



WARNING SIGNS ABOUT CIGARETTE SMUGGLING

AND ACTIONS GOVERNMENTS CAN TAKE TO EXTINGUISH THIS PROBLEM

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Physicians *for a* Smoke-Free Canada

1226 A Wellington Street ♦ Ottawa ♦ Ontario ♦ K1Y 3A1
Tel: 233 4878 ♦ Fax: 233-7797 ♦ www.smoke-free.ca
email: ccallard@smoke-free.ca

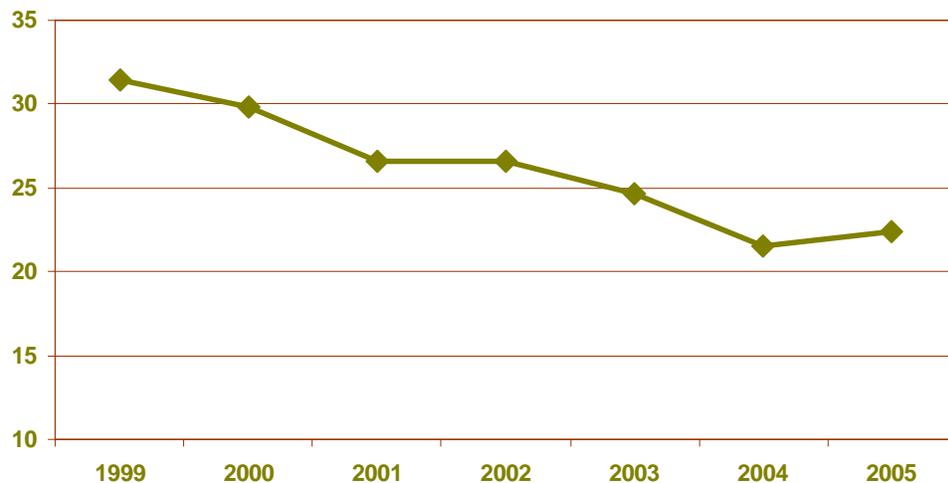
1 Summer 2006

Health Canada's survey of smokers (CTUMS) reveals that smokers report an increased in the amount of cigarettes smoked between 2004 and 2005.

Over the past half decade, as a result of several federal and provincial tobacco control strategies, the number of smokers have declined as have the number of cigarettes they say they smoke. Tax increases, severe restrictions on tobacco promotions, smoke-free workplaces and public places and mass media have contributed to one of the fastest declines in public health history.

Between 2004 and 2005, however, smokers reported that they had increased the number of cigarettes they smoked. Although the reported increase is small (4%), it is nonetheless a disturbing sign of erosion of tobacco control policies.

**Reported cigarettes smoked by daily smokers
(calculated from CTUMS)
(billions of cigarettes per year)**



2 September 2006 Quebec issues a revised budget forecast. Projected tobacco revenues are lowered by \$75 million.

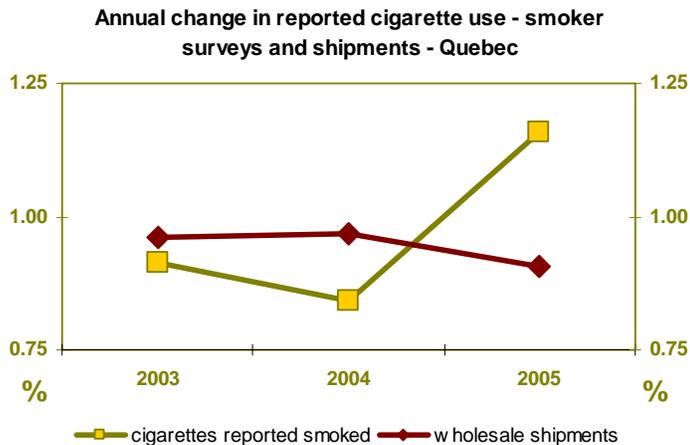
In September 2006, the Quebec government issued an update on its economic and financial situation¹, and informed bond markets and other financial observers that Quebec's projected revenues would fall from the \$852 million forecast in the 2006 budget² to \$777 million.

The government attributed this reduction in its projection to two factors: "the implementation of new provisions of the Tobacco Act, introduced last May, on sales of tobacco products. It may also reflect the rise in smuggling of these products." The smoke-free legislation which came into effect in Quebec on May 31st, 2006 can be expected to have a profound and lasting impact on the number of Quebecers who smoke, and of the amount of cigarettes that remaining smokers consume, but that impact would be much less than the one-tenth reduced forecast.

A more likely explanation is that Quebecers are continuing to turn to illegal sources of cigarettes.

A comparison of the amount of cigarettes Quebecers say they smoke³ and the number of cigarettes shipped into Quebec by legal manufacturers shows an increasing discrepancy between the two.

- the amount of cigarettes Quebecers say they smoke **has increased 16%** between 2004 and 2005
- the number of legal cigarette shipments into Quebec **decreased 9%** in the same period.



Although Quebec smokers say they have increased the number of cigarettes they smoke, legal shipments of cigarettes of decreased.

This difference suggests a 25% growth in illegal cigarettes during the past year.

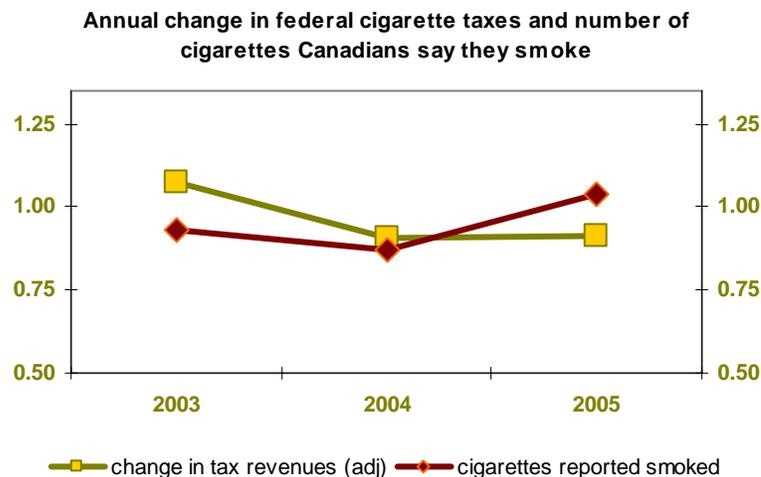
3 September 2006: Ottawa reports that tobacco tax revenues have fallen (by more than can be accounted for by reduced smoking)

The public accounts of Canada for 2005-2006, tabled in Parliament at the end of September 2006, reported that federal tax revenues for cigarettes had fallen by \$255 million (from \$3.0 billion to \$2.7 billion). This represented an 8.4% reduction year-over-year.

This is the amount of tobacco tax that would be paid by 440,000 pack-a-day smokers over the course of the year, but the actual number of Canadians who successfully quit in that period was only 190,000.

Between 2003 and 2005 federal tax revenues fell by twice the rate of the decline in the number of smokers or in the number of cigarettes Canadians reported that they smoked. (20% vs. 10%).

The growing discrepancy in official statistics and reported tobacco use suggests that 10% of cigarettes smoked in Canada 2005 were untaxed.



Federal taxes lost to smuggling have increased by \$280 million per year between 2003-04 and 2005-066 .

This is enough to pay for:

- **The entire 5 year budget** of the cancer strategy (\$260 million over 5 years)
- **35 times the budget** of the federal programme aimed at implementing better smuggling controls (\$8 million)

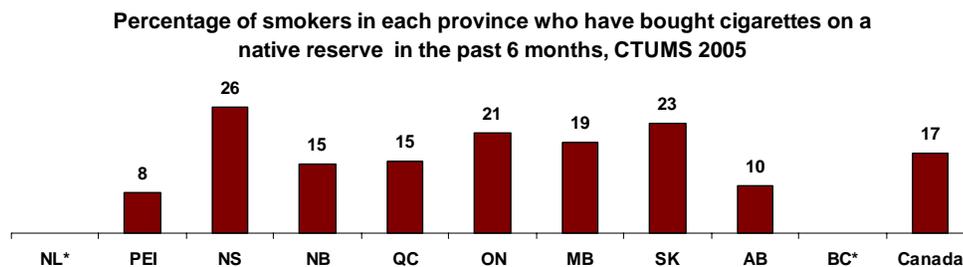
4 July 2006 Health Canada surveys report that 17% of Canadian smokers had bought cigarettes from a native reserve within in the past 6 months.

Cigarettes sold on native reserves for use by eligible first nations people are exempt from federal taxes and provincial taxes in some provinces, and are thus considerably cheaper than cigarettes sold in convenience stores or other outlets. Although, under Canadian law, it is only legal for tax-exempt cigarettes to be sold to Canadians with tax-exempt status (either diplomatic or first nations), the smoke-shacks on aboriginal reserves close to Canadian communities do not require purchasers to demonstrate eligibility under Canadian law for tax-free purchases. By travelling to first nations communities, Canadian smokers can purchase cigarettes at cheaper prices.

Cigarettes sold on aboriginal reserves include brands which are manufactured on reserves and on which no taxes have been paid as well as brands which are imported into the reserves without taxes being paid at source.

The Canadian Tobacco Use Monitoring Survey asked Canadian smokers not living on reserves whether they purchased cigarettes on reserves over the past 6 months. Almost one in five Canadians reported that they had done so (17%). The rates were highest in Nova Scotia (26%) and Saskatchewan (23%). (The data for Newfoundland and British Columbia were not reportable).

Because Ontario and Quebec are the most populous provinces, most of those who report that they purchased on reserves live in Ontario (46%) and Quebec (28%).

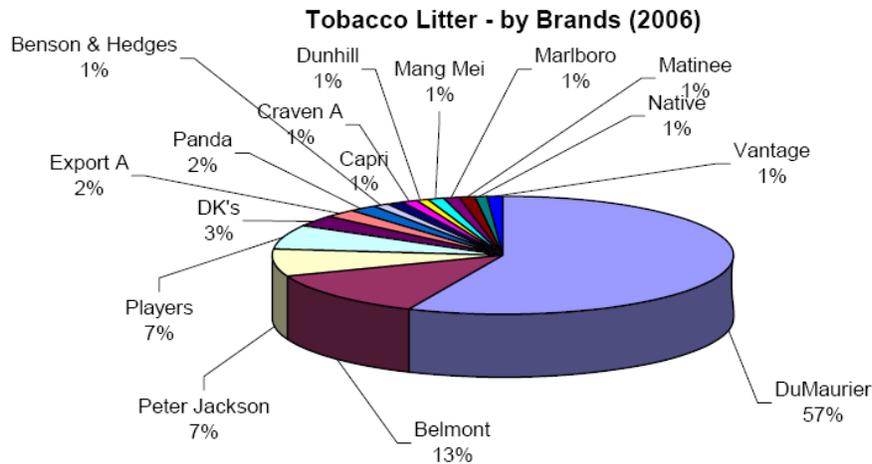


Some provincial governments have found ways to allow first nations governments to collect tobacco taxes and then have these monies returned to the band council. This approach:

- respects tax rights of first nations
- protects aboriginal and non-aboriginal communities from the health consequences of cheaper cigarettes
- increases funding to aboriginal governments.

5 October 2006:
Toronto Garbage audit reveals that 8% of cigarette package litter is for brands not sold on the legal market.

The City of Toronto conducts an annual audit of litter, and collects information on the manufacturers of candy, cigarettes, bottles and other consumer litter.⁴ Their analysis of garbage in the surveyed sites showed that almost one in ten cigarette packages left on the streets was a brand not legally sold in Toronto.



Toronto's garbage audit is consistent with estimates derived from falling tax revenues that 10% of cigarettes smoked are smuggled.

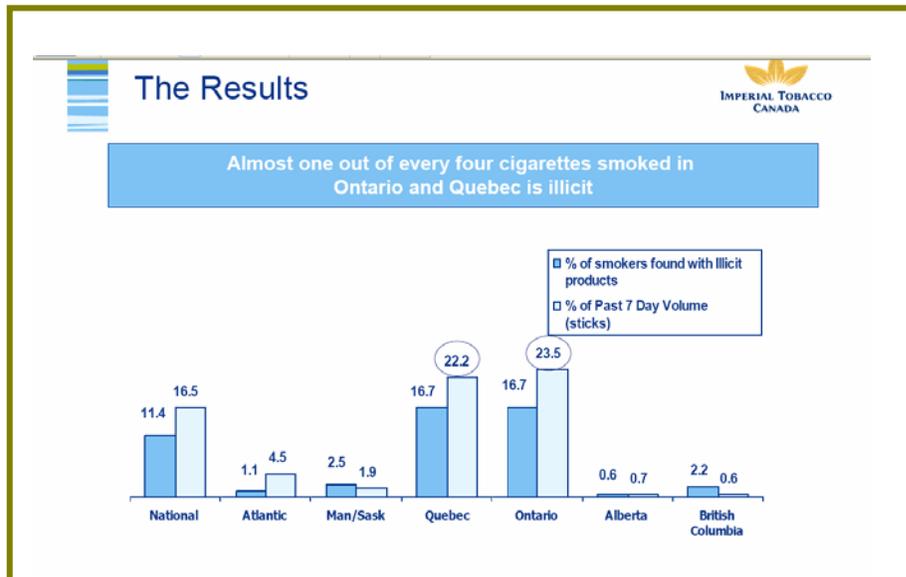
Government surveys show that those who try to find cheaper cigarettes want to quit smoking as much as other smokers. By restoring controls over cigarettes, governments could apply recovered taxes to effective programs to help these smokers quit.

6 October 2006: Imperial Tobacco reports that its survey of illegal cigarettes found that those who purchased illegal cigarettes smoked more than other Canadians.

Cigarettes are considered to be highly price elastic: that is to say, smokers will respond to higher cigarette prices by smoking fewer cigarettes or by quitting.

It is because of this price-sensitivity that illegal cigarettes are a major concern for public health strategies. Illegal cigarettes (that cost less) undermine other tobacco control strategies and result in more Canadians smoking, and also in Canadian smokers using more cigarettes each day.

Imperial Tobacco Canada Ltd. commissioned a survey of cigarette purchasing patterns in Canada⁵ and found that those who were in possession of price-reduced cigarettes (almost all of which were purchased on reserve) smoked, on average, 30% more cigarettes per day than those who didn't. The report does not support a conclusion that it is because of the availability of cheaper cigarettes that these individuals are smoking more because some self-selection of heavy smokers among those who find ways to purchase illegal cigarettes can be expected. This finding provides a strong health rationale to find effective ways to reduce smuggling.



It is not known whether ITL's report on smuggling shows higher levels because it was conducted a year later or because of different methodologies. **None of the Canadian agencies with responsibilities for tobacco systematically monitors illicit tobacco use** – neither Finance Canada, the RCMP, Health Canada the Canadian Revenue Agency nor the Canadian Border Services Agency (although records of seizures of contraband are collected)

7 October 2006: Imperial Tobacco reports that one-in-five packages of illegal cigarettes are sold in legal outlets.

Imperial Tobacco's survey of 2,300 smokers⁶ revealed that those who smoked untaxed brands often purchased them at retail or other outlets.

The research methodology used in this study involved in-home interviews, following which interviewers offered to purchase the current brands from the respondent smokers. This allowed for further analysis of the packages, and the determination of whether or not a brand was legal was independent of the smoker's knowledge.

The results showed that 20% of illegal cigarettes were purchased in convenience stores, gas stations or grocery stores, and that 36% were delivered through social sources.



Canadians who smoke illegal brands may not be aware that the brands they are smoking have not been properly taxed.

The Canadian government has not yet implemented methods to improve controls on cigarettes shipments (such as 'track and trace' controls on inventories and sales).

Recommendations to governments:

Federal actions:

1. revoke the federal tobacco manufacturer licence if the manufacturer is operating illegally, including if the manufacturer does not comply with provincial legislation.
2. prohibit the supply of raw materials (e.g. cigarette filters, cigarette paper, packaging, potentially electricity, in addition to raw leaf tobacco) to unlicensed tobacco manufacturers.
3. increase the minimum bond for all tobacco manufacturers to at least \$2 million (compared to current minimum of \$5000). Bonds would be forfeitable if a manufacturer is non-compliant with the law.
4. have a better package marking system, including a full tracking and tracing system.
5. ensure that provincial tobacco tax is collected on native produced product on which federal tax is collected.
6. combine the current federal GST and excise tax with a single (higher) excise tax rate. (In 2006, when the general GST rate was reduced, the excise tax on cigarettes was increased by a similar amount.)
7. persuade the American Government to shut down the 10 or so illegal tobacco manufacturing facilities on the New York state side of Akwesasne reserve - the current situation represents an enormous border security situation for the US that is not being addressed, in addition to being a primary source of contraband for Canada.
8. monitor use of contraband tobacco and make results public.
9. initiate government-to-government negotiations with first nations governments to control smuggling and invite first nations governments to implement the effective tobacco control measures included in the Framework Convention on Tobacco Control.

Provincial actions:

1. revoke manufacturer licences if a manufacturer is operating illegally.
2. prohibit the supply of raw materials (e.g. cigarette filters, cigarette paper, packaging, potentially electricity, in addition to raw leaf tobacco) to unlicensed tobacco manufacturers.
3. establish a refund/rebate system for products intended for tax-exempt sale on a reserve where this does not already exist.
4. establish a minimum bond of \$2 million for each tobacco manufacturer licence. Bonds would be forfeitable if a manufacturer is non-compliant with the law.
5. establish a distinct package marking for products intended for tax-exempt sale on reserve where such a system does not currently exist.

6. establish a quota system for reserves, to limit the quantity of product going to reserves for tax-exempt sale and ensure that the quota is no greater than the amount required for smokers in the community where such a system does not exist.

First nations' actions

1. acknowledge the health consequences of smoking cigarettes (both commercial and traditional tobacco contain harmful substances, it is the method and frequency of use that makes cigarettes more dangerous to health).
2. adopt measures to reduce cigarette use, including increased prices on cigarettes through first nations' tobacco taxes.
3. use powers of self government to adopt comprehensive tobacco control strategies.
4. follow the lead of Taiwan and other nations which have not been recognized as states by the United Nations, but which have implemented the measures of the Framework Convention on Tobacco Control.
5. work with the governments of Canada, the United States and the provinces to establish tax treaties or other fiscal arrangements that strengthen the financial resources of first nations communities while protecting the health of both first nations and neighbouring lands.
6. in the struggle for autonomy and self-government, recognize the fundamental importance of good health and exercise caution in using issues which harm health, like encouraging the sale of low-tax or no-tax cigarettes.

Data on cigarette consumption and tobacco taxation, 2001 – 2005

Current Smokers (Canadian Tobacco Use Monitoring Survey, CTUMS)					
	2001	2002	2003	2004	2005
Canada	5,411,822	5,414,334	5,332,325	5,079,767	4,889,511
Alberta	604,949	561,409	502,480	515,310	534,875
British Columbia	557,300	558,940	564,134	530,829	516,786
Manitoba	233,140	190,333	189,975	189,339	207,083
New Brunswick	153,580	129,856	150,453	150,542	134,871
Newfoundland	113,080	106,039	101,197	96,158	88,569
Nova Scotia	190,159	194,626	170,951	157,264	162,858
Ontario	1,878,927	1,911,472	1,932,375	1,871,234	1,668,588
PEI	28,396	25,892	24,342	24,415	22,241
Quebec	1,452,020	1,569,231	1,507,286	1,373,482	1,380,998
Saskatchewan	200,271	166,536	189,132	171,194	172,642

Reported cigarettes smoked by daily smokers calculated from CTUMS)					
	2001	2002	2003	2004	2005
Canada	26,553,928,923	26,574,236,428	24,664,596,432	21,541,058,708	22,425,704,317
Alberta	2,978,855,155	2,700,194,810	2,140,840,486	2,185,823,232	2,237,083,467
British Columbia	2,414,905,627	2,553,263,622	2,486,857,274	2,171,348,683	2,115,219,238
Manitoba	1,015,802,884	878,153,281	781,667,502	820,196,501	808,427,660
New Brunswick	858,201,432	673,118,181	768,877,683	771,196,565	683,216,892
Newfoundland	579,803,960	538,875,342	484,999,298	402,067,721	403,006,355
Nova Scotia	1,003,626,959	1,052,875,131	823,236,221	653,033,326	731,944,720
Ontario	9,922,974,863	9,604,557,732	9,182,128,924	8,249,630,501	7,882,125,944
PEI	155,974,465	142,664,192	124,577,712	112,963,303	108,368,865
Quebec	6,880,990,950	7,452,036,370	6,793,526,000	5,726,804,083	6,638,184,774
Saskatchewan	969,058,356	760,759,937	905,953,360	715,612,102	717,283,145

Wholesale sales of Cigarettes (reported to Health Canada)					
	2001	2002	2003	2004	2005
Canada	45,624,106,210	41,441,531,460	39,663,883,599	38,650,705,606	36,334,578,343
Alberta	5,403,177,975	4,698,793,405	4,488,114,020	4,736,237,475	4,897,380,695
British Columbia	4,463,669,760	4,264,772,155	3,999,082,010	4,091,723,020	4,030,723,480
Manitoba	1,561,810,000	1,432,112,045	1,379,936,995	1,378,556,785	1,404,091,080
New Brunswick	1,220,473,230	1,137,220,850	963,544,108	1,040,765,115	959,448,455
Newfoundland	687,089,400	670,870,485	647,626,421	711,420,216	682,636,845
Nova Scotia	1,595,802,400	1,471,921,820	1,329,996,815	1,384,512,608	1,312,831,995
Ontario	17,873,329,995	16,744,459,308	16,215,566,720	14,933,737,095	13,600,724,635
PEI	216,608,550	200,935,965	184,396,620	209,571,055	187,353,795
Quebec	11,083,889,425	9,443,435,517	9,084,619,825	8,785,032,387	7,958,172,358
Saskatchewan	1,468,930,275	1,326,899,110	1,323,960,265	1,335,317,450	1,267,302,005

Tax Revenues from excise and tobacco taxes					
	2001-02	2002-03	2003-04	2004-05	2005-06
Canada	\$2,509,545,230	\$3,111,054,391	\$3,349,877,973	\$3,029,139,958	\$2,773,826,877
Alberta	\$373,000,000	\$618,474,000	\$670,502,000	\$697,655,000	\$723,000,000
British Columbia	\$499,000,000	\$606,000,000	\$647,000,000	\$699,000,000	\$690,000,000
Manitoba	\$135,500,000	\$178,000,000	\$190,400,000	\$203,469,448	\$191,637,419
New Brunswick	\$69,672,000	\$91,912,000	\$97,000,000	\$96,500,000	\$90,500,000
Newfoundland	\$79,500,000	\$90,500,000	\$92,500,000	\$116,400,000	\$125,200,000
Nova Scotia	\$105,751,000	\$145,420,000	\$161,715,000	\$178,285,000	\$163,617,000
Ontario	\$703,000,000	\$1,183,000,000	\$1,350,000,000	\$1,453,000,000	\$1,379,000,000
Prince Edward Island	\$17,487,000	\$21,838,000	\$26,000,000	\$29,261,700	\$26,923,000
Quebec	\$652,000,000	\$867,000,000	\$889,000,000	\$901,235,000	\$751,591,000
Saskatchewan	\$120,049,000	\$158,472,000	\$176,747,000	\$187,029,000	\$171,107,000

Tax rates (excise and sales) on manufactured cigarettes		
	excise	sales
Canada	15.85	6%
Alberta	32.00	n/a
British Columbia	35.80	n/a
Manitoba	35.00	7%
New Brunswick	23.50	8%
Newfoundland	35.00	8%
Nova Scotia	31.04	8%
Ontario	24.70	n/a
PEI	34.90	n/a
Quebec	20.60	n/a
Saskatchewan	35.00	7%

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