



TOBACCO TAXES

High cost, little benefit

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Executive summary

- » Tobacco taxes are regressive. The poor tend to spend a higher proportion of their income on tobacco products, and they have higher rates of tobacco use than people with higher incomes. In 2018, Minnesotans with incomes of \$35,000 or less had a smoking rate of 24.1 percent compared to 8.7 percent among people with incomes over \$75,000. Predictably, the Minnesota Department of Revenue estimated that in 2018 individuals in the lowest population decile paid an effective tax rate of 2.77 percent on tobacco products compared to the 0.05 percent paid by individuals in the top decile.
- » Convenience stores in Minnesota lose when users are forced to patronize stores in other states with low taxes. After the 2013 tax hike, border communities saw, on average, a 30.1 percent decline in cigarette sales — 50 percent larger than the nationwide reduction of 19.8 percent — and a loss of about \$38 million in non-tobacco products. Consequently, Minnesota experienced a loss of 1,100 jobs, \$110.9 million in economic activity, and \$10.7 million in business and personal taxes due to the cigarette tax hike.
- » Cigarette tax hikes encourage smuggling as smokers who want to avoid high taxes cross state lines to buy in low-tax states and criminal entities are incentivized to transport large quantities of cigarettes into Minnesota from low-tax states for profit. In 2018, Minnesota had the fifth highest tax rate per pack of cigarettes in the country and also ranked fifth on cigarette smuggling — 36 percent of cigarettes smoked in Minnesota were smuggled in from other states. Between 2006 and 2018 Minnesota faced a 52 percent increase in cigarette smuggling. Coincidentally, the cigarette excise tax had grown by 142 percent during the same period.
- » E-cigarettes and other vaping products have been found to be significantly less harmful than traditional cigarettes, and they help smokers quit using tobacco. Making these products easily accessible could help reduce cigarette smoking as well as health issues associated with smoking. Alternatively, tax hikes and prohibition endanger public health by restricting access to vaping products and pushing people into using more harmful tobacco products.
- » Tobacco usage rates were already falling in Minnesota before the 2013 tax hike. Cigarette use declined by 90.1 percent among high school students and 78.0 percent for middle school students between 2000 and 2020. In fact, even after accounting for e-cigarettes, reported use of tobacco products among youths was significantly down in 2020 — 20.5 percent among high school students and 4.1 percent among middle school — compared to 2000, when it was 38.7 percent among high school students and 12.6 percent among middle schoolers.
- » Tax hikes have very little impact on tobacco use. This is because regular and long-term use is much more common among disadvantaged groups, such as people with mental health issues or low socioeconomic status, who are less likely to be deterred by high prices and therefore more likely to keep using tobacco. People with mental illnesses are two times more inclined to smoke than the average Minnesotan.

Introduction

On Jan. 26, Gov. Tim Walz unveiled his budget proposal for the next biennium — fiscal years 2022-23. Termed Minnesota’s COVID-19 Recovery Budget,¹ the proposal, among other things, aimed to resolve what has been termed a public health crisis — tobacco use. To decrease smoking and use of other tobacco products, especially among youths, Walz called for a \$1 cigarette tax hike per pack and the creation of a new gross receipts tax of 35 percent to be collected at retail on vaping products — i.e., sales of nicotine solution and devices. He also recommended introducing a 95 percent wholesale tax on electronic nicotine delivery systems (ENDS), like e-cigarette devices, to match the rate currently applied on nicotine and devices containing nicotine.

While Walz dropped the cigarette tax hike from his most recent budget proposal, he still plans to create a retail tax on nicotine and devices containing nicotine, as well as a wholesale tax on ENDS. In addition to Walz’s proposal, other bills were also

introduced this session to fight against tobacco use. On March 10, the Minnesota House Preventive Health Policy Division Committee passed a bill² to raise the excise tax per pack of cigarettes by \$1.50, as well as taxes on other tobacco products like e-cigarettes and chewing tobacco by 2 percent. The bill also calls for the taxation of e-cigarettes as tobacco products. In addition, another bill³ was introduced in the House of Representatives to ban flavored tobacco — including flavored e-cigarettes — to reduce their appeal to the young. These bills went nowhere, but clearly our lawmakers are on a mission to end tobacco use, and the war on nicotine will likely rage on into the foreseeable future.

Smoking is a proven public health problem so these proposals to curb smoking are well-intentioned and laudable. Evidence, however, suggests that not only are tax hikes and/or prohibition ineffective at reducing tobacco use, they also come with a myriad of other unintended consequences. ■



Generally, cigarettes and other tobacco products are what economists call “price inelastic,” meaning a rise in price does not significantly reduce demand. This is mainly due to tobacco’s addictive nature. Furthermore, regular and long-term cigarette use is much more common among disadvantaged groups like people with poor mental health who are unlikely to respond to price changes.

According to the National Institute on Drug Abuse,⁴ “People with mental illness smoke at two-to-four times the rate of the general population.” Smoking rates are, furthermore, highest among mentally ill individuals with compounding socio-economic conditions like poverty and low education. Not only do people with mental illness smoke more, but they are also less likely to quit compared to people with no mental illness.⁵

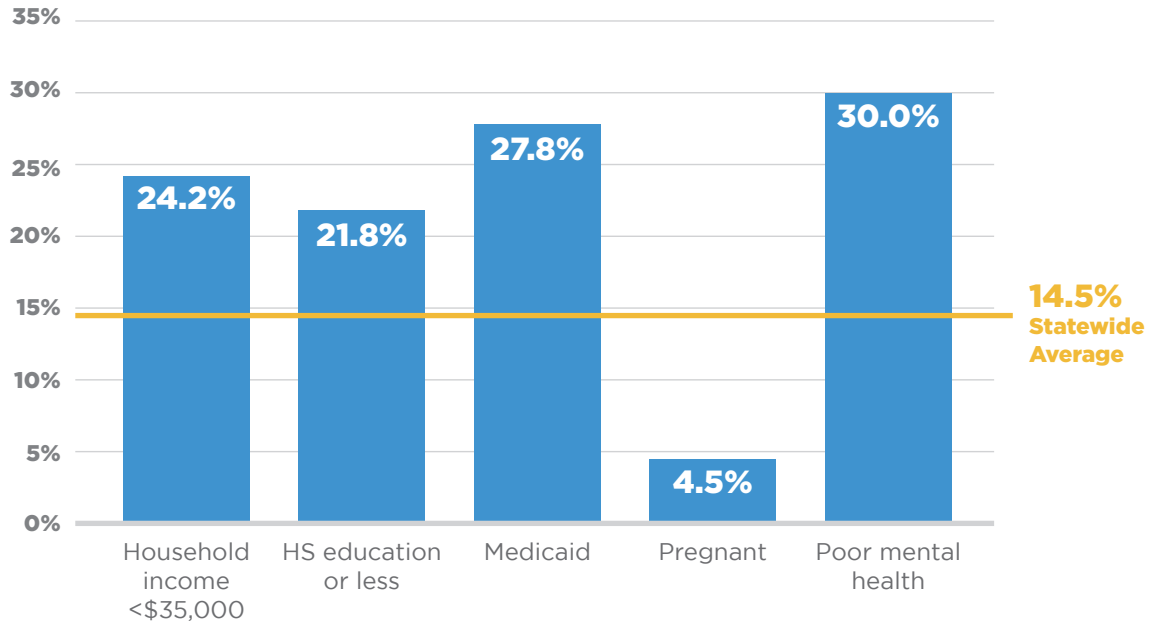
Indeed, evidence exists proving that tax hikes have only a minimal impact on smoking rates. Economists Kevin Callison and Robert Kaestner, for instance, had the following to say about the effect of tax hikes on smoking in their 2012 study:⁶

Estimates indicate that, for adults, the association between cigarette taxes and either smoking participation or smoking intensity is negative, small and not usually statistically significant.

Our evidence suggests that increases in cigarette taxes are associated with small decreases in cigarette consumption and that it will take sizable tax increases, on the order of 100%, to decrease adult smoking by as much as 5%.

A sub-50 percent increase in cigarette taxes, like the ones proposed, is therefore less likely to reduce smoking significantly. While there is evidence that tax hikes on cigarettes discourage people from smoking, these effects are mainly restricted to certain demographics that are more sensitive to prices — usually youths and young adults.⁷ These groups, however, are unlikely to be regular cigarette or tobacco users. Among adults, studies have documented little or no decline in smoking after tax increases, even among low-income individuals.⁸ In fact, when Minnesota increased cigarette taxes in 2013, smoking rates for people earning less than \$24,999 declined only 5.4 percent, while smoking rates for those earning \$50,000 or more declined 10.1 percent.⁹ Heavy/long-term smokers are simply not particularly discouraged from smoking by higher prices.¹⁰ ■

FIGURE 1
**Smoking Prevalence Among Minnesota Adults
by Subgroup, 2016**



SOURCE: MINNESOTA DEPARTMENT OF HEALTH



The 2013 cigarette tax hike

In 2013, Minnesota raised its cigarette excise tax by \$1.60 — a 130 percent change. After the tax increase, a 2017 study published by the Minnesota Department of Health (MDH) touted that smoking in Minnesota went down 10 percent. In 2021, MDH reported that between 2013 and 2019, among 11th graders, smoking fell from 12.2 percent to 5.3 percent.¹¹

These statistics, while shining a bright light on taxes, do not tell the whole story. For one, smoking has been on a steady decline even before the tax hike — for both adults and youths. Current cigarette use declined by 90.1 percent among high school students and 78.0 percent for middle school students between 2000 and 2020. Even after accounting for e-cigarettes, reported use of tobacco products among youths was significantly down in 2020 — to 20.5 percent among high school students and to 4.1 percent among middle schoolers — compared to 2000's rates of 38.7 percent and 12.6 percent. Uniformly, cigarette use initiation, which is given by the number of people who report "ever" smoking cigarettes declined for both middle and high school

students as shown in Figure 3, meaning fewer and fewer young people are taking up smoking.

This trend is not specific to Minnesota. According to the Centers for Disease Control and Prevention (CDC), tobacco use has declined nationally from 34.5 percent in 2000 to 23.6 percent in 2020 among high school students, and from 15.1 percent

in 2000 to 6.7 percent in 2020 for middle school students. Current cigarette use declined by 85.7 percent between 2000 and 2020 among high school students and 85.5 percent among middle school students. Likewise, adult smoking rates fell for both the nation and Minnesota between 1999 and 2018 (Figure 4). This strongly suggests that tax hikes, to the extent that they discouraged smoking, only did so at very small margins.

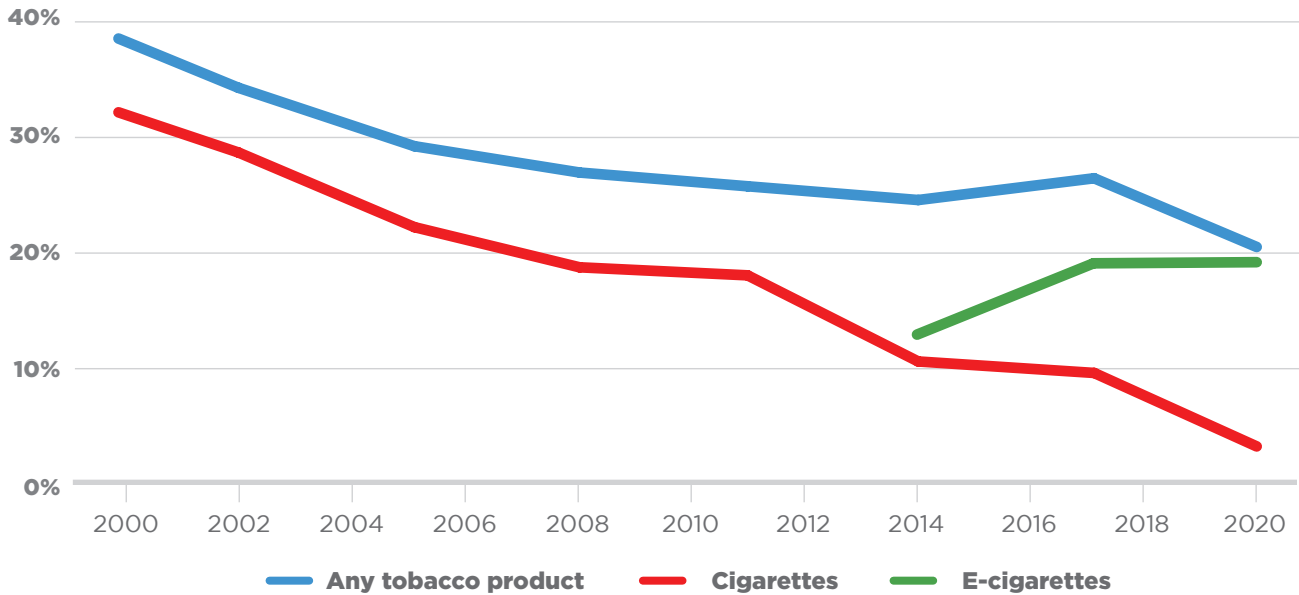
As of late, evidence has come out to suggest that youths are not responding to taxes as they used to. A 2015 study¹² found evidence suggesting that since 2005, youths have become less responsive to cigarette taxes. More specifically, there was "little evidence of a negative relationship between cigarette taxes and youth smoking" when they

Current cigarette use declined by 90.1 percent among high school students and 78.0 percent for middle school students between 2000 and 2020.

FIGURE 2

Percent of High School Students Who Used Various Tobacco Products

On one or more days in the past 30 days, 2000-2020 (Current use)

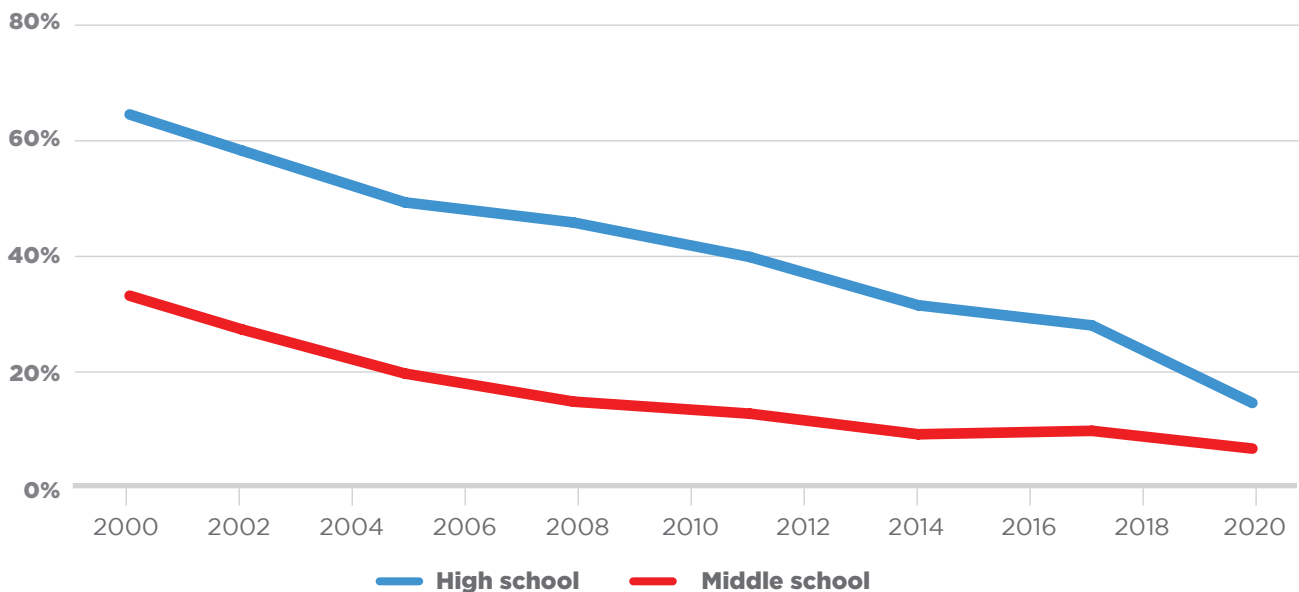


SOURCE: MINNESOTA DEPARTMENT OF HEALTH

FIGURE 3

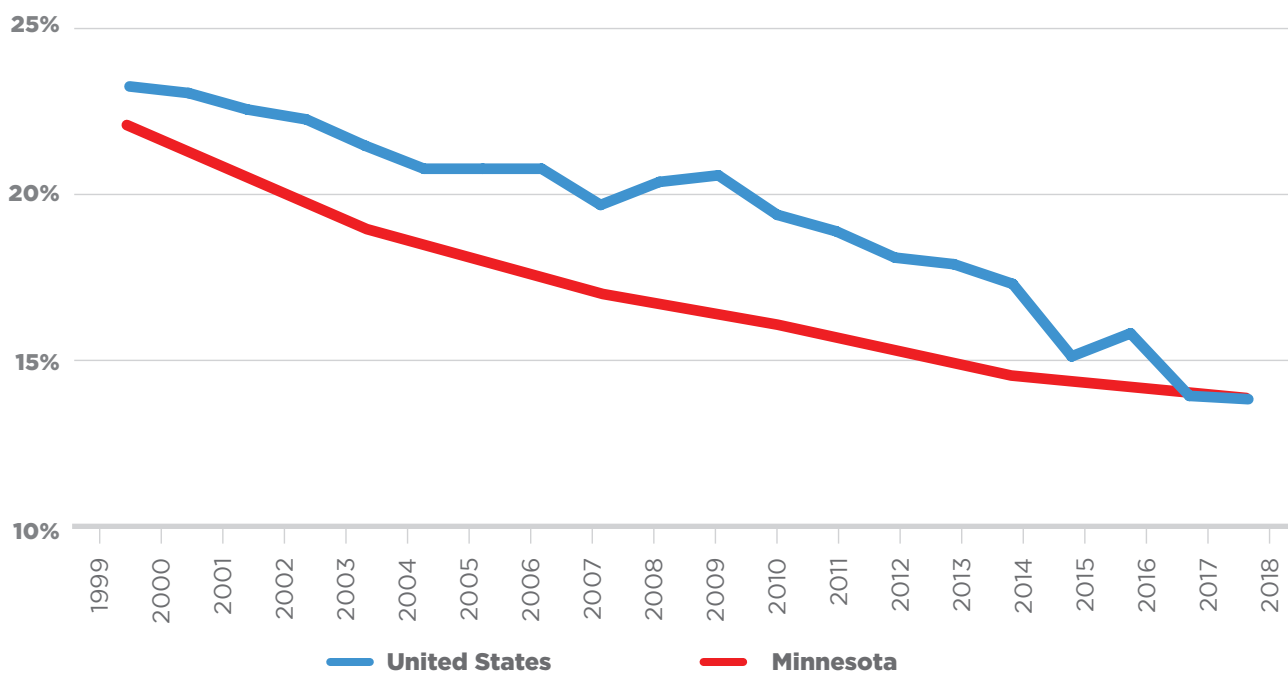
Percent of Students Who Have “Ever” Smoked Cigarettes

2000-2020



SOURCE: MINNESOTA DEPARTMENT OF HEALTH

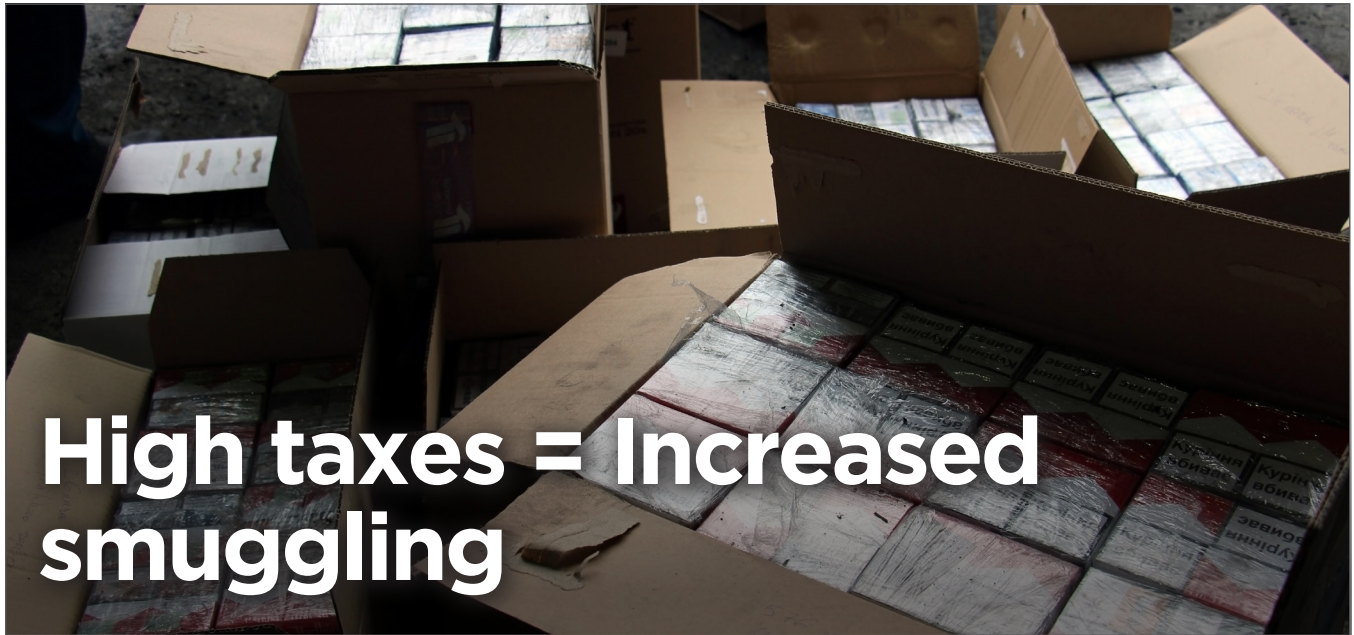
FIGURE 4
Percent of Adults Who Smoke
 1999-2018



SOURCE: MINNESOTA ADULT TOBACCO USE SURVEY, 2018

restricted their study to the period of 2007 to 2013. This puts an even bigger damper on the idea that tax hikes will reduce smoking among Minnesota's youth. Even the MDH reports that, in a lot of cases, tobacco use in youths is an influence mostly of

their social surroundings. According to the MDH, "Students who use tobacco are twice as likely as non-users to live with someone who also uses tobacco." Taxes are therefore not the magic bullet to tobacco use that lawmakers proclaim them to be. ■



While tax hikes have little discernible effect on tobacco use, they do encourage smuggling. Smokers who want to avoid higher taxes cross state lines and buy cigarettes from low-tax states for personal consumption — casual smuggling. Additionally, criminal entities may transport large quantities into Minnesota for profit from low-tax states — also known as commercial smuggling.

In 2018, a report by the Mackinac Center and Tax Foundation¹³ ranked Minnesota fifth highest among the states and D.C. on cigarette tax rate per pack — Minnesota's \$3.04 excise tax plus a \$0.574 sales tax pushed Minnesota's total tax burden per cigarette to \$3.614.

In the same year, Minnesota ranked fifth among the 47 states included in the study for its rate of cigarette smuggling — 36 percent of cigarettes consumed in 2018 were smuggled into the state. Prior to 2014, the number of cigarettes smuggled into Minnesota was already quite high — averaging about a quarter of all cigarettes consumed in the state. Notwithstanding, smuggling worsened after Minnesota's \$1.60 cigarette excise tax hike in 2013. Minnesota leapt 11 spots from 16th highest in 2013 to fifth highest in 2014¹⁴ and has consistently

If lawmakers raise the cigarette excise tax by \$1.50, we will have the country's highest tax rate per pack.

ranked high since then.

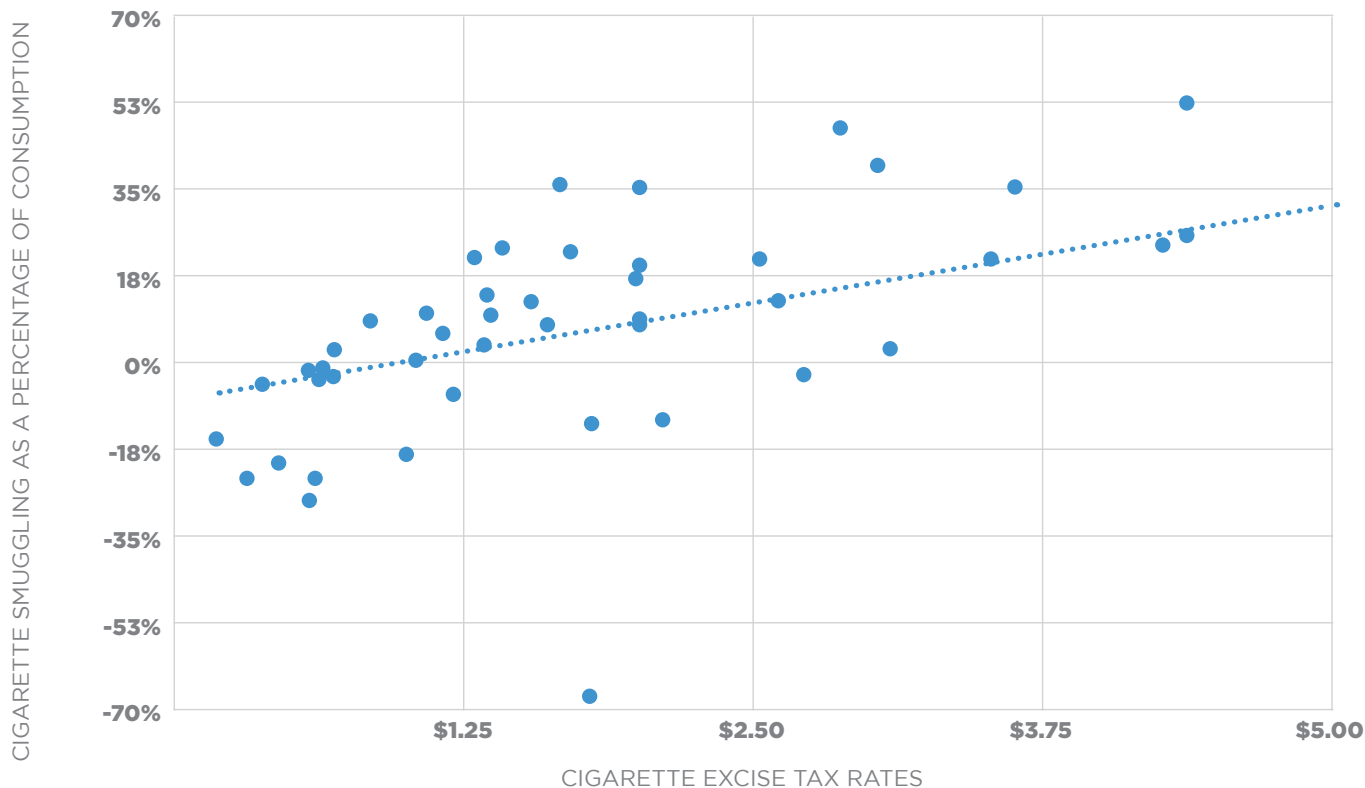
Currently, Minnesota's tax rate per pack of cigarettes is \$3.673 — a \$3.04 excise tax plus \$0.633 sales tax. Thanks to North Dakota's tax of 44 cents per pack, a Minnesotan buying cigarettes in the Peace Garden State currently stands to save \$3.233 in taxes. If lawmakers had raised the cigarette

excise tax by \$1.50, we would have had the country's highest tax rate per pack — \$5.173 — and Minnesotans buying in North Dakota would have saved \$4.733 per pack. Therefore, a Minnesota smoker, especially in the region bordering North Dakota, would have had a bigger incentive to buy even more of his

or her cigarettes in Fargo, Grand Forks or any other place across the state border. Furthermore, this would also have increased the incentive for smugglers to buy cigarettes from North Dakota and sell them in Minnesota for profit. With a \$1.50 tax hike, a commercial smuggler transporting 100,000 cigarette packs stands to make more than \$450,000 in profit due to the high tax difference.

The relationship between smuggling and high taxes is very well-documented — as shown in Figure 5, cigarette smuggling goes up as cigarette

FIGURE 5
Cigarette Smuggling vs. Cigarette Excise Tax Rates
 2018



SOURCE: THE TAX FOUNDATION AND THE MACKINAC CENTER FOR PUBLIC POLICY

excise tax rates increase. Minnesota has experienced a 52 percent increase in its smuggling activity between 2006 and 2018. Coincidentally, the cigarette excise tax rate had grown 142 percent during this same period. Raising taxes further would have worsened smuggling, increasing violent crime, theft and other offenses that go hand in hand with an underground market like murder and the sale of illegal weapons.¹⁵ According to researchers at the Mackinac Center, a what-if analysis using a prior model suggests that smuggling could have jumped to as much as 48.44 percent if the excise tax had gone up by \$1.50. In that case, almost half of all cigarettes consumed in Minnesota would be from outside of the state.

For Minnesota, where crime is rising and law enforcement is overwhelmed, increased smug-

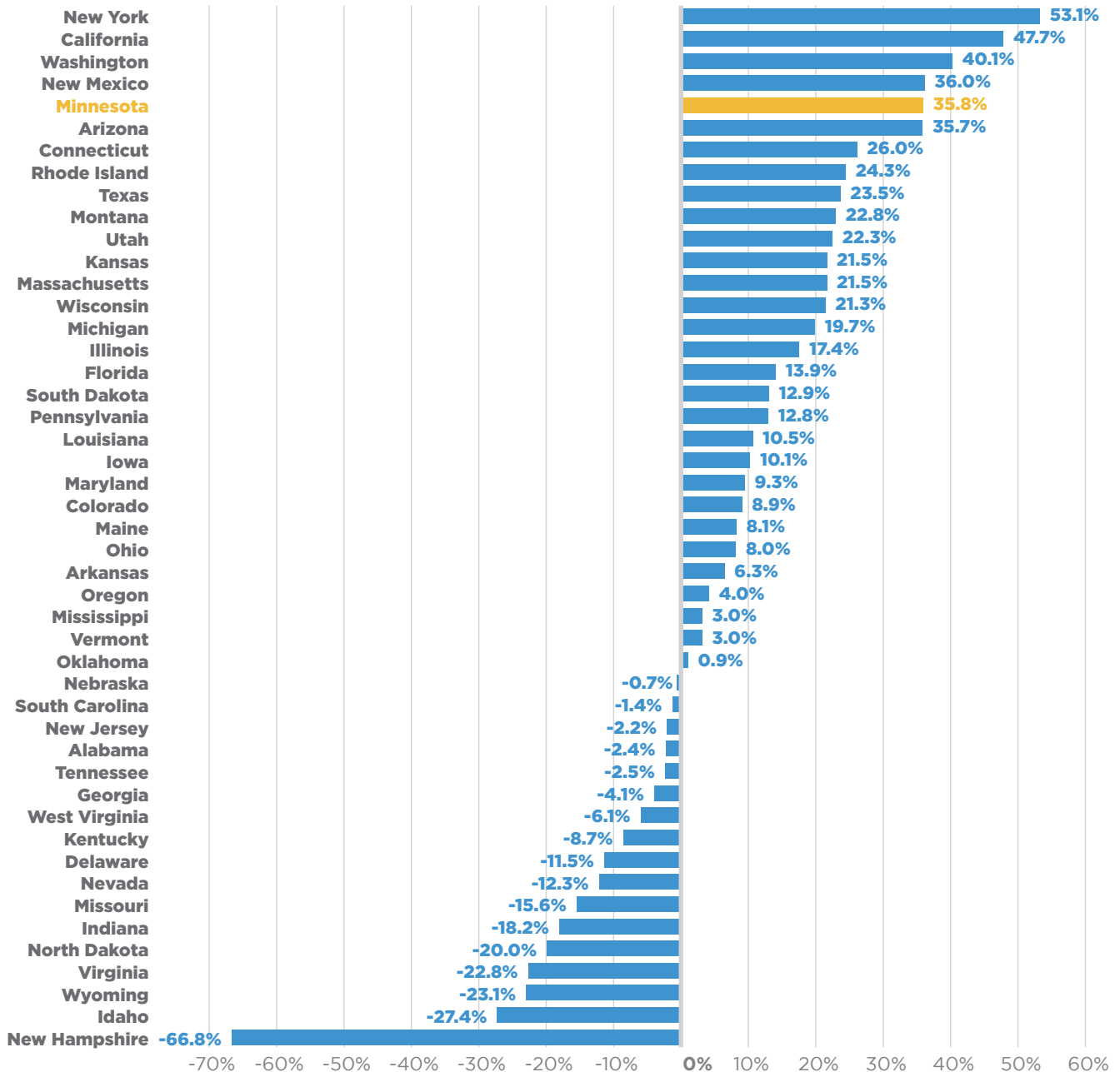
gling will further burden the public safety system, taking officers away from fundamental services so they can police tobacco prohibition or smoke out smugglers, work that does not contribute to increased public safety. Besides, unnecessary increased interactions between police and individuals could potentially worsen outcomes. After all, a lot of communities in Minnesota are averse to law enforcement.

By the same token, criminalizing the sale of flavored tobacco products will not decrease use but will create room for an illegal market and push sales to other states that have no such restrictions. One need not look further than Massachusetts, which banned flavored cigarettes only to face an increased rate of smuggling. According to an analysis by the Tax Foundation,¹⁶ even though sales of

FIGURE 6

Percent of Cigarette Consumption Smuggled

2018 (Positive = inflow, negative = outflow)

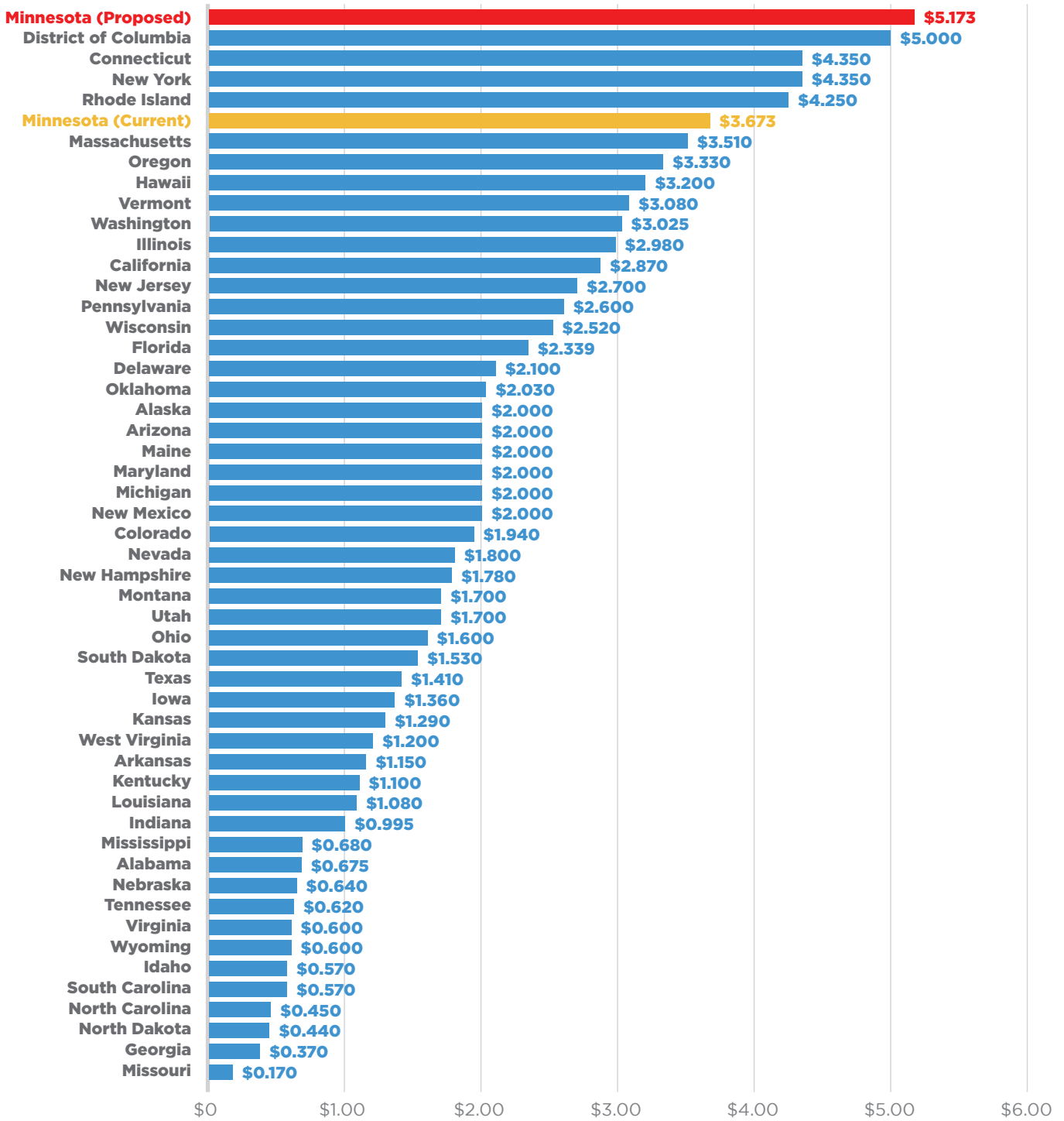


SOURCE: THE TAX FOUNDATION AND THE MACKINAC CENTER FOR PUBLIC POLICY

cigarette stamps declined in Massachusetts after the ban, sales of cigarette stamps in the Northeast were stable, proving that prohibition merely changed the point of sale and not usage. In Cana-

da, a ban on menthol cigarettes led to no decrease in smoking rates but rather a shift to non-menthol products, and also sales of menthol to Indian reservations where bans are not binding.¹⁷ ■

FIGURE 7
Cigarette Tax per Pack
 2021



SOURCE: TAX POLICY CENTER



Smuggling hurts Minnesota businesses and workers

Cigarettes and other tobacco products are the staple of the convenience industry, making up about 35 percent of all in-store sales in 2020, with cigarettes around 28 percent of all in-store sales.¹⁸ Tobacco sales also drive consumer spending on other non-tobacco products like gasoline, snacks, food and lottery tickets. Because tax hikes and prohibition merely shift sales, Minnesota convenience stores stand to lose significantly if our lawmakers go forward with proposed tax hikes.

When Minnesota increased the cigarette excise tax in 2013, cigarette sales in the state significantly dropped. Border communities saw on average a 30.1 percent decline in cigarette sales — 50 percent larger than the national reduction of 19.8 percent — and a loss of about \$38 million in sales of non-tobacco products. In contrast, the bordering states of Iowa, Wisconsin, South Dakota and North

Dakota saw increases in sales, mostly clustered at the border communities. Consequently, Minnesota experienced a loss of 1,100 jobs, \$110.9 million in overall activity and \$10.7 million in business and personal taxes due to the cigarette tax hike.¹⁹ We should expect similar results if taxes are raised even further.

Smuggling associated with tax hikes also costs Minnesota taxpayers — smugglers do not pay taxes and they hurt legitimate businesses that do pay taxes. The Mackinac Center for Public Policy²⁰ estimated that in 2018, Minnesota had the seventh highest number of cigarettes smuggled into its borders — 81.2 million. Because of that, an estimated \$293.5 million in tax revenue went uncollected. This is money that the Minnesota government could have invested in smoking prevention and cessation programs. ■



Tobacco taxes are regressive

Tobacco taxes hit the poor the hardest for two reasons:

1. Tobacco taxes are a tax on consumption, and low-income individuals tend to spend a higher proportion of their incomes on consumer products.
2. Low-income individuals consume cigarettes at disproportionately higher rates compared to high-income individuals and use cigarettes more frequently or with higher intensity.

In 2018, individuals who earned \$35,000 or less had a smoking rate of 24.4 percent compared to 8.7 percent for individuals with household incomes of \$75,001 or more. Additionally, 4.1 percent of smokers with incomes over \$75,000 smoked 21-plus cigarettes a day compared to 8.1 percent of smokers with \$35,000 or less.²¹

In the 2021 Minnesota tax Incidence Report,²² the Minnesota Department of Revenue noted that in 2018, cigarette and tobacco taxes were one of the

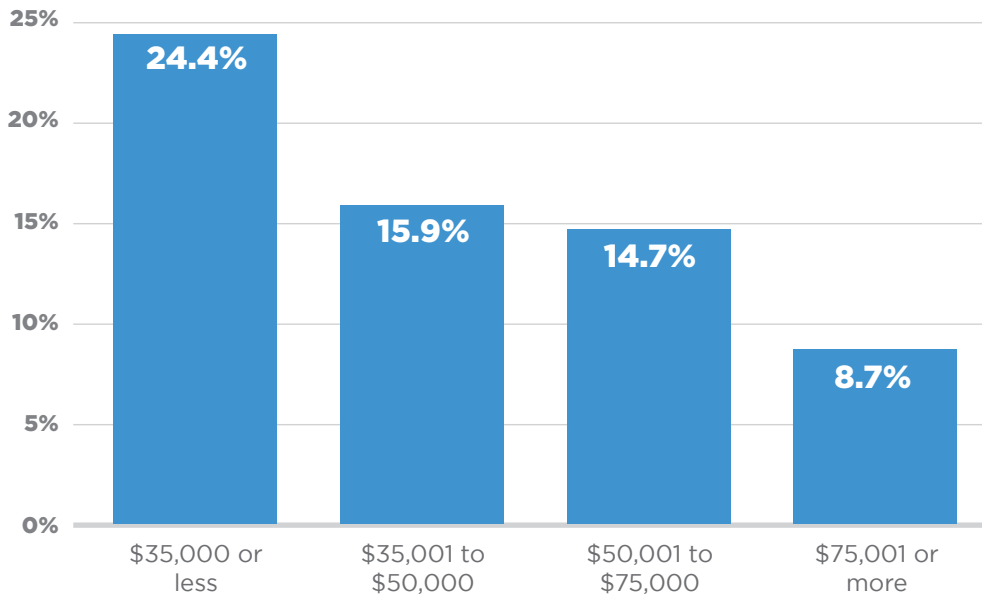
most regressive taxes. Households in the first population decile, i.e., the 10th with the lowest incomes, paid an effective rate of 2.77 percent on tobacco taxes compared to the 0.05 percent paid by those in the top decile — the 10th with highest incomes.

Consider, for instance, Minnesota's current tax per pack of cigarettes. At \$3.673 total tax per pack, a person with \$35,000 in income smoking one pack a day effectively spends 3.8 percent of total income on cigarette taxes. This is more than two times the rate paid by a person with \$75,000 in household income — 1.8 percent. Raising the excise tax by \$1.50 means low-income smokers — \$35,000 household income — will spend 5.4 percent of income on cigarette taxes while high-income smokers — \$75,000 household income — will spend 2.5 percent of their income on cigarette taxes. Given the fact that low-income nicotine addicts are less likely to respond to tax hikes, low-income Minnesotans will suffer much more significantly by tax hikes on tobacco products. ■

FIGURE 8

Adult Smoking Rates in Minnesota

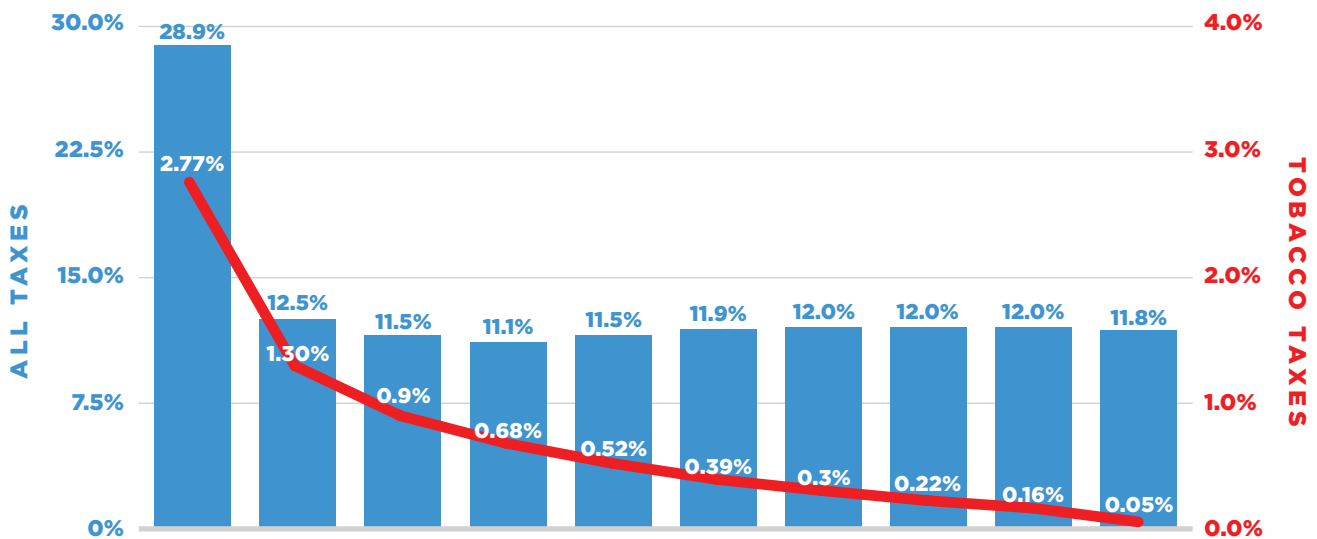
By income (2018)



SOURCE: MINNESOTA ADULT TOBACCO SURVEY, 2018

FIGURE 9

Effective Tax Rates by Population Decile



SOURCE: MINNESOTA DEPARTMENT OF REVENUE



Vaping restrictions increase cigarette use

Nicotine is generally not considered hazardous, but ingredients in cigarettes, when burned, create chemicals that are linked to cardiovascular and respiratory diseases as well as other health risks. E-cigarettes and other vaping products allow users to consume nicotine in vapor form. This means that users inhale little²³ to no²⁴ toxins. A study by Public Health England (PHE) estimated that e-cigarettes are around 95 percent less harmful compared to combustible cigarettes.²⁵ E-cigarettes are also generally less addictive compared to traditional cigarettes.²⁶

So, to put it shortly, e-cigarettes represent only a small fraction of the risk associated with smoking, which means that, as PHE puts it, “encouraging smokers who cannot or do not want to stop smoking to switch to e-cigarettes could help reduce smoking-related disease, death and inequities.” In addition to the little risk that they present to users, e-cigarettes also help people quit smoking. Numerous studies have documented evidence showing that people who vape are more likely to quit smoking than smokers who use traditional methods like counsel-

ling²⁷ or Nicotine Replacement Therapy,²⁸ or those who do not use e-cigarettes more frequently.²⁹ Research indicates that flavors play a role in making e-cigarettes more appealing to people who use them to quit or to cut back on smoking traditional cigarettes.³⁰

If policymakers are, therefore, serious about protecting public health, they should aim to re-

If policymakers are, therefore, serious about protecting public health, they should aim to reduce taxes on vaping products and refrain from criminalizing them.

duce taxes on vaping products and refrain from criminalizing them. Research³¹ has shown that e-cigarettes and traditional cigarettes are economic substitutes. Accordingly, hiking taxes on e-cigarettes and banning them only encourages people to use traditional cigarettes,³² which are more harmful. When Minnesota hiked its e-cigarette tax in 2013, for example, 32,400 adult smokers were deterred from quitting smoking.³³

Generally, regular use of e-cigarettes among youths is rare, but usually coincides with reduced cigarette smoking. A 2017 CDC study found that an increase in the use of e-cigarettes and hookahs was associated with a decline in cigarette use among

U.S. middle school and high school students.³⁴ It goes without saying, then, that making electronic devices hard to acquire among youths will likely increase cigarette smoking.³⁵ State bans on e-cigarettes, in particular, have been found to increase conventional cigarette use among 12 to 17-year-olds, effectively slowing the rate of decline on cigarette smoking among teenagers.³⁶

Vaping taxes are already high in Minnesota. Among the states that impose a wholesale tax, Minnesota has the highest rate at 95 percent, seconded by Vermont's 92 percent. Raising them even

further is not only counterproductive but ineffective. Minnesota youths are already misinformed about the real risk of e-cigarettes. In 2020, only 18.2 percent of Minnesota youths said they considered e-cigarettes to be less harmful than regular cigarettes, down from 35.2 percent of respondents in 2017. Tax hikes and prohibition send the message that vaping products are equally as harmful as, if not more harmful than, cigarettes — added misinformation that makes youths less likely to switch from traditional cigarettes to less harmful vaping products. ■

Conclusion

Gov. Tim Walz and other policymakers support raising tobacco taxes by claiming that high prices discourage people from using tobacco. Evidence, however, shows that this is not the case. Smoking and tobacco use is prevalent among long-term users who are likely to be addicted and therefore less likely to change their habits due to increases in prices.

Furthermore, cigarette tax hikes create room for illicit markets by encouraging smuggling from low-tax states, effectively robbing Minnesota of business, jobs, economic activity and tax revenue. High taxes on tobacco products also fall dispropor-

tionately heavily on the poor.

If policymakers want to reduce harm and health risks associated with tobacco use, they should reduce taxes on e-cigarettes and other vaping products and forgo criminalization of such products. Vaping is less harmful than combustible tobacco and helps smokers quit. Even the FDA³⁷ recognizes the role that “flavored noncombustible” tobacco products play in harm reduction by helping smokers switch to less harmful tobacco products. Fewer choices, as well as higher taxes, are not the way to achieve the results so many desire. ■

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