

Has the first tax hike of 2024 just dropped?

Tobacco tax bill would take nearly \$400 million and give a boost to smuggling

By Michael D. LaFaive and Todd Nesbit, Ph.D. | November 2023

Senate Bill 648 was introduced November 9 with little fanfare, but it deserves a lot of attention for the size and scope of the revenue grabs and unintended consequences it will cause. The proposal would raise excise taxes on cigarettes by 75% (from \$2.00 per pack to \$3.50), increase the tax on other tobacco products from 32% to 57% of the respective wholesale price and impose a new tax on electronic smoking products. The cigarette tax hike alone may swipe an additional \$381 million from consumers, after accounting for the expected increase in cigarette smuggling.

This proposal will hurt consumers and likely do little in the way of gains to public health. It will, however, enrich crime syndicates and the Hoosier state, as Michigan consumers cross into Indiana for lower-priced smokes. It is the tax-induced cost difference between jurisdictions that helps drive tax evasion and avoidance, what we call “smuggling.”

We published a statistical model to study the degree to which cigarettes are smuggled around the country,

as well as from Mexico and to Canada in 2008. We update that model every year. Through 2021 we estimate that 18.2% of total cigarette consumption in Michigan was a function of cigarette smuggling. We estimate that, if the higher tax rate were adopted, Michigan’s cigarette smuggling rate would leap to 30.6%.

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Michigan consumers are not sheep lining up to be sheared. Many seek out lower-priced cigarettes. Indiana, at \$1.00 a pack, is a long-time source for lower cost tobacco. In fact, so many Indiana smokes are smuggled out to other states that its state treasury pulled in \$82.5 million more than it would have in 2021 absent smuggling. Much of that is a function of consumers just buying cigarettes for their own use, but there is another, more insidious part of the story: organized, brazen crime.

The last time we recorded smuggling rates above 30%, Michigan experienced large, long-haul smuggling from states like North Carolina, hijackings of cigarette-laden trucks, pistol-whipped drivers,

violence against police as well as customers, and more. These crimes occur to profit from a legal product, and criminals are seeking an advantage offered because of state tax policy.

It would be hopelessly naïve to believe that the Great Lake State would not see more such activities under a higher tax rate. Once a whiff of smoke-driven illicit profit hits the air, criminal cells will turn their attention back to Michigan.

State officials can't keep contraband such as cigarettes, narcotics and cell phones out of Michigan prisons. We could make the Great Lake State a police state and it wouldn't prevent waves of illicit traffic from flooding the state.

In the face of this it seems particularly odd that SB 648 mandates only 1% of revenue from the new tax on electronic smoking products be dedicated to enforcement. In addition, the Whitmer Administration removed the requirement that Michigan State Police dedicate a minimum of 16,600 hours to tobacco tax enforcement. More smuggling and less enforcement are an invitation to lawlessness.

Will all this new mischief be worth it? Proponents of the tax hikes, if they directly address it at all, will argue "yes." We have long known that higher taxes have induced people to quit, but the story is more nuanced than tax hikers seem to believe. Economist Kevin Callison, then of Grand Valley State, co-authored the

study "Do Higher Taxes Reduce Adult Smoking" in 2014, finding that it would take a tax hike of 100% to reduce the adult smoking rate by just 5%.

This bill raises more than cigarette taxes by \$381 million. It also hikes the tax on wholesale prices of chewing tobacco, snuff and other tobacco products. According to the House Fiscal Agency, the category "other tobacco products" is expected to generate nearly \$109 million in tax revenue through fiscal 2024, before the tax hikes take effect. It is exceedingly difficult to estimate revenues from the new tax on electronic smoking products, but we do expect the tax to contribute to smuggling of the products.

Michigan consumers are taxed enough and have demonstrated their willingness to buy lower-taxed products themselves or from organized scofflaws. Lansing politicians should not give them more reasons to do so.

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