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**ANALYSIS OF THE IMPACT OF AN INCREASE
IN THE WISCONSIN CIGARETTE EXCISE TAX**

FOR THE:

**WISCONSIN PETROLEUM MARKETERS &
CONVENIENCE STORE ASSOCIATION**

BY:

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GOALS OF THE REPORT

The Wisconsin Petroleum Marketers & Convenience Store Association (WPMCA) engaged Donna M. Anderson, PhD from the University of Wisconsin-LaCrosse, and William D. Keip, president of Keip Government Solutions, to review the impact of an increase in Wisconsin's cigarette excise tax. Dr. Anderson and Mr. Keip were engaged to estimate the potential decrease in cigarette packs sold legally resulting from an increase in the cigarette excise tax, estimate the impact of a decrease in cigarette packs sold legally on state tax revenues, predict revenue losses to convenience stores, illustrate the impact of cigarette excise taxes on urban and extreme rural areas, and discuss cigarette sales smuggling, cigarette excise tax regressivity and product substitution.

EXECUTIVE SUMMARY

The January 2008 \$1.00 per pack cigarette state excise tax increase together with the \$0.62 Federal excise tax increase and the proposed \$0.75 per pack increase in the Wisconsin 2009-2011 budget bill represent a 308 percent change to the tax rate, raising the average carton price to \$64.50. Considering that the state excise tax was raised less than 18 months ago and the Federal Excise tax was raised in April 2009, this report recommends that the cigarette excise tax should not be re-visited for seven significant reasons:

1. Cigarette excise tax rate increases do not produce the desired revenues. A 42.0 percent increase in the cigarette excise tax rate would result in only a 6.8 percent increase (\$50.5 million) of total tax revenues in Fiscal Year 2010.
2. Cigarette excise taxes are an unreliable, declining and unstable funding source. Smoking bans, a national trend to stop smoking, product substitution, smuggling, and cross border sales are the major factors in making it difficult to accurately project cigarette excise tax revenues.
3. Raising cigarette excise taxes is bad public policy. Structural deficits, such as those facing Wisconsin, cannot be solved by relying on a declining tax source to fund services whose costs continue to increase.
4. Cigarette excise taxes target low-income consumers and are regressive. Such taxes single out those least able to afford to pay.
5. Smokers have options: Border Sales, the Internet, military bases and Native-American owned retail outlets. While the State of Michigan has a higher state excise tax rate, Wisconsin smokers can travel to the remaining Border States to obtain lower taxed cigarettes.
6. Cigarette excise tax increases have a negative effect on Wisconsin retailers. An increase will lead to lower sales, therefore reducing their profits.
7. Higher cigarette excise taxes result in increased crime. Various studies and reports illustrate the relationship between high tax rates and increased crime.

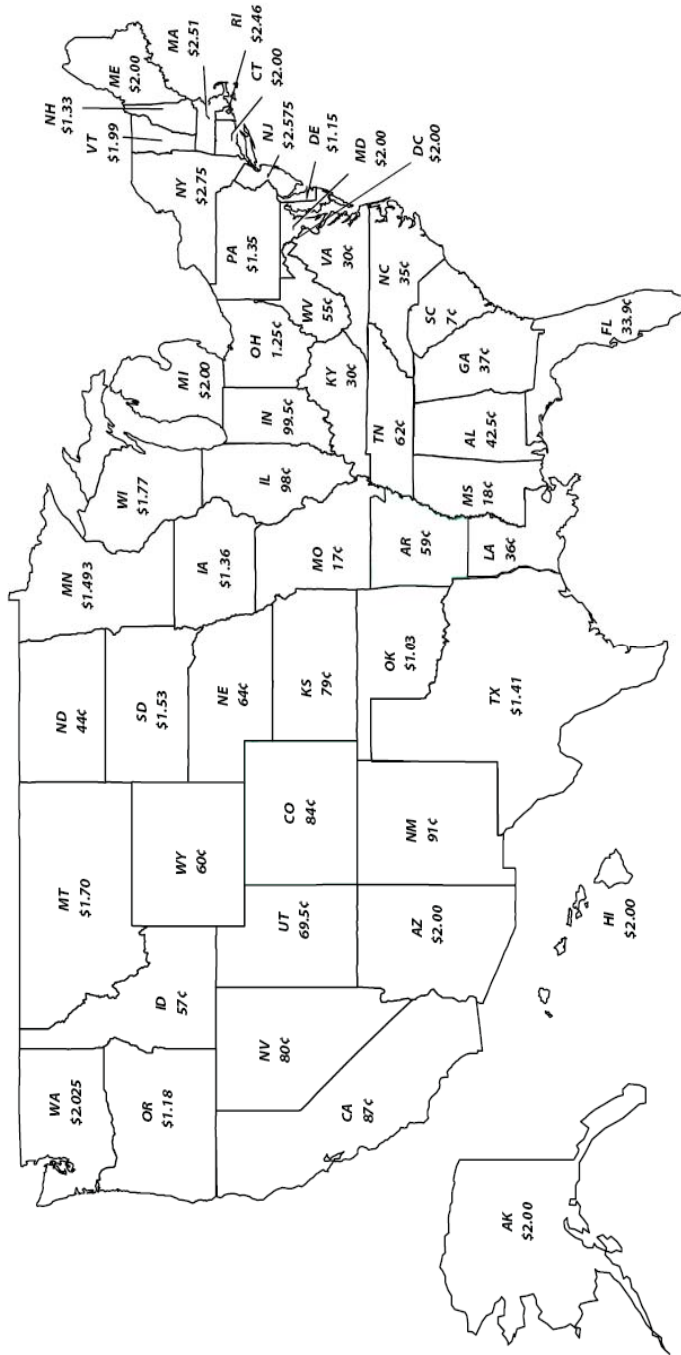
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U.S. MAP OF CIGARETTE EXCISE TAX RATES

Source: Tax Burden on Tobacco 2007 - Orzechowski and Walker

State Cigarette Excise Tax Rates

(As of January 1, 2009)



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EXCISE TAX RATES AND TAX REVENUES BY STATE

State by State Analysis of Tax Rates and Tax Revenues - 2009										
	Cig tax		Tax			Cig tax		Tax		
	Rate		revenues			Rate		revenues		
	(dollars)	Rank	(million)	Rank		(dollars)	Rank	(million)	Rank	
AK	\$2.000	6	\$64.5	40	MT	\$1.700	9	\$85.6	38	
AL	\$0.425	35	\$153.5	28	NC	\$0.350	38	\$233.8	20	
AR	\$0.590	31	\$128.9	32	ND	\$0.440	34	\$20.9	50	
AZ	\$2.000	6	\$397.2	14	NE	\$0.640	28	\$71.8	39	
CA	\$0.870	23	\$963.1	4	NH	\$1.330	15	\$161.2	27	
CO	\$0.840	24	\$197.8	24	NJ	\$2.575	2	\$764.7	7	
CT	\$2.000	6	\$331.9	17	NM	\$0.910	22	\$61.0	41	
DC	\$2.000	6	\$22.9	49	NV	\$0.800	25	\$130.0	31	
DE	\$1.150	18	\$118.7	33	NY	\$2.750	1	\$959.6	5	
FL	\$0.339	39	\$410.9	13	OH	\$1.250	16	\$927.9	6	
GA	\$0.370	36	\$217.6	23	OK*	\$1.030	19	\$225.3	21	
HI	\$2.000	6	\$101.6	36	OR	\$1.180	17	\$222.9	22	
IA	\$1.360	13	\$234.1	19	PA	\$1.350	14	\$1,031.9	3	
ID	\$0.570	32	\$47.8	46	RI	\$2.460	4	\$113.5	34	
IL	\$0.980	21	\$603.8	8	SC	\$0.070	43	\$27.5	47	
IN	\$0.995	20	\$515.8	9	SD	\$1.530	10	\$60.3	42	
KS	\$0.790	26	\$113.5	34	TN	\$0.620	29	\$265.8	18	
KY	\$0.300	40	\$179.5	25	TX	\$1.410	12	\$1,507.3	1	
LA	\$0.360	37	\$135.9	30	UT	\$0.695	27	\$57.5	43	
MA	\$2.510	3	\$419.6	12	VA	\$0.300	40	\$170.3	26	
MD	\$2.000	6	\$343.7	16	VT	\$1.990	7	\$57.3	44	
ME	\$2.000	6	\$145.4	29	WA	\$2.025	5	\$421.1	11	
MI	\$2.000	6	\$1,055.9	2	WI	\$1.770	8	\$460.4	10	
MN	\$1.493	11	\$394.5	15	WV	\$0.550	33	\$112.4	35	
MO	\$0.170	42	\$100.1	37	WY	\$0.600	30	\$24.8	48	
MS	\$0.180	41	\$49.2	45						

Source: Tax Burden on Tobacco 2009 - Orzechowski and Walker

*Not considered a border state as only the Upper Peninsula is contiguous to Wisconsin

Wisconsin and Border states are in **RED**.

Wisconsin ranks eighth in tax rate ranking while the two highest states for tax revenues are Texas, followed by Michigan. If the \$0.75 increase is approved, Wisconsin tax rate ranking would move from eighth to third in the nation.

Indiana, Iowa Illinois and Minnesota have lower tax rates than Wisconsin, so it is fair to say that a portion of their tax revenues were derived from Wisconsin smokers who travel to obtain the lower cigarette prices.

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REASONS TO OPPOSE A CIGARETTE EXCISE TAX RATE INCREASE

Cigarette excise tax rate increases do not produce the desired revenues

Chart 1 shows the estimated impact of the potential increase in the Wisconsin cigarette excise tax on taxable cigarette sales and state tax revenues in Wisconsin. Our estimates reflect a combination of decreased smoking by Wisconsin cigarette smokers and lost sales due to internet purchases, cross-border purchases and other methods of purchasing cigarettes outside of Wisconsin retailers.

CHART 1 - ESTIMATED IMPACT OF CIGARETTE EXCISE TAX

	FY ending 6/30/2008	FY ending 6/30/2009	FY ending 6/30/2010	FY ending 6/30/2010
		Federal Excise Tax Effect	Federal Excise Tax Effect	State Excise Tax Effect
Cigarette Excise Tax	\$1.77	\$1.77	\$1.77	\$2.52
Federal Excise Tax	\$0.39	\$1.01	\$1.01	\$0.39
Sales Tax per Pack	\$0.25	\$0.27	\$0.28	\$0.28
Cigarette Sales in (packs)	376,100,000			
Estimated Decline in Legal Packs Sold resulting from Federal Excise Tax Increase of \$0.62 beginning 4-1-09		-11,959,980 (12.72% decline)	-35,879,940 (12.72% decline)	
Subtotal of Estimated Cigarette Sales (packs)		364,140,020	328,260,080	
Estimated Decline in Legal Packs Sold resulting from Cigarette Excise Tax Increase of \$0.75 beginning 7-1-09				-44,752,808 (12.29% decline)
Total Estimated Cigarette Sales (packs)	376,100,000	364,140,020	328,260,080	283,507,272
Cigarette Excise Tax Revenue	\$455,722,000	\$644,527,835	\$581,020,342	\$714,438,324
Cigarette Sales Tax Revenue	\$94,401,100	\$98,317,805	\$91,912,822	\$79,382,036
Loss in Tie-In Sales Tax Revenue		(\$167,440)	(\$502,319)	-\$626,539
Total State Tax Revenue	\$550,123,100	\$742,678,201	\$672,430,845	\$793,193,821
% Change in Total State Tax Revenue		35.00%	-9.46%	6.80%
*Federal Tax applies to four months of Fiscal 2009 and twelve months of Fiscal 2010			25.54%	

An increase of \$0.75 would represent a 308 percent increase in Federal and State cigarette excise taxes in less than 20 months.

The Federal tax has increased by 159.0 percent while the state tax would increase by 42.0 percent and the effect on Wisconsin cigarette-related tax revenues of the combined tax increase is to raise revenues by only 32.3 percent. Further the effect of the 159.0 percent Federal tax increase will increase Wisconsin cigarette-related tax revenues by only 25.5 percent while the effect of the 42.0 percent state tax increase will increase Wisconsin cigarette-related tax revenues by only 6.8 percent, or \$50.5 million .

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The extremely small impact of this state excise tax increase calls into question the wisdom of such a tax. The ability to escape the tax through purchases of non-state tax cigarettes significantly reduces the effectiveness of the tax. Given the resources devoted to implementing and enforcing the tax, and the negative effect on convenience stores, other revenue-raising alternatives are recommended.

Cigarette excise taxes are an unreliable, declining and unstable funding source.

Nationally, cigarette tax revenues are affected by statewide smoking bans, a national trend to quit smoking, product substitution as a result of the higher retail cost of a pack of cigarettes and higher fuel costs that reduce disposable income. Increased smuggling and counterfeiting of cigarette tax stamps also result in lower cigarette excise tax revenues.

Compounding this downward trend is the increase in the cigarette excise tax rate. Unfortunately, as cigarette excise tax rates increase, the expected new revenues fall short of projections, resulting in lawmakers searching for additional cigarette tax hikes or other revenue sources to make up the shortfall.

As with all products, cigarettes are susceptible to “elasticity”. Price elasticity of demand is the responsiveness of quantity demanded to a change in price, with all other factors held constant. Cigarette sales are more elastic than cigarette consumption. Numerous studies have shown that when tax rates are increased, the increase in tax revenues is less than a dollar for dollar relationship. State revenue estimators find it difficult to project the elasticity, and therefore the new revenues, resulting in missed projections.

Wisconsin revenue estimators are not immune to the difficulties of estimating cigarette excise tax revenue. Projections become more difficult as tax rates climb, as smoking bans are enforced, as fuel prices rise and reduce disposable income and as more customers are forced to shop for low-tax cigarettes from legal and illegal sources. As with any study of this nature, it is plausible that other estimates, using different assumptions, will result in different revenue projections. Results of the January 2008, 130% state excise tax rate increase will be known by June 30, 2009. The model used herein represents the current State of Wisconsin tax and consumption scenario resulting in the estimates contained in this report. We believe that future increases will lead to a greater percentage decrease in sales, due to a higher base rate, an increased rate disadvantage with Border States, and the magnitude of recent rate increases relative to historical changes.

Budget officials anticipate that some actual tax collections will meet or exceed estimates while other tax categories will not meet estimates so that, on the average, actual revenues will meet estimates. The difficulty of estimating cigarette excise tax revenues, combined with the declining tax base and Wisconsin’s pending statewide smoking ban can compound the problem of meeting revenue estimates.

At best, tax increases are an imprecise tool. Case in point: all 50 states have excise taxes on cigarettes. But of the 40 that increased them between fiscal years 2003 and 2005, only eight met or exceeded revenue projections. Of the 32 that fell short, New Jersey missed by the largest margin, 67%, followed by Wyoming at 59% and Connecticut at 43%. (Challenges Ahead For Tobacco, January 2009)

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Ideally, government services are funded by growing, stable, reliable funding sources. Government program costs increase as more recipients become eligible and the costs to provide the services increase. Cigarette excise taxes are an unreliable, declining and unstable funding source.

Supporting Documentation/Citations

Last year New Jersey became the first state to see an actual reduction in cigarette tax revenues in the same year the tax rate increased. In fiscal year 2007, the year the tax rate was increased, the cigarette tax raised \$22 million less than the previous year. Conventional wisdom was proven wrong: ***A tax increase doesn't result inevitably in a revenue gain.*** Conventional wisdom also holds that while total cigarette sales might fall in the first year of a tax hike, they will stabilize or rebound in the succeeding year. That assumption has been proven wrong, too. In the second year following New Jersey's most recent tax hike, total sales continued to decline, as did tax revenues. So, as a result of a tax increase, ***New Jersey actually lost almost \$24 million in revenues.*** The anti-smoking hysteria that infects many high-tax advocates blinded them to economic realities. They believed only a small portion of smokers were price-sensitive. In fact, many smokers are price-sensitive. Some quit, but more opt to shop in cheaper venues. Bricks-and-mortar New Jersey cigarette sellers are losing purchasers to stores in other states, the Internet, and even the black market. Since these venues don't collect New Jersey taxes (or any taxes at all in some cases), ***the state is losing revenues.*** (The Heartland Institute, NJ Cigarette Tax Hike Reduces...., December 2008)

Cigarette taxes are an ***unstable source of revenue***, especially as higher prices force smokers to seek cigarettes through cheaper avenues including the black market. (Freedom Works, Here We Go Again....March 2008)

Reduced tobacco consumption, cigarette smuggling, and counterfeiting of cigarette tax stamps have regularly resulted in ***tobacco tax revenues failing to meet projections.*** (Heartland, Tax Hikes Often.....April 2008)

But many economists point out higher taxes and smoking bans reduce consumption, making tobacco revenue an ***unreliable funding source***. A 2007 study by the American Shareholders Association found the average state cigarette tax rate has more than ***doubled in the past seven years, from 42 cents to 92 cents a pack. Tobacco tax collections increased only 59 percent*** over that period. (Heartland, Tax Hikes Often.....April 2008)

Cigarette taxes are an inefficient and undependable source of funding because of their narrow tax base and the declining use of cigarettes. ***They rarely raise the revenues projected for them.*** As a result, smokers and non-smokers alike are often called upon to foot the bill as legislators scurry around in search of additional revenue. A recent National Taxpayers Union study found, "Taxpayers face a seven out of 10 chance of seeing another net annual tax hike within two years of a tobacco tax hike." (Heartland, Raising NH Cigarette Tax... October 2008)

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Revenue estimates are rarely met, causing budget problems. The inaccuracy of revenue estimates for tobacco tax hikes obviously creates difficulties for state fiscal planning. "Cigarette taxes are already an **unreliable revenue source**," said Scott Hodge, President of the Tax Foundation, "and that unreliability will surely get worse as tax rates climb and more customers are forced to shop for low-tax cigarettes from legal and illegal sources." (Tax Foundation, As Cigarette Taxes Rise....June 2005)

When the price of cigarettes goes up, demand drops substantially. And increasing cigarette excise taxes is one way to cause the price of cigarettes to go up; most research suggests that cigarette companies pass the full amount of the tax increases through to consumers in the form of higher prices. (Center on Budget and Policy Priorities, Cautions and Considerations, July 2002)

The state (NJ) anticipates a \$149.2 million reduction in cigarette tax revenue based on the 35 cent tax increase. This is most curious considering the state has had revenue increases each year from the cigarette tax up until now..... Aside from the loss in tax revenue, can the state afford the extra costs associated with law enforcement to combat the additional smuggling rings and the unsavory characters this "revenue raiser" reducer will bring to the state? (Enlighten-New Jersey blog March 2006)

Raising cigarette excise taxes is bad public policy

We understand that cigarette taxes are easier to sell to Wisconsin taxpayers. We further understand that Wisconsin faces a continuing struggle to live within its means. Structural deficits, such as those facing Wisconsin, result when states cannot support ongoing expenditures with current tax revenues. However, cigarette tax increases are not the magic bullet to solve Wisconsin's financial difficulties.

The National Conference of State Legislatures (NCSL) is a bipartisan organization that serves the legislators and staffs of the nation's 50 states, its commonwealths and territories. NCSL provides a report entitled "Principles of a High-Quality State Revenue System", the work of a group of legislators and legislative staff convened in 1985 by the NCSL and the Lincoln Institute of Land Policy. The report has served over the years as a guide for evaluation and modification of existing state and local revenue systems. A hike in the cigarette excise tax violates Principle #2 which states "A high-quality revenue system produces revenue in a reliable manner. Reliability involves stability, certainty and sufficiency." Cigarette excise taxes are not a stable source of revenue, are uncertain, and are not a sufficient source of revenue. Cigarette excise taxes are inconsistent with a high quality tax system. A tax hike also violates Principle #4 which states "A high-quality revenue system treats individuals equitably. Minimum requirements of an equitable system are that it imposes similar tax burdens on people in similar circumstances, that it minimizes regressivity, and that it minimizes taxes on low-income individuals." Cigarette taxes are regressive and do not minimize taxes on low-income individuals.

We suggest that it is bad public policy for state officials to be dependent on the smoking habit, the dwindling minority of people who actually smoke and on unreliable, unstable revenue such as the cigarette excise tax to fund essential state services.

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Supporting Documentation/Citations

Cigarette tax hikes *may encourage other increases* because the extra revenue often is tied to specific spending schemes (National Taxpayers Union, Study Snuffs out..... March 2008)

Politically, it's a great deal *easier to sell a tax on bad habits* than to increase taxes on hard-earned income (Heartland, Chicago Cigarette Tax Hike.... June 2004)

Combined with this political opportunism is an element of sheer hypocrisy. *The state is making itself as dependent on smoking as the dwindling minority of people who actually smoke.* And for the tax to raise revenue, the state needs to tax the poor. (Boston Herald, Cigarette Tax Burns Poor, April 2008)

The trend has developed because it is easy for politics to trump policy--and *there are few classes of citizens with less political power than smokers.* Politicians have been simultaneously unwilling to forego spending or raise broad-based taxes (i.e. taxes on sales or income) to pay for it, so they force smokers in many states to pick up the bill (Tax Foundation, Arizona is Hooked on.....September 2006)

If Prop 203 passes, Arizona will once again shoulder the burden of expanding government on a narrow and relatively poor base of its citizens in the short-term, while putting pressure on an increase in broad-based taxes in the long-term. *There are very few public finance economists who will say that such a trend is consistent with the economic principles of sound tax policy.* (Tax Foundation, Arizona Is Hooked On....September 2006)

From a policy standpoint, the proper role for cigarette taxes is only to compensate for what economists call "negative externalities" from smoking, such as increased health costs to taxpayer-funded healthcare systems. *There is little justification for relying on cigarette taxes as a general revenue source.* (Tax Foundation, Who Will Pay? April 2007)

Raising taxes on tobacco products is an easy political sell because tobacco tax revenue benefits all taxpayers but *only a minority of people must pay any significant amount of the tax.* (Tax Foundation, Tobacco Taxes Fastest.....May 2007)

State lawmakers have often used a legislative trick to enact steep tax hikes on tobacco: *linking a cigarette tax hike to a popular spending program that they want to take credit for.* Usually the spending program has nothing to do with smoking. This is exactly what is happening at the federal level now, as Congress proposes to link cigarette taxes to a popular health insurance program, the State Children's Health Insurance Program (SCHIP). (Tax Foundation, State Tobacco Tax Rates Have....July 2007)

The new spending commitments will be permanent and rapidly expand, while the revenues from tobacco taxes will decline (Tax Foundation, Cigarette Taxes Approaching..... September 2007)

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There certainly is a role for states to play in increasing cigarette taxes in order to discourage smoking. As noted, states also find raising cigarette taxes a convenient way to close budget gaps or even support new programs. States considering these actions, however, should be mindful of some problems associated with cigarette excise tax increases, including the effect on revenue stability and adequacy over time and the impact of higher taxes on lower-income residents. ***Cigarette taxes may not be an appropriate revenue source for every purpose because the revenue from cigarette taxes declines rather than grows over time.*** (Center on Budget and Policy Priorities, Cautions and Considerations, July 2002)

State financial problems develop when cigarette taxes are used — and particularly if they are earmarked — to fund education, health services, or other programs that inevitably grow in cost over time as a result of inflation, population growth, and other factors. ***A revenue source that declines over time cannot support a program that naturally increases in cost over time.*** (Center on Budget and Policy Priorities, Cautions and Considerations, July 2002)

Excise taxes are one of several elements in the revenue systems of the various states that generally do not grow in tandem with the economy. ***When states rely on substantial amounts of revenues that do not grow adequately, they develop what is known as “structural deficits.”*** If a state has a structural deficit, it cannot support the normal year-to-year growth in its expenditures and thus must either reduce spending or raise tax rates in most years — even when the economy is healthy and not in recession. A majority of states have such structural deficits. (Center on Budget and Policy Priorities, Cautions and Considerations, July 2002)

Cigarette excise taxes target low-income consumers and are regressive

Cigarette excise taxes single out a small segment of the population. Numerous reports show that higher cigarette excise taxes and *proposed tax hikes will be paid by those least able to afford to pay.* A greater proportion of the tax is paid by lower income consumers, and therefore a greater share of any tax increase will be borne by low-income consumers. Cigarette excise tax increases result in a redistribution of wealth from poor smokers to affluent non-smokers.

Lower income Wisconsin consumers are more likely to be smokers. A cigarette excise tax increase of any amount would be paid by *one fifth of Wisconsin’s adult population,* is unfair, taxes the poor, and some would argue that an increase in cigarette excise taxes results in balancing the budget on the backs of the poor.

To illustrate, a Wisconsin smoker with a median household income of \$38,400 currently pays \$1,124.00 in cigarette excise and sales taxes annually, an amount approaching the \$1,328.00 remitted for the Wisconsin Personal Income tax. If the \$0.75 increase was enacted, annual cigarette excise tax and sales taxes would *exceed the state income tax obligation by over \$200.00.* The variance is larger if a smoker’s estimated contribution to the cigarette settlement is included. *This means Wisconsin smokers would pay more cigarette excise and sales taxes than Wisconsin income taxes if the \$0.75 is approved.*

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Supporting Documentation/Citations

Wisconsin families earning less than \$18,000-**the poorest fifth** of Wisconsin non-elderly taxpayers-pay 10.2% of their income in Wisconsin state and local taxes which is **almost twice** the share the top 1% pay. (Institute on Taxation and Economic Policy, January 2003)

Like many other popular ways of raising government revenue, excise taxes on tobacco are regressive. In fact, tobacco taxes are more regressive than almost any other tax. **People with lower incomes spend a larger share of income on tobacco products than the wealthy.** If rich and poor people consume the same amounts of a good, the poor necessarily spend a greater portion of their income on that good. But in the case of tobacco, smokers are much more likely to have lower income than nonsmokers, making the regressivity problem even worse. (National Center for Policy Analysis, Taxing The Poor, June 2007)

Almost 29 per cent of adults with income of less than \$15,000 are smokers; by contrast, only 17.2 percent of people with incomes higher than \$50,000 smoke. Nearly 40 percent of people with only a GED certificate are smokers; just 11.7 percent of people with a college degree - and 8 percent of people with a graduate degree - are smokers. (National Center for Policy Analysis, Taxing The Poor, June 2007)

People in the **bottom 20 percent of income earners**, as a group, spend 2.33 percent of their income on tobacco products, **more than 10 times the percentage of income** paid by the highest earners. (National Center for Policy Analysis, Taxing The Poor, June 2007)

Laborers and construction workers spend 1.0 percent and 1.1 percent of their income on tobacco products, respectively, versus **just 0.24 percent for managers and professionals.**

On the average, **laborers and construction workers spend far more per year** on tobacco products (\$445 and \$557 respectively) **than managers and professionals** (\$211). (National Center for Policy Analysis, Taxing The Poor, June 2007)

Some taxes, such as income and estate taxes, fall heavily on upper-income households, while others—such as **cigarette, payroll and sales taxes—fall more heavily on low incomes.** (Tax Foundation, Which Taxes Weigh Most..... March 2007)

While the Governor's plan to boost education spending may be well intended, by funding the Schools First initiative through tobacco taxes rather than general sales taxes, it will **make low-income households in Tennessee much worse off** that they could otherwise be. Because the Governor's proposal relies almost entirely on cigarette tax revenue, at least three components of the plan have the perverse effect of redistributing millions of dollars from low-income to upper-income households in the state of Tennessee. (Tax Foundation, Who Will Pay Taxes..... April 2007)

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Statistics demonstrate that smokers tend to be concentrated in **lower-income groups**, which means if the Oklahoma Legislature were to pass yet another tobacco tax lawmakers truly would be trying to “**balance the budget on the backs of the poor.**” (OK Council of Public Affairs, Six Reasons...November 2003)

And, as is always the case with so-called "sin" taxes, Cook County's new cigarette tax will **hurt poor Chicagoans** the most (Heartland, Chicago Cigarette Tax Hike.....June 2004)

These taxes are a notoriously volatile source of revenue and unduly burden **low-income citizens.** (Heartland, Raising New Hampshire's.....October 2008)

In California, a state famous for its progressive politics, a proposition on the Nov. 7, 2006 ballot includes a **shockingly regressive tax on the state's poorest residents.** Unfortunately, that's the reality behind Proposition 86—an initiative that aims to cut smoking through a dramatic hike in the state's cigarette tax, from 87 cents to \$3.47 a pack, the nation's highest rate. It's nice to pretend that cigarette taxes come out of the hides of Big Tobacco. **But it's mostly low-income groups** who take it on the chin when cigarette taxes rise. Low-income Californians are much more likely to be smokers, and as a group they spend a lot more on cigarettes than the wealthy as a percentage of their income. One recent analysis of U.S. Census data found that tobacco taxes take a 50-times-larger share of income from those earning less than \$20,000 than those earning more than \$200,000. That makes cigarette taxes the **most regressive way** of funding state government programs (Tax Foundation, California Cigarette Tax..... October 2006)

Cigarette taxes generally are viewed as **highly regressive**; that is, they absorb a much higher proportion of the incomes of lower-income households than of higher-income ones. This is still another reason why caution should be exercised in using cigarette taxes as a revenue source. (Center on Budget and Policy Priorities, Cautions and Considerations, July 2002)

Low-income people are more likely to smoke than higher-income people. One study of smoking behavior in 1995 shows that 28.8 percent of people with family incomes below \$15,000 and 27.2 percent of people with family incomes between \$15,000 and \$25,000 smoked, as contrasted with 17.2 percent of people with incomes above \$50,000. (Center on Budget and Policy Priorities, Cautions and Considerations, July 2002)

Cigarettes also appear to **absorb a larger proportion of the budgets of lower-income** people than of higher-income people, who make many different kinds of discretionary purchases and who tend to save a significant portion of their income. According to one study, cigarette expenditures amount to 3.2 percent of the income of people in the bottom fourth of the income distribution, but only 0.4 percent of the income of people in the top fourth of the income distribution. Other studies have found similar results. (Center on Budget and Policy Priorities, Cautions and Considerations, July 2002)

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The Massachusetts House voted last week to raise the cigarette tax by a dollar – making it \$2.51 per pack, the third highest such tax in the country.... The tax increase will be **steeply regressive**. As a fraction of disposable income, the burden of the new tax on households making less than \$20,000 a year will be almost nine times the burden on those making \$50,000 or more (Boston Herald.com, Cigarette Tax Burns the Poor, April 2008)

Cigarette taxes have long been known to be a regressive revenue source. Lower-income households generally smoke at higher rates than upper-income households, and they spend a much larger fraction of their income on tobacco products. As a result, the burden of cigarette taxes falls most heavily on households toward the bottom of the income scale (Tax Foundation, Who Will Pay Taxes.... April 2007)

Tobacco taxes are regressive (OK Council of Public Affairs, Six Reasons... November 2003)

Cigarette taxes are bad tax policy particularly because they **single out a small segment of the population**, thereby giving non-smokers the misperception that these increases won't affect them. Cigarette and other "sin" taxes are a bad fiscal policy that nevertheless appeals to politicians wanting to raise revenue without angering most taxpayers. (Heartland Institute, Raising the NH Cigarette....October 2008)

Charts 2A and 2B provide evidence of the regressive nature of cigarette taxes. According to research using data from all states from the Tax Foundation¹, and Wisconsin-specific data from the *Wisconsin Medical Journal*², the burden of cigarette taxes falls disproportionately on lower-income individuals.

Chart 2A displays the estimated percentage of total taxes paid by income quintiles. The bottom quintile pays two percent of their total taxes on cigarette excise taxes while those in the top quintile pay only one tenth of one percent of their total taxes on cigarette excise taxes. Median household income for Wisconsin was \$46,142 for 2007.

This shows that an increase in the cigarette excise tax will disproportionately impact lower income families. In other words, the increase in the cigarette excise tax in Wisconsin will be regressive.

¹ Andrew Chamberlain, Gerald Prante. "Who Pays Taxes and Who Receives Government Spending? An Analysis of Federal, State and Local Tax and Spending Distributions, 1991-2004," Tax Foundation, (March 2007).

² David Ahrens, Priti Bandi, Jennifer Ullsvick, Paul Moberg. "Who Smokes? A Demographic Analysis of Wisconsin Smokers," *Wisconsin Medical Journal*, 104(4), (2005).

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CHART 2A CIGARETTE EXCISE TAX BURDEN BY INCOME QUINTILE

Chart 2a: Cigarette Excise Tax Burden by Income Quintile		
	Share of the State	Share of Quintile's
	Cigarette Tax Paid	Tax Burden Accounted
	By Each Income Quintile	For by the State
	Cigarette Tax	Cigarette Tax
Bottom Quintile	21.6%	2.00%
Second Quintile	23.1%	1.00%
Middle Quintile	21.8%	0.60%
Fourth Quintile	18.5%	0.30%
Top Quintile	15.0%	0.10%

CHART 2B – CIGARETTE EXCISE BURDEN BY INCOME AND GENDER

Chart 2B illustrates that lower income males and females smoke more cigarettes per day and therefore pay more in cigarette taxes per year, than those who earn over \$75,000 per year.

Chart 2b: Wisconsin Cigarette Excise Tax Burden by Income and Gender				
		Daily Average	Daily Average WI	Annual Average WI
Income/Gender	Smoking Rate	Cigarettes Consumed	Cigarette Tax Paid	Cigarette Tax Paid
\$10k-\$15k Male	32.00%	18	\$0.73	\$265
\$10k-\$15k Female	25.00%	14	\$0.44	\$161
\$15k-\$35k Male	28.00%	15	\$0.53	\$193
\$15k-\$35k Female	21.00%	12	\$0.32	\$116
\$35k-\$75k Male	22.00%	15	\$0.42	\$152
\$35k-\$75k Female	20.00%	13	\$0.33	\$120
>\$75k Male	13.00%	13	\$0.21	\$78
>\$75k Female	13.00%	11	\$0.18	\$66

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Options for smokers - Border Sales, the Internet, Military bases and Native-American owned retail outlets.

Smokers have options when it comes to purchasing cigarettes. Smokers can purchase tax free cigarettes at military bases, Native-American owned retail outlets and over the Internet. A logical result of higher Wisconsin cigarette excise taxes will be an increase in border sales in those Wisconsin counties with more desirable options outside of Wisconsin.

It is unlikely that smokers on the southeast border will visit Chicago, Illinois, as Chicago's local excise tax (coupled with the state tax and the Cook County excise tax) of \$36.66 per carton is higher than Wisconsin's current tax of \$17.70 per carton. However on the southwest border, the temptation to visit Illinois exists (the state tax is \$9.80 per carton). Wisconsin border counties also have access to lower cigarette excise tax rates in Minnesota and Iowa. For example, the savings per carton using Wisconsin's current tax is only \$2.80 if you visit Minnesota, but the savings per carton is \$4.10 in Iowa.

Supporting Documentation/Citations

Estimates show that there are over one billion Internet users worldwide and this growth in Internet use has fueled a corresponding increase in the e-commerce industry. Unfortunately, illegal Internet tobacco sales have also mirrored this rise in e-commerce. ***Some estimates point to a loss of almost \$14 billion in state revenue as a result of these remote sales.*** And, the ability of underage smokers to secure these products intended for adults is of tremendous concern as well. (American Wholesalers Marketers Association)

Retailers who own shops near the border ***will see cigarette sales drop*** (OK Council of Public Affairs, Six Reasons....November 2003)

In spite of large recent tax increases of the Illinois, Cook County, and Chicago cigarette taxes, some are proposing an Illinois cigarette tax hike of \$1/pack. This would raise the Illinois state tax to \$1.98 per pack. Illinois residents outside of Cook County could save \$18.10/carton in Missouri, \$16.80 in Kentucky and \$9.85 in Indiana. In Chicago the total state and local cigarette tax would be \$4.66/pack. ***A Chicago resident could save over \$44.90/carton in Missouri or over \$36/carton in Indiana.*** A van-load of cigarettes from Missouri would have a profit potential of nearly \$255,000. Such bootlegger incentives could create a situation reminiscent of the days of Al Capone. (Americans for Prosperity)

But the worst aspect of such condescension? It doesn't work very well. Punitive approaches such as higher cigarette taxes don't make smokers quit. ***They cause smokers to buy tax-free cigarettes on military bases, Indian reservations and over the Internet.*** Even with today's 87-cent tax, the California Board of Equalization says about 300 million untaxed packs of cigarettes are sold in the state each year—a figure that will boom if Proposition 86 passes. (Tax Foundation, California Cigarette Tax proposal.....October 2006)

Patrick Fleenor of the Tax Foundation says states that ***tax cigarettes at more than \$2 a pack "are getting close to that tipping point"*** where they may start to lose money from further tax increases. This is a special problem for those

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states -- such as California, Maryland and Wisconsin -- planning to raise cigarette taxes to pay for expanded government health-care coverage. (Tax Foundation, Cigarette Taxes Approaching..... September 2007)

In a 2006 survey, 27 percent of city smokers and 34 percent of smokers across the rest of the state **reported buying lower taxed or non-taxed cigarettes**. Outside of New York City, cigarettes often are easy to purchase on Indian reservations, and 75% of smokers buying lower taxed or non-taxed cigarettes outside New York City reported doing so. Among city smokers who purchased lower taxed or non-taxed cigarettes, 71% bought across state lines. (Tax Foundation, More Evidence Of Cigarette.....February 2008)

Politicians in Annapolis are scratching their heads wondering what happened to all those chain smokers who were supposed to help balance Maryland's budget. Last year the legislature doubled the cigarette tax to \$2 a pack to pay for expanded health-care coverage. Eight months later, cigarette sales have plunged 25% and the state is in fiscal distress again....**Residents of Maryland's Washington suburbs can shop in nearby Virginia, where the tax is only 30 cents a pack, and save at least \$15 per carton.....**Maryland is only the latest state to prove the folly of trying to finance government with a tax on a shrinking pool of smokers. In New York City and State, tobacco taxes have been raised so many times that the retail cost can exceed \$9 a pack -- about double the national average. Few budget-savvy smokers in the Big Apple pay that tax. Patrick Fleenor, an expert on tobacco taxes at the Tax Foundation, estimates that there is "now a 75% gap between cigarette sales in the city and cigarette consumption." In other words, **three out of four cigarettes are bought elsewhere or are contraband**. Out-of-state purchases, tax-free Internet sales and a cigarette black market are booming.....In New Jersey, about 40% of the Marlboros and Virginia Slims that are lit up escape the \$2.57-a-pack tax. (Wall Street Journal, Cigarette Tax Burnout, August 2008)

Tax Increases Threaten Retail Sales – Cigarette tax hikes are causing consumers **to turn to low tax states and the Internet. Cigarette tax hikes cause consumers to go Online**, where they can often avoid their own states' tax. According to the National Association of Convenience Stores (NACS) about \$5 billion of cigarette sales took place over the Internet in 2005 up from \$750 million in 2001. (Americans for Prosperity, The Effect of a 50-cent per-pack Cigarette Tax Hike on Kansas Retailers)

The vast majority of it (drop in sales) is smokers **shifting their purchases to tribal stores, the Internet, or the black market** to avoid paying any tax, or to neighboring states with lower tax rates.....The state Legislature and New York Gov. David Paterson decided in April 2008 to boost the excise tax as part of the state budget, ignoring warnings from the New York Association of Convenience Stores (NYACS) that it would merely trigger a new wave of tax evasion that would defeat the objectives of higher revenues and lower smoking rates....We can surmise that the lost revenue is now approaching a billion dollars annually....."These numbers confirm what we had predicted -- that due to the plague of cigarette tax evasion that our state has allowed to flourish, the June 3rd cigarette tax hike is self-defeating, and has succeeded only in crippling legitimate small business, chasing away much-needed tax revenue, promoting lawlessness,

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and thwarting anti-smoking initiatives," said NYACS President James Calvin (NY Association of Convenience Stores, Taxable Unit Sales of Cigarettes..... October 2008)

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WISCONSIN'S COMPETITIVE POSITION VERSUS BORDER STATES AT CURRENT TAX RATE AND THREE TAX INCREASES

WISCONSIN' COMPETITIVE ADVANTAGE/DISADVANTAGE OVER BORDER										
STATES AT WISCONSIN'S CURRENT TAX RATE AND THREE TAX INCREASES										
		WISCONSIN		WISCONSIN		WISCONSIN		WISCONSIN		
		ADV	DISAD	ADV	DISAD	ADV	DISAD	ADV	DISAD	
WI		At \$1.77		At \$2.02		At \$2.27		At \$2.52		
IN	\$0.995		77.9%		103.0%		128.1%		153.3%	
IA	\$1.360		30.1%		48.5%		66.9%		85.3%	
IL*	\$0.980		80.6%		106.1%		131.6%		157.1%	
MN	\$1.493		18.6%		35.3%		52.0%		68.8%	
* State tax of \$0.98 does not include Cook County \$2.00 excise tax rate nor Chicago \$0.68 tax rate										
Source: Tax Burden on Tobacco 2009 - Orzechowski and Walker										

Michigan not considered a border state as only the Upper Peninsula is contiguous to Wisconsin

Wisconsin's current tax rate is \$1.77 is compared to the current tax rates of Wisconsin's border states. Percentages in **BLACK** illustrate that Wisconsin has a competitive advantage over the border state, while percentages in **RED** illustrate where Wisconsin is at a competitive disadvantage.

At the current Wisconsin cigarette excise tax rate of \$1.77, Wisconsin is at a competitive **disadvantage** from 19 percent to 81 percent with all Border States.

If Wisconsin raises the current \$1.77 tax rate by 25 cents, we increase our competitive **disadvantage** to as large as 106 percent with Illinois.

If the Wisconsin tax rate is increased by 50 cents, our **disadvantage** over Indiana, Iowa, Illinois and Minnesota increase to a range of 52 percent to 132 percent.

If the Wisconsin tax rate is increased by 75 cents, our **disadvantage** over Indiana, Iowa, Illinois and Minnesota increase to a range of 69 percent to 157 percent.

Cigarette excise tax hikes have a negative effect on Wisconsin retailers

Wisconsin retailers are already impacted by some city and county smoking bans, resulting in lower sales and profits. An increase in the cigarette excise tax rate will result in higher retail prices for Wisconsin retailers. Wisconsin consumers pay the cigarette excise tax included in the retail price of a pack of cigarettes. The result is Wisconsin retailers' revenues are depressed as a result of lower cigarette sales. A loss of revenue and a loss of profits results in less state taxes to Wisconsin's coffers.

The Oil Franchise Tax proposal will exacerbate the problems faced by Wisconsin retailers as outlined by the Memorandum from the law firm of Foley & Lardner LLP which concludes that the no pass-thru provision will fail and that "oil companies will exit the Wisconsin market rather than incurring the cost of the tax..". They further conclude that "the price at the pump will increase" (supply down, demand unchanged). We believe that the Oil Franchise Tax proposal is a hidden tax on consumers, and when combined with the \$0.75 increase in the cigarette excise tax, this represents a "double-hit" on Wisconsin retailers.

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Under current state law, for sales that occur on reservations or trust lands, the tribes receive a refund of 100% of the excise tax on cigarettes sold to Native Americans and 70% of the tax on sales to non-Native Americans.

Tobacco sales are important to Wisconsin retailers. Wisconsin stores sold 334 million packs of cigarettes in FY 2008, with a gross retail value of nearly \$1.6 billion.

Tobacco sales support Wisconsin jobs. It is estimated that nearly 3,800 Wisconsin retailer and wholesaler jobs were supported by in-state tobacco sales. It is logical to assume that job losses will occur as cigarette excise tax hikes result in lost sales and lost profits. The consulting firm of Orzechowski and Walker estimate that 750 Wisconsin retailer and wholesaler jobs could be displaced due to the proposed 75 cent increase, and the 62 cent Federal Excise tax increase.

Wisconsin's has approximately 2,700 convenience stores (C-stores), all of which would be effected by a cigarette excise tax rate increase. Nationally, cigarettes comprise 34 percent of a typical C-store inside sales.

Supporting Documentation/Citations

The convenience store owner who *suffers lost profits when his customers buy fewer cigarettes* cannot make up the difference by stacking his shelves with caviar (Boston Herald, Cigarette Tax Burns the Poor, April 2008)

"When somebody comes in to buy cigarettes, they also buy other items in your retail establishment," says Professor Goss. So *not only do you lose cigarette sales, you lose sales of other retail items*, and he says it could be "quite significant" for those retailers. "As you raise the taxes, you get fewer and fewer consumers and the revenue base goes away." (Radioiowa.com, Economist Says Cigarette Tax.....January 2007)

The Illinois Policy Institute used the State Tax Analysis Mapping Program (STAMP) to assess the potential impact of Blagojevich's proposed 75-cent increase in the cigarette tax. It found:

- The state could lose as many as 7,878 jobs in 2006, and projected job losses over five years would reach nearly 50,000; *the retail industry would take the biggest hit, losing 5,914 jobs in 2006.*
- In just the first year the state would lose \$28 million in sales tax revenue and by 2010, the loss would climb to nearly \$36 million.
- Total losses in sales tax revenue would amount to \$198 million over the next five years.

These losses stem from the fact that smokers often buy other items when they purchase their cigarettes, like gas, milk and coffee, says Van Winkle. Peter Gill, spokesman for the Illinois Retail Merchants Association, says 40 percent of Illinois consumers live within a half hour of a state border, giving them easy access to stores in other states. (National Center for Policy Analysis, Illinois Dodges Cigarette Tax Hike, August 2005)

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Chart 3 reveals the estimated effect on the approximately 2,700 Wisconsin convenience stores, where an estimated 65 percent of taxed cigarette sales occur. Research conducted by Price-Waterhouse (1997) indicates that a consumer purchasing cigarettes at a convenience store spends an average of \$0.28 (per pack) on additional items, which the stores would lose due to the decline in cigarette sales.

Assuming convenience stores maintain this market share, they will sell approximately 26.2 million fewer packs of cigarettes if the excise tax is increased by \$0.75. This translates into \$19.7 million in lost profits in cigarette sales alone from the respective excise tax increases. Convenience stores will lose additional sales from goods that consumers normally purchase at the same time as they purchase cigarettes (“tie-in sales”). We estimate that they will lose an additional \$105.3 million in lost profits in tie-in sales resulting from the respective excise tax increases.

Thus, if Wisconsin increases its cigarette excise tax by \$0.75, Wisconsin convenience stores will lose an estimated \$55.5 million in total profits.

CHART 3 ESTIMATED IMPACT ON WISCONSIN CONVENIENCE STORES

Chart 3: Estimated Impact on WI Convenience Stores of Potential Increase in Cigarette Excise Tax

% Decline in Cigarette Packs Legally Sold	12.29%
Lost Cigarette Sales in WI	-\$198,942,301
Lost Cigarette Sales in WI Convenience Stores	-\$129,312,496
Lost Cigarette Profits in WI Convenience Stores	-\$19,746,018
Lost Cigarette Profits per WI Convenience Stores	-\$7,451
Lost Tie-In Sales in WI Convenience Stores	-\$105,308,000
Lost Profits in Tie-In Sales in WI Convenience Stores	-\$35,804,720
Lost Profits in Tie-In Sales per WI Convenience Stores	-\$13,511
Total Lost Profits in WI Convenience Stores	-\$55,550,738
Total Lost Profits per WI Convenience Store	-\$20,963

Effect on Wisconsin Bars and Taverns

If the higher excise tax causes cigarette prices to rise, smokers may stay home and not visit their local bar or tavern, therefore bar alcohol revenues will decline. Higher cigarette prices will cause some to quit smoking, reducing cigarette use, with such usage occurring while drinking alcoholic beverages. While smoking bans have reduced alcohol consumption at bars, smokers with limited disposable income that visit bars may reduce their alcohol purchases as they are paying more for cigarettes. The Executive Budget proposes a statewide smoking ban that would have an even more dramatic negative impact on bars and taverns.

Research evidence linking alcohol and cigarette consumption indicates that policies such as higher cigarette prices that reduce tobacco demand will also reduce alcohol demand, negatively impacting the tavern industry. Further, research indicates that a combination of higher cigarette taxes and smoking bans in taverns and bars creates a redistribution of tavern clientele towards nonsmokers, who consume less alcohol compared to smokers, causing further harm to this industry³.

³ Craig A. Gallet, Hyrum S. Eastman. “The Impact of Smoking Bans on Alcohol Demand,” *The Social Science Journal* 44 (2007).

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CIGARETTE EXCISE TAX RATE/REVENUE-20, 25, & 30 Years

WISCONSIN CIGARETTE TAX RATE AND REVENUE									
						Avg	Taxes Per		Per
						Per Capita	Retail	Rate	Packs
Year	Rate	Date	Taxes	Packs	Sales	Price	(mill)	per	Capita
FY	(Cents)	Changed	(mill)	(mill)	(Mill-pks)	(dollars)		rate	Sales
								(mill)	change
1979	\$0.16		\$88.0	547.9	117.1	\$0.587	\$5.5	34.24	0.3%
1980	\$0.16		\$89.3	555.1	117.6	\$0.612	\$5.6	34.69	0.4%
1981	\$0.16		\$90.8	564.3	119.9	\$0.649	\$5.7	35.27	2.0%
1982	\$0.25	8/81-5/82	\$110.3	548.2	115.6	\$0.750	\$4.4	21.93	-3.6%
1983	\$0.25		\$127.7	506.7	106.3	\$0.920	\$5.1	20.27	-8.0%
1984	\$0.25		\$126.6	503.5	105.6	\$1.008	\$5.1	20.14	-0.7%
1985	\$0.25		\$128.7	512.2	107	\$1.068	\$5.1	20.49	1.3%
1986	\$0.25		\$126.9	503.6	105.4	\$1.108	\$5.1	20.14	-1.5%
1987	\$0.25		\$128.9	510.6	106	\$1.163	\$5.2	20.42	0.6%
1988	\$0.30	0/1/87	\$147.7	496.2	102.6	\$1.286	\$4.9	16.54	-3.2%
1989	\$0.30		\$146.0	488.6	100.3	\$1.383	\$4.9	16.29	-2.2%
1990	\$0.30		\$140.8	463.1	94	\$1.511	\$4.7	15.44	-6.3%
1991	\$0.30		\$140.7	469.1	95.5	\$1.586	\$4.7	15.64	1.6%
1992	\$0.38	5/1/92	\$149.4	472.9	96.2	\$1.765	\$3.9	12.44	0.7%
1993	\$0.38		\$170.3	448.1	91.2	\$1.955	\$4.5	11.79	-5.2%
1994	\$0.38		\$177.4	466.8	91.8	\$1.786	\$4.7	12.28	0.7%
1995	\$0.38		\$180.5	475.0	93.5	\$1.880	\$4.7	12.50	1.9%
1996	\$0.44	7/1/95	\$202.0	471.0	92.1	\$2.005	\$4.6	10.70	-1.5%
1997	\$0.44		\$208.7	474.4	91.9	\$2.007	\$4.7	10.78	-0.2%
1998	\$0.59	11/1/97	\$252.0	457.9	88.7	\$2.108	\$4.3	7.76	-3.5%
1999	\$0.59		\$261.6	443.4	84.4	\$2.435	\$4.4	7.52	-4.8%
2000	\$0.59		\$251.6	426.6	80.1	\$3.128	\$4.3	7.23	-5.1%
2001	\$0.59		\$247.5	419.4	78.2	\$3.304	\$4.2	7.11	-2.4%
2002	\$0.77	10/1/01	\$293.5	408.3	75.3	\$3.846	\$3.8	5.30	-3.7%
2003	\$0.77		\$298.5	387.6	71	\$3.951	\$3.9	5.03	-5.7%
2004	\$0.77		\$296.1	384.5	69.9	\$3.813	\$3.8	4.99	-1.5%
2005	\$0.77		\$299.1	388.4	70.1	\$3.761	\$3.9	5.04	0.3%
2006	\$0.77		\$306.4	397.9	71.3	\$3.783	\$4.0	5.17	1.7%
2007	\$0.77		\$300.9	390.8	69.7	\$3.868	\$3.9	5.08	-2.2%
2008	\$1.77	1/1/08	\$460.4	376.1	66.7	\$4.093	\$2.6	2.12	-4.3%
	1006.3%	FY79-08	423.2%	31.4%	-43.0%	597.3%	-52.7%	-93.8%	
	608.0%	FY84-08	263.7%	25.3%	-36.8%	306.1%	-48.6%	-89.4%	
	490.0%	FY89-08	215.3%	23.0%	-33.5%	196.0%	-46.6%	-87.0%	

Source: Tax Burden on Tobacco 2009 - Orzechowski and Walker

We analyzed Wisconsin's cigarette excise tax rates, revenues and other metrics over 20, 25, and 30 years. The following conclusions result:

- Wisconsin's tax rate has increased from five times to ten times
- Wisconsin's tax rate has been increased three times since Fiscal Year 1995
- Excise tax revenues increased from over 200 percent to over 400 percent
- Packs sold legally have declined 23 percent to 31 percent
- Per capita sales of cigarettes declined 33 percent to 43 percent
- Taxes per rate (cents) have declined by 46 percent to 52 percent

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- The number of packs per rate (cents) has declined from a high of 35.3 million packs in 1981 to a low of 2.1 million packs in 2008
- In 19 of the past 30 years, Wisconsin experienced a decrease in per capita cigarette sales
- Total tax revenues have grown less than the increase in the tax rate, usually by half, and suggests that reduced consumption, border sales, the Internet, and smuggling have had an effect
- Pack sales, packs per rate and taxes per rate are down, suggesting that the cigarette excise tax is a declining revenue source
- After adjusting for inflation, Wisconsin's tax rate has increased over 400 percent from FY1988-2008

ANALYSIS OF A WISCONSIN CIGARETTE TAX INCREASE

WISCONSIN CIGARETTE TAX RATE INCREASES 1956-2008

ANALYSIS OF WISCONSIN CIGARETTE TAX RATE INCREASE 1956-2008								
Year	Rate	%	Date	Taxes	%	Packs	Per Capita Sales	Price
FY	(Cents)	CHG	Changed	(thous)	CHG	(mill)	(Mill-pks)	(cents)
1956	\$0.04	33.3%	07/01/55	\$14,786	34.4%	369.3	99.8	\$0.23
1957	\$0.04			\$15,414	4.2%	385.4	103	\$0.24
1958	\$0.05	25.0%	07/01/57	\$19,211	24.6%	384.2	101.1	\$0.26
1959	\$0.05			\$20,820	8.4%	416.4	107.8	\$0.26
1960	\$0.05			\$22,073	6.0%	441.8	112.8	\$0.26
1961	\$0.05			\$22,891		457.8	115.5	\$0.26
1962	\$0.06	20.0%	09/01/61	\$26,738	16.8%	445.6	110.8	\$0.27
1963	\$0.06			\$27,102	1.4%	451.7	110.4	\$0.28
1964	\$0.08	33.3%	08/15/63	\$33,620	24.0%	431.3	106.2	\$0.30
1965	\$0.08			\$35,970	7.0%	449.1	109.4	\$0.30
1966	\$0.10	25.0%	08/01/65	\$43,108	19.8%	440.5	106.3	\$0.32
1967	\$0.10			\$45,085	4.6%	450.8	108.3	\$0.33
1968	\$0.10			\$46,649	3.5%	466.5	111.4	\$0.34
1969	\$0.10			\$47,067		470.7	111.5	\$0.34
1970	\$0.14	40.0%	09/01/69	\$59,274	25.9%	450.3	106.4	\$0.39
1971	\$0.14			\$65,437	10.4%	467.4	105.4	\$0.40
1972	\$0.16	14.3%	11/05/71	\$73,981	13.1%	486.9	108.8	\$0.40
1973	\$0.16			\$79,207	7.1%	495	109.5	\$0.43
1974	\$0.16			\$81,904	3.4%	510.7	111.8	\$0.44
1975	\$0.16			\$82,735		518.4	113.5	\$0.47
1976	\$0.16			\$85,040		531.5	115.4	\$0.51
1977	\$0.16			\$86,415		540.1	117.2	\$0.52
1978	\$0.16			\$86,984		542.9	116.7	\$0.57
1979	\$0.16			\$87,984		547.9	117.1	\$0.59
1980	\$0.16			\$89,273		555.1	117.6	\$0.61
1981	\$0.16			\$90,783		564.3	119.9	\$0.65
1982	25*		8/82 & 5/82	\$110,331		548.2	115.6	\$0.75
1983	\$0.25	56.3%		\$127,739	40.7%	506.7	106.3	\$0.92
1984	\$0.25			\$126,571	-0.9%	503.5	105.6	\$1.01
1985	\$0.25			\$128,653	1.6%	512.2	107	\$1.07
1986	\$0.25			\$126,913		503.6	105.4	\$1.11
1987	\$0.25			\$128,917		510.6	106	\$1.16
1988	\$0.30	20.0%	09/01/87	\$147,667	14.5%	496.2	102.6	\$1.29
1989	\$0.30			\$146,000	-1.1%	488.6	100.3	\$1.38
1990	\$0.30			\$140,767	-3.6%	463.1	94	\$1.51
1991	\$0.30			\$140,746		469.1	95.5	\$1.59
1992	\$0.38	26.7%	05/01/92	\$149,382	6.1%	472.9	96.2	\$1.77
1993	\$0.38			\$170,282	14.0%	448.1	91.2	\$1.96
1994	\$0.38			\$177,393	4.2%	466.8	91.8	\$1.79
1995	\$0.38			\$180,498		475	93.5	\$1.88
1996	\$0.44	15.8%	07/01/95	\$202,005	11.9%	471	92.1	\$2.01
1997	\$0.44			\$208,714	3.3%	474.4	91.9	\$2.01
1998	\$0.59	34.1%	11/01/97	\$251,989	20.7%	457.9	88.7	\$2.11
1999	\$0.59			\$261,608	3.8%	443.4	84.4	\$2.44
2000	\$0.59			\$251,616	-3.8%	426.6	80.1	\$3.13
2001	\$0.59			\$247,472		419.4	78.2	\$3.30
2002	\$0.77	30.5%	10/01/01	\$293,464	18.6%	408.3	75.3	\$3.85
2003	\$0.77			\$298,473	1.7%	387.6	71	\$3.95
2004	\$0.77			\$296,060	-0.8%	384.5	69.9	\$3.81
2005	\$0.77			\$299,086		388.4	70.1	\$3.76
2006	\$0.77			\$306,392		397.9	71.3	\$3.78
2007	\$0.77			\$300,945		390.8	69.7	\$3.87
2008	\$1.77	129.9%	01/01/08	\$460,368	53.0%	376.1	66.7	\$4.09

*Rate increased to 20 cents on 8/1/81

Source: Tax Burden on Tobacco 2009 - Orzechowski and Walker

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The cigarette excise tax has been increased fifteen times over the last 53 years but **four times in the last 13 years**. While the results of the most current 130% rate increase will not be known until fiscal year-end, revenues declined in the second year after the increase became effective in two of the previous three rate increases.

In only one year (the July 1955 rate increase) did the percent increase in taxes exceed the percent increase in the cigarette excise tax rate. The most recent rate increase of 129.9 percent resulted in a 53.0 percent revenue increase.

Numbers in **RED** illustrate the percent change in revenues after a cigarette excise rate increase became effective.

Higher taxes results in increased crime

An indisputable fact is that higher cigarette prices result in increased cigarette smuggling. Higher cigarette excise tax rates result in more crime.

Researchers have documented the increasing incidence of cigarette smuggling brought about by tax differentials, the most recent report appearing in the March 2008 issue of the premier academic journal on tax issues, *The National Tax Journal*, titled "How Far to the Border?: The Extent and Impact of Cross-Border Casual Cigarette Smuggling."⁴ More extensive reviews of cigarette smuggling, and the unintended consequences, including escalating organized criminal activity can be found in the Mackinac Center for Public Policy's *Cigarette Taxes and Smuggling: A Statistical Analysis and Historical Review*⁵ and several Tax Foundation reports, including, "California Schemin': Cigarette Tax Evasion and Crime in the Golden State"⁶.

One example is Canada who increased cigarette excise taxes from \$1.90 to \$3.50 per pack (Canadian dollars). This resulted in a significant increase in illegal smuggling of cigarettes across the U.S. border to avoid paying the tax, leading to losses of millions of dollars of revenues from provincial and federal treasuries and creating hardships for corner store operators whose livelihood depends to a large degree on the cigarette trade. Canadian local and national government responded by cutting the tax by half in 1994.

The result of tax hikes are dollars being diverted from legitimate businesses and government to criminals. The cost of enforcement is unknown. However the CATO institute estimated that profits illegally obtained from smuggling cigarettes ranged from \$10 billion to \$17 billion for 2000. (Mackinaw Center for Public Policy 2002)

There are now stories of increased activity by terrorist cells that traffic in smuggled cigarettes. What is next?

⁴ Michael F. Lovenheim, "How Far to the Border?: The Extent and Impact of Cross-Border Casual Cigarette Smuggling," *National Tax Journal* LXI, no. 1 (March 2008): 1.

⁵ Michael D. LaFaive, Patrick Fleenor, Todd Nesbitt. *Cigarette Taxes and Smuggling: A Statistical Analysis and Historical Review*, Mackinac Center for Public Policy, (2007).

⁶ Patrick Fleenor. *California Schemin': Cigarette Tax Evasion and Crime in the Golden State*. Tax Foundation Special Report no. 145 (October 2006).

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Supporting Documentation/Citations

Patrick Fleenor, chief economist at the Tax Foundation and author of the Cato Institute report, "Cigarette Taxes, Black Markets, and Crime" said ***the black market is to blame***. Like drug laws, he said it's politically easy to pass laws against cigarettes but very difficult to enforce them without a major investment in personnel and technology. But even then you're only going to catch a small portion of those breaking the law, he said. (The Maryland Public Policy Institute)

Tobacco excise tax increases encourage ***bootlegging of cigarettes*** across state lines from low tax states to high tax states, underreporting of taxes by self governed reservations, regressive taxes on lower income groups and pressure on retailer margins. (National Association of Convenience Stores 2007 Annual Report)

Higher taxes mean more cigarette ***smuggling*** and therefore more crime, more lockups and most incarceration costs, plus overcrowding (OK Council of Public Affairs, Six Reasons.... November 2003)

The controversial Cook County, Illinois cigarette tax hike went into effect on May 1, 2004 pushing the price of a pack of smokes in Chicago to \$6..... Chicago can expect to see an invigorated black market for cigarettes, ***an increase in the crime*** and menace that come with black markets, and a growing presence of international terrorist organizations that fund themselves with bootlegged cigarettes (Heartland, Chicago Cigarette Tax..... June 2004)

Since the first state cigarette taxes were imposed in the 1920s, ***black markets and related criminal activity have plagued high-tax jurisdictions***. Such activity has proven to be resistant to law enforcement curtailment efforts. During the four months following the recent tax hikes, sales of taxed cigarettes in the city fell by more than 50 percent compared to the same period the prior year. Over the decades, a series of studies by federal, state, and city officials has found that ***high taxes have created a thriving illegal market for cigarettes in the city***. That market has diverted billions of dollars from legitimate businesses and governments to criminals. (Tax Foundation, February 2003)

First, the unavoidable ***consequence of inflated retail prices will be a flourishing and pervasive black market*** (Washington Post, Hooked on Cigarette Taxes, February 1999)

In a replay of Prohibition-era social decay, law-abiding citizens learn to break the law routinely, and states respond by adopting intrusive and sometimes abusive tactics to catch them. Organized criminals and terrorist cells begin ***trafficking in smuggled cigarettes***, and the states spend prodigiously to catch them, with almost no success. (Tax Foundation, As Cigarette Taxes Rise.... June 2005)

Charlotte News and Observer - February 15, 2006

Federal agents think a warehouse in North Raleigh was the staging ground for an operation that smuggled millions of dollars worth of North Carolina cigarettes into California to avoid that state's higher taxes. California officials think the sophisticated operation may have ***defrauded their state out of \$4.3 million***

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in cigarette taxes, according to a Bureau of Alcohol, Tobacco, Firearms and Explosives search warrant. From the loading dock of Five Star Wholesale, run out of a strip mall on Gresham Lake Road near Triangle Town Center, nearly a quarter-million cartons of cigarettes left for California in a two-year period, according to the federal search warrant... In just two days in June 2004, Geragosian bought close to \$40,000 worth of cigarettes, or 2,415 cartons, from JR Tobacco in Burlington, agents said. In all, ATF agents think more than 495,000 cartons of cigarettes -- with an estimated retail value of \$8.8 million -- were bought by Geragosian and others in North Carolina and sent to California. (Tax Foundation, Taxes on Cigarettes Increase Crime, Nov. 2006)

Buffalo News (New York) - July 25, 2006

New York City filed a lawsuit Monday against seven wholesale tobacco distributors -- three in Western New York -- for failing to collect taxes on **millions of cartons of cigarettes sold to retailers on Indian reservations statewide**. The suit filed in U.S. District Court in Brooklyn alleges that the wholesalers -- six in New York State and one in Vermont -- routinely sell cigarettes at about a 50 percent discount by excluding \$35 per carton in taxes. New York state and local governments estimate they lose more than \$500 million a year from untaxed cigarettes. Once shipped to the Indian reservations, the untaxed cigarettes are sold at shops, on the street or over the Internet, city officials said. Large quantities "are routinely trucked back into the city for subsequent resale to city residents, either at retail locations or by street corner 'bottle-ggers,'" the complaint said. (Tax Foundation, Taxes on Cigarettes Increase Crime, November 2006)

Scripps Howard News Service - August 07, 2006

According to a 2004 report from the U.S. General Accounting Office, "**cigarette smuggling results in lost tax revenues**, undermines government health policy objectives, can attract sophisticated and organized criminal groups, and could be a source of funding for terrorists." (Tax Foundation, Taxes on Cigarettes Increase Crime, November 2006)

Associated Press - September 21, 2006

A Canadian member of an alleged smuggling ring that dealt in contraband cigarettes, counterfeit Zig-Zag rolling papers and fake Viagra and steered some of the profits to Hezbollah guerrillas pleaded guilty Wednesday to racketeering charges, the government said... The indictment alleged that from 1996 to 2004, the group ran a multimillion-dollar cigarette-trafficking ring out of Dearborn, Michigan. It purchased low-taxed or untaxed cigarettes from North Carolina and a New York Indian reservation and resold them in Michigan and New York, **making profits by evading state cigarette taxes**, prosecutors said... Some members charged a "Resistance Tax" in excess of the contraband cigarettes' black market price to fund Lebanon-based Hezbollah, which has been classified as a terrorist group by the U.S. government, Murphy said. They also solicited money for Hezbollah's support of families of those killed in suicide bombings and other terrorist operations, he said. (Tax Foundation, Taxes on Cigarettes Increase Crime, November 2006)

Associated Press - October 6, 2006

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Two more people have pleaded guilty in a multimillion-dollar case involving the ***sale of untaxed cigarettes to Indian smoke shops in Washington***. Peter and Peggy Mahoney, 53 and 38 respectively, who operated the Warpath Smoke Shop on the Coeur d'Alene Reservation in Plummer, Idaho, also agreed Tuesday in U.S. District Court to forfeit \$1.4 million in cash... The money was part of the \$3.1 million in cash and \$2 million in bank accounts seized by a state and federal task force that investigated interstate smuggling of untaxed cigarettes, U.S. Attorney James A. McDevitt said. (Tax Foundation, Taxes on Cigarettes Increase Crime, November 2006)

The Tax Foundation estimates that ***half the cigarettes smoked in the Big Apple come from such illicit operations***. (Tax Foundation, Cigarette Taxes Approaching September 2007)

Each time the city raised its cigarette taxes, taxed cigarette sales dropped in the city but skyrocketed in jurisdictions all around the city, where taxes were lower. At the same time, law enforcement uncovered more ***cigarette bootlegging operations***, most run by organized crime syndicates. In 1989, city tax official Robert Shepherd told a gathering of tax administrators that in New York City, "It is literally more profitable to hijack a cigarette delivery truck than an armored truck." (Chicago Sun-Times, Hike in Cigarette Taxes....April 2004)

Canada increased cigarette excise taxes from \$1.90 to \$3.50 per pack (Canadian dollars) during the period from 1989 to 1993, ***resulting in a significant increase in illegal smuggling of cigarettes across the U.S. border to avoid paying the tax***. A carton of cigarettes on which all taxes are paid costs upward of \$44 in Canada, against as little as \$15 to \$20 for the contraband product. Hundreds of millions of dollars worth of illegal cigarettes enter Canada every month, chiefly through Mohawk reservations that straddle the border with the United States in Ontario and Quebec. According to law enforcement officials, the smuggling had attracted organized-crime gangs and increased violence in the area. It also led to losses of millions of dollars of revenues from provincial and federal treasuries and created hardships for corner store operators whose livelihood depends to a large degree on the cigarette trade. Canadian local and national government responded by cutting the tax by half in 1994. (New York Times, Canada Cuts Cigarette Taxes..... February 1994).

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Wisconsin Tax Effects - Methodology

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By means of a pooled time-series fixed effects regression analysis from 1976 through 2008 with five states as units of analysis – Wisconsin and the border states of Iowa, Illinois, Michigan, and Minnesota - the impact of excise taxes on cigarette sales is estimated. Cigarette sales rates measured as the number of packs per capita sold in a state in a year is the dependent variable, which, along with the state and federal tax rates in cents per pack in a year were obtained from *The Tax Burden on Tobacco: Historical Compilation 2008* (Orzechowski and Walker). The control variables of state unemployment rate and personal income for each year were obtained from the U.S. Bureau of Labor Statistics and U.S. Bureau of Economic Analysis, respectively. All tax, price, and income data were converted to constant (1983) dollars by means of the Consumer Price Index.

Elasticity estimates for the percentage increase in pack sales resulting from percentage changes in both the state excise and the federal excise taxes were obtained. For the state excise tax, an elasticity estimate of .29 means that a 10% increase in the state cigarette tax will decrease pack sales by 2.9%. The state tax is increasing by 42.37%, so the decrease in pack sales is estimated to be 12.29%. For the Federal excise tax, an elasticity estimate of .08 means that a 10% increase in the Federal excise tax will decrease pack sales by .8%. The Federal tax is increasing by 158.97%, so the decrease in pack sales is estimated to be 12.72%. Note that if Wisconsin's excise tax increased at the same percentage as the Federal excise tax, the resulting percent decline in Wisconsin sales of taxed cigarettes would be greater given the availability of lower- and un-taxed cigarettes from the internet, border states, smuggling, and Native American outlets.

Data on cigarette consumption for various demographic groups was obtained from “Who Smokes? A Demographic Analysis of Wisconsin Smokers”, by Ahrens, Ullsvick, Moberg (*Wisconsin Medical Journal*, 104(4): 2005). Data on the incidence of the tobacco tax by income quintile was obtained from “Who Pays Taxes and Who Receives Government Spending?” by Chamberlain & Prante (Tax Foundation, March 2007). Data on tie-in sales were obtained from “Tie-In Sales Final Report” (Price-Waterhouse, 1997). Data on convenience store profit margins and percent of cigarette sales were obtained from Orzechowski and Walker.

Chart 1 Additional Comment

Chart 1 show separately the estimated impact of the Federal excise tax on Wisconsin state tax revenues and the estimated impact of the state excise tax on Wisconsin state tax revenues for FY ending 6-30-10. We begin with an estimate of FY ending 6-30-09 Wisconsin tax revenues resulting from cigarettes sales. These revenues include the Wisconsin excise tax of \$1.77 per pack, and a sales tax amount of \$.27 per pack of cigarettes.⁷ Note that the Federal excise tax of an additional \$.62 was assessed towards the end of FY 2009 beginning on 4-1-09. The fixed effects regression model estimates that this would result in a decline of 12.72% in pack sales, or a total of 47 million packs.

⁷ WI sales tax rate of 5% on an average price per pack of \$5.40.

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We have prorated this pack decline so that $\frac{1}{4}$ of that decline occurred in the last 3 months of Fiscal year 2009 and the rest in Fiscal Year 2010. Thus, tax revenues for Fiscal Year ending 6-30-09 are estimated to be \$742,678,201.

To isolate the effect of the Federal excise tax on FY 2010 cigarette-related revenues, we have held the state excise and sales taxes constant. The effect of the $\frac{3}{4}$ of the decline in pack sales due to the Federal excise tax assessed in FY ending 6-30-10 will decrease revenues by 9.90%. The total effect of the Federal excise tax is to raise Wisconsin revenue by 25.10%. Estimates from the fixed effects regression model determine that the state excise tax alone would result in a decline in pack sales of 44 million packs. To isolate the effect of this tax alone on FY 2010 cigarette-related revenues, the Federal tax is held constant at \$.39. The effect of the state excise tax increase is estimated to raise Wisconsin revenue by 6.8%.