Editorial: Profits of Doom

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From a purely financial corporate perspective, cigarettes are a nearly ideal consumer product. Consumption begins at an early age (half of all smokers start before age 14), and for many smokers, it never stops: the onset of nicotine addiction occurs during the teenage years, and while four fifths of adult smokers would like to quit, only about 2.5% succeed each year.[1] The typical lifelong smoker smokes for approximately 50 years, consuming an average of more than 30 cigarettes per day. This translates into more than half a million cigarettes, for which, at today's prices, the consumer shells out roughly $50 000. The only drawback to the product, from the financial perspective, is its annoying tendency to kill so many of its consumers. An estimated 36% of lifelong heavy smokers die as a result of smoking,[2] each losing 2 decades of life expectancy.[3] This deprives the tobacco industry of an additional $8000 per smoker.

Two companies, Philip Morris and R.J. Reynolds, control two thirds of the US cigarette market (in 1992, 41.4 and 26.6%, respectively).[4] Accordingly, each can count on an average of at least $13 000 in lifetime revenue from a sizable proportion of the population, a total that exceeds the fondest dream of almost all other corporations. What makes this revenue especially attractive, however, is the fact that the tobacco companies' profit margins rank at the top of American industry, averaging three to five times those of average corporations.[5]

To protect this extraordinary level of profitability, particularly in an increasingly hostile social environment, the cigarette companies have to work diligently to maintain their favored position in Congress.[6,7] Fortunately for the industry, they have plenty of resources to devote to this task, and they spread those resources around liberally. The tobacco industry has few peers among interest groups when it comes to spending on campaign contributions and lobbying, for example.[7]

As would be expected, industry political expenditures also occur at the state and local levels, increasingly the locus of tobacco control activity.[1,8] It comes as quite a surprise, however, to learn the magnitude of those expenditures in the state of California, as discussed by Begay and colleagues[9] in this Public Health Policy Forum. According to them, the industry spent $7.6 million in that state in 1991–1992, nearly a 10-fold increase over that spent in 1985–1986. The speaker of the California Assembly, the authors report, received an astonishing $221 367 in 1991–1992, making him the nation's single greatest recipient of industry political largesse. Three other legislative leaders received from $33 000 to $49 000 each. Only eight incumbents in the 120-seat California legislature did not receive tobacco industry contributions.

Does the phrase "buying influence" ring a bell here? Begay and his colleagues think so. While they marshall no definitive proof, the authors see a clear connection between the industry's exercising its economic muscle in the political arena and the reductions in spending on statewide tobacco education that was mandated by the voter-passed 1988 initiative, Proposition 99. Proposition 99 raised the state cigarette excise tax by 25 cents per pack and earmarked resulting revenues for various

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purposes, including tobacco research and education. A landmark in the annals of tobacco control, the initiative passed despite a $21.2 million industry-sponsored campaign in opposition.[9]

In mid-1993 (as this is being written), arguably the most important lessons from Proposition 99 pertain to cigarette taxation and price. The first half of this year witnessed two independent, if not unrelated, developments that are of potentially historic proportions: (1) the Clinton administration indicated that it was considering a large increase in the federal cigarette excise tax—as much as $2 per pack—to help fund health care reform[10]; and (2) Philip Morris announced that it was lowering the price of Marlboro, the nation's and world's top-selling cigarette, by 40 cents per pack.[11]

Taxation is undoubtedly a powerful revenue generator and also a highly effective smoking control policy[1,12]; the California experience is consistent with earlier evidence in this regard.[13] Taxation may well be the most effective weapon with which to battle the economic might and political influence of the tobacco industry. The major voluntary health associations have estimated that a $2 increase in the federal cigarette tax, tied thereafter to inflation, would raise an additional $35 billion in revenues annually while encouraging some 7 million Americans not to smoke. Eventually, close to 2 million premature smoking-related deaths would be avoided as a result.[14] Incidentally, a $2 tax increase would merely bring the price of cigarettes in the United States up to international standards for industrialized nations.[15]

Widespread public support for increased cigarette taxation, particularly as it is tied to health care reform, adds to its attraction.[16] Yet despite the seemingly irresistible combination of public support and health and fiscal benefits, in the 2 decades from 1972 to 1992, neither federal nor state cigarette excise tax rates kept pace with inflation. In 1972, and for at least the 2 preceding decades, federal and state excise taxes constituted nearly half the average retail price of cigarettes. In 1992, however, taxes accounted for less than a quarter of the retail price, the lowest percentage on record.[12]

The declining tax share of the retail price of cigarettes not only resulted from the failure of taxes to keep pace with inflation; it also reflects the fact that wholesale prices have increased much more rapidly than the general rate of inflation. Over the past 2 decades, consumer prices rose by a factor of four whereas cigarette prices (without taxes) increased sevenfold.

Enter the Philip Morris decision to cut the price of Marlboro, the first significant price reduction in premium-brand cigarettes in decades. Ostensibly, the company's motivation was a fear of losing market share to the lower-priced generic and discounted brand cigarettes, although industry analysts have suggested other motives.[4] The generics and discounted brands have certainly been gaining market share with a breathtaking rapidity in recent years; they now account for close to 40% of the market, up from 11% as recently as 1988.[4,11]

The Marlboro price cut could have far-reaching implications for both the industry and the nation's health. Until now, this highly concentrated industry has kept cigarette prices well above those that would have prevailed in a more competitive market. In turn, high prices have limited consumption. The Marlboro price decline, sure to be mimicked throughout the industry,[4] will expand the market. More people will smoke and more will die. Incidentally, the companies' profit margins will fall significantly as well.[4]

Government has the power to reverse the expected increases in smoking simply by increasing excise taxes. If a $2 increase in the federal tax made sense before Philip Morris announced its new pricing policy, a $2.40 increase is justified today, simply to compensate for the Marlboro price cut. A major tax increase could reverse the damage to the public's health that has resulted from the growing influence of the discounted cigarettes. (In 1992, as the generics and discount brands captured increasing market share, per capita cigarette consumption failed to decrease for the first time in 20 years.[17])

The industry, of course, has mounted an aggressive, deceptive, and well-financed campaign in opposition to the proposed tax increase. As in California, federal legislators are receiving an earful from tobacco lobbyists. Industry public relations specialists are churning out press releases bemoaning the fate of thousands of farmers who will lose their jobs and expressing the industry's heartfelt concern for the downtrodden poor smoker who will bear a disproportionate burden of any new tax. But lest anyone view these expressions of sympathy as other than crocodile tears, consider the deafening silence of this same industry as it systematically raised wholesale prices for 2 decades. That hurt poor smokers and reduced farm employment in precisely the same manner as would a tax increase.

A large tax increase will cost some farmers their jobs as smoking declines, but the numbers are far smaller, and the transition much more gradual, than industry estimates indicate.[18] And while tobacco-state farmers will lose jobs, others will gain employment elsewhere throughout the country, in roughly comparable numbers, as money previously spent on tobacco is redirected to other goods and services.[18]

By virtue of their higher smoking prevalence (and, of course, their lower incomes), the poor are indeed likely to bear a more substantial financial burden from an increased tax unless, as is possible, they are so responsive to higher prices that they quit smoking proportionately more rapidly than price rises.[19] The impact on poor smokers certainly warrants attention in the development of a tax policy package.

While the relative financial burden on the poor is uncertain, the health implication is not: the poor will benefit disproportionately because far more low-income people will end up rejecting smoking as the price of cigarettes rises.[1,19] All Americans will share, with the poor, anticipated reductions in health care costs, including those accruing to Medicaid and Medicare.[20]

This brings us back to health care reform. There is a nice conceptual tie between taxing tobacco and restructuring health care delivery and finance. But it is important to recognize that a substantial increase in cigarette taxation would constitute significant "health care reform" all by itself, regardless of the fate of proposed changes in our health care delivery system. It would produce a public health achievement with few precedents while reducing the nation's health care bill in the process. It would also raise tens of billions of dollars in needed governmental revenues.

Thus, the Clinton administration would be well advised to turn a deaf ear to the cynical prophets of doom who peddle their deadly product with disregard, if not contempt, for the welfare of their customers. □

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