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Todd Nesbitt commentary: Proposed increase in cigarette tax is too high



Gov. John Kasich's recent proposal to increase the excise tax imposed on cigarettes by 80 percent, or \$1 per pack, will raise more than just revenue. It also will raise the rate at which cigarettes are illegally smuggled into the Buckeye State and likely increase other unintended consequences, such as violence against people and police.

The research I did with [Mackinac Center](#) colleague Michael LaFaive on cigarette smuggling — published this year in concert with the Tax Foundation — indicates that through 2013, about 7 percent of all cigarettes consumed in Ohio were illicit. That is a relatively trivial amount compared with Michigan, which has a smuggling rate of 25 percent. If Ohio raises excise taxes by \$1 per pack, we will see changes on both sides of the border and not all of them good ones.

Using a statistical model, LaFaive and I estimate that Ohio's smuggling rate will increase by almost 210 percent, from 7.1 percent of the market to 22 percent. That is, of all the cigarettes consumed in Ohio, 22 percent would be illicit. This would move Ohio from 27th among the 47 states in our model to 14th, displacing Illinois.

We also estimate that first-year revenue would increase dramatically, even more so than officials believe. According to the Ohio Office of Budget and Management, the state will generate an additional \$315 million in 2016 if the new tax is imposed. Our first-year estimates come in much higher, at \$410.1 million.

Our model breaks smuggling rates into two major parts: commercial and casual. Casual smuggling occurs when individuals cross some legal jurisdiction — into another state, such as Kentucky, for instance — and buy cigarettes for personal use. Commercially smuggled smokes occur via long-haul, large shipments for broad distribution by organized cells.

What is unique about Ohio is that in 2013, it was a net exporter of casually smuggled cigarettes. That is, for every 100 cigarettes consumed, an additional two were smuggled out to neighboring states. Many Wolverines seem to overlook their natural rivalry with Ohio in order to acquire less-expensive smokes.

This rate will invert if Kasich's tax-increase plan materializes, and 2.2 percent of the total smuggling rate will be attributed to casual smuggling. Michigan won't be the only source state, as every state bordering Ohio will have lower cigarette taxes.

All of this may seem like bad news for law-enforcement and revenue officials in Ohio, but it is only the tip of the iceberg. Kasich also wants to raise excise taxes on other tobacco products (loose tobacco, chew, etc.) from 17 percent of the wholesale price to 60 percent. But neighboring Pennsylvania has no tax on other tobacco products.

One doesn't need a doctorate in economics to understand the opportunities here, and rest assured the criminal class gets it. Organized traffickers, which we believe will move the majority of the smuggled cigarettes into Ohio (about 19 percent of all smuggled smokes), are no doubt looking forward to the higher excise taxes already.

In addition to smuggling, we also have witnessed every other sort of unintended mischief related to high cigarette excise taxes. Violence against police, people and property are a few. One high-profile smuggling case resulted in the arrest of traffickers running cigarettes between low-tax North Carolina (45-cent tax per pack) and Michigan and funneling their profits to support terrorist groups such as Hezbollah. If Kasich's tax increase passes, folks like that won't need to drive as far north to finance their activities.

It is true that an increase in cigarette excise taxes will help some people quit, but not nearly as many as politicians and health advocates think. Two studies by different academics suggest that up to 85 percent of the reduction in legal sales after any particular tax increase is a result of people avoiding taxes rather than people giving up smoking.

The solution is a more-rational tax policy. Raising the excise tax of a popular product by 80 percent when surrounded by much-less-expensive sources is a recipe for rampant disregard for the law, among other issues. The governor should propose a lower increase or none at all.

Todd Nesbitt is a senior lecturer in economics at Ohio State University and a member of the Board of Scholars at the [Mackinac Center for Public Policy](#) in Midland, Mich.