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Chair Freiberg, Vice-Chair Bierman, Members of the Committee,

My name is Ulrik Boesen, and I am a senior policy analyst at 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, and each year, we produce the State Business Tax Climate Index. We have a wealth of other data, rankings, and information at our website, [www.TaxFoundation.org](http://www.TaxFoundation.org).

I submit this testimony on HF 904 which deals with flavored tobacco products. While we take no position on the bill, I wanted to share some research on a flavor ban's effect on tax revenue. We have looked at data from Massachusetts which implemented a similar ban last June.

First of all, tobacco excise taxes are, due to their narrow design, an unstable source of tax revenue.<sup>1</sup> Bans that further narrow the tobacco tax base by banning a portion of tobacco sales altogether could worsen the instability of this revenue source. At the same time, a ban could drive up the costs of tax administration and law enforcement, especially if the lost revenue is made up by raising the tax rate on the remaining tobacco tax base.

Since June 1, 2020, Massachusetts has banned the sale of flavored tobacco products, including menthol cigarettes. Seven months into Massachusetts' flavor ban, we have data available to study the real-world effects. If we only look at Massachusetts, sales of cigarette tax stamps in the Bay State have declined 24 percent comparing June–November 2020 to the same months of 2019. That is compared to the first half of 2020, where Massachusetts only experienced a decline of roughly 10 percent compared to the first half of 2019. The existing decline in cigarette sales has, in other words, accelerated.

The problem is that Massachusetts' flavor ban has apparently not limited use, just changed where residents purchase their cigarettes. In fact, sales of cigarette tax stamps in the Northeast (Massachusetts as well as Connecticut, Maine, New Hampshire, New York, Rhode Island, and Vermont) have stayed remarkably stable, even increased a bit, following Massachusetts' ban when compared to sales in 2019.

From June 1, 2020 to September 30, 2020, 230,797,000 stamps were sold in the region. For the same period in 2019, that number was 225,897,000. This slight increase trends against the national figures, where sales in 2020 were projected to decline around 2 percent. In conclusion, Massachusetts sales plummeted, but not because people quit smoking—only because those sales went elsewhere.<sup>2</sup>

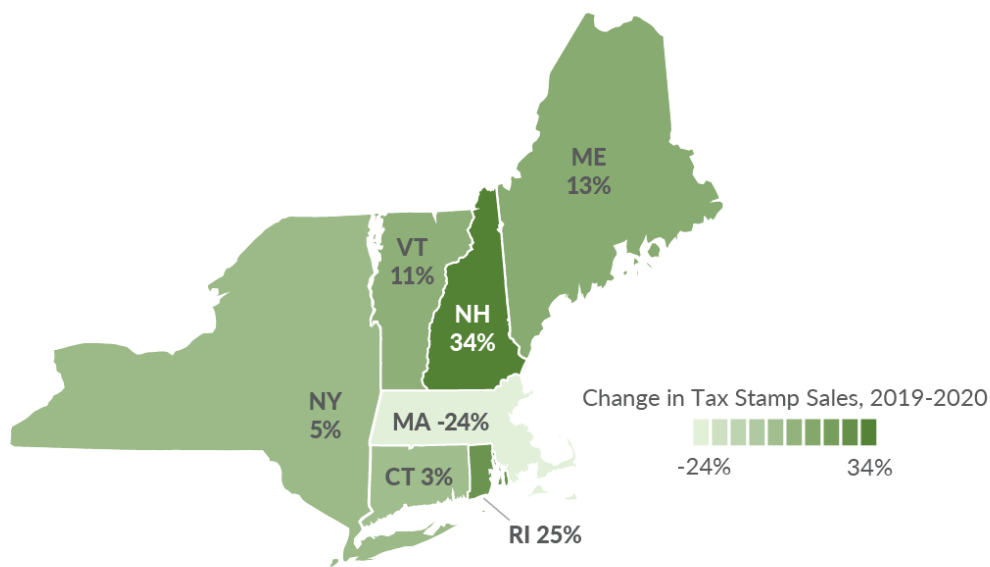
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<sup>1</sup> Ulrik Boesen and Tom VanAntwerp, "How Stable is Cigarette Tax Revenue?" Tax Foundation, July 9, 2020, <https://taxfoundation.org/cigarette-tax-revenue-tool/>.

<sup>2</sup> Ulrik Boesen, "Massachusetts Flavored Tobacco Ban Has Severe Impact on Tax Revenue," Tax Foundation, Jan 19, 2021, <https://taxfoundation.org/massachusetts-flavored-tobacco-ban/>.

## Massachusetts Ban Causes Cigarette Sales to Increase in Neighboring States

*Tax Stamps Sales in June-September 2019 versus June-September 2020*

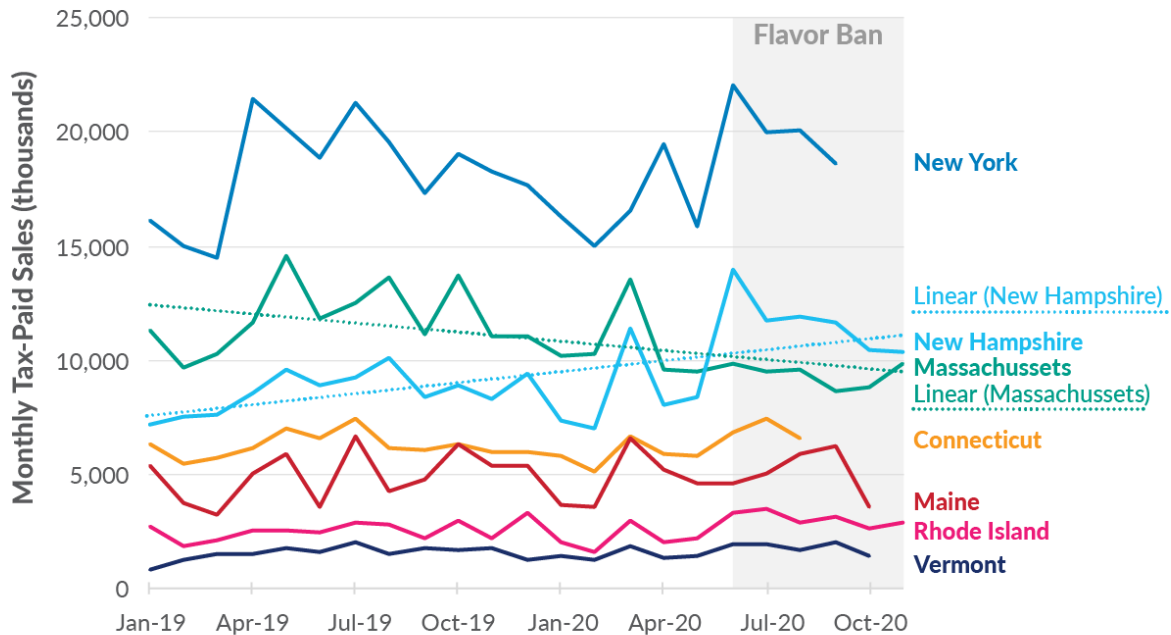


Source: Orzechowski & Walker Survey of State Departments of Revenue; Author's calculations.

If we look at individual states, we can see that increases are skewed. The increase in sales in the Northeast region is most notable in Rhode Island and New Hampshire, but all have seen increased sales following the ban. Unsurprisingly, New Hampshire benefits the most as that is already the state in the nation with the highest outflow of cigarettes.

## Sales Developments in Northeastern States Before and After Flavor Ban

Sale of Tax Stamps (Thousands)



Note: Trendlines added for New Hampshire and Massachusetts as they have experienced the highest volatility in sales. Data not available for some months for Connecticut, Maine, New York, and Vermont.  
Source: Orzechowski & Walker survey of state departments of revenue.

This decline and increase in sales have obviously impacted excise tax revenue in all these states but most notably in Massachusetts. Massachusetts collected \$557 million in cigarette and other tobacco products (OTP) excise taxes in FY 2019 (\$515 million from cigarettes). For FY 2020, the decrease in sales of 10 percent in the first half of 2020 (before the ban) translates to a decline in revenue of roughly \$50 million.

While this is still in the early days, assuming FY 2021's accelerated decline of over 20 percent continues through the rest of the fiscal year, the cost of the flavor ban could end up being approximately \$120 million for FY 2021 (not including sales tax losses). For the first six months of FY 2021, Massachusetts has lost more than \$60 million in excise tax revenue—more if we add sales tax revenue. Conservatively, the loss will end up being at least \$100 million this fiscal year. That is a significant cost to the state, especially considering that sales are simply shifting to other states, not actually being eliminated.

In December 2019, the Massachusetts Department of Revenue estimated the ban would decrease collections by the slightly lower \$93 million in FY 2021. Whichever estimate proves right, that revenue is now being collected by Massachusetts neighbors.



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According to Minnesota Department of Health 25 percent of cigarettes consumers smoke menthol cigarettes. Tobacco excise taxes raised \$624 million in fiscal year 2019.

If Minnesota has an experience similar to Massachusetts (roughly 20 percent decline in consumption), a flavor ban would result in an excise revenue decline of \$125 million in the first full fiscal year after implementation. This is revenue that is mainly allocated to the state's general fund and will have to be made up by taxpayers through other taxes, or through spending cuts.

To make matters worse, Minnesota already has rampant inflow of untaxed cigarettes. Over 35 percent of cigarettes consumed in the state are not taxed by the state. That means well-established networks of illicit providers of tobacco products stand ready to add a new product to their inventory. In other words, banning a popular and widely consumed product will only make smuggling worse. A \$125 million decline in revenue may be setting expectations low.<sup>3</sup>

All of this is not to say that lower tobacco consumption is a bad thing. The fact that fewer people are smoking is a good thing. Nonetheless, the lesson we have learned from Massachusetts is that flavor bans do not necessarily lower consumption—they may simply move tax revenue to jurisdictions without bans. We can observe this effect on a smaller scale by looking at sales data from the Duluth area. Duluth effectively banned flavored tobacco sales by limiting them to adult-only stores in 2018. Research shows that menthol sales all but vanished in Duluth after the ban, but went up 156 percent in stores just one mile or less from the city.<sup>4</sup>

Finally, state tax revenue is not the only thing impacted by this ban, however. A ban would also impact the large number of small business owners operating vape shops, convenience stores, and gas stations in Minnesota.

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<sup>3</sup> Ulrik Boesen, "Cigarette Taxes and Cigarette Smuggling by State, 2018," Tax Foundation, Nov. 24, 2020, <https://taxfoundation.org/cigarette-taxes-cigarette-smuggling-2020/>.

<sup>4</sup> Don Burke, "Tobacco Market Trends," Management Science Associates, Feb 11, 2019, [http://www.natocentral.org/uploads/Tobacco\\_Market\\_Trends\\_February\\_2019.pdf](http://www.natocentral.org/uploads/Tobacco_Market_Trends_February_2019.pdf).