



Prop 203 Leads to 20% Declines in Tobacco Tax Revenues for Health Care, Education, General Fund

In November of 2006, voters passed the Early Childhood Development and Health Initiative which increased tobacco taxes by 68%. ATRA opposed this tax increase and pointed out that the higher per-pack rate would lead to substantial declines in the revenues received by the existing recipients of the tobacco tax including the General Fund, the Tobacco Tax & Health Care Fund, and the Tobacco Products Fund. The Corrections Fund did not stand to lose any revenue because previous initiatives guaranteed to hold this fund harmless from any future decreases. With fiscal year (FY) 2008 data now available, it is possible to evaluate the actual losses these funds sustained as a result of the higher rate.

Table 1: Change in Tobacco Tax Revenues (FY 2006 to FY 2008)

| | | |
|---|---------------|--------|
| General Fund | -\$7,111,365 | -18.0% |
| Corrections Fund | \$0 | 0.0% |
| Tobacco Tax & Health Care Fund | -\$22,952,580 | -21.5% |
| Tobacco Products Tax Fund | -\$29,272,520 | -20.1% |
| Early Childhood Development & Health Fund | \$164,805,113 | 100.0% |
| Smoke Free AZ Fund | \$3,946,308 | 100.0% |

To evaluate the effect Prop 203 had on the previously existing recipients of the tobacco tax, ATRA compared the collections received by each of these recipients in FY 2008 to the amounts collected in FY 2006. The new tax was implemented half way through FY 2007, so the comparison in table 1 measures the first full year of collections at the higher price with the last full year of collections at the lower price. Aside from the Corrections Fund, each of the remaining three recipients of the tobacco tax saw their revenues decline by 18.0 to 21.5 percent (see table 1 above). The declines were slightly greater for the Tobacco Tax & Health Care Fund and the Tobacco Products Fund as these funds were required to backfill the declines that the Corrections Fund otherwise would have sustained.

Reviewing the historic tobacco tax collections of the General Fund demonstrates how tax increases have affected trends in tobacco tax collections (figure 1 on page 2). Since FY 1991, the General Fund tax on tobacco has been constant at \$0.18 per pack of cigarettes, yet the amount collected has declined significantly since that time. From FY 1991 to FY 1994, for the most part the total amount collected by this \$0.18 tax grew at a relatively slow pace. Half way through FY 1995 an additional \$0.58 tax per pack was implemented as a result of Prop 200. Despite the previous years' trend of constant or slightly increasing General Fund revenues from the tobacco tax, the collections decreased during FY 1996 and FY 1997. As these were the first two years for which the Prop 200 tax was collected throughout the entire year, the change in the trend of taxed tobacco sales was likely due to the higher price resulting from the new tax.

By the end of FY 1997, the market seemed to have fully absorbed the impact of the higher price on tobacco and a new trend in tobacco sales set in. For the next five years, sales of taxed tobacco remained relatively constant as demonstrated in the total collections of the \$0.18 General Fund tax. In 2002, Voters passed Prop 303 and added another \$0.60 to the tobacco tax, which again shifted the trend in sales of taxed tobacco. The new rates were effective for only the last half of FY 2003 and still the effect on sales and corresponding General Fund revenues is apparent. In FY 2004, the decrease is even greater as this was the first year in which the sales of every month were affected by the Prop 303 tax.

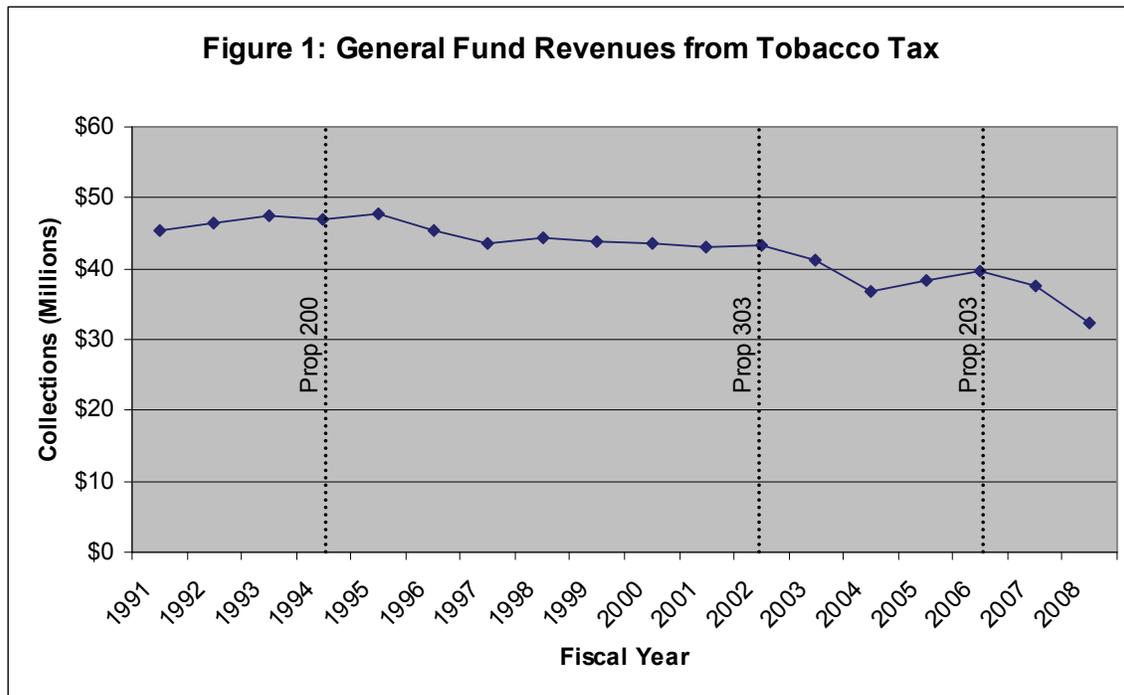


Figure 1: The above chart depicts the revenues that Arizona’s General Fund received from the constant \$0.18 per-pack tobacco tax. Dashed lines indicate the last fiscal year of collections prior to the implementation of new taxes on tobacco resulting from the indicated propositions. A decline in General Fund revenues follows each tax increase.

The market again adjusted to the new price and then collections actually increased from FY 2004 to FY 2006. The 2003 increased appropriation to the Tobacco Enforcement Unit of the Department of Revenue, which allowed the department to hire ten new investigators and four new auditors, likely contributed to an increase in tax compliance that influenced this increase in collections. But regardless of the reasons for the increased collections leading up to 2006, Prop 203 clearly had the predicted effect of decreasing the trend in taxed tobacco sales. This decrease in sales resulted in the decrease in General Fund revenues seen in figure 1. Taxed tobacco sales dropped in both FY 2007 and FY 2008. The decline was smaller in FY 2007 as the Prop 203 tax increase was only effective during the last half of the year. Based on the sales trends leading up to Prop 203, one might reasonably assume that tobacco sales would have at a minimum remained constant at the FY 2006 level had the price per pack not increased. Such an assumption implies that Prop 203 resulted in a General Fund loss of at least \$7.1 million (see table 1 on page 1).

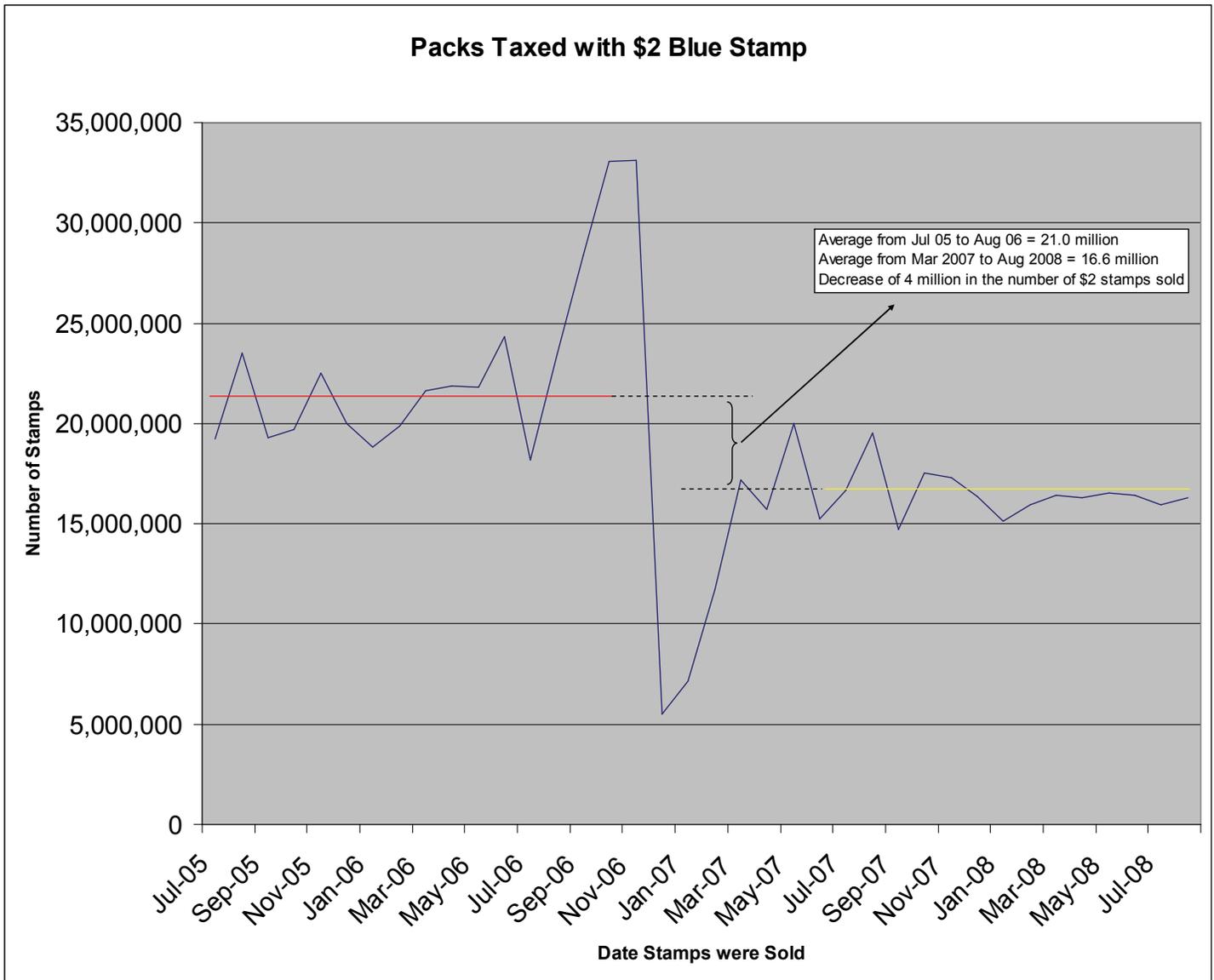
Justin Olson



Supplemental Data: Distribution of Tobacco Taxes FY 1986 to FY 2008

| Fiscal Year | General Fund | Corrections Fund | Tobacco Tax & Health Care Fund | Tobacco Products Tax Fund | Early Childhood Development and Health Fund | Smoke Free AZ Fund | Total |
|-------------|--------------|------------------|--------------------------------|---------------------------|---|--------------------|---------------|
| FY2008 | \$32,467,344 | \$6,206,674 | \$83,868,465 | \$116,127,254 | \$164,805,113 | \$3,946,308 | \$407,421,158 |
| FY2007 | \$37,558,776 | \$6,206,673 | \$100,500,062 | \$137,624,178 | \$74,445,246 | \$1,778,847 | \$358,121,881 |
| FY2006 | \$39,578,709 | \$6,206,674 | \$106,821,045 | \$145,399,774 | | | \$298,006,202 |
| FY2005 | \$38,360,552 | \$6,206,608 | \$102,310,127 | \$138,521,611 | | | \$285,398,898 |
| FY2004 | \$36,757,081 | \$6,206,674 | \$98,163,310 | \$133,563,168 | | | \$275,104,562 |
| FY2003 | \$41,174,667 | \$6,206,674 | \$105,027,137 | \$59,938,321 | | | \$212,346,799 |
| FY2002 | \$43,206,460 | \$6,206,674 | \$108,177,154 | | | | \$157,590,288 |
| FY2001 | \$43,124,883 | \$6,206,674 | \$108,709,176 | | | | \$158,040,733 |
| FY2000 | \$43,446,233 | \$6,196,674 | \$109,786,025 | | | | \$159,428,932 |
| FY1999 | \$43,895,551 | \$6,206,674 | \$112,735,957 | | | | \$162,838,182 |
| FY1998 | \$44,443,108 | \$6,206,674 | \$114,104,507 | | | | \$164,754,289 |
| FY1997 | \$43,676,616 | \$6,206,675 | \$115,961,006 | | | | \$165,844,297 |
| FY1996 | \$45,461,621 | \$6,206,673 | \$119,127,689 | | | | \$170,795,983 |
| FY1995 | \$47,728,667 | \$6,837,337 | \$54,623,325 | | | | \$109,189,329 |
| FY1994 | \$46,870,529 | \$6,206,674 | | | | | \$53,077,203 |
| FY1993 | \$47,385,665 | \$6,261,724 | | | | | \$53,647,389 |
| FY1992 | \$46,419,433 | \$6,128,751 | | | | | \$52,548,184 |
| FY1991 | \$45,474,466 | \$6,321,584 | | | | | \$51,796,050 |
| FY1990 | | | | | | | \$46,942,200 |
| FY1989 | | | | | | | \$50,529,043 |
| FY1988 | | | | | | | \$52,407,371 |
| FY1987 | | | | | | | \$51,219,849 |
| FY1986 | | | | | | | \$50,775,933 |

Supplemental Data: Blue Stamp Sales From July 2005 to July 2008



Supplemental Data: Red Stamp Sales From July 2005 to March 2008

