

# CRAIN'S

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## High tax fuels black market in cigarettes

Agencies crack down on smugglers

BY ANNE MICHAUD

Like the prohibition on alcohol in 1920s America, the high tax on cigarettes in New York City is giving rise to a vast network of illegal sales, complete with gangland-style violence.

Cigarettes are not banned here, of course, but at \$7.50-plus for a pack, they are prohibitively expensive for many smokers. To feed smokers' habits, bootleggers—from petty criminals to organized gangs and even terrorist organizations such as Hezbollah—are bringing cigarettes into the state and successfully evading the tax penalties.

"We're paying a lot of attention to this," says Garry McCarthy, deputy commissioner with the New York Police Department. "It's a black market people are moving into, and we have to squeeze it as hard as we can."

If there's any doubt about cigarette sales going underground, tax collection figures tell the tale. Legitimate vendors sold only 11.1 million packs in New York City



**LOSING OUT:** Mike Patel says teenagers sell cigarettes next to his newsstand.

last January, compared with 30.4 million packs in January 2002. Because the city collects \$1.50 on each pack sold, versus 8 cents prior to the July 2002 tax hike, monthly tax revenue increased to \$16.7 million this past January from \$2.4 million in January 2002. However, state tax revenue declined so much that the state and city together lost \$5.6 million in monthly revenue during the same period.

Much of that decline is probably not due to smuggling—studies show that 4% of smokers will quit for every 10% rise in the cost of cigarettes. But there is plenty of evidence that people who haven't quit are getting their nicotine fix illegally.

Mike Patel says cigarette sales are down by half at his newsstand at Broadway and Chambers Street. "If they increase the tax again, we're out of business," says Mr. Patel, who watches teenagers sell cigarettes from plastic grocery bags

near his stand. "They come with two bags full and sell them for \$5."

Some criminal sales are more blatant than others. People may not know that Internet cigarette purchases are illegal if buyers don't pay the appropriate taxes. Or that loading up on a few cartons at tax-free Indian reservations upstate or on Long Island is illegal for non-Indians, even though the governor is refusing to enforce the law.

### Gang rivalry

At a much higher criminal level, bootleggers drive to Virginia and North Carolina, where they load up car trunks and trailers with cheap cigarettes that can net them \$7,000 to \$140,000 a trip. Police believe the smuggling may be fueling street gang rivalries. The NYPD attributes two Brooklyn homicides and two shootings late last year to cigarette turf battles.

The lucrative trade is attracting organized crime and terrorism groups. Two years ago, 10 members

of Hezbollah were arrested in Charlotte, N.C., and convicted of using proceeds from cigarette smuggling to aid the organization.

"Since then, we have stepped up our enforcement quite a bit," says Joseph Green, senior special agent for the federal Bureau of Alcohol, Tobacco, Firearms and Explosives in New York.

The ATF seized 12,000 cases in New York—more than 2 million cigarettes—in a sting operation in the city last fall. Many were run up from Virginia; others were manufactured for export from the United States but were diverted back here. Counterfeit cigarettes are also being flown in from China, where they are packaged to look like well-known brands, such as Marlboro and Newport.

"Either the black market gets stopped, or we are going to have no legitimate distribution in the city of New York," says Leonard Schwartz, owner of Global Wholesale Co. in Brooklyn, which has

tributes cigarettes to stores. Mr. Schwartz, who also serves as chairman of the Wholesale Marketers Association, says he has had to lay off 15% of his workforce since the new city tax was enacted.

Small businesses are under so much pressure to make up for the losses that they are turning to illegal purchasing themselves. Sen. Frank Padavan, R-Bellerose, and Assemblyman Jeff Klein, D-Bronx, have introduced twin bills in the state Legislature that would reward wholesalers for turning in businesspeople who make suspicious cutbacks in their cigarette orders. Mayor Michael Bloomberg is pressing for the earliest possible passage of the bills.

### Sting operations

The city's Department of Finance has hired a new head of enforcement, Carlton Butler, to run sting operations to nab illegal sellers. He is formalizing relationships with agencies such as the ATF, the NYPD, the state police and the sheriff's office.

But some people aren't thrilled with the stepped-up enforcement.

"I'm outraged that they're creating new task forces," says E.J. McMahon, a senior fellow at the Manhattan Institute, a conservative think tank. "I don't want them keeping eye out for illegal cigarette sellers; want them watching the guys with suitcases with nuclear bombs."

All signs point to the bootlegging problem growing worse. City Finance Commissioner Martin Stark says that sellers are becoming more sophisticated, especially in the use of the Internet. Illegal distributors are said to be setting up home delivery routes.

Police, who are charging first-time offenders with a misdemeanor and expect that once criminals are caught for the second time and face felony charges, others will be deterred. "Over the course of time, we anticipate getting more bang out of the buck for these arrests," the NYPD's Mr. McCarthy says.

Mr. Green of the ATF predicts more violence as well. "The black market has continued to thrive and expand," he says. "Anywhere the criminal organizations have a potential to make a lot of money, the potential for violence increases."