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HEADLINE: States' smokescreen for tax hypocrisy

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BODY:
How elastic is sin? Not very, if you believe America's state governments.

They are the ones wagering that citizens love a sin, cigarette smoking, so much that their desire for cigarettes will not change no matter thetaxes levied on cigarettes. Or, to put the matter in economic terms, they think demand will be relatively inelastic. On the plane of common wisdom, the story also makes sense: addiction would not be addiction if you gave it up because it cost an extra dollar.

But it is important to remember that the states' wager on inelasticity is born of a nasty dependence of their own. The dependence on ever-increasing state budgets. For state finance types, watching those budgets go from surplus to deficit has been as painful as nicotine withdrawal. So, many are now pushing their governors and legislatures to get them a quick cash fix by raising cigarette excise taxes. Cigarettes are dirty but not too dirty for states to make money from them.

Martin Feldman, of Salomon Smith Barney, found 45 bills proposed in 22 states to raise tobacco taxes. This, he says, comes on top of excise tax increases in five states last year.

And the trend to cigarette sin taxes is a global one: the European Union has proposed a tobacco tax increase worth more than a dollar per pack. Both the EU and US state budgets into which such tax increases would be written are static ones that assume a certain rate of tax revenues. They assume demand is inelastic.

But the evidence here is at least a little smoky. A body of economic literature suggests cigarette demand can be elastic, at least among the young. In the 1990s, two economists, Frank J. Chaloupka of the University of Illinois and Michael Grossman of the National Bureau of Economic Research looked at youth smoking following tobacco tax increases in a number of states. They found that "large increases in cigarette excise taxes would lead to sharp reductions in youth smoking".

Moreover, higher prices for cigarettes not only reduced the purchase of cigarettes by smokers but also deterred young non-smokers from taking up smoking. Older smokers were less responsive, especially, it seems, women.

This hopeful finding - at least hopeful for those concerned about health, and not state coffers - is conditioned on a few assumptions. The biggest is that young people are not obtaining cigarettes in the black or grey markets or driving out of state for cigarettes.

But, as the authors note, youngsters' access to autos is more limited than that of adults, so the elasticity is probably a real phenomenon. We can therefore expect steep reductions in youth smoking in Alaska, Hawaii and New York - three states where the tax on a pack is Dollars 1 or more. Kids in Kentucky and Virginia (with taxes less than ten cents) will, by contrast, puff away.

All this makes sense given that a one dollar increase in the price of a pack of cigarettes represents a significant percentage of many a teenager's budget, especially during weak economic times.

Mr Chaloupka and his colleague John Tauras also did some research on nicotine replacement therapy, presumably a "better" behaviour than smoking. They found that demand for the patch, nicotine cigarettes and similar alternatives to smoking was also elastic.

Of course some nicotine gum chewers use the product to feed their addiction, rather than end it. Still, even the most avaricious states have steered away from taxing nicotine replacement, which is regarded as medicine.

But where does this leave our states? On the one hand, they say they abhor destructive behaviour, and have bitten a huge piece out of the side of the tobacco industry through anti-tobacco litigation. On the other, they are eager for revenue, and morally committed to obtaining it, even it means profiteering from bad behaviour.

This is troubling, especially when you consider that tobacco taxes, like liquor taxes, are regressive: they tend to weigh most heavily on the poorest and most vulnerable members of society. To make matters worse, the states not only tax but actually encourage another form of sin: gambling in government sponsored lotteries.

Thus, as Mr Feldman points out, citizens of Connecticut were last fall subjected to the spectacle of hearing their governor, John Rowland, intone on the virtues of fiscal solvency ("state government should strive to spend no more than it takes in") even as he prepared to push for higher tobacco taxes and increasing state revenues through the lottery. Then there is Mike Bloomberg, New York's mayor, who has proposed a tobacco tax increase of 1,700 per cent, bringing the price of a pack of cigarettes to Dollars 7.

Of course such revenue hounds defend themselves by claiming they are achieving two goals: balanced budgets in the short-run and reduced smoking in the long. Still, the most visible addiction in the tale of taxes and cigarettes is not smoking but public sector greed.

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