Chair Kelly, Vice-Chair Feldman, Members of the Committee,

My name is Ulrik Boesen, and I am a senior policy analyst at the Tax Foundation. We are a nonpartisan, nonprofit 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*, which enables business leaders, policymakers, and taxpayers to gauge how their states' tax systems compare. We have a wealth of other data, rankings, and information at our website, www.TaxFoundation.org.

I submit this testimony on Senate Bill 177 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. Massachusetts is a good comparison state for Maryland as both the Northeast and the Mid-Atlantic are regions with short distances to neighboring jurisdictions.

First of all, tobacco excise taxes are, due to their narrow design, an unstable source of tax revenue. Further narrowing 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.

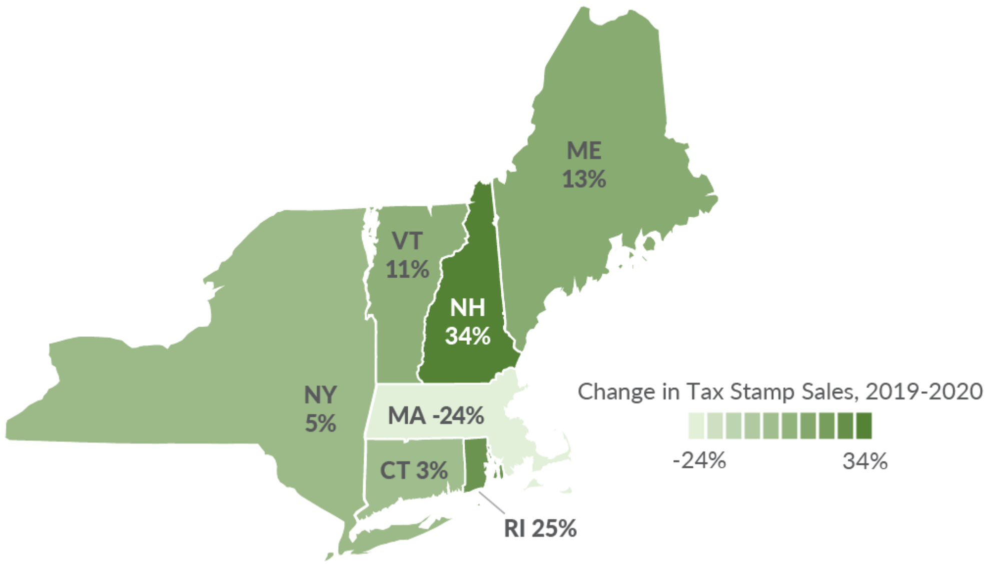
Since June 1, 2020, Massachusetts has banned the sale of flavored tobacco products, including menthol cigarettes. Seven months into Massachusetts' flavor ban, we have data available to study the real-world effects. If we only look at Massachusetts, sales of cigarette tax stamps declined 24 percent comparing June-November 2020 to the same months of 2019. Contrasted with the first half of 2020, where Massachusetts only experienced a decline of roughly 10 percent compared to the first half of 2019, it is clear that the existing decline in cigarette sales has 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 1st to September 30th of last year, 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. It's true that Massachusetts sales plummeted, but not because people quit smoking—only because those sales went elsewhere.

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.

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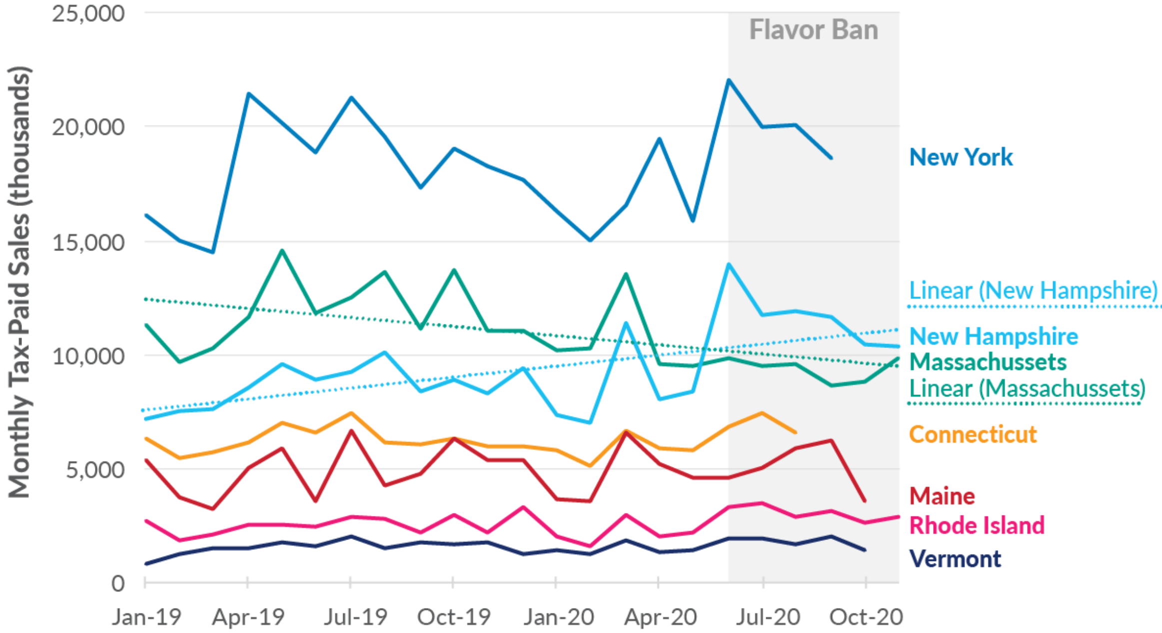
If we look at individual states, we can see that increases are skewed. The increase in sales in the Northeast region is most notable in Rhode Island and New Hampshire, but all states in the region, except Massachusetts, have seen increased sales following the ban. Unsurprisingly, New Hampshire benefits 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.

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This shift in sales volume has obviously impacted excise tax revenue in all these states but most notably in Massachusetts, which 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 still early in the new year, 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.

According to the fiscal note accompanying this bill's predecessor (SB233), 44 percent of cigarettes consumed in Maryland are menthol cigarettes. For other tobacco products, 40 percent to 60 percent of products are flavored. Cigarette excise taxes are projected to raise $299 million in this fiscal year and the other tobacco products tax is projected to raise $42.6 million.

According to the Maryland Department of Legislative Services, banning flavored tobacco in Maryland will lower revenue by over $69 million in the first full fiscal year after implementation. This figure is in line with the experience from Massachusetts. However, Maryland has more menthol smokers in the smoking population than Massachusetts and hence risks a larger impact on the levy's revenue generation.

To be clear, a reduction in 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. Maryland currently enjoys a low inbound rate of smuggling. If a large portion of the tobacco market were to be banned, that would likely change, with tax revenues leaking to surrounding states.

Finally, state tax revenue is not all that is impacted by this ban. A ban would also impact the large number of small business owners operating vape shops, convenience stores, and gas stations in Maryland, a high price to pay if the primary effect is to inconvenience smokers rather than to actually reduce smoking.