



Budget Points

Last One to the Party: Pennsylvania and the Proposed Other Tobacco Products Tax

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Would Raise Needed Dollars – and Save Lives

Just about everywhere in the United States people pay a state excise tax when they buy cigars, chewing tobacco, snuff, or loose tobacco to roll their own cigarettes. But not in Pennsylvania.

Though it taxes cigarettes – like every other state – Pennsylvania is one of only two states to exempt cigars from taxation and is the only state not to tax the other forms of tobacco.

It's a policy that costs the Commonwealth millions of dollars a year and appears aimed at protecting the state's modest tobacco industry, even though states where far more tobacco products are made levy a tax with no apparent opposition.

Besides bringing in revenue to meet the growing needs of Pennsylvania residents, taxing all tobacco products would have the added benefit of saving lives and reducing health costs. Studies have shown that taxing so-called gateway tobacco products, such as smokeless tobacco, will reduce tobacco usage, especially among young people.

In February 2010, Governor Ed Rendell proposed a tax on “other tobacco products,” which include cigars, chewing tobacco and loose tobacco. These products would be taxed at 30% of the wholesale price, with the tax applying to other tobacco products sold to Pennsylvania retailers, which would be passed on to consumers in the form of higher retail prices.¹

Other tobacco products are taxed based on their wholesale price in 33 of the 49 states that levy the tax. Rates range from 6.6% in Tennessee to 90% in Massachusetts. The tax would raise \$41.6 million in 2010-11, according to the Governor's Office of the Budget.

There are other proposals in the Pennsylvania Legislature to impose a tax on other tobacco products. In April 2010, Rep. Eugene DePasquale introduced HB2466, which would set the tax rate at 60% of the wholesale price of the tobacco product. Sen. Vincent Hughes introduced two bills in the summer of 2009: SB1064 mirrors the Governor's plan, while SB957 sets the tax rate at three and six-tenths cents per cigar/cigarillo and 36 cents per ounce for any other tobacco product. In January 2009, Rep. Dan Frankel introduced HB57, which would set the tax rate at 59.2% of the wholesale price of the tobacco product.

¹ Wholesale price defined as the purchase price charged to retailer. The tax is imposed on the dealer, manufacturer, or other seller to the retailer. The tax would not apply to sales of other tobacco products to retailers in other states.

Compared to the 33 states that tax based on wholesale price, Pennsylvania’s proposed tax rate of 30% would fall in the middle for cigars (tied for 17th) and smokeless tobacco (tied for 15th) (see Table 1).²

Table 1. Distribution of states that tax smokeless tobacco based on wholesale price

Tax on Wholesale Price	States
0-10%	TN, WV, GA, KS, VA
11-20%	NC, KY, DE, MD, OH, IL, NE
21-30%	IN, CT, NV, NJ, PA (as proposed)
31-40%	MI, SD, HI, ID, RI
41-50%	CA, NY, NH, IA, MT
Greater than 50%	OR, MN, AK, WA, ME, FL, MA

Source. Federation of Tax Administrators

States that do not levy other tobacco taxes as a percentage of the price base them instead on the weight of the product. Currently, only four states tax based on the weight of the other tobacco product.³

One reason why basing the tax on wholesale price is the standard in so many states is that the amount of revenue collected increases if prices go up. Additionally, it means that higher taxes are paid on “premium” products, which are a growing share of both the cigar and smokeless markets and are presumably purchased by those with higher incomes who can best afford the tax.

Smokeless Tobacco and Cigars Pose Serious Risk for Pennsylvania Youth

Tobacco use among Pennsylvania youth remains high. According to the most recent estimates compiled by the Pennsylvania Department of Health, about 9% of high school students in Pennsylvania use smokeless tobacco and 12% smoke cigars, while 3% of middle school students use cigars and smokeless tobacco products. Cigarettes, which are subject to an excise tax, are used by 4% of Pennsylvania middle schoolers and 18% of high school students.⁴

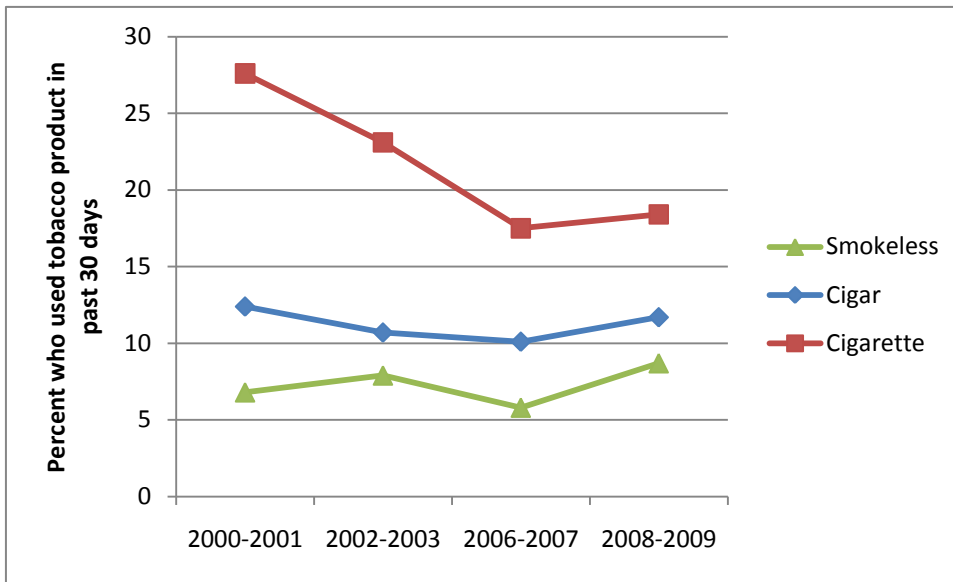
While cigarette use among Pennsylvania’s youth has declined significantly since 2000, use of smokeless tobacco is on the rise. Figure 2 shows the rates of recent tobacco use for Pennsylvania high school students. Use of smokeless products fell between 2002 and 2006, but increased sharply beginning in 2006. A tax on cigars and smokeless tobacco, as exists for cigarettes, would likely reduce consumption among young people.

² Author’s calculations based on Federation of Tax Administrators, “Other Tobacco Products Tax, January 1, 2010,” <http://www.taxadmin.org/fta/rate/otp.html>.

³ Federation of Tax Administrators, “Other Tobacco Product Tax, January 1, 2010,” <http://www.taxadmin.org/fta/rate/otp.html>.

⁴ Pennsylvania Department of Health, *Pennsylvania Tobacco Facts 2009/2010*, Tables B-2 and B-3.

Figure 1. Tobacco use by Pennsylvania high school use (grades 9-12)



Source: Pennsylvania Department of Health, *Pennsylvania Tobacco Facts 2009-2010*.⁵

Smokeless tobacco usage, in particular, is a serious issue in rural Pennsylvania. A recent Center for Rural Pennsylvania study of drug usage by 6th through 12th graders found that smokeless tobacco usage “remained a significant and growing problem in rural Pennsylvania and it appeared to be a somewhat more severe problem in the commonwealth than nationally.”⁶ The Center found that one in four rural 12th grade males had used smokeless tobacco during the previous month and that there is increasing use by urban males as well.

The tobacco industry is becoming increasingly sophisticated in creating products, messages, and promotions that appeal to specific market segments, including children.⁷ There has been significant growth of smokeless tobacco company advertising, which increased 72% between 1998 and 2005, and more cigarette companies have entered the market with branded products such as Camel Snus and Marlboro Snus.⁸

⁵ Table B-3 of Department of Health publication did not include data for years 2004-2005.

⁶ Keith R. Aronson, Mark E. Feinberg, and Lynn Kozlowski, *Alcohol, Tobacco, and Other Drug Use Among Youth in Rural Pennsylvania*, The Center for Rural Pennsylvania, May 2009.

⁷ National Cancer Institute, *The Role of the Media in Promoting and Reducing Tobacco Use*, Smoking and Tobacco Control Monograph No. 19, NIH Pub. No. 07-6242, June 2008, http://cancercontrol.cancer.gov/tcrb/monographs/19/m19_complete.pdf.

⁸ Campaign for Tobacco Free Kids, “Smokeless Tobacco and Kids,” <http://www.tobaccofreekids.org/research/factsheets/pdf/0003.pdf>. (Snus are a recent development in the U.S., having been first produced in Sweden. Snus are teabag-like packets of smokeless tobacco that are used much like dipping tobacco, without the spitting out of residue.)

All of these products pose significant health risks. Smokeless tobacco is a major source of cancer-causing nitrosamines, and cigars and smokeless tobacco increase the risk of cancers of the mouth, esophagus, and pancreas. In addition, cigar use is related to lung and larynx cancers.⁹

Smoking, not including smokeless tobacco or cigar use, adds \$5.2 billion in health care costs in Pennsylvania each year, with the state picking up \$1.7 billion of the bill through increased Medicaid costs.¹⁰ Although no specific estimates have been compiled for smokeless tobacco and cigar use, it seems likely that these, too, add to health care costs.

By increasing costs to consumers, an excise tax on other tobacco products can be expected to reduce consumption. A 1997 study by the University of Illinois – Chicago and the National Bureau of Economic Research concluded that increasing smokeless tobacco excise taxes “would reduce the frequency of smokeless tobacco use by adolescent males and would reduce the probability that a male youth consumes smokeless tobacco products.”¹¹

According to Smokefree Pennsylvania, the proposed tax in Pennsylvania is expected to cut consumption of other tobacco products by 4% to 8%, based on the product.¹²

Taxation Won't Harm Pennsylvania Farmers

Some Pennsylvania farmers have been claiming that the proposed tax would hurt their business.¹³ This seems highly unlikely.

Tobacco production in Pennsylvania peaked in 1918 and has been declining for almost a century. Over that time, the number of acres devoted to tobacco farming has declined by 83%, and annual production is down by 74%.¹⁴ Of the 63,000 farms in Pennsylvania, 1,150 grow tobacco – fewer than 2% of farms in the state. Those that do grow tobacco each devote slightly less than seven acres to the crop, on average.¹⁵

There are a number of reasons for the decline of tobacco farming. The amount of tobacco used in each

⁹ American Cancer Society, “ACS: Tobacco-Related Cancers Fact Sheet,”

http://www.cancer.org/docroot/PED/content/PED_10_2x_Tobacco-Related_Cancers_Fact_Sheet.asp?sitearea=PED.

¹⁰ Campaign for Tobacco Free Kids, “The Toll of Tobacco in Pennsylvania,”

<http://www.tobaccofreekids.org/reports/settlements/toll.php?StateID=PA>.

¹¹ Frank Chaloupka, Michael Grossman, and John Tauras, “Public Policy and Youth Smokeless Tobacco Use,” *Southern Economic Journal*, Vol. 64, no. 2 (October 1997): 503-516.

¹² Bill Godshall, *Testimony by Bill Godshall, Executive Director, Smokefree Pennsylvania, to the Senate Finance Committee*, February 13, 2009.

¹³ Lauren Boyer, “Farmers fight Rendell’s smokeless tobacco tax plan,” *Pittsburgh Post-Gazette*, June 16, 2009, <http://www.post-gazette.com/pg/09167/977739-100.stm>.

¹⁴ Pennsylvania Budget and Policy Center calculations from 1918 to 2009 using tobacco production data from U.S. Department of Agriculture, National Agricultural Statistics Service, http://www.nass.usda.gov/QuickStats/indexbysubject.jsp?Pass_name=&Pass_group=Crops+%26+Plants&Pass_subgroup=Field+Crops#top (select “Field Crop” and search for “Tobacco (All Classes)”).

¹⁵ 2007 Pennsylvania Census of Agriculture.

cigarette has dropped by 40% in the last 50 years, and only about half of the tobacco used in U.S.-made cigarettes is grown domestically.¹⁶ U.S. consumption of cigarettes also continues the decline that began when the public became aware of the health risks associated with smoking following the 1964 Surgeon General’s report that linked smoking to lung cancer.¹⁷

Pennsylvania accounts for 1.6% of U.S. tobacco production. About 96% of all tobacco produced in the country comes from six states, all of which have an excise tax on cigars and smokeless tobacco and still have managed to out-produce Pennsylvania significantly.

Table 2. Tobacco Production and Taxation by Leading Producer State, 2009

State	Acres	Pounds Produced	Value	Share of U.S. Production Value	Cigar/Smokeless Excise Tax
North Carolina (1)	177,400	423.9 million	\$745.7 million	49.8%	Yes
Kentucky (2)	88,700	206.9 million	\$383.2 million	25.6%	Yes
Tennessee (3)	21,600	50.0 million	\$104.7 million	7.0%	Yes
Virginia (4)	20,150	47.4 million	\$83.8 million	5.6%	Yes
South Carolina (5)	18,500	38.9 million	\$68.4 million	4.6%	Yes
Georgia (6)	14,000	28.0 million	\$47.6 million	3.2%	Yes
Pennsylvania (7)	8,200	18.7 million	\$23.7 million	1.6%	No

Source: USDA National Agricultural Statistics Service

Most American tobacco is grown for cigarettes – 94% according to the estimate by the Congressional Research Service.¹⁸ Based on the numbers, it is clear that any impact of a Pennsylvania tax on non-cigarette products would have a negligible impact on the tobacco farming industry, in Pennsylvania or any other state.

Tobacco Industry Is a Small Share of Total Employment in Pennsylvania

Pennsylvania is home to about 30 tobacco manufacturing businesses and 65 tobacco product wholesalers. Tobacco product wholesalers employed a total of 1,600 workers in 2008, or 0.6% of all wholesaling jobs in Pennsylvania. Tobacco product manufacturing accounted for 955, or 0.15%, of the state’s 644,700 manufacturing jobs.¹⁹ Most tobacco sales and production are for cigarettes, so total employment related to other tobacco products is likely a fraction of these figures.

Pennsylvania’s tobacco manufacturers are generally subsidiaries of big tobacco companies and distribute products to states beyond Pennsylvania, where excise taxes on other tobacco products are already imposed.

The largest tobacco products producer in Pennsylvania is John Middleton Co., a leading manufacturer in the U.S. of pipe tobacco and machine-made cigars. The company employs 770 people at two

¹⁶ Jasper Womach, *Report to Congress: U.S. Tobacco Production, Consumption, and Export Trends*, Congressional Research Service, June 2003, <http://www.nationalaglawcenter.org/assets/crs/RL30947.pdf>.

¹⁷ Frank Chaloupka, Michael Grossman, and John Tauras, “Public Policy and Youth Smokeless Tobacco Use,” *Southern Economic Journal*, Vol. 64, no. 2 (October 1997): 503-516.

¹⁸ Jasper Womach, *Report to Congress: U.S. Tobacco Production, Consumption, and Export Trends*, Congressional Research Service, June 2003, <http://www.nationalaglawcenter.org/assets/crs/RL30947.pdf>.

¹⁹ Figures come from the U.S. Bureau of Labor Statistics, Quarterly Census of Employment and Wages.

manufacturing facilities and a sales office in suburban Philadelphia. John Middleton is a subsidiary of tobacco giant Altria Group, which also owns mega-brands Philip Morris and U.S. Smokeless Tobacco.²⁰ Altria is a highly profitable company – netting \$3 billion in 2009 on \$24 billion in sales.²¹

When the proposed tax was announced, several cigar wholesalers said they would close up shop in Pennsylvania and head to Florida to escape the proposed excise tax.²²

The most vocal critic of the proposed other tobacco products tax, according to media accounts and legislative staff, is cigar distributor Cigars International, which employs approximately 175 people at a property tax-abated development zone site in Bethlehem.²³ This firm is not a “mom and pop” shop that would have any reason to fear being driven out of business by the proposed tax. Cigars International is part of the tobacco giant Swedish Match AB, which posted sales of \$2 billion and operating profits of \$476 million in 2009, and employed 11,000 people worldwide.²⁴ Swedish Match is the largest smokeless tobacco producer in the U.S., with a market share of 45%, by volume, and significant shares of the cigar and snuff markets.²⁵ Swedish Match AB faced an effective tobacco tax rate of 44% of its sales in other markets, and is still highly profitable, earning 12.3 cents (after all tobacco and income taxes) of net profit on each dollar of revenue.

The claim that manufacturers and wholesalers of other tobacco products will move out of state is exaggerated. Not only is Pennsylvania a populous state with a large market for other tobacco products, but these manufacturers and wholesalers are already subject to tax in every other state where they sell their products.

Policy Recommendation

Pennsylvania’s failure to tax tobacco products other than cigarettes is not only a revenue-loser for a state that can ill afford it but is also in effect a subsidy for the tobacco industry. Considering the need for revenue in the wake of the recession, the significant health risks associated with smokeless tobacco and cigar use, and the fact that taxing tobacco products is common practice across the United States, the modest tax being proposed in Pennsylvania is sensible policy that should be adopted.

The Pennsylvania Budget and Policy Center is a non-partisan policy research project that provides independent, credible analysis on state tax, budget and related policy matters, with attention to the impact of policies on working families.

²⁰ John Middleton Co., “Our Presence in Pennsylvania,” http://www.johnmiddletonco.com/en/cms/Company/About_Middleton/Our%20Presence%20in%20PA.pdf.aspx.

²¹ Altria Group, *2009 Annual Report*, <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzkzNTN8Q2hpbGRJRDR0tMXxUeXBIPM=&t=1>.

²² Florida is the only other state without an excise tax on cigars.

²³ Lyn Olanoff, “Cigars International moving headquarters from East Allen Township to Bethlehem,” *The Express-Times*, January 28, 2010.

²⁴ Swedish Match AB, “Income Statement,” <http://www.swedishmatch.com/en/Investors/Financial-tables/>

²⁵ Swedish Match AB, *Investor Presentation; Full Year 2009 Investor Kit*, http://www.swedishmatch.com/Documents/Presentations/2009_Q4_InterimPresentation_EN.pdf.