smuggling.

**Bigger Reductions in State Smoking-Caused Costs.** Tobacco use also takes a substantial monetary toll on the state and its residents. Annual tobacco-caused health care expenditures in South Carolina total \$1.09 billion, and an additional \$1.83 billion is lost due to smoking-caused productivity losses from smoking-death-shortened work lives. Tobacco use costs South Carolina’s Medicaid program \$393.0 million. South Carolina residents pay an estimated \$578 per household each year in federal and state taxes to cover smoking-caused government costs.<sup>‡</sup> Increasing the cigarette tax is one of the most effective methods to reduce these costs to the state and its taxpayers – and the larger the cigarette tax increase, the greater these broader savings will be.

\* See, e.g., TFK Factsheet, *Benefits & Savings From Each One Percentage Point Decline in Adult and Youth Smoking Rates in the United States*, <http://tobaccofreekids.org/research/factsheets/pdf/0235.pdf>.

† For a full list of benefits to South Carolina from a 93-cent cigarette tax increase, see Appendix B. For detailed information and references, regarding how these projections were made, see Appendix D.

‡ For more detail on the current toll of tobacco use in South Carolina, see Appendix A.

<b>Cigarette Tax Increases</b>	<b>5-Year Heart-Stroke Savings</b>	<b>5-Year Pregnancy Savings</b>	<b>Long-Term Healthcare Savings</b>	<b>Long-Term State Medicaid Savings</b>
30 Cents	\$5.2 million	\$4.1 million	\$438.2 million	\$81.0 million
93 Cents	\$16.1 million	\$12.7 million	\$1.3 billion	\$252.1 million
<b>Added Benefits from 93-Cents Increase</b>	<b>\$10.9 million</b>	<b>\$8.6 million</b>	<b>\$926.2 million</b>	<b>\$171.1 million</b>

As the above chart shows, in the first five years, a 93-cent tax increase would reduce health care costs from smoking-caused heart attacks, strokes and smoking-affected births by \$28.8 million, which is \$19.5 million more than the 30-cent tax increase.\* The pregnancy savings start immediately, as additional pregnant women are prompted not to smoke because of the cigarette tax increase. Heart attack and stroke savings start out small in the first year, but increase sharply each year until reaching a peak in eight to 10 years and then maintaining that high rate thereafter. In addition, these immediate savings represent only the tip of the iceberg for South Carolina, as a range of other smoking-caused health costs will decline as well.

The reductions in smoking levels among pregnant women and lower income smokers caused by a cigarette tax increase will translate directly into lower smoking-caused costs to the state Medicaid program. The decreasing smoking rates among workers will lower public and private sector employers' health care costs, while also increasing worker productivity by improving worker health and on-the-job performance, reducing the amount of smoking-caused work absences and work-time cigarette breaks, and having fewer health and productive work lives interrupted or ended prematurely because of smoking-caused illness and disability. Other savings from the smoking declines prompted by the rate increase would also accumulate, such as reduced property loss and damage from fewer smoking-caused fires and lower smoking-caused cleaning and maintenance costs.

Over the long-term, a 93-cent tax increase would also save \$926.2 million more than a 30-cent increase in overall reductions to smoking-caused health care costs. In addition, all of these savings would help to reduce skyrocketing Medicaid program costs because Medicaid covers approximately 12.3 percent of the state's total smoking-caused health costs and 50 percent of smoking-caused pregnancy-related health costs in the state.<sup>4</sup>

The state could multiply its public health and budgetary benefits by investing all or part of the additional revenue either to avoid cuts in the state Medicaid program or to expand the services it provides (e.g., to cover smoking cessation services and to otherwise increase health care access). Such investments of new state funds would not only improve public health in the state but would also increase the amount of money South Carolina would receive from the federal government through its Medicaid program reimbursements to the state. For every dollar the state spends on Medicaid, it gets a bit more than 69 cents back from Uncle Sam; so allocating \$100 million per year of the additional new cigarette tax revenues from a 93-cent increase to the state Medicaid program would actually cost the state only \$31 million per year (while still providing the state \$100 million worth of additional Medicaid coverage and benefits).<sup>5</sup>

Besides Medicaid, South Carolina will also see reductions to the smoking-caused health costs and non-health costs in other state or state-funded programs because of the smoking declines prompted by the cigarette tax increase – and private sector and individual smoking-caused costs will also decline.

**Bigger State Business Savings.** The reductions in smoking levels among South Carolina workers resulting from the 93-cent cigarette tax increase will also improve worker health and reduce smoking-caused productivity losses in the state caused by workers getting sick and

\* For a full list of benefits to South Carolina from a 93-cent cigarette tax increase, see Appendix B. For detailed information and references, regarding how these projections were made, see Appendix D.

dying from smoking before their normal working lives are completed. The CDC estimates those productivity losses in South Carolina to total \$1.83 billion each year.<sup>6</sup> Added to that are productivity losses from smoking employees taking more sick days, taking cigarette breaks when on the job, and being less productive when actually working.

A recent study found that smoking employees are absent from work on average 6.16 days per year due to illness, whereas nonsmokers are absent on average 3.86 days per year.<sup>7</sup> Similarly, a study done for the Indiana Health Department determined that the cost of smoking employees to businesses in just a single Indiana county totaled \$260.1 million per year from increased absenteeism and lost productivity, higher health insurance premiums, and increased recruitment and training costs from smoking employees' premature retirement and death.<sup>8</sup>

Compared to a 30-cent cigarette tax increase, a 93-cent increase will do far more to reduce these smoking-caused costs to the state's businesses and produce far greater improvements to the health and productivity of South Carolina's workforce. These improvements will not only help existing state businesses, but will also make South Carolina more attractive to businesses that may consider relocating to the state.

***Increased State Employment and a Stronger State Economy.*** There is also solid evidence that increasing state cigarette taxes will also increase employment levels – even in states with tobacco farming and cigarette manufacturing. For example, economic studies have found that even if smoking were entirely eliminated in the United States, the net economic effect on each state would be positive, with more jobs created as well as other increases in productive economic activity.<sup>9</sup> More recently, state-specific economic impact studies in New Hampshire, Texas, and even in the tobacco-farming and cigarette-manufacturing state of Virginia have found that substantial cigarette tax increases in those states would actually increase total state employment – and that reduced cigarette sales have, in the past, been linked with increased state retail employment.<sup>10</sup>

One way that cigarette tax increases improve economic activity in a state is that smokers who quit or cutback because of the increase will spend or use the money they formerly spent on cigarettes in other ways – and those alternative uses are likely to produce more jobs and more productive economic activity. For example, cigarette manufacturing and distributing is very capital intensive and does not create a lot of jobs for people, thus shifts to spending on other goods and services that are more labor intensive will create jobs. Spending on harmful consumables, such as cigarettes, creates high social costs. Conversely, spending on less harmful consumables along with increased consumer savings or investments will be more socially constructive and more economically productive.

### **The Current Tobacco Tax Situation in South Carolina**

South Carolina has not increased its cigarette tax rate since 1977. No other state has failed to increase its cigarette tax for so long. In fact, since 2000, 44 states, D.C. and Puerto Rico have raised their cigarette tax rates more than 80 times. Since South Carolina last raised its cigarette tax rate 30 years ago, inflation has gone up by more than 200 percent and cigarette prices have increased by more than 985 percent. When South Carolina raised its cigarette tax to seven cents per pack in 1977, the average state cigarette tax was only 12.6 cents per pack; now the nationwide state average is \$1.02 per pack and growing.

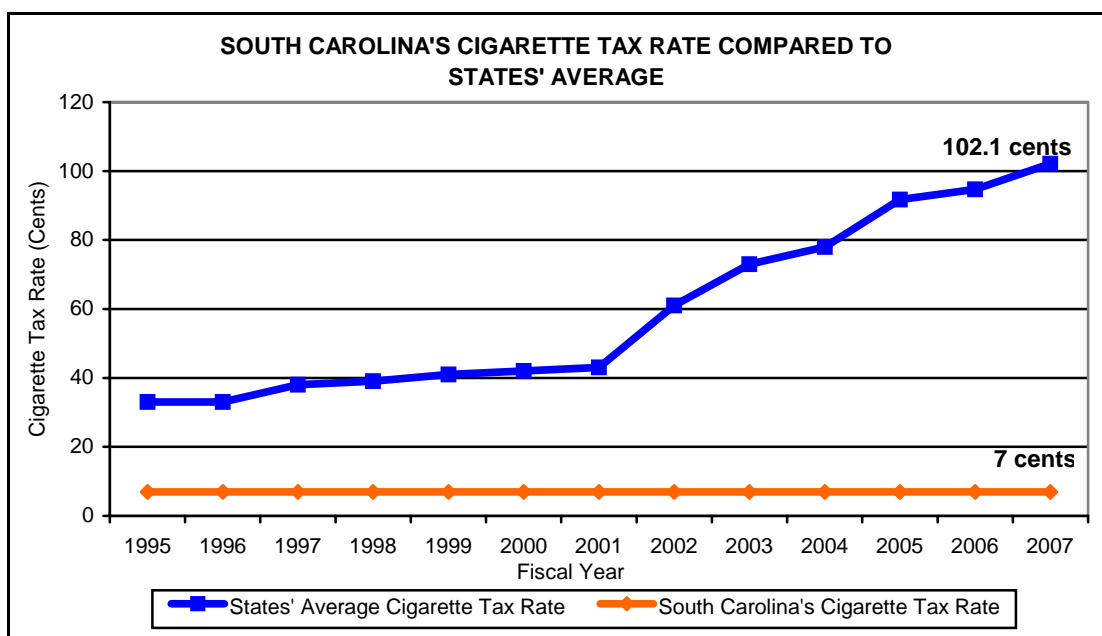
South Carolina's tax on other tobacco products is five percent of the manufacturer's price, the second lowest in the country among those states that tax other tobacco products as a

percentage of price. The average tax rate on other tobacco products for states with percentage-of-price rates is roughly 32 percent.

**South Carolina’s Cigarette Tax Rate is Falling Further and Further Behind Other States, and its Citizens are Suffering the Consequences**

Compared to states with higher cigarette tax rates, South Carolina is providing its smokers with larger subsidies, getting fewer cigarette revenues to offset the state’s smoking-caused costs, keeping their public and private sector smoking-caused costs and harms higher, and, overall, leaving itself at a considerable public health and competitive disadvantage. Because of its low cigarette tax rate, South Carolina receives only about \$27.7 million in cigarette tax revenues each year,<sup>11</sup> while smoking-caused health costs in the state total \$1.09 billion and smoking-caused productivity losses total more than \$1.83 billion each year.<sup>†</sup>

Largely because of its low cigarette tax rate (and its failure to invest more in state efforts to prevent and reduce tobacco use), South Carolina also has above average adult and youth smoking rates and higher per-capita deaths each year from smoking. Currently in South Carolina, 22.6 percent of adults smoke and 23.5 percent of high school students smoke.<sup>‡</sup>



In the past few years, even Kentucky raised its cigarette tax rate from 3 to 30 cents per pack; Virginia raised its state tax from three to 30 cents per pack; and North Carolina increased its cigarette tax from 5 cents to 35 cents per pack. By making such small increases (sometimes in two stages), however, these other tobacco states missed the opportunity to make significant improvements to their citizens’ health, sharply reduce their smoking-caused costs, and collect considerable new revenues for important state programs. Fortunately, many cities and towns in Virginia have established their own cigarette tax rates – ranging from 20 to 65 cents per pack in

<sup>\*</sup> See TFK Factsheet, *State Excise Tax Rates for Non-Cigarette Tobacco Products*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0169.pdf>.

<sup>†</sup> For more details on the costs of tobacco use in South Carolina, see Appendix A.

<sup>‡</sup> For more detail on the current toll of tobacco use in South Carolina, see Appendix A.

addition to the state's cigarette tax – to obtain some of the economic and public health benefits that state has missed.

In nearby Tennessee, Governor Phil Bredesen has proposed a 40-cent cigarette tax increase. Even more significantly, the Tennessee Business Roundtable, the Tennessee Chamber of Commerce and Industry, and many other business organizations have publicized their support for the rate increase.<sup>12</sup>

By increasing its cigarette tax rate to the average rate of all states, South Carolina could enjoy the benefits that many other higher tax states are enjoying: lower smoking rates, fewer smoking-caused deaths, fewer smoking-caused harms, and lower smoking-caused costs.

### **The Toll of Tobacco in South Carolina†**

Tobacco use takes a significant toll on South Carolina residents. Approximately one out of every five adults in South Carolina smokes; and, each year, more than 5,900 more South Carolina adults die prematurely from smoking. Approximately 240,000 kids are exposed to secondhand smoke in their homes, and between 580 and 1,040 people will die from the effects of others' smoking (secondhand smoke and pregnancy smoking) each year. For every person in South Carolina who dies from smoking, approximately 20 more state residents are suffering from serious smoking-caused disease and disability, or other smoking-caused health problems.

In addition, more than 22,800 South Carolina kids under 18 will try smoking for the very first time each year; and more than 6,500 kids who have already tried smoking become new regular, daily smokers. Unless these trends change, the U.S. Centers for Disease Control and Prevention (CDC) projects that more than 103,000 kids alive today in South Carolina will ultimately die prematurely from smoking.

All smoking-caused health costs in South Carolina total more than \$1.09 billion. The total Medicaid expenditures due to smoking-caused health problems amount to an estimated \$393 million. Secondhand smoking alone costs the state \$77 million each year. The CDC estimates that smoking-caused health costs and productivity losses in South Carolina total more than \$7.66 per pack sold in the state, and South Carolina citizens pay a total of \$944.7 million or \$578 per household in state and federal taxes to cover smoking-caused government costs whether there is a smoker in their home or not.

### **Maximize State Health Benefits & Cost Savings By Investing in Tobacco Control**

Investing just a small portion of the \$128.8 million in extra new revenue from the 93-cent increase to fully fund the state tobacco prevention program will maximize the many additional benefits South Carolina would receive from a 93-cent instead of a 30-cent cigarette tax increase.

South Carolina still falls far short of even the minimum amount recommended by the U.S. Centers for Disease Control and Prevention (CDC) for state tobacco prevention spending: \$23.9 million per year. In fiscal year 2007, South Carolina will invest only \$2.0 million in tobacco prevention. Just 9 cents of the proposed 93-cent cigarette tax increase would generate enough revenue for South Carolina to fully subsidize the state tobacco prevention program at the CDC recommended minimum.

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\* See TFK Factsheets, *Top Combined State-Local Cigarette Tax Rates (State plus County plus City)*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0267.pdf>, and *Local Government Cigarette Tax Rates*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0304.pdf>.

† For sources and more detail on the toll of tobacco in South Carolina, see Appendix A.

Comprehensive tobacco prevention efforts reduce state smoking rates by roughly one or two percentage points each year. From each one-percentage point decline in adult smoking rates, South Carolina saves \$305.9 million in reduced future health costs, and from each one-percentage point decline in youth smoking rates, the state saves \$178.5 million in future health costs. While it is not possible to make accurate projections of all the shorter-term savings, reducing smoking rates by one percentage point per year for five years would produce \$21.4 million in health care savings due to fewer smoking-affected births and fewer smoking-caused heart attacks and strokes. All of those savings are in addition to the lives and health that reduced smoking rates will save.\*

More funding would enable the state tobacco prevention program to work much more effectively to prevent and reduce tobacco use and its harms in the state, perfectly complementing the substantial public health benefits from the cigarette tax increase. In fact, there is evidence that coupling state tobacco tax increases with increased state funding for tobacco prevention efforts is an especially effective strategy for quickly and permanently reducing state tobacco-caused harms and costs. Tobacco tax increases can produce enormous public health benefits; but they are not enough, alone, to get the job done.†

### **Strong Public Support for Tobacco Tax Increases**

Polls conducted in numerous, diverse states throughout the country have consistently shown broad public and voter support for cigarette-tax increases. In more than 35 state polls, a strong majority supports an increase in the state's cigarette tax. These polls have found that Democrats, Republicans, men, women, minorities, and both high and low-income groups all strongly support tobacco tax increases – as do significant numbers of smokers.‡ In South Carolina, a January 2006 poll found that 71 percent of voters supported a 93-cent cigarette tax increase, including more Republicans than Democrats. In fact, more voters strongly favored a higher rate increase (93 cents) compared to those strongly favoring a smaller rate increase (53 cents). And, voters are more likely to vote for candidates who support a 93-cent cigarette tax increase.<sup>13</sup>

### **South Carolina's Cigarette Tax Rate is Failing to Keep Up with Cigarette Company Price Increases and Cigarette Company Marketing**

South Carolina's cigarette tax has also failed to keep up with the ongoing increases in cigarette prices in the state. But it does not make sense for the cigarette companies to get increasingly larger revenues and profits per pack while the state's share of cigarette revenues shrinks. Just since 1998, the average price of a pack of cigarettes has almost doubled, as the major cigarette companies have used the state tobacco settlements as an excuse to raise the prices they charge by more than \$1.00 per pack (more than twice the amount needed to cover all of their settlement-related costs).§ While competitive pressure from new, small manufacturers' brands temporarily dampened these major company price hikes in recent years, Philip Morris announced a brand new price increase at the end of last year and Wall Street tobacco industry

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\* For more detail on the benefits of a one-percentage point decline in smoking in South Carolina, see Appendix C. See TFK Factsheets, *Comprehensive Statewide Programs Reduce Tobacco Use*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0045.pdf>, and *Tax Increases Are Not Enough - States Must Also Invest in Tobacco Prevention Programs*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0221.pdf>.

† See TFK Factsheet, *Tax Increases Are Not Enough - States Must Also Invest in Tobacco Prevention Programs*, <http://tobaccofreekids.org/research/factsheets/pdf/0221.pdf>.

‡ See TFK Factsheet, *Voters Across the Country Support Significant Increases in State Cigarette Taxes*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0167.pdf>.

§ See TFK Factsheet, *U.S. Cigarette Companies' Settlement-Related Price Hikes Excessive*, <http://tobaccofreekids.org/research/factsheets/pdf/0071.pdf>.

analysts expect more to come. South Carolina's cigarette tax currently accounts for about two percent of the average price of a pack of cigarettes in the state, and that percentage is likely to shrink unless the state boosts its rate by more than a token amount.<sup>14</sup> In contrast, the cigarette companies receive about 68 percent of the money spent on cigarettes in South Carolina.<sup>15</sup>

The cigarette companies also use a portion of their revenues from South Carolina pack sales to increase smoking levels (and related harms and costs) in the state. In the most recent year for which good data is available, 2003, the tobacco companies spent \$298.9 million on marketing and promotions in South Carolina (which is more than 76 cents per pack sold in the state in 2003). That represents an increase of 24.7 percent from the prior year – and a 110.7 percent increase since 1998.<sup>16</sup> Cigarette company filings with the U.S. Securities and Exchange Commission also indicate that their marketing expenditures have continued to increase sharply since 2002. To offset the impact of the cigarette companies' promotional spending on state smoking levels, South Carolina needs to increase its cigarette tax (and, ideally, invest some of the additional new revenues in expanding the state's tobacco prevention efforts).

### **State Cigarette Tax Increases Help Low-Income Residents**

One of the strangest arguments against large cigarette tax increases (frequently made by the big cigarette companies) is that they are unfair to lower-income persons. While it is true that cigarette taxes are, technically, "regressive" – with lower-income smokers paying a larger share of the tax, proportionately, than higher-income smokers – increasing cigarette tax rates actually makes the tax less regressive. That happens because lower-income smokers are much more likely to quit or cutback because of a cigarette tax increase than higher-income smokers.<sup>17</sup> As a result, after the impacts of the cigarette tax increase play out, lower-income smokers will not only be smoking less than they were before, but also paying a smaller proportion of the overall cigarette tax, compared to higher-income smokers, than they were previously.

More importantly, the death, harm, disability, and suffering caused by smoking are currently focused much more in lower-income families and communities than among higher income families and communities. Smoking levels are higher among lower-income than among higher-income persons and lower-income persons have less access to health care, cessation assistance, and other treatment. Cigarette tax increases help to reduce this horrible burden among lower-income families and communities both by prompting current lower-income smokers to quit and by preventing lower-income kids from starting.\*

In addition, lower-income smokers who quit or cutback because of a state cigarette tax increase can secure an enormous "tax cut." A smoker who quits or cuts back not only avoids the cigarette tax increase on each pack he or she no longer smokes but also avoids the original state tax and saves all the other money previously paid for each pack. In South Carolina, a pack-a-day smoker who quits because of a 93-cent cigarette tax increase would save more than \$1,580 per year from no longer buying cigarettes – with additional savings from avoiding other smoking-caused costs.<sup>†</sup>

Given the consistently strong support for cigarette tax increases among low-income persons and the enormous benefits those tax increases bring to low-income smokers, families, and communities, the big cigarette companies' efforts to "protect" low-income communities from

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\* For more on the many benefits to lower-income persons and families from cigarette tax increases, see TFK Factsheet, *State Cigarette Tax Increases Benefit Lower-Income Smokers & Families*, <http://tobaccofreekids.org/research/factsheets/pdf/0147.pdf>.

† The current average price for cigarettes in South Carolina is \$3.35 per pack (including sales tax), adding a 93-cent cigarette tax increase will raise that average price to at least \$4.33 per pack (not even accounting for the fact that distributors and retailers typically increase their prices by more than the additional tax increase amount). \$4.33 times 365 days in a year equals \$1,580 in annual savings to a pack-a-day smoker who quits (or to a heavier smoker who reduces his or her consumption by a pack a day).

higher cigarette taxes is not only patronizing and misdirected but also hostile to lower-income interests. The cigarette companies' regressivity argument should be seen for exactly what it really is: a self-serving smokescreen designed to keep smoking levels up and protect cigarette company profits.\*

### **Maximize New State Revenues By Establishing a State Cigarette Tax Stamp**

South Carolina used to require tax stamps on its cigarettes, but repealed the order in 1996. Now, it is one of only three states that do not have a tax stamp to mark packs of cigarettes on which the state cigarette tax has been paid. Initiating such a tax stamp, along with any state cigarette tax increase, would make it much easier for state enforcement officials to find and stop untaxed cigarettes from being smuggled out of South Carolina and illegally resold. For example, Michigan, one of the states with the highest cigarette tax rates – and the only high tax state without a tax stamp – instituted a cigarette tax stamp for the first time in 1998, and its cigarette tax revenues immediately increased by more than 20 percent.† It is also important to note, however, that despite not having a tax stamp Michigan had still enjoyed enormous increases in new cigarette tax revenue when it had increased its cigarette tax rate by 50 cents per pack a few years earlier. By reducing cigarette smuggling, the new tax stamp simply increased the already substantial amount of new revenues the state was receiving from its cigarette tax increase. Similarly, South Carolina would gain a sizeable amount of new revenue from its 93-cent rate increase, which would be protected from smugglers by the tax stamp.

In 2005, Alaska initiated its first cigarette tax stamp requirement to protect and increase the new revenues it is receiving from its 60-cent increase, to \$1.60 per pack.<sup>18</sup> California, the only state with high-tech tax stamps, enjoyed a \$100 million increase in cigarette tax revenues in the first 20 months after the new tax stamps were introduced in 2005.<sup>19</sup> Taking advantage of new technologies of high-tech tax stamps can even better ensure that South Carolina maintains its high revenues and does not aid in cigarette smuggling.‡

### **Ways to Further Reduce Cigarette Smuggling and Tax Evasion (and Increase Revenues)**

With a high-tech state tax stamp, even a 93-cent increase to South Carolina's cigarette tax is not likely to spark substantial amounts of new cigarette smuggling in the state (there are much more profitable markets for smugglers in the many other higher-tax states and cities). But a substantial cigarette tax increase could prompt a rise in cigarette tax evasion by continuing South Carolina smokers. To minimize any potential tax evasion (and further deter any new cigarette smuggling), the state could take a number of relatively simple and inexpensive measures – thereby bringing in even more new revenues from the cigarette tax increase than projected.<sup>§</sup>

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\* For an analysis of the other self-serving arguments commonly made against tobacco tax increases by the cigarette companies and their allies, see TFK Factsheet, *Responses to Misleading and Inaccurate Cigarette Company Arguments Against State Tobacco Tax Increases*, <http://tobaccofreekids.org/research/factsheets/pdf/0227.pdf>.

† See TFK Factsheet, *The Michigan Story: Cigarette Tax Increases, New Revenues, and the Value of Tax Stamps*, <http://tobaccofreekids.org/research/factsheets/pdf/0279.pdf>.

‡ For more information on high-tech tax stamps, see TFK Factsheet, *The Case for High-Tech Cigarette Tax Stamps*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0287.pdf>.

§ To be conservative, the formulas used in this report to project the new state revenue amounts from the different cigarette tax increase amounts assume a significant amount of new cigarette smuggling and other smoker tax evasion efforts after the increases go into effect (as well as substantial pack sales declines from South Carolina no longer serving as a major supplier to criminal smuggling organizations). See Appendix D. If the new smuggling and tax evasion assumed in these formulas does not occur or occurs to a lesser extent, the state would obtain even more new annual revenues than projected in this report. Appendix E lists the many steps the state could take to minimize such smuggling and tax evasion and maximize new revenues.

Simply establishing a hotline for reporting illegal smuggling activity or contraband sales can be quite productive – especially if all retailers, distributors, and manufacturers are required to post the hotline number prominently in all their business locations. Similarly, relatively small increases in state enforcement resources directed at reducing illegal sales of contraband cigarettes by otherwise legally operating retailers could, for example, pay for themselves just in the fines and penalties they generate. This would simultaneously reduce the amount of state tax revenues lost to such contraband sales (both directly and by putting other retailers on notice that such contraband sales will be uncovered and prosecuted).

Another productive step would be to pass a strong new law, as many other states have done, to prohibit or restrict Internet and other mail-order sales of cigarettes and other tobacco products to state residents.<sup>\*</sup> Such sales are typically made with no payment at all of state taxes (and with no protections against sales to kids), and Internet cigarette sales have been growing steadily in recent years, with corresponding reductions to state cigarette tax revenues.<sup>†</sup> A tough new state law, however, would make it more difficult for state smokers to shift to Internet purchases after any new cigarette tax increase goes into effect – especially given the states attorneys’ general new agreement with the credit card companies. Under that agreement, South Carolina’s Attorney General may notify the credit card companies about any Internet vendors making sales to smokers in violation of either federal or state law (which is another reason why the state should pass its own Internet tobacco law), and the credit card companies will take away those vendors’ credit card rights.<sup>20</sup> Without the ability to accept payment by credit card, those Internet vendors will find it difficult if not impossible to stay in business – and that method of smoker tax evasion will be much harder to employ.

A strong new state Internet tobacco sales law would not only provide South Carolina with a more direct way to take advantage of the new agreement with the credit card companies but could also put other obstacles in the way of illegal Internet sellers efforts to sell contraband cigarettes to South Carolina smokers – for example, by blocking the ability of Internet vendors to have the cigarettes they sell delivered by common carriers.<sup>‡</sup>

As set forth in Appendix E, there are many other cost-effective steps South Carolina could take to further curtail tobacco tax evasion and cigarette smuggling – thereby increasing the total amount of net new tobacco tax revenues it would obtain from a 93-cent cigarette tax increase. But even without these additional measures, a 93-cent increase would bring South Carolina new annual state revenues of more than \$220 million.

### **Stop Helping Criminals and Terrorists**

Another reason for South Carolina to establish a tax stamp and increase its cigarette tax rate is so that the state will no longer serve as a supplier of cheap, easy-to-smuggle cigarettes for criminal syndicates and even terrorist organizations.<sup>21</sup> The cheap, stamp-free cigarette packs South Carolina offers to cigarette traffickers makes it much easier for them to smuggle the packs into high-tax jurisdictions for illegal resale. As a U.S. General Accounting Office report recently stated, “Terrorists have earned assets through the highly profitable illicit trade in

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<sup>\*</sup> For model legislation and additional information, see TFK website at <http://tobaccofreekids.org/research/factsheets/index.php?CategoryID=29>. For examples of other state laws and legislation to prohibit or restrict Internet tobacco product sales, see TFK website at <http://tobaccofreekids.org/reports/internet/resources.php#4>.

<sup>†</sup> See, e.g., TFK Factsheet, *Internet Sales of Tobacco Products: Reaching Kids & Evading Taxes*, <http://tobaccofreekids.org/research/factsheets/pdf/0213.pdf>.

<sup>‡</sup> See TFK Factsheets, *Model State Legislation to Restrict Internet & Mail-Order Tobacco Products Sales*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0230.pdf>, and *The Critical Importance of a Delivery-List Enforcement Provision in State Internet Tobacco Sales Legislation*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0259.pdf>.

cigarettes. According to officials from the ATF [U.S. Bureau of Alcohol, Tobacco, Firearms & Explosives], Hizballah, HAMAS, and al Qaeda have earned assets through trafficking in contraband cigarettes.”<sup>22</sup>

Going on, the GAO report cited the following example: “during 2002, an ATF investigation revealed a conspiracy where the defendants were illegally trafficking cigarettes from 1996 to 2000 between North Carolina, a low tax state, and Michigan, a high tax state, and funneling some of the illegal proceeds back to the Hizballah.” The seized assets, alone, in that North Carolina terrorist smuggling case were worth \$1.5 million, and the ATF investigation resulted in at least two convictions for cigarette trafficking, money laundering, and supporting terrorist organizations.<sup>23</sup>

By substantially raising its cigarette tax and establishing a tax stamp, South Carolina could get out of the business of supplying criminal syndicates and terrorist organizations.

### **Make Parallel Increases to State Tax Rates on Other Tobacco Products.**

While this report focuses on the broad range of substantial benefits South Carolina would enjoy from raising its cigarette tax by at least 93 cents per pack, the state could protect and expand these benefits by making parallel increases to South Carolina’s tax rate on other tobacco products, such as cigars and smokeless or spit tobacco. Right now, South Carolina’s tax on tobacco products other than cigarettes is only five percent of the wholesale price, the second lowest in the country among those states that tax other tobacco products as a percentage of wholesale price. The state average is roughly 32 percent. Massachusetts, Maine, Alaska, and Minnesota have the highest taxes of 90 percent, 78 percent, 75 percent, and 70 percent of the wholesale price, respectively.

Increases in the taxes and prices of smokeless tobacco produce the same kinds of reductions to the amounts consumed and the number of people who use smokeless products as cigarette tax and price increases reduce smoking. In addition, if smokeless tobacco taxes and prices are significantly lower than cigarette prices, kids can use the cheaper smokeless tobacco products as a gateway to a lifetime of tobacco addiction.\*

South Carolina’s current revenues from its 5 percent tax on other tobacco products total approximately \$4.3 million each year. If the state increases its cigarette tax to \$1.00 per pack, the parallel tax on smokeless tobacco and other tobacco products would be roughly 44 percent of wholesale price.† Such an increase would reduce the number of kids who use smokeless or spit tobacco by approximately 25.4 percent and reduce overall consumption by about 13.7 percent – with corresponding reductions to the death, disease, costs and other harms caused by the use of these other tobacco products.‡ And, that rate increase would bring the state more than \$34 million in additional new annual tobacco tax revenues.

### **Conclusion**

South Carolina is at a competitive disadvantage compared to many other states because its higher levels of smoking directly translate into more smoking-caused death, disease and disability, and higher public and private sector smoking-caused expenditures and costs.

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\* See TFK Factsheet, *Benefits From Increasing Smokeless Tobacco Tax Rates*, <http://tobaccofreekids.org/research/factsheets/pdf/0180.pdf> and the references cited therein.

† See TFK Factsheet, *State Excise Tax Rates for Non-Cigarette Tobacco Products*, <http://tobaccofreekids.org/research/factsheets/pdf/0169.pdf>.

‡ See TFK Factsheet, *Benefits From Increasing Smokeless Tobacco Tax Rates*, <http://tobaccofreekids.org/research/factsheets/pdf/0180.pdf> and the references cited therein.

One of the best ways to reduce smoking-caused harms and costs in South Carolina is to raise the state's cigarette tax, which will immediately reduce existing smoking rates and prevent new youths from becoming addicted smokers.

At the very minimum, South Carolina should increase its cigarette tax close to the nationwide state average. That means quickly raising its cigarette tax rate by 93 cents per pack to establish a new state cigarette tax of 100 cents per pack – and then quickly starting to enjoy all the many related public health benefits.

The people, businesses, and taxpayers of South Carolina deserve no less.

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## APPENDIX A

### THE TOLL OF TOBACCO IN SOUTH CAROLINA

#### Tobacco Use in South Carolina

- High school students who smoke: 23.5% [Girls: 21.7% Boys: 26.9%]
- High school males who use smokeless tobacco: 15.1%
- Kids (under 18) who try cigarettes for the first time each year: 22,800
- Additional Kids (under 18) who become new regular, daily smokers each year: 6,500
- Packs of cigarettes bought or smoked by kids in South Carolina each year: 11.5 million
- Kids exposed to second hand smoke at home: 240,000
- Adults in South Carolina who smoke: 22.6% [Men: 25.3% Women: 20.1% Pregnant Females: 13.0%]

Nationwide, youth smoking has declined significantly since the mid-1990s, but that decline appears to have slowed or even reversed. The 2005 Youth Risk Behavior Survey found that the percentage of high school students reporting that they have smoked cigarettes in the past month increased to 23 percent in 2005 from 21.9 percent in 2003. Adult smoking has been decreasing gradually over the last several decades, and 20.9 percent of U.S. adults (about 45 million) currently smoke.

#### Deaths in South Carolina From Smoking

- Adults who die each year in South Carolina from their own smoking: 5,900
- Annual deaths in state from others' smoking (secondhand smoke & pregnancy smoking): 580 to 1,040
- South Carolina kids who have lost at least one parent to a smoking-caused death: 5,500
- Kids alive in state today who will ultimately die from smoking: 103,000 (given current smoking levels)

Smoking, alone, kills more people each year than alcohol, AIDS, car crashes, illegal drugs, murders, and suicides combined. For every person in South Carolina who dies from smoking approximately 20 more state residents are suffering from serious smoking-caused disease and disability, or other tobacco-caused health problems.

#### Tobacco-Related Monetary Costs in South Carolina

- Annual health care expenditures in the State directly caused by tobacco use: \$1.09 billion
- Annual health care expenditures in South Carolina from secondhand smoke exposure: \$77.0 million
  - State Medicaid program's total health expenditures caused by tobacco use: \$393.0 million
- Citizens' state/federal taxes to cover smoking-caused gov't costs: \$944.7 million (\$578/household)
- Smoking-caused productivity losses in South Carolina: \$1.83 billion
- Smoking-caused health costs and productivity losses per pack sold in South Carolina: \$7.66

The productivity loss amount, above, is from smoking-death-shortened work lives, alone. Additional work productivity losses totaling in the tens of billions nationwide come from smoking-caused work absences, on-the-job performance declines, and disability during otherwise productive work lives. Other non-health costs caused by tobacco use include direct residential and commercial property losses from smoking-caused fires (about \$400 million nationwide); and the costs of extra cleaning and maintenance made necessary by tobacco smoke and tobacco-related litter (about \$4+ billion per year for commercial establishments alone).

#### Tobacco Industry Advertising and Other Product Promotion

- Annual tobacco industry marketing expenditures nationwide: \$15.4 billion (\$42+ million per day)
- Estimated portion spent in South Carolina each year: \$298.9 million

Published research studies have found that kids are three times more sensitive to tobacco advertising than adults and are more likely to be influenced to smoke by cigarette marketing than by peer pressure, and that one-third of underage experimentation with smoking is attributable to tobacco company marketing.

#### South Carolina Government Policies Affecting The Toll of Tobacco in South Carolina

- Annual State tobacco prevention spending from tobacco settlement and tax revenues: \$2.0 million [National rank: 38 (with 1 the best), based on percent of CDC recommended minimum]
- State cigarette tax per pack: \$0.07 [National rank: 51st (average state tax is \$1.00 per pack)]

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## **APPENDIX B**

### **BENEFITS FROM A 93-CENT CIGARETTE TAX INCREASE IN SOUTH CAROLINA**

**Current State Cigarette Tax: 7 Cents Per Pack (51st among all states)**

**Smoking-caused costs in state per taxed pack sold: \$7.66**

**Average retail price per pack: \$3.35 (state share from excise and sales taxes: \$0.23)**

**Annual health care expenditures in the South Carolina directly caused by tobacco use: \$1.09 billion**

**Total state Medicaid program smoking costs each year: \$393.0 million**

**Annual state cigarette tax revenue: \$27.7 million (2006)**

#### **Projected Benefits From Increasing the State Cigarette Tax By 93 Cents Per Pack**

- **New state cigarette tax revenues each year: \$220.9 million**
- **Pack sales decline in state: -160.7 million**
- **Percent decrease in youth smoking: 18.9%**
- **Increase in total number of kids alive today who will not become smokers: 60,700**
- **Number of current adult smokers in the state who would quit: 31,800**
- **Number of smoking-affected births avoided over next five years: 7,450**
- **Number of current adult smokers saved from smoking-caused death: 8,400**
- **Number of kids alive today saved from later premature smoking-caused death: 19,400**
- **5-Year healthcare savings from fewer smoking-affected pregnancies & births: \$12.7 million**
- **5-year healthcare savings from fewer smoking-caused heart attacks & strokes: \$16.1 million**
- **Long-term healthcare savings in state from adult & youth smoking declines: \$1,364.4 million**

These projections are based on research findings that a 10% cigarette price increase reduces youth smoking rates by 6.5%, adult rates by 2%, and total consumption by 4% (but adjusted down to account for tax evasion effects), and assume that the state tax will keep up with inflation. Nevertheless, the tax increase will both reduce smoking levels and increase state revenues because the higher tax per pack brings in more new revenue than is lost from the drop in the number of packs sold. These projections are fiscally conservative because they include a generous adjustment for lost state pack sales (and tax revenues) from new tax avoidance efforts after the tax increase by continuing continuing in-state smokers, and from fewer sales to smokers from other states or to smugglers. The new revenue estimate is for net new revenues above the prior year's revenue total. Kids stopped from smoking and dying are from all kids alive today. Long-term savings accrue over lifetimes of persons who stop smoking or never start because of tax increase. These projections assume that the state will follow standard practice and apply the cigarette tax increase to all previously tax-stamped or otherwise tax-paid cigarettes held in inventory by wholesalers or retailers on the effective date of the increase. Failing to tax such cigarettes held in inventory would open the door to massive pre-increase stockpiling by retailers and wholesalers to evade the increase, drastically reducing the amount of new state revenues. All cost and savings amounts are in 2004 dollars.

**For more information, see the Campaign Factsheets – including *Raising State Tobacco Taxes Always Reduces Tobacco Use (& Always Increases State Revenues)* – at <http://tobaccofreekids.org/research/factsheets/index.php?CategoryID=18>.**

**Sources.** Chaloupka, F, "Macro-Social Influences: Effects of Prices and Tobacco Control Policies on the Demand for Tobacco Products," *Nicotine & Tobacco Research*, 1999, and other price studies at <http://tigger.uic.edu/~fjc> and [www.uic.edu/orgs/impacteen](http://www.uic.edu/orgs/impacteen). Orzechowski & Walker, *Tax Burden on Tobacco*, 2005. USDA Economic Research Service, [www.ers.usda.gov/Briefing/tobacco](http://www.ers.usda.gov/Briefing/tobacco). Farelly, M, et al., *State Cigarette Excise Taxes: Implications for Revenue and Tax Evasion*, RTI International, May, 2003, [http://www.rti.org/pubs/8742\\_Excise\\_Taxes\\_FR\\_5-03.pdf](http://www.rti.org/pubs/8742_Excise_Taxes_FR_5-03.pdf). State tax offices. CDC, *Data Highlights 2006* [and underlying CDC data/estimates]. Miller, P, et al., "Birth and First-Year Costs for Mothers and Infants Attributable to Maternal Smoking," *Nicotine & Tobacco Research* 3(1):25-35, February 2001. Lightwood, J & Glantz, S, "Short-Term Economic and Health Benefits of Smoking Cessation - Myocardial Infarction and Stroke," *Circulation* 96(4):1089-1096, August 19, 1997, <http://circ.ahajournals.org/cgi/content/full/96/4/1089>. Hodgson, T, "Cigarette Smoking and Lifetime Medical Expenditures," *The Millbank Quarterly* 70(1), 1992. U.S. Census. National Center for Health Statistics.

**Projections will be updated and improved as updated underlying data becomes available and when new data and research findings prompt refinements to the projection models and formulas.**

## APPENDIX C

### **BENEFITS & SAVINGS FROM EACH ONE PERCENTAGE POINT DECLINE IN SOUTH CAROLINA SMOKING RATES**

The following estimates show the benefits and savings that are obtained in South Carolina for each one percentage point decline in adult and youth smoking rates in the state (e.g., from new state investments in tobacco prevention or increased state tobacco tax rates). These estimates can also be switched around to show what harms and costs South Carolina would suffer from each one percentage point increase to its smoking rates or from each one percentage point reduction the State fails to obtain (e.g., because it fails to sustain adequate state tobacco prevention funding or lets its tobacco tax rates erode over time).

#### **Fewer Smokers**

**Fewer current adult smokers: 32,200**

**Fewer current pregnant smokers: 570**

**Fewer current high school smokers: 2,400**

**South Carolina kids alive today who will not become addicted adult smokers: 10,200**

#### **Public Health Benefits**

**Today's adults saved from dying prematurely from smoking: 8,500**

**Today's high school smokers saved from dying prematurely from smoking: 800**

**South Carolina kids alive today who will not die prematurely from smoking: 3,300**

	<u>First Year</u>	<u>Over 5 Years</u>
<b><i>Fewer smoking-affected births:</i></b>	<b>570</b>	<b>2,830</b>
<b><i>Fewer smoking-caused heart attacks:</i></b>	<b>18</b>	<b>233</b>
<b><i>Fewer smoking-caused strokes:</i></b>	<b>11</b>	<b>125</b>

[The number of heart attacks and strokes prevented each year by a one-time decline in adult smoking rates of one percentage point starts out small but grows sharply until it peaks and stabilizes after about ten years.]

#### **Monetary Benefits (Reduced Public, Private, and Individual Smoking-Caused Costs)**

	<u>First Year</u>	<u>Over 5 Years</u>
<b><i>Savings from smoking-affected birth reductions</i></b>	<b>\$1.0 million</b>	<b>\$4.8 million</b>
<b><i>Savings from heart attack &amp; stroke reductions</i></b>	<b>\$1.2 million</b>	<b>\$16.6 million</b>

[Annual savings from fewer smoking-caused heart attacks and strokes grows substantially each year as more and more are prevented by the initial one percentage point smoking decline. Savings from prevented smoking-caused cancer are even larger, but do not begin to accrue until several years after the initial smoking decline.]

**Reduction to future health costs from adult smoking declines: \$305.9 million**

**Reduction to future health costs from youth smoking declines: \$178.5 million**

[These savings accrue over the lifetimes of the adults who quit and the youth who do not become adult smokers. Roughly 18.5% of smoking-caused healthcare expenditures in South Carolina are paid by its Medicaid program.]

At the same time that they reduce public and private smoking-caused costs, state smoking declines also increase public and private sector worker productivity and strengthen the state's economy.

For sources and more detail, see TFK Factsheet *Comprehensive State Tobacco-Control Programs Save Money*, <http://tobaccofreekids.org/research/factsheets/pdf/0168.pdf>.

See TFK website at <http://tobaccofreekids.org/research/factsheets> or <http://tobaccofreekids.org/research/factsheets/index.php?CategoryID=6> for additional related information.

## **APPENDIX D**

### **EXPLANATIONS AND SOURCES FOR TFK'S PROJECTIONS OF NEW REVENUES & BENEFITS FROM STATE CIGARETTE TAX INCREASES**

The Campaign for Tobacco-Free Kids (TFK) projections of increased state revenues and other benefits from raising state cigarette tax rates reflect the basic fact that cigarette tax increases both boost state cigarette tax revenues and reduce smoking because the increased tax per pack brings in more new revenue than is lost from the declines in pack sales caused by consumption declines or increased smoker tax avoidance prompted by the price increase.

These projections are based, in part, on research findings that a 10% cigarette price increase, if maintained against inflation, reduces youth smoking rates by 6.5% or more, adult rates by 2%, and total consumption by 4%. [See, e.g., Chaloupka, FJ, "Macro-Social Influences: The Effects of Prices and Tobacco Control Policies on the Demand for Tobacco Products," *Nicotine & Tobacco Research* (2000), and other price studies at <http://tiger.uic.edu/~fjc>; Tauras, J, et al., "Effects of Price and Access Laws on Teenage Smoking Initiation: A National Longitudinal Analysis," Bridging the Gap Research, ImpacTeen, April 24, 2001, and other price studies at <http://www.impactteen.org>.] But these elasticity findings are adjusted downward to be conservative and to account for some smokers avoiding the price increases through a range of tax evasion strategies. Despite such tax evasion, cigarette tax increases reduce smoking rates, which, in turn, reduces smoking caused disease, death, and economic costs. Parallel increases to state excise taxes on other tobacco products would similarly provide additional new state excise tax and sale tax revenue – while also reducing the use of these products in the state, and reducing related harms and healthcare costs.

These projections are fiscally conservative because they include generous adjustments for lost state pack sales (and reduced state revenue gains) caused by new tax avoidance efforts by continuing in-state smokers and, where applicable, fewer in-state cigarette sales to supply smokers from other states, informal smugglers, criminal smuggling organizations, or multistate internet sellers. [See, e.g., Farrelly, M, et al., "Cigarette Smuggling Revisited," U.S. Centers for Disease Control & Prevention (CDC), in press, and Farelly, M, et al., *State Cigarette Excise Taxes: Implications for Revenue and Tax Evasion*, RTI International, 2003, [http://www.rti.org/pubs/8742\\_Excise\\_Taxes\\_FR\\_5-03.pdf](http://www.rti.org/pubs/8742_Excise_Taxes_FR_5-03.pdf).] To account for possible additional declines in state cigarette sales and revenues from other factors – such as state tobacco prevention investments, other public and private tobacco prevention efforts, federal cigarette tax changes, cigarette company or other increases to cigarette prices, etc. – these projections also assume a background year-to-year decline in consumption of 1.5%. To be even more conservative, the projected amounts have also been rounded down.

Despite all of these conservative adjustments, the projections still show that non-trivial state cigarette tax increases will both significantly reduce smoking levels and substantially increase state revenues. The increased tax per pack will still bring in more new state revenue than is lost from the decrease in the number of packs sold caused by the tax increase from either consumption declines, tax avoidance, or smuggling. And that is exactly what has happened in every state that has significantly increased its cigarette tax rates. [See, e.g., TFK Factsheet, *Raising State Cigarette Taxes Always Increases State Revenues (and Always Reduces Smoking)*, <http://tobaccofreekids.org/research/factsheets/pdf/0098.pdf>.]

In those states that apply their sales tax percentage to the total retail price of a pack of cigarettes (including the state cigarette tax amount), a cigarette tax increase will raise state sales tax revenues per pack, which will offset sales tax revenue losses from fewer packs being sold. In addition, smokers who quit or cut back will likely spend the money they previously spent on cigarettes largely on other goods on which sales tax is collected, which further increases state sales tax revenues.

These projections assume that the tax increase is fully passed on in higher prices, and keeps up with inflation over time. The starting price per pack (before the proposed cigarette tax increase) used in these projections includes all federal and statewide excise and sales taxes but not any purely local taxes (except that NY City's \$1.50 per pack tax is factored into the overall NY State price per pack), and is based on data from *The Tax Burden on Tobacco*, 2004, reports of state cigarette tax increases, and USDA Economic Research Service, Tobacco Briefing Room, <http://www.ers.usda.gov/briefing/tobacco>. These projections assume that the state or district will follow standard practice and apply the cigarette tax increase to all previously tax-stamped or otherwise tax-paid cigarettes held in inventory by wholesalers or retailers on the effective date of the increase.

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\* Cigarette company price cuts and other factors could also work to increase cigarette consumption and/or sales in the state, which would increase state cigarette tax revenues beyond the projected amounts.

Failing to tax such cigarettes held in inventory would open the door to massive pre-increase stockpiling by retailers and wholesalers to evade the increase, drastically reducing the amount of new state revenues.

The projections for youths stopped from becoming smokers and avoided premature youth and adult deaths are calculated by applying the above findings regarding the effects of tax and price increases to the number of current adult smokers in each state and to estimates the U.S. Centers for Disease Control and Prevention (CDC) of the number of kids alive today in each state who will become adult smokers and the number projected to die from smoking. [CDC, *State Sustaining State Programs for Tobacco Control: Data Highlights 2004*, <http://www.cdc.gov/tobacco/datahighlights/Page4.htm>. For an explanation of how CDC makes these youth projections, see CDC, "Projected Smoking-Related Deaths Among Youth – United States," *MMWR* 45(44): 971-974, <http://www.cdc.gov/mmwr/preview/mmwrhtml/00044348.htm>, November 11, 1996, which also contains data on relative death risks of smokers, nonsmokers, former smokers, etc.

Because of research and data limitations, it is not yet possible to estimate health savings in each year following a cigarette tax increase, or even provide reasonable estimates of the total health care savings over the first five or ten years. Although smoking-caused healthcare cost savings from a cigarette tax increase will be relatively small in the first year after an increase, they grow quickly. The listed 5-Year savings from fewer smoking-caused heart attacks and strokes and from fewer smoking-affected pregnancies and related birth complications show just some of the many substantial savings from the smoking reductions prompted by a tax increase that begin to accrue immediately.

The projected healthcare savings from reducing the number of future youth and current adult smokers accrue over the lifetimes of kids alive in the state today who quit or don't start because of tax increase and over the lifetimes of those current adult smokers who quit because of the tax increase. Smokers' lifetime healthcare costs average at least \$16,000 higher than nonsmokers (in 2002 dollars), despite shorter life spans; but the savings per each adult quitter are less than that because adult smokers have already been significantly harmed by their smoking and have already incurred or locked-in extra, smoking-caused health costs. [Hodgson, TA, "Cigarette Smoking and Lifetime Medical Expenditures," *The Millbank Quarterly* 70(1), 1992. See, also, Nusselder, W, et al., "Smoking and the Compression of Morbidity," *Epidemiology & Community Health*, 2000; Warner, K, et al., "Medical Costs of Smoking in the United States: Estimates, Their Validity, and Their Implications," *Tobacco Control* 8(3): 290-300, <http://tc.bmjournals.com/content/vol8/issue3/index.shtml>, Autumn 1999. CDC, "Projected Smoking-Related Deaths Among Youth – United States," *MMWR* 45(44): 971-974, November 8, 1996, <http://www.cdc.gov/mmwr/preview/mmwrhtml/00044348.htm>. See also, "Annual Smoking-Attributable Mortality, Years of Potential Life Lose, and Economic Costs – United States 1995-1999," *MMWR*, April 11, 2002, [www.cdc.gov/mmwr/preview/mmwrhtml/mm5114a2.htm](http://www.cdc.gov/mmwr/preview/mmwrhtml/mm5114a2.htm).]

5-Year Heart & Stroke Savings projections show the estimated reductions in smoking-caused healthcare expenditures within first five years after the tax increase from reduced smoking-caused heart attacks and strokes, based on Lightwood & Glantz, "Short-Term Economic and Health Benefits of Smoking Cessation – Myocardial Infarction and Stroke," *Circulation* 96(4), August 19, 1997. These savings will increase steadily in subsequent years. The projected 5-Year Smoking Births Savings accrue from declines in smoking among pregnant women and corresponding reductions in smoking-caused birth complications and related first-year health costs. [Miller, D, et al., "Birth and First-Year Costs for Mothers and Infants Attributable to Maternal Smoking," *Nicotine & Tobacco Research* 3:25-35, 2001; and state pregnancy-smoking and births data.]

All projected savings have been adjusted to 2002 dollars using the same methodology the U.S. Centers for Disease Control and Prevention has used to update its data on state smoking-caused costs. The projected savings amounts would be larger if put in 2004 dollars, but using the CDC methodology to put them in 2002 dollars makes the projections more conservative and reliable and makes them comparable to the CDC's estimates of smoking-caused state costs. [See CDC, *Sustaining State Programs for Tobacco Control: Data Highlights 2004*, <http://www.cdc.gov/tobacco/datahighlights/index.htm>.] These projections do not include a range of additional short and long-term savings from other declines in smoking-caused health problems and other smoking-caused costs. [See, e.g., U.S. Department of the Treasury, *The Economic Costs of Smoking in the U.S. and the Benefits of Comprehensive Tobacco Legislation*, 1998.]

## APPENDIX E

### **STATE OPTIONS TO PREVENT AND REDUCE CIGARETTE SMUGGLING AND BLOCK OTHER ILLEGAL STATE TOBACCO TAX EVASION**

To try to block or reduce state tobacco tax increases, the major U.S. cigarette companies regularly overstate the amount of cigarette smuggling and tax-avoidance prompted by differences among different states' cigarette tax rates. In fact, every state that has increased its cigarette tax rate significantly has enjoyed substantial revenue increases despite declining smoking levels and pack sales.<sup>1</sup> At the same time, recent research indicates that the highest- tax states could increase their tobacco tax revenues by five or 10 percent if they implemented effective measures to reduce sharply both organized cigarette smuggling (which accounts for the majority of untaxed sales) and smoker tax avoidance.<sup>2</sup> New revenue aside, states should not tolerate illegal tobacco smuggling or any other tobacco-related crimes, especially if done by criminal organizations. Fortunately, there are a number of relatively simple and inexpensive measures that states could implement to minimize such smuggling and tobacco tax avoidance.

#### **Measures to Make Smuggling & Tobacco Tax Avoidance More Difficult**<sup>†</sup>

1. ***Improve state tobacco tax stamps.*** The few states that do not have tax stamps (NC, SC, and ND) should require them; and all states should take advantage of available new technologies to make their tax stamps larger, highly visible, easy to distinguish from other states' tax stamps, harder to counterfeit, and placed on two sides of the packages and under any cellophane wrapper – with the tax stamp coding providing information on each pack re what retailer or wholesaler originally purchased it from which distributor or manufacturer. California, for example, initiated new high-tech tax stamps and enjoyed a \$120 million boost to its cigarette tax revenues in the following 20 months.<sup>3</sup> Tax stamps on non-cigarette tobacco products should also be established or improved. Tax stamps could also provide a phone number or email address for reporting suspected illegal sales, smuggling, or tax evasion, with rewards for tips that lead to arrests (and new stamps could also include a quitline phone number for smokers who want to quit).
2. ***Require State tax-exempt stamps on all cigarettes and other tobacco products sold in state that are not subject to the state's tobacco taxes.*** Require distributors selling cigarettes to Indian Tribes and others that make legal cigarette sales within the state's borders free from state tax to stamp those cigarettes with special state tax-exempt stamps – and to report all such sales, including amounts sold to whom, to state tax collection officials. The stamps could state “for legal tax-exempt sales only.” These stamps would make it more difficult to illegally divert tax-exempt cigarettes into non-tax-exempt sales and would provide state officials with important data on the extent of tax-exempt sales and illegal diversion within the state. Several states already have such tax-exempt stamping requirements.<sup>4</sup>
3. ***Forbid the sale, purchase, or possession in the state of any tobacco products that are not marked with state tobacco tax stamps or other state tax-payment indicia establishing that all applicable state tobacco taxes have already been paid – other than small personal-use amounts and those held by or transported between licensed cigarette manufacturers, distributor/wholesalers, retailers or other licensed tobacco product businesses.*** This catch-all requirement prohibits all sorts of cigarette smuggling and tax avoidance, mandates tax payments, and facilitates enforcement by establishing that any significant amount of tobacco products found in the

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<sup>\*</sup> U.S. interstate cigarette smuggling typically occurs when smugglers purchase cigarettes in a low-tax state or other low-tax or no-tax jurisdiction (such as Indian Tribal lands) and then illegally smuggle them into a high-tax state for illegal resale to otherwise-legal retailers. Otherwise legal retailers then purchase the cigarettes from the smugglers at prices that reflect the avoided state cigarette taxes, and the retailers subsequently sell the cigarettes to unknowing consumers. Through this process, the retailers and the smugglers, and not the smokers, enjoy the lion's share of the tax-avoidance “savings.” In some cases, the cigarettes smuggled from the low-tax jurisdiction are sold directly to final customers via black-market sales, but these black-market sales are quite small compared to the sales through otherwise legal retailers. Some smokers also avoid paying the cigarette tax in their state by purchasing their cigarettes in a nearby lower-tax state, from stores on nearby military bases or Indian Lands (which typically do not charge state taxes), or from the Internet (where sales of cigarettes from Tribal lands and low-tax states are common).

<sup>†</sup> Although many of these measures refer only to cigarettes, they could be applied to other tobacco products, as well.

state without the appropriate tax stamp or tax-payment indicia are illegal goods (unless in the possession of licensed tobacco product businesses or their delivery services).

4. **Require better record keeping by distributor/wholesalers.** Require distributors and wholesalers selling cigarettes to retailers (which, in turn, sell them to state residents) to keep and maintain records of amounts sold, to whom, tax-stamp status, etc., and to regularly provide this information to state officials.
5. **Require better record keeping by retailers.** Require all retailers that sell cigarettes in the state to keep and retain accurate records regarding: a) their receipt of cigarettes from others (including date, quantity, from whom received, etc.); b) their total cigarette sales in the state (with monthly totals); and c) their sale of any cigarettes in quantities exceeding 2,000 cigarettes, or 10 cartons (including date, quantity, description, to whom sold, etc.).
6. **Block retail sales clearly not for personal use.** Place a maximum sale amount of 2,000 cigarettes (10 cartons) for any single sale to a consumer in the state – with parallel limits for the sales of other tobacco products.
7. **Educate smokers about existing state laws restricting smuggling and tax avoidance.** Most states already have laws that prohibit state smokers from bringing more than two cartons of cigarettes (or some other maximum amount) into the state from any other jurisdiction (including nearby states, Tribal lands, military bases, and duty-free shops) – and states that do not have any such laws should pass them. While enforcing such laws is difficult, many smokers do not even know they exist – and some would stop going to other jurisdictions to buy cheaper cigarettes (or at least reduce the size of their purchases) if they did know about these laws. Similarly, many smokers do not know that it is against state law to avoid paying state cigarette taxes by purchasing them over the Internet from website sellers that do not collect or pay the tax owed to the state. To educate smokers about existing laws prohibiting tax avoidance the State could post the information on various state website pages, issue related press releases, run related public education announcements, and require retailers to post notices or include notices with each tobacco product sale they make. Making periodic highly publicized “stings” to catch some of the cross-border or Internet shoppers who are illegally evading the state cigarette tax might be an even more effective way to dampen many smokers’ enthusiasm for these tax avoidance strategies.
8. **Publicize toll-free hot lines to encourage reports of smuggling or tax-avoidance activities.** Require state-based wholesalers, distributors, importers, exporters, and retailers of tobacco products to post prominent signs that provide a toll-free number and email address for reporting anyone suspected of smuggling tobacco products or buying or selling smuggled tobacco products. These or other signs could also provide information on how to identify legal versus smuggled cigarettes, notify smokers and others of the existing laws and penalties re buying smuggled cigarettes, bringing cigarettes into the state from other jurisdictions, etc., and inform employees of existing whistleblower protections. The toll-free number could also be included on the state tax stamps placed on tobacco products.
9. **Protect “Whistleblowers.”** To encourage the reporting of smuggling activities and protect witnesses, states could pass laws to protect the employees of retailers, distributors, wholesalers, importers, exporters, manufacturers, and delivery services from being fired or otherwise penalized by their employers if the employee notifies authorities about their employers’ smuggling-related wrongdoing or testifies about it in court.
10. **Work with Neighboring States.** To increase each state’s cigarette tax revenues, groups of neighboring states can work together to make their cigarette tax rates equal or similar to each other’s (by the lower-tax states raising their rates) and can coordinate and expand their mutual efforts to minimize cigarette smuggling and other tax avoidance through new parallel state laws and coordinated enforcement efforts.
11. **Put pressure on the States with extremely low cigarette tax rates to raise them.** The average state cigarette tax is more than 100 cents per pack, but South Carolina has a tax rate of only seven cents per pack and does not even put tax stamps on its cigarettes, making them even easier to smuggle and resell. Numerous other states also have rates way below the national average of over a dollar per pack. Cigarette tax increases in those states would help to dampen interstate cigarette smuggling by sharply reducing the available illegal profits. Similarly, very few Indian Tribes have their

own Tribal tobacco taxes, and they should be encouraged to establish them (see the next item). States and Tribes with low or no taxes on other tobacco products should also be urged to establish or raise them.

12. ***Enter into treaties with in-state Indian Tribes to eliminate tobacco product price disparities.***

Some smokers and smugglers go onto Tribal lands to purchase cigarettes and other tobacco products free of any state taxes. To reduce this problem, some states have entered into special compacts or agreements with the Indian Tribes located within the states' borders whereby the Tribe agrees to collect the state's tax (or a similar Tribal tax) on all of cigarette or other tobacco product sales on the Tribe's lands (whether sold to Tribal members or nonmembers) – thereby making the Tribal prices comparable to the prices charged elsewhere in the state – and the state agrees that the Tribe can keep all of the revenues it raises from charging the state (or Tribal) tax. These kinds of state-Tribal agreements are necessary because, otherwise, when a Tribe establishes a Tribal cigarette tax it is legally required to collect that Tribal tax on top of any state cigarette tax in all sales to non-tribal members, which produces an odd double-taxation problem.<sup>5</sup>

13. ***Support Federal Anti-Smuggling Legislation.*** While each state can do a lot, the federal government can do more. Most notably, the federal government could require all states to put tax stamps on their cigarettes, thereby stopping the sale in some low-tax states of blank packs that can easily be used for smuggling – and could require special tax stamps or restricted-sale notices on all tobacco products sold free of state taxes on Indian reservations, military bases, and duty-free shops. The federal government can also create nationwide standards for tax stamps; cigarette labeling (e.g., requiring unique serial numbers or markings indicating where packs may be legally sold); record keeping by manufacturers, wholesalers, and retailers; maximum sales amounts; and the like.<sup>6</sup> Federal legislation could also block tax-avoidance via Internet sales (see below).

### **Special Measures to Stop Illegal Tax-Free Internet & Mail Order Sales of Cigarettes**

The federal Jenkins Act requires all Internet sellers to provide each state with monthly reports listing state residents who have purchased cigarettes from the Internet sellers (including the quantities sold to each and the residents' mailing addresses), thereby enabling states to go after the in-state consumers to collect state taxes owed on the sales. The vast majority of Internet sellers, however, do not make the required Jenkins Act reports to the states, and federal officials rarely enforce the Act.<sup>7</sup> Some states have marginally increased the Internet sellers' compliance rate simply by contacting them and demanding the reports, and a few states have initiated lawsuits against some Internet sellers to try to force compliance, but overall compliance rates remain low. While these state efforts could be expanded, they are ultimately of limited value given the large number of Internet sellers and the ability of customers to find new non-complying vendors quickly and easily on the Internet. Even when Internet vendors comply with the Jenkins Act and provide the states with the customer information, going after each individual customer to collect owed taxes is an inevitably time consuming and ineffective process. Accordingly, states that wish to minimize Internet-based tobacco tax evasion must go beyond trying to enforce the Jenkins Act and also establish more effective tax collection strategies.

- ***Implement new State laws banning or restricting Internet tobacco product sales.*** New York State has a law in place that prohibits Internet or mail order sales of cigarettes into the state – and the courts have upheld that law against cigarette company and Internet vendor attacks.<sup>8</sup> To minimize Internet sales that avoid paying state taxes, a state could pass a ban similar to the New York law.<sup>9</sup> Alternatively, a state could establish laws – such as those in Maine, California, Texas and other states – placing new requirements on all Internet and mail-order sales of any tobacco products to any state residents.<sup>10</sup> To be effective, any such law must provide some way of interrupting illegal Internet sales without the state having to try to find and bring every one of the hundreds of active illegal internet sellers into court. The best way to do that is to block the illegal Internet sellers' deliveries to their customers in the state by instructing common carriers and other delivery services operating in the state not to make any deliveries for Internet sellers that are breaking state laws.<sup>11</sup>

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<sup>5</sup> Retailers on Indian Lands are allowed to sell tobacco products to members of the same Tribe free of state tobacco taxes but are not allowed (unless expressly authorized by a state) to sell state-tax-free cigarettes to anyone who is not a Tribal member. However, a state's ability to take enforcement action against Indian Tribes that fail to collect and remit state taxes on sales to non-members of the Tribe are severely limited because of Indian Tribes' sovereign immunity (e.g., states cannot bring Tribes into state court to enforce state tax collection laws).

- **Support new federal laws to minimize Internet-based tobacco tax evasion.** As with smuggling in general, new federal laws can more effectively restrict Internet-based tobacco tax evasion than state laws because the federal government has nationwide authority, can restrict interstate commerce in ways that states cannot, and can restrict U.S. Postal Service deliveries of illegally sold or contraband tobacco products. One effective federal bill to reduce tobacco tax evasion by restricting Internet tobacco product sales and strengthening other federal laws against contraband tobacco products was the Prevent All Contraband Tobacco Act, known as the PACT Act (S. 1117), which passed the Senate in the 2003-2004 legislative session but was not considered in the House.<sup>12</sup> New versions of the PACT Act will be introduced in both the House and Senate this session.
- **Subject Internet and other mail-order sellers of tobacco products to the same anti-smuggling measures and other state laws that apply to regular in-state retailers of tobacco products.** To create a more level playing field and reduce the unfair cost and price advantage of Internet tobacco product sellers (which underlies Internet-based tax evasion), make sure all anti-smuggling provisions and other state laws that apply to in-state retail sellers of tobacco products also apply to Internet or mail-order companies that sell tobacco products to persons in the state, including record-keeping requirements, applicable penalties, etc., with adjustments made to the requirements placed on in-state retailers, as necessary, to apply them in ways that account for the unique character of Internet sales.

### **Stronger Disincentives and Punishments for Smuggling**

- **Expand definition of illegal smuggling subject to state prosecution and penalties.** To reach more illegal smuggling and tax avoidance through state law enforcement, reduce the minimum number of cartons/packs/cigarettes that trigger smuggling violations or major smuggling penalties. Establish or fortify penalties for the manufacture, possession, or sale of counterfeit tobacco tax stamps or counterfeit tobacco products.
- **Increase existing fines for cigarette or other tobacco product smuggling.** Increase the minimum dollar amounts of existing fines and have no maximum amount so that meaningful fines can be levied against large economic entities involved in smuggling.
- **Seize vehicles and properties used in cigarette or other tobacco product smuggling.** Establish new provisions to allow for the state's seizure of vehicles used in cigarette smuggling, putting liens on property for the value of smuggled goods, etc. (as with state laws pertaining to illegal drug trafficking).
- **Withdraw right to sell tobacco products from retailers involved in smuggling.** State anti-smuggling laws could ensure that retail outlets in the state that buy smuggled cigarettes or knowingly sell smuggled cigarettes will lose their right to sell any cigarettes in the state for some period of time (e.g., from one to ten years depending on the severity of the violation).
- **Include jail or prison time for guilty large-scale smugglers or repeat offenders.** Going beyond just fines and other economic disincentives, state laws could call for jail or prison sentences for persons participating in large smuggling efforts or who are guilty of repeatedly violating the states anti-smuggling or tax-avoidance laws.

### **Endnotes for Appendix E**

<sup>1</sup> Farrelly, M, et al., *State Cigarette Excise Taxes: Implications for Revenue and Tax Evasion*, Research Triangle International, May 2003, [http://www.rti.org/pubs/8742\\_Excise\\_Taxes\\_FR\\_5-03.pdf](http://www.rti.org/pubs/8742_Excise_Taxes_FR_5-03.pdf). See also, Campaign for Tobacco-Free Kids (TFK), *Raising State Tobacco Taxes Always Increases State Revenues & Always Reduces Tobacco Use*, <http://tobaccofreekids.org/research/factsheets/pdf/0098.pdf>.

<sup>2</sup> Yurekli, A & Zhang, P, "The Impact of Clean Indoor-Air Laws and Cigarette Smuggling on Demand for Cigarettes: An Empirical Model," *Health Economics* 9:159-170, 2000; Farrelly, M, et al., "Cigarette Smuggling Revisited," U.S. Centers for Disease Control & Prevention (CDC), in press. See also, the references listed in endnote 1.

<sup>3</sup> Halper, E, "States Tobacco Revenue Surges," *Los Angeles Times*, December 27, 2005. TFK Factsheet, *The Case for High-Tech Cigarette Tax Stamps*, <http://tobaccofreekids.org/research/factsheets/pdf/0287.pdf>. California Revenue and Taxation Code Section 30162, <http://www.leginfo.ca.gov/cgi-bin/displaycode?section=rtc&group=30001->

[31000&file=30161-30165](http://www.leginfo.ca.gov/pub/01-02/bill/sen/sb_1701-1750/sb_1701_bill_20020926_chaptered.pdf). For the underlying legislation, see [http://www.leginfo.ca.gov/pub/01-02/bill/sen/sb\\_1701-1750/sb\\_1701\\_bill\\_20020926\\_chaptered.pdf](http://www.leginfo.ca.gov/pub/01-02/bill/sen/sb_1701-1750/sb_1701_bill_20020926_chaptered.pdf).

<sup>4</sup> See, e.g., Arizona's separate tobacco tax, with tax stamps, on Tribal sales, with the revenues remitted to the Tribes. AZ Revised Statutes, 42-3301 to 42-3307, <http://www.azleg.state.az.us/ars/42/title42.htm>.

<sup>5</sup> See above note re: AZ. For examples of State-Tribal tobacco tax compacts, National Congress of American Indians, [http://www.ncai.org/main/pages/issues/governance/agreements/tax\\_agreements.asp](http://www.ncai.org/main/pages/issues/governance/agreements/tax_agreements.asp).

<sup>6</sup> For a list of effective federal anti-smuggling provisions, see American Cancer Society, et al., *Proposed Federal Measures to Reduce Cigarette Smuggling and Protect Federal and State Tobacco Tax Revenues*, January 2003, <http://tobaccofreekids.org/research/factsheets/pdf/0226.pdf>.

<sup>7</sup> See, e.g., U.S. General Accounting Office, *Internet Cigarette Sales: Giving ATF Investigative Authority May Improve Reporting and Enforcement*, August 9, 2002, <http://www.gao.gov/new.items/d02743.pdf>.

<sup>8</sup> New York Public Health Article 13F, Section 1399-II, <http://assembly.state.ny.us/leg/?cl=91&a=71>. *Brown & Williamson Tobacco Corp. v. Pataki*, U.S. Court of Appeals for the Second Circuit, Docket Nos. 01-7806, 01-7813, February 13, 2003, <http://tobacco.neu.edu/Internet/CCA2ruling.pdf>.

<sup>9</sup> For model legislation, see <http://tobaccofreekids.org/research/factsheets/index.php?CategoryID=29>.

<sup>10</sup> For model legislation, see <http://tobaccofreekids.org/research/factsheets/pdf/0230.pdf>.

<sup>11</sup> For more information on blocking Internet deliveries, see the provisions in the above cited model statutes and the TFK Factsheet at <http://tobaccofreekids.org/research/factsheets/pdf/0259.pdf>. More on how to address Internet tobacco product sale is at <http://tobaccofreekids.org/reports/Internet> and <http://tobaccofreekids.org/research/factsheets/index.php?CategoryID=29>.

<sup>12</sup> For more information on the PACT Act, see <http://tobaccofreekids.org/reports/Internet>.

## **USEFUL RESEARCH STUDIES**

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## Report Notes

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<sup>2</sup> Chaloupka, F, Slater, S, & Wakefield, M, "USA: Price cuts and point of sale ads follow tax rise," *Tobacco Control* 8:242-246; Pierce, JP, et al., "Tobacco industry price-subsidizing promotions may overcome the downward pressure of higher prices on initiation of regular smoking," *Health Economics* 14:1061-1071, 2005; Loomis, BR, Farrelly, MC, & Mann, NH, "The association of retail promotions for cigarettes with the Master Settlement Agreement, tobacco control programmes and cigarette excise taxes," *Tobacco Control* 15:458-463, 2006.

<sup>3</sup> Consumers who reduce their purchases of tobacco products will use the money they save to purchase other state goods and services, which will further strengthen the state's economy. To the extent that such consumers purchase other goods subject to special state taxes (e.g., alcoholic beverages or gasoline), the decline in tobacco product sales will also increase those other forms of state revenue.

<sup>4</sup> Miller, L, et al., "State Estimates of Total Medical Expenditures Attributable to Smoking, 1993," *Public Health Reports*, September/October 1998.

<sup>5</sup> Office of the Assistant Secretary for Planning and Evaluation, U.S. Department of Health and Human Services, *Federal Medicaid Assistance Percentages*, <http://aspe.os.dhhs.gov/health/fmap.htm>.

<sup>6</sup> CDC, Data Highlights 2006 [and underlying CDC data/estimates], <http://www.cdc.gov/tobacco/datahighlights/2006/index.htm>; CDC's STATE System average annual smoking attributable productivity losses from 1997-2001(1999 estimates updated to 2004 dollars) CDC, "Annual Smoking-Attributable Mortality, Years of Potential Life Lost, and Economic Costs – United States 1995-1999," *Morbidity and Mortality Weekly Report (MMWR)*, April 11, 2002, <http://www.cdc.gov/mmwr/preview/mmwrhtml/mm5114a2.htm>.

<sup>7</sup> Halpren, MT, et al., "Impact of smoking status on workplace absenteeism and productivity," *Tobacco Control* 10(3):233-238, September 2001.

<sup>8</sup> Zollinger, TW, et al., "The economic impact of secondhand smoke on the health of residents and employee smoking on business costs in Marion County, Indiana for 2000," *Marion County Health Department*, February 2002.

<sup>9</sup> Warner KE, et al., "Employment implications of declining tobacco product sales for the regional economies of the United States," *JAMA* 275(16):1241-6, April 24, 1996. Warner KE & Fulton, GA, "The economic implications of tobacco product sales in a nontobacco state," *JAMA* 271(10):771-6, March 9, 1994. Warner KE, "Implications of a nicotine-free society," *Journal of Substance Abuse* 1(3):359-68, 1989. While these studies found that the major tobacco states, including South Carolina, might have a small net decrease in employment from the total elimination of all U.S. cigarette sales, the economy of South Carolina and the other tobacco states are now much less dependent on tobacco farming and cigarette manufacturing than they were when those studies were done, which sharply reduces any risk of reduced employment from disappearing cigarette sales.

<sup>10</sup> Gottlob, B, *The Fiscal and Economic Impacts of Increasing the Cigarette Tax in New Hampshire*, PolEcon Research, March 2003. Gottlob, B, *The Fiscal and Economic Impacts of Increasing the Cigarette Tax in Texas*, PolEcon Research, in press. Gottlob, B, *The Fiscal and Economic Impacts of*

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<sup>12</sup> Schelzig, E, "Business groups support cigarette tax," *Business Week*, March 21, 2007.

<sup>13</sup> Public Opinion Strategies, statewide survey of 500 likely voters, margin of error of +4.38%, January 17 and 19, 2006.

<sup>14</sup> Orzechowski & Walker, *The Tax Burden on Tobacco*, 2006, with updates to account for announcements of cigarette company price increases.

<sup>15</sup> The average retail price of a pack of cigarettes, with sales tax, in South Carolina is about \$3.35 after the major cigarette companies most recent price increases. The major cigarette companies' price charged to distributor/wholesalers is about \$2.28. Orzechowski & Walker, *The Tax Burden on Tobacco*, 2006. USDA Economic Research Service, Tobacco Briefing Room, <http://www.ers.usda.gov/briefing/tobacco>. Press reports on cigarette company price increases.

<sup>16</sup> U.S. Federal Trade Commission (FTC), *Cigarette Report for 2003*, October 22, 2004 [data for top six manufacturers only], <http://www.ftc.gov/reports/cigarette05/050809cigrpt.pdf>; FTC, *Federal Trade Commission Smokeless Tobacco Report for the Years 2000 and 2001, August 2003* <http://www.ftc.gov/os/2003/08/2k2k1smokeless.pdf>. [top five manufacturers]. State total a prorated estimate based on cigarette pack sales in the state. See also, TFK Factsheet, *Increased Cigarette Company Marketing Since the Multistate Settlement Agreement Went into Effect*, <http://tobaccofreekids.org/research/factsheets> and *State-Specific Tobacco Company Marketing Expenditures 1998-2003*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0271.pdf>.

<sup>17</sup> See, e.g., CDC, "Responses to Cigarette Prices By Race/Ethnicity, Income, and Age Groups – United States 1976-1993," *MMWR* 47(29):605-609, July 31, 1998 [smokers with family incomes at or below the national median are four times as likely to quit because cigarette price increases as those with higher incomes], <ftp://ftp.cdc.gov/pub/Publications/mmwr/wk/mm4729.pdf>.

<sup>18</sup> Alaska Statutes, Title 43, Chapter 43.50, Section 43.50.500 et seq., [http://www.legis.state.ak.us/cgi-bin/folioisa.dll/statx04/query=\\*toc/{@41}?next](http://www.legis.state.ak.us/cgi-bin/folioisa.dll/statx04/query=*toc/{@41}?next).

<sup>19</sup> Halper, E, "States Tobacco Revenue Surges," *Los Angeles Times*, December 27, 2005. TFK Factsheet, *The Case for High-Tech Cigarette Tax Stamps*, <http://tobaccofreekids.org/research/factsheets/pdf/0287.pdf>. California Revenue and Taxation Code Section 30162, <http://www.leginfo.ca.gov/cgi-bin/displaycode?section=rtc&group=30001-31000&file=30161-30165>. For the underlying legislation, see [http://www.leginfo.ca.gov/pub/01-02/bill/sen/sb\\_1701-1750/sb\\_1701\\_bill\\_20020926\\_chaptered.pdf](http://www.leginfo.ca.gov/pub/01-02/bill/sen/sb_1701-1750/sb_1701_bill_20020926_chaptered.pdf).

<sup>20</sup> See, e.g., Tedeschi, B, "Trouble for Online Vendors of Cigarettes," *New York Times*, April 4, 2005; Michel, L, "Internet cigarette sales take hit: Retailers on Cattaraugus Indian Reservation feeling impact as credit card companies stop participating in transactions," *Buffalo News*, April 4, 2005.

<sup>21</sup> See, e.g., Frazier, E & Wright, GL, "Charlotte on legal forefront of terror fight: Smuggling case reflects intrigue of tracking terrorist supporters," *Charlotte Observer*, October 14, 2001.

<sup>22</sup> U.S. General Accounting Office (GAO), *Terrorist Financing: U.S. Agencies Should Systematically Assess Terrorists' Use of Alternative Financing Mechanisms*, GAO-04-163, November 2003, page 11, <http://www.gao.gov/new.items/d04163.pdf>.

<sup>23</sup> GAO, *Terrorist Financing: U.S. Agencies Should Systematically Assess Terrorists' Use of Alternative Financing Mechanisms*, GAO-04-163, November 2003, at page 12-13, <http://www.gao.gov/new.items/d04163.pdf>.