



Donald Kenkel

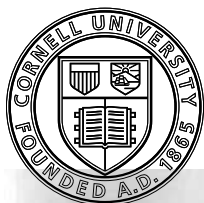
Professor,

Policy Analysis and Management, Cornell University

Tuesday, November 4th, 3:30 PM, The Rushmore Room, MVR 114

Excise Tax Avoidance: The Case of State Cigarette Taxes

This paper is an empirical study of consumers' decisions to avoid cigarette excise taxes. We use data from the U.S. 2003 Tobacco Use Special Cessation Supplement, which asked smokers directly about their cigarette purchases across state borders. Results from reduced-form models show that the probability of cross-border cigarette purchases responds in predictable ways to the economic incentives created by the distance to the border and state tax differentials. We extend our empirical analysis to estimate a structural endogenous switching regression model. In the structural border-crossing equation, the decision to cross the border depends on the difference between the endogenous home- and border-state prices. We estimate that the elasticity of border crossing with respect to the home-state price is 5.76. We use our results to extend the standard formula for the optimal Pigouvian tax to incorporate tax avoidance. Using an estimate that smoking generates external costs of \$1.36 per pack, after taking into account tax avoidance the optimal state tax falls to \$0.78. Regardless of how large smoking's externalities or internalities are, tax avoidance reduces the effectiveness of state excise taxes as a corrective policy tool, and points to the advantages of federal taxes.



Cornell University
Policy Analysis and Management

