Senate Committee on Assessment & Taxation
Senate Bill 233- Tobacco and liquor tax increases
Presented by Eric Stafford, Vice President of Government Affairs

THE KANSAS CHAMBER
UNITED FOR BUSINESS

Tuesday, March 24, 2015

Mister Chairman and members of the Committee, my name is Eric Stafford, Vice President of Government Affairs for the Kansas Chamber of Commerce. On behalf of the Kansas Chamber I appreciate the opportunity to provide written testimony **in opposition** to Senate Bill 233, which would dramatically increase the tax on alcohol and cigarettes in the state.

The Kansas Chamber Board-approved Legislative Agenda supports reductions in taxes to encourage investment and growth, not increase in taxes to sustain and maintain an appetite for spending. We support reductions in government spending instead of increasing the cost of doing business through tax increases and continue to encourage both the House and Senate to explore further savings available to the state. We understand that the Administration has suggested these 'sin' taxes as a way of plugging a revenue hole. However, targeting taxes on legitimate business products, whether alcohol, cigarettes or apple pie, is poor public policy given our peer states are looking to reduce their tax burdens, having taken a cue from what Kansas has started in recent years.

Now is not the time to succumb to the temptation of passing regressive tax increases to fill a temporary hole in the state's revenue stream. When the private sector experiences loss of revenue, it doesn't rush to increase the price of its products or services. Instead, businesses cut costs, reduce overhead, and may even reduce the price of the product or service to stimulate growth. Businesses, unlike government, can't force their customers to spend. The Legislature should avoid the temptation to force a tax increase to sustain growth in spending.

Increased taxes, especially sales and excise taxes, affect behavior. Tax more, get less. Taxing cigarettes and alcohol may be a way to socially engineer behavior but that is not the expressed intent of this bill. A $107M price tag has been affixed to this proposal to help plug a hole in a budget that can be plugged with reductions in spending. But, raising these taxes will affect behavior. Consider the Tax Foundation article attached, dealing with the phenomena of cigarette smuggling. It's obvious when reviewing the attached map why Missouri is a net-outflow state and Kansas is a net in-flow state for smuggled cigarettes. Our current ranking of 19th highest smuggling state would shoot to the top with passage of this legislation. Thank you for allowing us to testify in opposition to SB 233.

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The Kansas Chamber, with headquarters in Topeka, is the leading statewide pro-business advocacy group moving Kansas towards becoming the best state in America to do business. The Chamber represents small, medium and large employers all across Kansas.

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Cigarette Taxes and Cigarette Smuggling by State, 2013

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Key Findings

- Large differentials in cigarette taxes across states create incentives for black market sales.
- Smuggled cigarettes make up substantial portions of cigarette consumption in many states, and greater than 20 percent of consumption in fifteen states.
- The highest inbound cigarette smuggling rates are in New York (58.0 percent), Arizona (49.3 percent), Washington (46.4 percent), New Mexico (46.1 percent), and Rhode Island (32.0 percent).
- The highest outbound smuggling rates are in New Hampshire (28.6 percent), Idaho (24.2 percent), Virginia (22.6 percent), Delaware (22.6 percent), and Wyoming (21.0 percent).
- Smuggling rates jumped substantially in Illinois after hikes in state and county excise tax rates, from 1.1 percent of consumption in the last edition to 20.9 percent in this edition.
- Cigarette tax rates increased in 30 states and the District of Columbia between 2006 and 2013.

Public policies often have unintended consequences that outweigh their benefits. One consequence of high state cigarette tax rates has been increased smuggling as criminals procure discounted packs from low-tax states to sell in high-tax states. Growing cigarette tax differentials have made cigarette smuggling both a national problem and a lucrative criminal enterprise.

Each year, scholars at the Mackinac Center for Public Policy, a Michigan think tank, use a statistical analysis of available data to estimate smuggling rates for each state.[1] Their most recent report uses 2013 data and finds that smuggling rates generally rise in states after they adopt large cigarette tax increases. Smuggling rates have dropped in some states, however, often where neighboring states have higher cigarette tax rates. Table 1 shows the data for each state, comparing 2013 and 2006 smuggling rates and tax changes.

New York is the highest net importer of smuggled cigarettes, totaling 58.0 percent of the total cigarette market in the state. New York also has the highest state cigarette tax ($4.35 per pack), not counting the additional local New York City cigarette tax (an additional $1.50 per pack). Smuggling in New York has risen sharply since 2006 (+62 percent), as has the tax rate (+190 percent).

Smuggling in Illinois has also increased dramatically, from 1.1 percent to 20.9 percent since the last data release. This is likely related to the fact that the Illinois state cigarette tax rate was hiked from $0.98 to $1.98 in mid-2012. This increase in smuggling may continue in future data editions, as more recent increases in both the Cook County rate (from $2.00 to $3.00 per pack, effective March 1, 2013) and the Chicago municipal rate (from $0.68 to $1.18, effective January 10, 2014) have brought the combined state-county-municipal rate in the city of Chicago to $6.16 per pack of cigarettes, the highest combined rate in the country.[2]

Other peer-reviewed studies provide support for these findings.[3] Recently, a study in Tobacco Control examined littered packs of cigarettes in five northeast cities, finding that 58.7 percent of packs did not have proper local stamps. The authors estimated 30.5 to 42.1 percent of packs were trafficked.[4]

1 *See, e.g.*, Mackinac Center for Public Policy, Michael LaFaive, Todd Nesbit, & Scott Drenkard, *Cigarette Smugglers Still Love New York and Michigan, but Illinois Closing In* (Feb. 2015), http://www.mackinac.org/20900; Mackinac Center for Public Policy, Michael LaFaive, & Todd Nesbit, *Cigarette Smuggling Still Rampant in Michigan, Nation* (Feb. 2014), http://www.mackinac.org/19725; Mackinac Center for Public Policy, Michael LaFaive, & Todd Nesbit, *Higher Cigarette Taxes Create Lucrative, Dangerous Black Market* (Jan. 2013), http://www.mackinac.org/18128; Mackinac Center for Public Policy, Michael LaFaive, *Cigarette Taxes and Smuggling 2010: An Update of Earlier Research* (Dec. 2010), http://www.mackinac.org/14210; Mackinac Center for Public Policy, Michael LaFaive, Patrick Fleenor, & Todd Nesbit, *Cigarette Taxes and Smuggling: A Statistical Analysis and Historical Review* (Dec. 2008), http://www.mackinac.org/10005.

2 The Civic Federation, *Higher Tax Rates in Effect for Chicago Tobacco Consumers* (Jan. 2014), http://www.civicfed.org/civic-federation/blog/higher-tax-rates-effect-chicago-tobacco-consumers.

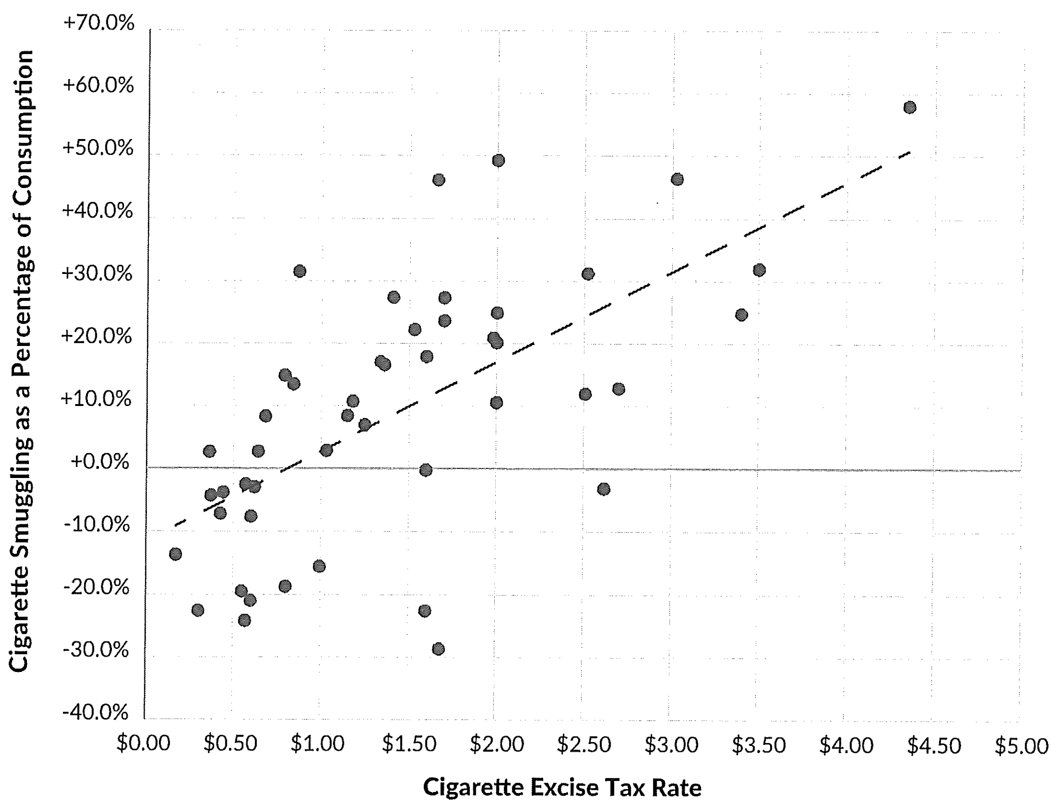
3 *See, e.g.*, Michael F. Lovenheim, *How Far to the Border?: The Extent and Impact of Cross-Border Casual Cigarette Smuggling*, National Tax Journal, Vol. LXI, No. 1, (March 2008). http://ntj.tax.org/wwtax/ntjrec.nsf/BF515771548F9D538525742E006CCBBA/$FILE/Article%2001-Lovenheim.pdf; R. Morris Coats, *A Note on Estimating Cross Border Effects of State Cigarette Taxes*, National Tax Journal, Vol. 48, No. 4, (December 1995), pp. 573-84, http://ntj.tax.org/wwtax/ntjrec.nsf/notesview/D7AF38C6EF8BF6D7852567EF0057A8C0/$file/v48n4573.pdf; Mark Stehr, *Cigarette Tax Avoidance and Evasion*, Journal of Health Economics, Vol. 24, (2005), pp. 277-97, http://legacy.library.ucsf.edu/documentStore/h/j/o/hjo10j00/Shjo10j00.pdf.

4 Kevin C. Davis et. al., *Cigarette Trafficking in Five Northeastern US Cities*, Tobacco Control, December 2013, http://tobaccocontrol.bmj.com/content/early/2013/12/11/tobaccocontrol-2013-051244.

Smuggling takes many forms: counterfeit state tax stamps, counterfeit versions of legitimate brands, hijacked trucks, or officials turning a blind eye.[5] The study's authors, LaFaive and Nesbit, cite examples of a Maryland police officer running illicit cigarettes while on duty, a Virginia man hiring a contract killer over a cigarette smuggling dispute, and prison guards caught smuggling cigarettes into prisons. Policy responses have included banning common carrier delivery of cigarettes,[6] greater law enforcement activity on interstate roads,[7] differential tax rates near low-tax jurisdictions,[8] and cracking down on tribal reservations that sell tax-free cigarettes.[9] However, the underlying problem remains: high cigarette taxes that amount to a "price prohibition" of the product in many U.S. states.[10]

Cigarette Smuggling Rises with Excise Tax Rates

Cigarette Smuggling vs. State Cigarette Excise Tax Rate, 2013



Note: Positive smuggling percentages are inflow to a state; negative percentages are outflow.
Source: Mackinac Center for Public Policy; Tax Foundation.

5 *See, e.g.*, Scott Drenkard, *Tobacco Taxation and Unintended Consequences: U.S. Senate Hearing on Tobacco Taxes Owed, Avoided, and Evaded*, Tax Foundation, July 29, 2014, http://taxfoundation.org/article/tobacco-taxation-and-unintended-consequences-us-senate-hearing-tobacco-taxes-owed-avoided-and-evaded.

6 *See, e.g.*, Curtis Dubay, *UPS Decision Unlikely to Stop Cigarette Smuggling*, Tax Foundation Tax Policy Blog, Oct. 25, 2005, http://taxfoundation.org/blog/ups-decision-unlikely-stop-cigarette-smuggling.

7 *See, e.g.*, Gary Fields, *States Go to War on Cigarette Smuggling*, Wall Street Journal, Jul. 20, 2009, http://professional.wsj.com/article/SB124804682785163691.html?mg=reno64-wsj.

8 *See, e.g.*, Mark Robyn, *Border Zone Cigarette Taxation: Arkansas's Novel Solution to the Border Shopping Problem*, Tax Foundation Fiscal Fact No. 168 (Apr. 9, 2009), http://taxfoundation.org/article/border-zone-cigarette-taxation-arkansass-novel-solution-border-shopping-problem.

9 *See, e.g.*, Joseph Henchman, *New York Governor Signs Law to Tax Cigarettes Sold on Tribal Lands*, Tax Foundation Tax Policy Blog, Dec. 16, 2008, http://taxfoundation.org/blog/new-york-governor-signs-law-tax-cigarettes-sold-tribal-lands.

10 *See* Patrick Fleenor, *Tax Differentials on the Interstate Smuggling and Cross-Border Sales of Cigarettes in the United States*, Tax Foundation Background Paper No. 16 (Oct. 1, 1996), http://taxfoundation.org/article/tax-differentials-interstate-smuggling-and-cross-border-sales-cigarettes-united-states.

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Table 1: 2013 Cigarette Tax Rates, Smuggling Percentages, and Changes Since 2006

	2013 Tax Rate (per pack)	2013 Consumption Smuggled (positive is inflow, negative is outflow)	2006 Consumption Smuggled (positive is inflow, negative is outflow)	2013 Smuggling Rank (1 is most smuggling, 50 least)	Smuggling Rank Change Since 2006 (e.g., NY changed from #5 to #1, so rank changed +4)	Cigarette Tax Rate Change, 2006-2013
New York	$4.35	+58.0%	+35.8%	1	+4	+190%
Arizona	$2.00	+49.3%	+32.1%	2	+5	+69%
Washington	$3.025	+46.4%	+38.2%	3	+1	+49%
New Mexico	$1.66	+46.1%	+39.9%	4	-2	+82%
Rhode Island	$3.50	+32.0%	+43.2%	5	-4	+42%
California	$0.87	+31.5%	+34.6%	6	+0	No Change
Wisconsin	$2.52	+31.2%	+13.1%	7	+11	+227%
Texas	$1.41	+27.4%	+14.8%	8	+8	+244%
Utah	$1.70	+27.3%	+12.9%	9	+11	+145%
Michigan	$2.00	+25.0%	+31.0%	10	-1	No Change
Connecticut	$3.40	+24.8%	+12.3%	11	+11	+125%
Montana	$1.70	+23.7%	+31.2%	12	-4	No Change
South Dakota	$1.53	+22.3%	+5.3%	13	+15	+189%
Illinois	$1.98	+20.9%	+13.7%	14	+3	+102%
Maryland	$2.00	+20.2%	+10.4%	15	+9	+100%
Minnesota	$1.60	+18.0%	+23.6%	16	-6	+1%
Florida	$1.339	+17.1%	+6.9%	17	+9	+294%
Iowa	$1.36	+16.7%	+2.4%	18	+15	+278%
Kansas	$0.79	+15.0%	+18.4%	19	-7	No Change
Colorado	$0.84	+13.5%	+16.6%	20	-6	No Change
New Jersey	$2.70	+12.9%	+38.4%	21	-18	+13%
Massachusetts	$2.51	+12.0%	+17.5%	22	-9	+66%
Oregon	$1.18	+10.8%	+21.1%	23	-12	No Change
Maine	$2.00	+10.6%	+16.6%	24	-9	No Change
Arkansas	$1.15	+8.5%	+3.9%	25	+6	+95%
Mississippi	$0.68	+8.4%	-1.7%	26	+11	+36%
Ohio	$1.25	+7.1%	+13.1%	27	-8	No Change
Oklahoma	$1.03	+3.0%	+9.6%	28	-3	No Change
Nebraska	$0.64	+2.8%	+12.0%	29	-6	No Change
Louisiana	$0.36	+2.8%	+6.4%	30	-3	No Change
Pennsylvania	$1.60	-0.1%	+12.9%	31	-10	+19%
South Carolina	$0.57	-2.4%	-8.1%	32	+9	+14%
Tennessee	$0.62	-2.9%	-4.5%	33	+5	+210%
Vermont	$2.62	-3.1%	+4.5%	34	-4	+46%
North Dakota	$0.44	-3.7%	+3.0%	35	-3	No Change
Georgia	$0.37	-4.2%	-0.3%	36	-1	No Change
Alabama	$0.425	-7.1%	+0.5%	37	-3	No Change
Kentucky	$0.60	-7.6%	-6.4%	38	+2	+100%
Missouri	$0.17	-13.7%	-11.3%	39	+5	No Change
Indiana	$0.995	-15.5%	-10.8%	40	+3	+79%
Nevada	$0.80	-18.8%	+4.8%	41	-12	No Change
West Virginia	$0.55	-19.5%	-8.4%	42	+0	No Change
Wyoming	$0.60	-21.0%	-0.6%	43	-7	No Change
Delaware	$1.60	-22.6%	-61.5%	44	+3	+191%
Virginia	$0.30	-22.6%	-23.5%	45	+0	No Change
Idaho	$0.57	-24.2%	-6.0%	46	-7	No Change
New Hampshire	$1.68	-28.6%	-29.7%	47	-1	+110%
Alaska	$2.00	N/A	N/A	N/A	N/A	+25%
Hawaii	$3.20	N/A	N/A	N/A	N/A	+129%
North Carolina	$0.45	N/A	N/A	N/A	N/A	+50%
District of Columbia	$2.50	N/A	N/A	N/A	N/A	+150%

Source: Mackinac Center for Public Policy; Tax Foundation.

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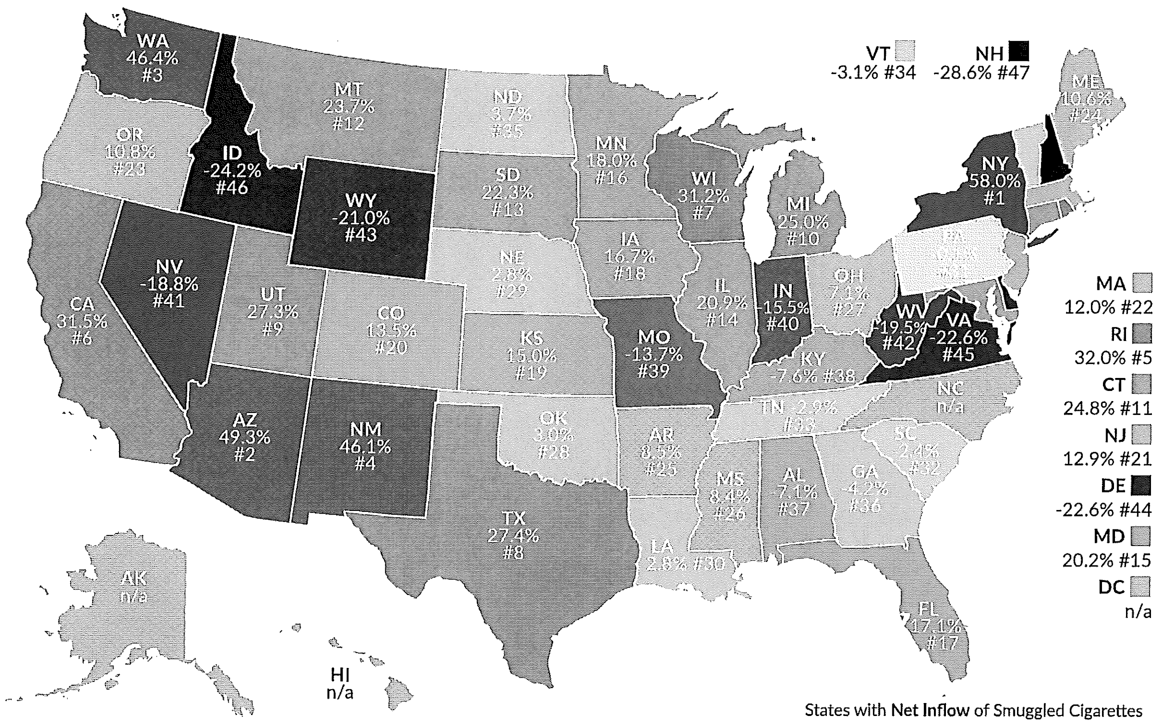
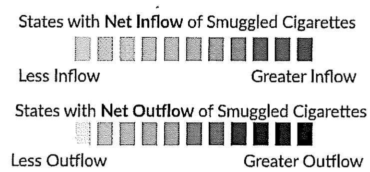
Cigarette Smuggling by State

Smuggled cigarettes consumed as a percentage of total cigarettes consumed, 2013





Note: Alaska, Hawaii, North Carolina, and DC are not included in the study. Data used from 2013 and is most recently available data. Data as of Jan 14, 2015.
Source: Mackinac Center for Public Policy; Tax Foundation.

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