CANADA’S CHEAP CIGARETTES

WHY THEY ARE A PROBLEM
WHAT CAN BE DONE ABOUT THEM

PHYSICIANS FOR A SMOKE-FREE CANADA
COALITION QUÉBÉCOISE POUR LE CONTRÔLE DU TABAC

JUNE 2017
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EXECUTIVE SUMMARY

Tobacco taxes are globally acknowledged as one of the most powerful tools for governments to reduce tobacco use. Higher cigarette taxes and prices encourage smokers to quit, help those who do quit to not relapse, discourage young people from starting and reduce the number of cigarettes that are smoked.

The setting of tobacco prices is a key tool for industry as well. Higher cigarette prices provide increased profits per unit sold. Lower cigarette prices generate sales and customers, and can blunt the impact of cigarette tax increases. In all cases, lower cigarette taxes help companies increase sales and profits.

For decades, tobacco companies have successfully campaigned to suppress federal and provincial tobacco tax increases throughout much of Canada. In the early 1990s, they fuelled contraband sales to pressure governments into tax cuts that exceeded a 70% tax cut in Quebec. Over the past decade, they have directed a political campaign to exaggerate fears of contraband, focusing their efforts on Ontario and Quebec. The result is that these most populous provinces have the lowest cigarette taxes in the country and the federal government has all but abandoned a health-directed tobacco tax policy.

The companies have modified their marketing practices to keep some brands inexpensive and to ensure that cigarettes remain affordable. Unlike previous decades, when all cigarettes were sold at the same price, since the early 2000s cigarette brands are marketed in increasingly disperse price ranges.

They have restructured their operations to allow them to use price as their key marketing tool. Imperial Tobacco shifted production to Mexico to reduce costs. Both Imperial Tobacco and Rothmans, Benson and Hedges eliminated wholesale and distribution “middlemen” to increase their influence over retailers and retail pricing.

Price ceilings have been imposed for cheaper brands, while profit-taking has been shifted to the more expensive brands. Such cross-subsidies remain a form of promotion protected by law. As a result, cigarettes remain essentially as affordable for many Canadians as they were a decade ago, while company profits remain high.

Governments in Canada have been slow to respond to this new marketing strategy. They have not yet put in place measures to monitor this practice, to evaluate its impact on public health, or to counter the use of price-based promotions to induce young people and others to smoke.

There are several measures that provincial and federal governments can implement to curb price-promotions for tobacco. These include both tax-based measures (such as excise taxes, license fees, surtaxes and other levies) and non tax-based approaches, such as price controls and additional marketing restrictions.

This paper calls on the federal government, in cooperation with the provinces, to implement effective price controls on cigarettes, including the introduction of a national minimum tax and standardized (uniform) local pricing. The rationale for the following recommendations lies in pricing and tax-avoidance strategies of the industry over the past three decades.
**Recommendations**

**Recommendations for Legislators:**

1. Request health and finance officials to provide regular reports on their tobacco control efforts, including steps taken to ensure the optimal pricing and tax interventions are in place.

2. Amend excise or tobacco tax laws to ensure that health impact is considered when setting tobacco tax levels.

3. Require Finance Ministries to consult with health ministers when setting tobacco tax levels.

**Recommendations for Ministers of Finance:**

4. Immediately increase the federal tobacco tax rate (or work with the provinces to collectively raise taxes) to ensure that the minimum combined federal and provincial tax on cigarettes in Canada is at least **$0.40 a cigarette** ($90 per carton). This would require minimum wage workers to allocate between 2 and 3 minutes’ wages to taxes on each cigarette.

5. Allocate the additional revenues from this tax increase (estimated at more than $2 billion) to programs aimed at phasing out contraband supply and to ensuring this tax contributes positively to social and health equity.

6. Standardize the local price for cigarettes, with a uniform retail price for all brands within each province. This should preferably be implemented to coincide with the introduction of plain and standardized packaging.

7. As an interim measure, if required, prohibit all marketing promotions which can have the effect of reducing the retail price of cigarettes:
   a) Ban all rebates, cash-card payments, slotting fees, trade allowances, entertainments or other promotions directed by tobacco manufacturers to retailers (to ensure that retailers receive no indirect payments for sales).
   b) Require public disclosure of wholesale prices by manufacturers.

8. Require the promotional relationship between tobacco product retailers and wholesalers to be severed.

9. Require retailers to install sales monitoring machines which record details of all tobacco sales, and make the resulting data available to public health researchers.

10. Work with retailers and others to develop alternative business models, economic incentives or other rewards which could be used to engage this sector in supporting tobacco reduction efforts.
1. **TOBACCO TAXES ARE KEY TO PUBLIC HEALTH**

A. **The importance of high cigarette prices to public health**

Tobacco use is a leading preventable cause of death and disease in Canada, responsible for about one in five deaths and one third of full-day hospitalization costs. [1] It is the greatest risk factor for the three first causes of death in Canada: cancer, cardiovascular disease and respiratory disease. Nicotine is a powerfully addictive substance, and more than half of those who are unable to quit will lose more than a decade of their life as a result of cigarette smoking. [2]

These are some of the reasons that governments give priority to policies and programs which prevent people from starting to smoke or which help them quit.

Among the most powerful policies that governments can adopt is to raise the price of tobacco products by implementing regular increases in tobacco taxes. The power of taxes to reduce smoking has been proven time and time again. The World Health Organization is among many who have concluded that “a significant increase in tobacco product taxes and prices has been demonstrated to be the single most effective and cost-effective intervention for reducing tobacco use, particularly among the young and the poor.” [3]

The International Agency for Research on Tobacco (IARC) summarized the evidence to link tobacco taxes with health outcomes. It concluded that there was a causal relationship between increasing taxes and reducing tobacco use among adults and young people and that such taxes have a larger impact with lower-income populations. This means that higher tobacco taxes can help address disparities in smoking rates between lower and upper income Canadians. Children, adolescents and those living on poor incomes are most price-sensitive, and so benefit even more from tax policies which keep tobacco prices high. (Some of these conclusions about the strength of the evidence behind tobacco taxes as a tobacco control policy are shown in Table 1.)

And yet federal tobacco taxes remain at such a low level (11 cents a cigarette), failing to even keep pace with inflation, that they cannot be considered as a meaningful public health intervention. The tax is simply high enough to generate considerable revenue for the federal treasury $3.2 billion dollars in 2015-2016, [4] of which incidentally less than 1% ($30 million) was spent by Health Canada to reduce smoking. [5]

For most Canadians, especially those living in the most populous provinces of Ontario and Quebec, tobacco taxes have not been high enough to have had the desired impact on smoking behaviour throughout the population. [6] [7] Between 2000 and 2014, the percentage of Canadians who smoke has fallen from 26% to 19%. Most of this progress is due to improvements in protecting young people from starting to smoke (there were 3.5 million more Canadians who had never smoked in 2014 than in 2001): this progress has been attributed to factors other than taxation. [7] The proportion of Canadians who had quit smoking did not change significantly over this 14-year period, remaining at 37%. [8]
**Table 1: IARC’s evaluation of evidence to support tobacco tax policies. [3]**

<table>
<thead>
<tr>
<th>Conclusion statement</th>
<th>Evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increases in tobacco excise taxes that increase prices result in a decline in overall tobacco use.</td>
<td><img src="image" alt="Sufficient*" /> <img src="image" alt="Strong†" /></td>
</tr>
<tr>
<td>Increases in tobacco excise taxes that increase prices reduce the prevalence of adult tobacco use.</td>
<td><img src="image" alt="Sufficient*" /> <img src="image" alt="Strong†" /></td>
</tr>
<tr>
<td>Increases in tobacco excise taxes that increase prices induce current tobacco users to quit.</td>
<td><img src="image" alt="Sufficient*" /> <img src="image" alt="Strong†" /></td>
</tr>
<tr>
<td>Increases in tobacco excise taxes that increase prices reduce the prevalence of tobacco use among young people.</td>
<td><img src="image" alt="Sufficient*" /> <img src="image" alt="Strong†" /></td>
</tr>
<tr>
<td>Increases in tobacco excise taxes that increase prices reduce the initiation and uptake of tobacco use among young people with a greater impact on the transition to regular use.</td>
<td><img src="image" alt="Sufficient*" /> <img src="image" alt="Strong†" /></td>
</tr>
<tr>
<td>Increases in tobacco excise taxes that increase prices lower the consumption of tobacco products among continuing users.</td>
<td><img src="image" alt="Sufficient*" /> <img src="image" alt="Strong†" /></td>
</tr>
<tr>
<td>Tobacco use among young people responds more to changes in tobacco product taxes and prices than does tobacco use among adults.</td>
<td><img src="image" alt="Sufficient*" /> <img src="image" alt="Strong†" /></td>
</tr>
<tr>
<td>In high-income countries tobacco use among lower-income populations is more responsive to tax and price increases than is tobacco use among higher-income populations.</td>
<td><img src="image" alt="Sufficient*" /> <img src="image" alt="Strong†" /></td>
</tr>
<tr>
<td>Changes in the relative prices of tobacco products lead to some substitution to the products for which the relative prices have fallen.</td>
<td><img src="image" alt="Sufficient*" /> <img src="image" alt="Strong†" /></td>
</tr>
<tr>
<td>Tobacco industry price discounting strategies price-reducing marketing activities and lobbying efforts mitigate the impact of tobacco excise tax increases.</td>
<td><img src="image" alt="Sufficient*" /> <img src="image" alt="Strong†" /></td>
</tr>
<tr>
<td>Tobacco tax increases that increase prices improve population health.</td>
<td><img src="image" alt="Sufficient*" /> <img src="image" alt="Strong†" /></td>
</tr>
<tr>
<td>Higher and more uniform specific excise taxes result in higher tobacco product prices and increase the effectiveness of taxation policies in reducing tobacco use.</td>
<td><img src="image" alt="Sufficient*" /> <img src="image" alt="Strong†" /></td>
</tr>
<tr>
<td>Tax avoidance and tax evasion reduce but do not eliminate the public health and revenue impact of tobacco tax increases.</td>
<td><img src="image" alt="Sufficient*" /> <img src="image" alt="Strong†" /></td>
</tr>
<tr>
<td>A co-ordinated set of interventions (a set of interventions that includes international collaborations strengthened tax administration increased enforcement and swift severe penalties) reduces illicit trade in tobacco products.</td>
<td><img src="image" alt="Sufficient*" /> <img src="image" alt="Strong†" /></td>
</tr>
<tr>
<td>Increases in tobacco tax increase tobacco tax revenues.</td>
<td><img src="image" alt="Sufficient*" /> <img src="image" alt="Strong†" /></td>
</tr>
<tr>
<td>Increases in tobacco tax do not increase unemployment.</td>
<td><img src="image" alt="Sufficient*" /> <img src="image" alt="Strong†" /></td>
</tr>
</tbody>
</table>

* Sufficient evidence: an association has been observed between the intervention under consideration and a given effect in studies in which chance bias and confounding can be ruled out with reasonable confidence. The association is highly likely to be causal.

† Strong evidence: there is consistent evidence of an association but evidence of causality is limited by the fact that chance bias or confounding have not been ruled out with reasonable confidence. However explanations other than causality are unlikely.
B. The tobacco industry has worked to keep tobacco taxes low.

1990s: fuelling contraband sales to defeat tax policy.
The current low-tax policy of the federal government has its origins in the tax-cut debacle of the mid 1990s – a series of policy set-backs which continues to haunt tax policy more than 20 years later.

Between 1989 and 1991, after decades of inaction, federal and provincial governments in Canada began to put steep tax increases on tobacco products in place. [9] The industry reacted strongly, put sustained pressure on governments to reconsider. In addition to threats of economic retaliation, like closing factories, and sending workers to protest outside Parliament, [10][11] the companies created the appearance of a grass-roots tax revolt. Postcards which protested the tax were printed in cigarette packages, smokers were encouraged by the companies to mail them to government: [12] and 3.3 million were received by the Prime Minister’s Office. [13] They created front-groups to repeat their message. [14][15]

They warned that illicit sales would result [16][17] – but did not mention that they were working to make sure this prediction came true. Beginning in 1992, each of the companies sold cigarettes to smuggling rings in the northern United States, knowing that their products would be returned to Canada through the porous borders of Akwesasne and sold in the illicit market. [18] They encouraged retailers to defiantly and openly sell these untaxed packages. [19]. Fourteen years later they acknowledged this wrongdoing, pleading guilty to acting unlawfully, and made partial restitution for lost revenues to governments. [20]

The political crisis created by these actions pushed the federal and five provincial governments to severely cut tobacco taxes. [21] On February 8, 1994, combined federal and provincial excise taxes fell from almost $30 in Ontario and Quebec to less than $10. This was a larger reduction than in any of the other provinces which cut provincial tobacco taxes (New Brunswick, Nova Scotia and Prince Edward Island). [22] [23]

Chart 1: Combined federal and provincial excise taxes on a carton of cigarettes before and after the tax cuts of February 1994.)
2000s: Fueling fears of contraband to prevent public health measures
Since 1994, the tobacco industry has stopped selling their own brands through the illegal market, but they continue to use contraband as a rallying cry against tobacco taxes and other public health measures. [24]

Tobacco industry campaigns on contraband cigarettes generate the impression that illicit tobacco sales are higher than they actually are, and that they represent a disproportionate threat to government revenues.

Studies conducted by researchers who are not associated with the industry conclude that contraband sales are a problem – but not one that is disproportionate to illegal sales in other commodities or to tobacco sales in other countries:

- A recent study found that “none of the data ... provide support to the tobacco industry narrative that cigarette contraband has been increasing in recent years” and that in Quebec there have been “relatively low levels of cigarette contraband since 2010, at levels no higher than in the early 2000s.” [25]

- A study conducted for the Quebec Finance Ministry based on 2002 data found that contraband tobacco represented about 5% of the taxes lost in the underground economy, and that illegal sales and lost tax revenues were higher in several other sectors. One-seventh (14%) of the construction and renovation industry, for example, was considered to be undeclared, causing a tax loss to Quebec of $872 million. Estimated taxes lost to illicit cigarettes, by comparison, were estimated at $118 million. [26]

- Statistics Canada estimates that one-tenth of the average household expenditures in the underground economy went to tobacco ($211 per year of a total of $2,156 in 2013). The industries which accounted for the majority of tax loss were residential construction (27%), retail trade (12.5%) and accommodation and food services (11.7%). [27]

- A report by the Ontario Tobacco Research Unit concluded in 2015 that there was no correlation between increasing tobacco taxes and contraband in Ontario or Canada. [28]
The Quebec government provides estimates of contraband sales and in its 2017 budget concluded that its enforcement activities had contributed to a fall in the market share of illicit tobacco to less than 15% as of 2011, notwithstanding federal and provincial tax increases in that period. [29]

BAT internally acknowledges that it uses fear of illicit sales to keep taxes low.
In recent months a secret presentation from Imperial Tobacco Canada’s parent, British American Tobacco was leaked to health researchers. In this 2012 report the company reviewed the impact of 5 years of contraband awareness campaigns in Ontario and Quebec, including their work on:

• “Mobilizing local governments to pressure big Government” to not raise taxes
• “Ensuring contraband is front and center in the media” through front groups like the National Coalition Against Contraband Tobacco
• “Rallying retailers to keep contraband a political issue” during the 2012 Quebec election campaign.

Their intention to suppress tax increases was unambiguously expressed in this internal and previously secret review. “Keeping the contraband issue alive” was a way to ensure NO further regulations and NO tax increases. [30]

With taxes kept low, the industry has raised its prices.
Information gleaned from co-operative retailers has revealed that since the summer of 2015, each of Canada’s tobacco companies has implemented a series of quarterly price increases. Over this 22-month period, the price increases on most brands, as shown in Chart 2, have exceeded $4 per carton.

This $4 per carton is the same amount as Quebec’s most recent tobacco tax increase in June, 2014 and more than the Ontario increases in 2016 and 2017. Those increases were decried as triggers for contraband by the retail associations that are supported by the companies. [31] [32] When an equivalent increase was implemented by the companies, these critics were silent.

Manufacturers’ price increases will contribute to lower smoking rates – but not as effectively as a tax increase will. That’s because, unlike taxes, price increases allow the industry to select which (higher priced) brands will be used to generate new revenues and which (lower priced)

**Chart 2: Price increases announced by major tobacco companies, August 2015 to June 2017.** [33]

<table>
<thead>
<tr>
<th>Brand</th>
<th>Category</th>
<th>August 2015</th>
<th>Dec 2015-Jan 2016</th>
<th>May-June 2016</th>
<th>December 2016</th>
<th>June 2017</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>ITL- Du Maurier</td>
<td>Premium</td>
<td>$1.00</td>
<td>$1.00</td>
<td>$1.00</td>
<td>$1.25</td>
<td>$2.00</td>
<td>$6.25</td>
</tr>
<tr>
<td>ITL-Matinée</td>
<td>Mid-priced</td>
<td>$2.00</td>
<td>$1.50</td>
<td>$1.50</td>
<td>$1.50</td>
<td>$2.00</td>
<td>$8.50</td>
</tr>
<tr>
<td>ITL-Pall Mall Red</td>
<td>Discount</td>
<td>$1.00</td>
<td>$1.50</td>
<td>$1.50</td>
<td>$1.50</td>
<td>$2.00</td>
<td>$6.00</td>
</tr>
<tr>
<td>RBH-Craven A</td>
<td>Premium</td>
<td>$2.00</td>
<td>$1.50</td>
<td>$1.50</td>
<td>$1.00</td>
<td>$2.00</td>
<td>$8.00</td>
</tr>
<tr>
<td>RBH-Accord</td>
<td>Mid-priced</td>
<td>$1.50</td>
<td>$1.00</td>
<td>$1.00</td>
<td>$2.00</td>
<td>$5.50</td>
<td></td>
</tr>
<tr>
<td>RBH-Philip Morris</td>
<td>Discount</td>
<td>$1.50</td>
<td>$1.50</td>
<td>$1.50</td>
<td>$1.50</td>
<td>$2.00</td>
<td>$6.50</td>
</tr>
<tr>
<td>JTIM-Export A</td>
<td>Premium</td>
<td>$1.00</td>
<td>$1.00</td>
<td>$1.00</td>
<td>$1.50</td>
<td>$1.50</td>
<td>$5.50</td>
</tr>
<tr>
<td>JTIM-Vantage</td>
<td>Mid-priced</td>
<td>$1.00</td>
<td>$1.50</td>
<td>$1.00</td>
<td>$1.00</td>
<td>$1.00</td>
<td>$5.50</td>
</tr>
<tr>
<td>JTIM-Liggett Ducat</td>
<td>Discount</td>
<td>$1.50</td>
<td>$1.50</td>
<td>$1.50</td>
<td>$2.00</td>
<td>$6.50</td>
<td></td>
</tr>
</tbody>
</table>
ones will be used to maintain customers. A wholesale price increase will not have the same
degree of health benefit as an overall increase in tobacco taxes. Unlike an across-the-board
and sudden price increase generated by a tax hike, manufacturers don’t shock consumers but
simply gradually nudge their prices upwards. Manufacturers also minimize price increases for
discount brands, which aim to attract the most price-sensitive smokers, including youth and
those who are economically disadvantaged.

Another reason to use taxes as the mechanism to raise the cost of smoking is that doing so
reduces flexibility for profit-making. Data released by Health Canada reveals that the recent
increase in wholesale prices resulted in an annual increase of $1 billion for this sector. [34] By
retaining low tobacco taxes while letting the industry increase its profits from tobacco use, the
government worsens the long-standing problem of the industry making communities pay for
the costs of tobacco-use, including the heavy burden on the health care system, while
extracting profits for shareholders.

C. Cigarette taxes in Canada

There are three levels of tax imposed on tobacco products in Canadian provinces.

- Excise taxes are imposed by the federal government (currently $21.56 for 200
cigarettes)
- Excise taxes are imposed by the provincial government (currently ranging from $29.80
for 200 cigarettes in Quebec to $60.80 in the Northwest Territories)
- Sales taxes, such as the GST, provincial sales tax or harmonized sales taxes are levied on
the purchase price, which includes the excise taxes. The net rate varies from 5% to 15%,
depending on the jurisdiction.

The levels of cigarette taxes are set by the finance ministers in each province, territory or by
the federal Finance Minister. Although most jurisdictions have an open consultation process in
the setting of budgets and tax levels, the process itself and the development of budgetary
decisions is one that is generally protected by the exemption of “cabinet confidence” in access
to information or freedom of information provisions in each jurisdiction.

Chart 3a: Cigarette tax rates and prices for a package of 20 cigarettes with a hypothetical
manufacturers’ price and retailer mark-up of $2 - May 2017 [35]
As a result, it is difficult to establish the extent to which health considerations are factored into decisions to raise tobacco taxes or to decide against doing so. There is no standard practice for governments to make transparent the consideration of health impact in the setting of tobacco tax rates.

The 2017 budgets of the largest provinces and the federal government illustrate the varying ways in which health is addressed.

- In its 2017 budget, the Ontario government cited “Ontario’s goal of having the lowest smoking rates in Canada” as the reason for a three-year phase in of a $1.00 per pack tax increase ($10 per carton). [36]

- The 2017 federal budget increased excise taxes only by an amount sufficient to replace revenues from the Tobacco Manufacturers’ Surtax that was rescinded, $0.53 per carton. The budget explanation claimed that “This change will reinforce the goal of reducing tobacco consumption” without explaining how a tax increase of less than three cents per cigarette would help achieve that goal. [37]

- The 2017 Quebec budget expressed confidence that their measures to control contraband were effective, but it gave no explanation for its decision to allow tobacco tax rates in that province remain the lowest in Canada. [29]

Little increase in federal tobacco taxes over the past 15 years – and none in sight. A number of tax increases since 1994 have raised the nominal tax rate for cigarettes across Canada beyond that of their 1993 value, even for the lowest-taxed province (Quebec). The federal tobacco tax has increased over the past 17 years by almost 40% (from 7.9 cents per cigarette to 10.8 cents). The impact is much less if the effect of inflation is considered: once adjusted for inflation the increase in federal taxes over the past 15 years is less than one-third of a cent per cigarette (i.e. from 7.9 cents per cigarette to 8.2 cents per cigarette).

<table>
<thead>
<tr>
<th>Province</th>
<th>Excise Taxes</th>
<th>Sales taxes applied to tobacco</th>
<th>Cost per carton</th>
</tr>
</thead>
<tbody>
<tr>
<td>British Columbia</td>
<td>$21.56</td>
<td>$47.80</td>
<td>$100</td>
</tr>
<tr>
<td>Alberta</td>
<td>$21.56</td>
<td>$50.00</td>
<td>$96</td>
</tr>
<tr>
<td>Saskatchewan</td>
<td>$21.56</td>
<td>$54.00</td>
<td>$106</td>
</tr>
<tr>
<td>Manitoba</td>
<td>$21.56</td>
<td>$59.00</td>
<td>$114</td>
</tr>
<tr>
<td>Ontario</td>
<td>$21.56</td>
<td>$32.95</td>
<td>$84</td>
</tr>
<tr>
<td>Quebec</td>
<td>$21.56</td>
<td>$29.80</td>
<td>$75</td>
</tr>
<tr>
<td>New Brunswick</td>
<td>$21.56</td>
<td>$51.04</td>
<td>$105</td>
</tr>
<tr>
<td>Nova Scotia</td>
<td>$21.56</td>
<td>$55.04</td>
<td>$111</td>
</tr>
<tr>
<td>Prince Edward Is.</td>
<td>$21.56</td>
<td>$50.00</td>
<td>$104</td>
</tr>
<tr>
<td>Newfoundland</td>
<td>$21.56</td>
<td>$49.00</td>
<td>$102</td>
</tr>
<tr>
<td>Northwest Terr.</td>
<td>$21.56</td>
<td>$60.80</td>
<td>$107</td>
</tr>
<tr>
<td>Nunavut</td>
<td>$21.56</td>
<td>$60.00</td>
<td>$107</td>
</tr>
<tr>
<td>Yukon</td>
<td>$21.56</td>
<td>$42.00</td>
<td>$88</td>
</tr>
</tbody>
</table>
The absence of a health-directed tobacco tax policy has resulted in cigarettes becoming more affordable in Canada over time. The International Tobacco Control Project assessed affordability in more than a dozen countries and found that Canada was one of only two OECD countries where they had become more affordable (between 2002 and 2010). [38]

There is no indication that the federal government is interested in changing its low-tax policies. In the consultation paper released by the Ministry of Health as part of the renewal of the federal tobacco control strategy (the current one expires in March 2018), the reference to price and tax suggests no enthusiasm for this approach:

*Increasing the price of tobacco products has also contributed to reductions in the number of youth who start smoking. Historically, federal and provincial tobacco tax increases have helped to reduce demand for tobacco products by making them more expensive. However, some may argue that increased prices have the potential to impose disproportionate economic pressures on disadvantaged populations and increase trade in contraband.* [39]

Chart 4: Federal excise tobacco taxes on cigarettes, nominal and adjusted for inflation

![](chart4.png)
2. Tobacco companies manipulate the price of tobacco products to keep some brands cheaper

Just as higher cigarette prices (such as those triggered by tax increases) benefit health by reducing smoking, lower cigarette prices (such as those which result from marketing campaigns) lead to higher smoking rates.

Tobacco companies use price promotions to reduce the price of cigarettes and to overcome the effect of taxes. Unlike taxes, which are a “one size fits all” approach applied equally across all brands, these price discounts can be targeted to specific groups of people, to selected neighbourhoods or for specified periods of time.

By segmenting their market into different price categories, companies can promote lower-priced cigarettes to smokers who might be encouraged to quit if prices go too high, and can make up the money they lose by these price reductions by taking a higher profit level on the premium cigarettes they sell to smokers who are less motivated by price.

Although the companies closely track prices charged in differing communities, [40] there is currently no system in place to monitor how variable prices are used as a promotion targeted at vulnerable populations. In the United States, lower prices have been observed near schools attended by poorer and more price-sensitive youth. [41]

In recent decades, price promotions have become commonplace around the world. In the United States, where the companies must report how much they spend on these and other types of promotions, price-promotions are the main form of cigarette advertising, representing 85% of the $8.9 billion advertising spend in 2013. [42]
A. Tobacco control laws continue to permit price promotions

Federal and provincial laws to restrict tobacco marketing also forbid some of the ways in which price can be used to encourage people to smoke. Under the federal Tobacco Act, for example, tobacco companies and retailers cannot give cigarettes away, cannot provide customers with rebates, redeem coupons or offer contests or other rewards. [43] The Quebec Tobacco Control Act has similar restrictions. [44]

These important laws were developed in the late 1990s in response to the lifestyle and sponsorship promotions that were the primary marketing device used to sell cigarettes at that time. These laws addressed the use of coupons and contests, promotions used by the companies in the 1980s, but they were not built to address a multi-priced market where cheap cigarettes were used to induce smoking.

As a result, many types of price promotion are not banned by law. Both federal and Quebec tobacco control laws, for example, expressly identify prices as a type of permitted informational advertising, [43] [44] These laws do not allow tobacco companies to give cigarette away, but they do not set any minimum prices for cigarettes, they do not forbid cross-subsidization in the tobacco market, nor do they forbid companies from selling some brands of cigarettes at a loss (loss-leaders).

Under these laws, tobacco companies and retailers can promote the price of certain brands on signs displayed at retail, as long as they conform to requirements regarding size, colour and content. [45] They can charge less if consumers buy two or more packages, such as bundled packages or cartons, as these are “part of regular marketing operations by the manufacturer.” [44]

Manufacturers can offer lower prices to selected retailers, and can choose which retailers are eligible for those discounts. They can enter into contracts with retailers that require the retailer to follow a pricing policy that results in lower cigarette prices. This has been ruled consistent with the federal Competition Act, where it was challenged by retailers, [46] [47] and continues despite protests from retailer groups. [48]

Manufacturers can lower the wholesale price of their products at any time and for any length of time. There is no minimum or maximum price at which they must sell their products. Although they are not known to have done so, federal laws do not expressly forbid them from selling below the price of tobacco taxes (although they would still have to pay the taxes).

On November 26, 2016 Quebec became the first province to forbid manufacturers from “offering rebates, gratuities or any other form of benefit related to the sale or the retail price of a tobacco product”. [44] Enforcement of this new restriction could prove difficult. However, even if its implementation is successful, this provision will not end price promotions, as it does not require the companies to charge each retailer the same price or to maintain stable prices from one order to the next. For example, the companies could legally change their prices from one week to the next, selecting which retailers they sell to in what period.
D. The new multi-price cigarette market.

Over the past decade, Canadian tobacco companies have transformed their marketing and distribution to exploit permissions for price promotions and to increase their ability to control cigarette prices.

Until a little more than a decade ago, tobacco companies sold each of their brands of manufactured cigarettes at the same price, and also at the same price as their competitors. Canada was unusual in this respect: in most parts of the world, price bands for cigarette (i.e. discount, mid-price and premium) was a well established marketing tool.

The pricing dynamic in the tobacco market is illustrated in one of the last newspaper advertisements for cigarettes, published in La Presse on December 28, 1988 three days before such ads were banned by federal law. In this advertisement, the Steinberg grocery chain offers all brands of cigarettes for sale at the same price, illustrating this point with pictures of each company’s leading brand. In this era, price competition was between retailers, not between manufacturers.

Instead of marketing cheaper brands of cigarettes to smokers who were more price sensitive, the companies historically promoted roll-your-own or semi-manufactured kits, exploiting the lower taxes that were charged on these forms of tobacco. This option is no longer relevant, after the tax treatment of these products was made more equal.

Beginning in 2003, the companies abandoned their one-price marketing for manufactured cigarettes and began to offer cheaper brands of cigarettes, which were variably labelled as “price”, “value for money”, “discount” or “budget”.

One price for all brands
La Presse, December 28, 1988

A variety of prices
One event which led to widespread price differentiation was new competition from smaller manufacturers, like ADL Tobacco and Grand River Enterprises. The oligopolistic nature of the Canadian cigarette market (with only three manufacturers) and lower taxes had allowed the companies to increase their wholesale prices and profit margins. Imperial Tobacco Canada’s earnings per cigarette grew from 1.3 cents per cigarette in 1990, to 4.2 cents per cigarette in 2003, the last year for which full financial statements were made public. [49] These high profits (and the ability to acquire machinery) made it possible for smaller companies to enter the cigarette market, despite their relatively higher production costs and other barriers to entry. Between 2001 and 2003, the market share of discount brands made by these small manufacturers grew to 12%. [50]

Rothmans, Benson &Hedges was the first of the main companies to respond by introducing its own lower-priced brands. It did this in 2003 when it repositioned its established brand, Number 7, into the “price category, dropping the per-package cost by about $2 per package. The company was reported as saying that they did so in response to “massive tax increases.” [51] Very quickly, Imperial Tobacco Canada lowered the price of Peter Jackson cigarettes and JTI-Macdonald introduced Macdonald Special.

Within four years, the market had been transformed. The major manufacturers had regained control of the market, but it was a market where price differentiation had become firmly established.

The market share of the newly-introduced lower priced cigarette products (including roll-your own) grew from under one-fifth in 2002 to one-half in 2006, [52] and 62% in 2012. [53]

At least one provincial health minister (Gary Mar in Alberta) raised concerns that this pricing system would hinder efforts to reduce smoking, but these concerns were dismissed by the federal government. [51]

The companies shifted their promotional efforts away from lifestyle and sponsorship advertising (which was phased out by October 2003 [43]) and towards promotions which focused on price and packaging, as illustrated by typical promotions from 1997 and a decade later.

As in the United States, traditional promotions (like print advertisements) have given way to price discounting, rebates and financial incentives for retailers. Although Canadian federal law requires tobacco companies to report expenditures on traditional advertising, it does not require any disclosure of spending on price promotions. [54] The personal work profile of an ITCO retail sales manager suggests that Imperial Tobacco had a “trade investment budget” for retail level promotions of $350 million in 2010. [55]
E. Tobacco companies have restructured their operations to better be able to manipulate prices.

Since 2005, the two largest tobacco companies have substantially restructured their distribution methods and their contractual relationships with retailers. The intent and effect of these changes is to provide the manufacturers with more control over the prices that retailers charge for their brands.

They have also reduced their production costs, giving them more room to reduce prices while remaining profitable. Imperial Tobacco, for example, closed its factories in Canada and relocated its production to Mexico, completing this move in 2007.

Until 2006, all of the cigarette manufacturers used wholesale distributors as to manage retail distribution of their tobacco products to retailers. Sales representatives managed contracts with retailers related to retail displays and other incentives, but did not exert influence over the price charged by retailers for their products. [56]

In 2006, Imperial Tobacco broke with this practice and set up a Direct to Store Sales (DSS) model for tobacco in Canada. Retailers began to order their products directly from Imperial Tobacco, and paid $3 less per carton than they had previously been charged by wholesalers. [57] A key motivation for the change was the company’s frustration with wholesaler’s refusal to pass discounts on to clients, a desire to drive up the distribution costs of its competitors relative to its own, and to impose “commercial trading terms” on retailers. [58] 1

During this period, retail display bans were being implemented across Canada. The Quebec and Ontario display bans came into force on May 31, 2008. Imperial Tobacco responded by shifting its retail promotion focus from "visual communication" (retail displays) to "category growth" (selling more cigarettes). [59]

On the first day that tobacco displays were banned in Quebec and Ontario (June 1, 2008), Imperial Tobacco implemented its new “CORE” program which institutionalized its new focus on pricing. This program set out to reward retailers who agreed to its pricing strategies, but ran into difficulties when retailers used the discount to increase their profit margins instead of reducing their prices. [60]

Two years later, the program had been redesigned with stronger controls over retail pricing. In 2010, ITL’s EXPANSION Preferred Pricing Program (PPP) was launched with the goal “to ultimately offer lower retail prices to consumers on ITCO products.” [61] A new “lowest price” brand, Pall Mall was concurrently put on the market. By this time having the lowest-priced brand on the market was an established goal for ITCO and the key task of sales representatives. [60]

Retailers who were enrolled in the program paid $5 to $6 less per carton for all ITL brands than did those who were not. In return they agreed to a ceiling price on ITL’s cheaper brands. There was significant resentment to this change by retailers who were not recruited, but who

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1 The story of Imperial Tobacco’s use of DSS to increase its influence over retailers and retail pricing is described in detail in a book co-authored by BAT’s marketing director, Jimmi Rembiszewski. (“From Great to Gone: Why FMCG companies are losing the race for Customers, p. 105-11).
were under economic pressure to reduce their profits on ITL brands or lose business to their competitors. [46] 2

In 2014, Rothmans Benson and Hedges also moved away from wholesale distribution and implemented its own direct-to-store delivery program (CONNEXIONS). [62] It also began contracting with retailers to offer reduced prices and other rewards in return for keeping prices low. Contracted retailers paid $4 to $6 less per carton, and other “trade allowances” were in place to lower retail prices. [63]

Tobacco sales representatives visit retailers regularly to gather data on prices, sales and local conditions. Retailers are encouraged in these visits, in media communications, or by contractual obligation to reduce their profit margin on discount brands of cigarettes, and to make up any lost revenues by charging relatively more for premium cigarettes. [40] What retailers lose on the “discount brand” swings, they are encouraged to make up for on the “premium” roundabouts or from the profits they make from other products that smokers purchase.

Retailers are rewarded for volume sales by receiving their products at lower cost. This can be in the form of a lower invoiced price, in the form of a rebate, or even in a ‘cash’ payment in the form of a prepaid credit card. [40]

The new pricing programs marked a second phase in the marketing of cheaper cigarettes, and the introduction of even cheaper “super value” brands - like Viceroy, Parliament, Pall Mall, Philip Morris and Ligget Ducat, etc. A recent report from JTI-Macdonald shows that in the past 5 years, the market share of the “super value” category grew by 70%. [64]

F. Cigarettes can be sold as loss leaders to attract new users.

Tobacco companies may follow the advice they give to retailers – to use the higher profits on premium cigarettes to offset the revenues they lose by selling cheaper cigarettes and to see cheap cigarettes as a way of attracting customers.

Very few company price lists have been made public; an RBH list from late 2014 shows a six-fold difference between the before-tax price it charges to retailers for its least and most expensive brands. [63] Without information on the costs of production, which are not currently available to government or the public, it is impossible to assert that the lowest cost brand is being sold below the cost of production and distribution, although this scenario warrants consideration.

In a traditional market, with many producers, prices will largely reflect the costs of production and distribution. But in a market, like Canada’s, with only a few large producers, the companies have greater power to control market pricing. [65]

It can be in the interests of tobacco companies to reduce the price of their cigarettes below profit-maximizing levels in order to trade-off short-run and long-run profitability. “The greater

2 Unlike traditional promotions, the industry was not obliged to report these modern retail promotions to the federal government. Much of the information available on these promotions was made public as a result of labour tribunal reviews of ITL’s employment practices, i.e. Piché et Impérial Tobacco Compagnie Itée, 2012 QCCRT 600, Garryer c Imperial Tobacco Canada limitée, 2015 QCCRT 60
price sensitivity of young people ... and the addictive nature of tobacco use may lead companies with market power to set prices lower than the short-run profit-maximizing level to ‘get more consumers hooked on the addictive good’ so that long run profits will be higher than they would be if prices were set higher in the short run and fewer young people took up tobacco use.” [65]

G. Tobacco companies can afford to manipulate cigarette prices

To be able to afford to relinquish short term profits in anticipation of long term business, an industry needs to have the financial capacity to manage the loss. Tobacco companies operating in Canada are in such a position.

The financial statements of Imperial Tobacco and Rothmans, Benson and Hedges were formerly made public on an annual basis. This practice ended after ITL was 100% acquired by British American Tobacco in 2000 and RBH by Philip Morris International in 2008. JTI-Macdonald was never a publicly owned company in Canada, and its financial records were not made public.

As a result of litigation efforts, however, the summary financial reports of ITL and RBH for 2014 were made public. These disclose that the gross revenue for both companies after excise taxes were deducted was around $1 billion ($1.1 billion for ITL and $946 million for RBH). Their profit from operations, (EBITDA) was around $500 million each ($535 million for ITL and $495 for RBH). [66] [67] Otherwise expressed, the operating profit margin for each company was about 50% (49% for ITL and 52% for RBH). For every $1 in sales, they retained 50 cents after paying all of the costs of production, distribution and management.

Chart 6: RBH Ontario prices to retailers, November 2014 (Cents per cigarette) [63]
3. **Price Manipulation erodes the health benefits of tobacco taxes**

A. **Smokers do not have to pay more for cigarettes than they did a decade ago**

Although data on cigarette prices in differing communities and neighbourhoods is routinely collected by tobacco companies and used for market research, there is no equivalent source of information to assist independent research on the public health impact of recent price differentiation and increased price competition in Canada.

ACNielsen data which tracks convenience store sales is available for purchase, although severe limitations are put on use by those who acquire the data. ACNielsen data for 2006 was acquired, but not for other years.

In the absence of robust data, it is not possible to state categorically whether cigarettes have become less affordable as a result of tax increases, or whether the companies have been able to offset the impact of such taxes through price-based marketing. The limited data that is available suggests that this may be the case.

Archival photographs of retail display of cigarettes which include prices have been located in retail trade publications, newspapers, television reports and other sources. Twenty price observations were found in photographs of Quebec retail displays taken between 2005 and 2015 and 15 were found in photographs taken in Ontario. [68]

This preliminary data, as shown in Chart 7 and Chart 8, show there was only a modest increase in the price of the cheapest brand of cigarettes charged to customers in the decade between 2005 and 2015, and that there was a decrease in the non-tax portion of the cigarette price. Once inflation has been taken into consideration, the cost to smokers of these cigarette declined slightly.

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**Chart 7: Lowest displayed price per cigarette and non-tax portion of price, (inflation adjusted, 2002=$1). Quebec 2005-2015 [68]**

![Chart showing the lowest displayed price per cigarette and non-tax portion of price, with inflation adjusted, 2002=$1, for Quebec from 2005 to 2015, with equations for cost to customer per cigarette and cigarette price exclusive of tax, inflation adjusted.](chart7.png)
B. Discount cigarettes disproportionately harm the health of disadvantaged Canadians.

Smokers who are most price-sensitive are those most likely to quit smoking as a result of higher tobacco prices. These are the same smokers who are most likely to purchase discount cigarettes. Price-based marketing is thus most likely to prevent the health benefits of tobacco tax policy on these individuals.

Smokers who have lower incomes and lower levels of education have been found to have a greater likelihood of quitting in response to tax increases. Although similar research is not available for Canada, studies elsewhere have found that middle and lower income smokers are the most likely to report using discount brands.

An important consideration in the setting of tax rates (including tobacco taxes) is the impact they will have on social equality, and the extent to which they might contribute to widening the gap between the ‘haves’ and the ‘have-nots’. Canadians who are poor are more likely to smoke than those who are better off - one fifth (20%) of Canadians with family incomes under $40,000 are daily smokers, compared with one-tenth (11%) of those with family incomes over $60,000. Tobacco taxes will consequently generate a disproportionate share of their revenue from those who are not well off.

By the same token, the health benefits of tobacco tax increases are greater for those with lower incomes. This stands to reason -- those with less disposable income are more responsive to price increases. Research has found that of all tobacco control interventions "increased price through taxation provide the most consistent positive evidence of reducing tobacco related inequities." [71]

A corollary is that tobacco control strategies which permit the availability of low-priced cigarettes are exacerbating health inequalities because they are setting the conditions under which the economically disadvantaged will be disproportionately influenced to continue smoking. This contributes to a lifelong disadvantage, as the dependence on tobacco use will result in a continued drain on the household economy and the burden of disease, disability and resulting income loss.

The Ontario Scientific Advisory Committee, in its 2016 Scientific Consensus Statement, concluded after a review of the available science that increasing tobacco taxes “has a positive equity impact.” [71]

C. Other countries are facing the same challenges

A number of studies have shown that, as in Canada, tobacco companies are increasing the price differential between discount and premium cigarettes, and that smokers are increasingly purchasing discount brands or price-reduced products.

Australia, like Canada, is considered a “dark market”. Following the implementation of display bans in that country, tobacco companies introduced lower priced cigarettes and contractual arrangements with retailers to control the price of the lowest cost cigarettes. [72] After plain packaging was introduced in 2012, the price spread between brands increased. [73] [74]

The United Kingdom is also a “dark market” with tobacco display bans and imminent plain packaging. Like Canada, cigarettes in the United Kingdom are increasingly price differentiated which has doubled the market share of “ultra low price” cigarettes. [75] Contractual agreements between companies and retailers linking retail prices to competitors’ brands were initially challenged by the (now defunct) Office of Fair Trading, [76] but were ultimately upheld in Court. [77] A review of the price of the cheapest brands in the U.K. found that the real (inflation adjusted) price did not grow in the decade 1999-2009. [75] The increase in those who used cheaper cigarette products was most prominent in those who were young and were economically disadvantaged. [78]

The United States is not a “dark market” and cigarettes continue to be displayed in retail and other locations. As discussed earlier, price-based promotions are now the predominant form of cigarette marketing in that country. Unlike Canada and the United Kingdom, price-discounts are often used by companies to reduce the price of premium brands. [79] Price discounting was ruled legal by the U.S. Supreme Court. [80]

The World Health Organization monitored cigarette affordability and price dispersion in its 2015 Report on the Tobacco Epidemic. It found that very large price gaps between cheap and inexpensive cigarettes was commonplace in developing countries. [81] Canada was one of only two OECD countries which did not provide this data to WHO.
4. STRATEGIES TO PROTECT PUBLIC HEALTH FROM LOW-PRICED CIGARETTES ARE AVAILABLE.

There are a number of public policy tools that can be called on to prevent tobacco companies from depressing the price of cigarettes to promote tobacco use.

A. Tax measures and Regulatory Charges

Raising the price of cheap cigarettes by increasing tobacco taxes is not only an obvious policy option, it is an approach fully supported by evidence and policy consensus.

For example, if the tax rate on cigarettes sold in Quebec (the lowest taxed province) were to be raised to that of the neighbouring province of New Brunswick (which has the lowest cigarette taxes of any of the other provinces other than Ontario) each cigarette would cost an additional 8 cents. The combined federal and provincial excise taxes on each package of 20 cigarettes would increase from $5.08 to $6.55.

Such an increase would raise the price floor for cigarettes. It would also make it more difficult for companies to inflate their profits on more expensive brands to offset their reduced profits on low-cost cigarettes.

1) Regular adjustments for inflation

One challenge to maintaining appropriately high levels of tobacco taxes is the erosive effect of inflation. Federal taxes have been increased $5.71 since 2002 (from $15.85 to $21.56), but once adjusted for inflation, the increase over the past 15 years is only $0.75.

2) A tax escalator

The World Health Organization recommends automatically adjusting specific tobacco taxes by an amount greater than inflation, as is done in Australia and New Zealand. [3] The United Kingdom increases its excise duty by the amount of inflation plus an additional 2% every year. [82]

3) License fees on manufacturers and retailers

Levies and license fees which are imposed on manufacturers are different than excise taxes in that they are usually used to recoup the regulatory and other costs associated with tobacco use. They have a secondary effect of raising product cost. [83]

Some of Canada’s 13 provinces and territories require that retailers be licensed, but such permits are issued by the finance ministries for tax-collecting purposes and are not, generally speaking, linked to any specific health objective. Only two provinces charge fees, and these are only nominal charges ($50 per year or less). About 20 municipalities charge tobacco retailers an annual licenses fee, usually as part of a schedule of fees for businesses for which the municipality incurs inspection costs. Some municipalities have linked these fees or permits to health objectives. The City of Lloydminster (which straddles the border between Alberta and Saskatchewan) has among the highest annual retail license fees: $1,100 for retailers who sell flavoured tobacco products and $750 who only sell non-flavoured tobacco. The by law specifies that “Funds collected from this fee will be used to support local agencies with tobacco reduction strategies.” [84]
Table 2: Provincial licensing requirements

<table>
<thead>
<tr>
<th>Province</th>
<th>Licensing or Registration Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>British Columbia</td>
<td>Tobacco Retail Authorization. (TRA). It can be suspended or cancelled for infractions under the Tax Act or the Tobacco and Vapour Products Control Act.</td>
</tr>
<tr>
<td>Alberta</td>
<td>No specific retail licence. Anyone with more than 1,000 cigarettes in inventory must have a permit issued under the authority of the Tobacco Tax Regulation. Municipalities may require business licenses and several have done so. These include the two largest cities, Edmonton and Calgary</td>
</tr>
<tr>
<td>Saskatchewan</td>
<td>No specific retail licence</td>
</tr>
<tr>
<td>Manitoba</td>
<td>Tobacco retail dealer’s permit issued under authority of Tobacco Tax Act.</td>
</tr>
<tr>
<td>Ontario</td>
<td>Tobacco Retail Dealer’s Permit is required under the Tobacco Tax Act for those who start selling tobacco products after June 30, 2010 and will soon be required for all retailers.</td>
</tr>
<tr>
<td>Quebec</td>
<td>Ordinary tobacco retailers must be registered with the tax authorities, in the same manner as other businesses. Any one who wants to be able to display tobacco products (i.e. specialty tobacco and vape shops) must register with the Health Ministry.</td>
</tr>
<tr>
<td>New Brunswick</td>
<td>New Brunswick tobacco retail licenses are issued under the authority of the Tobacco Tax Act and expire each year, and are location specific. The initial fee is $100, with an annual renewal fee of $50.</td>
</tr>
<tr>
<td>Nova Scotia</td>
<td>Retail Vendor’s Permits are issued by the provincial tax commission. The permit expires after 3 years unless renewed. The fee for the 3 year license is $124.60.</td>
</tr>
<tr>
<td>Prince Edward Island</td>
<td>A Tobacco Retail Vendor’s License is issued by the finance ministry, but requires prior inspection of signage and approval from the health ministry.</td>
</tr>
<tr>
<td>Newfoundland and Labrador</td>
<td>Tobacco Licenses are issued under the authority of the Tobacco and Vapour Products Control Act.</td>
</tr>
</tbody>
</table>

License fees for retailers which are assessed at a rate sufficient to cover the costs of retail regulation (e.g. sales to minors enforcement, price monitoring, retailer education) would have the secondary effect of increasing the price of tobacco products. Such fees can be assessed on a variable rate and based on annual sales in order to achieve an equitable impact on sales price, as illustrated below.

Conditions of such licenses can be applied to ameliorate the risks of tobacco retailing in addition to those posed by price-discounts. Examples of additional conditions of license include mandatory training of retailers regarding the health effects of tobacco use (France, 2017), [85], mandatory availability of health-information provided by non governmental organizations (Estonia, 2015). [86] Other conditions of license can be developed to help ensure that tobacco retail practice does not subvert public health.

Regulatory charges imposed on manufacturers have the potential to ensure that the costs of tobacco control are internalized into the price of cigarettes. One of the first agencies to implement an effective regulatory charge on tobacco manufacturers was the United States Food and Drug Administration which recovers user fees from tobacco manufacturers and importers, based on market share. [87] In 2016, almost US$600 million was collected, increasing the cost of cigarettes by about US$0.44 per carton. The revenues collected this way are spent on public education, regulatory science, regulatory activities and enforcement. [88]

France is another OECD country which has moved to require tobacco companies to pay for the costs of tobacco control. Since the beginning of 2017 France has imposed a special
“contribution sociale” on tobacco manufacturers, representing almost 6% of their revenue net of excise taxes. [89] The 130 million euros collected in this way is deposited in a special account, the use of which is assigned to the state agency responsible for health care. [90]

4) Targeted levies
Specific Levies have been proposed to address the significant environmental harm caused by tobacco litter. This is consistent with the concept of product stewardship, which shifts responsibility and the cost of protecting the environment from taxpayers to the manufacturer, retailer and consumer. San Francisco has imposed a cigarette litter abatement fee of US$0.20 per pack, which was less than the costs associated with cigarette litter. [91] [92]

Quebec has imposed environmental handling fees on new electronic products, paint, lightbulbs, batteries and other products. [93] A similar charge on tobacco products could provide revenue to address the environmental damage caused by smoking, while simultaneously raising the package price.

5) Cracking down on income tax avoidance
In recent years, at least two of the three tobacco companies have employed income tax avoidance measures which were exposed in unrelated court proceedings. These measures have allowed them to artificially enhance their profitability. Enforcement measures to address this tax avoidance would put pressure on the companies to increase their revenues from cigarette sales, including lowest cost brands.

- JTI-Macdonald has been restructured by its parent company, Japan Tobacco, so that its debt payments to the company exceed its profits. As a result, it operates at a loss in Canada, even though its earnings before taxes are otherwise $103 million. [94] If it were required to pay the normal 11.5% Quebec corporate income tax, and recovered this amount from its cigarette sales (2.5 billion in 2015), [95] each package would increase in price by 10 cents.

- Imperial Tobacco has entered into complex cross ownership arrangements with other companies owned by its parent, British American Tobacco. This arrangement reduced its taxes payable to the federal government by $12 million per year. [96]

- In 1994, the federal government introduced a 50% surtax on tobacco manufacturers profits, and for a number of years disclosed the revenues from this surtax. By shifting production to Mexico, Imperial Tobacco was able to avoid this surtax, and converting its profits into loan payments, JTI-Macdonald has similarly reduced the effect of this tax. [97] In its 2017 budget, the federal government scrapped the tax altogether, shifting the remaining burden to smokers in the form of a modest excise tax increase. [98]
B. Contraband measures

An important complement to a strengthened fiscal framework for tobacco is ensuring that it is not undermined by the market for illicit tobacco. This is a challenge which requires a whole-of-government response, and needs a higher level of involvement by the federal health ministry.

The challenge of reducing illicit tobacco in Canada is one that has currently been assigned to law enforcement departments. The Federal Tobacco Control Strategy principally assigns responsibility for illicit tobacco control to Revenue Canada, the Canadian Border Services Agency, and the Royal Canadian Mounted Police. [99]

Health ministries not only have reason to be fully engaged in efforts to address contraband, they arguably have a responsibility to do so. In addition to being untaxed, contraband tobacco sold in Canada does not usually conform to health regulations, including requirements for warning labels.

In the more than a decade since the tobacco industry mobilized a public relations effort to raise concerns about contraband tobacco [30], there have been no published reports by any federal departments which estimate the volume of contraband, or which confirm or counter the industry message. Nor have there been any attempts by Health Canada or other departments to assess the impact of contraband tobacco use on progress against tobacco use.

One consequence of the absence of reliable or consistent estimates of the illicit market is that it is more difficult to monitor progress on tobacco reduction efforts. For more than a decade, data on per-capita consumption of tobacco has not been made readily available.

There are other benefits to the federal government providing estimates of the contraband market and its potential impact. Health Canada and Revenue Canada have information on the wholesale shipments of taxed tobacco, including tobacco which is manufactured by Grand River Enterprises on the Six Nations Territory. This company pays federal tax, but not provincial tax. When its products are sold to anyone other than status Indians, they are considered illicit. [100] These federal departments are in a unique position to contribute insights from the production of this major manufacturer.

There are a number of actions that Health Canada and other federal departments can take to support efforts to reduce illicit supply or the impact of concerns about contraband on tobacco tax rates. These include:

- Adding federal controls to complement and strengthen measures in Ontario [36] and Quebec [101] to control the supply of ingredients necessary for cigarette manufacturing, such as filter materials and tobacco machinery.
- Regularly developing and making public estimates of the size of the illicit tobacco market.
- Commissioning or conducting analysis of the impact of illicit tobacco on smoking rates.
C. Price controls

There are a variety of policy tools available to government to reduce price competition for tobacco products.

Option 1: End price-based promotions

Many price-based promotions for tobacco are already illegal in Canada. Cigarettes may not be given away, and cannot be sold through coupons or prize-offerings.

But provincial and federal tobacco laws have made explicit provisions to allow for the price of cigarettes to be communicated to consumers, such as the exemption for “advertising that is intended to provide consumers with factual information about a tobacco product, including information about the price or the intrinsic characteristics of a tobacco product and about brands of tobacco products.” [44]

Examples of how tobacco control laws can be strengthened to reduce price promotion include:

- Banning cigarette price boards or other indicators of price
- Banning multi-pack discounts or product bundling

Option 2: Set a minimum price at which cigarettes can be sold (Minimum price laws)

Minimum price laws for tobacco were introduced decades ago in the United States to ensure fair competition and to protect small retailers from predatory business practices. They are now recognized by some as a potential way to protect public health from the risk of large tobacco companies using low prices to generate new customers, [102] and are seen as a complement to excise taxes. [83] Minimum price laws have been proposed as a way to address price dispersion in Canada. [103]

One-half of U.S. jurisdictions currently have minimum price laws for cigarettes. These state laws vary in the minimum mark-up they require of wholesalers (2% to 6.5%), or retailers (6% to 25%). They take varying approaches to protecting against the price discounts offered to wholesalers by manufacturers. [102] The methods used in the U.S. laws were not designed to respond to circumstances similar to those now existing in Canada, where wholesale distribution has been replaced with direct contracting with manufacturers.

American public health advocates propose a variety of ways to establish minimum retail prices. These are:

- A flat rate minimum price, with a specific floor price below which no tobacco product may be sold.
- A markup minimum price with a high minimum percentage markup at the retail level.

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3 The minimum markup approach may not be suitable for the circumstances in Canada, where tobacco companies can manipulate the wholesale price by virtue of their direct-to-store distribution system.
- **A hybrid flat rate or markup law** requiring both a high minimum percentage and a price floor. [104]

Minimum prices for tobacco have been implemented in a number of jurisdictions outside of the United States.

- **Quebec** already has a minimum retail price of $10 for total sale of non-cigarette tobacco products. [45] Federal law sets a minimum package size of 20 units for cigarettes and little cigars as a way to protect young people from affordable “kiddy packs”. [43]

- **Brazil** established minimum retail prices for cigarettes, effective 2012. [105] The price list for cigarettes is made public through Brazil’s regulatory office. [106]

- In 2010, **Malaysia** implemented minimum price laws for cigarettes, as well as reporting requirements for manufacturers to provide data on retail sales prices. Other price promotions were also banned. [107]

Minimum pricing is also used in other areas of public health, such as “social reference pricing” for alcohol. [108] In 2014, **British Columbia** imposed minimum prices on alcohol served in bars and restaurants, and banned happy hours. [109] In its 2016 budget, the **Ontario** government implemented a minimum retail price for table wine, which was already in place for beer and spirits. [110] [111].

One barrier to implementing this approach is the absence of an international scientific or policy consensus in support of cigarette price controls or minimum price laws.

The Guidelines for implementation for Article 6 (tax and price) of the Framework Convention on Tobacco Control suggests using specific taxes, such as the excise taxes already in place in Canada, to establish a minimum price. [112] The WHO’s Technical Manual on Tobacco Tax Administration similarly advocates for a minimum tax (not price) floor. [3]

Minimum price laws for tobacco and alcohol were attempted by a number of European countries (including Austria, Scotland and Ireland), but were found inconsistent with EU law and were discarded by the court as being a goal that could be achieved through taxation. [113]

In some jurisdictions, health groups have actively opposed minimum price laws, expressing concern that these serve to increase industry profits. [114] Some health researchers have concluded that minimum price laws are ineffective unless accompanied by appropriately high tax levels and other measures to curtail price promotions. [115]

**Option 3: Set a maximum price for cigarettes (price cap)**

Regulated pricing with price caps has been proposed as a way to respond to the industry’s pricing and marketing strategies. [116] The perceived benefits of limiting the profit margin on premium brands (and replacing it with taxes) include reducing the profitability (and power) of the industry and reducing price differentials between brands.
“By setting price caps close to the level of production costs, authors argue that the large companies that currently dominate the market will no longer be able to target specific audiences with low prices, because they cannot make up the profit loss through higher prices on other products or in other venues. Implemented by itself a price cap would then compress prices, but might actually lower average product prices. Supporters of price caps therefore recommend pairing them with high excise taxes.” [83]

Price cap regulations were initially implemented by electricity regulators, and are in place in the electricity sector in several Canadian and international jurisdictions. [117] They have also been used by federal government in Canada to address health-related and other market issues, such as generic drug pricing and telephone services.

Imposing controls on the maximum price that can be charged does not prevent the sale of discount cigarettes.

Option 4: Standardizing the price of cigarettes (price controls)
Standardizing the pricing of tobacco products could remove price competition altogether, protecting the public from this form of tobacco promotion and maximize the impact of tax hikes.

Canadian governments have on occasion imposed price structures on producers, especially in response to a monopoly market (e.g. cablevision, telephone, transportation). The purpose of these regulations was usually to ensure that the consumer did not face unfairly high prices as a result of the lack of competition.

The goal of standardized pricing for cigarettes would be quite different, and would be more aligned as a marketing restrictions aimed at protecting young people and others from inducements to use tobacco products.

Price standardization could be used to bring together the benefits of minimum price laws and price caps. It would prevent variable pricing by the industry (when prices are lower at certain times or in selected regions). It would prevent the companies from redesigning their retail rebate programs to skirt the intent of the amendments to the Quebec Tobacco Control Act which come into force in November 2016.
Many price promotions are already prohibited in Quebec. Regulated pricing would close those that remain, as it would:

- End variable pricing and temporary price reductions.
- End loss leaders and sales below cost
- End price-based promotional contracts with retailers and industry-initiated retail price fixing.

No country is known to have fully standardized the price of cigarettes by imposing the same price on all brands in all retail locations. In France, tobacco retailing is regulated by the revenue ministry (Ministère de l’économie et des finances), and a standardized price for each brand is set by regulation. Different brands of cigarettes are sold at different price levels, but the differentiation is less extreme than in Canada: in 2016 the cheaper brands (e.g. Pall Mall) sold for 90% of the price of the premium brands (e.g. Marlboro) – a difference of €0.50 per package of 20 cigarettes. Retailers may not deviate from the price list, which ensures consistent pricing across mainland France.

D. **Sunshine Laws.**

A decade has passed since Canadian tobacco companies introduced multi-price marketing and the impact of these promotions on smoking rates is still unmeasured.

Efforts to analyze their effect have been hindered by an absence of data available to health researchers or policy-makers, despite the fact that this information has been collected.

- Tobacco company sales representatives currently monitor retailer compliance with pricing agreements, and electronically gather pricing information on all brands (including competitors) in their retail visits. This information is not reported to government, and it is not made public.

- ACNielsen collects information from cash registers in selected convenience stores. When aggregated, this information is theoretically available for sale, and is believed to have been sold to some government departments.

- Tobacco manufacturers are required to provide monthly information to Health Canada on the quantities of cigarettes they sell for each brand, as well as the wholesale price. These requirements have been in place since 2000, but no data has been released to the public, even in aggregated anonymized form. In 2003, Health Canada reversed its policy of making per-brand sales data available through the provisions of the Access to Information Act.

In sum, a lot of data is disclosed (by retailers to manufacturers and ACNielsen, and by manufacturers to government), but there is very little public access to it.

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4 Recent legislation before Parliament (Bill S-5, the proposed Tobacco and Vaping Products Act) proposes to require greater disclosure, once regulations are in place. No indication has been given as to the timing of such regulations.
“Sunshine laws” have been proposed as a way to address price promotions. [120] This approach goes beyond disclosure in that it is aimed at providing public exposure of tobacco marketing. This has the potential to denormalize and reduce such marketing strategies, to create public awareness of tobacco industry marketing and to provide data that can be used to build more effective tobacco control policies.

The current federal reporting requirements provide a foundation for this approach. These regulations could be modernized to be more responsive to the current marketing practices of the industry and to facilitate analysis of the effects of this marketing on public health. Strengthening these regulations could include:

- Requirements for reports on all promotional payments or gifts given to retailers, including compensation for training, rebates, cash-cards, discounts, free trips, hockey tickets, etc.
- Disclosure by the industry to government of its market data, including pricing variance.
- The guarantee of public access to the information.

In other areas, governments can more directly monitor sales by requiring retailers to provide information on recorded sales. The system of “mandatory billing” in place for Quebec restaurants, for example, provides constant information on restaurant sales. Such a system, installed for tobacco retailers, could be an additional deterrent for illicit tobacco sales and an effective way for public health authorities to monitor tobacco pricing.
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