



DEPARTMENT OF AUDITS AND ACCOUNTS

270 Washington St., S.W., Suite 1-156
Atlanta, Georgia 30334-8400

Greg S. Griffin
STATE AUDITOR
(404) 656-2174

January 18, 2017

Honorable Jay Powell
Chairman, House Ways and Means
133 Capitol
Atlanta, Georgia 30334

SUBJECT: Fiscal Note
House Bill (LC 34 4989)

Dear Chairman Powell:

The bill would increase the excise tax on a pack of 20 cigarettes from 37¢ to 62¢, effective January 1, 2018.

Georgia State University's Fiscal Research Center (FRC) estimated that the bill would generate additional state revenue of \$118.0 million to \$123.0 million in FY 2019, the first year of the bill's full impact. Due to an expected decrease in cigarette consumption, the revenue gain would decline to between \$111.5 million and \$119.0 million in FY 2022. Details of FRC's analysis are included in the appendix.

Table 1. High and Low Projected Revenue Increases

| (\$ millions) | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 |
|---------------|---------|---------|---------|---------|---------|
| High Estimate | \$61.9 | \$123.0 | \$121.7 | \$120.4 | \$119.0 |
| Low Estimate | \$61.0 | \$118.0 | \$113.5 | \$112.5 | \$111.5 |

The Georgia Department of Revenue estimated one-time expenditures of \$162,250 as a result of the bill. Initial stamp production and inventory would cost \$158,000, and the remainder would be associated with IT updating the rates for returns and contract review.

Sincerely,

A handwritten signature in blue ink that reads "Greg S. Griffin". The signature is written in a cursive style with a horizontal line at the end.

Greg S. Griffin
State Auditor

A handwritten signature in blue ink that reads "Teresa A. MacCartney". The signature is written in a cursive style.

Teresa A. MacCartney, Director
Office of Planning and Budget

GSG/TAM/mt

Analysis by the Fiscal Research Center

Cigarette and smokeless tobacco use has experienced a consistent decline in Georgia since 2005, according to the Centers for Disease Control State Tobacco Activities Tracking and Evaluation System (STATE). Based on statistics from the Georgia Department of Revenue (DOR) this decline in use has resulted in a persistent decline in revenues generated by the current excise tax on tobacco products since FY 2005.

In addition to the expected continuation of this decline in consumption, an increase in excise taxes would be expected to have behavioral effects due to higher retail prices as more people reduce the amounts they consume, quit outright, or switch to alternatives. Prior to the prevalence of e-cigarettes, an untaxed potential substitute for traditional cigarettes, empirical research into cigarette consumption found, on average, that a 1 percent increase in the final price of a pack of cigarettes results in a 0.48 percent decline in the quantity of cigarettes purchased (a -0.48 price elasticity), though estimates vary. More recent research reveals that, in the presence of e-cigarettes, the behavioral response to a rise in cigarette prices is much stronger. According to a 2013 Citi Research report cited in Forbes and the South African Journal of Medicine, a 1 percent increase in cigarette prices may be expected to reduce consumption in the long-run by 0.8 percent (-0.8 price elasticity) given the availability of e-cigarettes.

LC 34 4989 proposes to increase the excise tax on a pack of cigarettes from 37¢ cents to 62¢, representing an increase in average retail price of cigarettes of approximately 5.3 percent in 2018. It is assumed that the increased cost of taxes is passed through to consumers in higher retail prices.

Key assumptions in high and low revenue estimates:

- Between FY 2005 and FY 2015, revenue raised by the excise tax on tobacco has been declining by 1.21 percent annually. Absent a change in cigarette taxes, this rate of decline is assumed to continue.
- Historical price trends are also assumed to continue in the absence of the proposed increase. According to the CDC's STATE data, the average price of cigarettes in Georgia increased at an average annual rate of 3.6 percent between 2005 and 2015.
- The low revenue estimates assume a relatively larger behavioral response to the tax-induced price increase in the number cigarette packs purchased. Specifically, the -0.8 long-run price elasticity estimate is assumed after the first year of higher prices; the first year response is assumed to be half that, a price elasticity of -0.4. The high revenue estimate assumes a less elastic or smaller behavioral response to the tax-induced price increase, using a -0.3 price elasticity for all years, the low end of the range most often cited.
- The increase in the price of cigarettes would also increase sales tax revenues because total expenditures for tobacco products increase as a result of the bill. Assuming no change in saving and a proportional reduction in other consumption types, it is estimated that around 64 cents of every dollar of increased tobacco expenditures would come from consumption that is not now taxed under the sales tax.

Finally, because tobacco products are also subject to sales taxes charged on the total retail price including excise taxes, it is expected that, there would be a small, but material, increase in sales tax revenue as a result of the bill. Under the high excise tax revenue case in the fiscal note, the increase in state sales tax revenue could be as high as around \$2.1 million in FY 2019. Under the low revenue case, which assumes a stronger negative behavioral response after the first year to the tax-induced price increases, the effect is estimated to be \$1.2 million.

Tables 2 and 3 detail the results of the analysis.

Table 2. Prices and Consumption Under Alternate Behavioral Response Assumptions

| | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 |
|--------------------------------------------------|---------|---------|---------|---------|---------|
| Cigarette Retail Price Per Pack | | | | | |
| Current Law and Baseline Trend | \$5.52 | \$5.72 | \$5.93 | \$6.14 | \$6.36 |
| Under LC 34 4989 | \$5.77 | \$5.97 | \$6.18 | \$6.39 | \$6.61 |
| Cigarette Consumption (millions of packs) | | | | | |
| Low Response, High Revenue Case | 503 | 493 | 488 | 482 | 476 |
| High Response, Low Revenue Case | 502 | 487 | 477 | 472 | 467 |

Table 3. High and Low Projected Revenue Gains under LC 34 4989 (detail)

| (\$ millions) | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 |
|----------------------------------------|---------------|----------------|----------------|----------------|----------------|
| Low Response, High Revenue Case | | | | | |
| Cigarettes Excise Tax | \$60.8 | \$120.9 | \$119.6 | \$118.3 | \$117.0 |
| Additional Sales Tax | \$1.1 | \$2.1 | \$2.1 | \$2.1 | \$2.1 |
| Total | \$61.9 | \$123.0 | \$121.7 | \$120.4 | \$119.0 |
| High Response, Low Revenue Case | | | | | |
| Cigarettes Excise Tax | \$60.1 | \$116.8 | \$113.0 | \$112.0 | \$111.0 |
| Additional Sales Tax | \$0.9 | \$1.2 | \$0.5 | \$0.5 | \$0.5 |
| Total | \$61.0 | \$118.0 | \$113.5 | \$112.5 | \$111.5 |