



Cigarette Taxes Fuel Rampant Smuggling

By Michael LaFaive and Todd Nesbit, Ph.D.

Summary

In their attempts to fix Michigan's economy, Gov. Rick Snyder and legislators should reject increasing cigarette taxes, which generate illegal activity such as smuggling, violent crime and the funding of terrorist activities.

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There is much to recommend in the proposals of the new administration of Gov. Rick Snyder, particularly on fiscal policy matters. He campaigned on significant business tax cuts and valuable spending reform, and talked of reining in the state's industrial policy empire in favor of a fairer, across-the-board series of economic reforms. Perhaps his most important recognition is that public employee benefits need be brought more in line with private-sector levels.

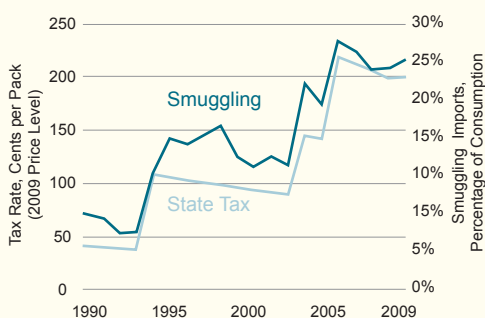
It is our hope that the Legislature agrees with Snyder and works to avoid budgetary quick fixes — such as cigarette tax increases — that have marked previous administrations and other state legislatures. The Mackinac Center has recently updated and expanded its 2008 study of cigarette taxes and smuggling, and we have found empirical and anecdotal evidence that shows massive smuggling still exists along with other — sometimes violent — unintended consequences.

Michigan taxes its cigarettes at \$2.00 per pack, tied for 11th highest in the nation. Because other states have much lower taxes per pack, there exists opportunities to capture a large portion of the tax differential as profit. Smugglers can acquire cigarettes inexpensively in North Carolina, which has a tax of just 45 cents per pack, and resell them in Michigan. North Carolina also does not require a tax stamp, which some states use to provide evidence that taxes have been paid. This makes it easier for smugglers to affix stolen or counterfeit tax stamps from the states into which the contraband smokes are smuggled.

In order to estimate the degree to which smuggling occurs, we developed a statistical model to measure the difference between legal paid cigarette sales and government survey data on smoking rates. The difference between rates of sales and smoking is our total smuggling rate. We also controlled for other important variables, such as border county population and distance to North Carolina, and divided the output by two types of smuggling: commercial (large, long-haul shipments) and casual, which is typically cross-border shopping for personal use. As the reader will note from the graphic, there is practically a marriage between high taxes and high smuggling rates.

We found that 26 percent of all the cigarettes consumed in Michigan in 2009 were smuggled into Michigan, a rate that ranks the Great Lakes State

Michigan Cigarette Tax Rates and Estimated Total Smuggling Import Rates, 1990-2009



10th among the 47 contiguous states whose smuggling rates we studied. Michigan ranks even higher (5th) for casual smuggling at 11.6 percent of total consumption, beating out all other states save New York (19.9 percent), Rhode Island (18.2 percent), Washington state (14.5 percent) and Montana (13.2 percent).

Remarkably, Michigan's smuggling rate would have been higher had it not been for cigarette smuggling exports — to Canada. Despite Michigan's high cigarette tax rates, they appear to remain an appealing alternative to Canadians. An amount equal to 3.5 percent of total consumption in Michigan is smuggled into to the Great White North, according to our model.

Aside from smuggling, there are plenty of other unintended consequences that follow large cigarette excise taxes. They include possible terrorist financing, property destruction, theft — including brazen semi-tractor hijackings — and violence against police and other people.

In our previous cigarette study, we told the story of Mohamad Hammoud, who with compatriots ran contraband cigarettes to Michigan. He used profits from the smuggling operation to help fund Hezbollah, sending cash and equipment to Lebanon, including night vision goggles, drilling and blasting equipment, stun guns and laser range finders. In December 2010, Hammoud asked the government to reduce his 155-year sentence to time served or no more than 15 years.

Just days after he appeared in court to request a lighter sentence, the federal government arrested two men in North Carolina suspected of cigarette smuggling and using proceeds from their illicit activities to fund a terrorist front group in Yemen. One of those arrested has family in Michigan. The threat of prison does not seem to be a deterrent.

Smugglers are not just people from out-of-state swarming Michigan to trade in contraband cigarettes. Our 2010 study described just one Upper Peninsula smuggling team that bought or ordered more than 40 million cigarettes from a federal undercover agent.

The bottom line with cigarette tax revenue is that politicians are as addicted to it as some people are to nicotine. Legislators in Michigan and elsewhere should balance budgets with cuts to spending, not by indirectly subsidizing criminal activities.

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