

# THE TOBACCO INSTITUTE

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I. I. BATHSON, Ph.D.  
Economist

Sept. 10, 1984.

To: S.D. Chilcote  
Roger Mozingo

## Report On Preliminary Findings Of A.C.I.R. Study On State Cigarette Smuggling And Taxation.

At the National Tobacco Tax Association meeting in New York City, Robert Klein reported on the ACIR study which is reviewed here, without benefit of receiving the report. This report has been sent out to everyone concerned including state administrators, so Bill Flaherty will likely review it. The conclusions arrived at will likely satisfy the tobacco industry and the states because it will not recommend any new demand for a uniform state tax rate, nor will it encourage states to recklessly increase their state tax rates.

The report is somewhat optimistic, and presents acceptable conclusions, sometimes for the wrong reasons and with data errors or incorrect trend analysis.

There will be a critic review in D.C. on Sept. 18 which should be attended by Tobacco Institute personnel, and a public hearing on Sept. 25 at the Rayburn Building at 9:30 a.m. which I plan to attend.

The review is presented in the order that Klein gave it in his address.

State by state estimates were calculated on the basis of the data provided from all but two states, and improvements over the 1970s was noted; I was surprised that Klein made a big thing out of the ethnic group variable as it affects smoking. He unintentionally misled the audience by noting that Hispanics and Asians smoke less(?) than others, whereas what he must have meant was that the apparent per capita consumption is smaller for them because of the large families of young children in the general population. This doesn't mean that these ethnic adults smoke less!

The same method was used as in 1977, one which was criticized by a Johns Hopkins thesis. Estimates are supposedly reasonable but not precise, says Klein. Although organized bootlegging is now said to be only a problem in 3 states (CT, WV, and ?), 26 states of 49 said that they had a smuggling problem. Everyone seems to think casual smuggling is not serious, largely, I believe, because most states think they can't stop it or do anything about it. Seven states said that the Indian sales was the worst problem now, and 10 states said that the problems had not changed significantly.

The Indian sales and military sales problems were measured and estimated, but some states do not really know the extent of these problems. The data are shaky, says Klein. These forms of smuggling seem to be still prevalent to Klein, to us, and to some state officials.

Klein believes that smuggling has declined sharply since the 1970s--he is evidently referring to organized crime, NOT casual. The net losses in state tax revenues is now about \$255 million or 5.4% of their total cigarette tax revenue.

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The study estimates that 70 percent of the losses are in 26 states and due to Indian and military sales--these are still smuggling losses. They estimate that about 1/4 of military sales are illegal. The Indian problem is getting worse in several states. The Bureau of Alcohol, Tobacco, and Firearms and the 1978 legislation are believed to have helped--at least the organized problem. A slight increase was noted for 1983 with higher taxes and prices all around.

Klein believes that the state PCCs are converging toward the mean, and the price elasticity has declined sharply. I think they measured the elasticity wrong the last time around, and the cigarette price elasticity of demand is low in general (roughly between -0.15 and -0.50). Klein attributes the decline to ethnic, religious, and cultural reasons. I don't agree. I attribute it to economic, but mainly social and health trends.

Klein sees the statistical coefficient declining, but some states are still away off the state average PCC, which he failed to point out.

They conclude that (organized?) smuggling is under control and a uniform tax is not needed now, but greater enforcement presence must be maintained by both federal and state officials. Military and Indian sales are now accounting for greater amounts of illegal sales, and the Dept. of Defense should charge the prevailing local prices at the commissaries to end illegal sales. Klein claims that the per capita consumption loss in packs per person per year has declined significantly in FL, AR, MN, NH, NY, PA, and TX--a dubious conclusion, and for reasons that are cultural.

The ACIR believe that states are relying on federal enforcement, and this should be corrected to discourage any growth in illegal activities.

cc: Henderson  
Kerrigan  
Marshall  
Duhaime  
Milway  
Prendergast

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