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Obama's Poor Tax

Why raising the tobacco levy will hurt the states.

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By BRAD SCHILLER

"I can make a firm pledge . . . no family making less than \$250,000 a year will see any form of tax increase." Remember that? It was Barack Obama, campaigning to become president last Sept. 12 in Dover, N.H.

Indeed, he promised repeatedly that 95% of American families would get a tax cut. So it's especially fitting that he chose April Fools Day to implement his first tax increase -- which will fall mostly on individuals and families who do not make anywhere near \$250,000 per year.

Early in February, the president signed a law to triple the federal excise tax on cigarettes -- which will jump from 39 cents per pack to \$1.01 today. His administration projects this tax hike will bring in at least \$38 billion over the next five years.

If you don't smoke, maybe you don't care. Maybe you even think a higher "sin tax" is a good thing. But health issues aren't the only concern here. There are also questions of fairness, federalism, macroeconomic impact, and crime.

The fairness issue is particularly troubling. According to the Centers for Disease Control and Prevention, only one in five Americans smokes, so the excise targets a minority -- and over half of all smokers are low income, and one of four are officially classified as poor.

Mr. Obama prefers to tout his tax cuts for low-income households. But his "stimulative" Make Work Pay tax cut gets dribbled out at \$8-\$10 a week. A pack-a-day smoker will pay half of that back in higher cigarette taxes. Smokers getting welfare, unemployment or disability checks instead of paychecks won't get as much in tax cuts, but they will still pay the whole cigarette tax increase. Anyone concerned about widening income inequality should have second thoughts about this distribution of the tax burden.

We should also note how this tax increase affects state finances. State governments rely on their own cigarette excise taxes for hefty revenue streams. In 2008, according to the National Tax Foundation, state governments took in \$15.4 billion in cigarette taxes. Hard-hit Michigan, Pennsylvania, and California each took in over \$1 billion; New York and Texas took in \$1.5 billion each.

Higher taxes discourage cigarette sales. Nobel economist Gary Becker pegs the long-run price elasticity of demand for cigarettes at 0.8 -- i.e., a 10% increase in price causes an 8% decline in unit sales. The Obama tax hike translates into a 13.3% increase in the average pack price. That implies a 10.6% decline in unit sales -- which the National Tax Foundation has calculated adds up to a \$1 billion overall revenue loss for hard-pressed states.

Because Southern states have low tax rates (most less than 40 cents per pack), the

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federal tax hike raises their cigarette prices by a larger percentage and thus cuts deeper into their unit sales. New York, by contrast, has the highest state taxes (\$2.75 a pack) and prices, so it gets hit less in percentage terms. The Tax Foundation estimates a 12.6% revenue loss for South Carolina this coming fiscal year, and a 6.7% loss for New York.

None of this is good for the economy. Consumers and state governments are already having a tough time making ends meet. Burdening them with a new \$38 billion tax and a \$1 billion cut in revenues isn't going to help create jobs. Estimates by the National Association of Tobacco Outlets of the job losses in cigarette manufacturing and distribution alone exceed 100,000.

Smugglers and counterfeiters won't lose their jobs, though. Both the General Accounting Office (GAO) and the Alcohol, Tobacco, and Firearms (ATF) agency have concluded that the multibillion-dollar cigarette-smuggling business grows with every excise tax increase. The ATF and GAO also believe that cigarette-smuggling is a form of cash laundering and profits for both organized crime and terrorist organizations.

Clearly, we were fools to believe that if we weren't wealthy, Mr. Obama wasn't going to raise our taxes. We'll be even bigger fools if we acquiesce to further tax increases of this kind.

Mr. Schiller, professor of economics at University of Nevada, Reno, is the author of "The Economy Today" (McGraw-Hill, 2008).

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