

Cigarette Smuggling in Response to Large Tax Increase in Indiana is Greatly Exaggerated

Indiana, like other states, has enjoyed substantial new revenue each time it has raised its cigarette tax rate, followed by years of higher revenue levels. However, concerns about increased tax avoidance and evasion have deterred the state from implementing large increases in its cigarette and other tobacco taxes.

In a new report, the Tobacconomics program shows that every state that has passed a significant cigarette tax increase has enjoyed a substantial, sustained increase in its state cigarette tax revenues. This revenue increase occurs, despite the significant declines in smoking rates and tax-paid cigarette sales caused by the cigarette tax rate increase, and despite any increases in cigarette tax avoidance and evasion.

In a detailed analysis of all significant state cigarette tax increases between 2006 and 2015 (increases of 50 cents or more per pack), we calculated the increase in state cigarette tax revenues in the first 12 months following a tax increase, changes in cigarette tax revenues in all neighboring states during that same 12-month period, and the total change in revenues in all neighboring states, in both absolute and percentage terms.

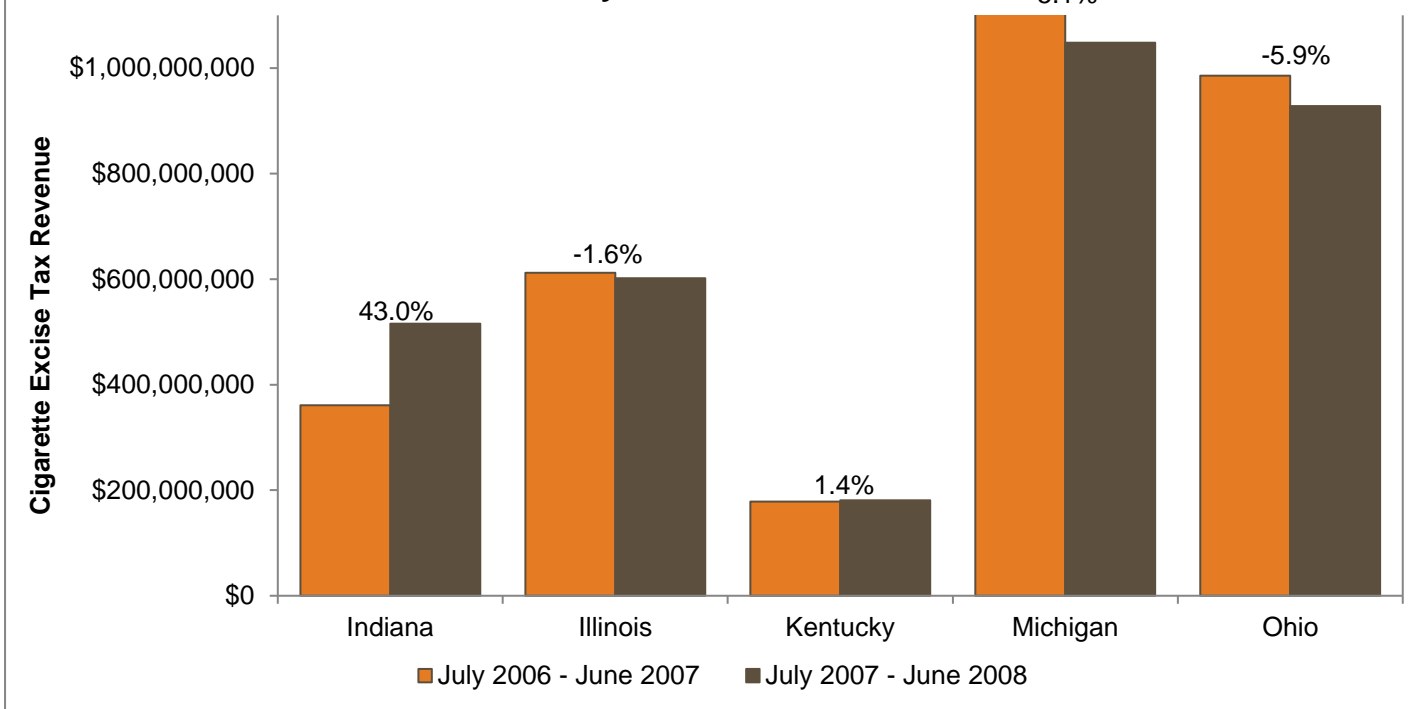
Several findings are clear. First, states that have implemented a significant cigarette tax increase have seen a significant increase in cigarette tax revenues in the 12 months following the tax increase. Second, states that border the state that raises its tax, and that do not raise their own tax, experience minimal changes in their own cigarette tax revenues, with tax revenues falling in most of these states. Third, any increases in cigarette tax revenues in states that border a state that raises its tax are modest at best,

implying that overall, any increases in sales in other states due to cross-border shopping by smokers in neighboring states or bootlegging of cigarettes from lower-tax states to a state that raises its tax are relatively small and are far below the reductions in sales in the state that raised its tax.

These findings are consistent with what happened following Indiana's last cigarette tax increase. The Indiana cigarette excise tax was last increased in July 2007, from 55¢ to 99.5¢ per pack. None of Indiana's neighbors raised its cigarette tax in the year that followed. Following the increase, Indiana's tax differential with Kentucky (a tax of 30¢ per pack) increased sharply, from 25.5¢ to 69.5¢. The tax increase eliminated the gap between Indiana and Illinois, with the new tax only slightly higher than the tax in Illinois (98¢), but still well below the combined state and local tax of \$3.66 in place in Chicago at that time. The tax differential between Indiana and Ohio narrowed from 69.5¢ to 25.5¢ per pack tax given Ohio's tax of \$1.25 tax. Finally, the tax differential between Indiana and Michigan narrowed from \$1.445 to \$1.005 per pack, given Michigan's tax of \$2.00 per pack.

As shown in the figure below, the significant increase in the Indiana tax led to a sizable, 43.0%, increase in the state's cigarette tax revenues. At the same time, revenues in most bordering states fell - by 1.6% in Illinois, 5.1% in Michigan, and 5.9% in Ohio - while revenues increase by a modest 1.4% in Kentucky. Combined cigarette tax revenues fell by 4.2% in Indiana's neighbors in the year following the tax increase.

**Cigarette Tax Revenues, Indiana and Neighboring States
July 2006 - June 2008**



As Indiana's past experiences with tobacco tax increases, as well as experiences in other states, clearly demonstrate, increasing tobacco taxes in Indiana will raise revenue despite any increases in tax avoidance and tax evasion. Based on a model that accounts for the impact of higher taxes and prices on tax paid sales, including changes in cross-border shopping, bootlegging, and other forms of tax avoidance and evasion, we estimate that a \$2.00 per pack increase in the Indiana state cigarette excise tax that goes into effect on July 1, 2019, will generate an increase of over \$385.5 million in the first year alone. Moreover, the increase in revenues would be sustained over time, with revenues declining slowly and predictably as tobacco use continues to fall in the state.

In addition to the revenue benefits, an increase in Indiana's tobacco tax rates would lead to significant improvements in public health. We estimate that a \$2.00 increase in the cigarette tax would prevent 58,100 youth from becoming adult smokers,

encourage 70,100 adults to quit smoking, and prevent 36,300 future smoking-caused deaths in the current Indiana population. Increases in taxes on other tobacco products would add to the public health impact by reducing the use of these products and minimizing incentives for smokers to switch from cigarettes to other forms of tobacco.

The improvements in health following the tax-induced reductions in tobacco use would lower health care spending in the state. We estimate that a \$2.00 increase in the cigarette tax would generate at least \$78.9 million in health care cost savings in the first five years, due to fewer smoking-caused cases of lung cancer, heart attacks, strokes, and pregnancy and birth complications. The state Medicaid program would save more than \$11.3 million in health care costs in the first five years. Given the long-term consequences of smoking, these benefits would grow over time. We estimate that, in the long term, the state would save \$2.7 billion in overall health care spending.