

South Carolina's Cigarette Tax: Issues and Options

In the past four years, more than thirty states have enacted cigarette tax increases, for reasons that include funding health care, discouraging smoking, and simply raising revenue to help balance state budgets. But South Carolina's tax has remained at 3 cents per pack since July of 1990. Should South Carolina follow the lead of other states that have chosen to rely more heavily on the cigarette tax--and if the tax rate is increased, how should lawmakers spend the proceeds? This policy brief provides a quick overview of this issue.

How South Carolina's Cigarette Tax Compares

South Carolina's cigarette tax was enacted in 1923. Originally set at 3 cents for each pack of cigarettes sold, the tax rate has gradually increased to 7 cents, where it has remained since 1978. South Carolina's tax is now the lowest in the nation.

Cigarette Taxes in 2007

Alabama	42.5¢
Florida	33.9¢
Georgia	37¢
N. Carolina	30¢
S. Carolina	7¢
U.S. Average	99¢

A Regressive Tax

Cigarette taxes are *regressive*: that is, low-income taxpayers pay more of their income in these taxes, on average, than do upper-income families. In 2006 the poorest South Carolinians spent 0.2 percent of their income, on average, on cigarette taxes, while the wealthiest families spent less than 0.02 percent of their income on these taxes. In other words, cigarette taxes are ten times more burdensome for low-income South Carolinians than for the wealthy.

Cigarette taxes are regressive for two reasons. First, low-income South Carolinians are more likely to smoke than are upper-income taxpayers. Second, the cigarette tax is the same fixed amount (7 cents per pack, or \$0.70 per carton) for the wealthiest smoker as it is for the very poorest South Carolina residents. This tax represents a much bigger share of income for low-income families than for wealthier South Carolinians.

A Declining Tax

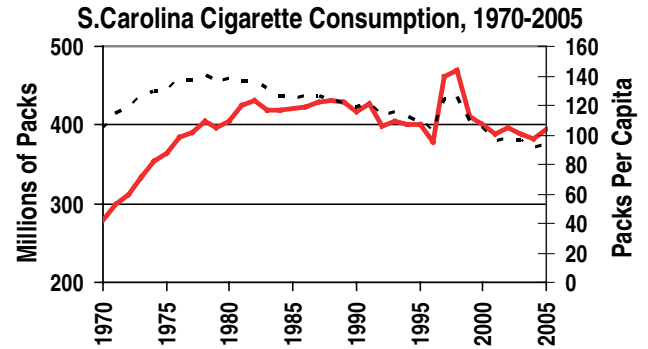
Lawmakers seeking to use cigarette taxes to fund public investments face one critical problem: cigarette taxes are among the slowest-growing revenue sources available. This is partially because these taxes are usually calculated on a per-pack basis rather than being based on the retail price: South Carolina's 7-cent-per-pack tax will always yield the same amount of tax revenue for each pack that is sold in, say, 2020, as it does today. (By contrast, general sales taxes are calculated as a percentage of the sales price of a taxable item. This means that when inflation drives prices up, sales tax revenues will automatically increase, but cigarette tax revenues will not.)

Because cigarette taxes are calculated on a per-pack basis, a state's cigarette tax revenues can usually only grow in two ways: as a result of an increase in the tax rate, or as the result of an increase in cigarette consumption. But the total number of cigarettes consumed by South Carolinians each year has declined steadily over the past two decades. In

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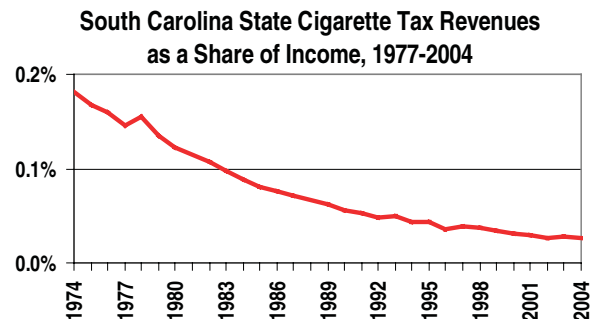
1982, the state taxed the sale of 430 million packs of cigarettes, or 136 packs per person. In 2005 taxable sales had declined to 394 million packs, or 94 packs per person.

Given this decline in smoking, it's not surprising that South Carolina cigarette tax collections aren't growing. In fiscal year 1997, the state collected \$31 million in cigarette taxes. But as recently as fiscal year 2004, collections were \$26 million—which means that over seven years, collections from this tax had actually declined. This is problematic because the public services funded by the cigarette tax cost more each year. All of South Carolina's cigarette tax revenue goes to the state's General Fund to pay for public services. In general, the cost of funding public services can be expected to grow from year to year as a state's income and population grow—so it's reasonable to expect that a tax should grow just as fast as a state's personal income grows.



Some state taxes perform better than others on this basic measure of adequacy. But few perform worse than the cigarette tax. South Carolina cigarette tax collections have fallen by three-quarters as a share of income over the past twenty five years.

On the other hand, cigarette taxes are a stable revenue source—the tax is less volatile than other taxes over the course of the business cycle, because economic downturns have little impact on smoking. In short, cigarette taxes are a predictably declining revenue source.



When Are Cigarette Tax Hikes Appropriate?

Taxes exist primarily to help pay for public services. But cigarette tax revenues grow more slowly than the cost of almost any public service that could be funded using these taxes. So South Carolinians seeking to use cigarette taxes to fund public services will almost certainly be disappointed in the long run. Many states are, in fact, using cigarette taxes to support programs, such as education or health care, that have a naturally increasing need for funding. While these taxes may bring in enough revenue to support these programs for a few years, a deficit will inevitably appear unless the cigarette tax rate is raised again. When these deficits recur, the public may be less willing to hike taxes a second time.

However, cigarette taxes are sometimes imposed not to raise revenue but to discourage smoking. To the extent that these taxes encourage consumers to stop smoking, they may be a successful social policy tool—and there is evidence that higher cigarette taxes can prompt smokers to quit. Moreover, if tax hikes do cause smokers to quit, states will enjoy savings in health care costs as smokers' health improves. Under these circumstances, cigarette taxes can be an appropriate social policy tool, despite the regressive impact of such a change. If a state is relying on the revenue from the tax to fund programs or supplement a state budget, however, cigarette taxes are a poor choice.

To find out more about this issue, contact ITEP at (202) 299-1066