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Will a Cigarette Tax Increase Really Help Uninsured Children?

Senators Orrin Hatch and Ted Kennedy have joined forces to establish a new government program to finance children's health insurance. They propose to fund the program by increasing federal cigarette taxes from 24 cents to 67 cents per pack — an increase of 43 cents. The Hatch-Kennedy tax promises to raise $30 billion over five years, with $20 billion to go for children's insurance and $10 billion for deficit reduction.

But the Hatch-Kennedy tobacco tax would not achieve its goal of paying for children's insurance and would hurt those it is intended to help. Here's why.

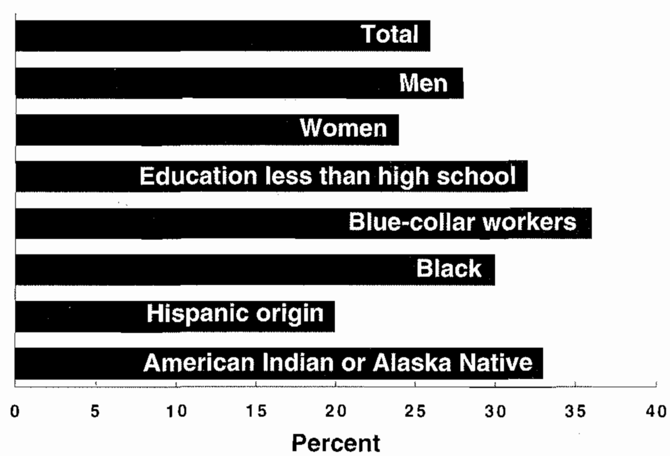
A False Promise. By promising to pay for children's health insurance with cigarette tax money, Hatch and Kennedy make a promise to children they cannot keep. How can the government guarantee an adequate supply of smokers to support children's health insurance in the future? The percentage of Americans who smoke already has declined dramatically.

- From 1965 to 1990 the average annual rate of people who smoke declined 2.4 percent for men and 1.5 percent for women.
- The percent of teens age 12 to 17 who smoke declined from 25 percent in 1974 to 9.8 percent in 1994.
- Overall, smoking declined from 42.3 percent of the adult population in 1965 to 25 percent in 1993.

That's good news for Americans' health, but it's bad news for those who want to rely on cigarette taxes to guarantee health insurance coverage for children.

FIGURE I

Demographics of Smokers



Source: Centers for Disease Control and Prevention, National Center for Health Statistics, National Health Interview Survey, 1991.

Targeting Vulnerable Populations. The most disturbing problem with the Hatch-Kennedy tax is that it discriminates against low-income and minority populations. According to the 1991 National Health Interview Survey, smokers are more likely to be blue-collar workers, have less than a high school education and be black, American Indian or Alaska Native. [See Figure I.] For that reason, a tax on tobacco is perhaps the most regressive of taxes — even more regressive than taxes on beer, wine or gasoline. A study by KPMG Peat Marwick found that:

- Families making less than $30,000 per year pay more than half of all taxes paid on cigarettes.
- By contrast, families making more than $60,000 pay only 14 percent.
- As a percent of income, lower-income families bear almost five times the burden of high-income families. [See Figure II.]

A direct correlation also exists between education and smoking. According to the National Center for Health Statistics:

- 47.2 percent of black males with less than 12 years of education smoke, while only 16 percent of those with more than 16 years of education smoke.
- Among white males, 39.7 percent of those with less than 12 years of education smoke, as compared to 14.1 percent with more than 16 years.

A Tax Hike Could Lead to Increased Crime. Supporters of the Hatch-Kennedy tobacco tax argue that a hike will create an incentive to help vulnerable populations kick the habit. But empirical data show that cigarette tax increases have not deterred a majority of smokers. According to a study published in the *American Journal of Public Health*, cigarette tax increases from 1955 to 1988 caused the average smoker to reduce

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consumption by about three packs per year (2.4 percent). So what happens to the majority of smokers who don't quit or cut their smoking in half in response to cigarette tax increases? They either pay more for their cigarettes or turn to the black market, as Canadian smokers did.

The Canadian Experience. In 1991, Canada introduced a $5 per pack ($3.72 in U.S. dollars) tax on cigarettes. What did Canadian smokers do? A great number of them avoided paying the new cigarette tax and instead purchased their cigarettes from smugglers. According to a 1994 article in the *Journal of the American Medical Association*:

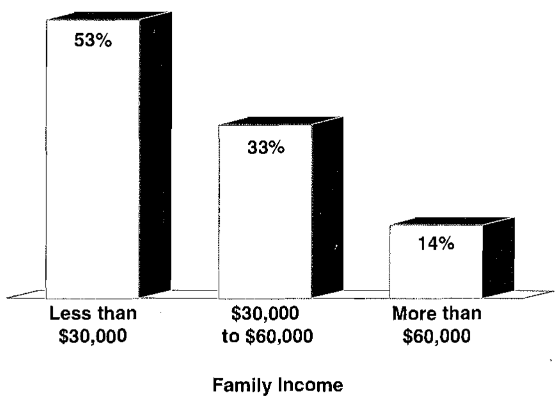
- An estimated 30 percent of cigarettes smoked in Canada were smuggled in and sold for about half the price of legal cigarettes.
- About 80 percent of those illegal cigarettes were manufactured in Canada, legally exported to the United States and then returned illegally.

In addition, cigarette smuggling became attractive to organized crime and increased the danger to law enforcement officials. It also created a hardship for the owners of small stores who relied on cigarette revenue. As a result, Canada eventually was forced to cut its cigarette tax in order to collect revenues.

Smokers Already Pay Their Way. One argument for higher cigarette taxes is that smokers increase costs to the health care system, draining public money that could be targeted toward other populations — such as children. But the truth is that smokers already pay their own way, according to a 1989 study conducted by Willard Manning of the Rand Corporation, Joseph P. Newhouse of Harvard University and other health economists and published in the *Journal of the American Medical Association.* The authors estimated a number of the costs associated with smoking such as the need for medical care, higher premiums for life insurance and the increased possibility of a fire or an auto accident. While factors such as increased medical care and life insurance premiums raise the social costs of smoking, the study also factored in decreased life expectancy, which lowers costs that arise from Social Security and Medicare.

FIGURE II

Who Pays Cigarette Taxes?



Note: The figure shows the share of all cigarette taxes paid by different income groups.

Source: "Measuring the Impact of Increasing Excise Taxes on the Progressivity of the Federal Tax System," The Policy Economics Group, KPMG Peat Marwick, March 1993.

According to the Rand study's authors, the combined 1989 federal and state tax of 37 cents per pack was more than double the 15 cents direct cost of smoking. Even after adjusting for inflation, the direct cost of smoking — 21 cents per pack in 1995 dollars — falls well below the 1995 average total of 63 cents per pack in federal and state taxes. Since smokers continue to overpay their incremental costs, an additional tax is unfair.

Better Ways to Provide Health Insurance. Before creating a new health insurance program for children, Congress can take two easy steps to solve most of the problems.

Make taxes fairer. The government subsidizes health insurance for employees by excluding it from income. The self-employed and employees who do not receive health insurance through an employer should also receive a subsidy — perhaps through a system of tax credits.

Allow everyone a Medical Savings Account. Parents need a way to pay for health insurance during job transition. Making personal Medical Savings Accounts available to a wider segment of the population would help by giving people a source of funds to pay for children's medical care and to pay health insurance premiums during job transition.

This Brief Analysis was prepared by Sue A. Blevins, president of the Washington D.C.-based Institute for Health Freedom, a nonpartisan, nonprofit research and education institute.