

June 21, 2011

Tobacco Tax Cut Likely to Lose Millions in Revenue, Leave FY12-13 Budget out of Balance

Near the close of their conference committee deliberations last week, negotiators from the House of Representatives and the Senate added provisions to the fiscal year 2012-2013 budget that, effective July 1, will both drop New Hampshire's cigarette tax rate from \$1.78 per pack to \$1.68 per pack and lower taxes on other tobacco products. Based on the latest data available from the Department of Revenue Administration, those provisions will likely reduce tax revenue by at least \$14 million over the biennium and perhaps by as much as \$30 million. However, it now appears that House and Senate negotiators failed to account for any such revenue loss in completing the conference committee's version of the FY 12-13 budget, meaning that the budget for the coming biennium will likely end up out of balance. Consequently, to offset any revenue lost to a cigarette tax cut, the House and the Senate may have to add to the hundreds of millions of dollars in spending cuts that they have already imposed, further undermining critical investments in education and public infrastructure and weakening protections for the state's most vulnerable citizens.

Tobacco Tax Reduction Likely to Lose at Least \$14 Million in Revenue

Earlier this year, the House of Representatives approved HB 156, an act reducing the rates of the tobacco tax. The Senate Ways & Means Committee subsequently recommended the measure inexpedient to legislate, but the Senate as a whole never acted upon that recommendation. While neither the House's, nor the Senate's, version of the FY12-13 budget included language similar to HB 156, the committee of conference added a modified version of the bill to the version of the budget it recommended last week.

HB 156 would have reduced the state's cigarette tax rate from \$1.78 per pack of 20 cigarettes to \$1.68 and would have lowered the tax rate on "other tobacco products," such as loose or smokeless tobacco, from 65.03 percent of their wholesale price to 48 percent. Consequently, the fiscal note accompanying the bill indicates that it will "decrease state revenues by an indeterminable amount in FY 2012 and each fiscal year thereafter." More specifically, it notes that:

The Department [of Revenue Administration] estimates if [cigarette] sales in FY 2012 were consistent with those of FY 2010, this bill would decrease cigarette tax revenue by \$12,778,586 ... For other tobacco products [OTP] ... the Department estimates if sales in FY 2012 were consistent with FY 2010, this bill would decrease OTP revenue by \$2,051,830.

However, the Department states the proposed decrease in the tobacco tax rate may actually increase sales by 2.7026% for cigarettes and 23.0236% for OTP ... Assuming sales growth at the rates stated above, the total revenue decrease is estimated at approximately \$7,696,967 ... in FY 2012.

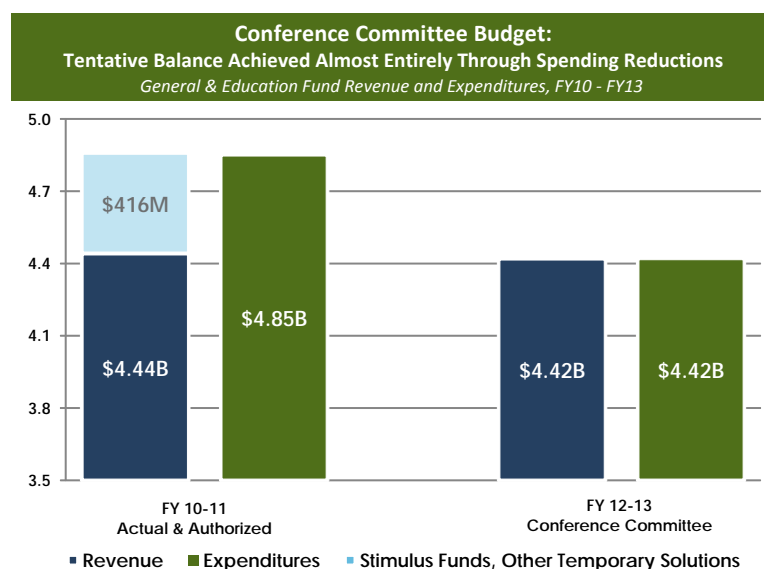
In short, even if the sale of tobacco products were to increase somewhat in the coming years, the Department of Revenue Administration still anticipates a revenue loss of \$7.7 million for FY 2012; a similar loss in FY 2013 would put the total for the biennium over \$14 million.

Yet, given the long-term trend in cigarette sales, such an increase seems uncertain at best. Over the thirty year period from 1981-2010, the number of packs of cigarettes sold in New Hampshire in one year declined from the number of packs sold in the prior year 21 times; on average, the number of packs of cigarettes sold has declined by 1.9 percent per year over this span of three decades.ⁱ

Indeed, the Senators and Representatives who added the substance of HB 156 to the FY12-13 budget recognized the likelihood that a tobacco tax rate reduction would lose revenue, as they included provisions that would restore the tax rates on cigarettes and other tobacco products to their current levels should tobacco tax collections for FY12-13 be lower than those for FY10-11. Still, as written, such a restoration would not occur until August 1, 2013, meaning that it would not happen until after the FY12-13 budget had already suffered the loss of millions of dollars in revenue.

Tobacco Tax Rate Reduction Likely to Push Budget Out of Balance, Force Steeper Spending Cuts

As the figure below indicates, the Office of the Legislative Budget Assistant (LBA) anticipates that, under the version of the budget recommended by the committee of conference, General and Education Fund expenditures will total roughly \$4.42 billion for FY 2012-2013, with revenue in those accounts reaching roughly the same amount.ⁱⁱ



Source: NHFPI calculations based on LBA Surplus Statements

Accordingly, the LBA expects a small combined General and Education Fund surplus – some \$587,000 – at the end of the biennium.

However, at the direction of House and Senate negotiators – who maintain that the change will be revenue neutral – the LBA’s accounting does not reflect any revenue loss from the reduction in tobacco tax rates. As noted above though, even under favorable circumstances, reducing the cigarette tax rate to \$1.68 per pack and

making corresponding changes to the rate for other tobacco products are likely to lower revenue by more than \$7 million per year. Thus, unless other sources of revenue grow more rapidly than projected – or spending lapses are larger than anticipated – the FY12-13 budget is likely to be out of balance.

Given the legislature’s reluctance to consider any form of a revenue increase for the upcoming biennium, the loss of funds arising from a tobacco tax cut means that further spending cuts may occur over the course of the biennium. This would, in turn, deepen the approximately \$430 million in spending reductions the conference committee’s version of the budget would make relative to actual and authorized expenditures for the current FY10-11 budget. Among the more notable cuts contained in the conference committee’s version of the budget are reductions, relative to the Governor’s recommended General and Education Fund appropriation levels for FY12-13, of \$115 million in uncompensated care payments to New Hampshire hospitals and of approximately \$10 million in child care services. In addition, like the House and Senate versions of the budget, the budget agreement struck by the conference committee would reduce General and Education Fund support for higher education in New Hampshire – that is, for community colleges and the state’s university system – by a total of more than \$140 million, relative to current levels, over the next two years.

At the very least, then, the inclusion of a tobacco tax reduction in the FY12-13 budget would forestall the restoration of funds to vital priorities as other sources of revenue grow. Should such additional revenues fail to emerge, policymakers would then likely embark on yet another round of budget cuts, further harming the state’s economic prospects and imposing still greater burdens on New Hampshire’s families and communities.

ⁱ Based on data from Orzechowski and Walker, *The Tax Burden on Tobacco*, Arlington, VA, 2010 Edition.

ⁱⁱ Legislative Budget Assistant’s Office, Comparative Statement of Undesignated Surplus, June 18, 2011.