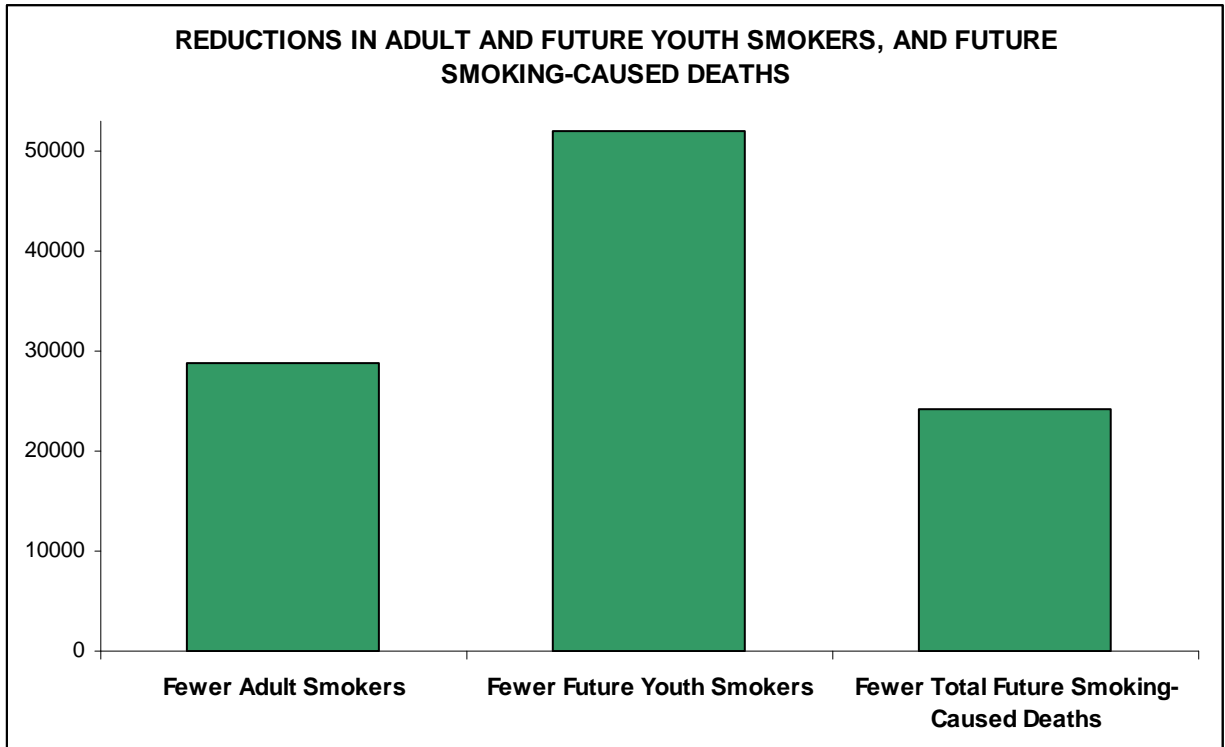


# TOBACCO TAX BENEFITS FOR MARYLAND

## REDUCING SMOKING, SAVING LIVES, AND SAVING MONEY



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

**October 2007**

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*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).*

# TOBACCO TAX BENEFITS FOR MARYLAND

## REDUCING SMOKING, SAVING LIVES, AND SAVING MONEY

### **Introduction & Executive Summary**

Governor Martin O'Malley's budget proposal includes a \$1.00 per pack increase to the state's cigarette tax rate to provide new funding to increase access to health care both through the state Medicaid program and by helping small businesses provide health care coverage to currently uninsured workers and their families. But besides providing new revenues, increasing the state cigarette tax rate would also reduce smoking, save lives, and reduce smoking-caused government, private-sector and household costs throughout the state.

***Smoking is taking a terrible toll on Maryland.*** The toll of tobacco use in Maryland remains very high. Each year, 6,800 adults die from their own smoking, 6,900 more kids become new addicted daily smokers, and countless other Maryland residents suffer from smoking-caused disease and disability – with annual smoking-caused health costs in the state totaling more than \$1.96 billion. In fact, the U.S. Centers for Disease Control and Prevention (CDC) estimates that smoking-caused health costs and productivity losses in Maryland total more than \$13.67 per pack sold in the state.\*

***Maryland's cigarette tax and the rest of the country.*** Maryland has not increased its cigarette tax for five years, when its new \$1.00 per pack tax rate became the 12th highest state cigarette tax rate in the nation. Since then, 42 other states and DC have increased their rates more than 70 times. Maryland's current \$1.00 per pack cigarette tax rate is below the statewide average, and well below nearby New Jersey's \$2.575 per pack rate. In fact, eight states now have cigarette tax rates of \$2.00 or higher. While New Jersey has the highest state rate, 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 (but no Maryland localities have their own cigarette tax).

***A \$1.00 increase to Maryland cigarette tax rate would quickly produce massive public health and economic benefits.*** In its fiscal note for HB754, which would have raised the state cigarette tax rate by \$1.00, Maryland's Department of Legislative Services estimated that a \$1.00 increase would generate more than \$220 million in additional new state revenue.<sup>1</sup> But that fiscal note did not even consider the fact that the cigarette tax increase would also produce enormous public health and economic benefits to the state and its residents, including:

- Preventing more than 52,000 Maryland kids from becoming addicted adult smokers
- Prompting more than 28,000 current adult smokers to quit for good
- Saving more than 24,000 Marylanders from dying prematurely from smoking
- Improving worker productivity throughout the state
- Cutting future public, private sector, and household health costs in Maryland by more than \$1.1 billion
- Reducing future state Medicaid program expenditures caused by smoking by more than \$177 million†

***Maryland voters strongly support a large state cigarette tax increase.*** An August 2007 poll found that 69 percent of likely Maryland voters support a \$1.00 cigarette tax increase, with supporting majorities in every major subgroup (gender, age, political party, race, and education level). Even a majority of smokers supports a \$1.00 Maryland cigarette tax increase.<sup>2</sup>

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\* For more detail on the toll of tobacco in Maryland, see Appendix A.

† For a full list of benefits to Maryland from \$1.00 cigarette tax increase, see Appendix B.

**Investments in comprehensive tobacco prevention programs would produce even more benefits and savings.** Investing just 10 cents of the new revenue from the cigarette tax rate increase to fully fund the state's efforts to prevent and reduce tobacco use and its harms would work to prevent and reduce tobacco use and its harms in Maryland even more effectively and powerfully – supplementing and maximizing the public health benefits and cost savings from the tobacco tax rate increases, alone.

**Lower-income households would 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 Maryland would be the largest beneficiaries from a \$1.00 increase. More than one-third of those expected to quit have incomes below 200 percent of the poverty line. Moreover, each smoker that quits would free his family from exposure to his or her secondhand smoke and would save more than \$2,000 per year for each pack per day no longer purchased due to the rate increase. Low-income families currently suffer disproportionately from smoking and smoking-caused disease and costs, but a \$1.00 rate increase would directly and substantially reduce that burden. Moreover, Governor O'Malley's proposal would further help low-income households by using the revenues from the \$1.00 rate increase to expand the state Medicaid program and to help more small businesses provide health insurance to workers and their families.

**Tobacco tax increases are a predictable and stable source of substantial new state revenues.** 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. Put simply, the increased tax per pack sold brings in more new revenue than is lost by the related pack sales declines. Moreover, once the dust has settled after a major cigarette tax increase, the new higher levels of state tobacco tax revenues typically decline by only about two percent per year, on average, because of ongoing reductions in state smoking rates. 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.

**Additional measures are available to the state to increase the large new tobacco tax revenues it would receive each year from raising its tobacco tax rates.** By taking steps to keep up with inflation and to minimize cigarette smuggling and tax evasion, Maryland could increase and protect the revenues that it would collect from a \$1.00 rate increase. Two especially promising strategies would be to prohibit tax-evading Internet sales of cigarettes and other tobacco products into the state; and to replace the state's old-fashioned cigarette tax stamps with a new high-tech tax stamp tracking and tracing system.

**Increases to the state's tax rates on other tobacco products would produce additional substantial benefits and savings.** Currently, the Governor's proposal does not include an increase in Maryland's tax currently low tax of only 15 percent of wholesale price for smokeless tobacco, cigars, and other tobacco products besides cigarettes. But taxing these other tobacco products at a comparable rate as the proposed new cigarette tax would require a new tax rate of at least 85 percent of the wholesale price. Implementing such a parallel tax rate increase on other tobacco products would bring the state an additional \$26 million more in new revenues each year – while also reducing these other forms of tobacco use and the many harms and costs they cause. Among other things, a higher tax rate on other tobacco products would reduce the number of kids using smokeless tobacco by more than a third and cut overall consumption by about 25 percent – thereby reducing the death, oral cancers and other health problems caused by smokeless use. Increasing the tax rates on smokeless tobacco products and cigars is especially important for reducing youth use because they are increasingly being produced and marketed with kid-friendly flavors, such as grape, cherry, and chocolate.

## **Increasing Maryland's Cigarette Tax Rate By \$1.00 Will Significantly Reduce Smoking and Related Harms**

Significant tobacco tax increases – particularly for cigarettes – are the fastest way to sharply reduce tobacco use and, more importantly, smoking-caused disease, death, and costs. Recent reports by the National Academy of Sciences' Institute of Medicine and the President's Cancer Panel have strongly recommended that states raise their tobacco tax rates to effectively reduce the toll that tobacco use takes on the states.<sup>3</sup>

Even the cigarette companies have repeatedly 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. For instance, in 1994, Ellen Merlo, Senior Vice President of Corporate Affairs, stated, "When the tax goes up, industry loses volume and profits as many smokers cut back."<sup>4</sup>

Indeed, the actual experiences of the states that have raised their cigarette tax rates firmly establish that cigarette tax increases reduce smoking rates and related harms (while increasing revenue).<sup>\*</sup> In Maryland, for instance, sales of cigarette packs declined by more than 11 percent after its 2002 state cigarette tax rate increase.<sup>5</sup>

Clearly, cigarette tax increases are one of the most effective ways to sharply reduce smoking, 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, smoking among pregnant women drops at a similar rate, and overall consumption declines by three to five percent.<sup>6</sup>

Applying these findings to a \$1.00 increase to Maryland's cigarette tax rate shows that the state will enjoy the following benefits.

<b>Cigarette Tax Increase</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>
\$1.00	52,100	16,600	28,800	7,600

Moreover, for every person who dies from smoking in the state there are another 20 people suffering from smoking-caused disease or disability. By reducing smoking levels in the state, a \$1.00 cigarette tax increase would reduce that suffering, as well – including, but not limited to, the benefits shown in the following table.

<b>Cigarette Tax Increase</b>	<b>5-Year Decline in Smoking-Affected Pregnancies</b>	<b>Fewer Cigarette Packs Sold</b>
\$1.00	5,000	59.5 million

These results might seem extraordinary, but other states and localities that have raised their cigarette tax significantly have obtained similar results.

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

**The Declines in Smoking and Smoking-Caused Harms from a \$1.00 Increase Will Reduce Government, Private Sector, and Household Smoking-Caused Health Costs throughout Maryland**

Extra healthcare expenditures in Maryland caused by smoking add up to more than \$1.96 billion, with the state Medicaid Program’s share an estimated \$476 million per year. Exposure to secondhand smoke, by itself, produces extra healthcare costs of \$78.5 million each year.\* Increasing the state’s cigarette tax rate by a substantial amount is one of the most effective methods to reduce these costs to Maryland’s government, businesses, and taxpayers

As the table below shows, in the first five years, a \$1.00 tax increase would reduce health care costs by \$21.3 million just from fewer smoking-caused heart attacks, strokes and fewer smoking-affected births, with overall healthcare savings over the lifetimes of the smokers who quit or kids who never start smoking because of a \$1.00 increase totaling \$1.18 billion in overall reductions to public, private sector, and household health care costs throughout the state.†

<b>Cigarette Tax Increase</b>	<b>5-Year Heart-Stroke Savings</b>	<b>5-Year Pregnancy Savings</b>	<b>Total Future Health Savings</b>	<b>Medicaid Share of Total Savings</b>
\$1.00	\$12.8 million	\$8.5 million	\$1.18 billion	\$177.6 million

The pregnancy savings would start immediately, as the cigarette tax increase stops pregnant women from smoking. The heart attack and stroke savings from the immediate smoking declines would start out small in the first year, but would then increase sharply each year until reaching a peak in eight to 10 years and then maintaining that high rate thereafter. In other words, the heart-stroke savings in the second five years would be substantially larger than the savings in the first five years. More importantly, these immediate heart-stroke and pregnancy cost reductions represent only the tip of the savings iceberg for Maryland, as the smoking declines from a \$1.00 rate increase would immediately begin to reduce numerous other smoking-caused health costs, as well.

All of these savings would help to reduce skyrocketing Medicaid program costs because Medicaid covers approximately 15.4 percent of the state’s total smoking-caused health costs and 50 percent of smoking-caused pregnancy-related health costs in the state.<sup>7</sup> Besides Medicaid, Maryland would also see reductions to the smoking-caused 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 health costs would also decline. Most notably, decreasing smoking rates among workers would also lower public and private sector employers’ health care and health insurance costs.

Governor O’Malley’s proposal will allocated a portion of the revenues from the cigarette tax increase to expand the state Medicaid program, which would multiply its public health and budgetary benefits. Such investments of new state funds would not only improve public health in the state but would also increase the amount of money Maryland would receive from the federal government through its Medicaid program reimbursements to the state. For every dollar the state spends on Medicaid, it gets 50 cents back from Uncle Sam; so allocating \$100 million per year of the additional new cigarette tax revenues from a \$1.00 increase to the state Medicaid program would actually cost the state only \$50 million per year (while still providing the state \$100 million worth of additional Medicaid coverage and benefits).<sup>8</sup>

\* For more detail on the economic toll of tobacco use in Maryland, see Appendix A.

† For a full list of benefits to Maryland from \$1.00 cigarette tax increase, see Appendix B. For detailed information and references regarding how these projections were made, see Appendix D.

## **The Smoking Declines From A \$1.00 Increase Will Also Reduce Public and Private Non-Health Costs**

By reducing smoking, a \$1.00 cigarette tax increase would also reduce a range of non-healthcare costs throughout the state, such as reducing the amount of property damage and loss from smoking-caused fires and shrinking smoking-caused cleaning and maintenance costs. But the biggest non-health-cost benefit might be the smoking-declines impact on improving worker productivity and reducing related losses.

***Reducing Productivity Losses in the State.*** Currently, the CDC estimates that the productivity losses in Maryland just from productive work lives being shortened by smoking-caused death reducing to total \$1.78 billion each year.<sup>9</sup> In addition, a recent study found that smoking further hurts productivity because employees who smoke 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>10</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>11</sup>

By reducing smoking among workers, a \$1.00 rate increase would cut public and private sector employer productivity losses by improving worker health and on-the-job performance, reducing the amount of smoking-caused work absences and work-time cigarette breaks, and reducing the number of productive work years lost from smoking-caused illness or disability interrupting or prematurely ending healthy and productive work lives. These improvements would not only help existing state government and business employers, but would also make Maryland more attractive to businesses that may consider relocating to the state.

***Increasing State Employment and Further Strengthening Maryland's Economy.*** There is also solid evidence that increasing cigarette tax rates will help to increase overall state employment levels. For example, economic studies have found that even if smoking were entirely eliminated in the United States, the net economic effect on the states would be positive, with more jobs created as well as other increases in productive economic activity.<sup>12</sup> More recently, state-specific economic impact studies in New Hampshire, Texas, and 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>13</sup>

One way that cigarette tax increases improve the 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 cigarettes in states with little or no cigarette manufacturing also exports state consumer dollars to those other states. More generally, spending on cigarettes creates high social costs; but spending on less harmful consumables along with increased consumer savings or investments will be more socially constructive and more economically productive.\*

***Small Cigarette Tax Increases Will Not Bring Maryland All These Public Health and Economic Benefits.*** Smaller cigarette tax rate increases will, of course, produce smaller

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\* For a full list of benefits to Maryland from a \$1.00 cigarette tax increase, see Appendix B.

smoking declines and fewer related health benefits and cost savings than larger cigarette tax increases – and some small cigarette tax increases will not produce any smoking declines or health care benefits and savings at all. Indeed, the public health benefits and cost reductions from smaller cigarette tax increases are far from secure and much less certain than those obtained from robust 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>14</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, would be limited or nonexistent, compared to a higher rate increase, which the cigarette companies could not offset effectively.

### **Increasing Maryland’s Cigarette Tax Rate By \$1.00 Will Produce Substantial New State Revenues**

The Maryland Department of Legislative Services has estimated that a \$1.00 cigarette tax increase would generate \$220 million in new annual state revenues<sup>15</sup> – much more than any smaller rate increase amount could produce – in addition to massive reductions in smoking-caused costs and benefits to public health.\*

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 related smoking declines and any related increases in cigarette smuggling or cigarette tax avoidance.<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. For instance, in Maryland, revenue collections from the cigarette tax increased by 29 percent compared to an 11 percent decline in cigarette pack sales after the state’s last cigarette tax rate increase in 2002.<sup>16</sup>

These funds have helped states balance budgets and fund essential services like health care, tobacco prevention, and education programs. Governor O’Malley has proposed to use the revenues from a \$1.00 cigarette tax increase to expand the state Medicaid program and help small businesses afford health care.<sup>17</sup>

### **Investing Some of the New Revenues to Expand State Tobacco Prevention Efforts Will Produce Even Larger Public Health Benefits and Cost Savings**

Directing some of the new revenues from a \$1.00 rate increase to expand the state’s efforts to prevent and reduce tobacco use would magnify the many public health benefits and cost benefits, described above, from the tobacco tax increases, alone.

Unfortunately, Maryland currently falls short of the *minimum* amount recommended by the U.S. Centers for Disease Control and Prevention (CDC) for state tobacco prevention spending: \$30.3 million per year. In fiscal year 2007, Maryland is spending \$18.7 million to prevent and

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\* For detailed information and references regarding how these projections were made, see Appendix D.

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

reduce tobacco use and its many harms and costs. Just 10 cents of a \$1.00 cigarette tax increase would raise enough revenue for Maryland to add to its FY 2007 investment in tobacco prevention to reach the CDC-recommended minimum and secure much more powerful public health benefits and related cost savings.

Comprehensive tobacco prevention efforts reduce state smoking rates by roughly one or two percentage points each year – and each one percentage point decline in smoking in Maryland from increased state tobacco prevention funding would produce the following public health and economic benefits, among others.

<b><i>Reduction in Current Adult Smokers</i></b>	<b>42,500</b>
<b><i>Reduction in Current Youth Smokers</i></b>	<b>3,300</b>
<b><i>Kids Alive Today Stopped From Becoming Addicted Adults</i></b>	<b>13,600</b>
<b><i>5-Year Reduction in Smoking-Affected Births</i></b>	<b>3,750</b>
<b><i>Total Future Smoking-Caused Deaths Avoided</i></b>	<b>16,800</b>

Each one-percentage point decline in adult and youth smoking rates secured by investments in tobacco prevention would also secure the following healthcare cost reductions.

<b><i>Future Health Cost Savings from Youth Smoking Declines</i></b>	<b>\$238.0 million</b>
<b><i>Future Health Cost Savings from Adult Smoking Declines</i></b>	<b>\$403.8 million</b>
<b><i>5-Year Savings from Fewer Smoking-Caused Heart Attacks, Strokes, and Fewer Smoking-Affected Births</i></b>	<b>\$65.6 million</b>
<b><i>Medicaid Share of 5-Year Savings from Fewer Heart Attacks, Strokes, and Smoking-Affected Births</i></b>	<b>\$16.7 million</b>
<b><i>Future Medicaid Savings from Youth &amp; Adult Smoking Declines</i></b>	<b>\$98.8 million</b>

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

One of the most frequent attacks made by the big cigarette companies against large cigarette tax increases is that they unfairly burden lower-income smokers. In fact, cigarette tax increases are one of the most effective ways of reducing the massive regressive burden caused by smoking on lower-income households and communities.<sup>†</sup>

Put simply, the death, harm, disability, and suffering caused by smoking are currently focused much more in lower-income families and communities because 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. Moreover, because lower-income smokers are more likely to quit or cutback in response to cigarette tax increases than higher-income smokers, the household public health and economic benefits from tax-prompted smoking declines are enjoyed predominantly by those with lower-incomes.<sup>18</sup>

\* For more detail on the benefits of a one-percentage point decline in smoking in Maryland, see Appendix C. See also, TFK Factsheet, *Comprehensive Statewide Programs Reduce Tobacco Use*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0045.pdf>.

† 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>.

More than one-third of those expected to quit have incomes below 200 percent of the poverty line and more lower-income smokers would quit in response to a significant cigarette tax increase compared to higher-income smokers: more than 1,100 lower-income smokers would quit in response to the \$1.00 rate increase compared to more than 700 higher-income smokers. Additionally, quitting would lead to roughly 300 fewer smoking-caused deaths among lower-income adults and roughly 100 fewer smoking-caused deaths among higher-income adults.

Lower-income smokers who quit or cutback because of a state cigarette tax increase will also 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 Maryland, a pack-a-day smoker who quits because of a \$1.00 cigarette tax increase would save more than \$2,000 per year from no longer buying cigarettes – with additional savings from avoiding other smoking-caused costs.<sup>\*</sup> And smokers who quit or cut back in Maryland would save more than \$260 million all together.

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 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.<sup>†</sup>

### **Maryland’s Cigarette Tax Rate Has Failed to Keep Up with Cigarette Company Price Increases and Cigarette Company Marketing**

Any cigarette company opposition to efforts to increase Maryland’s cigarette tax is, of course, based entirely on the companies’ desire to protect their own sales and revenues. They are happy to increase cigarette prices to maximize their own profits, but state cigarette tax increases reduce pack sales with all the new revenues going to the state rather than the companies. In fact, Maryland’s cigarette tax rate has failed to keep up with the ongoing increases in cigarette prices in the state. 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).<sup>‡</sup> While competitive pressure from new, small manufacturers’ brands temporarily dampened these major company price hikes in recent years, the major cigarette companies announced a brand new price increase in September 2007 (the last price increases were just the year before) and Wall Street tobacco industry analysts expect more to come.<sup>19</sup>

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<sup>\*</sup> The current average price for cigarettes in Maryland is \$4.47 per pack, adding a \$1.00 cigarette tax increase will raise that average price to at least \$5.52 per pack (including sales tax). \$5.52 times 365 days in a year equals \$2,014 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).

<sup>†</sup> 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>.

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

Because of past industry pricing and state tax policies, the cigarette companies have been getting increasingly larger revenues and profits from each pack sold in the state while the state's share of cigarette revenues has become smaller and smaller. Right now, Maryland's cigarette tax currently accounts for about 22.4 percent of the average price of a pack of cigarettes in the state.<sup>20</sup> In contrast, the cigarette companies receive about 44 percent of the money spent on cigarettes in Maryland.<sup>21</sup> A \$1.00 rate increase would make those shares of overall cigarette sales revenue more equal.

The cigarette companies also use a portion of their revenues from Maryland cigarette pack sales to maintain and increase smoking levels (and related harms and costs) in the state through extensive advertising and other marketing efforts. In 2005, the most recent year for which data is available, tobacco companies spent an estimated \$192.7 million on marketing and promotions in Maryland (which is about 71 cents per pack sold in the state in 2005). That represents a 74.7 percent increase since 1998.<sup>22</sup> Increasing Maryland's cigarette tax by \$1.00 per pack and investing some of the new revenue to expand state tobacco prevention efforts is one way to offset the impact of the cigarette companies' marketing and promotional spending in the state.

### **The New Revenues from Raising Maryland's Cigarette Tax Rate will be Stable and Predictable for Years to Come**

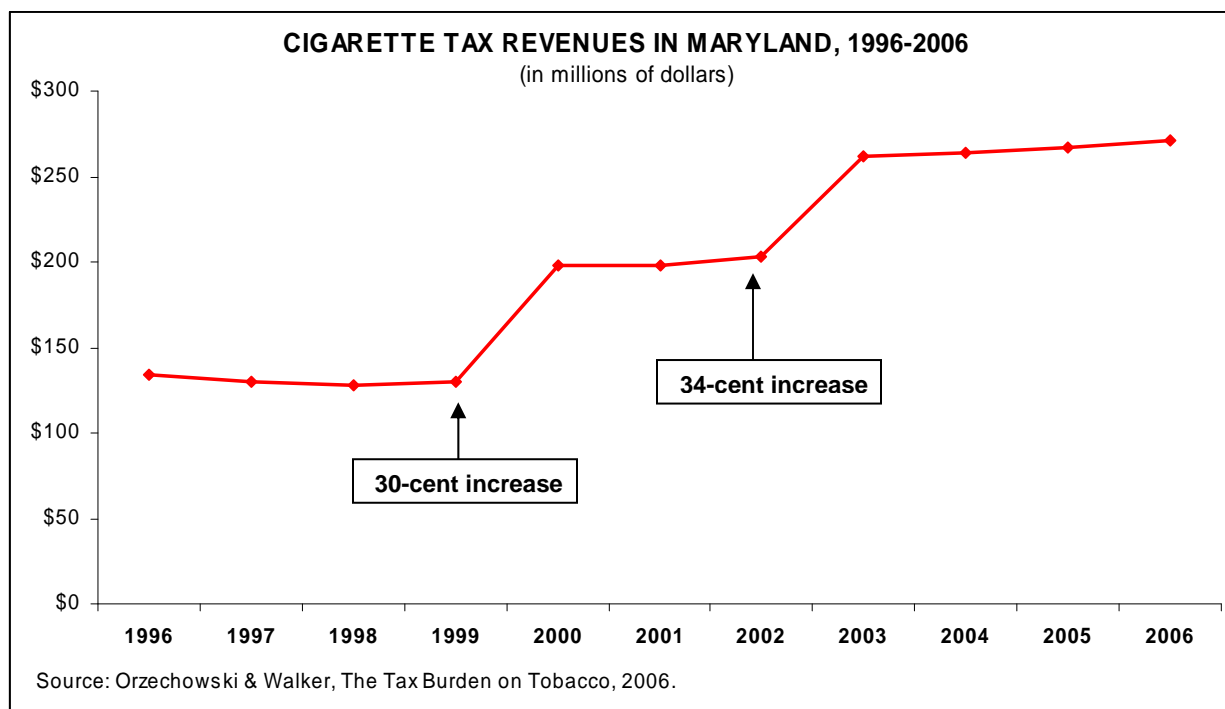
Year to year, state cigarette tax revenues are more predictable and less volatile than many other state revenue sources, such as state income tax or corporate tax revenues, which can vary considerably year to year because of nationwide recessions or state economic slowdowns. In sharp contrast, large 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. After a major cigarette tax increase, state tobacco tax revenues typically decline by only about two percent per year, on average, because of ongoing reductions in smoking levels.\*

Without any state cigarette tax increase, Maryland's annual cigarette tax revenues will gradually decline over time because of ongoing smoking declines in the state. But a \$1.00 per pack increase in the state's cigarette tax rate would not only stop those revenue declines from occurring but would also bring in more than \$220 million in net new annual revenue, according to the state's Department of Legislative Services' fiscal note.<sup>23</sup>

As shown in the graph below, Maryland's past experience with cigarette tax revenues shows that each time cigarette tax rates were raised in the past ten years, revenues increased significantly, then stayed stable until the next rate increase.

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



Because of ongoing smoking declines, the much higher levels of total state cigarette tax revenues established by a \$1.00 rate increase are likely then to start slowly declining by about two percent per year (in the absence of any additional rate increases). But the smoking declines behind those gradual revenue reductions would also be simultaneously producing much larger reductions in government and private sector smoking-caused expenditures.\* At the same time, the smokers who terminate or reduce their purchases of cigarettes will use the money they save to purchase other state goods and services, which will further strengthen the state's economy – and 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.

In addition, there are a variety of other actions Maryland could take to protect and maintain, or even increase, its cigarette tax revenues over time. For instance, the state can periodically increase its tobacco tax rates or index its cigarette tax rate to inflation.<sup>24</sup>

### **Maximizing Tobacco Tax Revenues By Minimizing Smuggling and Tax Evasion**

A \$1.00 increase to Maryland'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 other higher-tax states and cities), and increased tax evasion by continuing Maryland smokers would likely be marginal given smokers' preference for convenient purchases by the single pack. To minimize any tax evasion and smuggling, however, 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>

\* 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>.

† 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. See Appendix D. If the new

By reducing cigarette smuggling, establishing a new high-tech state tax stamp would increase the already substantial amount of new revenues the state would receive from its cigarette tax increase. For instance, 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>25</sup> Taking advantage of new technologies of high-tech tax stamps can even better ensure that Maryland maintains its high revenues and does not aid in cigarette smuggling.\*

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>26</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, Maryland’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>27</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 Maryland 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 Maryland smokers – for example, by blocking the ability of Internet vendors to have the cigarettes they sell delivered by common carriers.<sup>‡</sup>

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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.

\* 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>.

† 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>.

‡ 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>.

As set forth in Appendix E, there are many other cost-effective steps Maryland 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 \$1.00 cigarette tax increase. But even without these additional measures, the Maryland Department of Legislative Services has estimated that a \$1.00 increase would bring the state new annual state revenues of more than \$220 million.<sup>28</sup>

### **Increases to State Tax Rates on Other Tobacco Products Will Produce Additional Revenues, Public Health Benefits, and Cost Reductions**

While this report focuses on the broad range of substantial benefits that Maryland would enjoy from raising its cigarette tax, making parallel increases to the state's tax rate on other tobacco products, such as cigars and smokeless tobacco, would protect and expand these cigarette-tax benefits. In addition, if smokeless tobacco taxes and prices are significantly lower than cigarette prices, kids may choose to use the cheaper smokeless tobacco products as a gateway to a lifetime of tobacco addiction. Increasing the tax on other tobacco products will discourage switching to lower-cost products and help to prevent youth from using smokeless and cigar products, which often come in kid-friendly flavors such as grape, cherry, and chocolate.

Right now, Maryland's tax on tobacco products other than cigarettes is 15 percent of the wholesale price. Massachusetts, Maine, Alaska, and Minnesota have the highest taxes of 90 percent, 78 percent, 75 percent, and 70 percent of the wholesale price, respectively. An increase to Maryland's tax rate on smokeless tobacco and other tobacco products that paralleled a \$1.00 cigarette tax rate increase would bring the rate to 88 percent of wholesale price. That rate increase would bring the state more than \$26.9 million in additional new annual tobacco tax revenues. Equally important, it would save lives and promote public health.

Currently, 2.9 percent of high schoolers in Maryland use smokeless tobacco. The habit is more popular among boys than girls, with 4.4 percent of high school boys using smokeless tobacco compared to just 1.3 percent of girls.<sup>29</sup> Increasing the state's tax on tobacco products other than cigarettes to 88 percent of the wholesale price would reduce the number of kids who use smokeless or spit tobacco by approximately 47.5 percent and reduce overall consumption by about 25.6 percent – with corresponding reductions to the death, disease, costs and other harms caused by these tobacco products.

Governor O'Malley's proposal does not increase the tax rate for tobacco products other than cigarettes in Maryland. However, the additional \$26.9 million in revenue produced from a parallel increase in the tax rate on other tobacco products could provide more than enough money for essential state programs, such as its under-funded tobacco prevention efforts, that would expand the health benefits produced from a \$1.00 cigarette tax increase alone.

### **Conclusion**

A \$1.00 increase to the proposed state cigarette tax rate would immediately reduce adult and youth smoking rates throughout the state, producing enormous public health and economic benefits. The people, businesses, and taxpayers of Maryland deserve no less.

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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.

## APPENDIX A

### THE TOLL OF TOBACCO IN MARYLAND

#### Tobacco Use in Maryland

- High school students who smoke: 16.5% [Girls: 16.0% Boys: 17.2%]
- High school males who use smokeless tobacco: 4.4%
- Kids (under 18) who try cigarettes for the first time each year: 24,100
- Additional Kids (under 18) who become new regular, daily smokers each year: 6,900
- Packs of cigarettes bought or smoked by kids in Maryland each year: 10.8 million
- Kids exposed to second hand smoke at home: 270,000
- Adults in Maryland who smoke: 17.7% [Men: 19.0% Women: 16.5% Pregnant Females: 8.1%]

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 Maryland From Smoking

- Adults who die each year in Maryland from their own smoking: 6,800
- Annual deaths in state from others' smoking (secondhand smoke & pregnancy smoking): 590 to 1,060
- Maryland kids who have lost at least one parent to a smoking-caused death: 6,200
- Kids alive in state today who will ultimately die from smoking: 108,000 (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 Maryland 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 Maryland

- Annual health care expenditures in the State directly caused by tobacco use: \$1.96 billion
- Annual health care expenditures in Maryland from secondhand smoke exposure: \$78.5 million
  - State Medicaid program's total health expenditures caused by tobacco use: \$476.0 million
- Citizens' state/federal taxes to cover smoking-caused gov't costs: \$1.3 billion (\$627/household)
- Smoking-caused productivity losses in Maryland: \$1.78 billion
- Smoking-caused health costs and productivity losses per pack sold in Maryland: \$13.67

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: \$13.4 billion (\$36+ million per day)
- Estimated portion spent in Maryland each year: \$192.7 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.

#### Maryland Government Policies Affecting The Toll of Tobacco in Maryland

- Annual State tobacco prevention spending from tobacco settlement and tax revenues: \$18.7 million [National rank: 15th (with 1 the best), based on percent of CDC recommended minimum]
- State cigarette tax per pack: \$1.00 [National rank: 24th (average state tax is \$1.07 per pack)]

## Sources

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## **APPENDIX B**

### **BENEFITS FROM A \$1.00 CIGARETTE TAX INCREASE IN MARYLAND**

**Current State Cigarette Tax: 100 Cents Per Pack (24th among all states)**

**Smoking-caused costs in state per taxed pack sold: \$13.92**

**Average retail price per pack: \$4.42 (state share from excise and sales taxes: \$1.21)**

**Annual health care expenditures in Maryland directly caused by tobacco use: \$1.96 billion**

**Total state Medicaid program smoking costs each year: \$476.0 million**

**Annual state cigarette tax revenue: \$271.1 million (2006)**

#### **Projected Benefits From Increasing the State Cigarette Tax By \$1.00 Per Pack**

- **Decline in packs smoked in state: 8.8%**
- **Percent decrease in youth smoking: 15.4%**
- **Increase in total number of kids alive today who will not become smokers: 52,100**
- **Number of current adult smokers in the state who would quit: 28,800**
- **Number of smoking-affected births avoided over next five years: 5,000**
- **Number of current adult smokers saved from smoking-caused death: 7,600**
- **Number of kids alive today saved from later premature smoking-caused death: 16,600**
- **5-Year healthcare savings from fewer smoking-affected pregnancies & births: \$8.5 million**
- **5-year healthcare savings from fewer smoking-caused heart attacks & strokes: \$12.8 million**
- **Long-term healthcare savings in state from adult & youth smoking declines: \$1,185.4 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 in-state smokers. Projected new revenue amounts are for net new revenues above the actual cigarette tax revenues received by the state in the year preceding the tax increase. Without any tax increase, it is likely that the revenues would decline by a small amount. 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.

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## APPENDIX C

### **BENEFITS & SAVINGS FROM EACH ONE PERCENTAGE POINT DECLINE IN MARYLAND'S SMOKING RATES**

The following estimates show the benefits and savings that are obtained in Maryland 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 Maryland 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: 42,500**

**Fewer current pregnant smokers: 750**

**Fewer current high school smokers: 3,300**

**Maryland kids alive today who will not become addicted adult smokers: 13,600**

#### Public Health Benefits

**Today's adults saved from dying prematurely from smoking: 11,300**

**Today's high school smokers saved from dying prematurely from smoking: 1,100**

**Maryland kids alive today who will not die prematurely from smoking: 4,400**

	<u>First Year</u>	<u>Over 5 Years</u>
<b><i>Fewer smoking-affected births:</i></b>	<b>750</b>	<b>3,750</b>
<b><i>Fewer smoking-caused heart attacks:</i></b>	<b>20</b>	<b>252</b>
<b><i>Fewer smoking-caused strokes:</i></b>	<b>11</b>	<b>135</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>\$1.3 million</b>	<b>\$6.4 million</b>
<b><i>Savings from heart attack &amp; stroke reductions</i></b>	<b>\$1.3 million</b>	<b>\$18.0 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: \$403.8 million***

***Reduction to future health costs from youth smoking declines: \$238.0 million***

[These savings accrue over the lifetimes of the adults who quit and the youth who do not become adult smokers. Roughly 15.4% of smoking-caused healthcare expenditures in Maryland 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.

## 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 107 cents per pack, but many states have rates way below that average. 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>
- **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

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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).

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>. 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**

### **Tobacco Tax, Price, and Consumption**

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