



1325 G Street, NW, Suite 950 • Washington, D.C. 20005 • 202.464.6200 • taxfoundation.org

Dear Members of the Committee,

My name is Ulrik Boesen and I am a Senior Policy Analyst with the Tax Foundation. For those unfamiliar with us, we are a non-partisan, non-profit research organization that has monitored fiscal policy at all levels of government since 1937. We have produced the Facts & Figures handbook since 1941, we calculate Tax Freedom Day each year, we produce the State Business Tax Climate Index, and we have a wealth of other data, rankings, and information at our website, www.TaxFoundation.org.

I submit this testimony on HF3032. While we take no position on legislation, I wanted to share our research on implications of narrow-based taxation around the country.

The prospect of a ban on flavored tobacco and nicotine products highlights the complications of contradictory tax and regulatory policy, the instability of excise taxes that go beyond pricing in the cost of externalities. A ban on flavored tobacco, especially when including cigarettes, would have significant tax implications and result in unintended consequences such as increased smuggling. Tobacco excise taxes are an unstable source of tax revenue given that narrow taxes tend to be volatile due to their dependence on the activity of a small number of businesses or consumers.

Further narrowing the tobacco tax base by banning a portion of tobacco sales altogether could worsen the instability of this revenue source while driving up the costs of administration and law enforcement associated with the ban, especially if the lost revenue is made up by raising the tax rate on the remaining tobacco tax base. The consequences of a ban exemplify the issue of relying on general fund revenue from narrow-based excise taxes.

These consequences have a real cost which the taxpayers would have to cover as the ban could result in less revenue from the legal and regulated market. Further, where tobacco tax revenue is earmarked to certain government programs, the impact on revenue could lead to underfunded programs which will need funding from other sources.

Below is a calculation of implicated revenue in Minnesota. The numbers are based on tax collections and sales of menthol cigarettes. Cigarette tax collections make up more than 80 percent of tax collections on tobacco products. In addition, there could be reduced revenues from chewing tobacco, snus, cigars, cigarillos, and flavored vapor liquid. Taxes on these products raise about \$100 million a year in Minnesota. A large [percentage](#) of the products in these categories are flavored.

	Menthol Smokers as % of Smokers (FY2018)	Revenue from Menthol Cigarettes (FY2018)	Total Cigarettes Excise Revenue (FY2018)
Minnesota	27.4%	\$143,997,138	\$525,537,000

Source: STARS; Orzechowski and Walker, "The Tax Burden on Tobacco," Volume 53, 2018; Tax Foundation calculations.

The figures indicating revenue from menthol cigarettes reflect the annual loss of revenue if all current consumers of menthol cigarettes were to quit. That is almost certainly not going to



1325 G Street, NW, Suite 950 • Washington, D.C. 20005 • 202.464.6200 • taxfoundation.org

happen. In reality, some will quit, some will substitute to other tobacco or nicotine products, and some will access the products illegally. The last option is the most fiscally problematic because states will not only incur lost revenue, they will also take on increased costs related to enforcement of the ban. While it is impossible to estimate the exact revenue effect, it is clear that revenues will decline.

In the same way that exceptionally high tax rates on products can create the incentives for illicit activities, a ban certainly opens the door to contraband and bootleg activities. Thus, bans are likely to hurt public health by limiting adult smokers' ability to quit cigarettes and fuel black market activity similar to when states levy heavy taxation on cigarettes. Local bans in particular invite smuggling activity in the same way that occurs when localities have high cigarette excise taxes. Minnesota has the [sixth highest inflow](#) of cigarettes in the nation (see map at the end).

Cigarettes are already being smuggled into and around the country in large [quantities](#), and nicotine-containing liquid is coming into the U.S. from questionable sources. Black market liquids and cigarettes have the problem of being extremely unsafe and cost governments [billions](#) in lost taxes. The serious pulmonary diseases, which were first reported last year, have prompted the FDA to publish a [warning](#) about black market THC-containing liquid. Other [reports](#) of illicit products containing [dangerous chemicals](#) resulting in serious conditions have been released over the last months.

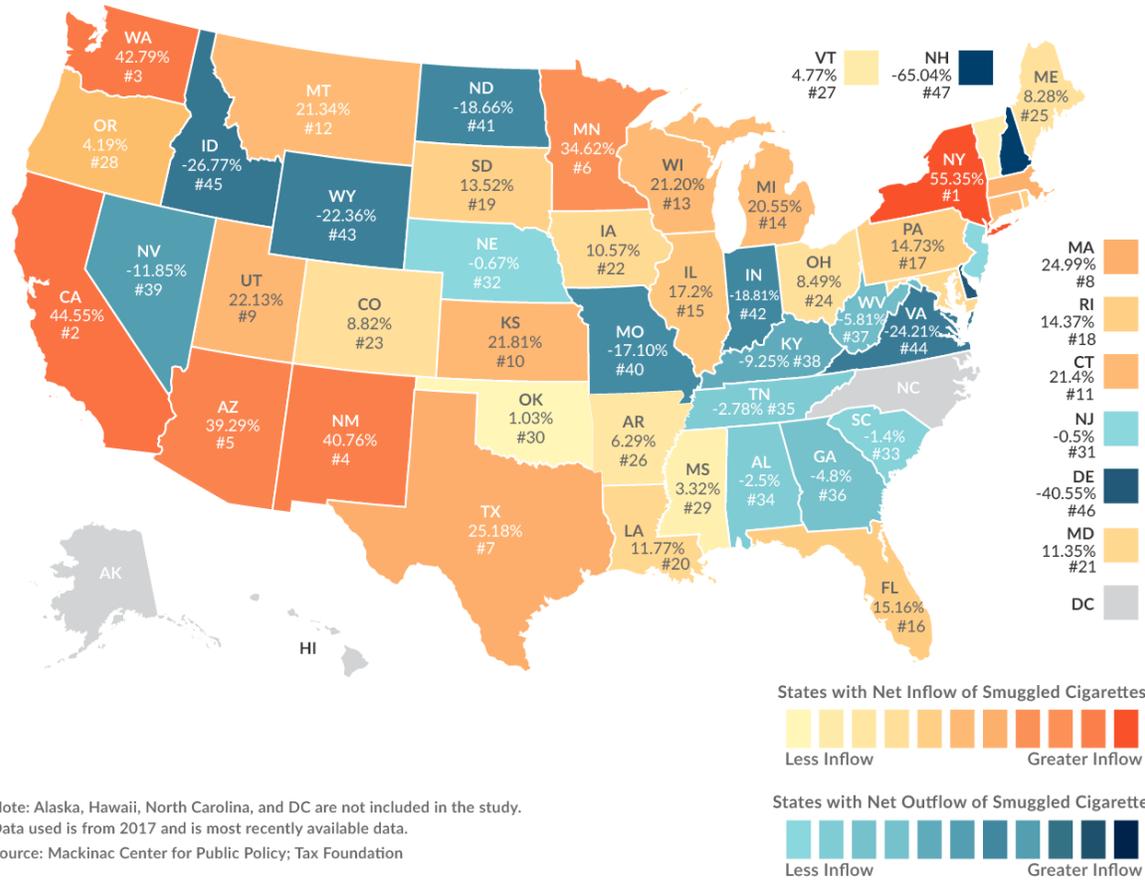
On top of the dangers to consumers, the legal market would suffer, as untaxed and unregulated products have significant competitive advantages over high-priced legal products. This would impact not only the large number of small business owners operating vape shops but also convenience stores and gas stations relying on vapers as well as tobacco sales. Policymakers should not lose sight of the law of unintended consequences as they set tax rates and regulatory regimes for nicotine products.

While youth uptake¹ is a very real concern which deserves the public's attention, outright bans could impede historically high smoking cessation rates. Lawmakers must thread the needle between protecting adult smoker's ability to switch and barring minor's access to nicotine products. Recent [publication](#) found that 32,400 smokers in Minnesota were deterred from quitting cigarettes after the state implemented a 95 percent excise tax on vapor products. Another [study](#) concluded that vapor products are highly elastic and "for every one standard e-cigarette pod (a device that contains liquid nicotine in e-cigarettes) of 0.7 ml no longer purchased as a result of an e-cigarette tax, the same tax increases traditional cigarettes purchased by 6.2 extra packs."

¹ A [survey](#) of high schoolers, published in the fall 2019, found that 27.5 percent of students vaped at least once in the last 30 days. Regular users (used 20 days out the last 30 days) account for less than 10 percent of high schoolers.

Cigarette Smuggling by State

Smuggled Cigarettes Consumed As a Percentage of Total Cigarettes Consumed, 2017



Note: Alaska, Hawaii, North Carolina, and DC are not included in the study. Data used is from 2017 and is most recently available data. Source: Mackinac Center for Public Policy; Tax Foundation