

We've come a long way from "If you haven't smoked, don't start. If you do smoke, quit." In the 1960s, opponents of smoking criticized the use of cowboys, the classic symbol of American individualism, to sell cigarettes. Today they criticize individualism itself, because it implies that people are responsible for their own behavior. The coughing cowboy has been replaced by the laughing merchant of death.

#### Chapter 4

### VICE CHARGE

*I hope they price them out of my range, because I'm really wanting to stop.*

—Kentucky smoker on the 1990 cigarette tax increase

#### I SAID, 'NO NEW TAXES'

The single most effective anti-smoking measure ever enacted by Congress was not intended to reduce smoking. It was intended to reduce the federal deficit. The Tax Equity and Fiscal Responsibility Act of 1982 was a compromise in which the Reagan administration agreed to tax hikes in exchange for substantial cuts in domestic spending. The spending cuts never quite materialized, but the tax hikes were felt immediately. Among other things, TEFRA doubled the federal excise tax on cigarettes, from eight to sixteen cents a pack, as of January 1, 1983. Around the same time, the cigarette companies, recognizing that smokers were already expecting to pay more, repeatedly raised wholesale prices, compounding the impact of the tax increase. Per capita cigarette consumption fell 6.7 percent that year, the biggest drop since 1932.<sup>1</sup>

The tax hike, which brought in an additional \$1.5 billion or so a year, was originally scheduled to expire in October 1985.<sup>2</sup> But the deficit continued to grow, despite many expressions of concern and resolutions to do something about it. "By the end of 1982," writes David Stockman, Reagan's first budget director, "the fiscal situation was an utter, mind-numbing catastrophe."<sup>3</sup> Determined to be fiscally responsi-

ble, Congress repeatedly extended the temporary tax increase, making it permanent in 1986.

The fact that Congress originally set an expiration date, observed health economist Kenneth Warner, demonstrated that the motivation for the eight-cent increase was "fiscal exigency and not public health." But tobacco's opponents recognized the opportunity to combine increased revenue with reductions in smoking—"Doing Good by Doing Well," as Warner put it.<sup>4</sup> In a February 1982 op-ed piece, Michael F. Jacobson, executive director of the Center for Science in the Public Interest, said tobacco and alcohol "are blamed for tens of thousands of deaths each year, and higher taxes would reduce this toll." Noting that the real value of the federal tax on cigarettes had declined by about 70 percent in the thirty-one years since it had last been raised, he argued that a higher tax would "both promote health and be politically acceptable."<sup>5</sup> After the tax hike went into effect, tobacco's opponents urged Congress not to let it lapse. "It's one tax that's certifiably good for our health," enthused syndicated columnist Ellen Goodman.<sup>6</sup> The *New York Times* recommended another eight-cent increase, calling it "poetic justice" and "a small payback . . . for what the cigarette habit costs government each year."<sup>7</sup>

The *Times* got its wish in 1990 when George Bush abandoned his "no new taxes" pledge. David Stockman had argued that raising excise taxes was "not inconsistent with the supply-side idea of restoring *income* tax incentives for production, savings, investment, and entrepreneurial activity."<sup>8</sup> Thus, Stockman reasoned, Reagan could accept an increase in the cigarette levy without violating the spirit of his promise to cut taxes. But Bush's pledge did not seem to leave any wiggle room. During the campaign he had written a letter to North Carolina Governor James Martin that said, "I will not raise taxes, period," specifically adding that he was "opposed to any increase in excise taxes, including those on tobacco or cigarettes."<sup>9</sup> At his January 1989 confirmation hearings, Bush budget director Richard Darman had explicitly ruled out excise tax increases, since they would fail the "duck test": "If it looks like a duck and walks like a duck and quacks like a duck, it is a duck."<sup>10</sup>

But that fall the Bush administration went duck hunting. After the *Wall Street Journal* reported that a Treasury Department task force was considering higher taxes on cigarettes, Tobacco Institute vice president

Walker Merryman expressed confidence that Bush would keep his promise.<sup>11</sup> Seven months later, the president announced that "the size of the deficit problem and the need for a package that can be enacted" required, among other things, "tax revenue increases."<sup>12</sup> Congress and the White House ultimately agreed on \$134 billion in new revenue over five years, including about \$6 billion from two four-cent hikes in the cigarette tax, taking effect in 1991 and 1993.<sup>13</sup>

It probably wouldn't have helped him win reelection, but Bush could have tried to explain away the increase in the cigarette levy by noting that he had promised "no *new* taxes." In the United States, tobacco taxes are nearly as old as the republic. Since the days of James I and Cardinal Richelieu, governments have recognized tobacco as a reliable source of income, and the record suggests that war is just as good for tobacco taxes as it is for tobacco consumption. Congress imposed a tax on snuff in the 1790s, eliminated it in 1804, and brought it back briefly in 1814 to help finance the War of 1812. The Civil War revived federal tobacco taxes, including a cigarette tax, and they've been with us ever since. In 1865, facing a huge war debt, Congress tripled the tobacco tax from eleven to thirty-three cents a pound, unintentionally prompting a sharp drop in per capita tobacco consumption, which fell from 1.3 pounds to 1 pound during the next three years.<sup>14</sup> The cigarette tax went up temporarily during the Spanish-American War and permanently during World War I, World War II, and the Korean War, reaching eight cents a pack in 1951. In 1964 Wisconsin Senator Gaylord Nelson, taking a cue from history, suggested a five-cent increase to help finance Lyndon Johnson's War on Poverty.<sup>15</sup> But apparently a metaphorical war just didn't rate another hike, and the tax remained at 8 cents until the Reagan-Bush double whammy.

Spread over three years, the second eight-cent increase did not have a noticeable impact on cigarette consumption. That fact did not discourage anti-smokers who had come to view the excise tax as a public health tool; they simply believed that bigger increases were necessary. In 1982 Michael Jacobson had recommended a tripling of the cigarette tax, from eight to twenty-four cents, a level it did not reach for more than a decade.<sup>16</sup> In 1989, the *New York Times* urged an increase in the neighborhood of twenty cents, which it said would mean half a million fewer

smokers.<sup>17</sup> By 1993, when the Clinton administration was floating the idea of raising the cigarette tax to help pay for its health care plan, the proposals had become even more ambitious. Anti-smoking groups such as the American Medical Association and the Coalition on Smoking or Health endorsed a *ninefold* hike, from twenty-four cents to \$2.24. Such an increase would have more than doubled the price of a pack of cigarettes, something guaranteed to get the attention of smokers.

In a March 1993 poll by Lou Harris and Associates, 74 percent of the respondents (roughly the nonsmoking proportion of the population) supported a one-dollar cigarette tax hike to pay for health care reform. The idea was politically astute, tying an increase in the tax on a product used by a minority of voters to the highly popular goal of universal health coverage. And it seemed to make a rough kind of sense, since cigarettes contribute to disease. The combination was so potent, *National Journal* reported in April 1993, that “even Rep. Charlie Rose, D.-N.C., sometimes known as ‘Mr. Tobacco,’ realizes that some tax increase is inevitable.” Anti-smoking activists at the Advocacy Institute were cocky enough to write a ditty about their impending victory, sung to the tune of “The Monster Mash”:<sup>18</sup>

We were working on the bill late one night  
 Had an idea that would cause a fright  
 Blaring through the halls came the sound of a sax  
 Bill playing the tune of the monster tax  
 The monster tax  
 (We did the tax)  
 It was a monster tax  
 (The monster tax)  
 The idea spread by fax  
 (We did the tax)  
 Opposed by industry hacks  
 (The monster tax)  
 We'll give ol' Joe the ax!

After months of speculation, in October 1993 President Clinton called for a seventy-five-cent increase—huge by historical standards but modest compared to some of the numbers that had been tossed around

(which may have been the whole idea). The tobacco companies campaigned aggressively against the tax hike, arguing that it would hit the poor hardest, that it would contribute to black-market activity, and that it would eliminate hundreds of thousands of jobs. In March 1994 some eighteen thousand tobacco farmers and industry employees attended a protest rally outside the White House organized by several cigarette makers, which closed down their factories and bused in their workers for the occasion.<sup>19</sup>

Less than two weeks later, the Health Subcommittee of the House Ways and Means Committee approved a \$1.25 increase in the cigarette tax, fifty cents more than Clinton had suggested. In June the full committee voted for a forty-five-cent hike, thirty cents less than the administration's proposal. That month the *Atlanta Journal and Constitution* reported that “the industry [hoped] to hold the tax to 48 cents”; in other words, the tobacco companies now viewed a doubling of the tax as a victory.<sup>20</sup> But compromise proved unnecessary. The reason had less to do with the tobacco industry's clout than with the program that was supposed to justify a higher cigarette tax. “One of the last best hopes for the industry,” the *New York Times* reported prophetically in March 1993, “is that the details of the Administration's health-care plan will prove so unpopular, or so unwieldy, that it will be unable to get through Congress, allowing cigarettes to escape unscathed.”<sup>21</sup> By fall 1994 Clinton's health care plan was dead, and so was his cigarette tax hike.

With the election of a Republican Congress that November, the chance of raising the tax seemed even more remote. In May 1997, attempting to save a budget agreement between the White House and Congress, Clinton himself helped kill a proposal to raise money for children's health insurance through a forty-three-cent hike in the cigarette tax. But Congress approved a more modest version of the plan that summer, after the proposed national tobacco settlement highlighted the industry's vulnerability. The budget bill that Clinton signed in early August will raise the federal cigarette tax by ten cents a pack in 2000 and another five cents in 2002. This fifteen-cent hike—aimed mainly at revenue, rather than deterrence—is the biggest federal increase ever, but it's tiny compared to what anti-smoking activists want.

Tobacco's opponents complained that the settlement proposal announced in June 1997 did not include any tax hikes. But the plan did require the cigarette companies to pass the \$368.5 billion cost of the deal on to their customers through higher prices, which would have the same impact as a tax increase. In September the president said if under-age smoking did not decline according to the government's schedule, the tobacco companies should have to pay penalties high enough to raise cigarette prices by up to \$1.50 a pack—an amount calculated to deter teenagers from smoking and help meet the official targets.

### LABORATORIES OF TAXATION

State legislatures have been more willing than Congress to increase cigarette taxes. While the federal tax has been raised just three times since 1951, state taxes have gone up more than three hundred times.<sup>22</sup> In fact, the National Governors' Association opposed the 1983 federal tax hike on the ground that it preempted a traditional source of state revenue. By 1969 every state and the District of Columbia taxed cigarettes, with rates ranging from two cents a pack in North Carolina to sixteen cents in Connecticut.<sup>23</sup> In 1996, when the rates ranged from two and a half cents in Virginia to eighty-two and a half cents in Washington state, the weighted average was about thirty-two cents, one-third more than the federal tax.<sup>24</sup> State legislators have often found it easier to extract money from an increasingly unpopular minority than from broad-based taxes on sales, income, or property. Since 1993 the Washington legislature, seeking money for the cleanup of Puget Sound, for anti-violence programs, and for health insurance subsidies, has raised the state's cigarette tax from thirty-four to eighty-two and a half cents a pack. In 1994 Michigan voters approved a referendum that tripled the cigarette tax to seventy-five cents a pack as part of a plan to reduce property taxes.

During the last decade several states have increased their cigarette taxes with the explicit aim of reducing smoking. In 1985 the Minnesota legislature raised the state's tax from eighteen to twenty-three cents a pack, earmarking some of the additional revenue for health education, including anti-smoking ads.<sup>25</sup> California's Proposition 99, approved by voters in 1988, increased the state's cigarette tax from ten to thirty-five

cents a pack, setting aside about a quarter of the money for anti-tobacco efforts, which have included research, promotion of local smoking ordinances, and a media campaign (discussed in chapter 3).<sup>26</sup> Taking a cue from California, anti-smoking activists in Massachusetts proposed a similar ballot measure, Question 1, in 1992. It raised the state's cigarette tax from twenty-six to fifty-one cents a pack, with some of the money paying for an anti-smoking ad campaign that began in 1993. In 1994 voters in Arizona also passed an initiative resembling Proposition 99, raising the state's cigarette tax from eighteen to fifty-eight cents a pack. All three initiatives prevailed despite well-funded opposition by the tobacco industry, which spent about \$10 million in California, \$5 million in Massachusetts, and \$4 million in Arizona.<sup>27</sup> The industry had more success in Colorado, where voters defeated a Proposition 99-style ballot measure by a large margin in 1994.

That year the Robert Wood Johnson Foundation announced \$10 million in grants for campaigns to raise cigarette taxes in nineteen states.<sup>28</sup> In 1996 Oregon voters approved an initiative raising the state's cigarette tax from thirty-eight to sixty-eight cents a pack, allocating the extra money to health insurance for the poor. In 1997 eight states—Alaska, Arkansas, Hawaii, Maine, New Hampshire, Rhode Island, Utah, and Wisconsin—raised their cigarette taxes. The increases ranged from a modest two and a half cents in Alaska (from thirty-one and a half cents to thirty-four cents) to a whopping forty cents in Hawaii (from sixty cents to a dollar, as of July 1998).<sup>29</sup> "We're getting clobbered," an industry official said. "Raising tobacco taxes is our No. 1 strategy to damage the tobacco industry," an American Cancer Society official told the *New York Times*, which reported that anti-smoking activists "hope to have campaigns going in all 50 [states] by next year."<sup>30</sup>

Like the 1983 federal tax hike, sizable increases in state cigarette taxes are generally followed by significant drops in sales. Cigarette purchases in California fell 14 percent in 1989, the year after the state tax rose by twenty-five cents a pack, compared to 4 percent nationwide.<sup>31</sup> In his statistical analysis of several state tax hikes, University of Scranton business scholar Richard McGowan found that increases of more than fifteen cents a pack in Massachusetts and Washington led to "a sharp and per-

manent decline in cigarette sales." He concluded that "the cigarette excise tax has proven to be the most effective public policy measure in decreasing cigarette sales if public policy makers have the will to raise the rate substantially."<sup>32</sup>

Most studies of the issue have found that the price elasticity of demand for cigarettes is somewhere between  $-0.4$  and  $-1.0$ —that is, for every 10 percent increase in the price of cigarettes, consumption drops 4 to 10 percent.<sup>33</sup> Research suggests that price increases cut consumption mainly by reducing the number of smokers (as opposed to reducing the amount consumed per smoker). One study indicated that a 10 percent price increase reduces smoking prevalence by roughly 3 percent.<sup>34</sup> Tobacco's opponents combine such figures with epidemiological data to estimate the impact of changing the cigarette tax. In 1985, when Congress was considering whether to extend the 1983 tax increase, Kenneth Warner cautioned, "If that tax is allowed to fall in half, upwards of half a million Americans will die earlier than if the tax had been left at 16 cents."<sup>35</sup> In 1993, urging Congress to raise the cigarette tax "by a minimum of \$2 a pack," a physician representing the Coalition on Smoking or Health said, "By your action you can save 2 million lives, and you can do it without spending a dime of taxpayers' money."<sup>36</sup>

That's a pretty appealing proposition. But a legislator who votes for a cigarette tax hike should not expect the sort of gratitude that a surgeon or a firefighter might receive. To be sure, some smokers who are inclined to quit may welcome the added incentive of higher prices. In 1990, with rumors of a cigarette tax hike in the air, a Kentucky smoker told a reporter, "I hope they price them out of my range, because I'm really wanting to stop."<sup>37</sup> Such smokers, like overweight people who enroll in fat farms, are looking for external assistance to reinforce their own will power. But many others will react like the California smoker who said of Proposition 99, "It's a form of extortion. The initiative is punitive and it's scary. It singles out a part of the population that is seen as offensive by another group."<sup>38</sup> Or like the spokesman for the Kentucky Smokers Rights Organization, who said of Bill Clinton's proposed seventy-five-cent tax increase, "This isn't about health-care reform. . . . What the administration wants is to reduce the use of tobacco by citizens of this country. This is about behavior modification. Where will it end?"<sup>39</sup>

Smokers of modest means are apt to resent tax hikes the most. Tobacco taxes are highly regressive, both because the poor are more likely to smoke and because poor smokers spend a larger share of their income on cigarettes than affluent smokers do. In 1990 smokers represented 19 percent of Americans earning \$50,000 or more a year and about 32 percent of those earning less than \$10,000. Tobacco taxes consumed 0.4 percent of the median income for smokers in the first group, versus 5.1 percent for smokers in the second group—nearly thirteen times as much. Compared to cigarette taxes, a head tax is a model of fairness.<sup>40</sup>

Yet tobacco's opponents seem to overlook the possibility that smokers might object to a cigarette tax hike. Defending a policy of reducing smoking through taxation against the charge that it amounts to "blaming the victim," Kenneth Warner wrote, "Given the effective deterrence function of a cigarette tax, one might consider a tax increase as a help-the-victim measure."<sup>41</sup> Responding to the argument that Proposition 99 hit the poor especially hard, the author of a letter to the *Western Journal of Medicine* said, "The benefits of the tax in terms of discouraging smoking are likely . . . to be progressive. A disproportionate number of lives of the poor are likely to be saved by a cigarette tax."<sup>42</sup> What about the "victims" who don't want to be "helped," the "lives" who don't want to be "saved"? The public health model ignores that question. It deals with populations, not people.

Advocates of higher tobacco taxes assume that legislators are doing smokers a favor by making cigarettes more expensive. That counterintuitive notion rests on the belief that people continue to smoke because they don't know any better or because they can't help it. "People do not understand the results of the market behavior called smoking," Warner insisted in 1985. "By raising the dollar price, we're providing information. We're saying, 'This is costly.' That's not just in dollars; that's in terms of health implications too."<sup>43</sup> In other words, tobacco taxes are supposed to communicate the same message as all those warning labels, surgeon general's reports, and anti-smoking ads: Cigarettes are bad for you. But as the Congressional Research Service concluded in 1994, "available data indicate the average smoker is aware of, or overestimates, the health risks of smoking."<sup>44</sup> Warner also argued that "we're dealing with a highly addictive process. Ninety percent of adults say they'd like

to quit if it were easy to do so; 60 percent claim they have tried within the past year."<sup>45</sup> Chapter 7 will explore the meaning of addiction, including the significance of those survey results. For now it should suffice to observe that giving up cigarettes when the price of a pack goes up twenty-five cents is not the behavior of someone who is powerless over nicotine.

As with the advertising ban, anti-smoking activists reinforce their argument for increasing cigarette taxes by urging us to save the children. They note that most smokers start before the age of eighteen and that teenagers are especially sensitive to price increases. "To reduce new recruits," writes Jack Nicholl, campaign manager for Proposition 99, "the price of tobacco must be elevated beyond the reach of teens. Boosting the tobacco tax is the best method yet tried for discouraging teen smokers."<sup>46</sup> Similarly, the Coalition on Smoking or Health argues that "raising tobacco taxes is the most effective way to rapidly and significantly reduce tobacco use by young people."<sup>47</sup> Even if that's true, this approach imposes a burden on all smokers, regardless of age, to deter a small minority who are not legally permitted to buy cigarettes in the first place. It's akin to taxing pornographic magazines so children can't afford them. Since every state already prohibits the sale of cigarettes to minors, a serious effort to enforce those laws seems a more appropriate response to underage smoking.

#### NONSMOKER'S BURDEN

For those who are not persuaded that we need higher cigarette taxes to protect smokers from themselves or to discourage minors from taking up the habit, tobacco's opponents have another argument: Cigarette taxes are a way of bringing home to smokers the costs they impose on society. "I believe that people should pay their own way and not pass their costs on to society," says Elizabeth Whelan, president of the American Council on Science and Health. "I wouldn't call it a tax. I would call it a user's fee."<sup>48</sup> John Banzhaf, executive director of Action on Smoking and Health, says "the fairest thing to do . . . would be to figure out the cost to society from smoking and then impose that in the form of a tax."<sup>49</sup> The "social cost" argument is more appealing than the other

rationales for raising cigarette taxes because it emphasizes fairness and individual responsibility. But it suffers from severe empirical and conceptual weaknesses. "I can't really defend the various economic numbers," Whelan concedes, "because I didn't get involved in how they were done. I also know that the dollar estimates put on the cost of smoking in society are almost impossible to come up with. . . . You can come up with any numbers you want. We've tried, and we just find it an impossible situation."<sup>50</sup>

Part of the problem is that basic issues about smoking-related costs remain unresolved. Tobacco's opponents often assert, for example, that smokers take more sick leave and generate higher medical expenses than nonsmokers. But the extent, significance, and even the existence of such differences have been questioned. A 1991 study published in *Applied Economics* found that when factors such as occupation, age, and drinking habits were considered, smokers were no more likely than nonsmokers to be absent from work. "Our results suggest that smokers miss no more work than non-smokers because they smoke," wrote Auburn University economist Richard W. Ault and his coauthors. "Rather smokers tend to be younger, heavier drinkers, blue collar workers, etc., and these groups will miss more work regardless of whether or not they smoke."<sup>51</sup> Similarly, a 1995 study by San Jose State University economist J. Paul Leigh, reported in the *Quarterly Review of Economics and Finance*, found that factors other than smoking accounted for much (though not all) of the difference in absenteeism between smokers and nonsmokers. After adjustment, the absence rate was about one percentage point higher for male smokers than for male nonsmokers; among women, the difference was less than one-third of a percentage point.<sup>52</sup>

The evidence concerning health care costs is also mixed. A decade ago the economist Thomas C. Schelling, who headed Harvard's Center for the Study of Smoking Behavior and Policy, observed, "It is not at all evident that over their lifetimes smokers incur greater medical-care costs than nonsmokers. . . . It seems a reasonable guess that the health-care costs that are obviated by premature deaths attributable to smoking are at least the order of magnitude of the health-care costs attributable to fatal smoking-induced illness."<sup>53</sup> A 1990 study reported in *Preventive Medicine* seemed to confirm Schelling's hunch,

finding that lifetime medical expenses are actually *lower* for smokers than for nonsmokers.<sup>54</sup> A 1992 article in the *Milbank Quarterly* criticized this conclusion, arguing that the study used too narrow a definition of smoking-related disease and overestimated the medical expenses of nonsmokers.<sup>55</sup> The most recent study of this issue, published by the *New England Journal of Medicine* in 1997, estimated that "health care costs for smokers at a given age are as much as 40 percent higher than those for nonsmokers, but in a population where no one smoked the costs would be 7 percent higher among men and 4 percent higher among women" because of longer life spans. Therefore, the authors concluded, "If people stopped smoking, there would be a savings in health care costs, but only in the short term. Eventually, smoking cessation would lead to increased health care costs."<sup>56</sup>

In addition to measurement problems, discussion of smoking-related costs is clouded by analytical confusion. Anti-smoking activists routinely fail to distinguish between costs that smokers pay and costs that other people pay. In a 1995 briefing paper, the Coalition on Smoking or Health asserted that "the total economic cost of tobacco exceeds \$100 billion per year." It cited a CDC estimate that treatment of smoking-related diseases cost \$50 billion in 1993 and an estimate by the U.S. Office of Technology Assessment that "lost economic productivity caused by smoking cost the U.S. economy \$47 billion in 1990."<sup>57</sup> The CDC figure includes all health care expenses related to smoking, regardless of who paid them. Less than half of the total (\$22 billion) represents taxpayer money. The OTA figure includes \$7 billion for "lost time at work" and "lost housekeeping services by homemakers," along with \$40 billion for the "forgone earnings of those dying prematurely."<sup>58</sup> Both estimates combine costs paid by the smoker (e.g., out-of-pocket health care, lost wages) with costs paid by others. Yet the Coalition on Smoking or Health simply divided \$100 billion by the number of cigarette packs sold in 1993 and declared, "On average, every pack of cigarettes is directly responsible for more than \$3.90 in health care costs and lost productivity."<sup>59</sup> In the context of an argument for raising cigarette taxes, this calculation is irrelevant and misleading.

Tobacco's opponents not only include inappropriate costs but also ignore important sources of savings. As noted above, smokers consume less health care in old age than nonsmokers because they tend to die earlier. They also spend less time in nursing homes and take less money out of Social Security and pension funds. From an economic perspective, these savings have to be considered along with the costs, even though it may seem distasteful. As the OTA noted, "Reduction or elimination of smoking would improve health and extend longevity, but may not lead to savings in health care costs. In fact, significant reductions in smoking prevalence and the attendant increase in life expectancy could lead to future increases in total medical spending, in Medicare program outlays, and in the budgets of the Social Security and other government programs."<sup>60</sup>

The first study to include long-term savings and distinguish costs paid by smokers from costs paid by third parties was published in the *Journal of the American Medical Association* in 1989. A group of researchers associated with the RAND Corporation, led by Willard G. Manning, considered the impact of smoking on fires, sick leave, nursing home care, pension programs, and payments under health, life, and disability insurance. They estimated that the external costs of smoking (those borne by people other than smokers and their families) totaled about fifteen cents a pack, based on a 5 percent discount rate. (The discount rate translates future dollars into present dollars.<sup>61</sup>) "On balance," Manning et al. concluded, "smokers probably pay their way at the current level of excise taxes."<sup>62</sup> The average state and federal excise tax burden was thirty-eight cents at the time.<sup>63</sup>

In 1994 the Congressional Research Service updated the findings of the RAND study. Adjusted for inflation, Manning et al.'s estimate of fifteen cents per pack became thirty-three cents in 1995 dollars, compared to a combined state and federal tax that averaged about fifty-seven cents.<sup>64</sup> The CRS noted that raising the discount rate to 10 percent would increase the per-pack cost to forty-two cents. At a discount rate a bit under 4 percent, the cost would drop to zero, and below that rate smoking would result in net savings. The CRS also considered the impact of including deaths attributed to secondhand smoke (a topic discussed in the next chapter) as a component of smoking's cost. While

"the link between passive smoking and disease is uncertain," the report said, "the best available estimate of this link implies external costs of no more than a few cents per pack."<sup>65</sup>

In a 1994 paper published by the National Bureau of Economic Research, W. Kip Viscusi updated the RAND data and adjusted them to take into account reductions in tar consumption since the 1950s. Viscusi used a 3 percent discount rate, "corresponding to the long-run real rate of return in the U.S. economy." He found that smoking generates net external savings between twenty-three and fifty-three cents a pack, depending upon whether lost income tax revenue is counted as a cost. "At reasonable rates of discount," he concluded, "the cost savings that results because of the premature deaths of smokers through their lower Social Security and pension costs will more than compensate for the added costs imposed by smokers. . . . On balance there is a net cost savings to society even excluding consideration of the current cigarette taxes paid by smokers." Based on these calculations, he noted, one could argue that "cigarette smoking should be subsidized rather than taxed." Like the CRS, Viscusi considered the evidence concerning the health effects of secondhand smoke shak. But he found that even when deaths from secondhand smoke were included in the cost calculation, there was no basis for raising cigarette taxes.<sup>66</sup>

Although they were careful not to count costs paid by smokers, the authors of these studies did not distinguish between costs paid by others voluntarily and costs imposed on others. Private insurers and HMOs, for example, agree to cover smokers in exchange for their premiums. If smokers generate bigger medical bills, that may be a reason to charge them higher premiums, but it is not an argument for government intervention. Similarly, if smokers take more sick leave than nonsmokers, are less productive on the job, or draw on group health insurance more, employers are in the best position to know and respond. Some companies already charge employees who smoke or who have smoking dependents more for health coverage. In principle, employers can also pay smokers less or refuse to hire them, though employment laws, including misguided "anti-discrimination" statutes backed by the tobacco industry, interfere with this freedom.

The government also forces people (a.k.a. taxpayers) to pick up the

tab for smoking-related illness through Medicaid and Medicare. As long as the government subsidizes health care, it will subsidize risky behavior, including not just smoking but heavy drinking, overeating, and hazardous recreation. Politicians and bureaucrats will then use those subsidies as an excuse for further meddling. The implications are troubling. In a 1976 essay commissioned by *Time*, John H. Knowles, president of the Rockefeller Foundation, reviewed the rise of taxpayer-funded health insurance and declared that "the cost of sloth, gluttony, alcoholic overuse, reckless driving, sexual intemperance, and smoking is now a national, not an individual responsibility."<sup>67</sup> Writing in *Daedalus* the following year, he said, "I believe that the idea of a 'right' to health should be replaced by the idea of an individual moral obligation to preserve one's own health—a public duty if you will."<sup>68</sup>

Even if we ignore that chilling prospect, the cost of treating smoking-related illness under taxpayer-funded programs still has to be weighed against the claims that smokers would make on Medicare and Social Security if they lived longer. Taking the long view, the CRS concluded that "reduced smoking probably would cause an increase in net budgetary costs."<sup>69</sup>

Many anti-smokers are offended by all this talk about the savings associated with smoking. In congressional testimony during the 1993 debate over Clinton's proposed tax hike, Jeffrey Harris, a physician and MIT economist, estimated that the "direct health care costs of smoking" were \$88 billion a year, or \$3.71 per pack. He cited the OTA's estimate for "lost productivity" and used it to calculate "forgone income taxes." But when it came to the costs avoided because smokers die earlier, he was suddenly squeamish. "This is not the kind of calculation in which a civilized society engages," he declared. "Premature deaths are not counted as a 'benefit' in decisions to fund research to cure diseases such as breast cancer or prostate cancer, or in decisions to stop the spread of AIDS or violence. . . . This is not a matter of cold economic calculation, but a matter of health."<sup>70</sup>

Harris's analogies make sense only if smoking is an unequivocal evil, like cancer, AIDS, or murder. But while public health specialists may consider smoking inherently undesirable, many smokers clearly have a different view. (Otherwise there would be no need for higher cigarette

taxes.) In any case, tobacco's opponents are the ones who introduced "cold economic calculation" to justify tobacco tax hikes. They switched the focus from the individual to the group, asking about the impact of smoking on "society as a whole." The question is reminiscent of the complaint made by James I that tobacco impaired the health and drained the property of his subjects, who were "created and ordained by God to bestowe both [their] persons and goods for the maintenance both of the honour and safetie of [their] King and Commonwealth."<sup>71</sup> Today's anti-smoking activists similarly blame smokers for reduced tax revenue and "lost productivity," as if every individual owes the state a full lifetime of income (at the highest possible wage?). Criticizing economists who do not treat cigarette tax hikes like funding for cancer research, Harris complained, "There is a double standard at work here."<sup>72</sup> Indeed.

### SMOKE SMUGGLING

Even if the case for higher cigarette taxes were convincing, practical problems would remain. Just as surely as they discourage consumption, taxes encourage evasion and smuggling. In 1996 the average price for a pack of cigarettes sold in the United States (including discount brands) was about \$1.85. The average state and federal tax burden represented more than 30 percent of that price.<sup>73</sup> Smokers are happy to avoid some or all of that burden, and sellers who can oblige them and supply cigarettes at a substantial discount stand to make a nice profit.

Many smokers can cut out the middleman by simply crossing the border to a state where the tax is lower. Business scholar Richard McGowan found that cigarette sales increased in New Hampshire after Massachusetts raised its cigarette tax in 1993. He reported that "New Hampshire appears to have directed its own state police to protect Massachusetts residents who buy cigarettes and alcohol in New Hampshire. New Hampshire state police harass undercover Massachusetts state police who sit in parking lots relaying license plate numbers of the cars of Massachusetts residents who are seen buying large quantities of cigarettes and alcohol in New Hampshire." McGowan also found that cigarette sales in Oregon rose after Washington increased its tax in 1994.

Two years later, when Washington raised its tax again, Oregon cut its tax. "States do indeed covet potential cigarette excise tax revenue from neighboring states," McGowan concluded. "Rather than raising their own cigarette excise taxes to raise additional revenue, many states are maintaining or even lowering their cigarette excise tax rate to attract smokers from neighboring states that have substantially increased their cigarette excise tax rate."<sup>74</sup> The Tax Foundation estimated that, because of growing disparities in cigarette taxes, cross-border shopping nearly quintupled between 1980 and 1994.<sup>75</sup>

In addition to interstate purchases by smokers, organized crime has long been involved in trucking cigarettes from low-tax states such as Virginia and North Carolina to high-tax states such as New York and Massachusetts. According to the Tax Foundation, the number of smuggled cigarettes rose more than 250 percent from 1980 to 1994.<sup>76</sup> When Michigan tripled its cigarette tax in May 1994, it created a tempting business opportunity for interstate smugglers. During the year after the tax hike, tax-paid sales in Michigan dropped 19 percent. By comparison, sales in North Carolina, where the cigarette tax was seventy cents lower, rose 14 percent. Sales also rose significantly in three other tobacco states—Kentucky, Virginia, and Tennessee—and in three states bordering Michigan that have lower cigarette taxes—Wisconsin, Indiana, and Ohio.<sup>77</sup> Since overall cigarette consumption in the United States did not change significantly between 1993 and 1994, these figures indicate that many Michigan smokers started buying cigarettes from other states, on their own or through bootleggers.

A 1995 report by the investigative accounting firm Lindquist Avey MacDonald Baskerville described several routes by which low-tax cigarettes reach Michigan. Some smugglers drive rented vehicles to North Carolina, where they purchase cigarettes from wholesalers and retailers in quantities of 299 or fewer cartons at a time, since records of larger sales are kept for inspection by the Bureau of Alcohol, Tobacco, and Firearms. Others buy cigarettes from Indian reservations in New York State. A typical smuggler might pay \$11 for a carton of premium-brand cigarettes and get \$15 from a retailer, who would then sell it for \$18 or \$19, compared to more than \$22 for fully taxed cigarettes.<sup>78</sup>

Smugglers who can avoid federal as well as state taxes stand to make

even more money. A 1994 report by Lindquist Avey MacDonald Baskerville estimated that untaxed cigarettes—which are smuggled from Mexico or diverted from duty-free shops, export shipments, or other untaxed sources—accounted for about 6 percent of U.S. consumption. One sign that smuggling is on the rise: Department of Agriculture figures indicate that exports of U.S. cigarettes to Mexico increased by a suspicious 2,424 percent between 1990 and 1994. Most of these tax-free cigarettes were presumably smuggled back into the United States. In California, just across the border, the state Board of Equalization estimated that 7 percent of the cigarettes sold in 1994 were contraband. A spokesman said smuggling “keeps getting worse every month.”<sup>79</sup>

If Mexico offers one reason to be cautious about raising cigarette taxes, our neighbor to the north offers another. In Canada, where the national government sharply increased cigarette taxes in 1989 and 1991, the consequences precipitated a crisis and a dramatic policy reversal. Before taxes were cut, a legal carton of cigarettes in Canada sold for about \$45, compared to between \$15 and \$20 in the United States.<sup>80</sup> Because of this big gap, smuggling by individuals and groups, including Mohawks operating out of reservations along the U.S.–Canadian border, rose dramatically. Smugglers brought in cigarettes and tobacco on boats and kayaks, in trucks carrying produce, on snowmobiles, even inside the bodies of cars and vans.<sup>81</sup> The number of contraband tobacco seizures by the Royal Canadian Mounted Police jumped from 303 in 1990 to 5,033 in 1993.<sup>82</sup>

A January 1994 story in the *New York Times* described Cornwall, Ontario, a small town near the Akwesasne Reserve along the border with New York State, as “Dodge City East” because of the violence associated with cigarette smuggling. “Shootings erupt almost nightly,” the *Times* reported. “In recent weeks cars have been torched with firebombs, shots have been fired into a civic complex on the waterfront and at a building housing the radio station, and the hallway outside a pool hall has been bombed.”<sup>83</sup>

By 1994 one-third of the cigarettes sold in Ontario and two-thirds of the cigarettes sold in Quebec were said to be contraband (either smuggled from the United States or diverted from Canadian exports).<sup>84</sup> Canadians bought the black-market cigarettes on the street, at flea mar-

kets, and in bars, restaurants, and convenience stores. Many merchants started keeping double inventories, with legal cigarettes on display and tax-free smokes below the counter. In January 1994, seventy-five retailers in St. Eustache, Quebec, defied police by openly selling contraband cigarettes. Hundreds of customers lined up for cigarettes at half the legal price. No arrests were made.<sup>85</sup>

In response to the smuggling, the violence, and the citizen rebellion, Prime Minister Jean Chretien announced big tax cuts in February 1994. “Smuggling is threatening the safety of our communities and the livelihood of law-abiding merchants,” he said. “It is a threat to the very fabric of Canadian society.” Solicitor General Herb Gray added: “Organized crime has become a major player in the contraband market. What we are seeing is a frightening growth in criminal activity. We are seeing a breakdown in respect for Canadian law. Canadian society is the victim.”<sup>86</sup>

You might think that Canada’s experience would give pause to people who want the price of cigarettes to be doubled or tripled. But John Banzhaf, who’d like to see a tax of about four dollars a pack, is not very concerned. “Are we going to have somewhat of a problem?” he says. “Sure. But we already have a problem with smuggling with all of the other drugs. Cigarettes, by and large, are harder to smuggle. They’re a lot bulkier. The amount of space that it takes to bring in a kilo of coke is less than [you’d need] for a carton of cigarettes. So that’s not going to be very profitable.” Since the number of Americans who smoke cigarettes every day is more than a hundred times the number who use cocaine every day, smugglers might disagree.<sup>87</sup>