61 CENT FEDERAL CIGARETTE EXCISE TAX HIKE COULD COST MARYLAND $47.7 MILLION ANNUALLY

(Estimated Dollars in Millions)	Treasury Assumptions	CBO Assumptions
Tobacco Settlement Agreement Reduction	**($13.21)**	**($11.74)**
Loss of State Excise Tax	**($34.45)**	**($30.62)**
Total Annual Loss to Maryland	**($47.66)**	**($42.36)**

The table above estimates the negative impact that an increase in the federal cigarette excise tax could have on revenues in the state of Maryland. Under the Tobacco Settlement Agreements, the amount paid by participating manufacturers is adjusted annually based on the volume of their shipments. As such, the proposed tax increase could cause Maryland's settlement payments to decline.[1] In addition, the reduction in tax-paid cigarette sales that is expected to follow the tax increase would negatively impact the state's excise tax revenues.

Taken together, as seen in the table above, the reductions in tobacco settlement payments and excise tax revenues could cost Maryland between $42.36 million and $47.66 million per year.[2] In January 2008, Maryland increased its cigarette excise tax rate by $1.00 to $2.00 per pack. The estimated loss in excise tax revenue is based on this new tax rate.

States rely on these revenues for a variety of purposes. In fact, states currently earmark approximately 51 percent of their tobacco excise tax revenues to specific programs. Maryland directs 69.9% of its cigarette excise tax revenues ($194 million in Fiscal Year 2007) to help offset interest on bond financing for the Tobacco Settlement Fund.[3]

---

[1] Tobacco Settlement Agreements include the Master Settlement Agreement ("MSA") and separate agreements with Florida, Minnesota, Mississippi, and Texas. All of the tobacco settlement agreements adjust their payments for changes in domestic volume. The MSA payments also account for volume changes in Puerto Rico, and roll-your-own product.

[2] The figures in the table above are based on an estimated reduction in tax-paid cigarette sales following the proposed $0.61 per pack federal excise tax increase. Totals may not add due to rounding. The estimates of cigarette price elasticity that are used in this paper are 10 years old and estimated the impact of price increases on consumer demand for cigarettes, not the impact of tax increases on tax-paid cigarette sales. The impact of cigarette excise tax increases on tax-paid cigarette sales has been the subject of a number of recent analyses. See: *Cigarette Purchasing Patterns Among New York Smokers: Implications for Health, Price, and Revenue*, NEW YORK STATE DEPARTMENT OF HEALTH, (March 2006); *Michigan's Cigarette and Tobacco Taxes 2005 Statistical Update*, MICHIGAN DEPARTMENT OF TREASURY, (July 2006); *Illinois' Cigarette Tax, Tobacco Products Tax, and Tobacco Settlement Update*, ILLINOIS COMMISSION ON GOVERNMENT FORECASTING AND ACCOUNTABILITY, (July 2006). Calculations are based on elasticity assumptions forwarded by the U.S. Department of the Treasury and the Congressional Budget Office ("CBO") in connection with Congressional hearings in 1998. *Testimony by Assistant Secretary for Financial Markets Gary Gensler before the Senate Democratic Task Force on Tobacco*, Treasury News, (May 13, 1998); *Proposed Tobacco Settlement Issues From a Federal Perspective*, CONGRESSIONAL BUDGET OFFICE, (April 1998). These elasticity estimates are based on testimony given in 1998, and reflect a general estimate of elasticity at that time, when prices for cigarettes were lower. The actual elasticity for a $0.61 federal tax increase could be different today. Philip Morris USA does not necessarily agree with, or endorse, the assumptions contained in this model. According to the Department of Agriculture, estimates of the price elasticity of demand for cigarettes range from -0.28 to -0.80, with most clustering between -0.40 and -0.75. Gale, H. Fredrick Jr. et. al., *Tobacco and the Economy: Farms, Jobs and Communities*, US DEPARTMENT OF AGRICULTURE, Agricultural Economic Report No. 789, (November, 2002). It is assumed that all manufacturers pass through the proposed tax increase and that the trade maintains its margins. The price increases in this analysis are for demonstration and comparison purposes only and do not necessarily reflect the actual price increases that may be passed on by either Philip Morris USA or any other tobacco company. In the absence of any mandatory price pass-through, each manufacturer would need to determine how much, if any, of the increased tax it will pass on to adult smokers. The price change also includes the maintenance of a trade margin of 17.2% and sales taxes. This margin is derived from: Thomas Capehart, *The Changing Tobacco User's Dollar*, US DEPARTMENT OF AGRICULTURE, TBS-257-01, (October 2004). Data is based on a weighted average price from Bill Orzechowski and Rob Walker, *The Tax Burden on Tobacco*, Vol. 42, (February 2008), funded by Philip Morris USA and other tobacco companies, and proprietary nationwide volume data gathered by PricewaterhouseCoopers in their capacity as auditor for the MSA. An adjustment to payments for the growth of non-participating manufacturers' sales is not included in these figures. Market share, volume adjustment and inflation figures used to estimate the MSA payments are from: *Independent Auditor's Notice of Preliminary Calculations for the Tobacco Litigation Master Settlement Agreement Subsection IX(c)(1) Account Payments Due April 15, 2007*, Notice ID: 0211. Using the Treasury's -0.45 estimate of the price elasticity of demand, nationwide sales would fall by about 1,467 million packs. Under the CBO's -0.40 elasticity the national decline would be 1,304 million packs. Using volume data for the year 2007, and based on the Treasury's elasticity assumptions, the volume adjustment provisions in the tobacco settlement agreements would have led to a $13.21 million reduction in Maryland's payments. Note that the sum of all the payment reductions to the 46 MSA states will add up to 98.8% the total MSA payment reduction. The 1.2% difference relates to the Smokeless Tobacco Master Settlement Agreement. Maryland's cigarette excise tax revenues could also be negatively impacted. Based on FY2007 tax-paid sales and an average price adjusted for the January 2008 excise tax increase, the state's paid cigarette sales could fall by 17.22 million packs. Maryland currently collects $2 per pack in excise taxes, according to Bill Orzechowski and Rob Walker, *The Tax Burden on Tobacco*, vol. 42, (February 2008); funded by Philip Morris USA and other tobacco companies. This reduction in tax-paid sales could result in a loss of $34.45 million in state excise tax revenues.

[3] *Dedicated State Tobacco Excise Tax Revenues: A Fifty-State Report*, FISCAL PLANNING SERVICES, INC., (June 6, 2008); funded by Altria Client Services Inc. This allocation is as of the fiscal year reported. Since that time, the tax may have been increased, and/or the allocation percentages changed.