

Tax hike on cigarettes would exacerbate an already large smuggling problem in Washington State and offer only little gains to public health

Fewer legal sales doesn't necessarily mean lower smoking rates

By Michael D. LaFaive and Todd Nesbit, Ph.D.; Adjunct Scholars for WPC

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Key Findings

1. *Increasing the excise tax on tobacco products in Washington by another 50 cents — to \$3.52 per pack — would exacerbate an already large smuggling problem.*
2. *Through 2013, Mackinac Center's economic model shows that Washington had the third-highest smuggling rate among 47 states.*
3. *Mackinac's estimate shows that, of all the cigarettes consumed in Washington in 2013, 46.4 percent were obtained as a result of tax evasion or avoidance.*
4. *Under a 50 cent increase in the tax, Mackinac estimates that smuggling will leap to 52.5 percent of the total market, moving Washington into second place among smuggling states.*

The Washington State Legislature appears again poised to go to the cigarette excise tax well. A proposal to hike the state's excise tax by another 50 cents — to \$3.52 per pack — would exacerbate an already large smuggling problem and offer little in the way of gains to public health.

We have created a statistical model to measure the degree to which cigarette smuggling occurs in most American states.¹ Through 2013, our model reported that Washington had the third-highest smuggling rate among 47 states. Our estimate shows that, of all the cigarettes consumed in Washington that year, 46.4 percent were obtained as a result of tax evasion or avoidance. The state's smuggling rate would be four points

higher if we did not subtract out cigarette smuggling exports going to Canada.

We are not the only team of scholars to tag Washington state with a very high smuggling estimate. On February 19, 2015 the National Research Council and the Institute of Medicine released its own state-by-state smuggling estimates in a report titled, "Understanding the U.S. Illicit Tobacco Market: Characteristics, Policy Contest, and Lessons from International Experiences," in which they estimate Washington's smuggling rate for 2012 at 45.5 percent.²

In other words, two groups of analysts, working independently, made nearly

1 "A State-Level Analysis - Cigarette Taxes and Smuggling," by Michael D. LaFaive, Patrick Fleenor and Todd Nesbit, Ph.D, Mackinac Center for Public Policy, December 3, 2008 at <http://www.mackinac.org/10030>.

2 "Understanding the U.S. Illicit Tobacco Market: Characteristics, Policy Contest, and Lessons from International Experiences," by Peter Reuter and Malay Majmundar, Committee on the Illicit Tobacco Market, February 19, 2015 at http://www.nationalacademies.org/OCGA/Briefings/OCGA_157010.

identical smuggling estimates. Even if both are off by 10 or 15 percentage points Washington still has a rampant problem that could get even worse. The state's own smuggling estimate for 2013 is 32.9 percent of the total market.

To measure the future impact of adding 50 cents per pack onto the state's existing tax, we reran our model at the higher rate. It reports that smuggling will leap to 52.5 percent of the total market, moving Washington into second place among smuggling states, behind only New York State, whose smuggling problems are exacerbated by New York City's municipal excise tax of \$1.50 and its proximity to tobacco state Virginia.

Perhaps more instructive is that the model is informing us that Washington is getting dangerously close to the point at which revenues from a higher excise tax will turn negative. We estimate that the higher excise tax will only raise about 3.3 percent or \$13.5 million more than it does now due to a drop in legal paid sales of 11.4 percent.

It is worth noting that the state's own estimates aren't too different. They estimate new revenues of \$18 to \$20 million in the year following the hike and a legal paid sales decline of 9.5 percent.

As a large percentage of Washington's population lives along the I-5 corridor, it does not strain credulity to suggest that large amounts of illicit cigarettes are being trucked up from Oregon, which maintains an excise tax of just \$1.31 per pack. We also suspect that Washington's busy port system facilitates the illegal transit of untaxed smokes, but our model is not yet designed to measure it.

Michael LaFaive is director of fiscal policy with the Mackinac Center for Public Policy in Midland, Mich. Todd Nesbit, Ph.D., is a senior lecturer in economics at The Ohio State University and a member of the Mackinac Center's Board of Scholars.

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We do recognize that supporters of such tax hikes for health reasons are well intentioned, but evidence suggests that illicit sources of smokes may be undermining their goals.

In 2004, economist Mark Stehr published a paper that suggested up to 85 percent of the change in legal paid sales of cigarettes may be attributed to tax avoidance or evasion, and not from people ending their smoking habits.

The authors of a 2014 study, "Do Higher Tobacco Taxes Reduce Adult Smoking?" published in the peer-reviewed *Journal of Economic Inquiry*, are skeptical as well. They write: "Considering all the evidence, we conclude that there is insufficient justification for the widespread belief that raising cigarette taxes will significantly reduce cigarette consumption among adults, even young adults."³

The reasoning behind this is simple. People turn to illicit markets for cheaper (and we argue, sometimes more dangerous) alternatives and those who still smoke have a "strong preference" for doing so. Lawmakers should never confuse declines in legal paid sales with a decline in smoking rates. The former need not lead to the latter, especially to the degree health advocates hope.

By opposing a further cigarette excise tax increase, Washington legislators will avoid forcing residents to accept substantial increases in lawlessness in exchange for modest reductions in smoking rates.

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3 "Do Higher Tobacco Taxes Reduce Adult Smoking?" by Kevin Callison and Robert Kaestner, *Journal of Economic Inquiry*, January 2014 at <https://olis.leg.state.or.us/liz/2015R1/Downloads/CommitteeMeetingDocument/49775>.