

# Study finds cigarette excise taxes can be counterproductive

By FRANK GREEN Richmond Times-Dispatch | Posted: Thursday, November 24, 2016 10:30 pm

A new study might give pause to Richmond officials considering an excise tax on cigarettes as discussed in recent budget talks and by candidates during the mayoral election.

Released this month, “The Fiscal Impact of Cigarette Tax Increases On Municipalities In Virginia” suggests that communities imposing or raising such taxes rarely reap expected revenue — and can actually lose revenue — thanks in large part to shoppers taking their business elsewhere.

“What we’re trying to do is tell localities, ‘Don’t raise the tax thinking that the income is going to go up by the same percentage because it doesn’t normally happen,’ ” said Michael Thompson, chairman and president of the Thomas Jefferson Institute for Public Policy, which sought the study.

He said, “The problem is, you raise the tax 20 percent and people will think the income will go up 20 percent. Well, it doesn’t happen. We had heard for years these anecdotal things and we thought this would be really kind of cool to find out what the actual figures are.”

The study, funded by companies in the tobacco industry, was conducted by the Beacon Hill Institute at Suffolk University in Boston. It looked at 27 cities and towns across the state with cigarette taxes. Among other things, researchers compared revenues before and after a tax increase.

In the 1970s, the Virginia General Assembly permitted cities and towns — which provide more services than counties — to expand their ability to raise local revenue. Counties were not included as a check for keeping towns and cities from raising taxes too high (Fairfax and Arlington counties, which provide services similar to cities, were allowed to tax cigarettes).

There are more than 100 Virginia jurisdictions that tax cigarettes, with rates ranging from \$1.15 a pack in Alexandria to 4 cents a pack in Clifton Forge (the federal government imposes a \$1.01 per pack tax and the state 30 cents a pack (the second-lowest state rate in the U.S.)).

The Beacon Hill study found that “cigarette taxes are subject to jurisdictional competition as consumers go shopping for lower priced options. More sensitive to price increases than originally presumed, consumers purchase their cigarettes in a neighboring tax friendly town, out of state, or even on the black market.”

“As a result local small businesses suffer the consequences, intended and unintended,” the study concluded.

The study cites the town of Vinton, near Roanoke, which doubled its 20-cent per-pack tax to 40 cents for the year that ended June 30, 2014. The town estimated the annual revenue would increase 43 percent, from



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a collection of cigarettes

\$322,000 to \$459,000. Instead, the revenue dropped 17 percent.

Working with local merchants to regain sales, the town lowered the tax to 25 cents but the market has not recovered. Two retailers were lost to the town and a cigarette outlet opened just outside of town. Vapor sales were also believed to have played a part.

The town of Ashland adopted a 19-cent-a-pack tax for the year that ended June 30, 2010, reaping some \$343,000. Revenue increased the next year but then dropped two straight years.

The Ashland tax was increased to 22 cents a pack for the year ending June 30, 2014, to help fund a 3 percent pay raise for employees — but revenue dropped 17 percent the next year and 7 percent the following year.

Ashland Mayor Jim Foley said the figures are accurate but omit some important context.

“Our tax revenue peaked in 2012 and was steadily declining before the additional three-cent tax in 2014. This decrease somewhat mirrors the decline in smoking overall,” he said.

Foley added, “There was also new development at the Lewistown exit just south of town with Bass Pro and other businesses. I believe this new commercial area took some of our overall business volume, including cigarette tax revenue.”

In some other towns and cities there were revenue gains after tax increases, but not as large as would be expected, found the study. There were two examples of cities where the revenue collected after a tax increase actually exceeded expectations — Poquoson in 2013 and Franklin, also in 2013.

Richmond does not tax cigarettes but during the city’s last budget session, council staffers estimated that a 60-cent-per-pack, or \$12 a carton, tax would generate about \$6 million a year.

Thompson is dubious. “It’ll be interesting because the counties around them don’t have the authority to raise a sales tax,” he said, adding that “people who smoke are going to be buying their groceries in Chesterfield.”

In Vinton, Thompson said, “they raised it, then they lowered it, but they didn’t get their sales back because people started shopping somewhere else.”

They did not try to determine whether the motive was health. “We were just looking at the budget impact. We tried to stay away from the social issue.”

The study found that from the year that ended June 30, 2010, to the end of June 2013, the most recent figures available, local governments collected 16.3 percent less in cigarette tax revenue even though local governments increased cigarette tax rates more than 50 times over the same period.

“The tax revenue collection increases are fleeting, often turning flat or negative in the years following an increase,” the study found. In addition, “Cigarette consumers are important to the health of small businesses such as convenience and small grocery stores, and increasing cigarette taxes can harm these businesses.”