



## Cigarette Smuggling Remains High in Michigan, Elsewhere

By Michael D. LaFaive and Todd Nesbit, Ph.D.

### Summary

The Mackinac Center, using its latest estimate of cigarette smuggling rates, shows that Michigan is No. 10 nationally in smuggled cigarettes. National and international data support the premise that higher tax rates encourage these illegal actions.

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Supporters of punitively high tobacco tax rates should be careful what they wish for. According to the Mackinac Center's latest estimate of cigarette smuggling rates, Michigan is No. 10 nationally in the proportion of cigarettes being smoked here that are illegally smuggled in.

This is the third such estimate the Center has produced in recent years, and the details are disconcerting. The smuggling rate here increased 12 percent since 2009, with contraband smokes now representing 29.3 percent of all consumption. States like Michigan should consider rolling back their steep excise taxes in an effort to thwart smuggling.

The increasing rate of both casual and commercial cigarette smuggling over the past two decades is staggering. Casual smuggling occurs when individuals shop in lower tax jurisdictions for personal consumption. For example, a Kalamazoo smoker can easily make a run for the Indiana border to stock up on much lower-priced smokes. In 2011, such activity represented slightly more than 15 percent of the cigarettes smoked here.

Commercial smuggling involves large-scale, long-distance shipments from states like North Carolina or Virginia; it supplied more than 16.2 percent of the cigarettes smoked here in 2011. We also find that Mexico is a source for cigarettes entering the country. Indeed, more than 20 percent of Arizona's overall smuggling rate can be attributed to Mexico.

At the same time, Michigan also is an out-bound smuggling source. We estimate a quantity equivalent to 3.6 percent of state consumption was smuggled out to Canada, which among other things lowered this state's net-smuggling rate.

Michigan's last cigarette excise tax hike occurred in July 2004. It is interesting to note that in every full year since that tax took effect, nominal tobacco tax revenues (which includes non-cigarette tobacco) have declined. From 2005 through 2011 revenues dropped from almost \$1.2 billion to just \$968 million.

It is naïve to think that the decline in tax revenue is just the result of smokers kicking the habit. A 2004 study by economist Mark Stehr in the *Journal of Health Economics* found that "up to 85 percent of the tax paid sales response" is a function of tax avoidance and not reducing or quitting smoking. Examples of this are not only tax-avoidant smokers, but

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Whether you live in Mexico or North Carolina, statistics show that people will smuggle to smoke less-expensive cigarettes.

also commercial smugglers who sell to retailers who are in on it, who then sell to unsuspecting buyers. Clearly, there is massive tax avoidance taking place in the Great Lake State.

Cigarette smuggling is responsible for much more than just state government revenue losses. It is associated with violence, theft, counterfeited and adulterated products and government corruption. One such example is a Maryland police officer who actually used his official patrol car, uniform and pistol to escort illicit cigarette shipments to their destination. When smuggling profits are sky high, there are those who will want a piece of the action. In 2010, A Virginia man admitted to hiring someone to kill another over illicit cigarettes.

The Mackinac Center employed its cigarette-smuggling model to estimate what would happen in Maryland if that state increased its latest cigarette excise tax from \$2 to \$3, as has been suggested. It showed smuggling skyrocketing to more than 50 percent of the total market and the possibility of a net negative decline in cigarette tax revenues.

The top 10 smuggling import states in the country are New York (60.9 percent); Arizona (54.4 percent); New Mexico (53 percent); Washington State (48.5 percent); Rhode Island (39.8 percent); Wisconsin (36.4); California (36.1); Texas (33.8); Utah (31.2); and Michigan (29.3).

New York should not come as a surprise. It has the highest tobacco excise tax in the nation at \$4.35 per pack, and New York City imposes another \$1.50 on top of that. Cigarettes are undoubtedly being run in from Virginia, among other states. Virginia has the second-lowest tax rate in the nation at 30 cents per pack.

New Hampshire's proximity to higher-tax states also makes it a significant smuggling source, with outbound smokes equivalent to 27 percent of the state market.

The conclusion from rapidly rising smuggling rates is that politicians' addiction to higher cigarette tax revenue has created an illegal trade that is hyper-profitable for the wrong people and is generating significant negative consequences for our society.

A better solution is to roll back excise tax increases to more reasonable levels and match any revenue losses with dollar-for-dollar cuts in spending.

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