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Rhode Island's Cigarette Tax Hike Would Fuel Smuggling

Rhode Island House Finance Committee

MACKINAC CENTER
FOR PUBLIC POLICY

Thank you for the opportunity to submit testimony on House Bill 7127.

Raising Rhode Island's cigarette tax by 75 cents per pack would significantly expand cigarette smuggling while reducing expected revenue. Our modeling estimates the increase would push tax evasion and avoidance — commonly known as smuggling — to 36% of total cigarette consumption, a 14-percentage-point increase. The higher rate would reduce cigarette excise tax revenue by 3.8% while drawing roughly 5 million additional packs into the state from lower-taxed or untaxed sources.

The outcome is predictable. At the proposed rate of $5.25 per pack, Rhode Island would widen tax differentials with neighboring Massachusetts and Connecticut, encouraging consumers to purchase cigarettes across state lines. Extensive research shows that cross-border shopping habits change quickly after a tax increase. Tax-stamp data and wholesale sales records consistently demonstrate that consumers respond rapidly to price disparities between neighboring jurisdictions.

New sales data reinforces that pattern. Using ZIP code-level wholesale data covering the third quarter of 2024 through the third quarter of 2025, we found that cigarette sales to retailers fell in 92% of Indiana ZIP codes bordering Michigan after Indiana increased its cigarette tax by $2 per pack. Over the same period, 64% of ZIP codes on the Michigan side of the border saw sales to retailers increase. The most plausible explanation is not a sudden change in smoking behavior. Rather, it came from consumers crossing the border for lower prices.

Rhode Island also faces exposure to organized smuggling networks. The proposed tax increase would create a $3.47-per-pack price advantage for nearby New Hampshire, providing strong incentives for long-haul trafficking operations. Historically, large interstate price gaps attract networks of organized criminal activity that transport untaxed cigarettes into high-tax states for resale. Our model suggests smuggling activity would likely be split roughly evenly between individual cross-border consumers and organized traffickers.

Our statistical model compares estimated cigarette consumption with legally recorded sales while controlling for variables such as border-county population, Native American reservation presence, and health trends. Adjusting tax rates within the model allows us to estimate smuggling and revenue outcomes under different conditions.

These results are consistent with decades of historical evidence. Consumers routinely seek untaxed and lower-taxed alternatives when governments sharply increase excise taxes on widely consumed products such as cigarettes. This activity undermines both projected tax revenue and public health objectives.

Rhode Island policymakers may hope to discourage smoking through higher taxes. But consumers who continue purchasing cigarettes at current tax levels have demonstrated a strong preference for the product. New tax increases are therefore likely to redirect purchases, not eliminate them, thus shifting sales to neighboring states or illicit markets.

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