



Cigarette Smuggling Rampant in Michigan

By Michael D. LaFaive

Summary

Michigan's high excise tax on cigarettes causes a variety of criminal activity, including smuggling, violence and the funding of terrorist activity. The solution is to lower, not increase, cigarette taxes.

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On Nov. 13, 2008, more than 150 law enforcement officers were involved in a major bust of 18 people involved in trafficking contraband cigarettes in the Detroit area. According to the Detroit Free Press, the smuggling ring involved "104,300 cartons of illegal cigarettes worth more than \$2 million in unpaid Michigan taxes."

A new study by the Mackinac Center for Public Policy, "Cigarette Taxes and Smuggling," shows that this single bust — despite its considerable size — represents only a small portion of illegally trafficked cigarettes in the Great Lakes State. The study finds that in 2006 almost 35 percent of all the cigarettes consumed in Michigan (legal and illegal) were smuggled into the state, and smuggling is not the only unintended consequence of high state cigarette excise taxes. It has also contributed to crime ranging from vandalism to violence to terrorism.

Cigarette smuggling is a function of two primary variables: the "home state" cigarette excise tax differential and the distance to lower-tax jurisdictions. The home state customarily refers to the state into which cigarettes are smuggled. Michigan's excise tax is \$2.00 per pack while Indiana's is less than half that amount and North Carolina is a mere 35 cents. Both states are sources of cigarettes for Michigan consumers but in two different ways: one involves "casual" smuggling, and the other "commercial" smuggling.

A casual smuggler crosses a state border seeking less expensive cigarettes for personal use. A 1995 report titled "Cigarette Smuggling in the State of Michigan" said that in July of that year Michigan police conducted surveillance of Indiana stores and in just four hours identified more than 180 Michigan residents who had purchased cigarettes and smuggled them back into the state. Commercial smuggling is a much larger operation and generally originates in tobacco states that have low excise taxes. In November 2007, a single arrest in Monroe County involved a van stuffed with an estimated 2,000 cartons in illegal cigarettes from Kentucky.

Private sales data of a large Midwestern distributor of cigarettes at the ZIP code level from January 2006 through September 2008 allows for tracking changes in sales to retailers in Michigan border counties, and by extension the sensitivity of retailers and consumers to tax-induced relative price changes.



Signs such as this one, found just inside the Michigan border, beckon shoppers to a tobacco store in Indiana. Lower cigarette taxes in other states promote both casual and commercial smuggling.

After Indiana hiked its taxes by 79 percent in July 2007, sales to retailers on the Michigan side of the border leapt by more than 53 percent. Sales to Michigan retailers bordering Wisconsin also increased, though by a modest 8 percent, when that state increased its taxes 130 percent in January 2008. These numbers argue strongly that retailers and consumers in Michigan change their behavior when presented with relative changes in price. Smuggling became less attractive to consumers as other states raised their taxes.

But cigarette smuggling is not the only issue that must be considered when studying tobacco tax hikes. There are a host of unintended consequences involved for states choosing to dramatically hike excise taxes. For example:

- Financing of a terrorist organization. Cigarette smuggling profits have been used to finance the Hezbollah in Lebanon. One smuggler involved in the scheme was said to have charged a 25 cent "resistance" tax on his smuggled cigarettes, the profits from which he funneled overseas;
- Brazen theft. Truckloads of cigarettes have been hijacked from underneath their drivers. These can be profitable operations for thieves because the cigarettes may already carry the state tax stamp indicia that provides evidence that taxes have been paid on the product;
- Counterfeiting of stamps and cigarettes. Criminals are not only making fake tax stamps to give the illusion that smuggled cigarettes are legitimate, they are also making cigarettes designed to be passed off as brand name smokes, but which are frequently adulterated with saw dust and other dangerous filler;
- Violence against people. One Detroit-based "cash and carry" customer was hijacked after buying cigarettes from a local wholesaler. He lost his automobile, his cigarettes and one kidney after being shot three times. It may be only a matter of time before an innocent person or police officer is killed over illicit tobacco; and
- Violence against property. The same wholesaler mentioned above has had the cement wall of their building busted through by thieves with sledgehammers looking to steal tobacco products.

Michigan should consider cutting its excise tax to reduce the frequency of all these crimes, or at the very least, raise excise taxes no further.

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