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TAXING SIN (ALCOHOL, TOBACCO, JUNK FOOD, AND GAMBLING)

The 81st Legislature faces the tough task of writing a state budget for 2010-11 in the midst of a serious economic recession. Even in times of robust economic growth, the state's antiquated revenue system does not produce adequate revenue.[1] Texas must address this problem in the long run to ensure our prosperity. In the short run, policymakers may look at sin taxes as a way to raise additional revenue. In this policy page, we consider whether current sin taxes can be increased or new sin taxes created.

Alcohol Taxes

Current Taxes

Texas taxes various types of alcohol (mixed beverages, liquor, beer, wine, and malt liquor). Alcohol taxes generated $784.1 million in fiscal 2008.

The tax on mixed beverages is 14 percent of gross receipts. The state shares revenue from the tax with the cities and counties, which each receive 10.7143 percent of tax collections in their jurisdiction. The state last increased this tax in 1990, from 12 to 14 percent of gross receipts. It accounts for three-quarters of all alcohol taxes—nearly $600 million to the state in fiscal 2008.

The beer tax generated $108 million in 2008. The state levies $6.00 per 31-gallon barrel or about 11 cents per six-pack. Beer distributors, manufacturers, and brew pubs pay the tax. The state last changed the tax in 1984, raising it from $5.00 per barrel. Texas' tax rate ranks 25th among the 50 states. The federal government imposes an additional tax of $18.00 per 31-gallon barrel. Because the tax is based on volume, not price, tax revenues grow only with consumption and do not reflect the increase in the price of beer over the past 25 years, although beer sales are subject to state and local sales taxes.

The tax on liquor, or "distilled spirits," produced $66 million in 2008. The state last increased this tax in 1985 from $2.00 to $2.40 per gallon. This tax also grows only with consumption, not with the increase in the price of liquor, because it is based on volume. However, state and local sales taxes apply to liquor sales. Texas' tax rate is sixth lowest among the states that tax liquor. (In 18 states the government directly controls the sales of distilled spirits.) The federal government levies $13.50 per proof gallon (one gallon of 100-proof liquor).

Additional Capacity?

The Legislature could raise alcohol tax levels and still leave Texas with only average or slightly above-average tax rates. For instance, increasing the beer tax to $9.00 per barrel (about 17 cents per six-pack) would still leave Texas with a rate below Oklahoma, Louisiana, and New Mexico, but could generate another $50 million a year. Because they are consumption taxes, alcohol taxes are probably regressive, but the comptroller's tax incidence study does not report on alcohol taxes. Even if regressive, higher rates would probably generate revenue, while discouraging alcohol consumption, which causes health and other social problems.

Tobacco Taxes

Cigarette taxes

Current Taxes

Texas imposes a tax of $1.41 per pack of 20 cigarettes (technically, $70.50 per thousand on cigarettes weighing three pounds or less per thousand, Tax Code §154.021(b)). The state raised the tax by $1.00 per pack, from 41 cents per pack to $1.41 per pack, during the 2006 special session, as part of a package of state tax increases intended to help offset the revenue lost by school districts to the one-third reduction in school property taxes. Before that, the state last raised the tax in 1990. Texas' tax rate is now the 17th highest among the states. In 2008, the cigarette tax generated $1.36 billion in revenue.

The federal government imposes a 39 cents per-pack tax. Congress is currently considering paying for an expansion of the State Children's Health Insurance Program with a federal tax increase of 61 cents, to $1.00 per pack.

Additional Capacity?

Despite the recent increase in Texas' cigarette tax rate, there is room for further increases. Since Texas' tax increase became effective on Jan. 1, 2007, eleven states also raised their tax rate—some more than once—dropping Texas from 14th highest in 2007 to 17th highest in 2008.

New York raised its state rate by $1.25 to $2.75, the highest in the nation, in June of this year. In addition, New York City levies $1.50 per pack, for a total tax rate of $4.25. Twelve states levy at least $2.00; six states allow cities or counties to levy additional taxes.

A cigarette tax is highly regressive—on average it takes a larger portion of the income of a low- or moderate-income family than of a higher-income family. However, because smoking poses significant health risks and higher cigarette taxes reduce smoking—particularly among more price-sensitive teenage smokers—the beneficial effects of higher taxes offset negative effects.

Smokeless Tobacco

Current Taxes

Texas also taxes other tobacco products, such as chewing tobacco (actual tobacco leaf) and snuff (finely ground tobacco, held between the cheek and gum).

Sales of smokeless tobacco, both chewing tobacco and snuff, are growing more quickly than sales of cigarettes. Producers market smokeless tobacco as safer than cigarettes and consumable in no-smoking areas, such as bars and restaurants. However, smokeless tobacco poses health risks similar to those associated with cigarette smoking, including cancer and heart problems.

During the 2006 special session, the Legislature raised the tax rate on chewing tobacco and snuff from 35.213 percent of the manufacturer's list price to 40 percent of the price. Before that, the state last raised these rates in 1990. Since Texas' increase, ten other states have raised the tax rates on non-cigarette tobacco products. The tobacco products tax, which includes cigars, raised $86 million in 2008.

The rate on chewing tobacco and snuff varies greatly among the states. Five states (Alaska, Maine, Massachusetts, Minnesota, and Washington) impose a tax of at least 70 percent of the wholesale price, while nine other states (Georgia, Kansas, Kentucky, Missouri, North Carolina, South Carolina, Tennessee, Virginia, and West Virginia) levy a tax of 10 percent or less of the wholesale price. Texas's rate ties with four other states for the 12th highest rate on chewing tobacco as a percentage of price, and ties with three other states for the ninth highest rate on snuff as a percentage of price.

Three states tax chewing tobacco according to weight, rather than price. Alabama taxes chewing tobacco at 1.5 cents per ounce. North Dakota taxes 16 cents per ounce, while Arizona levies 22.25 cents per ounce on chewing tobacco.

Thirteen states (Alabama, Arizona, Connecticut, Delaware, Iowa, Kentucky, Montana, New Jersey, North Dakota, Rhode Island, Utah, Vermont, and Wisconsin) tax snuff according to weight, rather than price, with rates ranging from one cent per ounce for the first 5/8 of an ounce (Alabama) to $1.66 per ounce (Vermont). In the past two years, Arizona, Iowa, and Wisconsin switched from taxing according to price to taxing according to weight.

The federal government also taxes non-cigarette tobacco products by weight. Federal taxes are 19.5 cents per pound on chewing tobacco and 58.5 cents per pound on snuff. As part of the bill to expand the State Children's Health Insurance Program, Congress may increase the tax on chewing tobacco to 50 cents per pound and the federal tax on snuff to $1.50 per pound.

Additional Capacity?

The Legislature could increase revenue by simply increasing the current percentage tax, though Texas' rates are in the top quarter of the states.

The Legislature could also increase revenue from smokeless tobacco by taxing by price rather than weight. In the 2007 legislative session, HB 1286 by Chisum and SB 667 by Carona proposed to change Texas' tax on non-cigarette tobacco products from 40 percent of the manufacturer's price per package to $1 per ounce. The fiscal note for these bills estimated that the proposed changes would increase state general revenue by $91.4 million in the 2008-09 biennium and nearly $275 million over the first five years.

Supporters of taxation by weight argue that if the tax aims to reduce the social harm caused by the health effects of tobacco use, then the amount of tobacco products consumed—rather than the price—better measures the discouraged activity.

Normally an industry opposes any increase in taxation, but the choice of price versus weight splits the smokeless tobacco industry. The current taxation by price benefits relatively inexpensive brands, since the state taxes less per can or package of cheaper products, while taxation by weight benefits higher-priced brands since the tax is less of the overall cost. In other words, taxation by weight makes the higher-priced brands more attractive to consumers than the lower-priced brands.

For instance, the current tax on a premium brand is roughly $1.20 per can, while a discount brand may be taxed at only 32 cents. However, the discount brands will soon account for the majority of smokeless-tobacco sales. Equalizing the tax per ounce at the higher level would give a one-time bump to state revenue because of the higher tax rate that accompanies the change. But a tax based on price grows as price grows, while a tax based on weight grows only as consumption increases, which is generally at a slower rate than price.

Making the change from price to weight while obtaining the one-time increase without the long-term loss requires linking the weight-based tax to a price index, so that the tax per ounce increases over time as the price of the product increases. For instance, Wisconsin for many years linked its gasoline tax (levied per gallon) with changes in the Consumer Price Index, so that the tax per gallon generally increased over time (although as a result of this link it actually decreased slightly in 1989 and 1994).

Because youth apparently prefer premium brands of smokeless tobacco, a switch to weight-based taxation—which would reduce the relative price of higher-priced brands—might encourage more use by young people. Weight-based taxation might also encourage tobacco companies to develop lightweight products, such as "snus"—very lightweight, spit-less packets of tobacco. A sufficiently high rate indexed to price and a sufficiently high minimum tax per package regardless of weight could address these health concerns.

In 2007, the tax equity note for the previously discussed HB 1286 and SB 667 showed that the proposed changes would increase regressivity, but only by a small amount. The taxes paid by the one-fifth of families with the lowest incomes (less than $25,000 per year) would increase by an average of 0.022 percent (about $3.00 a year) while taxes on the one-fifth of families with the highest incomes (over $110,000 per year) would increase by only 0.005 percent (less than one-quarter as much) although this translates to just more than $9.00 per year. Of course, a person who does not use tobacco products would see no change in their taxes, while those who chew tobacco frequently would see a larger increase.

Junk Food Taxes

Obesity is a problem, increasing risks for diabetes and heart disease. Child and adolescent obesity is also associated with increased risk of emotional problems: teens with weight problems tend to have much lower self-esteem and be less popular with their peers. Increased soda consumption also leads to more tooth decay and less calcium in a child's diet due to lower milk consumption. A tax on sugared soft drinks could help increase awareness of the need to limit sugar intake linked to obesity.

Recent data analyzed by CPPP indicates that a tax of one percent of the sales price of sugared soda drinks would generate about $57 million a year.[2] Including sugary sports drinks or candy bars would increase this revenue. Nineteen other states specifically tax soda pop and other snack foods, producing $1 billion a year in tax revenue.

Gambling

Taxing sin that is legal and legalizing sin to tax it are altogether different things. Thus, expanding gambling in Texas is controversial. Some support gambling as a way to increase revenue while fostering economic development. Others oppose gambling because of its social consequences.

Gambling has high social costs. One recent estimate of the social costs of gambling, such as increased crime, lost work time, bankruptcies and financial hardships faced by the families of gambling addicts, concludes that casino gambling causes up to $289 in social costs for every $46 of economic benefit.[3]

Gambling can cause addictive and destructive behavior much like alcohol and drugs. About 30 percent of the population does not gamble, and most people who gamble do so infrequently, such as on an occasional trip to Las Vegas. However, about 10 percent of the population gambles regularly and accounts for up to 80 percent of the wagers in casino enterprises.[4]

This means that the gaming industry's profits rely on a relatively small number of addicted gamblers who run up huge costs to themselves, their families, and society. While excessive gambling affects members of all social classes, the greatest social concern comes from its prevalence among lower-income households.

Taxing gambling is regressive. CPPP calculations, based on demographic information from the Texas Lottery Commission,[5] show that families with incomes in the $20,000 to $30,000 range spend an average of 0.37 percent of their income on lottery games each year, while families with incomes over $75,000 spend only 0.03 percent of their income, less than one-tenth as much, on lottery games.

And gambling revenue does not grow along with the growth of the state. The Texas Lottery generated roughly $1 billion for the Foundation School Fund each year for the past five years, showing little change. During the same period of time, enrollment in Texas public schools grew by 8 percent and inflation by 16 percent.

Conclusion

The nation is in a serious economic recession. This is no time to cut public spending, which stimulates the economy and protects vulnerable residents. New or increased sin taxes may be part of a balanced approach to writing the state budget for 2010-11.[6] In the long run, however, Texas needs to address its antiquated tax system.

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[1] Texas' current tax system cannot keep up with the growth in the state's needs, including public education. The state's long-term "structural deficit" can be eliminated only with a personal income tax, which can raise an adequate amount of money in a fair manner. See *The Best Choice for a Prosperous Texas: A Texas-Style Personal Income Tax,* at www.cppp.org/research.php?aid=766.

[2] Sources: *Beverage Digest*; March 2008; U.S. Census Bureau, Population Estimates 2007. U.S. sales of carbonated soft drinks totaled $72 billion in 2007. Texas consumption was about $5.7 billion, assuming Texans have average soda consumption per capita, so a 1 percent tax on soda sales would generate about $57 million a year.

[3] Grinols, "Gambling in America: Costs and Benefits," Cambridge University Press, 2004.

[4] Ibid.

[5] Table 2, "Any Game: Past-Year Lottery Play and Median Dollars Spent per Month by Demographics, Demographic Study of Texas Lottery Players 2007," prepared for the Texas Lottery Commission by the University of Houston Center for Public Policy at: www.txlottery.org/export/sites/default/Documents/demographicreport2007.pdf.

[6] Johnson, *Budget Cuts or Tax Increases at the State Level: Which is Preferable during a Recession?* (CBPP January 12, 2009), at: www.cbpp.org/1-8-08sfp.htm.