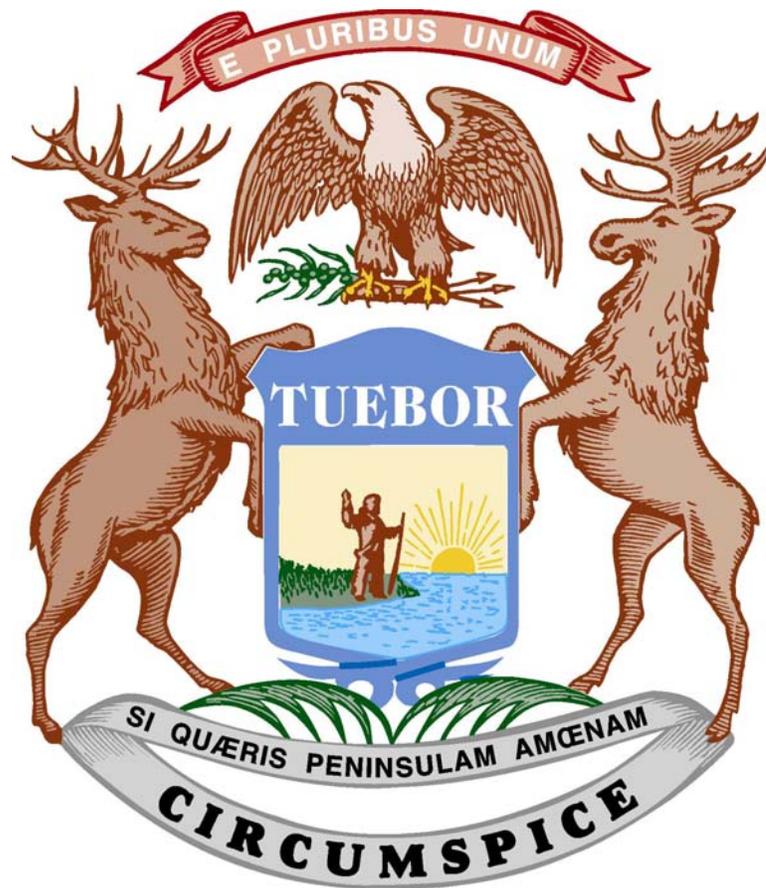
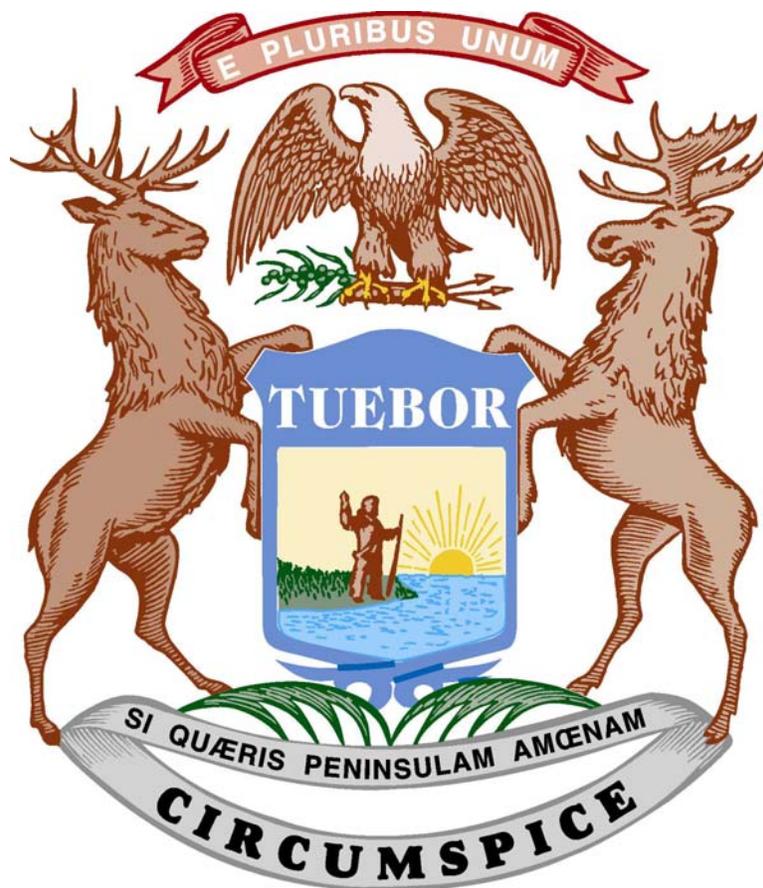


UPDATE ON THE IMPACT OF THE INDOOR SMOKING BAN 2011



Tax Analysis Division
Office of Revenue and Tax Analysis
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Scott Darragh of the Office of Revenue and Tax Analysis prepared this report under the direction of Howard Heideman, Director of the Tax Analysis Division, Office of Revenue and Tax Analysis, Michigan Department of Treasury. Questions on the report should be directed to Scott at (517) 241-2148.

Summary

Governor Granholm signed Public Act 188 of 2009 into law on December 18, 2009. This Act amended the Public Health Code, generally, to prohibit smoking in public places, in places of employment, and in food service establishments (such as restaurants, cafeterias, food courts in shopping malls, and bars). The prohibition took effect on May 1, 2010. Concern was raised before, during, and after the debate on the legislation that a smoking ban would adversely affect business activity at eating and drinking establishments. This update extends the initial results published in December 2010 and will report on the change in business activity as measured by tax collections from retail eating and drinking establishments and the sales of cigarettes, liquor, and certain lottery tickets. While this report is intended to provide information on the impact of the public smoking ban, it is important to note that the overall impact is still evolving and may not be known for several years and any initial impact discussed here is based on a relatively short time period. In addition, turbulent economic times make it difficult to confidently interpret the preliminary data presented here and attribute any result directly to the smoking ban.

Table 1 compares sales tax collections from eating and drinking establishments before and after the ban. Column four reports the percentage change in sales tax collections for the year prior to the ban (June 2009 through May 2010) by establishment group, and overall statewide sales tax collections. The period June through May is used because most eating and drinking establishments report their sales tax collections in the month following the sale (e.g., May sales would be reported on the June return). Collections from most of the eating and drinking establishments for the year prior to the ban were below collections for the prior year, June 2008 through May 2009. The one notable exception was family restaurants and cafeterias, the category that accounts for approximately ½ of all sales tax collections from eating and drinking establishments. The percentage changes in collections for the year following the ban are presented in the column five and these were generally higher for eating and drinking establishments compared to June 2009 through May 2010. The growth in sales tax collections at eating and drinking establishments grew 2.6 percent compared to growth in all sales tax collections of 6.4 percent. The two groups that saw declining collections were taverns that serve liquor and taverns that sell beer and/or wine only. The decline in collections from taverns is consistent with the decline in sales of liquor for on-premise consumption that will be discussed below.

Table 2 compares income tax withholding collections from eating and drinking establishments before and after the ban. Withholding tax is based on the earnings from employees at these establishments, so it provides an additional indicator on how the establishments were faring before and after the smoking ban was enacted. Column four presents the growth in withholding tax collections before the ban was enacted, comparing collections from June 2009 through May 2010 with collections from June 2008 through May 2009 for eating and drinking establishments. Column five presents the year-over-year growth in withholding tax collections for the period after the ban took effect, again June through May. There was a strong acceleration in the growth of overall withholding tax collections statewide beginning in the summer of 2010. However, that acceleration in growth was less robust among eating and drinking establishments. Overall income tax withholding grew 5.7 percent for all establishments, while withholding grew 3.2

percent at eating and drinking establishments. Among the three groups of establishments that account for the highest tax payments (taverns with liquor, family restaurants, and fast food) all showed an acceleration in growth over the summer. The growth in withholding tax payments from taverns that serve liquor seems to portray a different picture from the decline in sales tax payments reported in Table 1. This is a statistical conflict that will likely be resolved in time. Either sales will pick up to allow taverns to maintain the higher compensation that was paid to employees during the first year of the ban, or compensation will be reduced to reflect the lower sales. Growth in withholding for all taverns was 0.3 percent, significantly less than withholding at other eating and drinking establishments.

Table 3 compares sales of cigarettes, liquor, and Club Games operated by the Michigan Lottery before and after the enactment of the smoking ban. Taxable sales of cigarettes usually decline over time as cigarette consumption declines. The year prior to the smoking ban reflects that trend, with a 3.9 percent decline in taxable cigarette sales compared to the prior year. Once the ban took effect, the decline in taxable sales accelerated with taxable sales of cigarettes declining 6.4 percent for June 2010 through May 2011. It seems likely that the smoking ban reduced the opportunity for cigarette smoking and, as a result, reduced taxable cigarette sales.

Because of the complementary nature of liquor and cigarette consumption, i.e., customers at taverns often liked to smoke, it would make sense that the smoking ban might reduce the amount of alcohol consumed at taverns as smoking customers cut short their time in the tavern. There is some evidence that this did, in fact, occur. From May 2009 through April 2010, sales of liquor declined both for off-premise (-1.0 percent) and on-premise consumption (-4.0 percent), compared to sales from May 2008 through April 2009. After the smoking ban took effect on May 1, sales of liquor for on-premise consumption declined by 3.2 percent from May 2010 to April 2011, compared to sales in the prior year, while sales for off-premise consumption increased by 3.2 percent for the same period. The divergence in the growth of sales of liquor for on- and off-premise consumption is consistent with the smoking ban reducing liquor sales at establishments that serve liquor. It should be noted that these simple comparisons do not establish causality, but rather highlight the correlation between the smoking ban and a declining share of liquor sales occurring at drinking establishments. The comparison periods used here reflect sales by the Michigan Liquor Control Commission to taverns which are not generally subject to the delays in tax reporting.

Customers at various bars and restaurants in Michigan may also play Club Games offered by the Michigan Lottery. These Club Games include Club Keno and Pull Tabs, which are often played by customers at taverns where liquor is served. The data in Table 3 seem consistent with the smoking ban having a negative impact on sales of the Club Games. When comparing year-over-year sales, sales for May 2009 through April 2010 (prior to the ban) were down 0.7 percent. After the smoking ban took effect, year-over-year sales were down 13.6 percent for May 2010 through April 2011. The sharp decline focused in the time period after the smoking ban took effect is consistent with the ban adversely affecting sales of Club Games.

Conclusion

It would appear that the smoking ban that took effect on May 1, 2010, has reduced the activity at taverns that serve liquor compared to activity in the prior year. Specifically, sales tax collections from these establishments, sales of liquor for on-premise consumption, and sales of Club Games all declined relative to their trends for the 12 months prior to the ban taking effect. It is not possible to be sure that the decline will be long lasting, but the declines across a number of activities at these establishments appear to imply an impact for at least most of the first year following the enactment of the indoor smoking ban. There is no clear trend from the sales or withholding tax collections from other retail eating and drinking establishments that would indicate the smoking ban has adversely affected these businesses.

It is important to mention several reasons why drawing long-term conclusions from these early data would be premature. First, the short-term response to the smoking ban may be very different from the long-term response. Some customers may respond favorably to smoke-free establishments and replace former customers who reduced purchases at these establishments initially following the implementation of the ban. Alternatively, customers who reduced purchases once the ban was implemented may return and increase those purchases in the future. As the smoke-free environment becomes the norm the behavior of patrons may adjust.

Second, the data presented here are aggregated across all establishments statewide. The impact of the smoking ban has likely affected some establishments within each group far more than others. As a result, individual taverns may find that their sales tax payments to the state have declined by far more than 2.8 percent. Liquor and lottery sales may have declined at individual establishments by more than the statewide totals discussed here. As a result, the impact of the smoking ban on individual proprietors of eating and drinking establishments may be very different than the average impact statewide.

Finally, it is important to keep in mind that the smoking ban took effect during a turbulent economic period in the state. With economic activity depressed overall, the complete impact of the smoking ban will be difficult to assess. Were sales in 2009 and early 2010 exceedingly low due to the economic downturn, thus reducing the observed decline in sales at eating and drinking establishments after the ban? Did the modest upswing in economic activity during 2010 raise sales at these establishments overall, again hiding some of the impact due to the smoking ban? A better assessment of the long-term impact of the smoking ban will require evaluating the impact during more normal economic times.

Table 1
Sales Tax Collections from Retail Eating and Drinking Establishments
Year-Over-Year Comparisons
(\$ millions)

<u>Group</u>	(1) June 2008 - <u>May 2009</u>	(2) June 2009 - <u>May 2010</u>	(3) June 2010 - <u>May 2011</u>	(4) Percent Change <u>(1) to (2)</u>	(5) Percent Change <u>(2) to (3)</u>
Taverns with liquor, food incidental	\$63.8	\$62.8	\$61.1	-1.52%	-2.76%
Taverns with beer/wine only, food incidental	\$8.7	\$8.0	\$7.7	-7.75%	-3.71%
Night clubs	\$4.4	\$3.0	\$3.0	-32.64%	1.27%
Hotel dining rooms	\$3.4	\$3.3	\$3.6	-3.81%	10.13%
Family restaurants and cafeterias	\$288.4	\$289.4	\$301.4	0.33%	4.15%
Fast food, pizza, lunch counters	\$219.2	\$216.5	\$220.6	-1.21%	1.90%
Caterers, concessions, and vending	\$21.8	\$18.6	\$19.9	-14.70%	7.41%
Total sales tax collections	\$6,384.4	\$6,139.6	\$6,531.7	-3.83%	6.39%
Total collections eating and drinking establishments	\$609.6	\$601.5	\$617.4	-1.33%	2.64%
Eating and drinking establishments except taverns	\$537.2	\$530.7	\$548.6	-1.20%	3.37%

Source: Michigan Department of Treasury

Table 2
Withholding Tax Collections from Retail Eating and Drinking Establishments
Year-Over-Year Comparisons
(\$ millions)

<u>Group</u>	(1) June 2008 - <u>May 2009</u>	(2) June 2009 - <u>May 2010</u>	(3) June 2010 - <u>May 2011</u>	(4) Percent Change <u>(1) to (2)</u>	(5) Percent Change <u>(2) to (3)</u>
Taverns with liquor, food incidental	\$13.2	\$12.9	\$13.0	-1.54%	0.76%
Taverns with beer/wine only, food incidental	\$1.5	\$1.4	\$1.3	-9.10%	-3.54%
Night clubs	\$0.8	\$0.7	\$0.7	-17.24%	0.04%
Hotel dining rooms	\$0.7	\$0.7	\$0.8	8.78%	7.06%
Family restaurants and cafeterias	\$90.1	\$91.9	\$94.2	2.07%	2.44%
Fast food, pizza, lunch counters	\$43.2	\$44.8	\$47.4	3.80%	5.70%
Caterers, concessions, and vending	\$10.7	\$10.2	\$10.5	-4.63%	3.44%
Total withholding tax	\$7,095.0	\$6,711.0	\$7,094.1	-5.41%	5.71%
Total withholding eating and drinking establishments	\$160.1	\$162.7	\$167.9	1.62%	3.23%
Eating and drinking establishments except taverns	\$145.4	\$148.4	\$153.6	2.01%	3.51%

Source: Michigan Department of Treasury

Table 3
Cigarette, Liquor, and Lottery Sales
Year-Over-Year Comparisons

<u>Commodity</u>	(1) May 2008 - <u>April 2009</u>	(2) May 2009 - <u>April 2010</u>	(3) May 2010 - <u>April 2011</u>	(4) Percent Change <u>(1) to (2)</u>	(5) Percent Change <u>(2) to (3)</u>
Cigarettes (millions) (i)	10,200.1	9,798.1	9,166.8	-3.9%	-6.4%
Liquor (\$ millions) (ii)					
Off premise	\$764.6	\$756.7	\$781.0	-1.0%	3.2%
On premise	\$184.3	\$176.9	\$171.2	-4.0%	-3.2%
Lottery Club Games (\$ millions) (iii)	\$551.6	\$547.4	\$473.2	-0.7%	-13.6%

Notes and sources:

- i. Cigarette sales from Michigan Department of Treasury and represent sales reported for June - May.
- ii. Liquor sales from Monthly Financial Report, Michigan Liquor Control Commission. Fiscal year totals imputed from tax collections.
- iii. Lottery sales from Michigan Lottery. Excludes sales of Club Keno "To Go".