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OUR MISSION
is to educate members and all South Carolinians about state and local public policy based on the traditional South Carolina values of individual liberty and responsibility, free enterprise and limited government.

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PROPOSED CIGARETTE TAX INCREASE TO COST SOUTH CAROLINA 4,100 PRIVATE-SECTOR JOBS

Legislation under consideration by the South Carolina Senate would raise the cigarette tax by 700 percent and cost the state more than 4,100 jobs, according to a dynamic analysis conducted by economists at the Beacon Hill Institute at Suffolk University. The tax increase is expected to particularly hurt low-income workers employed in the retail sector of South Carolina’s economy.

If approved by the Senate, House Bill 3584 would increase the state tax on cigarettes from 7 cents to 57 cents per pack. The bill has already passed the House and would establish a new health care program that would extend taxpayer-subsidized health insurance to families earning up to 200 percent of federal poverty level (FPL). That equates to \$44,100 for a family of four in a state with a median household income of \$43,508 (as of 2007). In addition, the legislation would extend state-subsidized insurance to high-risk insurance pool participants who earn up to 400 percent of FPL – \$88,200 for a family of four. Ironically, only \$5 million of the \$147 million in revenue expected from the bill would go to smoking prevention and cessation efforts.¹

The Beacon Hill Institute dynamic analysis demonstrates the tax increase will cost 4,114 private sector jobs and reduce disposable income in South Carolina by \$214 million.²

Dynamic Tax Revenue Changes	FY09-2010
Change in state funds (\$ millions)	168.59
Change in taxes at the local level (\$ millions)	(15.03)
Total tax change (state + local) (\$ millions)	153.56
Changes to Economic Indicators	
Change in private employment (jobs)	(4,114)
% change	(0.24)
Change in government employment (jobs)	1,554
% change	0.37
Net change in employment (jobs)	2,560
	(0.12)
Change in nominal investment (\$ millions)	(14.1)
% change	(0.05)
Change in real disposable income (\$ millions)	(214.0)
% change	(0.22)
Change in real state Gross Domestic Product (\$ millions)	(232.52)
% change	(0.15)

¹A fiscal analysis of the bill by the S.C. Board of Economic Advisors also anticipates a \$4 million decline in General Fund revenue, owing to reduced cigarette sales.

²It is essential to analyze the economic impact of a tax change from a “dynamic” perspective rather than a “static” perspective. A static analysis simply looks at the immediate revenue impact to government, without examining the inevitable changes in economic activity that the tax change would bring about. Thus a static analysis of a tax increase, such as that provided by the S.C. Board of Economic Advisors for HB 3584, tends to overlook the resulting negative impact on overall economic activity, including private sector job loss.

- After taking into account the effects of the tax increase on the economy, the state government would gain \$168.59 million and local governments would lose \$15.03 million in tax revenue. The combined state and local government revenue gain would be \$153.56 million.
- The tax increase would eliminate 4,114 private sector jobs and \$14.1 million in new investment. The retail sector would be the hardest hit: suffering 1,374 job losses and a \$2.94 million reduction in new investment. These losses are a result of declining cigarette sales as well as lost sales of other items sold by retailers. The job losses could be expected to occur over the next year and would be cumulative.
- South Carolina's real disposable income would decline by \$214 million, and real State Gross Domestic Product would drop by \$233 million.
- Although the new health insurance program created by HB 3584 could result in job growth in the insurance industry, economists at Beacon Hill believe these gains would be minimal. In part, this is because the legislation provides consumers an incentive to drop their existing coverage so as to become eligible for the state-subsidized plan. (Indeed, the State Budget and Control Board estimates that 40,092 persons eligible for HB 3584's premium subsidy *already have* health insurance.³) Likewise, the bill provides an incentive for large employers of lower-income workers to not offer health insurance insofar as the premium subsidy only applies to individuals and small businesses.

It goes without saying that increasing the cigarette tax to 57 cents per pack will reduce demand for cigarette products.⁴ Reduced demand, however, translates into less income for retailers who sell cigarettes and for manufacturers of products (snack foods, beverages, alcohol) consumers tend to purchase along with the cigarettes. The tax will also encourage consumers from South Carolina to look to alternative markets in other states, the internet and underground markets. This is especially the case given that current cigarette per/pack rates in neighboring states are much lower than the anticipated increase:

Virginia: 30 cents/pack

Florida: 33.9 cents/pack

North Carolina: 35 cents/pack

Georgia: 37 cents/pack

A cigarette tax increase will affect much more than cigarette sales. Businesses along the entire supply chain for a variety of products will suffer a reduction in sales and profits. In turn, these businesses will be forced to reduce employment and investment expenditures. Tax revenues at the state and local levels will decline as a result.

Finally, the cigarette tax increase, combined with smoking cessation efforts by the state, should reduce *taxable* cigarette sales in South Carolina and thus place downward pressure on future cigarette tax revenues.

³Lawmakers have alternatively referred to the insurance premium provided by the bill as a "tax credit" or a "subsidy." The language of the bill only refers to a "premium credit" to be paid either to the insurer or the small employer. Given that the legislation lacks reference to any form of tax liability on the part of the insurer or the employer, it seems to be providing for a direct subsidy.

⁴Because this projection does not include the federal cigarette tax increase of 62 cents per pack that went into effect March 31, 2009, the job losses will likely be even more severe.

Consider the following:

- The tax increase can be expected to reduce cigarette tax revenues by at least 1.1 percent annually.
- After raising its cigarette tax by 25 cents in 2003, Georgia projected \$180 million in new revenue; actual revenue came in at \$117 million – 35 percent less than projected.
- After a 10-cent cigarette tax increase in 2005, Virginia expected to raise \$62 million in new revenue; instead, they collected \$52 million – 16 percent less than anticipated.

Relying on a declining revenue source to fund recurring expenses is a recipe for future tax increases. In this case, a tax increase is all the more likely because one-third of South Carolinians aged 19-64 earn at or below 200 percent of FPL. With such a large eligible population, there will be substantial pressure to expand coverage beyond the spending limit envisioned by HB 3584. On top of that, administrative costs for the program are expected to be much higher – 17 percent – than initially anticipated (1 percent each for the Department of Insurance and Department of Health). The end result will be, not only a tax increase for smokers, but for all South Carolinians.

