

THE ECONOMIC EFFECTS OF A 24-CENT/PACK CIGARETTE TAX INCREASE IN MINNESOTA

Minnesota is considering a proposal to increase its current 38-cent cigarette tax by a whopping 24 cents. At 62 cents per pack, Minnesota would have the highest cigarette tax in the nation. Hawaii would be a distant second at 42 cents per pack. Cigarette taxes would be significantly lower on all Minnesota borders. This situation could lead to significant tax avoidance and financial losses. Dwindling sales would make Minnesota retailers the big losers. Any tax increase, on top of Minnesota's presently high cigarette, tax would penalize Minnesota's low and modest income citizens.

FINANCIAL LOSSES

* A 24-cent tax increase, would create staggering tax differences on all borders. Smokers could save a significant \$3.90 of excise taxes per carton by buying in South Dakota, save \$3.20 in North Dakota, save \$3.20 in Wisconsin and save \$3.10 in Iowa. These would be the highest tax differences along any state's borders.

* It is estimated that cigarette sales (packs) would plunge by nearly 16%. Hundreds of Minnesota convenience stores and grocery outlets would experience a significant loss in retail sales. Tobacco sales, for example, account for almost 20% of the total sales in convenience stores.

* By way of comparison, California raised its cigarette tax by 25 cents per pack (from 10 cents to 35 cents/pack) on January 1, 1989. California cigarette sales plunged by 13.8% during calendar year 1990.

* Minnesota has had its share of retail set-backs as well. The cigarette tax was increased by 5 cents per pack at the beginning of FY 1986 and sales fell by 7% by the end of FY 1986. The tax was boosted by 15 cents at the end of FY 1987 and sales fell by a significant 12% during FY 1988.

* Table I estimates the retail damage wrought by the tax increase. For example, nearly \$164 million in Minnesota retail sales would be lost if the cigarette tax were increased by 24 cents/pack.

- o \$109 million in lost cigarette sales.
- o \$55 million in lost tie-in sales to retailers.
- o Cigarette volume could drop by 62 million packs (nearly a 16% reduction in sales).

* A 24-cent cigarette tax increase could cost Minnesota retailers and wholesalers more than \$23 million in annual income

from the decrease in cigarette sales alone.

* Minnesota convenience stores would be especially hard hit. The Convenience Store News reports that tobacco products account for the highest percentage of sales in U.S. convenience stores, or approximately 20% of total convenience store sales. They contribute nearly 10% to total sales in chain drug stores, and more than 40% of all cigarettes sold are purchased in supermarkets.

* In addition, Minnesota's sales tax (6%) is applied directly to the cigarette tax increase - a "tax on a tax". This means that the 24 cent cigarette tax increase will trigger an additional 14 cent per carton (1.4 cent/pack) sales tax increase. In other words, the total tax increase per carton will be \$2.54 (not just \$2.40).

* To top it all off, the federal excise tax on cigarettes just went up by 4 cents per pack on January 1, 1991. This will only add to the woe of Minnesota retailers. The federal tax increase will likely lead to a 1.5% reduction in sales on its own.

CROSS BORDER IMPACT

* Minnesota is in a vulnerable position regarding cigarette taxes. A 24-cent tax increase would create a rather large bounty. A two smoker family would be able to save \$411 in excise taxes by purchasing cigarettes in South Dakota, save \$338 in North Dakota, save \$338 in Wisconsin and save \$327 in Iowa.

* The sensitivity of cigarette sales to tax increases is in, large part, due to the proximity of Minnesota's population to border states. The Minneapolis-St. Paul area, with nearly 2.3 million residents, lies close to the Wisconsin border. Duluth, MN is also close to the Wisconsin border. Morehead and Grand Forks are situated on the North Dakota border. All together over 60% of Minnesota's population is close to a border state.

* Lurking further to the south is Missouri. The Missouri cigarette tax is 13 cents per pack. Current cigarette excise tax savings with Minnesota are 25 cents/pack. This would blossom to a whopping 49 cents per pack under the new tax proposal. Per capita sales in Missouri (120 packs) are over 30% greater than per capita sales in Minnesota (91 packs). Any further tax increases are likely to stimulate cross border sales from the Show-Me State.

* Current and potential border tax differences (cents per pack):

	<u>Current Rate</u>	<u>Current Difference</u>	<u>Difference 24 Cent Boost</u>
MN	38	--	--
SD	23	15	39
ND	30	8	32
WI	30	8	32
IA	31	7	31

* Minnesota and Wisconsin, in the past, have had problems with tax-free sales on Indian reservations. And, sales on Indian reservations have been estimated by the Advisory Council on Intergovernmental Relations to be 3.8% of Wisconsin cigarette sales. Further Minnesota tax increases could put a strain on previous agreements to stem this problem.

REGRESSIVE AND UNFAIR TAXATION

* The 908,000 Minnesota residents who choose to smoke would be unfairly taxed. They will have been hit hard by a barrage of tax increases on cigarettes over the past eight years. This includes an 8 cent federal excise tax increase in 1983, 20 cents in state cigarette tax increases since 1983, a 4 cent federal tax increase in 1991, and yet another state tax of 24 cents/pack. This would add up to a 56 cent/pack tax increase in the last eight years alone.

* Especially hard hit would be Minnesota's low income families. According to the 1989 Sales and Marketing; Survey of Buying Power, 247,700 Minnesota families (16% of all Minnesota households) had an effective buying income less than \$10,000 per year. An average two-smoker family would have to pay an additional \$253 per year in excise taxes if the cigarette tax were raised by 24 cents per pack.

* According to Nickels and Dimes, a recent study by the Citizens for Tax Justice, Minnesota families with incomes below \$9,000 pay 6 times more, as a percentage of income, in cigarette taxes than those making above \$68,000. The Congressional Budget Office (CBO) calls the cigarette tax "the most regressive of all."

* The regressive impact of cigarette taxes is especially harmful to minority groups. For example, the smoking rate among persons 18 years and older is 33% for blacks but 28.5% for whites. In other words, the black smoking rate exceeds the white smoking rate by 15.4%

* Blacks comprise nearly 1.2% of all Minnesota households. According to the 1980 Census, 42% of black households in Minnesota had incomes less than \$10,000 compared to 27% for whites. As a consequence, a Minnesota cigarette tax increase will be especially harmful to low income blacks.

* At 38 cents per pack Minnesota's current cigarette tax takes a whopping 4% of income from a two-smoker family with a \$10,000 annual income. A two-smoker family with \$60,000 would pay less than one percent of income. A 62 cent tax (24-cent/pack increase) would take an astounding 6.5% of income from a two smoker family with \$10,000 annual income.

* The smoking rate is 50% greater for those with annual incomes below \$10,000 (about 32% of low income adults smoke) compared to those with incomes above \$60,000 (about 21% of high income adults smoke).