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## Cigarette Tax Hike of 75 Percent Will Create Great Lake of Smuggled Smokes

Raising the state's tobacco tax will send smokers to out-of-state sources for cigarettes

By Michael D. LaFaive and Todd Nesbit, Ph.D.

The opening weeks of a legislative session — and with a new governor at the helm — often produce a hailstorm of new policy proposals. One of those — House Bill No. 4188 — would raise cigarette taxes by \$1.50 per pack and impose the tobacco tax on e-cigarettes.

This may be part of a plan to acquire more revenues to meet the spending demands of the new administration. Most of the new money generated from the tax on traditional cigarettes — 90 percent — would flow to the state's General Fund, rather than health initiatives. A large tax increase will come with unintended consequences — including large-scale tax evasion — that will undermine any positive health outcomes the law's sponsors hopes to achieve.

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Michigan makes it illegal to bring a single untaxed cigarette into the Great Lake State, but we expect substantial increases in such activity. We estimate (using data through 2016) that hiking the cigarette excise tax to \$3.50 from \$2 will cause legal in-state cigarette sales to decline by nearly 18 percent due to tax evasion. Only if sales go down by more than 18 percent can we expect the smoking rate to have declined. We predict that after the tax increase, 36 percent of all cigarettes consumed in the state thereafter will be acquired as a function of tax evasion. Our estimate is made by comparing legal paid sales of cigarettes across states to their smoking rates. The difference must be explained, and we — and other scholars — believe most of it can be laid at the foot of smuggling.

Some tax evasion will be casual, in the form of consumers making small purchases for their own use. Much of that will involve Indiana, which has a cigarette tax of just 99.5 cents per pack. The gulf between Indiana's tax and the proposed rate of \$3.50 in Michigan will drive bargain hunters to Indiana retailers early and often.

We are not the only scholars to identify cigarette smuggling as a large problem, especially in high-taxed areas. One of us (LaFaive) has catalogued two dozen other studies from university scholars, consultants and think tank researchers that show cigarette tax noncompliance to be a significant issue

### Summary

A proposal to raise the state excise tax on cigarettes by \$1.50 a pack will cause cigarette sales in Michigan to decline by 18 percent — and lead to increased smuggling from outside the state.

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Raising the state's tobacco tax will send smokers to out-of-state sources for cigarettes.

A 2005 paper in the Journal of Health Economics by economist Mark Stehr, titled “Cigarette Tax Avoidance and Evasion,” concludes that up to 85 percent of the after-tax change in consumption is a function of tax evasion and avoidance. The rest comes from kicking the smoking habit. In other words, most people keep smoking after a tax increase; they just acquire their smokes elsewhere. Another paper is co-authored by Kevin Callison, then an economist at Grand Valley State University. The article in the journal Economic Inquiry, titled “Do Higher Taxes Reduce Adult Smoking,” found that it takes a 100 percent increase in cigarette tax rates to reduce the adult smoking rate by about five percent.

Remarkably, smuggling isn’t the only major consequence of these higher taxes. In Michigan we have seen violence against police, people and property, all tied to the illicit trade in smokes. Delivery trucks have been hijacked and drivers hogtied by scofflaws looking for an easy buck. All of this is a function of Lansing politicians turning cigarette packs into little gold bars through implementing sky-high taxation.

This is what makes the current proposal baffling. The press release associated with the bill mentions neither the cigarette tax hike nor the fact that 90 percent of the new revenues expected from it would flow to state’s General Fund instead of, say, to health initiatives.

House Bill 4188 reads like just another Lansing revenue grab. Its advocates may sell it as a way to improve public health, but the evidence shows it will not be very effective at doing that. Indeed, the increased cost of lawlessness in the state may offset any good done by persuading a tiny portion of the population to stop smoking traditional cigarettes, while enriching Indiana retailers and their state treasury.

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