Cigarette Taxes, Black Markets, and Crime
Lessons from New York’s 50-Year Losing Battle
by Patrick Fleenor

Executive Summary

As large state government budget gaps have opened in the past year, lawmakers across the country are turning to cigarette taxes for added revenue. Twenty states raised cigarette tax rates in 2002, and more hikes may be on the agenda during state legislative sessions in 2003.

Proponents of high cigarette taxes portray them as innocuous levies that improve public health. Yet those taxes have long been known to have a dark side. Since the first state cigarette taxes were imposed in the 1920s, black markets and related criminal activity have plagued high-tax jurisdictions. Such activity has proven to be resistant to law enforcement curtailment efforts.

Thanks to recent city- and state-level tax hikes, New York City now has the highest cigarette taxes in the country—a combined state and local tax rate of $3.00 per pack. Consumers have responded by turning to the city’s bustling black market and other low-tax sources of cigarettes. During the four months following the recent tax hikes, sales of taxed cigarettes in the city fell by more than 50 percent compared to the same period the prior year.

New York has a long history of cigarette tax evasion. Former governor Malcolm Wilson dubbed the city the “promised land for cigarette bootleggers.” Over the decades, a series of studies by federal, state, and city officials has found that high taxes have created a thriving illegal market for cigarettes in the city. That market has diverted billions of dollars from legitimate businesses and governments to criminals.

Perhaps worse than the diversion of money has been the crime associated with the city’s illegal cigarette market. Smalltime crooks and organized crime have engaged in murder, kidnapping, and armed robbery to earn and protect their illicit profits. Such crime has exposed average citizens, such as truck drivers and retail store clerks, to violence.

The failure of New York policymakers to consider the broader effects of high cigarette taxes has been a mistake repeated across the country in the stampede to maximize tax revenue from this demonized product. Too often, policymakers do not consider these effects in the erroneous belief that people do not respond to government-created economic incentives. The negative effects of high cigarette taxes in New York provide a cautionary tale that excessive tax rates have serious consequences—even for such a politically unpopular product as cigarettes.
You almost can't find a legal cigarette in New York City.

Former New York congressman Ned Pattison

Introduction

As large state government budget gaps have opened in the past year, lawmakers across the country are once again turning to cigarette taxes for added revenue. Twenty states raised cigarette tax rates in 2002, and more hikes may be on the agenda during state legislative sessions in 2003.

Proponents of high cigarette taxes portray them as innocuous levies that improve public health. Yet those taxes have long been known to have a dark side. Since the first state cigarette taxes were imposed in the 1920s, black markets and related criminal activity have plagued high-tax jurisdictions. In many instances, such activity has proven to be very resistant to law enforcement's efforts to curtail it.

Nevertheless, both the state and the city of New York enacted large increases in their cigarette excise tax rates in 2002. New York State increased its tax rate from $1.11 to $1.50 per pack in April (see Table 1). New York City dramatically increased its rate from 8 cents to $1.50 per pack in July. In the first four months following those tax hikes, sales of taxed cigarettes plummeted by more than 50 percent compared to the same period the prior year. Good news for public health? Not if consumers simply turned to the black market and other low-cost sources of cigarettes.

This paper examines New York’s half-century battle with cigarette black markets and related crime. It documents consumer responses to tax increases and discusses law enforcement and policy efforts to curb the negative side effects of high cigarette levies. Finally, the paper discusses national and international experiences with cigarette taxes and finds that New York’s experience is typical of jurisdictions levying high cigarette taxes.

The Origins of Cigarette Taxation in New York City

Cigarette taxes have long been a source of controversy in New York. Prior to the enactment of cigarette excises, there was considerable debate regarding the pros and cons of raising government revenue with those special levies. The New York Times reported in 1938 that opponents of the tax argued that two types of “border activity” would result from imposing taxes on cigarettes. The first, border shopping, occurs when consumers purchase cigarettes directly from retailers in low-tax jurisdictions. The second, cigarette bootlegging, occurs when criminals illegally transport cigarettes from a low-tax to a high-tax jurisdiction to expropriate the tax differential. The warnings from the 1930s turned out to be highly prescient: both of those types of border activity soared in subsequent decades as cigarette taxes in New York rose.

The city government was the first to experiment with a cigarette tax when it imposed a temporary 1 cent per pack levy in 1938 (Table 1). At the time, a pack of cigarettes cost around 15 cents. As had been predicted, this tax triggered the beginnings of border shopping, cigarette bootlegging, and ancillary crime in the city according to contemporary accounts. The state government experienced similar problems when it enacted its own tax in 1939. Even after the expiration of the temporary city levy, these problems were particularly acute in the New York City area because of its close proximity to New Jersey, which did not tax cigarettes until 1948.

Throughout the 1940s, proponents of cigarette taxes pushed for the reintroduction of a local tax in New York City on top of the state tax. State authorities were hesitant to give the city the power to levy such a tax out of concern that it would exacerbate problems with border activity. The incentive to engage in such activity increased when the state cigarette tax rose to 3 cents per pack in 1948.

The politics of a local cigarette tax in New
York City changed in 1952 when the city found itself facing a large budget gap. City officials pressured the state government for the right to tax cigarettes and the state eventually relented. New York City enacted a 1 cent per pack cigarette excise in June 1952.

The two uppermost lines in Figure 1 illustrate the effects that this levy and the state excise have had on taxed cigarette sales—ones on which the applicable excises have been paid—in the city and state of New York. These two series (left axis) show per capita sales of taxed cigarettes in each of these jurisdictions relative to the national average. Meanwhile, the bottommost pair of lines in the figure (right axis) show the amount of applicable state and city excises (measured in 2002 dollars) in each of these jurisdictions. While this paper is primarily concerned with the sale of taxed cigarettes in New York City, the statewide series is also included in the graph to show how the two tax systems affect each other. Over the years, changes in the state excise have been a major factor affecting taxed cigarette sales in the city and vice versa. Table 1 lists tax rate changes over time. Annual sales and tax data are listed in Table 2.

Figure 1 reveals a clear pattern. During periods of moderate taxation, sales of taxed cigarettes in the state and city remained high. Sharp increases in tax rates, on the other hand, have resulted in taxed cigarette sales falling as a result of both reduced consumption and, more important, according to government officials who have studied the problem, increased border activity.

Table 1
New York Cigarette Tax Rate History (cents per pack of 20)

<table>
<thead>
<tr>
<th>New York City</th>
<th>New York State</th>
</tr>
</thead>
<tbody>
<tr>
<td>May 1, 1938–June 30, 1940</td>
<td>1</td>
</tr>
<tr>
<td>June 1, 1952–April 30, 1959</td>
<td>1</td>
</tr>
<tr>
<td>May 1, 1959–May 31, 1963</td>
<td>2</td>
</tr>
<tr>
<td>June 1, 1963–May 31, 1971</td>
<td>4</td>
</tr>
<tr>
<td>June 1, 1971–December 31, 1975</td>
<td>4 to 8</td>
</tr>
<tr>
<td>January 1, 1976–July 1, 2002</td>
<td>8</td>
</tr>
<tr>
<td>July 2, 2002–present</td>
<td>150</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>New York State</td>
<td></td>
</tr>
<tr>
<td>June 1, 1939–December 31, 1947</td>
<td>2</td>
</tr>
<tr>
<td>January 1, 1948–March 31, 1959</td>
<td>3</td>
</tr>
<tr>
<td>April 1, 1959–March 31, 1965</td>
<td>5</td>
</tr>
<tr>
<td>April 1, 1965–May 31, 1968</td>
<td>10</td>
</tr>
<tr>
<td>June 1, 1968–January 31, 1972</td>
<td>12</td>
</tr>
<tr>
<td>February 1, 1972–March 31, 1983</td>
<td>15</td>
</tr>
<tr>
<td>April 1, 1983–April 30, 1989</td>
<td>21</td>
</tr>
<tr>
<td>May 1, 1989–May 31, 1990</td>
<td>33</td>
</tr>
<tr>
<td>June 1, 1990–May 31, 1993</td>
<td>39</td>
</tr>
<tr>
<td>June 1, 1993–February 29, 2000</td>
<td>56</td>
</tr>
<tr>
<td>March 1, 2000–April 2, 2002</td>
<td>111</td>
</tr>
<tr>
<td>April 3, 2002–present</td>
<td>150</td>
</tr>
</tbody>
</table>

Sources: New York State Department of Taxation and Finance and New York City Department of Finance.

aBase tax rate of 4 cents. High tar and nicotine cigarettes faced up to a 4-cent surcharge.

Sharp increases in tax rates have resulted in taxed cigarette sales falling.
In June 1963, New York City doubled its cigarette tax. The following year, per capita sales of taxed cigarettes fell from 14 percent above the national average to 2 percent below it.

1952–63: Modest Taxes and Modest Side Effects

The enactment in 1952 of a 1 cent city excise on top of the existing state levy raised cigarette taxes in the city to 4 cents per pack, or the equivalent of 27 cents per pack in today's dollars. Nevertheless, Figure 1 shows that total cigarette excises remained at historically modest levels and taxed cigarette sales were relatively high. During the five fiscal years following the enactment of the tax, the city's taxed cigarette sales averaged 111 percent of the national average. Such sales highlight the fundamental nature of New York City's cigarette market. The above-average income of city residents coupled with the large number of incidental purchases by commuters, business travelers, and tourists create ideal conditions for the sale of cigarettes.

Strong sales encouraged the state to raise its cigarette tax from 3 to 5 cents per pack in April 1959. One month later, the city doubled its tax from 1 to 2 cents per pack. Figure 1 shows that taxed cigarette sales fell as a result of those tax hikes. In New York City, taxed sales fell from 117 percent of the national average to 106 percent in the year following the hike.

1964–89: Bootlegging and Violence

In June 1963, New York City doubled its cigarette tax from 2 to 4 cents per pack. In the following year, per capita sales of taxed cigarettes fell from 14 percent above the national average to 2 percent below it. The city would never see its sales of taxed cigarettes exceed the national average again. Then, in 1964, the U.S. surgeon general issued his famous report linking smoking to a variety of health problems. Citing the findings of the report, New York State doubled its cigarette tax from 5 to 10 cents per pack in April 1965. New York City was embarking on what Roy
Table 2
New York Cigarette Tax Rates and per Capita Taxed Sales Relative to U.S. Average (packs of 20)

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>United States Taxed Sales per Capita</th>
<th>New York City Taxed Sales as a Percentage of U.S. Average</th>
<th>Tax Rate (cents per pack, $2002)</th>
<th>New York State Taxed Sales per Capita</th>
<th>New York State Taxed Sales as a Percentage of U.S. Average</th>
<th>Tax Rate (cents per pack, $2002)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1953</td>
<td>126</td>
<td>141</td>
<td>112</td>
<td>135</td>
<td>107</td>
<td>20</td>
</tr>
<tr>
<td>1954</td>
<td>118</td>
<td>132</td>
<td>112</td>
<td>132</td>
<td>112</td>
<td>20</td>
</tr>
<tr>
<td>1955</td>
<td>115</td>
<td>128</td>
<td>111</td>
<td>128</td>
<td>111</td>
<td>20</td>
</tr>
<tr>
<td>1956</td>
<td>116</td>
<td>131</td>
<td>113</td>
<td>130</td>
<td>112</td>
<td>20</td>
</tr>
<tr>
<td>1957</td>
<td>119</td>
<td>133</td>
<td>112</td>
<td>133</td>
<td>112</td>
<td>19</td>
</tr>
<tr>
<td>1958</td>
<td>121</td>
<td>137</td>
<td>114</td>
<td>136</td>
<td>113</td>
<td>19</td>
</tr>
<tr>
<td>1959</td>
<td>126</td>
<td>147</td>
<td>117</td>
<td>141</td>
<td>112</td>
<td>21</td>
</tr>
<tr>
<td>1960</td>
<td>131</td>
<td>139</td>
<td>106</td>
<td>144</td>
<td>110</td>
<td>30</td>
</tr>
<tr>
<td>1961</td>
<td>132</td>
<td>146</td>
<td>110</td>
<td>147</td>
<td>111</td>
<td>30</td>
</tr>
<tr>
<td>1962</td>
<td>132</td>
<td>150</td>
<td>113</td>
<td>148</td>
<td>112</td>
<td>30</td>
</tr>
<tr>
<td>1963</td>
<td>134</td>
<td>153</td>
<td>114</td>
<td>147</td>
<td>109</td>
<td>29</td>
</tr>
<tr>
<td>1964</td>
<td>130</td>
<td>128</td>
<td>98</td>
<td>143</td>
<td>109</td>
<td>29</td>
</tr>
<tr>
<td>1965</td>
<td>134</td>
<td>134</td>
<td>99</td>
<td>140</td>
<td>104</td>
<td>36</td>
</tr>
<tr>
<td>1966</td>
<td>133</td>
<td>105</td>
<td>79</td>
<td>124</td>
<td>94</td>
<td>56</td>
</tr>
<tr>
<td>1967</td>
<td>134</td>
<td>113</td>
<td>85</td>
<td>126</td>
<td>94</td>
<td>54</td>
</tr>
<tr>
<td>1968</td>
<td>132</td>
<td>112</td>
<td>85</td>
<td>127</td>
<td>97</td>
<td>53</td>
</tr>
<tr>
<td>1969</td>
<td>130</td>
<td>106</td>
<td>82</td>
<td>122</td>
<td>94</td>
<td>60</td>
</tr>
<tr>
<td>1970</td>
<td>126</td>
<td>105</td>
<td>83</td>
<td>120</td>
<td>95</td>
<td>57</td>
</tr>
<tr>
<td>1971</td>
<td>131</td>
<td>108</td>
<td>82</td>
<td>123</td>
<td>93</td>
<td>54</td>
</tr>
<tr>
<td>1972</td>
<td>130</td>
<td>96</td>
<td>74</td>
<td>120</td>
<td>92</td>
<td>57</td>
</tr>
<tr>
<td>1973</td>
<td>134</td>
<td>95</td>
<td>71</td>
<td>119</td>
<td>89</td>
<td>62</td>
</tr>
<tr>
<td>1974</td>
<td>140</td>
<td>99</td>
<td>71</td>
<td>123</td>
<td>87</td>
<td>57</td>
</tr>
<tr>
<td>1975</td>
<td>133</td>
<td>101</td>
<td>76</td>
<td>124</td>
<td>93</td>
<td>52</td>
</tr>
<tr>
<td>1976</td>
<td>143</td>
<td>114</td>
<td>80</td>
<td>125</td>
<td>88</td>
<td>48</td>
</tr>
<tr>
<td>1977</td>
<td>136</td>
<td>104</td>
<td>76</td>
<td>127</td>
<td>93</td>
<td>45</td>
</tr>
<tr>
<td>1978</td>
<td>138</td>
<td>106</td>
<td>77</td>
<td>127</td>
<td>92</td>
<td>43</td>
</tr>
<tr>
<td>1979</td>
<td>138</td>
<td>110</td>
<td>80</td>
<td>125</td>
<td>91</td>
<td>39</td>
</tr>
<tr>
<td>1980</td>
<td>134</td>
<td>112</td>
<td>84</td>
<td>128</td>
<td>95</td>
<td>34</td>
</tr>
<tr>
<td>1981</td>
<td>139</td>
<td>113</td>
<td>81</td>
<td>130</td>
<td>94</td>
<td>31</td>
</tr>
<tr>
<td>1982</td>
<td>137</td>
<td>115</td>
<td>84</td>
<td>129</td>
<td>94</td>
<td>28</td>
</tr>
<tr>
<td>1983</td>
<td>129</td>
<td>109</td>
<td>84</td>
<td>125</td>
<td>97</td>
<td>30</td>
</tr>
<tr>
<td>1984</td>
<td>127</td>
<td>105</td>
<td>82</td>
<td>119</td>
<td>94</td>
<td>37</td>
</tr>
<tr>
<td>1985</td>
<td>126</td>
<td>105</td>
<td>83</td>
<td>117</td>
<td>93</td>
<td>35</td>
</tr>
<tr>
<td>1986</td>
<td>122</td>
<td>99</td>
<td>82</td>
<td>114</td>
<td>94</td>
<td>34</td>
</tr>
<tr>
<td>1987</td>
<td>120</td>
<td>97</td>
<td>81</td>
<td>110</td>
<td>91</td>
<td>34</td>
</tr>
<tr>
<td>1988</td>
<td>114</td>
<td>95</td>
<td>83</td>
<td>107</td>
<td>93</td>
<td>32</td>
</tr>
<tr>
<td>1989</td>
<td>108</td>
<td>89</td>
<td>83</td>
<td>100</td>
<td>93</td>
<td>34</td>
</tr>
<tr>
<td>1990</td>
<td>103</td>
<td>85</td>
<td>83</td>
<td>94</td>
<td>92</td>
<td>47</td>
</tr>
<tr>
<td>1991</td>
<td>101</td>
<td>77</td>
<td>77</td>
<td>86</td>
<td>86</td>
<td>52</td>
</tr>
<tr>
<td>1992</td>
<td>99</td>
<td>76</td>
<td>77</td>
<td>82</td>
<td>83</td>
<td>50</td>
</tr>
<tr>
<td>1993</td>
<td>96</td>
<td>73</td>
<td>76</td>
<td>77</td>
<td>81</td>
<td>50</td>
</tr>
<tr>
<td>1994</td>
<td>89</td>
<td>65</td>
<td>73</td>
<td>71</td>
<td>79</td>
<td>68</td>
</tr>
<tr>
<td>1995</td>
<td>90</td>
<td>65</td>
<td>72</td>
<td>70</td>
<td>77</td>
<td>66</td>
</tr>
<tr>
<td>1996</td>
<td>88</td>
<td>59</td>
<td>67</td>
<td>65</td>
<td>73</td>
<td>64</td>
</tr>
<tr>
<td>1997</td>
<td>88</td>
<td>56</td>
<td>64</td>
<td>63</td>
<td>71</td>
<td>63</td>
</tr>
<tr>
<td>1998</td>
<td>85</td>
<td>58</td>
<td>68</td>
<td>63</td>
<td>75</td>
<td>62</td>
</tr>
<tr>
<td>1999</td>
<td>78</td>
<td>56</td>
<td>72</td>
<td>61</td>
<td>78</td>
<td>61</td>
</tr>
<tr>
<td>2000</td>
<td>76</td>
<td>53</td>
<td>69</td>
<td>55</td>
<td>73</td>
<td>78</td>
</tr>
<tr>
<td>2001</td>
<td>75</td>
<td>47</td>
<td>63</td>
<td>48</td>
<td>64</td>
<td>114</td>
</tr>
<tr>
<td>2002</td>
<td>73</td>
<td>45</td>
<td>62</td>
<td>46</td>
<td>63</td>
<td>121</td>
</tr>
</tbody>
</table>

Source: Author’s calculations based on data from the Internal Revenue Service, the New York State Department of Taxation and Finance, and the New York City Department of Finance.

Notes: Tax rate for New York City includes city and state taxes. Weighted-average tax rate used during years that had a rate change. Per capita taxed sales for 2002 are estimated using the latest available data.
Goodman, its finance administrator, would call an “astonishing saga.”

“From that very moment,” according to Goodman, “bootlegging became a major problem” in the city. Initially small-scale independent bootleggers accounted for much of the cigarette smuggling in New York. They would typically drive to a low-tax jurisdiction, fill the trunks of their cars with cigarettes, and then peddle them at locations throughout the city. The story of one such bootlegger is discussed in the following box. The expansion of such activity allowed bootleg cigarettes to quickly claim a substantial share of the New York market. In the 12-month period following the 1965 doubling of the state’s cigarette tax, sales of taxed cigarettes in the state fell by 14 percent. Meanwhile, taxed sales in the city plunged 22 percent. At the same time, cigarette sales in jurisdictions where New York bootleggers purchased cigarettes rose sharply. For example, taxed sales in Washington, D.C., which levied only a 2 cent per pack tax, rose 25 percent. In North Carolina, which did not levy a cigarette tax, the reported rise in cigarette sales was “astronomical.”

The large profits that could be made smuggling cigarettes did not go unnoticed by organized crime, which soon entered the racket.

---

**Mr. X: An Independent Bootlegger**

Since the 1940s New York’s small-scale bootleggers had been driving to low-tax jurisdictions and purchasing cheap cigarettes. They returned to New York City and resold them at train and subway stations, apartment buildings, work sites, and on the streets. Smugglers offered consumers cost savings and convenience, often taking orders and making home and office deliveries. In the early 1970s those activities were explored by the New York State Commission of Investigation, which heard testimony on cigarette smuggling. One satisfied customer of a bootlegger told the commission that “every Monday [he] came and took your order. Every Wednesday he delivered it . . . [he] was just as regular as a milkman.”

The commission also heard testimony from a bootlegger named Mr. X, a name given to ensure anonymity. Mr. X stumbled upon the profitable business when driving back from Florida in 1966. He noticed that a carton of cigarettes that cost $3.65 in New York City cost just $1.65 in North Carolina. A few weeks later, Mr. X drove to North Carolina, loaded his vehicle with 500 cartons of cigarettes, and resold them in New York for a tidy profit.

Finding that there was almost unlimited demand for his bootleg smokes, Mr. X began making weekly trips to North Carolina. During the next three years, Mr. X smuggled an average of 3,500 cartons of cigarettes into the city each week. The commission estimated that Mr. X’s smuggling operation cost the state and city of New York at least $844,775 (about $4.4 million in 2002 dollars) in lost excise tax revenue. In its investigation, the commission identified hundreds of similar independent bootleggers. Based on today’s tax rates, an operation like Mr. X’s would cost the state and city of New York about $5.5 million annually in lost cigarette excise taxes.

Although Mr. X had several encounters with police, it was not law enforcement that drove him out of the bootlegging business. Rather, it was organized crime. Mr. X first noticed the entry of mobsters into the racket in 1967 while waiting in line with other bootleggers to receive a load of cigarettes from a North Carolina tobacco wholesaler. He recognized some of the people waiting alongside him as underworld figures he had seen in media reports. The involvement of such individuals concerned him, and after being hijacked by mobsters he left the smuggling business in 1968.
organized crime, which soon entered the racket. Among those criminals were former alcohol bootleggers who had honed their smuggling skills during Prohibition. The arrival of organized crime changed New York’s cigarette smuggling in two ways. First, smuggling increased in sophistication. Instead of trunk loads, organized crime moved truckloads of bootleg cigarettes into the city, affixed counterfeit tax stamps, and sold them in the ordinary retail market. The smuggling of cigarettes became one of the underworld’s most lucrative endeavors and prompted Finance Administrator Goodman to call it the “principal stoking facility of the engine of organized crime.”

The violence unleashed by high cigarette taxes was not confined to the illegal side of the cigarette trade. Soon criminals began to prey on the legitimate side of the industry as well, particularly truckers, wholesalers, distributors, and retailers. Many of those businesses were caught wholly unprepared for the new security risks. Prior to the tax hikes, those firms operated just like other companies handling similar merchandise. The tax hikes, by literally increasing the value of cigarettes

The Demise of a Trucking Company

Marion Auto Trucking performed general hauling services for the Lorillard tobacco company in New York City and parts of New Jersey. The company was well managed and had been in business since the 1920s. It had made substantial investments to modernize its fleet, including equipping trucks with alarm systems and experimenting with camouflaging trucks in an effort to thwart hijackings and theft.

The firm’s success in preventing theft changed on July 10, 1970, when armed men commandeered one of Marion’s trucks. The driver was removed from the vehicle and taken to a remote area and released. The thieves made off with the truck’s cargo of 258 cases (154,800 packs) of cigarettes. During the next several months, two more of Marion’s trucks were hijacked, resulting in the loss of about 400 cases of cigarettes. In other instances, Marion trucks were stopped at gunpoint and the drivers removed, but security systems prevented the thieves from seizing any cargo.

Prior to the rash of hijacking, Lorillard had insured Marion under its corporate policy. After the hijackings, it was forced to purchase its own theft insurance. As Marion was getting its new policy in place, another truck was hijacked and 198 cases of cigarettes were lost. After that, the company could get only very limited insurance coverage. Marion instituted further security measures, including a telephone tracking system that monitored drivers on the road and removing the running boards from trucks to make them harder to commandeer. Such measures proved costly and, coupled with drivers’ fears of violence, harmed the firm’s efficiency. Fifteen months into the string of hijackings, and after 51 years in business, Marion closed its doors, laying off all of its employees.

Today, 200 cases of cigarettes in a modest-sized transport truck would have a retail value in New York City of around $1 million and would be an even more tempting target for thieves.
overnight, altered the situation dramatically. Soon the hijacking of trucks carrying cigarettes became commonplace. As had occurred in other high-tax jurisdictions, it became difficult to find firms that were willing to transport legal cigarettes from southern factories to the New York City metropolitan area.\textsuperscript{23} Those that dared to do so faced exorbitant rates for insurance and needed to invest in elaborate security systems. A state commission investigating cigarette bootlegging documented how the situation deteriorated to the point where it was often necessary to transport cigarettes around the city in convoys: a delivery truck, which itself had someone “riding shotgun,” would be surrounded by additional vehicles with armed guards.\textsuperscript{24} Such conditions drove up costs and, coupled with employee fears of violence, forced many legitimate businesses to close. The story of one such business is discussed in the proceeding box.\textsuperscript{25}

Much to the dismay of other states and localities, the ancillary crime associated with New York’s illegal cigarette trade quickly spread beyond its borders. Across the country, trucks carrying cigarettes were hijacked and businesses selling cigarettes were robbed to supply the illicit market in New York.\textsuperscript{26} New York mobsters also infiltrated the legitimate cigarette industry in low-tax states to secure reliable sources of inexpensive cigarettes.\textsuperscript{27}

The first response of lawmakers in New York to the rise of black-market activity was to increase the penalties for cigarette bootlegging. Counterfeiting cigarette stamps was elevated to a felony, sentences and fines were increased, and mandatory prison sentences were prescribed for cigarette smugglers. The city started prosecuting cigarette smuggling cases in its criminal courts using the resources of its district attorneys’ offices, rather than its civil corporation counsel’s office. It also began conducting grand jury investigations of cigarette-smuggling cases.\textsuperscript{28}

Enforcement and licensing activities were also bolstered. The number of New York State cigarette tax inspectors swelled from 16 in 1965 to 176 in 1967.\textsuperscript{29} Substantial resources of the state police were diverted to help fight cigarette bootlegging. New York City passed a licensing bill that heavily regulated cigarette distribution and expanded the city’s powers of search and seizure. The city went so far as to enlist the help of its fruit and vegetable inspectors in its war on cigarettesmuggling. In addition, it embarked on a public relations campaign aimed at convincing the public not to buy contraband cigarettes.\textsuperscript{30}

Yet even with those new resources and expanded powers, law enforcement proved to be very ineffective at combating cigarette bootlegging. In the 12-month period following the 1965 doubling of the state tax rate, the state tax commissioner was able to seize just 70,000 cartons of contraband cigarettes.\textsuperscript{31} At the time, it was estimated that illegal cigarettes were entering New York State at the rate of more than 100,000 cartons per day.\textsuperscript{32} By 1967, government officials estimated that one-quarter of the cigarettes consumed in New York State were the product of bootlegging.\textsuperscript{33} Efforts by city officials proved equally ineffective at stopping the flow of illegal cigarettes into the city, prompting Finance Administrator Goodman to state, “Of all of the assignments that [the Finance Administrator’s Office has] had, none of them was more challenging, and frankly none more vexatious, more frustrating, than that of administering the cigarette tax in New York City.”\textsuperscript{34}

Both the magnitude of the bootlegging problem and the swiftness with which it captured such a large share of the cigarette market stunned New York officials. In response, Gov. Nelson Rockefeller convened a conference on cigarette bootlegging in 1967, which included governors of 14 states, New York’s congressional delegation, and federal officials.\textsuperscript{35} At the meeting, the governor called for stronger federal, state, and local anti-bootlegging laws, increased law enforcement, greater federal involvement, and more regulation of the industry. Confident that the war on cigarette bootlegging could be won, the governor signed legislation hiking the state’s cigarette tax by another 2 cents per pack in June 1968. The governor was wrong—taxed sales in the
state and the city continued to slide relative to the national level as the tax hike encouraged further bootlegging.

By 1970 stepped-up state and city law enforcement efforts were barely making a dent in cigarette smuggling. During that year, the State Department of Taxation seized 112,000 cartons of illegal cigarettes.\textsuperscript{36} That was at a time when it was conservatively estimated that 110,000 cartons of bootleg cigarettes were entering New York State every day.\textsuperscript{37} Efforts in New York City were even less successful. During that year the city’s enforcement efforts netted just 1,000 cartons of contraband cigarettes.\textsuperscript{38}

The Rockefeller Report

The problems arising from New York’s massive illegal cigarette market and the inability of law enforcement officials to do much about it prompted Governor Rockefeller to request that the New York State Committee of Investigation examine the problem in the spring of 1971. As fate would have it, the commission got to witness firsthand the effects of tax hikes when both the city and the state governments enacted tax hikes during its tenure.

In June 1971 New York City instituted a “tar and nicotine tax,” which placed a 3 or 4 cent surtax on cigarettes with tar or nicotine levels, or both, above certain thresholds. That system led to even more evasion problems as bootleggers increasingly smuggled higher nicotine brands into the city and dealers sought to have their high-nicotine cigarettes illegally taxed at lower rates.\textsuperscript{39} After witnessing the administrative and enforcement problems associated with the tax, the commission’s chairman, Paul J. Curran, stated that this scheme “opened up another hornet’s nest in terms of enforcement and administration over and above the normal straight-out problems of too high a tax to start with.”\textsuperscript{40}

Then on February 1, 1972, the state of New York raised its cigarette tax from 12 to 15 cents per pack. Predictably, that led to more bootlegging and taxed sales fell in both the state and the city of New York.

When it released its report in March 1972, the commission concluded that the problem of cigarette smuggling in the state was much more serious than had been thought. It estimated that from 1966 to 1971 about 400 million packs of illegal cigarettes had been smuggled into the state each year. As a result, the commission estimated that the legitimate cigarette industry had lost more than $2 billion ($10 billion in 2002 dollars) in sales, the state of New York had lost $294 million ($1.5 billion in 2002 dollars) in sales and excise tax revenue, and the city had lost as much as $90 million in revenue ($450 million in 2002 dollars).\textsuperscript{41}

The commission’s chairman described the situation in New York City as “desperate” and noted that there were two cigarette distribution systems in the city, one legal and one illegal.\textsuperscript{42} The commission’s report found that the illegal side of the cigarette trade was largely the province of organized crime and documented a host of crimes associated with it, including attempted murder, torture, kidnapping, and armed robbery. The report concluded that law enforcement efforts had been unable to effectively deal with the problems associated with the illicit market and described such efforts as “completely ineffective and a failure.”\textsuperscript{43}

The Promised Land for Bootleggers

The magnitude of cigarette smuggling and the inability of law enforcement to combat it led Governor Rockefeller to assemble a task force to seek “new approaches” to the problem in early 1973.\textsuperscript{44} When the task force released its report later that year, one of the task force’s key recommendations was full repeal of New York City’s taxation of cigarettes. Rockefeller’s resignation from the governorship, however, meant that he was not able to implement the task force’s recommendations. Nonetheless, his successor, Malcolm Wilson, enthusiastically embraced a trial repeal of the city’s cigarette taxes. In his first message to the state legislature in January 1974, the new governor stated:

One major incentive to organized
crime is the high New York City cigarette taxes, piled on top of the state tax, which have made that city the promised land for cigarette bootleggers. Cigarette bootlegging costs our taxpayers $85 million annually in lost tax revenues from legitimate sales. It puts small, honest storekeepers out of business and costs people their jobs. It provides front money for loan sharking, the drug traffic and other enterprises of organized crime.

I propose a one year, experimental repeal of New York City's taxes on cigarettes. The state will make appropriate adjustments to make up for the city's net direct loss from the repeal of these taxes. This action will not promote cigarette smoking. It will merely take cigarette sales from the black market, where they destroy the jobs of honest men and produce crooked profits, and shift these sales to the open market, where they will preserve jobs, promote honest profits, and provide needed public revenues.

During the legislative session, the governor fought hard for the proposal. It failed to pass, however, in large measure because of opposition from upstate legislators who felt that a scheme to replace lost city tax revenue would unfairly transfer funds from other parts of the state.

**Bloody Turf Battles**

While politicians in Albany grappled with ways of curbing the illegal cigarette trade during the mid-1970s, the crime associated with it worsened as mobsters waged increasingly bloody battles for control of the city's cigarette markets. Such turf battles coupled with efforts to silence witnesses resulted in a string of homicides. Meanwhile, the legitimate side of the industry lived under constant threat and was forced to undertake extraordinary security measures. Those conditions prompted Paul Curran to testify to Congress that workers were “confronted almost daily with the risk and dangers of personal violence which are now inherent in their industry.”

Commenting on the security measures being taken, one New York City police detective noted that “many dealerships in the New York area are secured like fortresses and trucks making deliveries are more like armored cars than delivery vans.”

In January 1976, the city replaced its special tax and nicotine surtax with a uniform 8 cents per pack excise. Although this eliminated some of the problems associated with administering the more complex surtax, it boosted overall cigarette tax rates, and sales of taxed cigarettes fell as the black market expanded. Meanwhile, policy experts continued to inform legislators that law enforcement was of limited use in fighting cigarette smuggling and that tax reduction was the best way of mitigating the problem. That was the message of yet another task force, the New York State Special Task Force on Cigarette Bootlegging and the Cigarette Tax, which was formed to look at the problem. When it issued its report in May 1976, it recommended that the New York City cigarette tax be abolished and the state tax be reduced from 15 to 13 cents per pack.

**The Contraband Cigarette Act of 1978**

New York City was not alone in the fight against cigarette bootlegging in the late 1970s. Across the country, jurisdictions with high cigarette taxes faced similar problems, prompting the federal government to request that the Advisory Commission on Intergovernmental Relations study the issue. When the ACIR released its report in May 1977, it stated that cigarette smuggling in the United States was primarily due to tax differentials. One of its recommendations was that governments exercise restraint when considering raising cigarette taxes.

The ACIR also recommended that a federal law be enacted to prohibit the transport of large quantities of cigarettes across state lines with the intent of evading state and local excises. Congress responded by passing the...
Contraband Cigarette Act in 1978 (PL 95-575). The law prohibits the transport, receipt, shipment, possession, distribution, or purchase of more than 60,000 cigarettes (300 cartons) not bearing the official tax stamp of the state in which the cigarettes are located. Violation of the statute is punishable by up to five years in prison and a $100,000 fine. Vehicles used in smuggling activities are also subject to seizure.

Passage of the Contraband Cigarette Act is often credited with the uptick in taxed cigarette sales in New York City relative to the national average during the 1979 and 1980 fiscal years. Although it is undoubtedly true that the act had some deterrent effect, that effect is frequently overstated. Federal counterbootlegging operations were largely in their planning stages during this period, and after the first major crackdown in the city during the later half of fiscal 1980, taxed sales actually fell relative to the national average the following year. Moreover, by increasing the penalties associated with bootlegging cigarettes between states, the act may have had the unintended effect of encouraging criminals to steal cigarettes from businesses within the state. In the aftermath of the act’s passage tax officials reported an increase in robberies and thefts from retailers and wholesalers as well as hijackings of trucks carrying cigarettes.

What had an unambiguously positive effect on reducing both cigarette bootlegging and ancillary crime was the de facto tax reduction that occurred during the later half of the 1970s and early 1980s. Between 1976 and 1982 high inflation helped to lower real cigarette excises by more than 40 percent. That helped to boost taxed cigarette sales in the city from 80 to 84 percent of the national average. Meanwhile, tax-paid sales in the state rose from 88 percent of the national level to 94 percent. The state government’s decision to hike cigarette taxes from 15 to 21 cents per pack on April 1, 1983, reversed that trend, and taxed sales in the state and the city fell relative to the national level during the later half of the decade.

1990-2002: Soaring Taxes and Plummeting Sales

The past 13 years have witnessed considerable tumult in New York’s cigarette markets as state and city taxes have been increased to record levels with little regard shown for the lessons learned during the prior decades. As in the past, these tax hikes have been frequently sold to voters as a way of improving public health. In defense of the latest increase in July 2002, for example, which sent the price of legal, brand-name cigarettes soaring to more than $7.50 per pack in the city, Mayor Michael Bloomberg stated that “we all know that smoking kills, And increasing the cigarette tax saves lives.”

In fact, data from the Centers for Disease Control on cigarette use shows that large tax hikes have not led to significant declines in the number of New Yorkers who smoke. Overall, the prevalence of smoking among adults in New York State has followed the nationwide trend and dipped only slightly during the past decade, from 24.4 percent in 1991 to 23.2 percent in 2001. That occurred in spite of a near doubling of the real cigarette tax rate in the state during the period. Similarly, smoking rates in the city fell from 21.7 percent in 1993 (the earliest year for which data are available) to 20.7 percent in 2001. Meanwhile, smoking rates among young adults (aged 18 to 24) in the state—those often cited as the targets of tax hikes—have risen sharply during the last several years. While overall smoking rates have remained essentially flat in recent years, Figure 1 shows that sales of taxed cigarettes in both the state and the city have plummeted to record lows as New York’s tobacco consumers have increasingly filled their demand with low-tax cigarettes.

“More Profitable to Hijack a Cigarette Delivery Truck Than an Armored Truck”

New York’s latest era of problems stemming from its high taxes on cigarettes began just before the beginning of fiscal 1990 when
the state hiked its cigarette tax from 21 to 33 cents per pack. Predictably, taxed sales dropped in both the city and the state. Unlike state legislators, tax experts recognized the trouble that further tax hikes would cause. Robert Shepherd, an official in the state’s Department of Taxation and Finance Tax Enforcement Office, pointed out to a meeting of tax administrators in 1989 that “in New York it is literally more profitable to hijack a cigarette delivery truck than an armored truck.” Yet the following year the state raised its tax rate further to 39 cents per pack. Taxed cigarette sales fell to 86 and 77 percent of the national average in the state and city, respectively.

As taxed sales continued to fall, New York officials searched for ways of slowing the flow of hundreds of millions of dollars of revenue out of state and city coffers. Having demonstrated their inability to do much about bootlegging, state officials took aim at border shoppers by demanding that merchants on Native American lands stop selling tax-free cigarettes to non-Indians. Price-conscious consumers had long patronized such establishments since they offered cigarettes that were not subject to state and local sales or excise taxes. Tribal leaders balked at the state’s request, and a protracted legal battle ensued that eventually made its way to the U.S. Supreme Court. When it handed down its decision, the Court ruled that the state could require that taxes be paid on sales to non-Indians. Price-conscious consumers had long patronized such establishments since they offered cigarettes that were not subject to state and local sales or excise taxes. Tribal leaders balked at the state’s request, and a protracted legal battle ensued that eventually made its way to the U.S. Supreme Court. When it handed down its decision, the Court ruled that the state could require that taxes be paid on sales to non-Indians. That decision was met with loud protests from tribal leaders, some of whom threatened to refuse to collect the taxes. After a lengthy stalemate, Gov. George Pataki reversed his position and even went so far as to propose legislation authorizing tax-free sales on Indian lands.

While the state was embroiled in a legal dispute with Native Americans, an even larger source of tax-free cigarettes opened up when the World Wide Web exploded onto the scene in 1994. Almost overnight, retailers in low-tax jurisdictions set up websites offering low-priced cigarettes. From fiscal 1994 to 1996, sales of taxed cigarettes in New York State fell from 79 percent of the national average to 73 percent. In New York City, taxed sales fell from 73 to 67 percent.

Both the state and the city got a brief respite from declining taxed sales during the late 1990s after New Jersey doubled its cigarette tax from 40 to 80 cents per pack. That not only discouraged border shopping by New York residents; it also encouraged residents of the Garden State to buy cigarettes in New York. As a result, taxed sales in New York City rose to 72 percent of the national average in 1999.

That brief increase in New York’s taxed cigarette sales came to an abrupt end in March 2000 when the state raised its cigarette tax to $1.11 per pack. Anticipating that such a large tax hike would lead to substantial increases in border activity and related crime, governments at all levels mobilized to deal with the problems. Edgar Domenech, special agent in charge of the Bureau of Alcohol, Tobacco and Firearms’ New York division, for example, forecast that the prospect of earning $60,000 per vanload of smuggled cigarettes would markedly increase bootlegging. Concerned about a rise in crime, the agent told the Daily News that “when you talk about the financial gain that’s there . . . you’re going to have competition that can lead to violence.” In a view echoed by state officials, Domenech predicted that organized crime would increase its involvement in the illegal cigarette trade.

The state government attempted to combat the expected growth in border activity on several fronts. In a controversial move, Governor Pataki again targeted border shoppers by signing into law legislation that effectively banned the sale of cigarettes to New Yorkers by Internet retailers. In addition, to try to thwart bootlegging, the state bolstered enforcement, increased penalties for cigarette smuggling, and developed new cigarette tax stamps that were supposed to be both more easily recognizable and difficult to counterfeit. None of those measures had much of an effect on border activity, however, and taxed cigarette sales in the city and state, compared to the national average, fell substantially in fiscal 2001. To make matters worse for the state, a federal court invalidated
Cigarette Smuggling and Terrorism

On June 21, 2002, a federal court found Mohamad Hammoud, 28, guilty of providing material support for terrorists in his role as leader of a Charlotte, North Carolina-based cell that raised money for the Lebanese group Hezbollah by smuggling cigarettes within the United States. Hammoud’s brother, Chawki, 37, was also convicted of charges related to the bootlegging operation. As the trial proceeded, eight others pled guilty to various charges associated with this scheme.

The State Department has labeled Hezbollah a terrorist organization, citing among other acts its involvement in the 1983 bombing of the U.S. embassy and Marine barracks in Beirut that killed 241 American servicemen. While investigators have not found any connection between cigarette smuggling and those responsible for the September 11, 2001, attacks, a wide range of terrorist groups are known to use the proceeds from cigarette smuggling to fund their operations. For example, counterfeit cigarette tax stamps were found in an apartment used by members of the Egyptian Islamic Jihad cell that carried out the 1993 bombing of the World Trade Center. One of the individuals accused of being part of an al-Qaeda sleeper cell outside Buffalo, New York, also has a criminal history involving cigarette bootlegging.

According to court testimony, the Hammouds ran a fairly typical bootlegging operation. The brothers purchased large quantities of cigarettes in North Carolina where the tax rate is 5 cents per pack. They then transported them to Michigan where the tax rate was 75 cents per pack and resold them (the Michigan rate has since increased to $1.25 per pack). During the five-year life of this bootlegging operation, officials estimate that the Hammouds moved millions of dollars worth of cigarettes between the two states.

The scheme began to unravel when a police detective moonlighting as a security guard at a retail store noticed the brothers purchasing hundreds of cartons of cigarettes and notified the federal Bureau of Alcohol, Tobacco and Firearms. Beginning in 1996, ATF agents closely monitored the activities of the Charlotte cell, sometimes flying to Europe and the Middle East to piece together the money trail. It took until the middle of 2000 for agents to amass enough evidence for arrest warrants. On July 20 of that year, the brothers and numerous accomplices were taken into custody in raids on homes and businesses in Michigan and North Carolina.

The Hammouds’ bootlegging operation was driven by the prospect of expropriating the 70 cent per pack tax differential that existed between North Carolina and Michigan. Today, similar operators could reap more than quadruple the profits by operating between North Carolina and New York City, where the combined state and local cigarette tax is $3 per pack.

Inspectors in Miami discovered more than $300,000 worth of bogus tax stamps.

the state’s ban on Internet cigarette sales in July 2001, ruling that it interfered with interstate commerce.66

New York’s Cigarette Tax Hikes in 2002

In April 2002 the state hiked its cigarette tax to $1.50 per pack. In July the city also hiked its cigarette tax—from 8 cents to $1.50 per pack. Cigarette smugglers probably could not believe their good fortune. Many probably cheered as they worked up their new profit projections on computer spreadsheets. Sure enough, over the next four months sales of taxed cigarettes in the city fell by more than 50 percent compared with the same period the prior year.67
As in the past, highly sophisticated bootlegging operations are often run by organized crime. In August 2002, for example, authorities stumbled upon one such operation when customs inspectors in Miami discovered more than $300,000 worth of bogus tax stamps, manufactured in Paraguay, en route to New York. Recently, two other groups are said to have become increasingly involved in large-scale bootlegging in New York. According to John Dugan, an ATF area supervisor, “When it comes to smuggling and counterfeit stamps, traditional organized crime is involved, terrorist groups are involved, and street gangs are involved.” The proceeding box discusses recent evidence that has come to light regarding how international terrorists are using cigarette smuggling to fund their operations.

After being largely driven out of the racket by organized crime during the late 1960s, small-scale smugglers have reemerged as a major supplier of bootleg cigarettes over the past two decades. Today, many small-scale smugglers simply peddle illegal packs of cigarettes like illicit drugs on city streets. In August 2002 a New York Post reporter interviewed a man loitering outside a McDonald’s and selling $5 packs of Newports from a crumpled plastic bag. The man laughed when asked about the extent of such illegal sales and said that he had a lot of company. Another told the paper that he made about $200 a day hawking cigarettes that he acquired each morning from a truck that brought them into the city from a low-tax jurisdiction. Somewhat more elaborate operations allow customers to contact bootleggers via pager when they need a nicotine fix.

If history is any guide, the involvement of several rival groups in large-scale cigarette smuggling operations that also face competition from small-scale bootleggers creates a very volatile situation. Recall that during the late 1960s and the 1970s large-scale bootleggers moved first to stamp out their small-scale competitors before engaging in bloody turf battles among themselves. The situation has the potential to be much worse today because all of the groups involved in large-scale bootlegging today have displayed a propensity for extreme violence.

Recent tax hikes have also increased incentives to engage in crime against the legitimate cigarette industry. City and state excises now push the retail value of a truckload of cigarettes into the millions of dollars. That fact will surely increase the incidence of truck hijackings, a crime that the ATF reports has already increased markedly in recent years. New York’s cigarette tax hikes also put retail clerks at greater risk. The recent tax hikes have increased the value of the 200 or so cartons of cigarettes typically stored in the backroom of a retail store to about $15,000. That is an attractive target for armed robbery or burglary. Indeed, just days before the city’s 19-fold increase in its cigarette tax in 2002, the New York Post reported a brazen, daytime robbery of a tobacco store in Brooklyn. During the incident, two men approached the manager of the store while he stood outside the business. They threatened him, imprisoned him in the store’s restroom, and stole $30,000 worth of cigarettes. Later that night, thieves made off with 600 cartons of cigarettes from a convenience store in Queens. Similar thefts, which authorities believe were committed to supply New York’s black market, have occurred as far away as Virginia and North Carolina.

New York Is Not Unique

New York has not been alone in its losing battle against the illicit cigarette trade. Across the country and around the world, jurisdictions with high cigarette taxes have faced similar problems.

Cigarette Smuggling in the United States

The history of cigarette smuggling in the United States closely parallels the experience of New York City. In the 1940s and 1950s, cigarette taxes remained moderate across much of the nation, and cigarette bootlegging, often carried out by small-scale boot-
leggers, was a localized problem. That situation began to change in the 1960s as states responded to growing concerns about smoking and health by substantially raising tax rates. During 1965 alone, 22 states hiked their cigarette tax rates. By 1973, Americans faced cigarette taxes averaging 13 cents per pack (52 cents in 2002 dollars)—nearly three times the level two decades earlier, in constant dollar terms.

Such high levels of tax triggered enormous amounts of cigarette bootlegging. By the mid-1970s, ACIR estimated that 14 states, containing about half the U.S. population, had serious problems with cigarette bootlegging. Another 9 states were said to have moderate problems. As a result of border activity, the ACIR estimated that state and local governments lost nearly $400 million in tax revenue annually ($1.4 billion in 2002 dollars).

As in New York, a wave of crime accompanied the growth of the illegal cigarette trade nationwide. ACIR reported that organized crime became heavily involved in cigarette bootlegging. It also found that high cigarette taxes encouraged criminal activity against the legitimate cigarette industry. The commission reported that state and local law enforcement efforts were generally ineffective at curtailing cigarette bootlegging and related crime.

The serious problems with cigarette bootlegging and related crime that many jurisdictions experienced by the mid-1970s deterred most governments from raising cigarette taxes further during the late 1970s and early 1980s. As had been the case in New York, that standstill in tax increases, coupled with high general inflation, had the effect of reducing real cigarette taxes. By 1983, Americans faced average cigarette tax rates not seen since the early 1960s. When ACIR revisited the issue of cigarette bootlegging in 1985, it found that only two states continued to experience serious problems with cigarette smuggling.

The lessons learned during the 1960s and 1970s were short-lived, however, and by the late 1980s cigarette taxes were once again rising across the country. In 1989 alone, 14 states raised their cigarette taxes. Tax hikes continued through the 1990s, and today Americans face real state cigarette excises that are near the high levels of the mid-1970s. Some states are tempting fate by imposing very high tax rates, for example, Massachusetts ($1.51 per pack), New Jersey ($1.50), Washington ($1.42), Rhode Island ($1.32), Oregon ($1.32), and Michigan ($1.25). Recent reports indicate that cigarette bootlegging and related crime are on the rise across the country. The director of the ATF has stated that federal and state governments in the United States currently lose about $1.4 billion annually to cigarette bootlegging.

### International Cigarette Smuggling

Governments around the world have responded to growing concerns about smoking and health by raising cigarette tax rates. Today, cigarettes are one of the most heavily taxed commodities; a recent estimate is that levies average about $1.25 to $1.50 per pack worldwide. As a result, cigarettes are one of the most commonly smuggled goods in the world. According to the World Health Organization, some 20 billion packs of cigarettes are smuggled internationally each year. As a result, governments experience revenue losses of between $25 billion and $30 billion annually.

Countries levying high cigarette taxes have experienced considerable problems with the crime associated with cigarette bootlegging. Governments in Canada, Europe, Latin America, and Asia have reported problems with violence associated with cigarette black markets. For example, a rash of murders and disappearances in Germany accompanied the growth of the illegal cigarette market caused by high taxes and reportedly made the streets of Berlin more dangerous than at any time since World War II. Canada’s experiment with exorbitant cigarette taxes in the early 1990s is discussed in the following box. Numerous international conferences and meetings have been convened to examine the global problem of cigarette black
Canada: Retreat from High Cigarette Taxes

Canada's experience in the early 1990s illustrates the problem of cigarette smuggling at the international level when governments impose excessive tax rates. A series of tax hikes beginning in 1984 pushed up federal taxes in Canada from 42 cents per pack to $1.93 per pack in 1993 (in Canadian dollars). Provincial taxes increased dramatically as well; for example, Ontario's tax rate rose from 63 cents per pack to $1.66 per pack by 1993.

The tax hikes caused cigarette smuggling between Canada and the United States to soar. In a 1998 report on the issue, the U.S. General Accounting Office noted that the tax increases “led to large-scale smuggling between the United States and Canada conducted almost entirely by organized crime. Violence increased, merchants suffered, and in one year alone, Canada and its provinces lost over $2 billion (in Canadian dollars) in tax revenues.”

Bootleg cigarettes were smuggled into Canada by truck and ferry across the St. Lawrence from New York State. Cigarettes were also smuggled in from other foreign sources using smaller boats loaded from ships waiting in international waters. In addition, Canadian cigarettes intended for export were illegally diverted back into the lucrative domestic black market.

Smuggled cigarettes gained a huge share of the overall Canadian market by 1993. The Canadian government estimated that more than 60 percent of the cigarette market in the province of Quebec was contraband. In other provinces, contraband cigarettes comprised between 15 and 40 percent of the market.

A wave of violent crime accompanied the growth of cigarette black markets in Canada. Disputes flared up between rival organized crime groups. Criminals also laid siege to the legitimate cigarette industry and subjected employees at all levels of the distribution chain to danger. The country experienced a rash of truck hijackings, and warehouses and shops were robbed and burglarized. In one case, a convenience store clerk was shot in the head with a sawed-off shotgun and killed for just 10 cartons of cigarettes.

The rapid growth of the cigarette black market and related crimes sparked concern at the highest levels of the Canadian government. Prime Minister Jean Chretien stated that “smuggling is threatening the safety of our communities and the livelihood of law-abiding merchants” and noted that smuggling “is a threat to the very fabric of Canadian society.” The Canadian solicitor general, Herb Gray, concluded that “organized crime has become a major player in the contraband cigarette market. What we are seeing is a frightening growth in criminal activity. We are seeing a breakdown in respect for Canadian law. Canadian society is the victim.”

After trying other methods of combating the problem, the Canadian government and the provinces sharply cut their cigarette taxes in 1994. Federal and provincial taxes in Ontario fell by $1.92 per pack. Those measures greatly reduced cigarette smuggling and related crime problems in Canada.

markets and crime, but the obvious solution of reducing excessive tax rates seems to escape serious consideration by governments.94

Conclusion

When governments try to extract tax revenue from the economy, they foster an array
of responses from citizens who have an economic incentive to avoid the tax. Higher tax rates create even greater incentives for avoidance, evasion, and black-market activity. New York City's experience with cigarette taxes vividly illustrates these problems.

New York's high cigarette taxes have spawned a massive black market that has diverted billions of dollars from legitimate businesses and governments to criminals. More troubling than the financial losses is the crime associated with the city's illicit cigarette market. The enormous profits that can be made smuggling cigarettes into New York have lured small-time crooks, mobsters, street gangs, and terrorists into the racket. Those criminals have engaged in a host of violent activities, including murder, kidnapping, and armed robbery, to earn and protect their illicit profits. Such crime has frustrated law enforcement efforts to curtail it and exposed regular citizens, such as truck drivers and retail store clerks, to violence.

The failure of New York policymakers to consider the broader effects of high cigarette taxes has been a mistake repeated across the country in the stampede to maximize taxes on this demonized product. Too often, policymakers do not consider those effects in the erroneous belief that people do not respond to government-created economic incentives. The negative side effects of high cigarette taxes in New York provide a cautionary tale that high tax rates have serious consequences—even for such a politically unpopular product as cigarettes.

Notes


4. Ibid.


9. In Figure 1 the average number of packs consumed per capita in the United States during each fiscal year is set equal to 100. A number of 120 for the city or state would therefore show that per capita taxed cigarette sales in that jurisdiction were 20 percent higher than the national average. Likewise, a number of 80 would mean that taxed sales in the jurisdiction were 80 percent of the national average. Presenting the data in this manner helps to control for changes in the prevalence of smoking (which has fluctuated dramatically over the past half century) and allows readers to more clearly see the effects that tax rate changes have had on taxed cigarette sales over the years. Annual per capita cigarette sales for the United States as well as New York City and State are listed in Table 2. All of the data illustrated in Figure 1 are consistent with the New York City fiscal year that runs from July 1 of the prior calendar year to June 30 of the current year. The 2003 fiscal year, for example, began on July 1, 2002, and will end June 30, 2003.


12. Ibid.


16. Ibid.

17. Ibid.


19. For a discussion of how the entry of organized crime changed the nature cigarette smuggling into New York, see Goodman. See also Weintraub, “The Bootlegging of Cigarettes Is a National Problem.”


21. Ibid.


24. For a discussion of the security measures taken by trucking firms, see ibid., pp. 100-10.

25. Source of material in box: New York State Commission of Investigation, pp. 101-5. Calculations are the author’s, based on retail price data from Orzechowski & Walker.


29. Ibid.

30. Ibid.


32. New York State Commission of Investigation, p. 86. See also Goodman, p. 4.

33. Ibid. See also New York State Commission of Investigation, pp. 84–89.

34. Goodman, p. 3.


37. Ibid.
38. Ibid.
40. Curran, p. 36.
41. New York State Commission of Investigation, p. 86. See also Curran, p. 37.
42. Ibid., pp. 36, 37.
43. New York State Commission of Investigation, p. 130.
45. Ibid., p. 10.
46. Ibid.
49. ACIR, Cigarette Bootlegging, p. 107.
51. Ibid.
52. ACIR, Cigarette Bootlegging, p. 1.
53. Ibid., p. 5.
54. Ibid.
67. Author’s conversation with William Orzechowski.


75. Ibid.


78. Author’s calculations based on average state tax rates weighted by population.


80. Ibid., p. 3.

81. Ibid., p. 1.

82 Ibid., p. 2.

83. Author’s calculations based on average state tax rates weighted by population.


85. Author’s calculations based on average state tax rates weighted by population.

86. Kim, p. 1.


89. Ibid.

90. Ibid.


94. One recent gathering was the Conference of the International Convention against Illicit Trade in Tobacco, New York, July 30, 2002.

Published by the Cato Institute, Policy Analysis is a regular series evaluating government policies and offering proposals for reform. Nothing in Policy Analysis should be construed as necessarily reflecting the views of the Cato Institute or as an attempt to aid or hinder the passage of any bill before congress. Contact the Cato Institute for reprint permission. Additional copies of Policy Analysis are $6.00 each ($3.00 each for five or more). To order, or for a complete listing of available studies, write the Cato Institute, 1000 Massachusetts Ave., N.W., Washington, D.C. 20001, call toll free 1-800-767-1241 (noon - 9 p.m. eastern time), fax (202) 842-3490, or visit our website at www.cato.org.