SURVEYING THE DAMAGE

Cut-Rate Tobacco Products and Public Health in the 1990s

Canadian Cancer Society
Non-Smokers' Rights Association
Physicians for a Smoke-Free Canada
Quebec Coalition for Tobacco Control

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Surveying the Damage: Cut-rate Tobacco Products and Public Health in the 1990s

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Key Recommendations

- Cigarette taxes should increase by at least $10.00 per carton ($5.00 federal, $5.00 provincial) in Ontario, Quebec, New Brunswick, Nova Scotia and Prince Edward Island.

- If provinces are unwilling to make a joint increase with the federal government, the federal government should set aside the “gentleman’s agreement” and move quickly to act alone to raise tobacco taxes.

- The loopholes allowing lower taxes for tobacco sticks and roll-your-own tobacco should be eliminated.

- The federal government should adopt a comprehensive tobacco control program which includes measures equal in scope and impact to those recommended by the World Health Organization and the U.S. Centers for Disease Control. A minimum of $120 million per year should be invested in reducing tobacco use.

- The Health Promotion Surtax on tobacco manufacturer profits, scheduled to expire in February 2000, should be increased and made permanent.

- The export tax should be increased to $12 per carton, with an equivalent amount for tobacco sticks and roll-your-own tobacco. The exemption for shipments to foreign duty-free stores and shipments that have foreign taxes paid should be removed. The exemption for prior years’ production should be reduced from 2.5% to 1.5%.

- Canada should entirely eliminate duty-free sales of tobacco, which provide access to low-priced tobacco and reduce government revenue.

- Clearly visible, province-specific tax markings should be printed on cigarette packs.

“In reality, the most effective way to deter children from taking up smoking is to increase taxes on tobacco.”

World Bank, Curbing the Tobacco Epidemic: Governments and the Economics of Tobacco Control, 1999, p. 5.

Introduction

Five and a half years have elapsed since the dramatic, smuggling-induced tobacco tax rollback of 1994, which reduced the price of cigarettes by about half in much of Canada.

The public health consequences of this rollback are now well established. Public health has suffered as decades-long progress against tobacco use has slowed dramatically.[1] Low cigarette prices have neutralized the beneficial impact of advertising and promotion restrictions, of improved package warnings, of smoke-free environments and of public education has been undermined by low cigarette prices.

On the financial side, Canadian governments have relinquished billions of dollars in revenue as a result of the 1994 rollback. Tobacco industry profits, meanwhile, have continued to set new records, year after year, with annual pre-tax profits increasing by a staggering 62% between 1993 and 1998.[2]

Canadian cigarettes are now among the lowest priced and least taxed in the industrial world. Cigarettes in U.S. border states are now CDN$17 per carton more expensive than in Ontario and Quebec, because multibillion-dollar litigation settlement payments to U.S. state governments have been passed on to smokers through hefty cigarette price increases. Other alleged incentives to smuggle have been similarly addressed. Moreover, tobacco industry participation in contraband activities along the Canada-U.S. border has been exposed, leading to both prosecutions and convictions. (In at least two cases, investigations continue.)

The importance of restoring cigarette taxes is acknowledged with virtual unanimity among politicians and policy advisors. Yet, despite widespread support for a significant tax increase, only minor adjustments have been made. Continued delays are attributed to a 'gentleman's agreement' with the provinces, under which the federal government will make no tobacco tax increases without provincial consent.

"*The fact is that the Canadian manufacturers have benefited directly from this illegal trade. They have known perfectly well that their tobacco exports to the United States have been re-entering Canada illegally. I believe they have not acted responsibly.*"

The Right Honourable Jean Chrétien, Prime Minister, House of Commons, February 8, 1994

[1] In the 11 years preceding the rollback (1983-1993), per capita consumption fell by 42.3%. In the five years since the rollback, the decline in per capita consumption has almost stopped, and has now fallen to only 3.2%. See figure 14 and Appendix A, Tables F and G.
[2] Not including RJR-Macdonald, which is not publicly traded and for which figures are not available.

"Therefore, much as we may all regret the necessity of lowering cigarette taxes, we must do so at least until we have put the smuggling networks out of business. Then we will be able to restore the appropriate level of taxation that the situation needs."

The Rt. Hon. Jean Chrétien, House of Commons February 8, 1994

The 1994 tax reduction was presented as a temporary measure which would be reversed as smuggling was brought under control. This temporary measure is entering its sixth year, and risks permanency. The time has long pasts for the government to restore cigarette prices to levels high enough to protect young Canadians from becoming addicted to cigarettes and high enough to encourage Canadian smokers to reduce the amount they smoke – or, better yet, to quit.

Part 1

The Health Consequences of Tobacco Use

Tobacco products remain the leading cause of preventable disease, disability and death in Canada; and they remain the only consumer products which kill when used exactly as intended. Health Canada reports that 21% of all deaths in Canada are attributable to smoking.[3] Of these 45,000 tobacco-caused deaths per year, two-fifths are the result of cancers, two-fifths from cardiovascular disease and one-fifth from respiratory diseases like emphysema. Not all of tobacco's victims are adults: Health Canada estimates that, on average, two infants die every week, either as a result of tobacco-caused Sudden Infant Death Syndrome or respiratory illness caused by second-hand smoke.[4]

"There is no doubt that taxation plays a key role in our attempts to reduce tobacco use among all young Canadians who are particularly price sensitive. For this reason, I fully support further tax increases and any initiative aimed at countering attempts, such as the Player's Insta-Kit, to avoid taxation."

Hon. Allan Rock, Minister of Health, letter to Ken Kyle, Director of Public Issues, Canadian Cancer Society, October 9, 1998.

Tobacco products cause more harm than any other category of consumer products, and kill far more Canadians than any other type of drug. The rate of addiction is very high, and smoking is more likely to have lethal consequences than are other high-risk behaviours. One half of all long-term smokers will die early as a result of smoking; one half of these will die in middle age, losing 20-25 years of life.

Figure 1
Tobacco-caused deaths in Canada, 1999

	Annual Rate
Total	**45,214**
• Men	29,229
• Women	15,986
• Infants	105
• Cancers	17,703
• Cardiovascular diseases	17,562
• Respiratory diseases	9,498

Source: Health Canada, "Deaths in Canada due to Smoking, January, 1999

Although tobacco-caused deaths are higher among men (29,000 a year) than women (16,000 a year), the number of deaths among women is rising dramatically. From 1986 to 1996, tobacco-caused deaths among women rose from 9,000 to 16,000, or more than 75%.

From a public health perspective, cigarette taxes are not just a financial measure: they are a critical component of public health protection. This strategy is particularly important to disadvantaged populations, who increasingly carry the burden of the tobacco epidemic.[5]

[3] Health Canada, Information Sheet "Deaths in Canada due to smoking," January 18, 1999.
[4] Ibid.
[5] Statistics on smoking prevalence amongst different categories of the Canadian population come from documents on the Health Canada web site. Aboriginal smoking: http://www.hc-sc.gc.ca/msb/fnihp/tobacc_e.htm. By occupational category, economic status, gender/age: http://www.hc-sc.gc.ca/main/lcdc/web/bc/nphs/nphs16_e.html.

Smokers from all walks of life report that they want to quit.[6] The majority of them support taxes as part of a plan to help smokers quit.[7] Evidence suggests that the health of economically disadvantaged smokers is likely to benefit most from a tax-related price increase in cigarettes, as they are more likely to reduce the amount smoked as a result of price increases than wealthier smokers.[8]

Figure 2
Percentage of Canadians who smoke on a regular or occasional basis.

	% who smoke
• Men	31%
• Women	26%
• Young adult men (20-24 years)	39%
• Young adult women (20-24 years)	32%
Aboriginal Canadians	
• First Nations	56%
• Metis	57%
• Inuit	72%
Economic status	
• Lowest income adequacy	38%
• Highest income adequacy	21%
Education	
• Less than high school	33%
• College or University	23%
Occupation	
• Forestry workers	56%
• Unemployed > 12 months	50%
• Transportation workers	46%
• Mining, fishing, construction	43%-45%
• Involved in labour dispute	42%
• Teaching or medicine	18%-19 %

Source: See footnote #3

[6] According to the National Population Health Survey 1996/97, 49% of smokers are considering quitting within the next six months. Among the remaining 51%, it is very likely that a good number plan to quit in the longer term, or wish they didn't smoke but have become discouraged because of past smoking attempts. This is confirmed by data supplied by Imperial Tobacco (Letter to Physicians for a Smoke-Free Canada, June 30, 1999 from Brian Levitt, President and Chief Executive Officer, Imasco Ltd.), which shows a steady rise in the percentage of smokers who say they "intend to quit," from 38.2% in 1979 to 51.2% in 1991, the most recent year for which figures were provided.
[7] For example, Environics poll conducted for Health Canada, January 1999.
[8] Townsend, JL, Roderick P, Cooper J. Cigarette smoking by socioeconomic group, sex and age: effects of price, income and health publicity. British Medical Journal 1994; 309 (6959) 923-6.

Part 2

High Tobacco Taxes Discourage Smoking

Tobacco taxation is an essential policy tool to prevent nicotine addiction among teenagers and to reduce the death toll among people who are already addicted. This is the consensus view of health groups in Canada and in other industrialized countries. International organizations such as the World Bank recommend increased tobacco taxes. Despite its varying public comments, the tobacco industry itself, in its internal documents, acknowledges the effectiveness of cigarette taxes in reducing consumption and preventing tobacco use among teenagers. Indeed, the enormous energy that the industry devoted to obtaining a tax rollback in 1994 provides a clear indication of how it views this issue.

"There is no question that increasing taxes will cause a decrease in smoking. This point is perhaps best illustrated by the present situation in Canada..."

Philip Morris USA, "Political and Social Trends," Appendix to the 1991 Five-Year Plan, document number 2021342198 in State of Minnesota, et al. v. Philip Morris, Inc., et al.

Price Elasticity and Cigarettes

If the cost of bread skyrocketed to $1000 a loaf, very few people would eat sandwiches; on the other hand, if bakeries were giving it away for free, more bread would be eaten. This fundamental principle of economics is doubtless familiar to the vast majority of Canadians, though they may not have heard the technical term for it, *price elasticity of demand.* Simply put, when the price of a product increases, consumption decreases, and vice-versa. To put a figure on price elasticity, economists usually calculate the percentage drop in consumption for each 1% increase in price. Thus, if price elasticity for a product is -0.8, a price increase from $1 to $1.01 will lead to a 0.8% decline in consumption.

The price elasticity of demand depends on a host of factors, including the perceived importance of a particular product, the availability of alternative products, purchasers' income levels and brand image and so on. In the case of cigarettes, there is a complicating factor: nicotine is addictive. For many smokers, addiction obviously makes it harder to reduce consumption (or quit altogether) in response to increases in cigarette prices. However, "harder" does not mean "impossible" for all smokers. In a 1992 report, the U.S. Surgeon General pegged price elasticity for cigarettes at –0.47. Similar figures have been calculated in separate studies of the United Kingdom, Western Europe, Austria, Ireland, New Guinea and Canada.[9] Interestingly enough, an internal Philip

"Our Forecasting Group has determined that younger adult smokers, particularly younger adult male smokers, tend to be very price sensitive. The effect of a price increase on younger adult male smokers could be three to four times greater than on smokers in general, in terms of negative impact on volume."

Internal RJReynolds memo from Gregory Novak to J.W. Johnston and H.J. Lees, dated Sept. 20, 1982, available on RJR site as doc 50015 1647.

[9] See R.L. Andrews and G.R. Franke, "The determinants of cigarette consumption: a meta-analysis," in *Journal of Public Policy Marketing* 1991; 81-100. For Canada, see the Health Canada publication by N.E. Collishaw, M.J. Kaiserman and B. Rogers, *Monitoring Effectiveness of Canada's Health-Oriented Tobacco Policies*, 1990.

"…I have a report of a study done about ten years ago that is the only one that I know of that attempted to determine the price elasticity of cigarettes by age and sex. It is quite a good study, published as a National Bureau of Economic Research monograph… According to their calculations, the 20-25 year-olds, and particularly males 20 to 25, are much more sensitive to price than other groups, and the effect of price on this group works mainly through the propensity to start smoking."

Philip Morris in-house economist Myron Johnson, in a 1992 memo to a fellow executive discussing the impact of California's 1989 excise tax increase on sales of Marlboro Red brand cigarettes.

Morris marketing study in 1991[10] claimed that elasticity in the U.S. cigarette market was steadily increasing. It forecast that elasticity would hit –0.88 that year, which is higher than most published estimates.

Whatever the precise figure, even tobacco industry analysts agree on the following three things:[11]

- Short-term price elasticity for cigarettes is lower than for most major consumer products. In other words, because of nicotine's addictiveness, it takes a much bigger price increase, compared to other products, to trigger an equivalent drop in consumption.
- Long-term elasticity seems to be higher than short-term elasticity. In other words, a major tax hike may cause some smokers to quit in six months' time, in addition to those who quit right away.
- Young people are more price-sensitive than adults.

Youth Smoking and Cigarette Prices

At least from their parents' point of view, the economic behaviour of teenagers often seems irrational. Teens are known to spend enormous sums on brand-name, prestige items like running shoes or jackets, when much cheaper, no-name versions are available. The same behaviour has been noted with respect to cigarettes. In countries where discount, no-name cigarettes are widely available, teenagers generally stick with the heavily promoted, big-name brands, despite the extra expense.[12]

The reason is straightforward: teenagers are not just buying running shoes or cigarettes, they are also buying the brand imagery of Nike or Player's Racing. But young people do not have unlimited resources any more than their elders do. It makes a very real difference to their behaviour whether a pair of Nikes costs the same as three months' or three weeks' supply of Players.

There are at least three plausible explanations as to why teenagers are more price sensitive than adults with respect to cigarettes:

- Almost all adult smokers are addicted to nicotine. Many teenage smokers are not yet as seriously addicted.

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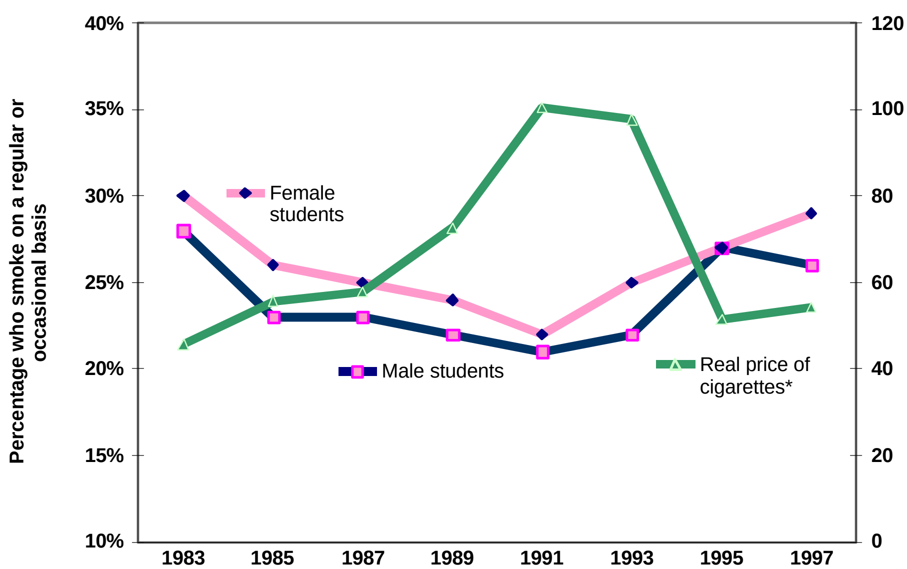
[10] Philip Morris U.S.A., *Price Elasticity in the Cigarette Industry*, document number 2045540114 in **State of Minnesota, et al. v. Philip Morris, Inc., et al**.
[11] See also "Analysis of cigarette price elasticities", February 1990, prepared by Policy Economics Group, KPMG Peat Marwick for internal use of Philip Morris USA, doc no. 2044982672.
[12] Frank J. Chaloupka, "How effective are taxes in reducing tobacco consumption?" in *Studies in Risk and Uncertainty*, edited by W. Kip Viscusi, Boston, MA, Kluwer Academic Publishers, forthcoming.

- Teenagers generally have less money than adults (though they also tend to have fewer financial obligations).
- All teenagers are *potential* customers for the tobacco industry. Adults in their 30s or 40s who have never used tobacco products are very unlikely to take up smoking. To the extent that high prices can discourage novice smokers, they thus affect only teenagers and young adults.

How big is this difference in price sensitivity between teenagers and adults? According to the 1992 U.S. Surgeon General's report on Smoking and Health in the Americas, the price elasticity of demand for cigarettes is more than three times higher among youth aged 12-17 (–1.40) than for adults aged 20-74 (-0.42).

A more recent (1998) analysis of U.S. National Health Interview Survey data from 1976 to 1993 confirmed this overall trend. It estimated price elasticity for those aged 18-24 to be –0.58, almost six times as high as for those aged 40 or more (–0.10).[13]

Figure 3
Youth Smoking in Ontario, Grades 7, 9, 11 and 13, 1983 – 1997



Sources: Expert Panel on the Renewal of the Ontario Tobacco Strategy, *Actions Will Speak Louder than Words,* , February 1999 (smoking data), Statistics Canada Consumer Price Index (for real price of cigarettes)
* Real price figures include only legally sold, i.e. non-smuggled cigarettes. Average real price in 1991 and 1993 was almost certainly somewhat lower, due to smuggling

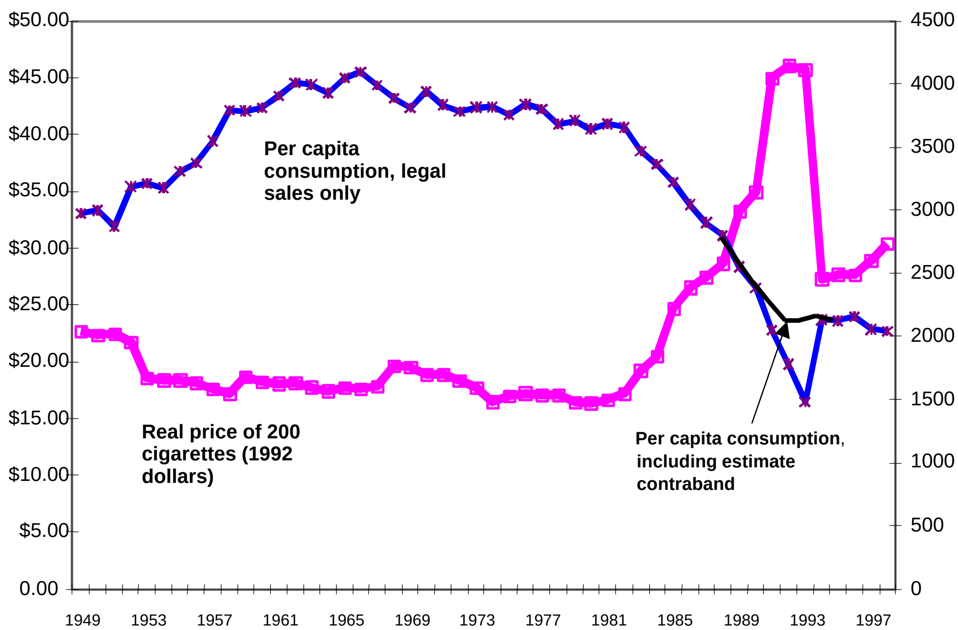
[13] "Response to Increases in Cigarette Prices by Race/Ethnicity and Age Groups — United States, 1976-1993," in *Morbidity and Mortality Weekly Report*, **47**:29, pp. 605-609.

Historical Experience

The historical record provides striking confirmation of the link between real cigarette prices and consumption. Researchers in Canada, Great Britain, France and South Africa have independently plotted consumption against real prices, and found that the two move in mirror image.[14]

Suggesting that the level of tobacco taxes has no measurable impact on the course of the tobacco epidemic, as the Canadian tobacco industry suddenly began doing in 1992 (see Chronology of key dates, p. 39) is as reasonable as suggesting that the law of gravity can be temporarily abolished.

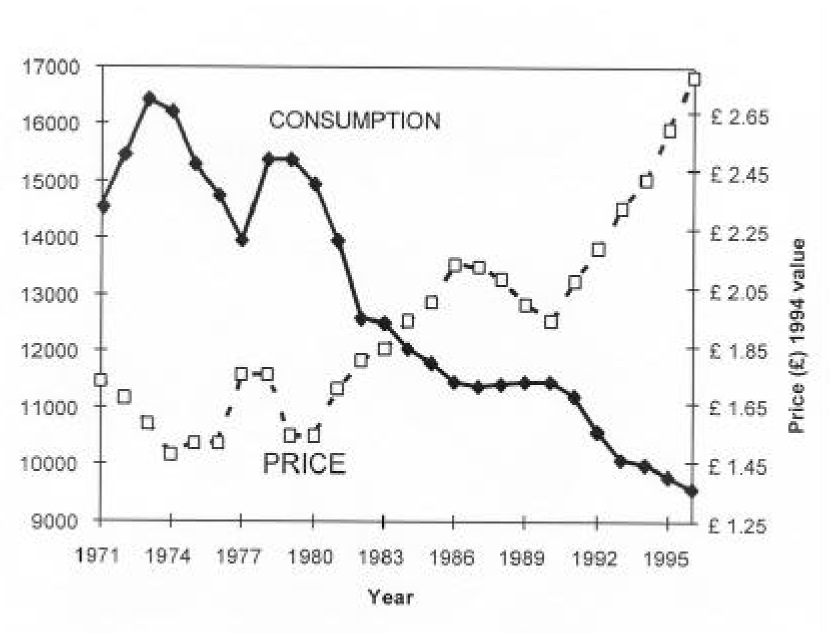
Figure 4A
Real Prices and Cigarette Consumption Canada, 1949-1998



Source: Real price calculated from Consumer Price Index. For calculation of per-capita consumption, see Appendix A, Table G.
NB: Price figures represent only legally sold cigarettes. In high-smuggling years, the effective price was lower.

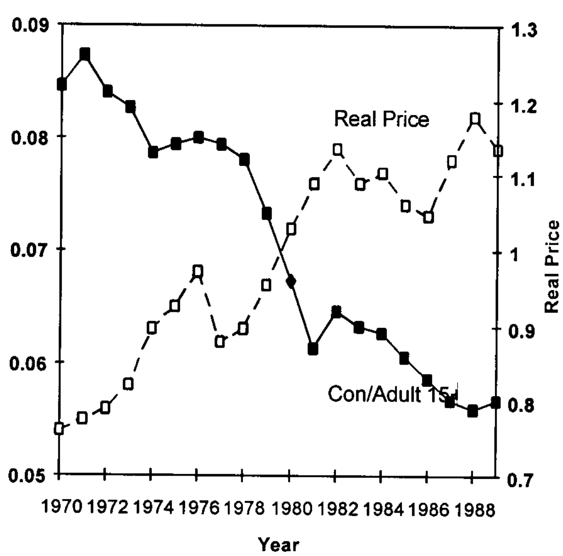
[14] Joy Townsend, "Price and consumption of tobacco," in *British Medical Bulletin* 1996; 52: 32-142.

Figure 4B
Real Prices and Cigarette Consumption United Kingdom, 1971 – 1996



Source: J.L. Townsend, "The role of taxation policy in tobacco control," *in I. Abedian et al., ed., The Economics of Tobacco Control: Towards an Optimal Policy Mix, 1998.*

Figure 4C
Real Prices and Cigarette Consumption South Africa, 1970 – 1989

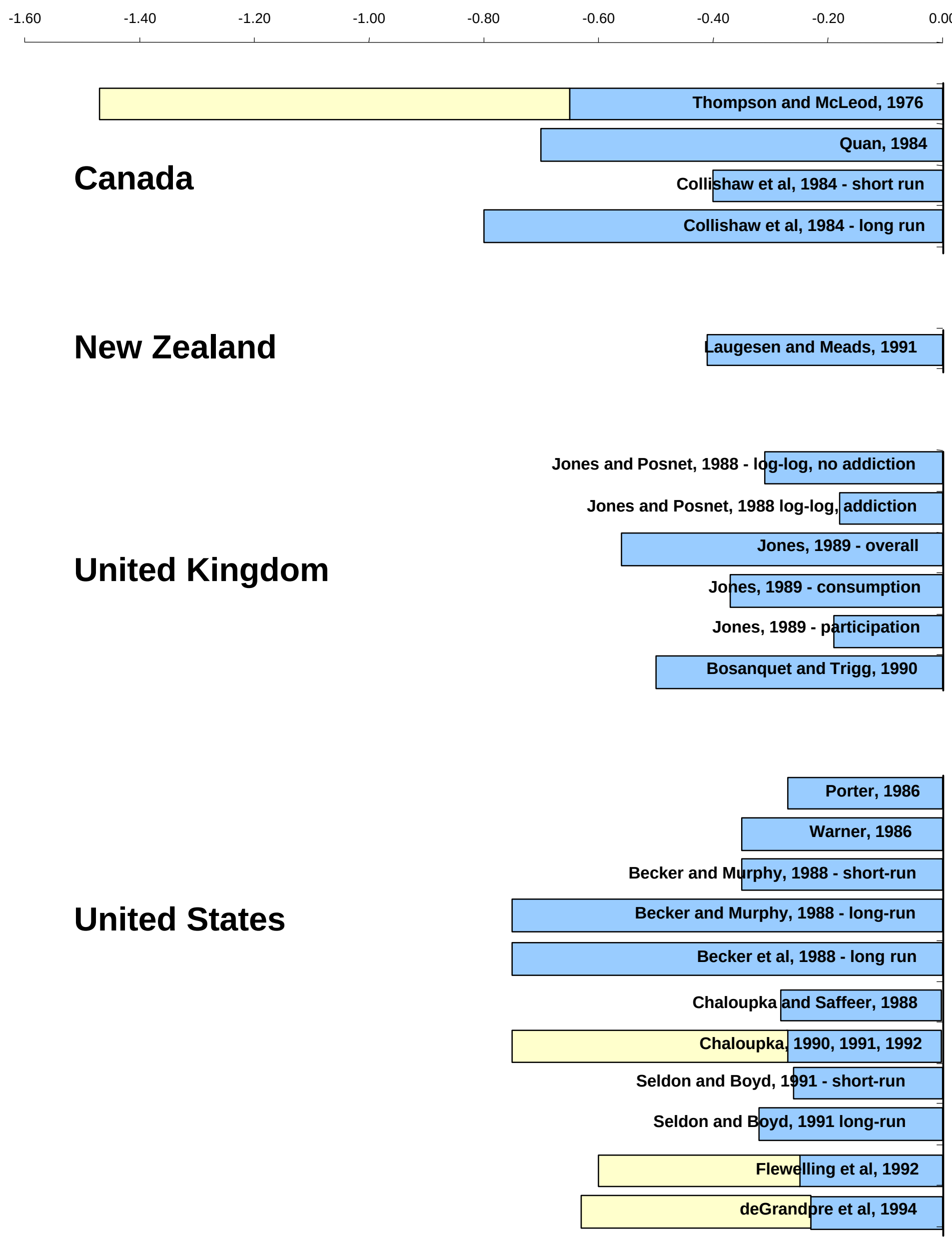


Source: J.L. Townsend, "The role of taxation policy in tobacco control," in I. Abedian et al., ed., *The Economics of Tobacco Control: Towards an Optimal Policy Mix*, 1998.

"The finance department's second announced objective has been to use taxes to reduce consumption. Let me make it clear -- there is no kidding anyone on this -- it works. That is, taxes do impact on consumption ... there is no question that consumption is down measurably over the last five years and there is no question in our minds that taxes have been a significant factor in that."

Bill Neville, President, Canadian Tobacco Manufacturers' Council, testimony before the House of Commons Legislative Committee F on Bill C-10, An Act to amend the Excise Tax Act and Excise Act, September 26, 1991, pp.3:5-3:6.

The Ontario Tobacco Research Unit reviewed the impact of price on tobacco use, and explored the relationship of addiction and other variables to price-response.[15] Their summary of several studies showed consistent measurable benefits to increasing the price of tobacco.



[15] , "Evaluating the Effects of Price on the demand for tobacco products : Review of methodologies and studies." Bernard C.K. Choi, Roberta Ferrence and Anita Pak, OTRU Literature Review Series No. 11, April 1997.

Health Impacts

There are approximately 7 million smokers in Canada, of whom 50% can expect to die of tobacco-related causes unless they succeed in quitting.

Applying the U.S. Surgeon General's estimate of price elasticity of –0.47, a 10% hike in Canadian cigarette prices (= $3 per carton, in the case of Ontario and Quebec) could be expected to reduce cigarette consumption by 4.7%. Some of that would come from smokers who cut back but who are unable to quit. Some would come from teenagers deciding not to take up smoking. Much of it would come from adult smokers finally succeeding in quitting.

Applying the U.S. Surgeon General's estimate for participation (smoking prevalence) elasticity (–0.31)[16], Canada could expect to have over 125,000 fewer smokers as a result of even a modest, 10% tax hike in the five low-tax provinces.

Even if the studies quoted by the Surgeon General were off by a factor of two, we are still dealing with a decision that, by itself, could prevent tens of thousands of tobacco-related deaths.

[16] I.e. the portion of price elasticity of demand related to people starting to smoke or quitting smoking, rather than adjusting how much they smoke.

Part 3

How Tobacco Products are Taxed in Canada

Several legal instruments are used to impose taxes on tobacco products and on their manufacturers and purchasers at the provincial, territorial and federal levels.

At the federal level, the following taxes are applied[17]:

The *Excise Act* imposes duties at various unit rates on domestically produced tobacco products. Excise duties are imposed on cigarettes, cigars, tobacco sticks, other forms of manufactured tobacco and raw leaf tobacco at the time these products are packaged for consumption.

The *Excise Tax Act* imposes excise taxes on both imported and domestic tobacco products at a unit rate, and at an ad valorem rate for cigars. These sales levies are imposed at the time the manufacturer delivers the goods to a purchaser, and must be remitted at the end of the month following the month the tax is imposed, with more frequent remittance by large manufacturers. An Excise Tax is also imposed on exports of tobacco, subject to certain exemptions.

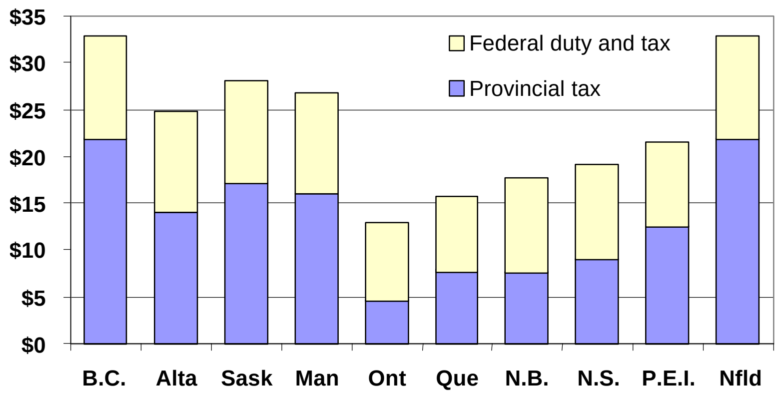
The *Excise Tax Act* also imposes a 7% Goods and Services sales tax on the sale of tobacco products.

The Customs Tariff imposes customs duties on imports equivalent to the excise duties that are imposed on domestically produced tobacco products.

Provincial and territorial government taxes on tobacco are usually imposed through provincial/territorial tobacco tax acts. Most provinces also impose sales taxes on cigarettes. The rates of taxation in these provinces have historically varied, but the disparities increased dramatically after 1994.

[17] The description of tobacco taxes is taken from Excise Tax Review, Finance Canada, February 1997.

Figure 5
Tobacco Taxes on Manufactured Cigarettes



Sources: See data in Appendix A, Table A. This does not include GST or provincial sales tax.

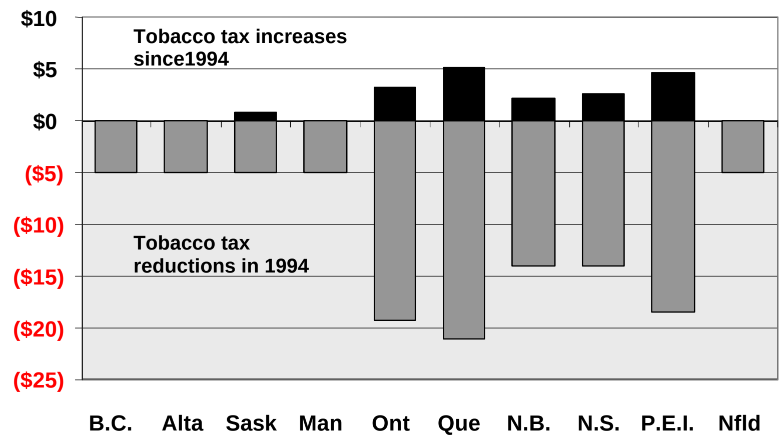
Before 1994, the federal excise tax and duties were the same in every Canadian province. On February 8, 1994, the federal government reduced excise tax rates on most tobacco products by a base amount in every province, and made subsequent additional cuts in Ontario, Quebec, New Brunswick, Nova Scotia and Prince Edward Island to match provincial tobacco tax reductions.

Since 1994, there have been only three rounds of tax increases in the 'low-tax' provinces, resulting in federal tax increases of the following amounts (these were roughly matched by provincial tax increases) :

- February 1995 — $0.60 (matched in Quebec only; the matching increase in Ontario was not implemented)
- November/December 1996 — $0.70 (Ontario, Quebec, New Brunswick, Nova Scotia, Prince Edward Island)
- February 1998 — $0.60 (Ontario, Quebec, Nova Scotia, PEI); $0.40 (New Brunswick)

These modest tax increases have done little to restore equal tax rates across Canada.

Figure 6
Taxes increases and decreases since 1994



Sources: See data in Appendix A, Table I.

Inflation Reduces Tobacco Taxes Invisibly

The unit-based taxes imposed on tobacco products do not increase automatically with changes in the cost of living in the same way that ad valorem taxes do. As a result, the absence of any tax increase on unit-based taxes during a period of even low inflation results in a *de facto* tax cut.

When cost-of-living adjustments are considered, taxes on tobacco products are 7% lower in the summer of 1999 than they were in the summer of 1994 in the five 'high-tax' provinces. In the five 'low-tax' provinces, the real price of tobacco products has increased by only a modest 0% to 8% (see Figure 8).

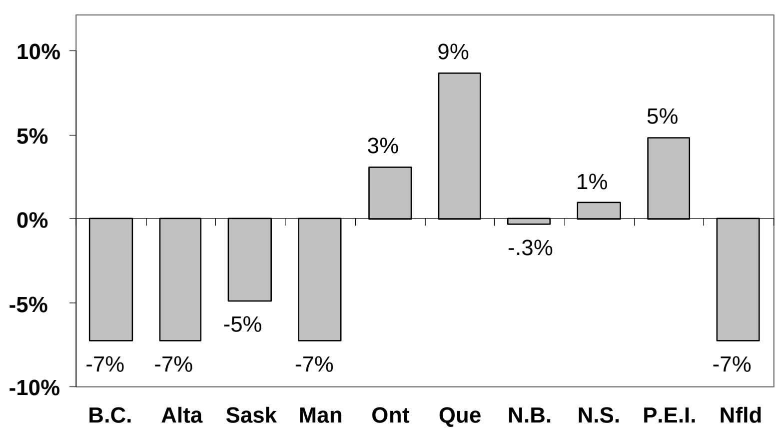
The largest increase in taxes since 1994 has been in the province of Quebec, where joint federal-provincial tax increases have raised the price of cigarettes by $5.08 per carton. In Prince Edward Island, the increase has been $4.60 per carton, in Ontario only $3.20 per carton. New Brunswick and Nova Scotia trail at $2.20 and $2.60 respectively. Among the provinces which did not reduce taxes in 1994, Saskatchewan is the only one to impose a further tax increase ($0.80 per carton).

Figure 7
Tobacco tax (federal and provincial) increases and decreases in Canadian provinces, 1994-1998

Province	Amount of 1994 tax rollback	Post-rollback tax increases, (to Sept. 1/99)	Tax increases (decreases) adjusting for inflation	Percentage of real tax increase since 1994	Year in which nominal taxes return to 1993 levels	Year in which real taxes return to 1993 levels
BC	$ 5.00	—	($2.95)	-7%		
AB	$ 5.00	—	($2.33)	-7%		
SK	$ 5.00	$0.80	($1.69)	-5%		
MB	$ 5.00	—	($2.49)	-7%		
ON	$19.20	$3.20	$0.95	3%	2032	2179
PQ	$21.00	$5.08	$2.77	9%	2022	2062
NB	$14.00	$2.20	($0.10)	-.3%	2034	
NS	$14.00	$2.60	$0.30	1%	2024	2578
PE.	$18.50	$4.60	$1.83	5%	2021	2114
NF	$ 5.00	—	($2.84)	-7%		

Sources: See data in Appendix A, Table I.

Figure 8
Real change in cigarette taxes since the 1994 tax roll-back.



See data in Appendix A, Table I.

Discount Pricing and Low taxes on "Roll-Your-Own" Cigarettes and "Tobacco Sticks"

Tobacco products are taxed on a per-unit basis, but not all tobacco units are equally priced. Manufactured cigarettes are taxed at much higher rates than are tobacco 'sticks' and roll-your-own ("fine cut").

In the case of roll-your-own tobacco, taxable units are defined in terms of weight. In recent years, tobacco manufacturers have actively marketed new forms of such tobacco that are designed to provide more cigarettes per weight and, consequently, more cigarettes per tax dollar paid. These 'expanded' forms of tobacco have reduced the amount of tobacco needed in a roll-your-own cigarette from 1 g/cigarette (in the 1980s) to 0.7 g/cigarette (in the early 1990s) to 0.45 g /cigarette today for at least one brand (Rockport). Because taxes have not been adjusted to respond to the new 'expanded' tobaccos, the cost of roll-your-own cigarettes has fallen dramatically.

Tobacco sticks are an innovation developed by tobacco manufacturers simply to exploit tax loopholes. The market share of tobacco sticks has grown steadily: 1.3% in 1994, 2.1% in 1995, 2.6% in 1996, 2.8% in 1997 and 3.8% in 1998.[18] This growth in market share — which has occurred simply because of government failure to close the loophole — has decreased government revenue and impeded health objectives.

In late 1997, Imperial Tobacco began marketing the Player's Insta-Kit. This product is a fully manufactured cigarette except that it is up to the smoker to place the filter overwrap over the filter. Although some provinces have ruled that this product is a cigarette, Revenue Canada has ruled that the product is a tobacco stick and thus eligible for reduced taxation. Rothmans, Benson & Hedges initially commenced proceedings in the Federal Court of Canada against Revenue Canada to overturn the ruling. After the Court ruled that it was premature to bring the claim to court, Rothmans, Benson & Hedges then

[18] Imasco Ltd., 1998 Annual Report, p.25; Imasco Ltd., 1996 Annual Report, p.25.

launched its own competitive product similar to the Player's Insta-Kit, the Rockport Presto-Pak. This loophole exploitation could be ended if the tax rate on tobacco sticks was equalized with the tax rate on cigarettes.

Researcher Josie d'Avernas, Senior Consultant with the Program Training and Consultation Centre in Kitchener, Ontario, has found that teenagers are purchasing Presto Paks:

> "Our organization, the Program Training and Consultation Centre, recently completed a series of workshops to train community workers in smoking cessation strategies for teens. Part of each workshop included a panel of local teenagers who smoke, to get a first-hand discussion about what works and what doesn't work to motivate and support teens in smoking cessation.
>
> It concerns me greatly that at each workshop (there were three in total) low prices for tobacco were mentioned by teens as something that makes it hard to get serious about quitting smoking. Agreement was universal that higher prices would be one of the most effective things we could do to motivate smoking cessation.
>
> It was also apparent that teens were aware of the existence of Presto Packs. Indeed, they reported knowing people who bought them, or bought them themselves, because of their lower price as compared to cigarettes.
>
> This is an issue of great concern that I feel compelled to draw to your attention. It is one more gaping hole that the tobacco industry has punched into our tobacco control efforts. If these Presto Packs continue to be priced significantly lower than cigarettes, they are certain to draw a large youth market. This must be stopped."[19]

Figures 9A and 9B show the comparison between tax rates for cigarettes, tobacco sticks and fine-cut units at both the federal and provincial levels. As indicated by the figures, it is really the federal government that is responsible — far more than the provinces — for

[19]Josie d'Avernas (Program Training and Consultation Centre), letter to Rob Cunningham (Canadian Cancer Society), February 17, 1999.

the failure to equalize tax rates between cigarettes and tobacco sticks. Adding GST and provincial sales taxes further widens the price gap between these categories of tobacco products.

Figure 9A
Federal Tobacco Taxes on 200 cigarettes/sticks/fine-cut units

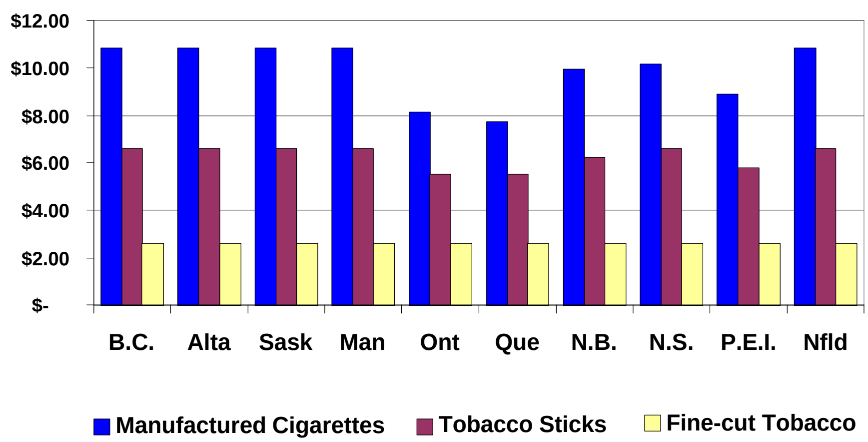
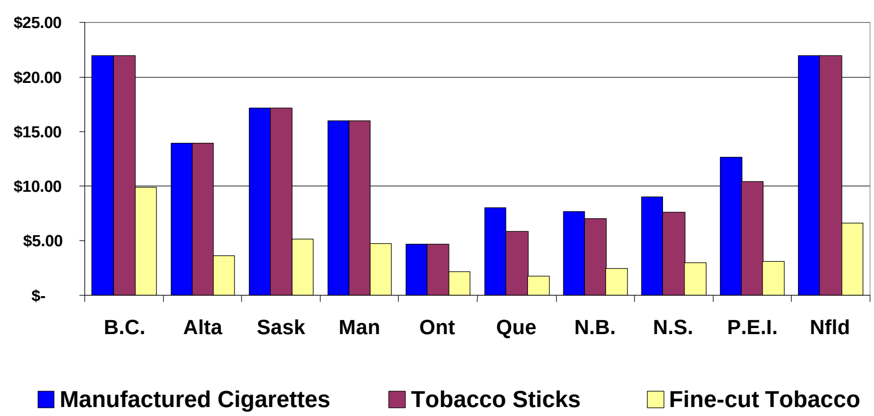


Figure 9B
Provincial Tobacco Taxes on 200 cigarettes/sticks/fine-cut units



Sources: See data in Appendix A, Tables A, B, C.

Manufactured cigarettes vary in price from 15 cents each (in Ontario) to 27 cents each (in Newfoundland). Tobacco sticks range from 12 cents each (in Ontario) to 23 cents each (in Newfoundland). Roll-your-own cigarettes can be made for as little as 6 cents each (in Ontario) to 9 cents each (in British Columbia).

There is no public interest rationale for providing lower tax rates on some forms of tobacco than on others, or for providing any form of 'cheap' cigarette. And yet the tobacco tax policies of many governments do exactly this. Availability of lower-priced tobacco products deters quitting and facilitates increased daily consumption.

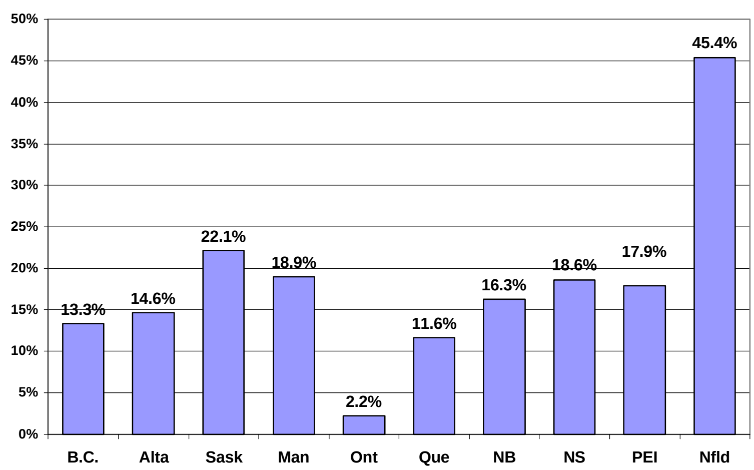
Fine cut and tobacco sticks make up a considerable portion of the market in many provinces, as indicated in Figure 10. The market share for these cigarette alternatives tends to be greatest where the price differential between cigarettes and fine cut is greatest.

Current tax rates for manufactured cigarettes, tobacco sticks and fine-cut tobacco are provided in Appendix A, Tables A to C.

"U.S. Cigarette Sales continue to fall…. With the price of an average pack of cigarettes going from roughly $1.90 to $2.70 per pack over the last 18 months, we have anticipated consumption to be down by double digits. In 1993, volume was 460 billion units. We project this could drop to between 410 billion and 420 billion units in 1999."

John C. Maxwell
"The Maxwell Report USA", Tobacco Reporter, May 1999

Figure 10
Sales of fine-cut tobacco and tobacco sticks as percentage of total tobacco market, by province, 1997



Sources: Wholesale shipment data provided to Health Canada by tobacco manufacturers and released under Access to Information.

Canada's tobacco taxes: in the OECD basement

There is a natural tendency in Canada to compare tax rates with those in the United States. In issues of tobacco taxation, this has had unfortunate consequences, as the tax levels in the U.S. have been among the lowest in the developed world.

The 1998 master settlement agreement between the U.S. State Attorneys General and the U.S. tobacco industry resulted in payments to government which were passed on to smokers in the form of price increases. Strictly speaking, this is not a tax, but has had an equivalent, beneficial health impact by significantly reducing sales of tobacco products.

The court settlement and subsequent price increase have also resulted in cigarettes being more expensive throughout the United States than in Central Canada for the first time in decades, if ever. Canada's cigarette prices and tobacco taxes are much lower than in most other developed countries, as indicated in Table 1.

Table 1
Average Retail Cigarette Price and Total Taxes per Pack (Canadian Dollars/Pack), Selected Countries, April 7th, 1999

Country	Price	Tax	Tax Incidence
United Kingdom	9.75	8.39	86%
Denmark	8.13	6.65	82%
Ireland	8.09	4.85	71%
Sweden	7.84	5.51	70%
Finland	7.46	5.68	76%
United States (Highest – Anchorage, Alaska)	6.92	2.85	41%[20]
Canada (Highest - NF)	**6.66**	**4.98**	**75%**
France	5.97	4.51	76%
Germany	5.43	3.84	71%
Belgium	5.28	3.94	75%
Netherlands	4.90	3.52	72%
Austria	4.69	3.47	74%
United States (Lowest – Kentucky)	4.52*	0.51	11%[21]
Italy	3.86	2.88	73%
Canada (Lowest – ON)	**3.79**	**2.10**	**55%**
Greece	3.59	2.61	73%
Portugal	3.52	2.80	80%
Spain	2.43	1.77	73%

Notes:
All figures given for equivalent of 25-cigarette pack in most popular price category.
Tax incidence refers to the portion of the total retail price made up of applicable taxes and fees, including excise, sales, VAT, etc. Exchange rates as of April 7th, 1999.
Sources: *Non-Smokers' Rights Association, European Union, Alaska Dept. of Revenue, Tobacco Institute.*
**US prices do not include manufacturers' price increase of August 17th, 1999, equivalent to $0.41 per pack of 25 at April exchange rate.*

[20] Many American states, including Alaska, allow municipalities to impose local taxes on tobacco. Note that U.S. prices include approx. 84¢ Canadian per pack to cover the cost of the November 1998 settlement with State Attorneys General. If this sum were considered a tax, total tax incidence in Anchorage would be 53%.
[21] U.S. prices include approx. 84¢ Canadian per pack to cover the cost of the November 1998 settlement with State Attorneys General. If this sum were considered a tax, total tax incidence in Kentucky would be 30%.

Prices in the United States will continue to rise, increasing the room available for tax increases in Canada. For example, iIn late August 1999, manufacturers increased their price to wholesalers by 18¢ per pack of 20, for a retail price increase of more than CDN$ 3.00 per package once sales taxes are factored in. This further widens the gap between Canadian and American cigarette prices.

Recommendations

The federal government should move as quickly as possible to restore cigarette taxes to levels which promote health and prevent disease. Desirably, they should work with the provinces to co-ordinate increased tax levels in all jurisdictions. If there is no immediate agreement with the provinces, the federal government should be prepared to move quickly and unilaterally.

- Cigarette taxes should increase by at least $10.00 per carton ($5.00 federal, $5.00 provincial) in Ontario, Quebec, New Brunswick, Nova Scotia and Prince Edward Island.

- If provinces are unwilling to make a joint increase with the federal government, the federal government should set aside the "gentleman's agreement" and move quickly to act alone to raise tobacco taxes.

- From a public health perspective, a single, major tobacco tax increase is preferable to a series of small tax increases, since it is more likely to have a significant impact on consumption and youth smoking prevalence."

- Ontario taxes should be increased by a further $1.00 per carton (50¢ federal, 50¢ provincial) to remove the current differential between Ontario and Quebec taxes.

- There should also be a federal cigarette tax increase in the four Western provinces, in Newfoundland and the territoreis of at least $3.00 per carton.

- In Alberta, there should be an additional provincial increase, given that tobacco taxes are significantly lower than in neighbouring B.C. and Saskatchewan.

"That in the opinion of this House, the government should (a) restore the tax on cigarettes to the level existing at January 1, 1994; (b) increase the rate of tax on tobacco sticks so that the tax rate on tobacco sticks is equal to the tax rate on cigarettes; (c) increase the rate of tax on fine cut tobacco, smokeless tobacco and leaf tobacco intended for retail sale so that the tax on one gram of tobacco is equal to the rate of tax on one cigarette; and (d) improve the tax-paid markings that are required on packages of tobacco products and apply the incremental revenue to health care."

Reform M.P. Dr. Keith Martin, Private Member's Motion M337, tabled February 17, 1998.

Restoring balance

Tax policy should be used to ensure that all forms of cigarettes (manufactured, 'sticks' and roll-your-own) are equally priced, and that benefits to public health resulting from expensive cigarettes are not undermined by cheap alternatives.

- The loopholes allowing lower taxes for tobacco sticks and roll-your-own tobacco should be eliminated.

- The tax rate on a tobacco stick and on the quantity of roll-your-own needed to make a cigarette (now less than 1g) should equal the tax rate on one cigarette.

- Similarly, the loophole for raw leaf tobacco and for smokeless tobacco should be eliminated. The tax on one gram of raw leaf tobacco and on one gram of smokeless tobacco should be equalized with the tax rate on one cigarette, as is the case in Western Canada and Newfoundland.

Part 4

Cigarette Smuggling — Myths and Realities

Fear of smuggling remains the single biggest obstacle to implementing a health-based tobacco taxation policy in Canada's five low-tax jurisdictions. This fear is likely the product of several years of very deliberate public relations efforts by the tobacco industry — efforts that can safely be described as *myth making.*

The mythical view of cigarette smuggling, as advanced by tobacco manufacturers, runs something like this: through the 1980s and early 1990s, Canadian governments, urged on by health agencies, increased cigarette taxes past the point that consumers (i.e. smokers) were willing to tolerate. Some smokers began crossing into the United States to buy cigarettes, taking advantage of the huge tax differential between the two countries. Realizing there was a tremendous market, small-time smugglers, primarily in the Akwesasne area, began running larger and larger quantities of US-bought cigarettes across the border. Tobacco companies were powerless to stop the spontaneous tax revolt by millions of otherwise law-abiding smokers. Finally, faced with a massive black market, governments did the only sensible thing and rolled back tobacco taxes. Fortunately, claims the Canadian tobacco industry, tax levels have no influence on the "adult choice" of whether or not to smoke.

By force of repetition, this mythical view has become accepted by many as the definitive interpretation of the 1992-94 "smuggling crisis." Yet it ignores several significant facts:

Fact: Prices in seven of 12 Canadian jurisdictions came down by only $5 per carton in 1994. High taxes have been sustained in Western Canada and Newfoundland. If smuggling were a spontaneous tax revolt by individual smokers, why has there been no apparent, significant erosion of legitimate sales due to smuggling into these regions?

Fact: Several countries have higher cigarette taxes than Canada's high-tax provinces, including Australia, Great Britain, Ireland, Norway, Sweden, Finland and Denmark.

Fact: In Europe, smuggling tends to be worse in to Southern Europe than in to Northern Europe, though prices are generally *lower* in the South than in the North.[22]

[22] See "Cigarette smuggling in Europe: who really benefits," by Luk Joosens and Martin Raw, in *Tobacco Control*, 1998;**7**:66-71.

"After the tax cut that was supposed to break this vicious cycle, both levels of government were again denied additional billions in revenue while the companies recorded excellent profits. With the help of smuggling and lower prices during these years, tobacco use increased, especially among the most vulnerable groups -- and in particular, young people. This did not, however, prevent the industry from proclaiming its "right" to promote its products.

These recent revelations have destroyed, once and for all, the image of innocence, the pure-as-driven-snow image, that the tobacco industry has always drawn for itself, and paid for with its own advertising. It's time now to move on to an in-depth inquiry into the practices of the tobacco industry with respect to both the manufacturing and marketing of its products. Compared to the United States, Canada has fallen way behind. It's time to catch up."

Jean-Robert Sansfaçon, "Respectable accomplices" Le Devoir, January 7, 1999 (editorial, translation)

Fact: Cigarette prices in U.S. border states are now considerably higher than in Ontario and Quebec. Indeed, Central Canada now has lower prices than anywhere in the United States. Why has no smuggling been noted flowing from Canada to the U.S.?

Fact: Tobacco manufacturers benefited financially from smuggling. More than 90% of smuggled cigarettes in Canada originated in Canadian factories and were exported to the United States, only to return to Canada as contraband. Manufacturers earned their profit whether or not product was seized by law enforcement officials. The availability of contraband encouraged consumption while pressuring governments to reduce tobacco taxes.

Fact: The tax rollback of 1994 halted the long-term downward trend in per capita cigarette consumption in Canada, and resulted in major jumps in youth smoking in Central Canada. (See Part 5.) Teenagers and young adults provide the overwhelming source of new smokers, and are therefore crucial to the tobacco industry's long-term sales and profits. The Canadian tax cut was also a major argument for the American industry, as it lobbied heavily against cigarette tax increases in that country subsequently.

Recently, evidence has emerged of direct corporate involvement in contraband activity. Convictions have been obtained at both the corporate and managerial levels. Though police investigations in both Canada and the United States are on-going, they provide another reason to be sceptical of the industry's good faith on the smuggling issue. At the very least, the tobacco industry has a significant financial interest in promoting its particular view of smuggling's causes and the available policy solutions.

The Historical Context

Until the early 1980s, there was no discernible upward trend in the real price of cigarettes in Canada. What tax increases there had been since the 1950s had been eaten away by inflation. And thanks to rising incomes, cigarettes were actually far more affordable to Canadians than in the early 1950s. In the early 1980s, Canada had the highest level of per capita cigarette consumption in the world.

Health groups discovered the benefits of tobacco tax increases at about the same time as Canadian governments stepped up their search for new sources of revenue. Increased cigarette taxes could be relied upon to cut smoking, especially among young people, bring in extra revenue, and be popular with the public. The result was a slow but accelerating rise in cigarette prices, and a dramatic drop in cigarette consumption and youth smoking. By 1991, according to government surveys, only 23% of teens aged 15 to

19 were current smokers[23] — down from 43% in 1981.[24] In a single decade, Canada had almost halved youth smoking rates as it moved to put cigarette prices on a par with those in Northern Europe.

Not surprisingly, these tax increases caused alarm amongst Canada's tobacco manufacturers, and at their corporate headquarters in the United States and Europe. At first, the industry responded publicly with its usual boilerplate arguments[25]:

- Tax increases cause inflation.

- Tax increases cause a decrease in consumption, leading to direct job losses in the tobacco industry and indirect losses amongst suppliers. "The unprecedented series of tax increases poses a significant threat to the long term well-being of this important Canadian industry and its suppliers, customers and shareholders," complained Rothmans Ltd. in its 1983 annual report.

As tobacco companies were doubtless annoyed to discover, these arguments carried little weight with Canadian governments, who correctly realized the tremendous public health gains associated with decreased consumption. The 1991 federal tax increase of $6 per carton appears to have triggered a change in strategy, with a new emphasis on the dangers of smuggling.

In reaction to the federal tax hike, the tobacco lobby launched a major advertising campaign suggesting that then-Finance Minister Michael Wilson "wants you to step outside for a cigarette" — step outside to the United States, that is. At the same time, Canadian manufacturers began increasing their cigarette shipments to the United States. There has never been a market for Canadian-style cigarettes among American smokers, who are used to tobacco blends with a notably different taste. Nor have U.S. cigarettes ever achieved significant market penetration in Canada, with a longstanding market share of less than 1%. As a result, the only legitimate reason to ship cigarettes south would have been to cater to Canadians travelling in the United States.

In the early 1990s, however, there were, increasingly, some pressing **illegitimate** reasons to ship cigarettes south. Various criminal groups had discovered there was money to be made by transporting cigarettes across the border into Canada for sale on the black market. The Mohawk community of Akwesasne, positioned on the Canada-U.S. border,

"This week, an affiliate of RJR Reynolds Tobacco International pleaded guilty and was fined $15 million for helping smugglers slip exported Canadian cigarettes back into Canada through a Mohawk reserve that straddles the border near Cornwall, Ont….This conviction has real significance. Now we know how the tobacco industry can behave. A company has been found to have participated in actions that broke Canadian law and subverted the tax system.

Perhaps we shouldn't be surprised at such behaviour from an industry with a history of deception in the way its products are developed, manufactured and marketed. Perhaps we shouldn't be surprised when we know how actively Canadian cigarette manufacturers co-operated with smugglers ¾ by increasing their exports from 500 million cigarettes a year in the late 1980s to almost 20 billion before Canada cut its tobacco taxes.

Still, it's reassuring to know that criminal activity has been exposed and that a little more moral ground has been yanked from under the feet of the tobacco industry. If Canada decides to raise taxes again, the cigarette manufacturers won't be taken seriously if they warn about smuggling."

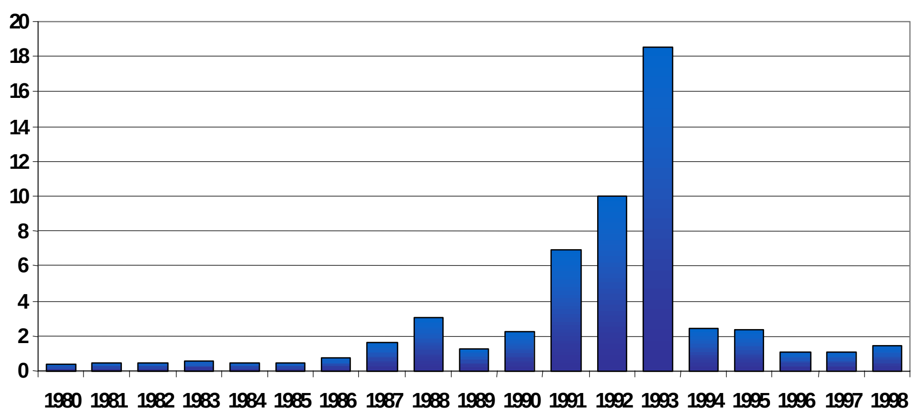
Montreal Gazette, "Caught in the act," editorial, December 26, 1998.

[23] Statistics Canada, General Social Survey, 1991.
[24] Statistics Canada Labour Force Survey, 1981.
[25] See also "Key Area Paper: Excise Taxation of Tobacco Products," a 1992 document from British American Tobacco, which controls Canada's Imperial Tobacco, produced as document 699138223 in the **State of Minnesota et al. v. Philip Morris, Inc., et al.** case. This paper lists arguments to be used to fend off tax increases and lobby for tax rollbacks.

was a particular focal point. A long-running dispute about gambling had already led to a militarization of the community and tense relations with New York State authorities, making it a difficult area for police and customs authorities to intervene.

Canadian cigarette companies have never denied that most of the merchandise shipped south during this period was destined to be re-imported as contraband. But they denied dealing directly with criminals. Limiting their "exports" to the United States would simply mean replacing Canadian-made contraband with American-made contraband, they claimed.[26] This last argument ignored Canadian smokers' dislike for American-style cigarettes, and the simple fact that American brands, had they been smuggled in large quantities, would have been much more obviously visible as contraband. Further, Canadian companies would quickly have taken action to address smuggling that reduced their collective market share, such as smuggling of new brands with Canadian-style tobacco blends.

Figure 11
Canadian Cigarette Exports (in billions) to the United States, 1980-1986



Sources: Statistics Canada, Exports by Commodity, Catalogue 65-004, December issues, 1980 – 1998. See Appendix A, Table J.

[26] "If there's smuggling, we're unapologetic that it should be Canadian cigarettes," said industry lobbyist Bill Neville. Quoted in "Threats derailed tobacco tax. Companies warning led Ottawa to ease 'war on smugglers,'" in *The Globe and Mail*, May 22nd, 1992, pp. A1, A6.

Criminal Investigations

As has since emerged in several American criminal cases, the tobacco industry did more than simply fill orders for Canadian cigarettes placed by U.S. wholesalers. By early 1992, for example, truckloads of RJR-Macdonald cigarettes were being sold directly to an organized smuggling ring in upstate New York; one long-time executive with RJR-Macdonald and its U.S. parent, R.J. Reynolds, recently pleaded guilty in connection with this criminal activity.[27]

In late 1992, R.J. Reynolds set up a subsidiary, Northern Brands International, specifically devoted to selling Export "A" cigarettes in the United States. On Dec. 22, 1998, following an investigation by U.S. federal authorities, Northern Brands International pleaded guilty to evading U.S. excise taxes on Export "A" cigarettes destined for the Canadian black market. The company was convicted and fined US$15 million. [28] Police investigations into RJR's role continue.

Criminal investigations of tobacco companies have not been limited to RJR-Macdonald brands. In 1995, U.S. authorities raided the headquarters of tobacco company Brown & Williamson, the U.S. sister company of Imperial Tobacco, looking for evidence of corporate involvement in smuggling Canadian cigarettes back from duty-free warehouses in Louisiana. This led to the 1997 guilty plea and conviction of Michael Bernstein, Brown & Williamson's East Coast region account manager.

More recently, the largest U.S. tobacco company, Philip Morris, disclosed in a Securities and Exchange Commission filing that it too is under investigation by American authorities for alleged involvement in smuggling along the Canada-U.S. border.[29] Philip Morris International owns 40% of Canada's Rothmans, Benson & Hedges.

In 1992, the Canadian federal government did make one serious attempt to cut off cigarette smugglers' supply lines at the source, i.e. the factory gates of Canada's big three tobacco manufacturers. On Feb. 12 of that year, the government imposed an $8 per carton export tax, designed to make smuggling uneconomical. Shipments to the U.S. dropped steeply.

"700 RCMP officers will be dedicated to anti-contraband operations, double the current level…
Our stepped up enforcement measures will apply everywhere in Canada. The police will seize contraband and lay charges wherever it is appropriate to do so. My message is simple: anyone participating in the contraband trade in any capacity whatsoever is breaking the law. They will be subject to the full range of sanctions and penalties provided by the law".

The Honourable Herb Gray,
Solicitor General of Canada
News conference,
February 8, 1994.

[27] United States of America v. Leslie Thompson, a/k/a Les Thompson, Criminal Action No. 99-CR-93 (TJM), Plea Agreement, dated March 25th, 1999.
[28] United States of America v. Northern Brands International, Inc., Criminal Action No. 98-CR-, Plea Agreement in a Criminal Case, dated Dec. 22nd, 1998.
[29] Philip Morris Companies Inc., Form 10-Q, Quarterly Report to the Securities and Exchange Commission, filed November 16, 1998.

"In February 1992, the Canadian government imposed a $8 per carton tax on cigarette exports in the hope of reducing, if not eliminating, cigarette contraband. However, the tax was repealed in April 1992 as a result of industry pressure involving manufacturing facility closings, moving export production overseas and buying tobacco abroad.

When the export tax was announced. RJR Macdonald moved make/pack equipment from its Canadian production facility to Puerto Rico and began manufacturing Canadian Export A brand cigarettes. This brand accounts for over 85% of the company's total manufactured cigarette volume. While the Puerto Rican made volume is unknown, it is believed to be small. The Puerto Rican volume is intended for sale outside of Canada, however, some of it seems to have found its way back into the country. Even though the export tax was repealed, Puerto Rican production has continued."

Canadian Cigarette Industry Review, 1993. Philip Morris p. 2045680323

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Manufacturers responded with a massive lobbying effort, including threats to move their production facilities out of the country in order to render the export tax meaningless.[30] Less than two months later, the government buckled under the pressure and repealed the tax, in return for industry promises to co-operate in fighting smuggling. Despite these commitments, Canadian tobacco manufacturers continued to increase their shipments to New York state. In 1993, the industry stepped up public relations efforts to obtain a major tax rollback.

In a bizarre reversal of its past position in Canada, the tobacco industry began publicly claiming that higher cigarette taxes have no effect on smoking rates. This denial of normal economic principles was backed up with a study specially commissioned by the industry.[31] Meanwhile, tobacco industry lobbyists in the United States, attempting to fend off a proposed federal tax increase in that country, continued to maintain exactly the opposite.[32]

The industry also used every opportunity to highlight the extent of smuggling, for example by commissioning forensic accountants to produce estimates of the market share of contraband cigarettes. The tobacco industry's spin was clear: smuggling was out of control and caused by overly high tax rates imposed by unrealistic politicians.

In January 1994, Quebec news was dominated by an apparently spontaneous tax revolt by convenience store owners, who began openly selling smuggled cigarettes to push for a tax rollback. *La Presse* soon uncovered close links between the "tax revolt" organizers and the Association des détaillants en alimentation (ADA), a group partially funded by the tobacco industry and run by a former industry public relations employee. A representative of the Canadian Tobacco Manufacturers' Council was present at a meeting where "spontaneous" illegal sales were planned.[33]

Though the story was front-page news, the Quebec and federal governments decided to go ahead with a major tax rollback in early February. Including sales taxes, the net result was to reduce the real price of cigarettes in Quebec from $47 to $23 per carton.

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[30] See, for example, Imasco's 1991 annual report, published in 1992 during the period when the export tax was in effect. In reference to the "misguided" tax, CEO Jean-Louis Mercier commented in his report: "We do not condone smuggling but we are prepared to take whatever steps are necessary to protect the company's interests in legitimate export markets. Ultimately, this could involve transferring some production outside Canada." (p. 6 of annual report.)
[31] Paul M. Jacobsen and M.C. McCracken, *Smoking Trends in Canada: An Analysis of the Data*, February 1993 Informetrica study.
[32] See for example "The Facts about Tobacco Taxes and Jobs," entered as Philip Morris document no. 2044720151 in the **State of Minnesota et al. v. Philip Morris, Inc., et al.** case.
[33] "Les Épiciers ont créé de toutes pièces le mouvement des 'dépanneurs généreux," in *La Presse*, Jan. 27, 1994, pp. A1-A2. See also: "Retailers group links protesters to tobacco firms," *Globe and Mail*, Jan. 28, 1994, p. A4.

Fearful of a possible surge in inter-provincial smuggling, Ontario, New Brunswick and PEI soon followed with their own cuts. Nova Scotia held out a few months longer, but eventually cuts its taxes also. Western Canada, Newfoundland and the two territories held the line. In contrast, the Northwest Territories increased its tobacco taxes in 1994 by $5 per carton, to replace the $5 per carton federal decrease.

At the time of the federal tax rollback, the government restored the 1992 tax on tobacco exports, albeit with new exemptions, and imposed a surtax on tobacco company profits, both of which are still in effect.

In the opinion of PM Inc. and PMI, increases in excise and similar taxes have had an adverse impact on sales of cigarettes. Any future increases, the extent of which cannot be predicted, could result in volume declines for the cigarette industry, including PM Inc. and PMI, and might cause sales to shift from the premium segment to the discount segment.

Cigarette company Philip Morris, 10-Q filing with the U.S. Securities Exchange Commission, Aug. 12, 1999, p. 30.

The Disappearing, Re-Appearing Price Differential

Just as Canadian public health was suffering its biggest setback in decades, with the tax rollback, the tobacco industry in the United States came under unexpected attack from a new quarter. In 1994, the State of Mississippi filed a lawsuit against cigarette manufacturers to recover health costs incurred to treat smokers for tobacco-induced disease. This set off a series of lawsuits across the United States, forced the release of tens of millions of hitherto secret industry documents, and also made it politically much easier to raise excise taxes.

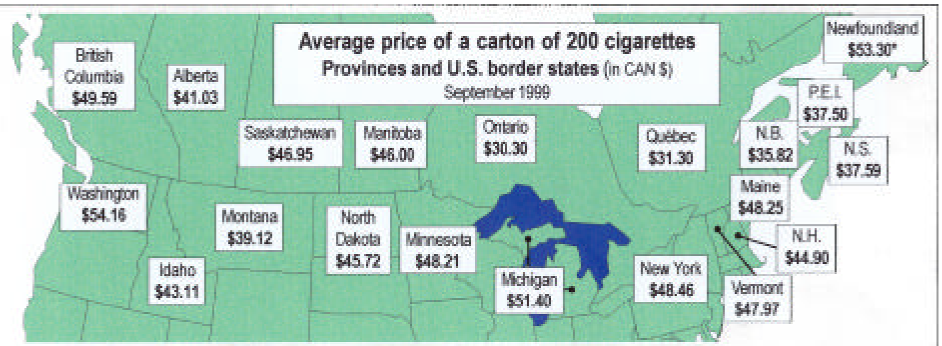
In November 1998, U.S. tobacco companies agreed to pay out US$ 206 billion over 25 years to settle outstanding claims from 46 states. This was over and above the US$ 40 billion agreed to in previous settlements with Mississippi, Florida, Texas and Minnesota. The result was an almost immediate increase in American cigarette prices to cover the cost of the settlement. U.S. manufacture price increases in 1997 – 1998 totalled CDN$11, plus a further CDN$ 3 in August 1999.

The combined effect of the settlement, assorted state tax increases, and the falling Canadian dollar is that **cigarettes are now more expensive** in **every single state** in the United States than they are in Ontario and Quebec. This includes tobacco-belt states such as Kentucky, where the state excise tax is only 3¢ per pack.

In all but one of the U.S. states bordering Ontario and Quebec, a carton of cigarettes is now over CDN$17 Can. more expensive than north of the border. In the remaining state, New Hampshire, a carton is CDN$ 13 more expensive than in neighbouring Quebec.

Figure 12

Cigarette prices along the Canada-United States border, September 1999



Notes:
Canadian data as of July 1999. U.S. data taken from an industry publication, *The Tax Burden on Tobacco*, adjusted for estimated price increases due to litigation settlement, July 1999 tax increase in New Hampshire, and manufacturers' increase announced to wholesalers Aug. 27, 1999. ("Cigarette Packs to Jump 22 Cents," Associated Press, Aug. 31, 1999.) At Sept. 7th exchange rate: $1 U.S. = $1.4913 CAN.
Prices include all state, provincial and federal taxes. Local sales and tobacco taxes in U.S. are excluded.
*Lower taxes are in effect in part of Labrador.
Source: *Smoking and Health Action Foundation, Ottawa.*

> *"Cigarette smuggling is not caused principally by "market forces". It is mainly caused by fraud, by the illegal evasion of import duty."*
>
> **Luk Joossens and Martin "Raw cigarette smuggling in Europe: who really benefits?" *Tobacco Control* 1998;7:66-71 (Spring)**

Aboriginal Status and Cigarette Smuggling

The 1989 Oka crisis and the role of Akwesasne as a point of entry for smugglers have left some policy-makers and members of the general public with the impression that the legal status of aboriginal Canadians in general, and of Mohawks in particular, is an insurmountable obstacle to any major cigarette tax increase. This view appears often to be based on lack of knowledge of the legal situation as well as on pessimism on the state of relations between aboriginal and non-aboriginal Canadians.

First, a quick note on the tax status of aboriginals. Under Canadian law, tobacco products sold on Indian reserves to status Indians (as defined by the *Indian Act*) are not subject to provincial tobacco taxes, provincial sales taxes, the federal GST or the Harmonized Sales Tax (HST, in effect in New Brunswick, Nova Scotia and Newfoundland). Federal tobacco taxes do apply, however. On-reserve sales to non-Indians must include all of these taxes. All sales off-reserve, whether to Indians or non-Indians, must include all taxes.

Some aboriginals, in particular some Mohawks, have argued that they never ceded control of international commerce to the British or Canadian Crown and that it is therefore perfectly legal for them to cross the Canada-U.S. border with shipments of cigarettes (or other goods) and sell them to non-aboriginals. This interpretation has been rejected by Canadian courts.[34] It is, at any rate, largely irrelevant. With respect to the prospects of preventing a repeat of the 1992-94 smuggling crisis, the issue is **not** whether governments can "control" aboriginal smugglers. The issue is whether they can control the smugglers' suppliers, i.e. Canada's tobacco companies. In this respect, the export tax re-instated in 1994 is an obstacle to any resurgence in smuggling, and would be more so if deficiencies in the current export tax are corrected.

It should also be noted that aboriginal communities are far from overjoyed at being misused as centres of organized crime. Aboriginal leaders are also increasingly expressing concern about the exceptionally high smoking rates in their communities. In various parts of Canada, several recent initiatives have directly addressed the issue of tobacco taxation on reserves. Authorities in Kahnawake, near Montreal, recently signed an agreement with the Quebec government with respect to tobacco, alcohol and fuel taxes, under which the community is setting up a system to restrict tax-free sales of these products to community members.[35] Meanwhile, in British Columbia, the Kamloops, Cowichan, Westbank and Sliammon reserves have authority to collect their own tobacco taxes as part of a pilot project.

The Export Tax

When smuggling was at high levels in 1991-1994, the bulk of contraband originated in Canada, was exported to the U.S., and returned to Canada as contraband. Most of the exports to the U.S. were made on a tax-exempt basis, that is without even paying U.S. tobacco taxes. To address this export supply ending up as contraband, an $8.00 per carton export tax was imposed in February 1992, only to be repealed less than two months later following heavy industry lobbying.

On February 8, 1994, the federal government reimposed the export tax, this time with exemptions for brands not sold in Canada, for products on which the foreign national tobacco tax was paid, and for products totalling not more than 3% of prior year's production. In November 1996, a further exemption was added, namely shipments going to duty-free outlets. In the 1999 federal budget, the exemption for prior year's production was reduced from 3% to 2.5%.

The fact that tax-exempt tobacco is available in U.S. duty-free outlets does not undermine the opportunity that now exists to increase Canadian taxes in light of the new high U.S. prices. Past smuggling into Canada did not arise because of the existence of duty-free

[34] R. v. Vincent (1993), 12 O.R. (3d) 427 (Ont. C.A.).
[35] *Agreement on fiscal matters related to tobacco, petroleum and alcohol products*, signed March 30th, 1999.

"New Democratic Party Health Critic Judy Wasylycia-Leis called on the federal government today to substantially increase tobacco taxes and to dedicate part of the revenue to a campaign to discourage smoking by young people.

'The significant rise in U.S. tobacco prices has opened the door for the Liberal government to take decisive action on this vital health concern,' said Wasylycia-Leis. 'There has been a tremendous outpouring of support for strong measures to discourage youth smoking.'

New Democratic Party news release, January 14, 1999.

tobacco outlets, but because of the complicity and actions of manufacturers. Police scrutiny and a properly drafted export tax will prevent manufacturers from re-starting tax-exempt exports to the U.S. that can come back to Canada as contraband. If there is no supply, there is no contraband.

The U.S. market has demonstrated that it can sustain high prices notwithstanding the fact that there are duty-free outlets on the other side of its northern and southern borders. If the U.S. can sustain high prices without smuggling, so can Canada.

The current export tax should be reformed. The only exemptions should be brands not sold in Canada, and 1.5% (down from 2.5%) of prior year's production (this 1.5% would be sufficient to cover traditional level legitimate exports to duty-free outlets plus to tax-paid distribution). The 1.5% could be defined to cover cigarette equivalent units (cigarettes, sticks, fine cut). At present, the exemptions to the export tax are so extensive that there is insufficient control on the quantity of tobacco products that manufacturers could potentially export without the export tax.

Conclusions and Recommendations

In our view, the primary cause of the 1992-94 cigarette smuggling crisis was a high-risk tobacco industry strategy to reverse the world precedent-setting Canadian tax increases of the 1980s and early 1990s. Smuggling was supply-driven, with the supply provided by Canadian manufacturers.

Much of Canada is now at the low end of tobacco tax levels in developed countries, and more is known about corporate involvement in past smuggling activities. Both facts make a repeat of the tragic events of the early 1990s unlikely.

Nevertheless, several policy measures could effectively reduce the smuggling risk still further:

- Loopholes in Canada's existing export tax on cigarettes should be closed. In particular, the blanket exemption for cigarette shipments going to foreign (mostly U.S.) duty-free stores should be eliminated, as should the exemption for products on which the foreign tax has been paid. Instead, there should be a total ceiling of 1.5% of prior-year production for all exemptions to the export tax, whatever the stated destination of the export shipments, and this total ceiling should truly reflect reasonable levels of legitimate exports. The exemption for brands not sold in Canada could remain.

- The export tax should be increased to $12 per carton, with an equivalent amount for tobacco sticks and roll-your-own tobacco. This would further cut into the profit margin of anyone trying to smuggle back duty-free, Canadian-made cigarettes from the United States.

- Canada should entirely eliminate duty-free sales of tobacco, which provide access to low-priced tobacco and reduce government revenue. The European Union recently eliminated duty-free tobacco sales for travellers within the EU, establishing a precedent for other regions. Norway and Australia are also considering similar steps.[36] Canada should enter into a bilateral agreement with the United States, the EU and other jurisdictions until a multilateral agreement can be reached.

- The quantity of duty-free tobacco products that returning residents can bring into Canada should be reduced. The present quota is unreasonably high: 200 cigarettes, *plus* 200 tobacco sticks, *plus* 200 grams of roll-your-own, *plus* 50 cigars. A more sensible approach would be to set an overall quota of 200 cigarettes or cigarette-equivalent units.

- Clearly visible, province-specific tax markings should be printed on cigarette packs. This would address concerns about inter-provincial smuggling, and make it impossible to simply re-wrap smuggled packs with fraudulent 'tax-paid' tear tapes. This measure was announced in the 1999 federal budget and should be implemented as soon as possible.

- Canada should support the development of the International Framework Convention on Tobacco Control, with provisions to address international tobacco smuggling.[37]

- The RCMP should step up its enforcement activities against cigarette smuggling, and investigations should concentrate on major suppliers of contraband, rather than on small-time smugglers. Corporate involvement in smuggling should be one of the issues investigated by a Royal Commission of Inquiry into the tobacco industry, as recommended by the National Tobacco OR Kids Coalition.

"The Minister of National Revenue will be making changes to the requirements for stamping and packaging of tobacco products under the Tobacco Departmental Regulations to further improve enforcement. The security features of tear strips, which are used as stamps under the Excise Act to provide evidence of payment of excise duties, will be improved. In addition, a province-specific identifier will be required on each package containing tobacco products. These changes will ensure that the identification of the intended province of sale cannot be altered and will assist enforcement agencies in controlling the illegal movement of tobacco products from provinces with reduced rates of federal tobacco taxes to other provinces."

The Budget Plan 1999, p.217

[36] Bloomberg News, "Norway's Finance Minister Considers Scrapping Tax-Free, DN Says," Feb. 4, 1999.
[37] In May, the 191 member governments of the World Health Assembly, the governing body of the World Health Organization, approved plans to begin work on drafting such a convention. See WHO press release: "World Health Assembly Paves Way for Framework Convention on Tobacco Control," May 24, 1999.

"Where the government went wrong, the single biggest blunder it made in this war on cigarette smoking was in 1994 when it capitulated and dramatically decreased the amount of tax on a package of cigarettes."

Progressive Conservative M.P. Greg Thompson, House of Commons, September 30, 1998.

Fear of a resurgence in smuggling should not block governments from restoring tobacco taxes to levels more favourable to public health. A $10.00 per carton increase in the low-tax provinces will not prompt significant smuggling for the following reasons:

- As shown in the tax map on page 30, the retail price of a carton of cigarettes in Ontario and Quebec is now about CDN$17.00 per carton *lower* than in neighbouring U.S. states such as New York and Maine. New Brunswick prices are about CDN$ 10.50 Can. per carton lower than in neighbouring Maine. At the time of high smuggling in 1993, the reverse was true, with prices in Canada dramatically higher than in the U.S.

- Unlike in 1993, there is now an export tax in place that will help prevent Canadian companies from engaging in massive exports of product intended for the contraband market. Canadian companies will no longer feed into the smuggling chain. This export tax can easily be improved to remove any existing deficiencies. If there were to be smuggling of non-Canadian cigarettes, then Canadian companies would actively co-operate with police to stop this type of smuggling.

- With an effective export tax in place, U.S. reserves and duty-free stores cannot be expected to be a significant source of contraband into Canada since these outlets cannot obtain tax-exempt product (without the export tax) directly or indirectly from Canadian manufacturers, except in small, traditional quantities that would serve the legitimate duty-free market. Similarly, smuggling from Canadian reserves should not increase significantly if smugglers cannot obtain tax-exempt Canadian product (without the export tax) from Canadian manufacturers via the United States.

- Police, governments and the media are now aware of the tactics and illegal activities the industry previously used to cause smuggling. Tobacco companies would not engage in the same behaviour again with impunity. Further, RJR-Macdonald is no longer controlled by R.J. Reynolds of the United States, but rather by Japan Tobacco, in which the Japanese government has a controlling share. This should have a chilling effect on contributions to smuggling.

- Canadian cigarettes exported to the U.S. do not have the prominent black and white warnings now found on packages sold in Canada. This difference helps to distinguish packages legitimately and illegitimately available in the Canadian market.

- Quebec restructured tobacco taxes in 1998 to remove provincial sales tax on tobacco but to increase tobacco tax by an equivalent amount. This has helped address tax evasion through Indian reserves, where sales tax was often not being collected.

Further changes to the Quebec *Tobacco Tax Act* help to control the quantity of tax-exempt tobacco available on reserves.

- Higher tobacco taxes in Ontario and Quebec would reduce the price differential between Central Canada and the West, and thus *reduce* what inter-provincial smuggling there may be now or in the future.

Figure 13
Advertisement for individually marked cigarettes

This product advertisement from the trade journal "Tobacco Reporter" illustrates the capacity to individually mark cigarettes and to protect trade marks – and tax revenues – from counterfeit and smuggling.

***Tobacco Reporter*, May 1999, p. 15.**

Cigarette Smuggling — Key Dates

"ITL decided in March to once again make our products available to distributors in the U.S. Following substantial competitive losses in volume and share in DFX (duty free exports) channels in 1993 and early 1992. This, coupled with a newly reached agreement with Philip Morris USA to distribute Player's products south of the border resulted in full availability of all major Canadian brands in alternative channels by the second half of the year.

"The Annual Tobacco Industry Review 1993. Strictly Confidential." Imperial Tobacco Market Analysis Group. February 1994.

January 1992: Leslie Thompson, a long-time executive with RJR-Macdonald and its U.S. parent, R.J. Reynolds, begins selling truckloads of Canadian cigarettes to an organized smuggling ring in upstate New York.[38]

February 12, 1992: The federal government attempts to stem the flow of Canadian cigarettes to smuggling rings in the United States by imposing an $8 per carton export tax. Following intensive industry lobbying, this was repealed on April 8, 1992.

1992: Imperial Tobacco decides to supply cigarettes to U.S. distributors to facilitate their being smuggled back to Canada.

Late 1992: R.J. Reynolds sets up a new subsidiary, Northern Brands International, perportedly to promote the sale of Export "A" cigarettes in the United States.

1993: In February, U.S. police pull over a rental truck in Louisiana for failing to stop at a weigh station. They discover contraband: 150 cases of Canadian-made Imperial Tobacco cigarettes, en route back to Canada. In the ensuing investigation, U.S. Customs authorities raid a bonded warehouse in Louisiana and find records for 8,000 cases of Canadian-made cigarettes supposedly sold duty-free to fishing vessels passing through the area. A warehouse employee fingers Brown & Williamson, the U.S. sister company of Canada's Imperial Tobacco, as supplier of the cigarettes. U.S. Customs sends in an undercover agent to investigate.

1992-93: Imperial Tobacco, frustrated with Brown & Williamson, makes an agreement with Phillip Morris to distribute Player's to U.S. markets.[39]

1993: Imperial Tobacco expresses concerns internally that "RJR have also continued to operate on the fringes of the law; often off-pricing and actively developing smuggled distribution."[40]

Feb. 1, 1994: Health groups run a full-page ad in *the Globe and Mail* warning of the dramatic health and financial impact of an impending tobacco tax roll-back.

Feb. 8, 1994: Federal rollback in tobacco taxes matched by Quebec, and followed by New Brunswick, Ontario, PEI and Nova Scotia.

[38] This chronology draws on documents filed in U.S. district Court, Northern District of New York in 1998.

[39] William Marsden, "CEO knew of tobacco smuggling," *Montreal Gazette*, April 29, 1999, p. A1-A2.

[40] "The Annual Tobacco Industry Review 1993." Strictly Confidential. Imperial Tobacco Market Analysis Group, February 1994.

1994: The U.S. Customs undercover agent buys Canadian cigarettes from Michael Bernstein, Brown & Williamson's East Coast Regional Account Manager. Once sufficient incriminating evidence has been gathered against Bernstein, authorities confront him. According to court documents filed by U.S. federal agents, Bernstein and one of his subordinates, Richard Wingate, "confirmed the company's knowledge and intent to defraud the United States and Canadian Governments of tax revenues," and agreed to help provide proof.

1995: On Jan. 11th, a party of 50 to 100 U.S. federal agents raid the headquarters of Brown & Williamson in search of evidence related to the smuggling of cigarettes into Canada and Mexico. They seized numerous computer and paper files.

May 1996: The U.S. Department of Justice charges Bernstein and Wingate with "conspiracy to defraud the United States" and with assisting smuggling. The alleged smuggling stretched back to 1989.

July 1996: Bernstein's former subordinate, Wingate, pleads guilty.

July 11, 1997: RJR-Macdonald issues news release: "Following the publication in the Syracuse Post-Standard and the Hamilton Spectator of an article which alleges that RJR-Macdonald is the subject of a police investigation, the company issued the following statement today: 'It is RJR-Macdonald's policy not to comment on matters of this nature. We can only confirm that RJR-Macdonald has not seen the affidavit and has not been contacted by any law enforcement officials about it. RJR-Macdonald's sales of its products are always made in full compliance with applicable laws, both in the U.S. and in Canada. We are, as always, ready to fully co-operate with the authorities should they contact us.' "

July 16, 1997: Bernstein pleads guilty to charges of trafficking in contraband cigarettes. He is later fined.

July 24, 1997: R.J. Reynolds and subsidiary Northern Brands International receive subpoenas from a federal grand jury relating to smuggling into Canada.[41]

January 20, 1998: CBC-TV broadcasts a documentary on *The Fifth Estate* detailing the Brown & Williamson and RJR-Macdonald cases, including evidence of parties at a secluded fishing lodge in British Columbia involving smugglers and RJR-Macdonald executives. One executive, RJR-Macdonald Chief Operating Officer Stan Smith, is named in the broadcast. His employment with the company is subsequently ended. Smith was a

[41] "RJR Nabisco is Subpoenaed in Smuggling Investigation," *Wall Street Journal*, Aug. 12, 1997.

plaintiff along with the company in challenging the constitutionality of advertising and promotion restrictions in the federal *Tobacco Act*, which was passed in April 1997.[42]

Jan. 21, 1998: The Canadian Cancer Society, the Non-Smokers' Rights Association and the Canadian Council for Tobacco Control call for both a criminal investigation of the tobacco manufacturers related to smuggling and a Royal Commission into the tobacco industry.[43]

Jan. 24, 1998: In an interview on CBC Radio's *The House*, CTMC President Robert Parker comments on *the fifth estate* broadcast: "I personally think that's the sleaziest piece of attack journalism I've seen in a long time. ... I think the absence of charges, after all these years, is eloquent evidence that there's nothing to these charges."[44]

June 26, 1998: Knight Ridder news service reports that RJR and Imperial Tobacco are under investigation by the R.C.M.P. for smuggling matters.[45]

[42] Lisa Fitterman, "Tobacco firm picks plaintiff; Executive cited in CBC investigation," *Montreal Gazette*, Feb. 4, 1998, p. A4.

[43] Canadian Cancer Society, Non-Smokers' Rights Association and Canadian Council for Tobacco Control, "Health organizations call for both a criminal investigation of the tobacco manufacturers related to smuggling and a Royal Commission into the tobacco industry" [news release] January 21, 1998.

[44] Transcript, *The House*, CBC Radio, Jan. 24, 1998.

[45] Raja Mishra (Knight Ridder), "Canada tax drove up cigarette smuggling" *Lexington (KY) Herald Leader*, June 26, 1998.

September 1998: RJR-Macdonald sales representative Christopher Gibb-Carsley, an employee in Montreal, is charged in Quebec Court with smuggling offences.[46]

Nov. 5, 1998: After a lengthy investigation and a string of plea bargains by accomplices, smuggler Larry Miller, the head of a network in New York State, pleads guilty to assorted charges and agrees to testify against his suppliers in the tobacco industry.[47]

November 1998: Philip Morris, the largest U.S. tobacco company, reports to the Securities and Exchange Commission that it is under investigation for alleged involvement in smuggling along the Canada-U.S. border.

December 22, 1998: Northern Brands International pleads guilty to evading U.S. taxes and agrees to pay US$15 million as part of a plea bargain.[48]

March 25, 1999: Leslie Thompson, a former senior executive with RJR-Macdonald and Northern Brands International, pleads guilty to a smuggling conspiracy. It is reported that

[46] Michel Auger, "Contrebande; RJR Macdonald nie toute complicité" *Le Journal de Montreal*, Sept. 30, 1998, p.5.

[47] « Le dirigeant d'un réseau de contrebande mohawk avoue tout », La Presse Canadienne, Nov. 7, 1998.

[48] U.S. Department of Justice, "R.J. Reynolds Affiliate Pleads Guilty, Pays $15 Million in Criminal Fines and Forfeitures as Part of Cigarette Smuggling Operation," news release, Dec. 22, 1998.

the conspiracy defrauded the Canadian government of more than US$ 650 million in tobacco taxes. The plea bargain in U.S. district court in Syracuse, New York includes a seven-year jail term, although this was still to require court approval.[49]

March 26, 1999: RJR-Nabisco acknowledges that its Canadian subsidiary RJR-Macdonald is co-operating with the R.C.M.P. in a smuggling investigation relating to the same events that gave rise to the Northern Brands International investigation.[50]

April 17, 1999: *La Presse* reports that RJR-Macdonald and Revenue Canada are discussing a plea bargain arrangement for smuggling that would see the company pay about $150 million in fines.[51]

April 28, 1999: Imperial Tobacco Chairman, Don Brown, tells the *Montreal Gazette* that Imperial Tobacco willingly supplied cigarettes for eventual return to Canada via smugglers.[52]

May 3, 1999: *Globe and Mail* reports that the RCMP executed a search warrant at the RJR-Macdonald headquarters in Toronto and its factory in Montreal.[53]

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[49]William Marsden, "RJR Nabisco executive pleads guilty for part in $650M cigarette smuggling scam" *National Post*, March 27, 1999. American Press, "Tobacco Exec Charged with Smuggling" March 25, 1999. "RJR Executive Helped Smugglers Sell Cigarettes Illegally in Canada" *Wall Street Journal*, March 26, 1999.

[50]RJR-Nabisco Holdings Corp., 10-K filing with the U.S. Securities and Exchange Commission, March 26, 1999, p.12.

[51]André Noël, "Tabac: des nicodollars à recouvrer" *La Presse*, April 17, 1999, pp.A1-A2.

[52] "CEO knew of tobacco smuggling, " Montreal Gazette, April 29, 1999, p. A1.

[53]Paul Waldie, "Mounties search tobacco firm in contraband case" *Globe and Mail* May 3, 1999.

Part 5:

The Impact of the Tax Cut: A Five-Year Review

Governments presented the 1994 tobacco tax rollback as a temporary, strategic retreat that in no way signalled diminished commitment to protecting the health of Canadians from the disastrous effects of tobacco products and the misleading marketing of the tobacco industry. Five years later, a sober examination of the facts shows that very serious damage has been done and continues to be done, far beyond what governments predicted at the time of the rollback. Lower cigarette prices have injured public health by increasing cigarette smoking to levels higher than would otherwise be the case. They have also robbed public finances of billions of dollars. Five years later, it is also clear who gained most from the rollback: tobacco companies, which continue to set new profit records and have added to their Canadian customer base for decades to come.

High- and Low-tax Regions: A unique policy comparison

Although cigarette taxes were reduced by $5.00 per carton throughout Canada on February 8, 1994, subsequent cuts were much less evenly felt. Five provinces elected to join the federal government in reducing the price of cigarettes. Five provinces made no reductions at all.

As a result, cigarettes in the 'high-tax' provinces (British Columbia, Alberta, Saskatchewan, Manitoba and Newfoundland) are almost twice as expensive as they are in 'low-tax' provinces (Ontario, Quebec, New Brunswick, Nova Scotia, Prince Edward Island). More than 75% of Canadians live in the 'low-tax' provinces.

City	Price per 200 cigarettes	Price per 200 cigarettes
	Jan 94	*Jan 99*
St. John's	$59.43	$52.07
Yellowknife	$46.62	$50.77
Vancouver	$51.30	$50.11
Regina	$48.83	$48.23
Winnipeg	$48.69	$45.25
Whitehorse	$49.10	$44.31
Edmonton	$43.47	$39.92
Saint John	$48.78	$38.84
Charlottetown	$50.02	$36.71
Halifax	$49.01	$36.09
Montreal	$47.46	$29.88
Toronto	$45.57	$27.95

Source: Statistics Canada, "Tobacco Prices, 1994-1999," custom printout, July 26, 1994.

This variety in cigarette tax policies across Canada has created a unique, if unintended, social laboratory in which to monitor the impact of the cigarette tax rollback and to test cigarette-tax theory.

This unique circumstance provides confidence in assessing the consequences of the tax rollback. The results of this unintended experiment also confirm that high cigarette taxes provide a greater benefit to public health and to public finances than do low cigarette taxes, and strongly support a move to upwardly harmonize cigarette taxes with the levels in Western Canada and in most developed countries.

Five Years Later: More Young Canadians are Smoking

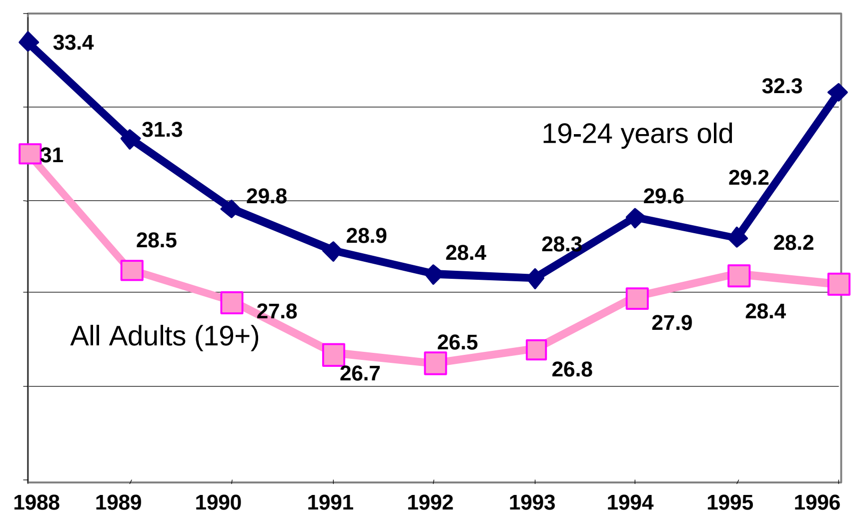
Since cigarettes became less expensive in 1994, Canadian government surveys show that more teenagers and more young adults are smoking today than at the beginning of the decade. This is in contrast to sustained, significant declines in smoking prevalence in these age groups since the mid-1970s.

"[Y]ounger Canadians are, indeed, more sensitive to price changes than adults."

Department of Finance, "Tobacco Taxes and Consumption" June 1993, p.iv.

Figure 14
Smoking Rates among Canadian Adults and Young Adults, 1988 – 1996

Source: Letter from Richard Kauffeld, Chairman and CEO, RJR-Macdonald to David Sweanor, Senior Legal Counsel, Non-Smokers' Rights Association, and Tom Stephens, June 10, 1997



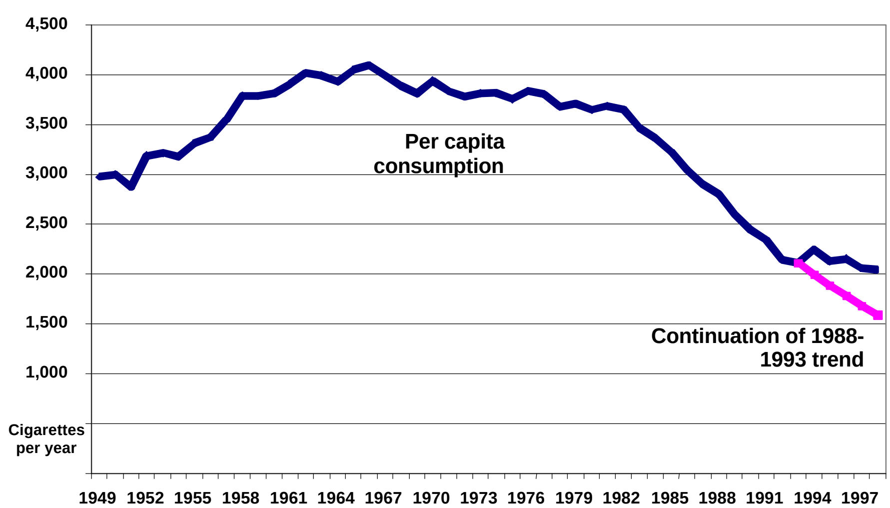
Tobacco industry data (which, unlike government data is collected on a monthly and yearly basis and with consistent methodologies) confirms that smoking rates increased after the 1994 rollback. RJR-Macdonald provided smoking rates to the Non-Smokers' Rights Association in 1997 for the years 1988 to 1996. This company surveys respondents aged 19 or older. While the surveys show an increase in smoking in all age groups after 1994, there is a more pronounced increase among Canadians aged 19-24.

Five Years Later: Canadians are Smoking More Cigarettes

From a public health perspective, both the number of people who smoke (smoking prevalence) and the amount of cigarettes that are smoked (cigarette consumption) are of consequence. Health is affected both by the number of smokers (each of whose health can be expected to suffer as a result of smoking) and the amount smoked (greater quantities of cigarettes smoked result in greater disease).

For many years, Canadians were the world's heaviest smokers. In 1981, Canadians smoked an average of 3,685 cigarettes per person (over 15 years of age) per year. During the 1980s and early 1990s, this number began to drop significantly: by 1992 it had fallen to 2,143 cigarettes per person (over 15 years of age) per year.

Figure 15
Cigarette Consumption[54], 1949 – 1998, with projection of continued reduction had pre-1994 trend continued.



Sources: See Appendix A, Table G.

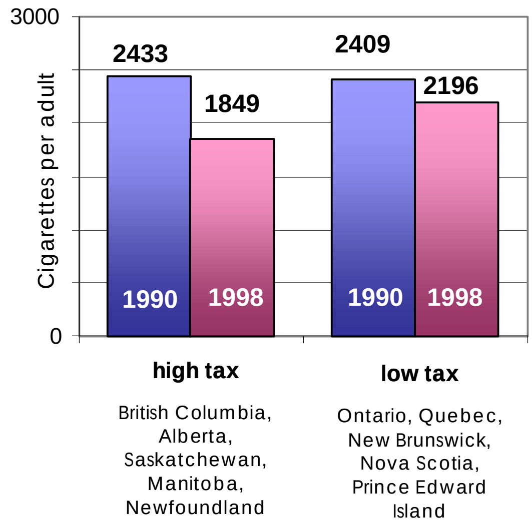
The 1994 tax cut arrested the dramatic progress made in the previous 12 years. If the average decline established between 1988 and 1993 had continued, per capita

[54] Including estimates of consumption of contraband cigarettes.

consumption in 1998 would have been 1,590 cigarettes, compared to the actual figure of 2,042, a difference of fully 22%.

There is a stark difference in reductions of cigarette consumption between the regions of Canada where cigarette taxes were maintained and those where they were cut. Per capita consumption in the 'high-tax' provinces dropped by 24% during this eight-year period; in the 'low-tax' provinces, it dropped by less than 8%.

Figure 16
Cigarette Consumption Per Capita (15+), 1990 and 1998



Sources: See Appendix A, Table F.

Five Years Later: Governments Lose Billions

When the federal government forecast in 1994 that cutting cigarette taxes would cost the federal treasury $300 million a year, its prediction was far short of the mark. The annual shortfall in federal tobacco tax revenue was twice the amount forecast, as the Auditor General pointed out in his 1996 report to Parliament. In each fiscal year since the rollback, federal tobacco-tax revenues have been lower than in 1993-94, by an average of $575 million. This is a conservative estimate of revenue losses, since the reference year (1993-94) included almost two months of the new low-tax regime and since the estimate excludes lost GST revenue.

“We are concerned, however, that the departments have not fully reviewed the cost and benefits of the anti-smuggling measure. For example, the 1994 Budget Plan forecast that the anti-smuggling initiative would result in a $300 million decline in tobacco tax revenue in 1994-95. Ex post federal revenue from tobacco taxes declined by over $600 million in 1994-95 compared with 1993-94.

**Report of the Auditor General
September 1996**

Like the health consequences, the revenue consequences of this decision continue to be felt. Continued delays in restoring taxes add to the cumulative burden of this decision. Together with losses to provincial treasuries, public finances are $4.8 billion poorer from reduced tobacco revenues in 1998-99 than they were in 1993-94, not including sales taxes. The cumulative loss to federal revenues for the five-year period is $2.9 billion, not including GST.

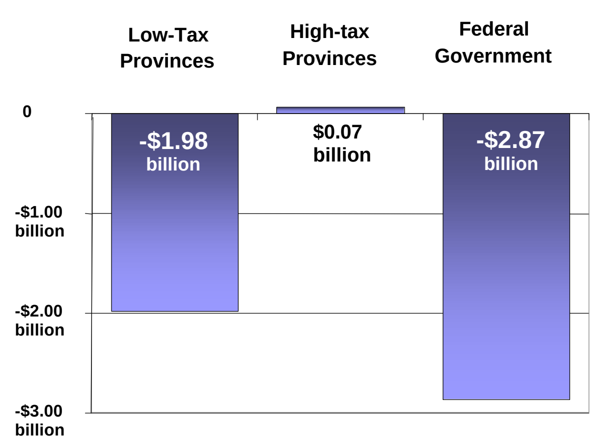
Foregone federal revenues resulting from lower cigarette taxes are enough for the federal government to:

- Double the budget of Environment Canada (currently $531 million)
- Triple the budget of the Medical Research Council (currently $275 million)
- Fund the operating costs of two universities the size of the University of British Columbia (current operating costs $344 million).

The provinces which joined the federal government in reducing cigarette taxes shared in the loss: their joint revenues were depleted by almost $2 billion in the five-year period, not including sales taxes (see Appendix A, Table D) .

Figure 17:
Five-year cumulative impact of cigarette tax-cuts on provincial and federal government tobacco-tax revenues (1994-95 to 1998-99)

Sources: Public Accounts for each jurisdiction, 1994-95 to 1997-98; budget



documents for 1998-99.

It should be noted that these figures on revenue loss measure only the effects of the decision to roll back taxes, *once smuggling had already become a serious issue.* For example, these figures do not include the taxes that should have been paid on smuggled cigarettes. According to a separate estimate by the Non-Smokers’ Rights Association for the years 1990 through 1998, the federal treasury alone was deprived of *roughly $15 billion* through cigarette smuggling and the tax rollback it led to.

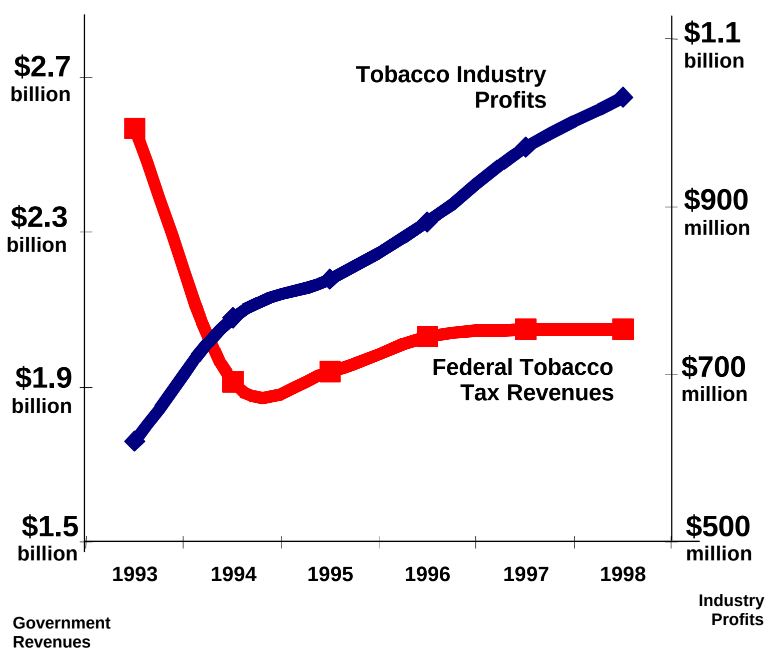
By contrast, provinces which chose to address smuggling with increased enforcement instead of tax cuts experienced very little tax loss. In aggregate, these five provinces actually increased their tax revenues by $72 million dollars.

Rumours of significant increases in smuggling from low-tax provinces like Ontario and Quebec into the high-tax western provinces are not, *prima facie*, supported by tax revenue data, which shows that these provincial governments have been able to defend their revenue base against illegal sales. Interprovincial smuggling could be addressed by raising taxes in the low-tax provinces.

"Federal and provincial government tax policies over several years have pushed the retail price of cigarettes to extraordinary levels. The very high retail prices, more than any other factor, account for the decline in domestic industry sales."

Imasco Ltd., Annual Report 1990, p.6.

Figure 18:
Tobacco industry pre-tax profits and federal tobacco-tax revenues, 1993-94 to 1998-99.



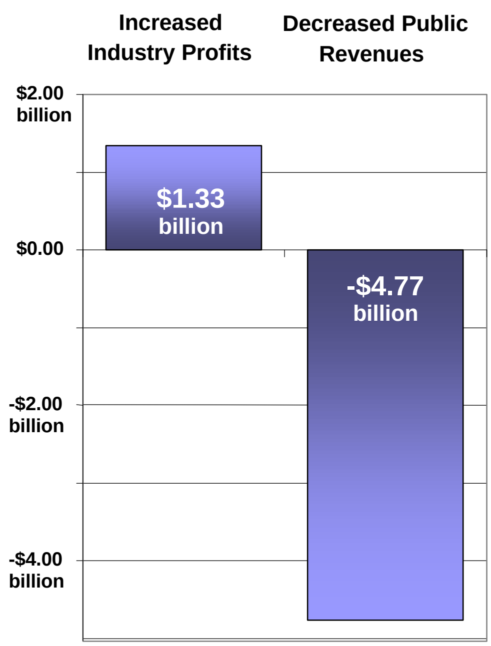
Sources: Public Accounts for each jurisdiction, 1994-95 to 1997-98; budget documents for 1998-99 and annual reports, IMASCO Ltd and Rothmans Inc, 1994 to 1998. Profits for Canada's third manufacturer, RJR-Macdonald are not publicly available nor included in this estimate.

Five Years Later: Tobacco Industry Profits up $1.33 billion

"The Corporation continues to expect that future earnings performance may be adversely affected by two major factors: declines in industry volumes caused by continued excessive taxation; and, constraints on market share imposed by increasingly stringent government controls over the marketing and sale of tobacco products."

Rothmans Inc., "Annual Report 1991" p.11.

Figure 18 :
Cumulative increased industry profits and decreased public revenues, 1993-94 to 1998-99.



Where lower cigarette taxes proved harmful to government tax revenues, they have been a boon to tobacco industry profits. Profit levels continue to spiral upwards, with companies reporting year after year of record-breaking earnings. Moreover, the industry's success in rejuvenating its customer base in the 1990s means this upward trend will likely continue — especially if governments fail to rejuvenate their approach to tobacco taxation.

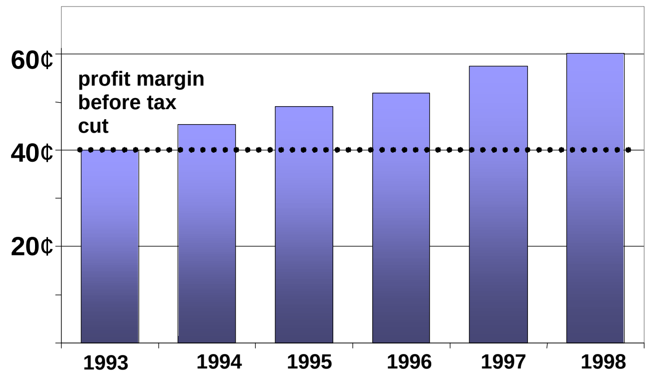
The major force behind increased tobacco industry profits is the dramatic rise in the wholesale price charged by tobacco companies throughout Canada. According to its annual reports, industry-leader Imperial Tobacco has increased its prices at least six times since 1994, including by the following amounts:

- April 1996 — 3.2% increase
- December 1996 — 3.6% increase
- April 1997 — 2.9% increase
- October 1997 — 4.3% increase
- April 1998 — 4.4% increase
- April 1999 — 4.4% increase

Each of these price increases highlights an inconsistency in the tobacco industry arguments for low taxes and against export taxes. On the one hand, the companies argue that tax increases trigger smuggling; on the other hand, this stated concern does not dissuade them from raising their own prices at a rate many times higher than the inflation rate. If smuggling truly were driven by demand and not by supply, it should not make any difference whether price increases are caused by taxation or industry profit-taking.

Since 1994, pre-tax profit margins on Imperial Tobacco cigarettes have increased by 50% — from $0.40 per package to $0.60 cents per package (or an increase of $1.60 per carton). In short, after convincing governments to enter into a price war with smugglers, the industry has rushed in to partially fill the price gap. This opportunistic behaviour, at public expense, deserves a firm government response. One possibility that should be explored is a tax measure to simultaneously force down manufacturers' prices and increase tax levels. (See recommendations section.)

Figure 19
Imperial Tobacco gross profit per package of 25 cigarettes, 1993 - 1998



Sources: IMASCO annual reports. See Appendix A, Table K.

Conclusion and Recommendations

The 1994 decision to give into tobacco industry pressure and cut cigarette taxes has had a profound and negative impact on both the health of Canadians and the finances of their governments. The tax cut contributed to the rapidly increasing profitability of tobacco companies, including $1.3 billion in cumulative incremental profits over five years. By the most conservative estimate, it led to the loss of almost $5 billion dollars in public revenue. It was followed by an increase in smoking, especially compared to what would otherwise have been the case.

The decision by governments in Western Canada and Newfoundland to refrain from cutting provincial taxes but to focus on other anti-smuggling initiatives (such as increased enforcement) appears to have succeeded in protecting provincial tax revenues and in further discouraging smoking.

The government should move quickly to reverse the 1994 policy decisions by implementing the tax increases recommended in Part 3.

Part 6

Using Tobacco Taxes to Fund Effective Measures to Reduce Smoking

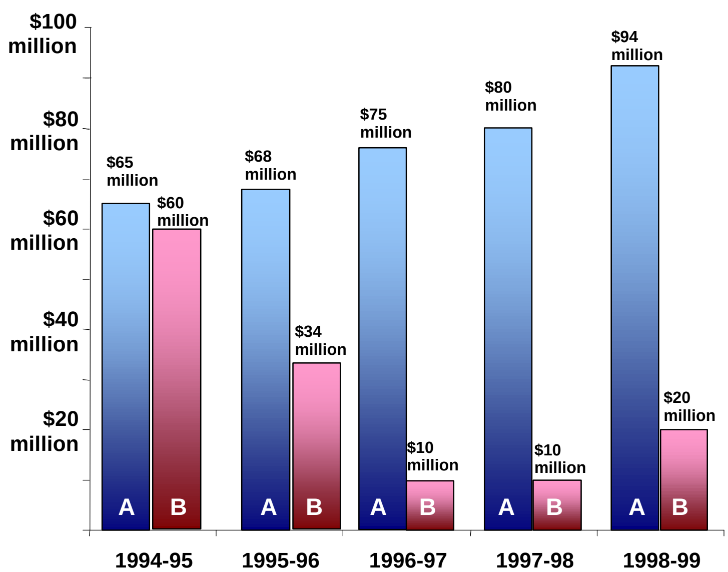
Since 1994, the tobacco tax policy of many provinces and the federal government has led to lost public revenues and losses to public health. There is another loss which should be considered in a review of this policy: the lost opportunity to apply revenues from cigarette taxes to effective programs to reduce smoking.

When lower cigarette taxes were announced in February 1994, they were accompanied by a modest surtax on tobacco company earnings for three years (at the end of the three years, it was renewed for a further three). This surtax, the Prime Minister assured Parliament "will fund the largest anti-smoking campaign this country has ever seen." (Hansard, February 8, 1994).

"We are imposing, effective immediately, a substantial increase in corporate taxes on Canadian tobacco manufacturers. We are imposing a three-year health promotion surtax on tobacco manufacturing profits. ... [T]he federal government will receive up to $200 million in extra revenue over the three years. The money generated by this surtax will fund the largest anti-smoking campaign this country has ever seen."

Prime Minister Jean Chrétien, House of Commons, February 8, 1994

Figure 20
Estimated Revenues from the "Tobacco Manufacturers' Health Promotion Surtax" on tobacco companies and expenditures on anti-tobacco programming



Sources: Formal accounting has not been provided either for revenues under the Tobacco Manufacturers' Health Promotion Surtax or expenditures under the Tobacco Demand Reduction Strategy. Total expenditures for 1994-97 were $104 million, according to Health Canada's "Evaluation of the Tobacco Demand Reduction Strategy, Final Report, July 1998."

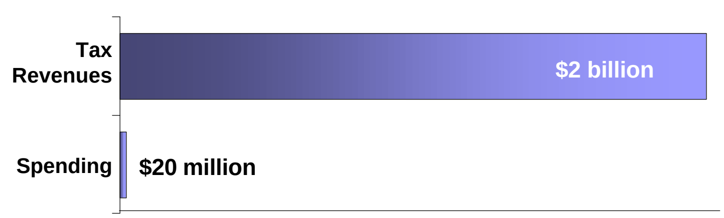
In 1994, Health Canada did, in fact, launch the largest anti-smoking campaign this country has ever seen. It was also one of the shortest-lived. And although the health promotion surtax was renewed for a further three years, the “health promotion” measures it funded quickly became fraction of their original levels. In the past five years, the government has collected almost $400 million in tobacco “health promotion” surtaxes, but would appear to have spent less than half of that on all tobacco-reduction measures.

Contrasting total government revenues from tobacco sales with money spent on reducing tobacco use reveals an even more glaring discrepancy, because federal tobacco tax revenue is much greater than the new surtax . For every carton of cigarettes sold, the federal government receives approximately $10 in excise tax and duties, but spends less than 10¢ on all public measures to reduce tobacco use. That is, of the total $2 billion received in tobacco taxes, the federal government spends only $20 million on any form of tobacco control.

The federal government budget for the following activities must currently be drawn from less than 1% of all tobacco tax revenues:

- enforcement of tobacco laws (i.e. discouraging retailers from selling to children, or promoting awareness of current laws)
- monitoring tobacco use (i.e. Statistics Canada surveys and other methods)
- research into ways to reduce smoking (i.e., behavioural research to support better counselling, or regulatory research to develop less addictive cigarettes)
- public education programs (i.e. school-based education programs)
- public education campaigns (i.e. mass media advertising)
- health promotion programs (i.e. programs to help smokers quit)

Figure 21
Federal revenues from tobacco taxes and duties and expenditures on anti-tobacco programming, 1999



Sources: Public Accounts of Canada, 1998-99 (revenues); Expenditures estimated for 1998-99.

It is not only in comparison with tobacco-based revenues that the federal government's investment in measures to reduce smoking falls short. Relative to the human and financial consequences of tobacco use, prevention measures for tobacco by all governments and funders are significantly smaller than they are for other health issues of lesser health import. Since there is no evidence that other health issues are receiving too much funding, this is a further indication that tobacco-use prevention is underfunded.

A 1996 report by the Canadian Centre for Substance Abuse reported that, while tobacco killed five times as many Canadians as alcohol and 45 times as many as illicit drugs, governments spent three times as much on research and prevention programs for alcohol as they did for tobacco, and an equal amount for illicit drugs and tobacco.

Figure 22
Costs of Substance Abuse and Government Spending on Prevention & Research

	Alcohol	Tobacco	Illicit Drugs
Human Health			
• Deaths	6,701	33,498	732
• Years Life Lost	186,257	495,640	31,147
Economic Costs			
• Direct Health Care Costs	$1,300,600,000	$2,675,500,000	$88,000,000
• Indirect Costs	$4,136,500,000	$6,818,800,000	$823,100,000
Expenditures on Prevention			
• Prevention & Research	$141,400,000	$48,000,000	$41,900,000

Source: The Costs of Substance Abuse in Canada. Canadian Centre for Substance Abuse, 1996.

Tax Revenues from Kids' Smoking

Every year, about 70 million packages of cigarettes are smoked by children too young to legally be sold or provided with cigarettes (see Appendix A, Table H). Irrespective of whether or not these children were illegally sold the cigarettes or whether they were illegally provided with them by adults, taxes were paid on the 70 million packages. This results in revenues of $90 million to combined provincial governments and $80 million to the federal government.

For every dollar the federal government spends on measures to prevent smoking (including measures to protect minors and stop illegal sales), it receives $4 from youth who smoke. The net profit to the federal government from under-age smoking is $60 million.

World Health Organization recommends comprehensive programs to reduce tobacco use

Tobacco is currently responsible for 7% of deaths world-wide. Within 20 years, the number of global tobacco-caused deaths is expected to increase to 20% of all deaths – the percentage now observed in Canada. Gro Harlem Brundtland, the new director-general of the World Health Organization has identified tobacco as one of two areas for intense attention within the WHO.

To reduce tobacco use, WHO recommends a comprehensive strategy - including the allocation of a portion of tobacco tax revenues to anti-smoking measures. WHO also recommends that tobacco taxes be kept high enough to discourage smoking, and that governments ensure that cigarette taxes rise faster than inflation. Other measures promoted by WHO include a total ban on advertising and sponsorship, smoke-free environments and prominent health warnings.

World Health Organization:
A 10-Point Programme for Successful Tobacco Control

Tobacco control must come from all sectors, and it must be comprehensive in scope. The international health community has recognized that a partial solution to this major problem in not enough. The following, derived from the World Health Assembly resolutions, along with recommendations from other international and intergovernmental bodies, lists some key elements that should be included in comprehensive national tobacco control programmes:

1. Protection for children from becoming addicted to tobacco through such measures as the banning of sales to and advertising targeted at children.

2. Implementation of fiscal policies to discourage the use of tobacco, such as tobacco taxes that increase faster than the growth in prices and income.

3. Allocation of a portion of the money raised from tobacco taxes to finance other tobacco control and health promotion measures.

4. Health promotion, health education and smoking cessation programmes. Health workers and institutions set an example by being smoke-free.

5. Protection from involuntary exposure to environmental tobacco smoke (ETS).

6. Elimination of socioeconomic, behavioural and other incentives which maintain and promote the use of tobacco.

7. Elimination of direct and indirect tobacco advertising, promotion and sponsorship.

8. Controls on tobacco products, including prominent health warnings on tobacco products and in any remaining advertisements; limits on and mandatory reporting of toxic constituents in tobacco products and tobacco smoke.

9. Promotion of economic alternatives to tobacco growing and manufacturing.

10. Effective management, monitoring and evaluation of tobacco issues.

Source: WHO Fact Sheet No. 159, May 1998

The U.S. Centers for Disease Control and Prevention recommend minimum funding on tobacco control ten times higher than current federal funding

In the United States, rigorous analysis has recently been given to the evaluation of tobacco-control measures, with a view to establishing both the scope and the intensity of activities needed to reduce smoking. Much of this interest and activity was sparked by the recent settlement between U.S. attorneys general and U.S. tobacco companies, which resulted in payments to state governments funded by price increases on tobacco products.

To assist state governments in investing this money in programs and measures which would reduce smoking, the U.S. Centers for Disease Control reviewed the evidence supporting public and other measures, and provided guidelines based on this evidence. For each jurisdiction, they provided an estimate of how much money was required in each area of activity to meet the standards established by 'best practices.'[55] These practices were culled in large measure on the evidence of jurisdictions like California and Massachusetts which had significantly reduced tobacco use following the adoption of special levies on tobacco products.

Based on CDC guidelines, Canadian governments (federal and provincial) should increase their budgets five-fold to twenty-fold from the current $20 million.

[55] Best Practices for Comprehensive Tobacco Control Programs. U.S. Department of Health and Human Services. Centers for Disease Control and Prevention. National Center for Disease Prevention and Health Promotion. Office on Smoking and Health. August 1999.

Figure 23

Centers for Disease Control Guidelines for Tobacco Control Funding

	Guidelines for spending in a jurisdiction of 30 million people	
	Lower	*Upper*
Community-based programs to reduce tobacco use, i.e. • Local partnerships with ethnic or cultural communities • Educational programs to youth, retailers, enforcement, etc • Promote local policies, i.e. smoke-free restaurants	US$ 32 million	US$ 80 million
Community-based programs to minimize health effects • Asthma programs • Dental counselling • Cancer registries	US$ 4 million	US$ 4.75 million
School Programs i.e. • Evidence-based curricula, teacher training, tobacco-free policies	US$ 25 million	US$ 37 million
Enforcement • Smoke-free places • Sales to minors	US$ 750,000	US$ 1.5 million

Partnership programs, i.e.
• Programs delivered by agencies better equipped than government for targeted populations, such as.
  • Quit-lines, physician training
  • Racial minorities, labour unions
	US$ 13 million	US$ 31 million

Counter-marketing, i.e. • Media advocacy, paid counter-advertising • Replacement of tobacco sponsorship	US$ 31 million	US$ 95 million
Cessation programs, i.e. • Full implementation of medical guidelines on smoking cessation • Development of appropriate materials	US$ 30 million	US$ 103 million
Surveillance and Evaluation, i.e. • Surveys on tobacco use and attitudes • Evaluation of impact and establishment of best methods	US$ 13.6 million	US$ 35 million
Administration and Management	US$ 6.8 million	US$ 17.7 million
TOTAL recommended by CDC	**US$ 156 million**	**US$ 407 million**
Per Capita Cost	**US$ 4.95 (CDN$ 7.00)**	**US$ 12.88 (CDN$ 18.00)**
Current federal government spending on tobacco control	**CDN$ 20 million**	**CDN$0.66**

Source: Centers for Disease Control and Prevention, Best Practices for Comprehensive Tobacco Control Programs—August 1999.

Ontario Expert Panel Recommends Increased Tobacco Taxes and Increased Program Funding

In December 1998, the Ontario Minister of Health (the Hon. Elizabeth Witmer) appointed an expert panel to advise on the renewal of the Ontario Tobacco Strategy, and appointed leading Ontario researchers on tobacco to this panel. These individuals are among Canada's foremost authorities on public health and tobacco use.

These epidemiologists, sociologists and medical experts reviewed the extensive evidence behind public health measures which encourage or discourage smoking among children and adults. The expert panel was unequivocal in its support for a comprehensive tobacco strategy funded on the basis of 0.5 cents per cigarette sold per year, introduced over a three year period. This is the equivalent to $250 million at a federal level – more than ten times the current federal investment.

"We recommend that the government of Ontario take action on tobacco prices, public education, marketing including packaging, labelling and information disclosure, retail controls, smoke-free spaces, supports for smoking cessation, finance and infrastructure, research, monitoring and evaluation and cost recovery litigation. Action is needed in all of these areas if the tobacco disaster is to be abated. Piece-meal measures, based on ease of implementation, low cost or other considerations, will not work."

Actions Speak Louder than Words. Report to the Minister of Health from her Expert Panel on the Renewal of the Ontario Tobacco Strategy. February 1999.

The expert panel recommended[56]:

- An immediate tax increase on cigarettes in Ontario to equal surrounding jurisdictions
- Active lobbying for co-operation on taxes with federal government and Quebec
- Tax paid markings printed directly on cigarette packages
- Intensive mass media campaigns
- Community-based public education programs
- School-based prevention programs
- Plain packaging, additional health warnings and ingredient information and package health warnings
- An end to deceptive labelling, such as 'light' and 'mild.'
- Stronger regulations to prevent sales to minors
- Tobacco products placed out of sight and behind counters at point of sale
- A ban on chewing tobacco and snuff
- Mandatory disclosure by tobacco companies of marketing and research
- Smoke-free indoor public places, with immediate implementation in youth recreation facilities
- Ban smoking in all indoor workplaces, with allowances for separately ventilated and enclosed smoking areas
- Comprehensive program to assist smokers in quitting

[56] Actions Speak Louder Than Words. Getting Serious About Tobacco Control in Ontario. A report to the Minister of Health from her Expert Panel on the Renewal of the Ontario Tobacco Strategy. Addiction Research Foundation, 1999.

- Increased staffing to manage strategy, with Chief Medical Officer in leadership role
- Comprehensive arm's length research
- Suing tobacco companies

Tobacco Industry Responsibility Act

Senate Bill S-13, introduced by Senator Colin Kenny in 1998 and sponsored in the House of Commons by Dr. Carolyn Bennett, mobilized Canadian communities to call on the government to invest in a meaningful campaign to protect kids from tobacco. S-13 proposed to set up an agency to run an effective anti-smoking campaign, and to fund its annual $120 million budget with a levy on tobacco manufacturers of 50¢ for each carton of cigarettes sold in Canada.

Responding to a government point of order, the House of Commons Speaker ruled that constitutional constraints prevented the bill from being introduced in the House of Commons after it had cleared the Senate. Although his ruling killed S-13, there is continued support for the kind of measures it proposes. In November 1998, a Canadian Cancer Society sponsored Environics poll showed that 76% of Canadians were supportive of the measures in this bill (82% when the undecided were factored out). Support was equally demonstrated across income, occupation, age and education categories. It was also equally felt across Canada (West 79%, Ontario 74%, Quebec 76%, Atlantic 80%). Only 17% of Canadians were opposed.

Senator Kenny's proposal satisfied a number of concerns triggered by recent events in tobacco control. Where the federal government had quickly decimated its anti-tobacco initiatives in 1995, S-13 promised stable funding over time, with adequate resources to achieve the desired effect. Where the government had shied away from the style of strong counter-advertising proven effective in U.S. campaigns (and well received in British Columbia), S-13 proposed an arm's length agency which would have the independence to pursue this strategy. Where the federal government's tax policy had resulted in increased tobacco industry profits, S-13 proposed to directly claw back $120 million of those new profits.

Although the government opposed S-13 on procedural grounds, it repeatedly emphasized its support for the principles of the bill. Several weeks after the Commons Speaker struck down bill S-13, the Honourable Allan Rock, Minister of Health, asked his caucus colleagues to review the issue of a youth education campaign against smoking and to make recommendations to him. The report of a caucus committee was received by the Minister in June 1999, but has not yet been made public.[57]

Recommendations for Investing in Health

- The federal government should adopt a comprehensive tobacco control program which includes measures equal in scope and impact to those recommended by the World Health Organization. This program could be designed on the evidence supplied by the U.S. Centers for Disease Control and Prevention and reflect the wide public and political support given to Bill S-13, the *Tobacco Industry Responsibility Act*, the Senate bill rejected in a controversial decision by the Commons Speaker. It should be noted that Bill S-13 recommended the allocation of a minimum of $120 million per year, while the CDC recommendation, if applied to Canada, would work out to a minimum expenditure of $ 222 million. Health Canada's current $20 million per year is far below these recommendations, far below the more than $90 million per year collected from the Tobacco Manufacturers' Health Promotion or the more than $80 million in federal tax revenue collected from illegal sales to youth.

- The Health Promotion Surtax on tobacco manufacturer profits, scheduled to expire in February 2000, should be made permanent. In addition, the surtax rate should be increased.

- The proposed increase in tobacco taxes and revenues could facilitate the expansion of the federal government's current tobacco control efforts and the fulfilment of expectations for a government replacement for Bill S-13, the *Tobacco Industry Responsibility Act.*

Recommendations for a "Clean-Hands" Tax Policy

- The 'health promotion surtax' on tobacco industry profits, which is due to expire in February 2000, should be renewed. As the government indicated in 1994, this is an appropriate mechanism to raise money to prevent and reduce tobacco use.

[57] According to the *Globe and Mail*, the caucus committee report called for both a tax increase and a "new Health Canada tobacco bureau to oversee a mass-media campaign aimed at getting young people to either quit or not start smoking." Anne McIlroy, "Ottawa urged to increase taxes on cigarettes," *Globe and Mail*, June 11, 1999, p. A4.

- The government should stop diverting this surtax revenue away from health promotion measures which reduce smoking. Currently, almost three-quarters of the surtax is spent on other objectives.

- Clear objectives for the ‘health promotion surtax’ should be set and a transparent accounting of how it is spent provided. No summary of expenditures on tobacco initiatives has been released since 1996-97.

- The government should refuse to profit from the sale of cigarettes to children. Federal revenues received from the illegal sale of cigarettes to minors is more than $80 million a year. This money should be allocated in its entirety to measures to reduce smoking.

Summary of Recommendations

The decision to roll back tobacco taxes was a deliberate policy shift made over the strenuous objections of experts both in the health community and in other policy areas. It was not, however, a one-time decision. Subsequent budget cycles have required governments to re-think and re-examine this decision. The federal and provincial governments involved have continued to refuse to restore taxes, other than through modest increases in some provinces. As a result, the damage from their initial 1994 decision accumulates and compounds.

"The psychology of smoker demand is such that they are more likely to absorb smaller and more frequent price increases than larger and less frequent price increases."

British American Tobacco, Key Area Paper: Excise Taxation of Tobacco Products, May 1992, p. 4. (Document number 699138229 in State of Minnesota, et al, v. Philip Morris, Inc., et al.)

To assist governments in rebuilding tobacco tax policies which protect children from nicotine addiction and which encourage smokers to quit, as well as strengthening policies which prevent the criminal contraband trade, we make the following recommendations:

Regaining lost ground

- Cigarette taxes should increase by at least $10.00 per carton ($5.00 federal, $5.00 provincial) in Ontario, Quebec, New Brunswick, Nova Scotia and Prince Edward Island.

- If provinces are unwilling to make a joint increase with the federal government, the federal government should set aside the "gentleman's agreement" and move quickly to act alone to raise tobacco taxes.

- From a public health perspective, a single, major tobacco tax increase is preferable to a series of small tax increases, since it is more likely to have a significant impact on consumption and youth smoking prevalence.

- Ontario taxes should be increased by a further $1.00 per carton (50¢ federal, 50¢ provincial) to remove the current differential between Ontario and Quebec taxes.

- There should also be a federal cigarette tax increase in the four Western provinces, in Newfoundland. And the territories of at least $2.00 per carton.

- In Alberta, there should be an additional provincial increase of at least $3.00 per carton, given that tobacco taxes are significantly lower than in neighbouring B.C. and Saskatchewan.

Restoring balance

- The loopholes allowing lower taxes for tobacco sticks and roll-your-own tobacco should be eliminated.

- The tax rate on a tobacco stick and on the quantity of roll-your-own needed to make a cigarette (now less than 1g) should equal the tax rate on one cigarette.

- Similarly, the loophole for raw leaf tobacco and for smokeless tobacco should be eliminated. The tax on one gram of raw leaf tobacco and on one gram of smokeless tobacco should be equalized with the tax rate on one cigarette, as is the case in Western Canada and Newfoundland.

Investing in Health

"The Americans have given us a safety margin by increasing their own taxes, which could help us."

Quebec Finance Minister Bernard Landry, Canadian Press, "Landry hints about higher cigarette tax", March 19, 1999

- The federal government should adopt a comprehensive tobacco control program which includes measures equal in scope and impact to those recommended by the World Health Organization. This program could be designed on the evidence supplied by the U.S. Centers for Disease Control and Prevention and reflect the wide public and political support given to Bill S-13, the *Tobacco Industry Responsibility Act,* the Senate bill rejected in a controversial decision by the Commons Speaker. It should be noted that Bill S-13 recommended the allocation of a minimum of $120 million per year, while the CDC recommendation, if applied to Canada, would work out to a minimum expenditure of $ 222 million. Health Canada's current $20 million per year is far below these recommendations, far below the more than $90 million per year collected from the Tobacco Manufacturers' Health Promotion or the more than $80 million in federal tax revenue collected from illegal sales to youth.

- The Health Promotion Surtax on tobacco manufacturer profits, scheduled to expire in February 2000, should be made permanent. In addition, the surtax rate should be increased.

- The government should stop diverting this surtax revenue away from health promotion measures which reduce smoking. Currently, almost three-quarter of the surtax is spent on other objectives.

- Clear objectives for the 'health promotion surtax' should be set and a transparent accounting of how it is spent provided. No summary of expenditures on tobacco initiatives has been released since 1996-97.

- The government should refuse to profit from the sale of cigarettes to children. Federal revenues received from the illegal sale of cigarettes to minors is more than $80 million a year. This money should be allocated in its entirety to measures to reduce smoking.

- The proposed increase in tobacco taxes and revenues could facilitate the expansion of the federal government's current tobacco control efforts and fulfill the need for a government replacement for Bill S-13, the *Tobacco Industry Responsibility Act.*

Preventing Smuggling

- The export tax should be increased to $12 per carton, with an equivalent amount for tobacco sticks and roll-your-own tobacco. This would further cut into the profit margin of anyone trying to smuggle back duty-free, Canadian-made cigarettes from the United States.

- The export tax exemption for cigarette shipments going to foreign (mainly U.S.) duty-free stores should be removed.

- Canada should entirely eliminate duty-free sales of tobacco, which provide access to low-priced tobacco and reduce government revenue. The European Union recently eliminated duty-free tobacco sales for travellers within the EU, establishing a precedent for other regions. Norway and Australia are also considering similar steps.[58] Canada should enter into bilateral agreements with the United States, the EU and other jurisdictions until a multilateral agreement can be reached.

- Clearly visible, province-specific tax markings should be printed on cigarette packs. This would address concerns about inter-provincial smuggling, and make it impossible to simply re-wrap smuggled packs with fraudulent 'tax-paid' tear tapes. This measure was announced in the 1999 federal budget and should be

[58] Bloomberg News, "Norway's Finance Minister Considers Scrapping Tax-Free, DN Says," Feb. 4, 1999.

implemented as soon as possible.

- Tax-paid markings on each cigarette should be implemented.

- Canada should support the development of the International Framework Convention on Tobacco Control, with provisions to address international tobacco smuggling.[59]

- The RCMP should step up its enforcement activities against cigarette smuggling, and investigations should concentrate on major suppliers of contraband, rather than on small-time smugglers. Corporate involvement in smuggling should be one of the issues investigated by a Royal Commission of Inquiry into the tobacco industry, as recommended by the National Tobacco OR Kids Coalition.

Anticipated Benefits

- The recommended tax increases will result in a significant reduction in tobacco use, particularly among youth.

- Through a greatly enhanced tobacco control program, the government can expect to reduce smoking further and greatly reduce future health-care costs and economic losses. The Health Promotion Surtax (estimated at over $90 million per year) and the federal tax revenues received as a result of illegal cigarette sales to children (estimated at over $80 million per year) could provide a funding base for such a program; a portion of the increased revenue resulting from the tobacco tax increase could also be used.

- The recommended increases in low-tax provinces will generate about $1.5 billion in incremental revenue for governments, split between provincial and federal governments. The federal treasury could anticipate $750 million in additional revenues, with $450 million for Ontario, $250 million for Quebec and $65 million for the Maritime provinces.

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[59] In May, the 191 member governments of the World Health Assembly, the governing body of the World Health Organization, approved plans to begin work on drafting such a convention. See WHO press release: "World Health Assembly Paves Way for Framework Convention on Tobacco Control," May 24, 1999.

Appendix A

Tables

Table A: Taxes and Prices for Manufactured Cigarettes across Canada, July 1999

Per 200 Manufactured Cigarettes (1 carton)	*Prov. Tobacco Taxes*	*Federal Excise Tax*	*Federal Excise Duty*	*Product Cost (approx)*	*Price before sales taxes*	*Prov. Sales Tax*	*Federal GST*	*Final Retail Price*	*Cost per Smoke*
'Low-Tax' Region									
Ontario	$ 4.70	$ 2.65	$ 5.50	$ 13.50	$ 26.35	8.0%	7.0%	$ 30.30	$ 0.15
Quebec	$ 8.00	$ 2.25	$ 5.50	$ 13.50	$ 29.25	0.0%	7.0%	$ 31.30	$ 0.16
New Brunswick	$ 7.70	$ 4.45	$ 5.50	$ 13.50	$ 31.15	8.0%	7.0%	$ 35.82	$ 0.18
Nova Scotia	$ 9.04	$ 4.65	$ 5.50	$ 13.50	$ 32.69	8.0%	7.0%	$ 37.59	$ 0.19
Prince Edward Island	$ 12.65	$ 3.40	$ 5.50	$ 13.50	$ 35.05	0.0%	7.0%	$ 37.50	$ 0.19
'High-Tax' Regions									
British Columbia	$ 22.00	$ 5.35	$ 5.50	$ 13.50	$ 46.35	0.0%	7.0%	$ 49.59	$0.25
Alberta	$ 14.00	$ 5.35	$ 5.50	$ 13.50	$ 38.35	0.0%	7.0%	$ 41.03	$0.21
Saskatchewan	$ 17.20	$ 5.35	$ 5.50	$ 13.50	$ 41.55	6.0%	7.0%	$ 46.95	$0.23
Manitoba	$ 16.00	$ 5.35	$ 5.50	$ 13.50	$ 40.35	7.0%	7.0%	$ 46.00	$0.23
Newfoundland	$ 22.00	$ 5.35	$ 5.50	$ 13.50	$ 46.35	8.0%	7.0%	$ 53.30	$0.27

Source: Tax rates and estimate of product cost provided by Finance Canada. Estimated product cost does not reflect diverse selling conditions.

Table B. Taxes and Prices for Tobacco Sticks across Canada, July 1999

Per 200 Tobacco Sticks	*Prov. Tobacco Taxes*	*Federal Excise Tax*	*Federal Excise Duty*	*Product Cost (approx)*	*Price before sales taxes*	*Prov. Sales Tax*	*Federal GST*	*Final Retail Price*	*Cost per Smoke*
'Low-Tax' Region									
Ontario	$ 4.70	$ 1.85	$ 3.67	$ 11.50	$ 21.72	8.0%	7.0%	$ 24.98	$0.12
Quebec	$ 5.90	$ 1.85	$ 3.67	$ 11.50	$ 22.92	0.0%	7.0%	$ 24.52	$0.12
New Brunswick	$ 7.00	$ 2.53	$ 3.67	$ 11.50	$ 24.70	8.0%	7.0%	$ 28.41	$0.14
Nova Scotia	$ 7.60	$ 2.93	$ 3.67	$ 11.50	$ 25.70	8.0%	7.0%	$ 29.56	$0.15
Prince Edward Island	$ 10.40	$ 2.13	$ 3.67	$ 11.50	$ 27.70	0.0%	7.0%	$ 29.64	$0.15
'High-Tax' Regions									
British Columbia	$ 22.00	$ 2.93	$ 3.67	$ 11.50	$ 40.10	0.0%	7.0%	$ 42.91	$0.21
Alberta	$ 14.00	$ 2.93	$ 3.67	$ 11.50	$ 32.10	0.0%	7.0%	$ 34.35	$0.17
Saskatchewan	$ 17.20	$ 2.93	$ 3.67	$ 11.50	$ 35.30	6.0%	7.0%	$ 39.89	$0.20
Manitoba	$ 16.00	$ 2.93	$ 3.67	$ 11.50	$ 34.10	7.0%	7.0%	$ 38.87	$0.19
Newfoundland	$ 22.00	$ 2.93	$ 3.67	$ 11.50	$ 40.10	8.0%	7.0%	$ 46.12	$0.23

Source: Tax rates and estimate of product cost provided by Finance Canada. Estimated product cost does not reflect diverse selling conditions.

Table C: Taxes and Prices for Fine-Cut Tobacco across Canada, July 1999

Per 200 gr. Fine-cut tobacco	*Prov. Tobacco Taxes*	*Federal Excise Tax*	*Federal Excise Duty*	*Product Cost (approx)*	*Price before sales taxes*	*Prov. Sales Tax*	*Federal GST*	*Final Retail Price*	*Cost per Smoke**
'Low-Tax' Region									
Ontario	$ 4.70	$ 2.13	$ 3.67	$ 11.00	$ 21.50	8.0%	7.0%	$ 24.73	$0.05
Quebec	$ 3.80	$ 2.13	$ 3.67	$ 11.00	$ 20.60	0.0%	7.0%	$ 22.04	$0.06
New Brunswick	$ 5.48	$ 2.13	$ 3.67	$ 11.00	$ 22.28	8.0%	7.0%	$ 25.62	$0.06
Nova Scotia	$ 6.70	$ 2.13	$ 3.67	$ 11.00	$ 23.50	8.0%	7.0%	$ 27.03	$0.06
Prince Edward Island	$ 6.82	$ 2.13	$ 3.67	$ 11.00	$ 23.62	0.0%	7.0%	$ 25.27	$0.06
'High-Tax' Regions									
British Columbia	$ 22.00	$ 2.13	$ 3.67	$ 11.00	$ 38.80	0.0%	7.0%	$ 41.52	$0.09
Alberta	$ 8.00	$ 2.13	$ 3.67	$ 11.00	$ 24.80	0.0%	7.0%	$ 26.54	$0.06
Saskatchewan	$ 11.40	$ 2.13	$ 3.67	$ 11.00	$ 28.20	6.0%	7.0%	$ 31.87	$0.07
Manitoba	$ 10.60	$ 2.13	$ 3.67	$ 11.00	$ 27.40	7.0%	7.0%	$ 31.24	$0.07
Newfoundland	$ 14.66	$ 2.13	$ 3.67	$ 11.00	$ 31.46	8.0%	7.0%	$ 36.18	$0.08

*Source: Tax rates and estimate of product cost provided by Finance Canada. Estimated product cost does not reflect diverse selling conditions. *Calculations for roll-your-own based on .45 grams per cigarette, given the availability of the brand Rockport.*

Table D. Tax Revenues (not including sales taxes) from cigarette sales for provincial and federal governments, 1991-92 to 1998-99.

Revenues from Tobacco Taxes ($000,000)	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	5 year Impact
			🡐 Pre-roll-back	Post roll-back 🡒					
'low-tax region'									
Prince Edward Island	$18.3	$18	$17.9	$12.4	$13.4	$13.9	$13	$13.4	-$23
Nova Scotia	$105	$102	$90.1	$60.4	$67.7	$86.3	$75.8	$74.6	-$85
New Brunswick	$59.6	$50.3	$43.5	$34.9	$38.1	$40.9	$42.35	$43	-$18.2
Quebec	$513	$411.3	$288.2	$184	$264.6	$283.1	$323	$490	$103.7
Ontario	$1,028	$969	$773	$324	$337	$356	$425	$470	-$1,953
'High-tax region'									
Manitoba	$129.8	$128.1	$123.2	$116.1	$112.4	$109.7	$112.9	$110	-$54
Saskatchewan	$104.6	$115.2	$110.8	$115.6	$114.1	$116.7	$123.6	$123	$39
Alberta	$322.1	$313.1	$312	$322	$311	$317	$330	$345	$65
British Columbia	$433	$483.2	$482	$516.7	$482.3	$487.9	$486	$476	$36
Newfoundland	$55.3	$61.7	$67.8	$67.5	$65.8	$63.6	$64	$64	-$14
Federal government	$3,312	$2,980	$2,566	$1,914.3	$1,941	$2,031	$2,049	$2,049	-$2,865
'Low-tax' provinces	$1,724	$1,550	$1,212.7	$615.7	$720.9	$780.2	$879.1	$1,091	-$1,976
'High-tax' provinces	$1,044	$1,101.5	$1,096.2	$1,138	$1,085.7	$1,095	$1,116.5	$1,118	$72
Total - Federal & Provincial taxes	**$6,080.8**	**$5,632.2**	**$4,878.9**	**$3,668**	**$3,747.6**	**$3,906.2**	**$4,044,**	**$4,258**	**-$4,769.7**

Sources: Public accounts and/or budget documents for each jurisdiction.
The revenue loss derived by comparing revenues in 1998-99 to those in 1993-94 results in an underestimate of the total loss. Revenues in 1993-94 were lower than they would have been without the tax roll back, because they include revenues for two months after the roll-back (February and March, 1994).

Table E. Earnings (before income taxes) from cigarette sales for tobacco companies in Canada, 1991 to 1998

Earnings from Cigarette Sales ($000,000)	1991	1992	1993	1994	1995	1996	1997	1998
Imperial Tobacco	$397	$432	$462	$592	$645	$705	$775	$815
Rothman's Benson & Hedges	$129	$147	$158	$173	$168	$177	$196	$188
RJR-Macdonald		------------------- Not available--------------------------						
Industry Total (minus RJR-Macdonald)	**$526**	**$579**	**$620**	**$765**	**$813**	**$882**	**$971**	**$1,003**

Sources: Imasco Limited Annual reports, 1991 – 1998; Rothmans Incorporated Annual Reports, 1991 – 1998. Where fiscal years for Rothmans ends March 31, and information has been included in the previous calendar year.

Table F. Per-Capita Consumption (15+) of Cigarettes & Equivalents, by province 1988 – 1998

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
'Low-Tax' Region											
Ontario	2,517	2,479	2,277	2,009	1,811	2,206	2,222	2,183	2,225	2,094	2,133
Quebec	3,312	2,918	2,615	2,184	1,502	1,016	2,470	2,360	2,417	2,298	2,290
New Brunswick	3,159	2,663	2,285	1,587	1,519	1,302	1,773	1,928	2,111	1,906	1,995
Nova Scotia	3,502	2,879	2,437	2,112	2,234	2,020	2,401	2,400	2,529	2,433	2,045
Prince Edward Island	2,187	2,407	2,178	1,927	1,989	1,693	2,128	2,195	1,965	1,814	1,979
'High-Tax' Region											
British Columbia	2,416	2,269	2,136	1,927	1,945	1,820	1,708	1,574	1,568	1,507	1,437
Alberta	3,375	3,182	2,992	2,855	2,830	2,716	2,793	2,516	2,426	2,381	2,411
Saskatchewan	2,482	1,917	1,804	1,613	1,463	1,370	1,407	1,541	2,025	1,995	1,987
Manitoba	3,559	3,215	2,642	2,295	2,324	2,230	2,037	1,655	1,726	1,758	1,788
Newfoundland	3,064	2,782	2,411	2,243	2,111	1,633	1,781	1,758	1,721	1,324	1,754
Average – High Tax	2900	2653	2433	2232	2210	2073	2038	1865	1897	1857	1849
Average – Low-Tax	2883	2667	2409	2061	1707	1723	2303	2248	2303	2175	2196

Sources:
Population estimates, Statistics Canada estimates for July of each year.
Tobacco Sales based on monthly shipment data provided by the tobacco companies to Health Canada, and obtained under Access to Information; fine cut is converted to cigarette equivalents at .7 grams per cigarette. Data does not include sales from companies other than the three major manufacturers, who share 99% of the market.

Table G . Per-Capita Consumption (15+) of Cigarettes & Equivalents, 1949 - 1998

	Cigs*	Fine Cut*	Contraband *	Total*	Pop 15+*	Per cap
1949	16,836,000	11,430,000	0	28,266,000	9,509	2,973
1950	17,172,000	11,750,000	0	28,922,000	9,642	3,000
1951	15,672,000	12,380,000	0	28,052,000	9,759	2,875
1952	17,844,000	14,060,000	0	31,904,000	10,006	3,188
1953	21,000,000	11,840,000	0	32,840,000	10,217	3,214
1954	22,116,000	11,110,000	0	33,226,000	10,452	3,179
1955	24,576,000	10,700,000	0	35,276,000	10,659	3,309
1956	27,000,000	9,620,000	0	36,620,000	10,856	3,373
1957	30,144,000	9,430,000	0	39,574,000	11,153	3,548
1958	32,404,000	10,800,000	0	43,204,000	11,395	3,792
1959	33,822,000	10,210,000	0	44,032,000	11,625	3,788
1960	34,829,000	10,300,000	0	45,129,000	11,840	3,812
1961	36,699,000	10,390,000	0	47,089,000	12,046	3,909
1962	38,683,000	10,570,000	0	49,253,000	12,273	4,013
1963	39,877,000	10,120,000	0	49,997,000	12,513	3,996
1964	40,639,000	9,620,000	0	50,259,000	12,792	3,929
1965	43,013,000	9,980,000	0	52,993,000	13,088	4,049
1966	46,276,000	8,710,000	0	54,986,000	13,423	4,096
1967	46,864,000	8,160,000	0	55,024,000	13,791	3,990
1968	46,269,000	8,750,000	0	55,019,000	14,143	3,890
1969	46,582,000	8,620,000	0	55,202,000	14,490	3,810
1970	49,823,000	8,660,000	0	58,483,000	14,843	3,940
1971	50,864,000	8,890,000	0	59,754,000	15,582	3,835
1972	53,292,000	6,974,000	0	60,266,000	15,935	3,782
1973	54,864,000	7,359,000	0	62,223,000	16,309	3,815
1974	57,123,000	6,705,000	0	63,828,000	16,722	3,817
1975	57,756,000	6,592,000	0	64,348,000	17,141	3,754
1976	60,745,000	6,577,000	0	67,322,000	17,545	3,837
1977	61,787,000	6,316,000	0	68,103,000	17,919	3,801
1978	61,610,000	5,660,000	0	67,270,000	18,271	3,682
1979	63,866,000	5,227,000	0	69,093,000	18,620	3,711
1980	64,494,000	4,784,000	0	69,278,000	19,008	3,645
1981	66,559,000	4,764,000	0	71,323,000	19,357	3,685
1982	66,338,000	5,553,000	0	71,891,000	19,666	3,656
1983	63,089,000	6,026,000	0	69,115,000	19,923	3,469
1984	61,734,000	6,165,000	0	67,899,000	20,174	3,366
1985	58,953,000	6,866,000	0	65,819,000	20,427	3,222
1986	55,436,000	7,413,000	200,000	63,049,000	20,707	3,045
1987	52,613,000	7,863,000	510,000	60,986,000	21,009	2,903
1988	51,053,265	8,026,798	560,000	59,640,063	21,298	2,800
1989	47,601,965	7,749,215	1,060,000	56,411,180	21,696	2,600
1990	45,917,521	6,657,578	1,270,000	53,845,099	22,027	2,445
1991	39,363,928	6,423,598	6,430,000	52,217,526	22,299	2,342
1992	35,060,790	5,079,936	8,200,000	48,340,726	22,556	2,143
1993	30,224,722	3,829,427	14,500,000	48,554,149	23,009	2,110
1994	45,743,167	3,964,233	2,500,000	52,207,400	23,284	*2,242*
1995	45,581,675	3,833,467	800,000	50,215,142	23,631	*2,125*
1996	47,117,904	4,050,144	500,000	51,668,048	23,981	*2,155*
1997	45,520,274	3,969,216	500,000	49,989,490	24,294	*2,058*
1998	45,613,257	4,183,810	500,000	50,297,067	24,635	*2,042*

Had trend continued

All numbers are in 000s except for per capita data

Population Sources:

- *Statistics Canada Catalogue 91-512 Occasional, "Population 1921-1971, Revised annual estimates of population, by sex and age group, Canada and the provinces", 1973*
- *Statistics Canada, Catalogue No. 91-537, "Revised Intercensal Population and Family Estimates,July 1, 1971-1991*
- *Statistics Canada, Catalogue No. 91-213, "Annual Demographic Statistics", annual, 1992-1998.*
- *Note: There is an unusually big jump in the population difference between 1970 and 1971, perhaps because different data sources used.*

Sales data:

- *Statistics Canada, Catalogue No.32-022, monthly, December issues, 1988-98*
- *Goodyear, Michael, "Canadian tobacco taxation 1867-1994" Hamilton Regional Cancer Centre, Hamilton, ON, Canada, 7 September 1994.*

Contraband estimates:

- *For 1986 – 1991 Canadian Tobacco Manufacturers' Council, [untitled, 1993] summary of Canadian and American tobacco sales, including sales of Canadian contraband.*
- *For 1992, Lindquist Avey Macdonald Baskerville "1992 contraband estimate -- an update" September 27, 1993.*
- *For 1993, Lindquist Avey Macdonald Baskerville, "The impact of reducing tobacco taxes on the contraband market" June 27, 1994*
- *For 1993, Lindquist Avey Macdonald Baskerville, "Cigarette smuggling in the United States" August 15, 1994.*
- *For 1993 – 1995, Imasco Ltd. "Annual Report 1995" 1996.*
- *For 1996-1998, contraband has been estimated at 500 million units per year.*
- *There is some difficulty in estimating contraband, thus creating resulting uncertainty in per capita consumption estimates.*

Cigarette equivalents

- *Throughout the time period in the graph, one gram of fine cut has been treated equivalent to one cigarette. However, in more recent years, manufacturers have expanded fine cut tobacco so that less is required to make one cigarette. At least one brand today (Rockport) requires just .45g to make one cigarette. Some other brands need only .55g to make a cigarette. If fine cut were converted at .55g per cigarette, 1998 per capita consumption would be 2142, 6.8% higher than represented on the graph.*

Table H. Federal and Provincial Tax Revenues from the underage sale of cigarettes to children,

	Minimum Age	Number of underage smokers	Cigarettes smoked per day by underage smokers	Cigarettes smoked per year by underage smokers
Prince Edward Island	19	1,670	15,532	5,669,180
Nova Scotia	19	16,014	145,689	53,176,485
New Brunswick	19	12,559	117,415	42,856,475
Quebec	18	151,589	1,338,839	488,676,235
Ontario	19	191,103	1,637,290	597,610,850
Newfoundland	19	11,378	105,511	38,511,515
Manitoba	18	21,865	196,399	71,685,635
Saskatchewan	18	17,584	154,973	56,565,145
Alberta	18	55,959	518,601	189,289,365
B.C.	19	71,339	605,626	221,053,490
Canada		**551,060**	**4,835,875**	**1,765,094,375**

	Provincial Taxes on underage smoking	Federal Taxes on underage smoking	Provincial Sales tax on underage smoking	GST/HST on underage smoking
Prince Edward Island	$358,575	$252,278	$0	$69,546
Nova Scotia	$2,403,577	$2,698,706	$695,335	$608,418
New Brunswick	$1,649,974	$2,132,109	$533,991	$467,242
Quebec	$19,547,049	$18,936,204	$0	$5,002,822
Ontario	$14,043,854	$24,352,642	$6,298,818	$5,511,466
Newfoundland	$4,236,266	$2,089,249	$714,003	$624,753
Manitoba	$5,734,850	$3,888,945	$1,012,380	$1,012,380
Saskatchewan	$4,864,602	$3,068,659	$587,570	$822,598
Alberta	$13,250,255	$10,268,948	$0	$2,540,736
B.C.	$24,315,883	$11,992,151	$0	$3,586,040
Canada	**$90,404,890**	**$79,679,895**	**$9,842,100**	**$20,246,005**

Source: The figures were calculated by Physicians for a Smoke-Free Canada using the following in-puts:

- *Smoking rates among under-age smokers and number of cigarettes smoked by underage smokers derived from the Youth Smoking Survey, 1994 (Health Canada, 1996)*
- *Population estimates adjusted for legal smoking age in each province based on tables provided by Statistics Canada*

These estimates are conservative because:

(a) smokers underestimate the number of cigarettes smoked per day when self-reporting

(b) other surveys of youth have found higher prevalence among 15-19 year olds than the 1994 Youth Smoking survey)

(c) sales for the three territories are excluded – about .3% of the population.

Table I. Changes in tobacco taxes 1994 – 1999, including adjustments for inflation.

	1994 reduction (per carton of 200 cigarettes)	Increases since 1994 (per carton of 200 cigarettes)	% increase in Tobacco Taxes 1994-98	Total taxes pre-roll-back (per carton)	Total taxes pre roll-back adjusted for inflation to 1999	Tax change since 1994 adjusted for inflation	% change in tobacco taxes adjusted for inflation
B.C.	$5.00	$0	0%	$37.85	$40.80	-$2.95	-7 %
Alta	$5.00	$0	0%	$29.85	$32.18	-$2.33	-7 %
Sask	$5.00	$0.80	16%	$31.85	$34.33	-$1.68	-5 %
Man	$5.00	$0	0%	$31.85	$34.33	-$2.48	-7 %
Ont	$19.20	$3.20	17%	$28.85	$31.10	$0.95	3 %
Que	$21.00	$5.08	24%	$29.61	$31.92	$2.77	9 %
N.B.	$14.00	$2.20	16%	$29.45	$31.75	-$0.10	-0.3%
N.S.	$14.00	$2.60	18%	$29.45	$31.75	$0.30	0.9%
P.E.I.	$18.50	$4.60	25%	$35.45	$38.22	$1.83	4 %
Nfld	$5.00	$0	0%	$36.41	$39.25	-$2.84	-7 %

Table J. Canadian Exports of Cigarettes and Tobacco, 1980 – 1998 (000s).

Year	Total Canadian Exports of Cigarettes and Fine-cut Tobacco	Canadian Exports of Cigarettes	Canadian Exports of Fine-cut Tobacco (in cigarette equivalents)
1980	404,767	381,058	23,709
1981	414,915	400,332	14,583
1982	442,799	410,423	32,376
1983	507,263	476,333	30,930
1984	486,943	468,276	18,667
1985	493,711	477,100	16,611
1986	737,006	716,871	20,135
1987	1,636,101	1,079,809	556,292
1988	3,033,619	3,008,005	25,614
1989	1,220,998	1,122,489	98,509
1990	2,246,903	1,682,828	564,075
1991	6,896,137	4,510,166	2,385,971
1992	10,043,786	7,595,113	2,448,673
1993	18,599,074	15,660,930	2,938,144
1994	2,454,381	1,475,387	978,994
1995	2,360,933	1,050,872	1,310,061
1996	1,078,328	830,365	247,963
1997	1,052,925	882,763	170,162
1998	1,428,192	1,184,114	244,078

Source: Statistics Canada, Exports by Commodity, Catalogue 65-004, December issues, 19980 – 1998.

Table K. Imperial Tobacco earnings (pre-tax profits) per cigarette or cigarette equivalent, 1990 – 1998

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Billions of cigarettes (and equivalents) sold	28.3	30.6	28.3	28.9	32.7	32.9	34.0	33.7	34.2
Profits ($ millions)	$367.1	$397	$432	$462	$592	$645	$705	$775	$815
Profit per cigarette	$0.013	$0.013	$0.015	$0.016	$0.018	$0.019	$0.021	$0.023	$0.024
Profit per package (25)	$0.32	$0.32	$0.38	$0.40	$0.45	$0.49	$0.52	$0.57	$0.60
Annual profit per pack-a-day smoker	$118.37	$118.39	$139.29	$145.87	$165.20	$178.89	$189.21	$209.85	$219.65

Source: IMASCO Annual Reports, 1990 – 1998.