



# **Anti-Contraband Policy Measures: Evidence for Better Practice**

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## Executive Summary

Tobacco taxation has been used in many jurisdictions as a policy measure to discourage smoking. The effectiveness of taxation strategies can be undermined by widespread availability of tobacco products. This knowledge synthesis presents information on a wide-range of tobacco anti-contraband measures, in an effort to ascertain the relative effectiveness of various policy measures for addressing contraband in Canada and around the world. This report is based on a comprehensive literature search, a series of key informant interviews, and four Expert Focus Panels with participants from Canada, the United States and several European jurisdictions.

This paper identifies and defines the different forms of contraband tobacco, including casual bootlegging, organized international smuggling, illicit manufacturing, tax-avoidance from duty-free sources, and counterfeit cigarettes.

The effectiveness of ten anti-contraband policy measures are explored: licensing, tax-markings/stamping, tracking and tracing, record-keeping/control measures, enhanced enforcement, export taxation, tax harmonization, tax agreements/compacts, legally binding agreements with the tobacco industry and memoranda of understanding (MOUs), and public awareness campaigns.

Analysis suggests that both type of contraband and means of distribution influence the effectiveness of different policies and the unintended consequences of action. For example, policy measures that were effective for legally manufactured, but cross-border smuggled cigarettes in the 1990s are less effective for illicitly manufactured and counterfeit cigarettes that dominate contraband activity today in many countries.

Case studies of Brazil, Australia and Canada indicate that while contraband sources often emerge domestically, given the ease of transport and manufacture, sources can be easily displaced to neighboring or overseas jurisdictions.

Inter-agency cooperation (both domestic and international) emerges as a vital component of all successful anti-contraband strategies. The dynamic nature of contraband supply requires a comprehensive approach that focuses on both immediate and future threats.

Policies designed to ensure contraband tobacco products do not appear in the legitimate retail sector (such as tax-paid markings, licensing, record-keeping) and measures to ensure that counterfeit products are easily identified (such as enhanced taxation stamps) are vital resources. Adequate investment in enforcement is critical to the success of anti-contraband measures.

Given the global scope of the phenomenon, greater international cooperation and information sharing is paramount.

Obstacles and potential solutions to implementing various anti-contraband measures are examined from the unique perspective of Canadian First Nations.

Very little data exists on contraband tobacco and there is almost no evaluative research on the effectiveness of anti-contraband policy measures, making study of the problem extremely challenging.

## Section One: Research Approach and Background

### Background of Contraband Tobacco

Tobacco smuggling/tax-evasion is a global issue, with unique manifestations in different regions across the world. According to the Framework Convention Alliance, a conglomeration of international tobacco-control non-governmental organizations (NGOs) and advocates, approximately 10.7% of global sales are illicit, representing 600 billion cigarettes.<sup>1</sup> Revenue loss due to contraband is estimated to be \$40-50 billion US annually.<sup>2</sup> The illicit trade and consumption of tobacco products affects numerous priorities, including public health, revenue, and crime reduction. To eliminate contraband tobacco, the cooperation and attention of numerous governments, organizations, and agencies is required.

The World Health Organization Intergovernmental Negotiating Body (INB) is holding annual meetings to create an illicit trade protocol that countries can use to address contraband problems. The draft protocol highlights three areas for attention: the supply chain, enforcement, and international cooperation. To control the supply chain, INB delegates propose licensing of all supply chain participants, customer identification and verification requirements, tracking and tracing of products through the supply chain, record keeping duties for key participants, preventative measures adopted by all supply chain participants, a ban on all internet and phone sales of tobacco products to consumers, and a ban of tax-free and tax-reduced tobacco products to international consumers. To enhance enforcement, INB delegates propose the establishment of a comprehensive set of offences, measures to hold corporations liable for offences, dissuasive sanctions, measures to enable searches and seizures, recovery of unpaid taxes from manufacturers, the destruction of confiscated property, enhanced investigative techniques, enhanced law enforcement capacity, and public education about contraband. To promote international cooperation, INB delegates propose information sharing between jurisdictions, assistance and cooperation with respect to training and technologies, exercise of jurisdiction, joint investigations, law enforcement cooperation, provision of mutual legal assistance, extradition, and transfer of prosecution proceedings where necessary.<sup>3</sup>

Scholars have differentiated between the various methods of tobacco smuggling/tax-evasion, emphasizing differences in the scale of the smuggling, as well as the motivations of the actors involved. For our purposes, the following definitions will be used:

<sup>1</sup> Framework Convention Alliance. (2008). *How Big Was the Global Illicit Tobacco Trade Problem in 2006?* Framework Convention Alliance, February 2008. <http://www.fctc.org/docs/documents/fca-2008-inb-illicit-trade-inb1-factsheet-how-big-was-illicit-trade-2006-en.pdf>; Accessed 25 April 2008.

<sup>2</sup> Ibid.

<sup>3</sup> WHO Framework Convention on Tobacco Control Conference of the Parties. Intergovernmental Negotiating Body on a Protocol on Illicit Trade of Tobacco Products, Second Session. Geneva, Switzerland, October 20-25. Accessed on April 14, 2009 from: [http://www.who.int/gb/fctc/PDF/it2/FCTC\\_COP\\_INB\\_IT2\\_3-en.pdf](http://www.who.int/gb/fctc/PDF/it2/FCTC_COP_INB_IT2_3-en.pdf).

**Cross-border shopping:** refers to tobacco products purchased in one jurisdiction for personal consumption in another. Consumers take advantage of a lower tax-rate on products they plan to consume in a higher-taxed jurisdiction.<sup>4</sup> Though these purchases are in excess of legal cross-border duty-free shipments, this activity is generally for personal use, and the goods are not likely to be sold to external sources.

**Bootlegging:** Joossens et al. (2000) define bootlegging as:

The purchase of cigarettes and other tobacco products in low-tax jurisdictions in amounts that exceed the limits set by customs regulations for resale in high-tax jurisdictions.<sup>5</sup>

In contrast to cross-border shopping, bootleggers may utilize a low-tech system of organization to facilitate the resale of lower-taxed cigarettes to purchasers for profits.<sup>6</sup> This amounts to tax-avoidance, as not all applicable taxes are collected.

**Organized cigarette smuggling:** Large-scale organized smuggling is defined as the:

Illegal transportation, distribution, and sale of large consignments of cigarettes and other tobacco products, generally avoiding all taxes. This type of smuggling usually involves millions of cigarettes that are smuggled over long distances, often involving large organized crime networks and sophisticated systems for distributing smuggled cigarettes at the local level.<sup>7</sup>

Rather than an informal collection of a small number of actors, large-scale organized smuggling represents highly-coordinated attempts to divert shipments of tobacco products to the illicit market. What constitutes contraband is, in general, “any tobacco product that does not comply with the provisions of all applicable ... statutes. This includes importation, stamping, marking, manufacturing, distributing, and payment of duties and taxes.”<sup>8</sup> Thus, contraband can encompass cross-border bootlegging operations, large-scale container fraud, or illicit manufacturing operations (see Figure 1).

<sup>4</sup> Joossens L, Chaloupka F J, Merriman D, Yurekli A. (2000) “Issues in the Smuggling of Tobacco Products.” In: Jha P, Chaloupka F J, Eds.. *Tobacco Control in Developing Countries*. London, UK: Oxford University Press. p. 395.

<sup>5</sup> Ibid, p. 397.

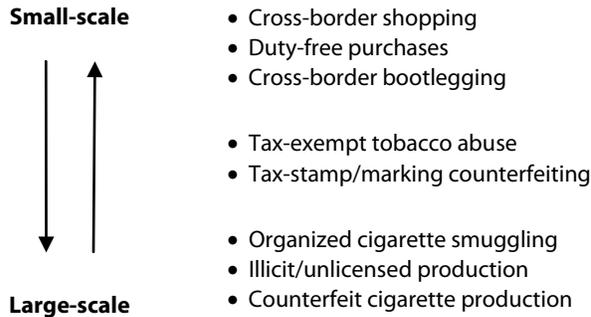
<sup>6</sup> Ibid, p. 398.

<sup>7</sup> Ibid.

<sup>8</sup> Royal Canadian Mounted Police (RCMP). (2008) *Contraband Tobacco Enforcement Strategy*. RCMP Customs and Excise Branch and the Government of Canada., p. 12. Note: the report from which this quote was taken refers to “federal and provincial statutes,” though this has been removed in order to allow the definition to apply in a global sense.

Counterfeit cigarettes are a recent phenomenon, with a broadening global reach. They result from both attempts to replicate cigarette packages or stamps/markings and the illicit production of cigarettes to explicitly look like a commercial brand when no connection to the legal company exists.

**Figure 1: Types of Contraband Tobacco**



Our study has been designed primarily to assess issues surrounding large-scale smuggling, given that most estimates suggest these activities result in the greatest losses of revenue. However, policies relevant to casual tobacco tax evasion, through purchases of tax-exempt tobacco from Aboriginal communities and other untaxed sources are also discussed.

### ***Policy Measures***

Through review of the literature and consultation with co-investigators, ten anti-contraband policies were identified, which have been implemented in a number of jurisdictions. The policies identified are:

- Licensing
- Tax Markings/Stamps
- Tracking and Tracing
- Record-keeping/Control Measures
- Enhanced Enforcement
- Export Taxation
- Tax Harmonization
- Tax Agreements with First Nations and Native American Communities
- Legally Binding Agreements and Memoranda of Understanding (MOU) with Industry
- Public Awareness Campaigns

### **Licensing**

Licensing is a component of explicit regulation of various bodies in the tobacco supply chain including: manufacturers, distributors, wholesalers, and in some cases, the retailers and/or growers. Relevant entities are required to apply for a license in order to carry on business in the production or

sale of tobacco. In general, licensing regimes impose specific obligations and regulations on the licensed entities. Failure to comply with such obligations or regulations can prompt a financial penalty, a suspension of the license or, in extreme cases, a revocation of the license.

### **Tax Markings/Stamping**

Most jurisdictions have a means of demonstrating that relevant taxes have been paid on each package of tobacco product, including “duty paid” markings or tax-stamps on the outer packaging. For products that are destined for export to another jurisdiction, or to duty-free zones, some jurisdictions apply special stamps/markings indicating that duty has not been paid on the product. The use of such stamps/markings allows inspection/enforcement officials to analyze each package of cigarettes for sale in retail outlets to ensure that the price of the product includes relevant taxes.

In some jurisdictions, the package markings have special characteristics allowing for authorities to determine whether the product is legitimate or counterfeit through scanning technologies. The markings/stamps can also contain encrypted information that reveals the origin of the product and relevant information about its destination on scanning.

### **Tracking and Tracing**

Tracking and tracing mechanisms use machine-readable markings on tobacco packages containing information about the product, such as its origin and destination. In a comprehensive tracking and tracing regime, authorities are able to track the movement of the product along the supply chain. During inspections or seizures, inspectors are able to scan the marking on the package, both to trace the origin of the product, and to determine the last point at which the product was scanned. This provides investigators with a clear view of where the product came from, where it was destined to go, and at what point the product was diverted from its intended route. Similar to enhanced tax-paid markings, tracking and tracing markings also allow authorities to quickly determine whether a package of cigarettes is counterfeit.

### **Record-Keeping/Control Measures**

Record-keeping and control measures impose regulations and obligations on entities involved in the tobacco supply chain without requiring explicit licensing of these bodies. For instance, specific record-keeping obligations can be applied to retailers of tax-exempt products, or to growers and transporters of tobacco leaf. An example of a control measure is the restriction of the purchase of cigarette-producing machinery to those with a permit.

An example of a record-keeping requirement involves Internet sales of tobacco products that are distributed through the postal service. This is an emerging concern in the United States and other jurisdictions. Mandatory publication (to the required authorities) of online vendors’ customers and/or special protocols on the shipment of tobacco products through the postal service are potential solutions.

A final area included under this heading is the provincial regulation of tax-exempt tobacco sold by on-reserve retailers in Canada. Some provinces choose to allocate a specific amount of tax-exempt product for each reserve within their jurisdiction, while others opt for a refund-based policy, whereby retailers must apply for a reimbursement of the tobacco tax for sales to eligible tax-exempt customers. The various approaches, coupled with the identified better practices will be discussed below.

### **Enhanced Enforcement Measures**

A vital component of all anti-contraband measures is the ability of authorities to enforce regulations and identify products which are illicit. Investment in enforcement resources for personnel or technology for excise or customs officials is an important policy measure to address smuggling and tax-evasion issues.

The analysis addresses three distinct forms of enhanced enforcement. First, border control enforcement focuses on investments in measures such as container scanners, increased customs personnel, and other resources tailored towards identifying smuggled product prior to entering a new jurisdiction. Inspection capacities/seizures focus on the ability of officials to inspect licensed or registered entities in the legal supply-chain to identify illicit goods. This includes the seizure of tobacco products being smuggled by consumers from one jurisdiction to another. Some specific measures are: retail inspections, manufacturer inspections, and seizures of cigarettes and vehicles used in contraband trafficking. Finally, criminal investigations/intelligence focuses on other forms of enforcement that seek to identify and intercept key contraband organizers and producers. One example of this is investigation of organized crime groups.

### **Export Taxation**

In accordance with general trade practice, exported goods are generally not subject to taxes (or duties). Historically, in several jurisdictions, untaxed exports of cigarettes have been diverted into the contraband market to be sold in receiving countries without tax or smuggled back to country of origin and sold as contraband. Export taxes on tobacco products aim to decrease the amount of exported tobacco to restrict this source of diversion.

### **Tax Harmonization**

Harmonization can mean either bringing tax rates up, so that all jurisdictions impose a similar level of tax, or reducing the tax burden so that the potential for cross-border purchases of cheaper tobacco products is minimized. Harmonization of excise taxes can help minimize tax avoidance among consumers who purchase goods in a nearby jurisdiction with lower excise taxes.

### **Tax Agreements with Aboriginal Communities**

In Canada and the United States, Aboriginal persons are exempt from paying some or all taxes on

tobacco products purchased in their communities. This situation has given rise to contraband activity in which on-reserve vendors sell untaxed cigarettes to non-Aboriginal persons. Some communities have entered into agreements or compacts with either the federal governments or the state/provincial governments that may help equalize the taxation of tobacco products between off-reserve and on-reserve retailers, thereby minimizing the potential for tax-evasion/avoidance.

### **Legally Binding Agreements and Memoranda of Understanding (MOUs) with the Tobacco Industry**

In some jurisdictions, specific legal agreements have been made with tobacco manufacturers in order to address issues of smuggling/tax-evasion, with agreed upon penalties and consequences for failure to abide by the agreement. Other jurisdictions have entered into MOUs with tobacco manufacturers or other organizations in the tobacco supply-chain to address issues of smuggling/tax-avoidance. In contrast to legal agreements which are legally-binding, MOUs are voluntary in nature.

### **Public Awareness Campaigns**

The final policy identified is the use of public awareness campaigns to inform the public and/or relevant sectors of the supply-chain about issues regarding smuggling/tax-evasion, including obligations under the law. Campaigns may focus on the criminal elements involved in the illicit trade, the health impact of cheap or counterfeit tobacco, or simply the obligations of retailers or distributors in terms of package markings and legal requirements.

### **Case Study Selection**

A series of comprehensive case studies was conducted to enable analysis of the effectiveness of the various policy measures. In this section we describe how cases were selected and provide an overview of the case studies. Full descriptions are provided in Section Three.

### **Anti-contraband Measures in Canada and the United States**

A key objective of this paper is to synthesize existing information about anti-contraband tobacco measures in Canada and the United States from the early 1990s to the present. A significant body of research already exists on the former, while little comprehensive research has been conducted on the latter. However, the announcement of the 2008 *Tobacco Enforcement Strategy* by the Royal Canadian Mounted Police has resulted in a greater degree of clarity regarding the current production of contraband tobacco in Canada and the United States.

This section will attempt to examine the smuggling of counterfeit cigarettes into Canada, largely through British Columbia (BC), and the potential it has in terms of displacing the “baggies” of contraband cigarettes currently seen in Canada. “Baggies” refers to loose cigarettes sold in clear plastic sandwich bags.

### **Control of Tax-exempt Tobacco Distribution in Canada**

Section 87 of the Canadian *Indian Act* declares that the “personal property of an Indian or a band situated on a reserve” is tax exempt.<sup>9</sup> With regard to tobacco, First Nations consumers are exempt from paying sales tax on tobacco products, but manufacturers still need to pay federal excise taxes.

Most provinces have methods for allowing the sale of tax-exempt tobacco products in First Nations communities which also control the sales of tax-exempt products to non-Aboriginals, who are required to pay the appropriate taxes. A comparative examination of these policies can contribute to a better understanding of ways to minimize tax-avoidance through the purchase of tax-exempt cigarettes, while still respecting First Nations treaty rights.

### **Aboriginal Taxation Agreements/Compacts**

Several Canadian First Nations communities and US Native American communities have negotiated taxation agreements with federal and provincial/state governments. In examining the impact of these agreements or compacts on minimizing tax-avoidance, the First Nations Tax (FNT) and First Nations Goods and Services Tax (FNGST) agreements between the Government of Canada and several First Nations communities will be reviewed. Additionally, experiences from the Cowichan Tribes in the Province of BC, and lessons from Washington State’s tax compacts will be examined in order to assess the impact on tax-avoidance, as well as community health and revenue.

### **California**

The State of California’s *Cigarette and Tobacco Products Licensing Act* in 2003 implemented a comprehensive licensing regime, as well as a new tax-stamp, in an attempt to address concerns of smuggling and tax-evasion. The State’s experience with licensing, pack marking, regulations and control measures, as well as enhanced enforcement efforts is examined.

### **Brazil**

Since the late 1990s Brazil has attempted to address concerns of cigarette smuggling and illicit production. This case study looks at the role of an export tax in 1998; the “special registry” which imposed licensing and regulatory conditions in 1999; and finally, the implementation of an enhanced taxation-stamp. This case study provides unique insight into a regionalized context of smuggling in which policies and practices of neighboring states play an important role.

<sup>9</sup> Department of Justice Canada. (2008) *Indian Act*. Government of Canada. Last updated 28 November 2008: <http://laws.justice.gc.ca/en/ShowFullDoc/cs/I-5///en>: Accessed December 18, 2008.

**UK**

Beginning with the *Tackling Tobacco Smuggling Strategy* of 2000, the UK government has implemented a series of initiatives to address concerns of smuggling and cross-border shopping. Policies have included enhanced enforcement capacities, legal agreements and MOUs with the tobacco manufacturers, public awareness campaigns, and pack markings.

**European Union Agreements**

In 2004 and 2007, the European Union negotiated agreements with Philip Morris International, and Japan Tobacco International, respectively. These agreements imposed obligations such as know-your-customer protocols, tracking and tracing requirements, and mandatory seizure repayments for product found in the illicit market. The impacts of these agreements with the tobacco industry are assessed in order to ascertain whether this is an approach other regional or national bodies can replicate.

**Australia**

The case of Australia is unique due to a contraband tobacco product known as “chop-chop.” Chop-chop tobacco is produced when growers divert bales of chopped tobacco leaves to be sold on the black market. Australia is also distinct in licensing of tobacco growers. Because tobacco growers were bought out by the tobacco industry and the Australian Government, the Australian case also provides insight into the impact that a change in the source of illicit goods has on the overall distribution and resiliency of the illicit market.

**Policies and Case Study Comparisons**

In comparing the selected case studies, a significant degree of policy overlap appears, allowing a comparison of the results from one jurisdiction to another. Table 3 outlines this comparison, focusing on the specific policies implemented to address issues of smuggling/tax-evasion.

**Table 1: Policies and Case Study Comparisons**

	<b>Canada</b>	<b>California</b>	<b>Brazil</b>	<b>UK</b>	<b>EU</b>	<b>Australia</b>
Licensing	X	X	X			X
Marking/Labeling	X	X	X	X		
Tracking and Tracing		X	X			
Record Keeping / Control Measures	X	X				X
Enforcement	X	X		X		X
Export Taxation	X		X			
Tax Harmonization	X				X	
Aboriginal Tax Agreements / Compacts	X					
MOUs / Legal Agreements	X			X	X	
Public Awareness				X		

Alongside these comprehensive case studies, specific examples from various jurisdictions will be used to supplement the lessons drawn for each policy.

## **Research Methods**

### ***Literature Search***

A systematic literature review was undertaken, collecting both academic and non-academic materials on contraband tobacco and relevant policies.

While our search found many articles on contraband tobacco, tobacco smuggling, or tobacco tax-evasion, few of these articles actually deal with the impact of specific policy measures. Instead, articles often provide descriptions of how smuggling/evasion is conducted, measurements of the extent of smuggling/evasion, and/or documentation about the tobacco industry's role in facilitating smuggling/evasion. One of the core challenges of this study has been to isolate those articles which have specific information pertaining to anti-contraband policies, and the impact that these have had on evasion/smuggling.

### **Data Sources**

Literature searches were conducted using various databases. Searches were conducted multiple times, in order to catch new information. Keywords used included *tobacco* or *cigarette*, and *smuggling*, *contraband*, *evasion*, *trafficking* and *counterfeit*. A complete list of the search terms and dates, by database, can be found in Appendix 2.

The following search engines or databases were used when searching for literature:

- ProQuest (multiple databases)
- Ovid MEDLINE
- Center for Disease Control (CDC) Smoking and Health Database
- Scopus
- CBCA Reference
- Google Scholar
- Criminal Justice Abstracts
- PAIS (Public Affairs Information Service) International
- ISI Web of Science

Once documents were identified through these searches, analysis was conducted of the works cited in these articles, in order to identify additional documents for inclusion.

Grey, or unpublished literature, was obtained using Google Scholar, SIGLE (System for Information on Grey Literature), and through analyses of works cited in retrieved articles.

The journal *Tobacco Control* was independently searched for articles on tobacco smuggling or evasion. These searches were conducted in October 2007, and April 2008.

During the course of the research, numerous international organizations and non-governmental organizations arose as significant sources of information on contraband tobacco and associated policy. Websites of these organizations were frequently accessed in order to search for reports. The research officer also subscribed to several mailing lists in order to learn about new reports or studies in a timely manner.

Furthermore, reports or studies were identified through several other media listservs and mailing lists, including:

- Media Network
- GLOBALink
- ASH Daily News
- Tobacco.org daily updates
- OTRU-net (Ontario Tobacco Research Unit)
- Framework Convention Alliance

Finally, co-investigators and experts were consulted early in the research stage in order to identify relevant literature and case studies.

### **Study Collection**

Because of the limited amount of literature on cigarette smuggling, inclusion criteria were initially set to include any research or study that addressed tobacco smuggling or evasion in any way. Many of these studies attempt to quantify the size of the illicit market, or describe the methods of smuggling/evasion but few analyze the effects of policies that have been implemented to address these issues. One reason for this is that the size and shape of the illicit market are difficult to ascertain (succinctly put by one informant, “smugglers don’t file annual reports”). Another reason is that data and information are often difficult to obtain from governmental officials; in many cases, because the required data is not collected.

Overall, 114 publications met our broad inclusion criteria. Of these, only 13 specifically addressed issues of contraband policy. The main research objectives of other studies were:

- Measurement of illicit market/evasion: 25 articles.
- Description of smuggling/evasion activities: 44 articles.
- Analysis of the actors involved: 15 articles.
- Description of policies available: 17 articles.
- Other: 11 articles.

Table 2 lists the thirteen documents that addressed “anti-contraband tobacco policy” and whose results are included in this knowledge synthesis.

**Table 2: Selected Documents**

Studies Identified as “Anti-Contraband Policy” Studies
1. Cunningham R. (1996) <i>Smoke and Mirrors: The Canadian Tobacco War</i> . International Development Research Centre: Ottawa, ON.
2. Geis G. (2005) <i>Chop-chop: the illegal cigarette market in Australia</i> . Centre for Tax System Integrity. Working Paper 48. <a href="http://ctsi.anu.edu.au/publications/WP/48.pdf">http://ctsi.anu.edu.au/publications/WP/48.pdf</a>
3. Iglesias R et al. (2007) <i>Tobacco Control in Brazil</i> . HNP Discussion Paper, The World Bank: Washington, DC.
4. Joossens L and Raw M. (2008) Progress in combating cigarette smuggling: controlling the supply chain. <i>Tobacco Control</i> (online Sept 10, preceding publication) <a href="http://tobaccocontrol.bmj.com/onlinefirst.dtl">http://tobaccocontrol.bmj.com/onlinefirst.dtl</a>
5. Joossens L and Raw M. (2003) Turning off the Tap: the real solution to cigarette smuggling. <i>International Journal of Tuberculosis and Lung Disease</i> 7, 3: 214-222.
6. Joossens L and Raw M. (2000) How can cigarette smuggling be reduced? <i>British Medical Journal</i> 321: 947-50.
7. Joossens L. (2003) <i>Report on Smuggling Control in Spain</i> . World Health Organization
8. Joossens L and Raw M. (1998) Cigarette smuggling in Europe: who really benefits? <i>Tobacco Control</i> 7: 66-71.
9. Joossens L, Chaloupka F J, Merriman D, Yurekli A. (2000) Issues in the Smuggling of Tobacco Products. In: Jha P, Chaloupka F J, editors. <i>Tobacco Control in Developing Countries</i> . London, UK: Oxford University Press.
10. Schneider S. (2000) Organized contraband smuggling and its enforcement in Canada: An assessment of the anti-smuggling initiative. <i>Trends in Organized Crime</i> 6, 2: 3-31.
11. Shafey O, Cokkinides V, Cavalcante et al. (2002) Case-studies in international tobacco surveillance: cigarette smuggling in Brazil. <i>Tobacco Control</i> 11: 215-219.
12. Slemrod J. (2007). Are Tax Elasticities System-Dependent? Evidence from Michigan Cigarette Tax Policy.” Under Review.
13. VanWynsberghe R. (no date) <i>Tobacco Taxation and First Nations and Inuit People of Canada: A Discussion Paper</i> . Prepared for the First Nations and Inuit Health Branch, Pacific Region: Health Canada.

Studies that specifically evaluated the impact of anti-contraband policies were subject to a quality assessment framework to analyze the research methods used and the overall quality of the study itself (see Bader 2006). The quality assessment tool used in this study (see Appendix 3) was adapted to take into consideration the nature of the available literature. This tool focuses on quality of evidence

and of analysis of anti-contraband measures. Not all of the above documents were peer-reviewed scientific articles, but many were reports written for various national or international organizations, where a peer-review process may not have occurred. However, given the paucity of research available to inform evidence on tobacco smuggling policies, these reports were included in our quality assessment process.

The quality assessment framework assessed each article based on research aims/objectives, methods of data collection and analysis, and relevance to the broader academic field. Each question on the framework was scored as either “strong,” “moderate,” or “weak,” or in some cases as “not applicable.” Question scores were tallied, and the report was given a final score of either “strong,” “moderate,” or “weak,” based on average ratings.

Each study was assessed independently by two members of the research team. When different scores were found, the ratings would be discussed, and if agreement could not be found on the appropriate score, a third reviewer was brought in to score the document. Of the 13 studies included, four were scored as strong, three as moderate, and six were considered weak. After the quality assessments, it was clear that few strong policy papers exist on the topic of anti-contraband measures. For example, many studies relied on secondary data sources, public trade data, and interviews with policymakers. It should be emphasized that these sources of data are often problematic, as public trade data might be flawed, interviews with policymakers might be limited in terms of confidential data that can be provided, etc. This is also a limitation of this paper which relies heavily on key informant interviews and data collection. This highlights the need for transparent data on tobacco and cigarette seizures, estimates of the illicit market, and trade and license data. Without these sources of information, it is difficult to generate scientifically rigorous studies of the effects of anti-contraband policy measures.

During the literature search, a number of reports outside the peer reviewed scientific literature were identified, but were not subject to the quality assessment (as many are not specifically research reports). A total of 39 governmental reports and 45 non-academic reports were identified. While these reports will not be synthesized as the published research articles, they will inform the literature review (See Appendix 1 for all literature identified). The rationale for not including these reports in the overall quality assessment was that most were not studies on the efficacy of particular tobacco smuggling measures, but were often either descriptive analyses of the smuggling market itself, or in the case of governmental reports, often descriptions of the tobacco market in any given jurisdiction, with analysis around changing patterns in excise tax collection, estimations of the illicit market, and descriptions of policy implementation. Given the lack of focus on the anti-tobacco smuggling initiatives themselves, these articles were not assessed, but still serve to inform our understanding of the context and policy choices of various governments in addressing tobacco contraband.

### **Key Informant Interviews**

A total of forty-seven key informant interviews were conducted with representatives from academia, non-governmental organizations, governments, and international organizations. Key informants were chosen for their overall knowledge of tobacco smuggling or their intimate knowledge of a specific anti-contraband policy measure. Key informants' knowledge of anti-contraband measures was assessed based on their involvement with, published reports, their position in government, i.e. administering public-policies around tobacco smuggling, or through networking with other experts in the field, such as at the Intergovernmental Negotiating Body on a Protocol on Illicit Trade in Tobacco Products INB-1 negotiations through the World Health Organization. Table 3 outlines the number of interviewees by informant background.

**Table 3: Key Informant Interview Participants**

<b>Informant Background</b>	<b>Interviews</b>
Policymaker: excise taxes	16
Policymaker: enforcement/inspection/customs	15
NGO/Advocate	7
Academic	9
TOTAL	47

Forty-seven interviews were conducted. Thirty-three of the key informant interviews were conducted over the telephone, nine were completed in person, and five informants submitted written answers. Interviews lasted from twenty-nine to thirty minutes. The interviews were semi-structured. The interviews were digitally recorded and transcribed verbatim. Data were coded and categorized into analyzable units and organized under different headings. A descriptive 'node' was the unit of categorization and one node categorized all instances of the same topic, for example, all instances where licensing was mentioned in an interview were coded at a licensing node. All the interview transcripts were coded using N6 qualitative software in order to facilitate organization and categorization of the research data and facilitate in-depth analysis.

Questions focused on specific information such as seizure data, revenue data, and inspection data, and included open-ended questions such as "How effective has policy A been in addressing problem X?" Key informants were also usually asked what future changes they would like to see in their specific policy and overall global anti-contraband efforts.

### **Expert Focus Panels**

Nearing the conclusion of the knowledge synthesis, the research team drafted two comprehensive documents based on the data, literature, and key informant interviews. The first of these documents

was an overview of the case studies and literature review, while the second was a knowledge synthesis paper that outlined preliminary conclusions about the effects of each of the ten anti-contraband policy measures under a variety of contexts.

A series of four expert focus panels were convened in order to validate, enrich understanding of, and further assess the feasibility of implementing the various policy measures. The 31 experts who participated in the four panels were from government agencies, the academic community, and the NGO/advocacy community (Table 4). These panels allowed the research team to revise the knowledge synthesis paper and case studies and helped provide insight into gaps in the paper. The first expert focus panel, held in Brussels, Belgium involved experts from the European Union and from European countries. The second panel, convened in Ottawa, Ontario included participants from Ontario, Quebec and New York State. Participants in the third panel, held in Victoria, British Columbia, hailed from California, British Columbia and Alberta. The fourth expert focus panel took place in Toronto, Ontario and was dedicated to learning the perspectives of Aboriginal communities. Aboriginal experts from both on-reserve and off-reserve communities participated. This panel provided input from the Aboriginal community into the feasibility, strengths and weaknesses of the various anti-contraband policy measures.

**Table 4: Expert Focus Panel Participants**

Expert Background	Participants
Policy maker: enforcement/inspection/customs	11
Policy maker: taxes/regulation	6
Policy maker: health	1
Community leader	6
NGO/Advocate	4
Academic	3
TOTAL	31

The panel sessions were digitally recorded and transcribed verbatim. As with the interviews, data were coded and categorized into analyzable units and organized under different headings, using N6 qualitative software to facilitate in-depth analysis.

**Literature Review**

Review of the literature revealed a limited number of studies directly assessing anti-contraband policies and flagged underlying difficulties in undertaking such research. Many of the publications do not report on rigorously designed studies, due in part to the inherently difficult nature of data collection in this area. Nonetheless, the publications reviewed provide valuable insight into this under-studied field.

In his book, *Smoke and Mirrors: the Canadian Tobacco War*, Rob Cunningham (1996) provides a comprehensive chapter on tobacco smuggling in the 1990s in Canada and the policy responses from the federal and provincial governments. He argues that increasing tobacco taxes throughout the 1980s—as part of a tobacco control strategy—began to have increasingly positive effects on smoking rates, as well as on government revenues.<sup>10</sup> However, the taxation differential between the United States and Canada stimulated a smuggling market, where dramatic rises in exports (an increase from 1.2 billion cigarettes in 1989 to 18.6 billion cigarettes in 1993) were shipped to bonded warehouses in the US. The products were often re-routed back into Canada, largely through the Akwesasne reserve on the Ontario, Quebec, and New York State borders.<sup>11</sup> Cunningham describes the policy measures subsequently adopted by the federal government, beginning with an export tax in 1992. Despite having a marked impact on exports to the US, the new tax was vigorously opposed and repealed less than two months after adoption.<sup>12</sup> In 1994, a series of federal and provincial (Québec, Ontario, Nova Scotia, New Brunswick and Prince Edward Island) tax cuts were implemented.<sup>13</sup> While these measures did significantly reduce smuggling into Canada, Cunningham also describes the negative consequences of this policy, especially on youth smoking rates.<sup>14</sup> This chapter details the interrelation of public health, fiscal policy, and enforcement policy when addressing concerns of smuggling and tax-evasion. Furthermore, Cunningham reveals how smuggling policy is intimately linked to public health policies on tobacco control, whereby the solution to one problem (smuggling) might exacerbate another (youth smoking).

Gilbert Geis has authored a collection of work on “chop-chop” tobacco in Australia. Chop-chop refers to loose tobacco that had been grown in Australia, and sold directly to consumers who then roll their own cigarettes.<sup>15</sup> A significant component of this research focuses on the ability of the Australian Taxation Office, which licenses the growers, to control the supply of the legal market.<sup>16</sup> Chop-chop became popular in the 1990s when growers began diverting tobacco to the illicit market, due in part to the declining revenues associated with tobacco farming and the sizeable excise taxes applied to tobacco. Given the geographical isolation of Australia, growers did not foresee a substantial export market for their goods, because of production and shipping costs, causing them to look for internal markets in which to sell their crops.<sup>17</sup> Licensing and enforcement of tobacco

<sup>10</sup> Cunningham R. (1996) *Smoke And Mirrors: the Canadian tobacco war*. International Development Research Centre: Ottawa, ON. Chapter 11: Taxation and Smuggling.

<sup>11</sup> Ibid.

<sup>12</sup> Ibid.

<sup>13</sup> Ibid.

<sup>14</sup> Ibid.

<sup>15</sup> Geis G. (2005) *Chop-chop: the illegal cigarette market in Australia*. Centre for Tax System Integrity. Working Paper 48, p. 4.

<sup>16</sup> Ibid, p. 1.

<sup>17</sup> Ibid, p. 6.

growing was difficult because growers were reticent about providing information on fellow growers' dealings. Finally, Geis notes that diversion of tobacco into illicit markets usually involved multiple actors, further frustrating efforts to lay charges.<sup>18</sup> Geis' work illuminates how an illicit market can work internally, as opposed to across borders.

Roberto Iglesias has authored several reports on tobacco control in Brazil, one for the World Bank in 2007, and one for the Pan-American Health Organization (PAHO) in 2006. Since the report for the World Bank is based on the previous work done for PAHO, it is the only study included here. The report argues that smuggling can undermine tobacco control initiatives, and therefore a comprehensive anti-smuggling strategy is required.<sup>19</sup> Iglesias et al. (2007) corroborate the data found by Shafey et al. (2002) providing further evidence of increased illicit manufacturing activity in Paraguay.<sup>20</sup> It is also noted that some manufacturers in Brazil also produce for the illicit market, thereby requiring domestic controls as well as regional cooperation.<sup>21</sup> Iglesias concludes that the sources of tobacco smuggling are dynamic as long as there remain sufficient demand and distribution networks for contraband. He cites the need for greater surveillance and data collection to help inform policymaking and research.

The work of Luk Joossens and Martin Raw has been particularly instructive to the literature on tobacco smuggling and policy interventions. Six of the thirteen articles we identified as addressing issues of anti-contraband policies were either written or co-written by Luk Joossens, and three of these five articles involved Martin Raw. The research of Joossens and Raw has often examined policy interventions to address cigarettes diverted to the black market by the tobacco industry itself.

In 2008, Joossens and Raw highlight the importance of controlling the supply chain to combat large-scale cigarette smuggling.<sup>22</sup> Using examples from the UK, Italy, and Spain, the authors describe the policies used in each of these countries over 10 years to dramatically reduce smuggling. It was found that scrutiny of and legal action against cigarette companies was very effective at stymieing large, organized smuggling rings. Financial investment in anti-contraband measures was found to be recouped many-fold by tax revenue increases, also making this an effective policy. Voluntary and non-binding memoranda of understanding with the tobacco industry were found to be ineffective in the cases studied. The authors recommend increased border controls using scanners and other high-

<sup>18</sup> Geis G. (2005) *Chop-chop: the illegal cigarette market in Australia*. Centre for Tax System Integrity. Working Paper 48, p. 17.

<sup>19</sup> Iglesias R et al. (2007) *Tobacco Control in Brazil*. HNP Discussion Paper, The World Bank: Washington, DC, p. 90.

<sup>20</sup> Ibid, p. 35.

<sup>21</sup> Ibid, p. 36.

<sup>22</sup> Joossens L, Raw M. (2008). Progress in combating cigarette smuggling: controlling the supply chain. *Tobacco Control* (online Sept 10, preceding publication) <http://tobaccocontrol.bmj.com/onlinefirst.dtl>

tech devices to prevent cigarettes from entering the country; increased use of overt markings to help identify shipment destinations; increased punishment of people found dealing in contraband; lawsuits to expose tobacco industry wrongdoing in court; collaboration among different countries to coordinate anti-smuggling efforts; and making the industry liable for all their products that end up on the black market, in effect forcing the industry to control its supply chain. All policies proposed aim to cut off the supply of contraband.

Joossens and Raw (2003) focus on the UK experience. The authors assert that the UK solution of greater border controls and reduced excess exports is the best response to the smuggling crisis, because reductions in tobacco taxes could increase smoking prevalence.<sup>23</sup> Finally, the authors contend that the tobacco industry itself often promotes the smuggling of their products, because smuggling does not impact profits and is a foundation from which to advocate for an excise tax reduction.<sup>24</sup> The authors also emphasize that border enforcement has limited effects, and that a better solution lies in export and distribution controls on tobacco manufacturers themselves. Examples include: chain-of-custody markings, labeling, and tracking and tracing systems.<sup>25</sup>

In his 2003 report on smuggling in Spain for the World Health Organization, Luk Joossens once again explains how smuggling became a problem in Spain despite having the lowest tobacco taxes in the European Union.<sup>26</sup> The flow of illegal cigarettes from neighboring Andorra was stopped once effective border controls were put in place, and greater regional cooperation was organized, demonstrating that effective smuggling controls can be instituted irrespective of excise tax rates, so long as policies focus on the source-of-supply and distribution networks.

Joossens and Raw (2000) discuss how smuggling might be reduced, and reiterate that smuggling markets exist even in comparatively low-tax jurisdictions. The authors discuss case studies from Canada, Sweden, and Spain to demonstrate their points. They point out that Canada and Sweden both reduced their tobacco taxes in order to address concerns over smuggling, but this resulted in increases in smoking rates (especially among youth), and in the case of Sweden, seems to have done little to undermine the smuggling market.<sup>27</sup> The Spanish experience shows how surplus exports to

<sup>23</sup> Joossens L. and Raw. M. (2003) Turning off the tap: the real solution to cigarette smuggling. *International Journal of Tuberculosis and Lung Disease* 7, 3: 214-222, p. 215.

<sup>24</sup> Ibid.

<sup>25</sup> Ibid, p. 220.

<sup>26</sup> Joossens L. (2003) *Report on Smuggling Control in Spain*. World Health Organization, p. 3-4.

<sup>27</sup> Joossens L. and Raw M. (2000) How Can Cigarette Smuggling Be Reduced? *British Medical Journal* 321: 947-50, p. 948.

Andorra were smuggled back into Spain, free of tax.<sup>28</sup> Through collaboration between governments and the European Anti-Fraud Office (OLAF), the smuggling routes used from Andorra to Spain were closed off, and greater public scrutiny of this issue caused illicit routes to disappear.<sup>29</sup> The authors conclude that taxes do not need to be reduced in order to minimize smuggling and that strong border controls can be an effective anti-contraband measure.

Joossens and Raw (1998) dispute the assumption that high taxes correlate to high smuggling rates, and instead suggest that the problem is more directly related to fraud and illegal imports/exports. The authors note that 32% of all global exports go missing, as reported by US Department of Agriculture statistics and reports on duty-free sales. Further proof is the Spanish case study, where despite having the lowest excise tax rates in the European Union; Spain also had one of the most significant smuggling problems.<sup>30</sup> Further, the authors reveal the benefits the tobacco industry receives from smuggling. It is argued that although manufacturers collect normal profits from sales to an importer/distributor, industry also benefits from smuggled access to closed markets. This is seen in Argentina, Italy, Bulgaria, and China.<sup>31</sup> Finally, the authors propose policies that might be useful at controlling these types of smuggling, specifically harsher penalties for smuggling, tax-stamps on all tobacco products, record-keeping, tracking and tracing mechanisms on all packaging, restricting sales to licensed vendors, and reduced and better controlled exports.

In a chapter in *Tobacco Control in Developing Countries*, Joossens, Chaloupka, Merriman, and Yurekli (2000) analyze global smuggling markets, corroborating the argument that excise taxes are not directly correlated with smuggling rates. They differentiate between small-scale cross-border shopping and bootlegging, and large-scale organized smuggling.<sup>32</sup> The authors use the Canadian case study to demonstrate the role of the tobacco industry in facilitating smuggling across the border as a market strategy, and to create pressure to decrease taxation rates.<sup>33</sup> The authors establish that while the federal government and a number of provinces reduced their taxation rates to undermine the smuggling markets, a number of other provinces maintained their higher tax rates, and smuggling, nonetheless, seemed to dissipate.<sup>34</sup> Furthermore, since Canadian taxation rates then dropped to below several US states along the Canada-US border, the flow of smuggling should have

<sup>28</sup> Joossens L. and Raw M. (2000) How Can Cigarette Smuggling Be Reduced? *British Medical Journal* 321: 947-50, p. 948.

<sup>29</sup> *Ibid*, p. 948-9.

<sup>30</sup> Joossens L. and Raw M. (1998) Cigarette Smuggling in Europe: who really benefits? *Tobacco Control* 7: 66-71, p. 67.

<sup>31</sup> *Ibid*, p. 68.

<sup>32</sup> Joossens L, Chaloupka F J, Merriman D, Yurekli A. (2000) "Issues in the Smuggling of Tobacco Products." In: Jha P, Chaloupka F J, editors. *Tobacco Control in Developing Countries*. London, UK: Oxford University Press, p. 395-399.

<sup>33</sup> *Ibid*, p. 400.

<sup>34</sup> *Ibid*, p. 401.

reversed back into the United States, but this did not occur.<sup>35</sup> The problem, more than excise rates, is one of industry facilitation and exacerbation.

A second article that addresses the Canadian case is Stephen Schneider's (2000) evaluation of the Anti-Smuggling Initiative. Here, Schneider documents the Anti-Smuggling Initiative (ASI) implemented in 1994/95 as part of the *National Action Plan on Smuggling*.<sup>36</sup> He separates his analysis into the impact the ASI had on capacity, cooperation and coordination, reduction of the contraband tobacco supply, and disruption of organized crime and money laundering.<sup>37</sup> He asserts that the ASI helped to invest in resources and personnel, which were necessary to address smuggling.<sup>38</sup> Investments in resources allowed for greater investigative capacities, which helped disrupt the high-level organizers in smuggling operations.<sup>39</sup> The results related to coordination and cooperation are ambivalent, suggesting that the ad hoc nature of most partnerships undermine the benefits that might be realized with more concrete partnerships and cooperation.<sup>40</sup> He suggests that while the supply and seizure of contraband products dropped significantly in the post-ASI period, this might be due to the decline in cigarette shipments, rather than to enforcement.<sup>41</sup> Ultimately, Schneider concludes that the tax cuts may have been the foremost measure that resulted in the cigarette smuggling decline, but he does note that due to the simultaneous implementation of the tax cuts with the ASI, it is hard to definitively isolate the effects of each.

Analyses of smuggling operations between Brazil and Paraguay have been a central focus of South American contraband scholars. Shafey et al. (2002) provide a description of smuggling activities in Brazil, and assess import/export data between Brazil and Paraguay. The authors suggest that the dramatic rise in exports from Brazil to Paraguay coincided with the increase in the illicit market in Brazil, likely because exports to Paraguay were smuggled back into Brazil, tax-free.<sup>42</sup> The authors suggest that by attempting to control the rise in exports through an export tax, smugglers responded by increasing manufacturing operations in Paraguay (from approximately 2 manufacturers to 20), maintaining a continued flow of tobacco into the Brazilian market.<sup>43</sup> The authors also mention the importance of regional cooperation in addressing smuggling concerns where marking and labeling obligations might allow for improved enforcement capacities.

<sup>35</sup> L, Chaloupka F J, Merriman D, Yurekli A. (2000) "Issues in the Smuggling of Tobacco Products." In: Jha P, Chaloupka F J, editors. *Tobacco Control in Developing Countries*. London, UK: Oxford University Press, p. 401.

<sup>36</sup> Schneider S. (2000) Organized Contraband Smuggling and its Enforcement in Canada: An Assessment of the Anti-Smuggling Initiative. *Trends in Organized Crime* 6, 2: 3-31.

<sup>37</sup> Ibid.

<sup>38</sup> Ibid, p. 14.

<sup>39</sup> Ibid, p. 15.

<sup>40</sup> Ibid, p. 16.

<sup>41</sup> Ibid, p. 18.

<sup>42</sup> Shafey O, Cokkinides V, Cavalcante et al. (2002) Case-studies in International Tobacco Surveillance: cigarette smuggling in Brazil. *Tobacco Control* 11: 215-219, p. 217.

<sup>43</sup> Ibid.

Only one academic publication addressed anti-contraband policy measures in the United States. While many papers have been written on either the impact of tax-elasticities when smuggling exists, or on the overall measurement of smuggling as a whole, the literature on specific policies to address smuggling in the United States is sparse. An exception is the 2007 paper by Joel Slemrod, from the University of Michigan. Slemrod's report analyzes the impact of Michigan's tax-stamp policy in 1998, given smuggling issues that arose in 1994 after a significant tax-increase. Utilizing a number of statistical models, Slemrod attempts to estimate the tax-elasticities associated with taxation increases, comparing the impact in 1994 (with no tax stamp) to tax increases in 2002 and 2004 (with a tax stamp). He finds that after a similar tax increase in 2002, the per capita taxed cigarette consumption dropped by significantly less than in 1994, largely due to the existence of the tax-stamp.<sup>44</sup> Slemrod argues that in 1994 consumers were able to evade the tobacco tax by purchasing tobacco products in lower-taxed, neighboring states, or through the smuggling of cigarettes from significantly lower-taxed jurisdictions that didn't require a tax-stamp.<sup>45</sup> However, once the tax-stamp was applied in 1998, the same tax-evasion methods were markedly more difficult, especially the smuggling of cheaper cigarettes to retailers. This implies that a tax-stamp can be a useful control on tax-evasion and smuggling on smaller-scales.<sup>46</sup>

The final scholar included in the literature review is Robert VanWynsberghe, who prepared a discussion paper for the First Nations and Inuit Health Branch of Health Canada 2007 on the application of tobacco taxes in First Nations communities. In this report, VanWynsberghe explores the application of the Canadian First Nation Tax, (FNT) and the First Nations Goods and Services Tax (FNGST). VanWynsberghe argues that many First Nations leaders view non-taxation as an inherent treaty right, not to be violated.<sup>47</sup> He asserts that significant revenue generation and decreased smoking rates are achievable from those communities that have adopted the FNT or FNGST.<sup>48</sup> He also speculates that these taxes would reduce what he terms "down the road" sales where non-Aboriginals travel to reserves to purchase tax-exempt cigarettes. Unfortunately, no comprehensive case studies or reviews of particular taxation agreements are cited in support of his arguments.

<sup>44</sup> Slemrod J. (2007). "Are Tax Elasticities System-Dependent? Evidence from Michigan Cigarette Tax Policy." *Under Review*.

<sup>45</sup> *Ibid*, p. 6.

<sup>46</sup> *Ibid*, p. 16.

<sup>47</sup> VanWynsberghe R. (no date) *Tobacco Taxation and First Nations and Inuit People of Canada: A Discussion Paper*. Prepared for the First Nations and Inuit Health Branch, Pacific Region: Health Canada, p. 21.

<sup>48</sup> *Ibid*.

## Section Two: Effects of Anti-Contraband Policy Measures

This section provides an overview of the knowledge gained about the effectiveness of each of the ten identified policy measures. A listing of the relevant case studies is provided in Section Three, to facilitate reader understanding. Lessons from case studies not addressed within this synthesis are provided to complement the overall policy analysis.

### Licensing

#### Relevant Case Studies

- California
- Brazil
- Canada
- Australia

#### *California*

In California, legislation in 2003 required the specific licensing of all elements of the supply-chain from the manufacturer to the retailer. The licensing provisions specify the obligations of all licensees, and also require entities to only do business with other licensed entities in the supply-chain.<sup>49</sup> Informants suggested that the licensing of all aspects of the supply-chain (specifically, the retailers) has been significant in allowing penalties to be increased, and suspensions to be issued.<sup>50</sup> Some key informants suggested that given the significance of tobacco products to many small-retailers, the threat of a license suspension or revocation was essential to ensure compliance. The substantial number of tobacco retailers in the State, roughly 40,000, indicates that a comprehensive licensing regime can be rolled-out despite numerous entities existing in the market.

The need to couple licensing requirements with strong enforcement was a common theme in California, where the increase in the number of site inspections (from 8,490 in 2004 to 12,112 in 2006) was fundamental to ensuring licensee compliance. Inspectors in California were given “limited peace officer” status allowing them to issue citations on the spot when they found retailers with illegal products. This ensured that penalties were issued faster and more effectively, thereby reinforcing license obligations with actual enforcement. This phenomenon is described in more

<sup>49</sup> Key informant interview, 2008 Apr 15

<sup>50</sup> *Ibid.*

detail in the “enhanced enforcement” section, but suggests that licensing provisions are only as effective as their compliance and enforcement. In terms of effectiveness, the percentage of seizures per site inspection dropped significantly after the implementation of the licensing regime. The 2004-05 annual report from the Board of Equalization Investigations Division states that only 13% of all inspections (9,236 inspections were done in 2004-05 – 98% of these were at the retail level) led to a seizure, whereas prior to the licensing implementation the seizure rate was around 27% of all inspections.<sup>51</sup> This significant decrease has continued, as the 2006-07 report states that of the 10,130 inspections completed (9,967 of these at the retail level), only 329 seizures were made, bringing the seizure rate to 3.2%.<sup>52</sup> The explicit licensing of the tobacco supply-chain, combined with increased inspections and penalties appears to have had a significant impact on the number of retailers caught with illicit tobacco products.

### **Canada**

In Canada, very few provinces specifically license tobacco retailers. No evidence was found that either supported or refuted the efficacy of licensing Canadian retailers to curb contraband activity. Anecdotally, key informants did note that when the province of British Columbia began issuing “Tobacco Retail Authorization” (TRA) Certificates (as of September 1, 2007), this helped facilitate retail inspection and limited the number of tax-exempt retailers, thereby mitigating the risk of having multiple points of access to tax-exempt products.<sup>53</sup> Key informants also mentioned that retail outlets have not been a large focus of the contraband problem in that province; rather, informal sales of loose contraband cigarettes (baggies) are the predominant problem. Furthermore, numerous other key informants were clear that while inspection of retail entities is an important first step, a much greater level of scrutiny and enforcement would be necessary if inspections were to ever yield substantial results among those involved in the trade, as there were often loopholes to be exploited in a more partner-based approach to retail licensing.

Numerous key informants from various jurisdictions noted that while tobacco retail outlets are not specifically licensed, inspections still occur on-site both for product inspection, and for youth access reasons. Therefore, if a retailer was caught with contraband, they would be issued the respective penalties/fines. In some cases key informants also noted a “negative licensing” scheme, where these retailers would be specifically recorded as unable to sell tobacco products due to their non-

<sup>51</sup> California State Board of Equalization (2006) *Investigations Division: 2004-05 Annual Report*. State of California. January 2006, p. 14.

<sup>52</sup> California State Board of Equalization (2008) *Investigations Division: 2006-07 Annual Report*. State of California. Publication 345, April 2008, p. 18.

<sup>53</sup> Victoria Expert Focus Panel, 2008 Jul 29.

compliance. Thus, many key informants argued that licensing as a broad policy was not wholly necessary, and instead, inspection officers simply required adequate resources, authority, and workers.<sup>54</sup>

Several key informants noted the importance of broad authority to inspection personnel, who told stories of contraband product being hidden in secret shelves, in ceilings, and even packed into machines such as automated bank tellers. Those key informants argued that the efficacy of inspections is reduced in jurisdictions where tobacco enforcement officers are not allowed to look behind retail shelves, enter other rooms in the building, or search the entire premise; broader powers would be a crucial improvement.<sup>55</sup>

Many key informants noted the difficulties encountered in attempting to find contraband at registered outlets, given that most distribution networks of contraband would simply move to informal networks, such as sales between friends, coworkers, and in pubs, where tobacco inspection officials do not have jurisdiction.<sup>56</sup> To illustrate how monitoring and control of legitimate retail outlets does not eliminate the sale of contraband tobacco, key informants revealed that retail outlets are sometimes found with illegal cigarettes stored in a car in the back parking lot, sold only to those customers who know to ask for them. However, many key informants did acknowledge that once contraband was taken out of the retail chains, distribution was impeded and the volumes distributed shrank. This was likely because some customers were either unaware of which retailers to approach or wary of purchasing cigarettes from a street vendor.<sup>57</sup> Controlling tobacco sold at retail chains appears to be important to decrease contraband tobacco distribution. While licensing can assist with this process, it does not appear to be an essential element.

### **Australia**

Very few jurisdictions maintain specific control or regulation of tobacco growers at the other end of the supply chain. Australia emerged as the only case study where tobacco growers were specifically licensed by authorities. Many key informants indicated that licensing growers would be impractical in some jurisdictions given the sheer numbers of growers. Australia only has about 300 growers, allowing a much greater degree of manageability than Brazil, with over 30,000 growers.<sup>58</sup> Despite mandating grower licensing, some informants felt that inspection methods undermined the spirit of

<sup>54</sup> Brussels Expert Focus Panel, 2008 Jun 09.

<sup>55</sup> Key informant interview, 2008 May 08.

<sup>56</sup> Brussels Expert Focus Panel, 2008 Jun 09

<sup>57</sup> Victoria Expert Focus Panel, 2008 Jul 29.

<sup>58</sup> Key informant interview 2008 Jan 16.

the law by being too lenient. For example, among Australian growers who are not considered high risk (approximately 30 growers were high risk in 2005), inspection personnel might announce the date of their planned inspection to growers.<sup>59</sup> Unsurprisingly, Geis (2005) notes that non-high-risk growers would temporarily re-locate their illegal bales of tobacco before the inspection, and then retrieve the bales afterwards.<sup>60</sup> According to the Australian Tax Office (ATO), visits to high-risk growers are not announced in advance, likely improving compliance.<sup>61</sup> High-risk growers received between two and six inspections/visits during each growing year.<sup>62</sup>

ATO officials note the difficulty of catching a grower involved in the illegal trade. As one informant stated:

We had a number of issues around the legality of seizures as well in that even though you saw a truck coming out of a particular property we couldn't prove that that tobacco was from that property.<sup>63</sup>

Given the difficulties in inspecting growers, and the reliance on crop-yield estimates, ATO officials note that they have been more successful in seizing products after they were moved off the growers' property, rather than implicating the growers themselves. While the licensing provisions might have improved the ATO's capacity to monitor tobacco growing, ensuring compliance with legal sales was difficult.

Similarly, while tobacco growers in Ontario are required by law to sell through the Ontario Flue-Cured Tobacco Growers' Marketing Board, as in Australia, there is potential for tobacco diversion. While the extent of tobacco diversion remains unknown, anecdotal evidence suggests that, similar to Australia, struggling tobacco growers sometimes divert some of their crops to the illicit market.<sup>64</sup>

Many key informants note that the licensing of tobacco manufacturers is an important step in adequately monitoring manufacturers, although a large number of loopholes exist in licensing regulations.

<sup>59</sup> Response from Australian Tax Office (ATO).

<sup>60</sup> Geis G. (2005) *Chop-chop: the illegal cigarette market in Australia*. Centre for Tax System Integrity. Working Paper 48, p. 17.

<sup>61</sup> Response from ATO.

<sup>62</sup> Key informant interview 2008 Jan 16.

<sup>63</sup> Ibid.

<sup>64</sup> See: Standing Committee on Public Safety and National Security. *Evidence: Monday, June 9, 2008*. Ottawa (ON): House of Commons, Canada. SECU, No. 035; 2008 Jun 9.

## **Brazil**

Most cases confirm that licensing procedures are only as effective as their compliance and inspection capacities. Because licensing controls in Brazil were lacking during the smuggling crises in the mid-to-late 1990s, key informants suggest that the enforcement of obligations and penalties under the Special Registry in 1999 was a more effective approach. The Special Registry is a licensing requirement for manufacturers in Brazil, and allows for greater federal oversight of manufacturing, as well as improved tax-collection, although Brazilian key informants do mention that officials have encountered difficulties enforcing the obligations of the registry related to tax compliance. At the time of writing, five manufacturers were under judicial authorization to manufacture cigarettes, despite refusing to pay the requisite excise taxes. According to Brazilian officials, manufacturers complained that the registry measures and tax changes in 1999 were overly burdensome, resulting in the current court-cases. The Brazilian case reminds us that though licensing is an important component of Brazil's anti-contraband strategy, compliance and enforcement are equally important.

Similarly, Canadian health advocates have declared that tobacco manufacturing licenses are poorly enforced, allowing some manufacturers to produce contraband cigarettes or fail to pay excise taxes.<sup>65</sup> The Canada Federal Budget 2008 included a clause where:

Amendments are proposed to make explicit the Minister's authority to refuse to issue, or cancel a license where access to the premises of a licensee or registrant is impeded.<sup>66</sup>

This is a curious statement, as licenses require inspection in order to have any impact. Many of the issues around tobacco manufacturer licensing in Canada relate to whether federal inspectors are allowed to enter First Nations reserves. This complicates the issue further, because the inspection may not be refused by the manufacturer, but the community itself. CRA key informants acknowledged that the CRA notifies the band council of its intended presence on-reserve as a courtesy,<sup>67</sup> albeit compromising the ability of inspectors to identify any illegal activities if they exist, although notice may prove positive for the relationship between the CRA and the First Nations.

Overall, licensing appears to be an important component in addressing contraband tobacco and is essential at the manufacturer level. Additional components can be applied to licensing; such as the

<sup>65</sup> Non-Smokers' Rights Association, Canada. (2006) *It's Time for Action on Tobacco Smuggling and Contraband*. NSRA, Toronto, Ontario, p. 4, and key informant interviews.

<sup>66</sup> Department of Finance Canada. (February 26 2008). *The Budget Plan 2008: Responsible Leadership*. Government of Canada. Accessed on April 29, 2008 from: <http://www.budget.gc.ca/2008/pdf/plan-eng.pdf>.

<sup>67</sup> Victoria Expert Focus Panel

levying of bonds prior to receiving a license; record-keeping; or, application of control measures to those who are licensed, making licensing an effective anti-contraband measure. However, the most crucial element, as demonstrated in essentially every single case study, was that licensing and regulatory controls were only as effective as the enforcement capabilities underpinning these policies. As demonstrated by some of the case studies, if retailers or other entities in the tobacco market are not convinced that they will ever be caught, or sufficiently punished for breaking the law, licensing regimes prove futile. However, when sufficient penalties and monitoring are coordinated, the results can be quite positive, as demonstrated most clearly in the case of California. In addition to other approaches, especially enforcement and inspections as outlined below, licensing remains a policy of interest for anti-contraband measures.

## **Marking/Stamping**

### **Relevant Case Studies**

- Canada
- Brazil
- California
- UK

The policy of marking/stamping duty-paid products seems to be the most basic of all anti-contraband policies. At its most basic, duty-paid markings (in the form of stamps, stickers, or tear-tapes) allow inspection authorities to identify (especially at the retail level) what packages are duty-paid, and what packages are not. Furthermore, “enhanced” tax-stamps or markings can provide useful information to inspectors, such as the date/place of manufacture, and contribute to anti-counterfeit measures. However, some US states still do not stamp cigarette packages,<sup>68</sup> and the United Kingdom only began placing “duty-paid” markings on cigarettes in 2000.

### **Retail Environment**

Duty-paid markings play a crucial role in visibly demonstrating that retail tobacco products are duty-paid. Without such visible markings, inspection is more difficult, relying on invoices and other distribution information, rather than simple product inspection. Many key informants noted the role of duty-paid markings in keeping untaxed tobacco products out of retail outlets. Similar to licensing, duty-paid markings and tax-stamps can ensure that contraband is not sold in retail outlets,

<sup>68</sup> At the time of writing, cigarettes were not being stamped in North Carolina, South Carolina, and North Dakota.

and pushes the contraband market to informal distribution networks, which are not as accessible as commercial retailers. The potential to displace illicit products to the informal underground market is a significant obstacle to the efficacy of package markings, but marking and stamping were still described by key informants as vital tools.

### ***Tax Exempt Markets***

Several key informants also indicated the importance of having two distinct markings, one for cigarettes sold tax-exempt to Canadian Aboriginal consumers and another for the full duty-paid sales to non-Aboriginals. Key informants noted that distribution networks exist where tax-exempt products are diverted from on-reserve retailers to off-reserve retailers or networks. Without visible duty-paid markings, it is difficult for inspection officials to seize these products. The sale of “black stock” tobacco (indicating federal excise tax paid, but not the provincial tobacco tax) helps ensure that tax-exempt product is not smuggled off reserves to provincial retail outlets.

### ***Cross State/Provincial Smuggling***

Within federal jurisdictions tax-stamps can play a critical role in controlling smuggling across state or provincial borders. In the absence of tax-stamps it becomes difficult for inspection officials to determine what products are tax-paid the appropriate state/provincial tobacco tax, and what products might have been smuggled in from a neighbouring jurisdiction. For example, when the State of Michigan dramatically increased its tobacco tax in 1994, from 25¢ to 75¢ per pack,<sup>69</sup> it became the state with the highest tobacco tax in the United States. Tax in neighboring Indiana was 16 ¢ per pack, Ohio was 24¢ per pack, and North Carolina (a state without a tax-stamp) sold cigarettes taxed at 5¢ per pack.<sup>70</sup> Significantly, Michigan was the only “high-tax” state that did not have a tax-paid stamp, precipitating cross-state line sales and smuggling of unmarked product from North Carolina and neighbouring states into Michigan.<sup>71</sup> Revenue officials noticed that “sales declined by 16.4 % between 1993 and 1995,” and continued to decline by much more than the normal decline of 2 % due to decreased consumption and decreased uptake.<sup>72</sup> In response, Michigan implemented a tax-paid stamp in 1998, and the program had a “large and immediate effect.”<sup>73</sup>

<sup>69</sup> Slemrod J. (2007) “Are Tax Elasticities System-Dependent? Evidence from Michigan Cigarette Tax Policy.” *Under Review*, p. 6.

<sup>70</sup> Towne G. (no date) *Cigarette Tax Stamps*. State of Michigan. Accessed on April 27, 2008 from: <http://www.senate.michigan.gov/sfa/Publications/Notes/1998Notes/Jafe98gt.html>.

<sup>71</sup> Campaign for Tobacco-Free Kids. (no date) *The Michigan Story: Cigarette Tax Increases, New Revenues, and the Value of Tax Stamps*.

<sup>72</sup> Michigan Department of Treasury. (2000) *Michigan’s Cigarette and Tobacco Taxes 1999*. Office of Revenue and Tax Analysis. September 2000, p. 39.

<sup>73</sup> *Ibid*, p. 42.

There was a 16.9% increase in packs sold, while neighboring states experienced declines.<sup>74</sup> Moreover, revenues increased in 1998 and 1999, despite no new taxes.<sup>75</sup> Joel Slemrod at the University of Michigan analyzed the effects of tobacco tax increases in 1994 and similar increases in 2002, and found that “the claim that stamping increased taxed sales seems to be more clearly supported by the data.”<sup>76</sup> Slemrod states that “Michigan’s recent experience with cigarette taxes is an excellent illustration of the importance of the enforcement regime to understanding the effect of a change in the tax rate on the tax base.”<sup>77</sup> This suggests that markings alone are not sufficient and must be accompanied by strong enforcement.

### ***Counterfeiting of Tax-Stamps and the California Experience***

Key informants noted that basic tax-stamps/markings are susceptible to counterfeiting operations. This makes contraband difficult to identify and creates an environment where the retailer can plead ignorance to possessing illicit goods. Moreover, consumers are duped into purchasing a product that they assume is legal. In California, an enhanced tax-stamp was implemented in order to address the issue of counterfeiting, whereby each stamp contained a machine-readable stamp with a unique identifying number, and information on who applied the stamp, when, as well as the fiscal value of the stamp for each package of cigarettes.<sup>78</sup> Key informants agreed that the tax-stamp has been useful in addressing counterfeit (either stamps, or the product as a whole), though some suggested the real credit should go to the investments in inspection personnel and capacity-building. In addition, key informants asserted that they could identify counterfeit stamps fairly easily, and that the 2004 investments in inspection personnel are what dramatically increased their capacity to carry out more inspections, culminating in greater seizures. However, other key informants stated that the use of a unique identification number on each tax-stamp is what impeded counterfeiting. In California the enhanced tax-stamps contain information about the place/date of affixation, the denomination of the stamp, and a unique identification number, allowing inspection officials to trace, in a limited capacity, each package of cigarettes, and ensure that each package stamp corresponds with the information in their Board of Equalization database for that individual stamp. This acts as an anti-counterfeit guard because even if individuals manage to counterfeit the stamp, the stamp would not link to the database.

<sup>74</sup> Michigan Department of Treasury. (2000) *Michigan’s Cigarette and Tobacco Taxes 1999*. Office of Revenue and Tax Analysis. September 2000, p. 42.

<sup>75</sup> Ibid.

<sup>76</sup> Slemrod J. (2007) “Are Tax Elasticities System-Dependent? Evidence from Michigan Cigarette Tax Policy.” *Under Review*, p. 17.

<sup>77</sup> Ibid, p. 16.

<sup>78</sup> White L. (March 2007) “Stamping in California: A Look at California’s Alternative Cigarette Tax Stamp Program could prepare distributors in case other states follow suit.” *Distribution Channels*; The American Wholesale Marketers Association, [http://www.sicpa.com/public/pdf/news/stamping\\_reprint.pdf](http://www.sicpa.com/public/pdf/news/stamping_reprint.pdf)

Analysis of Board of Equalization Investigations Division data shows that the enhanced taxation stamp has had a substantive impact on counterfeiting. In 2004-05, the Investigations Division reported that 70% of all seizures made involved counterfeit stamped cigarettes, 37% involved unstamped cigarettes, and 6% involved tax stamps from other states (the percentages do not add up to 100% because some seizures involve various types of illicit cigarettes).<sup>79</sup> However, in 2006-07 it is reported that of the 329 seizures made, only 43.2% involved counterfeit stamped cigarettes, while 57.2% contained unstamped cigarettes, and 2.8% involved other-state stamped cigarettes.<sup>80</sup> In 2004-05, 869 seizures of counterfeit-stamped cigarettes were made, while in 2006-07 only 142 seizures involved counterfeit-stamped cigarettes.<sup>81</sup> Overall, inspections have increased from 2004-05 to 2006-07, but the amount of counterfeit-stamped cigarettes have decreased six fold over this period, indicating a deterrent effect on counterfeiting.

### ***Counterfeit Cigarettes in Canada and the Need for Tax Stamps***

In 2008, the Canada Revenue Agency announced plans to implement a new tax marking system with “new hidden security features.”<sup>82</sup> Analysis of seizure data by the Canada Border Services Agency (CBSA) and statements from Western Canadian key informants imply that the counterfeit problem might be far more pronounced than is assumed. For example, the CBSA seized a total of 268,000 cartons of cigarettes in 2007. Of these, 93% were seizures of marine containers from China. Though information was limited, approximately 50% of these marine container seizures contained counterfeit Canadian and U.S. brands, while a further 50% contained Chinese cigarettes, all of which are illicit goods. Marine container seizures by the CBSA are nearly as large as seizures made by the RCMP in the Cornwall area surrounding the Akwesasne/St. Regis reserve, indicating that overseas smuggling, including counterfeit smuggling, might present a larger problem than previously thought. As such, the application of enhanced tax markings to cigarettes sold in Canada might prove that the counterfeit market is much larger than currently assumed, if existing tear-tape technologies have been compromised by counterfeiting.

Key informants in BC described a 2002 seizure of counterfeit products that were marked with counterfeit BC tear-tapes. In response, BC tobacco inspectors began specifically looking for counterfeit goods, and made significant numbers of seizures from retailers within the province. As a result, the BC government signed a Memorandum of Understanding (MOU) with Imperial Tobacco

<sup>79</sup> California State Board of Equalization (2006), p. 15.

<sup>80</sup> California State Board of Equalization (2008), p. 19.

<sup>81</sup> California State Board of Equalization (2006) and (2008).

<sup>82</sup> Lambert S. (2008) “Federal Government Hires Swiss-Based Firm to Help Fight Counterfeit Tobacco.” *The Canadian Press*, January 9.

in order to develop special anti-counterfeit tear-tapes which could be read under special scanners. According to key informants, the measure caused the counterfeit market among BC retailers to disappear.<sup>83</sup> Still, recent tobacco seizures in BC were found to be marked with counterfeit Ontario and Québec tear-tapes, indicating that some form of national distribution network for counterfeit products still operates.

The application of anti-contraband tax-markings can both safeguard retail outlets from the sales of counterfeit marked product and illuminate an existing counterfeit tobacco problem. From experiences in Europe, key informants noted that it is highly likely that significant counterfeit markets will surface, making anti-counterfeit safeguards very important. However, package markings are less effective if enforcement efforts are not undertaken, or when contraband cigarettes are sold through informal outlets without inspection. For example, during the 1990 smuggling crisis in Canada, the majority of the contraband being smuggled into Canada (between 70% and 90%) originated in Canada, and bore an “export only” marking.<sup>84</sup> Despite the fact that the packages had the requisite markings, enforcement was difficult because informal sales forced enforcement officials to rely on intercepting shipments rather than intercepting at point-of-sale.

Similarly, the Brazilian experience demonstrates a situation where cigarette packages were supposed to bear an “export only” marking on them, though many key informants attest that this was not the case, allowing manufacturers to argue that goods seized at borders crossings were counterfeit. Key informants assert that the implementation of the 1999 special registry and control stamps have been effective and the enhanced tax-stamp program implemented in 2007 is expected to have an even greater result. In this case, the fact that the tax-stamping machines are directly connected to each production line means that Brazilian Revenue officials know about all cigarettes produced. If the stamping machine is taken off-line, penalties can be imposed. Furthermore, the fact that stamping machines connect to the same power supply as the manufacturing machine means that attempts to unplug the stamping machine would result in power-loss to the manufacturing machinery as well.

These results indicate the importance of tax-paid markings. In cases where tax-differentials between geographically close jurisdictions are significant, the potential for smuggling of unmarked product is real (see the Michigan example). Thus, the ability to quickly and easily identify tax-paid cigarettes at the retail level is crucial. The utility of tax-paid markings is compromised when sales are made informally through street vendors or personal sources. Baggies of cigarettes are easy to identify as illegal, but given that such sales are often made through informal means, it is difficult to curb this

<sup>83</sup> Key informant interview on 2008 May 08.

<sup>84</sup> Non-Smokers' Rights Association/The Smoking and Health Action Foundation (Canada). (1994) *The Smuggling of Tobacco Products: Lessons From Canada*. August 1994, p. 18.

form of contraband activity. Stamp counterfeiting further lowers the utility of tax-paid markings and necessitates machine-readable, enhanced stamps.<sup>85</sup> UK and European officials have seen increases of counterfeit cigarettes over the last number of years, indicating the utility of covert markings, as overt markings are susceptible to abuse. Finally, similar to the lessons related to licensing, the effectiveness of tax-paid markings is dependent on the resources allocated to inspection and enforcement officers. The examples of both Canada (both 1990s and current) and Brazil illustrate this.

## Tracking and Tracing

### Relevant Case Studies

- EU agreements
- Brazil
- California

Key informants suggested that one of the major benefits of enhanced tracking and tracing stamps is their potential for storing information and being connected to sophisticated databases. Tracking and tracing capabilities allow officials to provide two vital functions. First, tobacco products can be tracked as they are distributed along the supply-chain, allowing officials to proactively follow products that they feel are being diverted to the illicit market. Second, tracing capabilities would allow officials to scan a product found in the illicit market, and retrieve information on who produced the product, who distributed it, and at what point it was diverted from the legal market.

Discussion of tracking and tracing regimes is prevalent in the literature and interviews with experts, although no jurisdictions have implemented this strategy in full. The closest examples are the agreements between the European Union and Phillip Morris International (PMI) and Japan Tobacco International (JTI), which stipulate preliminary tracking and tracing elements. In these agreements, each master case of cigarettes contains a barcode which provides officials with the date and place of manufacture. This allows for easy identification of the producer and also acts as an anti-counterfeit mechanism. Furthermore, a database of “first purchasers” is maintained, ensuring that rigid “know-your-customer” protocols must be upheld, which acts as a tracking device to ensure that disproportionate amounts of product are not shipped to markets with little demand. While the tracking and tracing components of the agreement do not cover every step of the supply-chain, the

<sup>85</sup> For instance: Newman A. (2008) “Arrest of Cigarette Seller Is a Coup, Brooklyn Officials Say.” *The New York Times*. April 11, 2008. Here, 2.1 million counterfeit stamps from various US states were seized.

information provided on each pack/carton of cigarettes, combined with the first purchaser database provides information to enforcement officials when starting an investigation. Since the companies agree to repay the duties when genuine products are seized, the tracing element, concretely linking a manufacturer to smuggled products, is not wholly necessary, as the manufacturers have no legal ability to dispute the claims of any wrongdoing. However, a broader tracking regime would assist officials in identifying major distribution points and actors, especially if the purchaser database can be expanded to second-level and third-level entities.

While California and Brazil are often cited as jurisdictions with tracking and tracing, it should be noted that though they have the capability to implement this sort of policy, they do not actually do so in practice. Brazil's system comes close to a tracking and tracing system, where information about production is uploaded to an authority-controlled central database in real time. These upgrades will help identify manufacturers who produce cigarettes without paying the requisite taxes. Finally, while formal tracking or tracing protocols do not exist, tax-stamps can provide information about the first-point of distribution, and tax value.

Similarly, as Californian key informants noted, each stamp in California has a unique ID number which provides information during an investigation, such as when the products were shipped, and who applied the stamp. Given the lack of broad tracking and tracing elements and the lack of manufacturing in California, these stamps act as an anti-counterfeit measure, as information can be verified with the central database to prove that a stamp is not counterfeit.

### ***Need for International Cooperation***

Many key informants noted the importance of implementing comprehensive tracking and tracing systems in numerous jurisdictions. Otherwise, there remains potential for the tracking and tracing regime in one jurisdiction to be undermined, as shipments legally could be made through other, non-compliant, jurisdictions, thereby ending the tracking or tracing abilities. In the early 1990s, Canadian tobacco manufacturers agreed to “place identification codes on cartons of Canadian brands sold into the duty-free and export markets,” in order to get a better understanding of what entities were fuelling the illicit market.<sup>86</sup> In response, tobacco companies began sending all of their export goods to the same US warehousing operation, so that single distributors could not be identified as fuelling the illicit market.<sup>87</sup> If a tracking and tracing regime was enacted, shipments might be sent to a non-participating jurisdiction, in order to complicate any tracking or tracing provisions, similar to what occurred in Canada. While policies might be proposed to restrict trade to these jurisdictions, this might run counter to free trade laws, further complicating this issue.

<sup>86</sup> Non-Smokers' Rights Association/The Smoking and Health Action Foundation (1994), p. 14.

<sup>87</sup> *Ibid*, p. 15.

Perhaps the most significant lesson from the application of tracking and tracing capabilities is the dual role such markings would serve, both as an anti-counterfeit measure, and as a means of gathering information on production and distribution for investigative purposes. The availability of information pertaining to the time/place/date of manufacture would enable the identification of legitimate versus counterfeit products. The ability to cross-reference production markings on the pack with a database at the level of manufacture removes any possibility of manufacturers claiming they either did not produce the product, or that the product is counterfeit. The availability of such information directly at the manufacturer level (as in Brazil, and within the EU agreements) provides insight into production amounts, and given proper controls, can eliminate production overruns, where product is manufactured after business hours to evade taxes. Since the Brazilian machinery uses the same power supply as the production machinery, such checks can ensure that the system is not abused, if subject to frequent inspections.

An important final consideration on tracking and tracing is its relationship to markings/stamps. These policy measures play different but complementary, roles. Tracking and tracing was repeatedly emphasized as vital to investigations and identifying the source and distribution of smuggled goods. For example, tracking and tracing markings are used to identify distribution points, and the production source of packages of cigarettes, emphasizing their investigative utility. Conversely, tax-paid markings/stamps are generally applied as fiscal measures to indicate that duty has been paid and prevent the smuggling and sale of illicit goods. As the Michigan case study shows, tax-stamps were appropriate to control smuggling lower-taxed cigarettes into Michigan because the overt markings made illegal, unmarked, products stand out. A strategy that requires a stamp that contains overt duty-paid markings, covert information about manufacturer source (such as Brazil), and distribution information (such as the EU agreements), is a good policy for risk management.

## **Record-Keeping and Control Measures**

### **Relevant Case Studies**

- Canada
- California
- EU
- Australia

Record-keeping and control measures were identified as a “catch all” policy category, emphasizing measures that require information collection, or entity obligations, without formally requiring licensing or similar arrangements. This section will consider three major forms of record-keeping/control measures: tax-exempt distribution controls in Canada, record-keeping of Internet sales of cigarettes in the US, and raw material controls.

### ***Tax-Exempt Distribution in Canada***

As described above, Section 87 of the *Indian Act* in Canada reaffirms the treaty rights of Aboriginals to exempt them from taxation of personal property, including tobacco products. The distribution of tax-exempt tobacco products to First Nations retailers has been a source of tax-evasion, as tax-exempt product can be smuggled off the reserve and sold to non-Aboriginal consumers from on-reserve retailers.

In order to regulate and control the supply of tax-exempt tobacco products on First Nations reserves, each province has policies for the sale of tax-exempt tobacco products. The two main mechanisms for these sales are either a quota system or a refund system. A quota or allocation system predetermines the amount of tax-exempt products to be distributed to reserve retailers, usually based on population and consumption estimates. Allocation systems, where tax-exempt products are limited based on a formula that takes into account population and consumption averages, appear to be ineffective because allocation formulas are often generous, and provide no mechanism to ensure that non-eligible consumers cannot purchase the product. Key informants in Ontario noted that the allocation system in the province of Ontario was particularly ineffective, as products manufactured on First Nations reserves were often shipped to reserves in excess of the allocation formula, therefore undermining the premise of the allocation policy altogether. If stringent controls and tight allocations cannot be guaranteed, quota systems become irrelevant.

Alternately, some provinces have a refund policy, whereby tobacco products are sold to on-reserve retailers with all provincial and federal taxes included. Products are then sold to Status Indians on a tax-free basis (provided identification is shown), and the retailer must apply to provincial authorities for a refund. As an adjunct to these policies, some provinces impose a “purchase quota,” whereby only a certain number of tax-exempt products can be purchased by the same customer at any given time, acting as a measure to stop the purchase of very large quantities of tax-exempt product for potential resale to non tax-exempt purchasers. Tobacco products sold under these provincial policies are either marked with “black-stock” markings, indicating Canada duty-paid (and therefore no provincial duties paid), or display the province’s duty-paid tear-tape. The markings are important, as provinces that do not mark duty-paid products sold on-reserves with the black-stock markings can have difficulties identifying which products are eligible for sale to Status Indians.

The use of black stock markings<sup>88</sup> for tax-exempt cigarettes sold on reserve is a means to prevent the diversion of tax-exempt products to retailers off reserve. The ability to separately mark the tax-

<sup>88</sup> “Black stock” markings indicate that federal excise taxes have been paid, but that provincial tobacco taxes – identified as a consumption tax, have not been paid.

exempt product from the fully-taxed product has been identified in certain cases as a useful first line of control.

Refund systems appear to be slightly more effective than allocation systems, because proof of Native status must be obtained before any tax-exempt retail sales can take place. However, in cases where the retailer uses a paper based system to track refundable sales, the refund system is prone to abuse because there are no immediate controls on tax-exempt purchases. Instead, sales records are submitted to the provincial government and analyzed afterwards. Given this time-lag, consumers can abuse refund systems without immediately being caught. For instance, while several jurisdictions have purchase quotas per customer, many key informants noted that some individuals might jump from store to store, buying their personal quota at each retailer. To prevent this, revenue officials need to analyze tax refund requests and categorize them by name, in order to identify offending customers' purchase patterns and take appropriate action. Use of a real-time system of sales can prevent this, where personal purchases are updated instantly in a database. Unfortunately, because such systems require significant investments by both the revenue departments and retailers, they are not widely-used in Canada.

The allocation of tax-exempt products to a reserve, coupled with a refund mechanism for individual purchases, similar to what exists in Manitoba, is theoretically the most comprehensive approach to managing the distribution of tax-exempt products to First Nations retailers. In this model, both the supply (through an overall allocation) and each individual sale (through the refund), is managed.

An important policy demonstrated by BC is the application process for tax-exempt retailers themselves, where such retailers must prove that an appropriate market exists in their community, and that the demand is not sufficiently met by existing retailers. By strengthening the provisions on the tax-exempt retailers themselves, rather than at the customer level, controls can be put in place limiting the ability of customers to abuse the system by jumping from store to store. Instead consumers would be forced to either attempt to over-purchase at a single store (thus making it easier to catch the customer), or travel to a neighboring reserve, which can add costs in terms of transportation.

### **Tax Notices**

Tax notices are being used to curb illicit purchases of tobacco over the Internet. The US General Audit Office (GAO) analyzed internet cigarette sales in 2002, and reported on the application of the *Jenkins Act* by six states. Briefly:

The *Jenkins Act* (15 U.S.C. §375-378) requires any person who sells and ships cigarettes across a state line to a buyer, other than a licensed distributor, to report the sale to the buyer’s state tobacco tax administrator.<sup>89</sup>

Endeavoring to notify residents in their jurisdictions that taxes are owed, several states have attempted to collect customer information from Internet vendors. The GAO report notes that “there was little response by Internet vendors notified,” and “several officials noted that Native Americans often refused to report cigarette sales, with some Native American vendors citing their sovereign nation status as exempting them from the *Jenkins Act*.”<sup>90</sup> Table 5 outlines some of the successes that these initiatives have had:

**Table 5: Six States’ Efforts to Promote Jenkins Act Compliance Since 1997**<sup>91</sup>

State	Number of Internet vendors identified and notified	Number of Internet vendors that responded with reports	Number of residents identified and notified	Number of residents that responded	Amount of taxes, penalties, and interest collected
Alaska	15	2	3	1	\$9,850
California	167 (approx.)	20 (approx.)	23,500 (approx.)	13,500 (approx.)	\$1.4 million (approx.)
Massachusetts	262	13	None	None	None
Rhode Island	Unknown	None	None	None	None
Washington	186	8	800 (approx.)	560 (approx.)	\$29,898
Wisconsin	21	6	696	696	\$80,200

Compared to other states in the GAO report, California was most successful at recovering tobacco taxes lost through Internet purchases. Nonetheless, although over one million dollars (US) in taxes were collected, this tax was collected from less than 60% of people who were contacted about their Internet tobacco purchase. Additionally, only 12% of Internet tobacco vendors contacted for customer information actually provided that information. Given that this data is based on a small fraction of the retailers known to be selling to Californian consumers, it appears that post-sale tax collection from Internet sales is not effective. The lack of enforcement and collection of tobacco taxes owed makes this method of anti-contraband control particularly ineffective.

<sup>89</sup> United States General Accounting Office. (2002) *Internet Cigarette Sales: Giving ATF Investigative Authority May Improve Reporting and Enforcement*. GAO: Washington, DC, p. 1.

<sup>90</sup> *Ibid*, p. 12.

<sup>91</sup> *Ibid*, p. 13.

## **Material Controls**

A number of jurisdictions have considered restricting the sale of tobacco manufacturing machinery and/or the supply of other products in tobacco production only to licensed tobacco manufacturers. The Canadian 2008 federal budget proposes to “limit the possession and importation of tobacco manufacturing equipment to persons holding a license.”<sup>92</sup>

Informants suggested that similar controls should be placed on raw materials such as tobacco paper, filters, and acetate tow. However, no cases were reported in the literature or by key informants of any jurisdiction attempting to implement this, though this might prove a significant anti-contraband initiative.

A concern cited during the Canadian government’s Standing Committee on Public Safety and National Security May 2008 meeting was whether tobacco leaf is also being supplied to illicit manufacturers.<sup>93</sup> The majority of Canadian tobacco growers resides in Ontario, and must sell their tobacco products through the Ontario Flue-Cured Tobacco Growers’ Marketing Board. However, concerns have arisen that some growers might be selling to the illicit market (similar to the Australian context).<sup>94</sup> Little evidence exists of the role of tobacco growers in the illicit market, and the experience of Australia might suggest that controls over sales of tobacco leaf may only have limited impact.

Restricting access to machinery and raw materials can supplement other measures currently in place, such as licensing and marking obligations. For instance, controlling the supply of machinery/raw materials requires that a licensing system already exists so that controls can be applied to specific entities. While Canada does not specifically license its growers, restricting the distribution of tobacco leaf to the requisite marketing boards, and then requiring that tobacco leaf only be sold to licensed entities can achieve the same ends.

<sup>92</sup> Department of Finance Canada. (2008), p. 317.

<sup>93</sup> See:

<http://cmte.parl.gc.ca/cmte/CommitteePublication.aspx?SourceId=240251&Lang=1&PARLSES=392&JNT=0&COM=13205> evidence sections 1615.

<sup>94</sup> See: RCMP (2008), p. 22.

## **Enhanced Enforcement**

### **Relevant Case Studies**

- California
- UK
- Brazil
- Canada
- Australia
- EU

Enhanced enforcement is a necessary component of all of the policy measures described. This section addresses the three categories of enhanced enforcement: border controls, investigations/intelligence, and inspections/seizures.

### ***Border Controls***

Policies or strategies aimed at better securing borders can have a substantial impact, but are vulnerable to many obstacles. One UK key informant holds that the main issue is to have a secure border, because once the illegal product makes it past the “pinch point” of Customs, any further inspection/enforcement operations will require catching-up to products that were missed the first time. Thus, capturing illegal goods prior to distribution is paramount. Unfortunately, customs officials are ill-equipped to inspect every container, as the sheer volume of trade allows officials to physically inspect only a tiny fraction of shipped containers. Some key informants attested that the inspections rate is as low as 2 or 3%. Key informants often noted that a seized container of contraband products is seen as simply “the cost of doing business,” which can be offset by successfully smuggling two or three other containers into the country.

UK informants also observed that some smugglers have taken to shipping smaller quantities, often through postal or other courier services, to be assembled by smaller ‘cottage industry’ units in the country. Large packages of mailed tobacco, followed by a package of counterfeit cigarette boxes are assembled within the country, and then distributed. Though much smaller than the vast quantities smuggled in containers, this can nevertheless become a substantial avenue for smuggling products.

### ***Investigations/Intelligence Building***

While this paper cannot comment extensively on intelligence capacities, it should be emphasized that many key informants discussed the importance of intelligence building in order to disrupt organized criminals and major producers/suppliers of contraband. Sharing information and intelligence emerged as a fundamental component, with some key informants noting the potential

for intelligence silos to develop within organizations that do not not share intelligence with relevant counterparts. Canadian key informants attested that information sharing and cooperation methods are in place in the country, with communication between the Royal Canadian Mounted Police (RCMP), provincial authorities, and when required, the Canadian Border Services Agency (CBSA) and the CRA. The networks that have developed and the workshops held by Canadian officials appear to have fostered a fairly coherent and cooperative policy community. The ability for joint-operations and intelligence sharing is essential, especially in federal states, when several agencies might have the potential to address contraband issues. For instance, key informants from Manitoba cite the teaming of federal and provincial enforcement officers together to engage in issues of intelligence building and enforcement as better practice. This enables immediate sharing of information between federal and provincial agencies, facilitating coordinated enforcement. Similar arrangements did not seem to appear formally within the rest of Canada, save for the joint task-forces active in Cornwall, Ontario near the Akwesasne reserve.

On-reserve police force assistance has also been mentioned as necessary in addressing smuggling. Key informants noted that cooperation from the Akwesasne Mohawk Police Service has enabled many seizures to be made in the Akwesasne/Cornwall areas, and is therefore a promising development in enforcement. However, joint-agency enforcement officers must be mindful of the jurisdictional questions between First Nations and the provincial/federal governments.

Key informants ranged in opinion on the level of international cooperation they observed, noting that there are often restraints put on international information sharing. Within Canada, key informants often cited a strong working relationship between Canadian and American officials, suggesting that cross-border collaboration can work well. However, some key informants distinguished between “information sharing” and “intelligence sharing,” where key-pieces of intelligence might not be readily supplied to international governments. European key informants noted that joint efforts are difficult, with intelligence or information sharing being a greater obstacle to surmount. However, many identified the European Anti-Fraud Agency (OLAF) as a key player in coordinating European efforts, and improving information sharing. Given the cross-border nature of the problem, international cooperation is a key part of the solution.

### ***Inspection/Seizure Capacities***

A cross-cutting theme throughout the case studies is the need for substantive deterrents to minimize the willingness of actors to participate in the illicit market since the ability to effectively penalize a retail outlet for having contraband products or to penalize individuals for smuggling contraband products can have an impact.

For example, in the California study, the perspective of some key informants was that the real triumph was the increased inspection capacity, as well as the “limited peace officer” status. It is

reported in the 2004-05 Investigations Division Annual Report that 51 new positions were added to the Investigations Division, many of which would be added to the existing 29 investigators, representing a dramatic investment in this unit.<sup>95</sup> Given the overall investment into the Investigations Division, inspections of licensed sites have remained at over 10,000 inspections per year since fiscal year 2005-06, but the number of seizures made has decreased nearly fourfold, from 1,206 seizures in 2004 to 331 in 2007.<sup>96</sup> Apparently, increasing the likelihood of receiving a financial penalty for possessing unmarked product (as well as possibly having a license suspension or revocation), had a considerable effect on increasing compliance.

Similarly, the experience of the UK suggests that when customs officials began seizing both smuggled products, and the vehicles involved, it resulted in a significant decrease in cross-border smuggling. Implementation of steep penalties to individuals who distribute contraband products is therefore effective within a broader enforcement strategy.

The experience of Canada and Brazil, however, indicate that seizures and penalties alone are not adequate solutions to smuggling crises. As previously stated, the RCMP seized 618,077 cartons of cigarettes in 2007, and while financial penalties might be stiff, the contraband market remains vibrant. Similarly, although seizures have also increased in Brazil, both cases demonstrate that individuals will continue to smuggle goods across the border if the potential profits are significant. Brazilian key informants assert that the Brazilian judicial system is lenient on smugglers, suggesting that inflicting a fine on an already poor individual is an ineffective deterrent. However, key informants have observed that if the penalties for engaging in smuggling are weak, seizures of products, and fines for smuggling might be seen as simply “the cost of doing business.” Ensuring that enforcement officials have authority to apply deterrents to smuggling is fundamental, where seizure of vehicles or similar “proceeds of crime” penalties might address some of these concerns.

<sup>95</sup> California State Board of Equalization (2006), p. 2.

<sup>96</sup> California State Board of Equalization (2008) *Investigations Division – Cigarette and Tobacco Products Inspection Program*. Updated March 25, 2008. Accessed on May 27, 2008 from: <http://www.boe.ca.gov/invest/inspectionprog08.htm>.

## Export Taxation

### Relevant Case Studies

- Brazil
- Canada

Brazil and Canada (1992/94) are the two major cases where export taxes have been applied to address increases in exported cigarettes that are diverted to the smuggled market. In Canada, an export tax of \$8 per carton was first applied in 1992, with the immediate impact of reducing exports to the US by 67%.<sup>97</sup> However, the tobacco industry organized a number of protests against the measure, and threatened to move production (and the associated jobs) to other jurisdictions. The export tax was repealed, and exports to the US rose once again. Additionally, when the federal excise tax and numerous provincial tobacco taxes were decreased in 1994, an equivalent export tax was once again applied, and exports subsequently fell. It is difficult to assess whether it was the tax decreases, the export tax, or the increased scrutiny of the tobacco industry itself that helped eliminate the smuggling problem (likely a combination of all three), but it is clear that export taxes can have an immediate effect.

In Brazil, when exports to neighboring Paraguay were being smuggled back into the country an export tax of 150% of the product value appears to have had an immediate and dramatic impact. Exports from Brazil decreased from over 72 billion cigarettes in 1998 to 6.3 billion cigarettes in 1999, to a further 710 million cigarettes in 2000.<sup>98</sup> This measure also had the effect of increasing the number of manufacturing operations in Paraguay from approximately two in the early 1990s to over 20 manufacturers by 2000, which meant that the illicit market remained vibrant.<sup>99</sup> Thus, the effectiveness of an export tax might be dependent on the ability of manufacturers to produce their goods for the illicit market in a neighboring jurisdiction, in order to evade the taxes. The variety of free-trade protocols across the globe may also be a barrier to export taxes. In 2000, when Brazil extended its export tax on cigarettes to machinery and cigarette paper as well, in order to stop the exports of these goods to manufacturers around Brazil, MERCOSUR (a regional trade agreement between Argentina, Uruguay, Paraguay, and Brazil) overturned the export tax on these items, due to the restriction this put on free-trade.

<sup>97</sup> Non-Smokers' Rights Association/The Smoking and Health Action Foundation (1994), p. 8.

<sup>98</sup> Iglesias R. (2006) *Brasil: a Economia Do Controle Do Tabaco nos países do Mercosul e associados. Organização Pan-Americana da Saúde*, p. 38.

<sup>99</sup> Shafey O, Cokkinides V, Cavalcante et al. (2002) "Case-studies in International Tobacco Surveillance: cigarette smuggling in Brazil." *Tobacco Control* 11: 215-219, p. 217.

In both contexts the export tax had a significant short-term impact on the immediate contraband market, but both cases saw the illicit market return (as in Canada), or stay relatively the stable (as in Brazil), rather than decline over the long-term. The important lesson to be learned is that large, organized contraband distribution networks are highly flexible and resilient, and the source of operations, given their mobility and relatively cheap cost, can become quite fluid. For instance, almost immediately after the export tax in Brazil was applied, cigarettes were produced and smuggled back into the country from Paraguay, indicating that the distribution networks might have stayed the same, only the producers of the illicit cigarettes had changed. Similarly, while Canada's illicit market has fluctuated over time, the source of the contraband changed considerably in recent years, escalating the issue in Canada to levels similar to the early 1990s. Therefore, an export tax should be applied alongside other policies aimed at controlling both the production and distribution of contraband tobacco, and should be rolled out with extensive monitoring of changes in the source and distribution of contraband.

## **Tax Harmonization**

### **Relevant Case Studies**

- EU
- Canada

Tax-harmonization can be either a tax decrease (to minimize the price differential between smuggled goods and legitimate goods), or a tax increase by “laggard” jurisdictions. There are few examples where a jurisdiction lowers tobacco taxes to curb smuggling. The cases of Canada and Sweden illustrate this. Canada's tax-rollback in 1994 is particularly instructive due to the significant health ramifications seen afterwards. Several reports and informants found it curious that smuggling in Canada did not shift to an east-west situation, moving from lower-taxed provinces to higher-taxed provinces, contradicting prevailing economic ideology about tax decreases. A caveat here might be the geographical size of Canadian provinces, though evidence from numerous jurisdictions points to the salient role of distribution networks in exacerbating smuggling, even between relatively low-taxed jurisdictions.

As for Sweden, Joossens and Raw (2000) argue that two substantial tax increases in 1996 and 1997 spurred the smuggling market, resulting in dramatic seizure rate increases, from 6 million cigarettes in 1995 to 39 million in 1997.<sup>100</sup> In response, the Swedish government repealed the tax increases, and

<sup>100</sup> Joossens L and Raw M. (2000) “How Can Cigarette Smuggling Be Reduced?” *British Medical Journal* 321: 947-50, p. 217.

consequently “tax paid sales per capita rose from 34 packs in 1997 to 51 packs in 1998.”<sup>101</sup> Cigarette confiscations only fell by a limited amount, from 46 million in 1998 to 32 million in 1999, but did increase back up to 45 million in 2000.<sup>102</sup> Thus, while the tax decrease had an impact on tax-paid distributions, it appears an illicit market remained.

Many scholars point to Spain, which had a major smuggling crisis despite having the lowest tobacco taxes in the European Union, as a contradiction to the tax-reduction thesis. In *Tobacco Control in Developing Countries*, Merriman, Yurekli, and Chaloupka (2000) assert that a tax rates are not the only indicator of smuggling, as public transparency also features prominently.<sup>103</sup>

The authors suggest:

Retail price differentials between neighboring countries alone cannot account for the cross-country variance in smuggling. Smuggling requires evasion of border controls or bribery of border guards. A retail network must be available to distribute smuggled cigarettes. Conditions that contribute to smuggling include high levels of government corruption, an established informal market for cigarettes (sales of cigarettes by street vendors), and a well-organized criminal establishment.<sup>104</sup>... Empirical results suggest that factors other than price, and particularly transparency, are very important.”<sup>105</sup>

Taking these factors into consideration, it seems as though tax-harmonization through taxation decreases is a suboptimal solution to smuggling issues. Given the relatively cheap price of producing and distributing cigarettes, as seen most clearly in the “baggie market” in Canada, drastic cuts to tobacco taxes would be required in order to equalize these markets.

Broad literature exists on the impact of tobacco pricing on cessation and prevention (especially among youth) of cigarette smoking, providing evidence that when taxes go up, smoking goes down. Reducing tobacco taxes as a means to limit smuggling is not effective in the larger context of tobacco control. Lower taxes may cause smuggling to decrease (as in Canada in 1994), but at the same time it causes smoking to increase (as in Canada in 1994), trading one issue for another.

<sup>101</sup> Joossens L, Chaloupka F J, Merriman D, Yurekli A. (2000) “Issues in the Smuggling of Tobacco Products.” In: Jha P, Chaloupka F J, editors. *Tobacco Control in Developing Countries*. London, UK: Oxford University Press, p. 402.

<sup>102</sup> Joossens L and Raw M. (2000) “How Can Cigarette Smuggling Be Reduced?” *British Medical Journal* 321: 947-50, p. 217.

<sup>103</sup> Merriman D, Yurekli A, Chaloupka F J. (2000) “How big is the worldwide cigarette-smuggling problem?” In: Jha P, Chaloupka F J, editors. *Tobacco Control in Developing Countries*. London, UK: Oxford University Press.

<sup>104</sup> Ibid, p. 366-67.

<sup>105</sup> Ibid, p. 376.

The effect of equalizing tax rates by increasing taxes in lower-taxed regions remains an issue to be explored, especially in the European Union. Mandating minimum levels of taxation may help undermine cross-border smuggling and bootlegging, while similarly promoting public health.

## **Taxation Agreements/ Compacts with First Nations Communities**

### **Relevant Case Studies**

- Canada
- US

Tax agreements with First Nations communities involve implementing a tax on tobacco products that is comparable to similar taxes paid in the off-reserve community, as a mechanism to raise revenue for the community and equalize the price between on-reserve and off-reserve retailers, thereby undermining incentives to smuggle tax-exempt product

In addition to discouraging tax evasion, key informants noted that First Nations taxation agreements/compacts may be effective at improving public health for Aboriginal smokers, who might similarly be induced to stop smoking in response to price. While this was often proposed as a long-term solution to tobacco control on-reserve, most informants also observed the significant obstacles inherent to this approach. As such, taxation agreements are not considered to be an immediate solution to contraband.

A major finding of the VanWhysberghe report is the perspective of “taxation immunity” among many Aboriginal communities in North America.<sup>106</sup> While daunting, this phenomenon may hinge on something as simple as language. Key informants concurred that some communities routinely levy a “band fee” on purchases of cigarettes, suggesting that that this might be an important area for collaboration. Greater collaboration between governments and First Nations, coupled with sensitivity to the community’s language and approach, might provide a first-step in discussions around equalizing tobacco prices on- and off-reserve.

In Canada, the example from the Cowichan Tribes in BC is the only case where a reserve taxes cigarettes at the same rate as the provincial government. One key informant indicated that this agreement has been influential in shrinking tax-evasion by non-Aboriginals, while also contributing

<sup>106</sup> VanWynsberghe R. *Tobacco Taxation and First Nations and Inuit People of Canada: A Discussion Paper*. Prepared for the First Nations and Inuit Health Branch, Pacific Region, Health Canada.

to the community's resources and revenues, but no research has been done to confirm this. The key informant supporters of this model were primarily non-Aboriginal, and as such, we must remain mindful of First Nations' treaty rights, and the uniqueness of the Cowichan example. The city of Duncan, BC is situated within the Cowichan region, therefore representing different geographic conditions than most First Nations reserves in Canada. Most reserves are in more remote regions and one concern cited by many was that taxing tobacco products on-reserve would undermine consumers' incentive to travel out of their way to buy products on-reserve, suggesting that the unique geographical situation of Cowichan might not translate to other reserve communities across Canada.

The Government of New Brunswick collaborates with First Nations by refunding bands for 95% of the tobacco tax collected on sales of tobacco products to non-Aboriginals. This model does not require changing Section 87 rights of First Nations communities, but provides an incentive for bands to collect taxes from non-Aboriginals, given that the community will retain the taxes.

Especially in cases where the local economy is dependent on tobacco sales, the economic impact of tax agreements with reserve communities should be evaluated. Numerous key informants felt that communities would have no incentive to collaborate on taxation agreements if it meant that non-Aboriginal consumers might cease purchasing cigarettes on-reserve. The impact of tax harmonization on the local economy was a central element to Washington State's compact with the Puyallup Tribes, which ratified the collection of a "tribal tax" equivalent to 80% of the State rate, making this a useful case study to examine further. Here, although a "tribal tax" is levied, it does provide some degree of economic incentive for non-Native purchasers, thereby providing a form of compromise between State and the Native community.

Given the length of time required to make such agreements, the nation-to-nation negotiations that may be warranted, and the economic concerns inherent in a First Nations tobacco tax, taxation agreements might be considered as a long-term policy alternative. Broadening taxation agreements with First Nations, including models similar to that of New Brunswick, could be an important avenue to collaboration between First Nations and provincial and federal governments. Attention to the economic impact of tobacco on-reserve and the public health concern of Aboriginal youth smoking is desperately needed, not primarily as an anti-contraband measure, but generally as a public health measure.

## Legally Binding Agreements and Memoranda of Understanding (MOUs) with the Tobacco Industry

### Relevant Case Studies

- UK
- EU

Legal agreements and memoranda of understanding (MOUs) signed with the tobacco industry both represent direct agreements made with industry in regards to production and distribution practices. However, legal agreements can obligate a manufacturer or distributor to adhere to the agreement; failure to comply by the terms of the agreement can result in prosecution, while a MOU can only state what should be done. MOUs may sometimes contain strong wording about potential future prosecution, none of the specified penalties are legally binding and companies submit to them on a voluntary basis only.

The European Union-Phillip Morris International (EU-PMI) and European Union-Japan Tobacco International (EU-JTI) legal agreements have been hailed as victories in undermining smuggling. The imposition of mandatory seizure repayments, as well as controls over the supply-chain, including tracking and tracing, has been declared a success by most key informants. The European Union Anti-Fraud Office (OLAF) has been notified of over 1000 seizures of PMI products since the agreement, though over 80% of these have involved counterfeit cigarettes.<sup>107</sup> Since signing the agreement with JTI in 2007, no seizures of JTI products have been made.<sup>108</sup> OLAF officials state that given the stringent obligations placed on tobacco manufacturers, pertaining to know-your-customer protocols and tracking and tracing capabilities, tobacco companies are “fully committed to controlling their supply chains.”<sup>109</sup>

The MOUs in place in the UK were considered dubious by key informants. Some suggested the voluntary approach had ‘no teeth’, and gave the manufacturers time to control their supply-chains to avoid penalties and investigations into their actions. In terms of rigorous penalties, key informants noted that MOUs are an ineffective tool to address smuggling because they do not mandate legally binding mandatory penalties. As discussed in the UK case study, numerous key informants argued that it was the real or perceived threat of criminal investigations in the early 2000s that prompted

<sup>107</sup> Statement by OLAF.

<sup>108</sup> Ibid.

<sup>109</sup> Ibid.

many tobacco manufacturers to control their supply-chains, rather than the MOUs themselves. Emphasizing that seizure of genuine UK products fell prior to MOUs being signed, informants do not attribute the decline in genuine UK cigarettes seizures to MOUs.

Without legally-binding penalties, agreements with the industry may have limited impact, as seen in the UK, the “gentleman’s agreement” in Canada in the early 1990s, and other cases.<sup>110</sup> Thus, most key informants preferred legislated supply-chain measures similar to the EU agreements with PMI and JTI. While the feasibility of an approach that attempts to legislate mandatory penalties for facilitating smuggling might appear low, especially to achieve the same degree of rigor that the mandatory seizure repayments that the EU agreements contain, key informants noted this might not be an insurmountable obstacle. The fact that JTI signed an agreement with the EU is indicative that companies might be interested in this sort of arrangement. Furthermore, some informants suggested that since counterfeit cigarettes make up such a large market-share in many countries, the tobacco industry might agree to legislated agreements, in order to help facilitate the ability of governments and international organizations to seize counterfeit products.

Yet, some key informants expressed discomfort with governments entering into agreements with the tobacco industry (often involving information sharing), alluding to the history that some manufacturers have had in encouraging smuggling markets. Others felt that regardless of past practices, stringent agreements (such as those with the EU) can provide effective controls on supply-chain distribution, and should therefore be considered in other contexts. In particular, OLAF officials cite their agreements as particularly effective, and suggest that the companies have been largely compliant with all of the protocols.<sup>111</sup>

## **Public Awareness Campaigns**

### **Relevant Case Studies**

- UK
- Canada

Our research indicates that few comprehensive anti-contraband public awareness campaigns have been executed. Most governments have online information and brochures, but few have actively

<sup>110</sup> Joossens L and Raw M. (2008) “Progress in combating cigarette smuggling: controlling the supply chain.” Tobacco Control (online Sept 10, preceding publication), <http://tobaccocontrol.bmj.com/onlinefirst.dtl>

<sup>111</sup> Statement by OLAF.

mobilized their population to be vigilant about spotting and reporting sources of contraband tobacco.

Key informants questioned the effectiveness of this approach, suggesting that it is highly unlikely that consumers will change their purchasing behaviors in response to media campaigns, because price is an overriding factor in the purchase of contraband cigarettes. Key informants also suggested that some consumers actually like to think they are “sticking it to the taxman,” and that tax-evasion is a victimless crime. Public awareness campaigns tailored around the illegality of contraband and how contraband may fund organized crime might prove useful, though many key informants were not optimistic.

The “counterfeit kills” campaign in the UK might be effective according to some key informants, based on the uncertainties that exist when consumers purchase counterfeit cigarettes. Key informants suggested campaigns tailored towards helping consumers to identify counterfeit cigarettes might be useful in undermining some distribution sources. However, other key informants were less hopeful, focusing on two points. First, they argued that a campaign outlining the harmful consequences of counterfeit cigarettes would be ineffective because the majority of smokers already know that commercial cigarettes are unhealthy. Therefore, arguments based on counterfeits being especially unhealthy might not have an effect. Second, some were concerned that by campaigning against counterfeit cigarettes, such initiatives might have the unintended consequence of “re-legitimizing” commercial brand cigarettes as less harmful. While this is not a direct contraband concern, it highlights the multiple priorities that policymakers must take into account when implementing policy.

A final further consideration shed more positive light on public awareness campaigns. It was emphasized by several key informants that there are various types of contraband smokers, some of them being more innocent than others. For those who are either unaware of the legal ramifications of their actions, or are first-time smokers, it was suggested that public awareness campaigns might be more effective, and consumers might either change their purchasing habits to stop participating in an illegal activity, or might avoid purchasing cheap cigarettes, due to their uncertain ingredients. Most policies aimed at addressing contraband are regulatory or fiscal measures at the supply-side, with little affecting the overall demand-side of the equation. Thus, public awareness campaigns represent one potential avenue for affecting smokers’ perceptions and willingness to purchase contraband cigarettes, especially in addressing counterfeit and non-domestic brand cigarettes, where regulatory options are more limited.

## Section Three: Case Studies

As demonstrated in the literature review, two case studies, Spain and Canada 1990s, have already been well-explored by scholars of anti-contraband policies. These cases will serve as a supplement to the case studies conducted by the knowledge synthesis team which are modern Canada, Australia, Brazil, the EU, and the UK.

### Spain

As described by Joossens' work, smuggling in Spain seemed paradoxical, in that it had the lowest tobacco tax rates in the European Union at the time. Nevertheless, a distribution network existed, and therefore smuggling thrived. Joossens and Raw (2000) claim that the illicit market made up 15% of the overall cigarette market in Spain in 1995, the largest source of this being exports into neighboring Andorra, which were smuggled into Spain.<sup>112</sup> Exports from the UK to Andorra increased from 13 million cigarettes in 1993 to 1520 million in 1997. Joossens and Raw suggest this would have required "each Andorran (including children and non-smokers) ... [to smoke] 60 British cigarettes a day."<sup>113</sup> Alternately, they infer that the cigarettes were then smuggled out of Andorra and into Spain. An internal British American Tobacco document suggests that same, as it states:

Smuggling is a traditional and highly lucrative trade in Andorra. The growth has increased rapidly in recent years as Andorran supply has replaced that which used to enter Spain by sea and has been subjected to increased controls because of the links with the drug trade.<sup>114</sup>

The Spanish government, in coordination with the European Anti-Fraud Office and other European jurisdictions had the Spanish border patrolled, and enforcement capacities increased.<sup>115</sup> As a result, the illicit market share fell from approximately 15% in 1995 to 5% in mid-1999.<sup>116</sup> Furthermore, cigarette tax revenues increased from by 25% from 1997-1998, and tax-paid sales of cigarettes increased from 78 billion in 1997 to 89 billion in 1998.<sup>117</sup>

<sup>112</sup> Joossens L and Raw M. (2000) "How Can Cigarette Smuggling Be Reduced?" *British Medical Journal* 321: 947-50, p. 948.

<sup>113</sup> Ibid, p. 949.

<sup>114</sup> Joossens L. (no date) *Report on Smuggling Control in Spain*. World Health Organization, p. 4.

<sup>115</sup> Ibid, p. 5.

<sup>116</sup> Joossens L and Raw M. (2000) "How Can Cigarette Smuggling Be Reduced?" *British Medical Journal* 321: 947-50, p. 948.

<sup>117</sup> Ibid.

This case study presents support for enhanced enforcement policies and controls on exports, rather than changes to tax policies. The fact that Spain had the highest levels of smuggling in the European Union, while also having the lowest tax rates, indicates that the correlation between taxes and smuggling is not the whole story.

### **Canada: Early 1990s**

The contraband market in Canada was estimated to be at 30% in the early 1990s, with the highest prevalence existing in Quebec and Ontario.<sup>118</sup> As the tax differential between US and Canadian cigarettes grew during the 80s and 90s, a smuggling ring emerged with a dramatic increase in cigarette exports from Canada to the United States, from 1.2 billion cigarettes in 1989 to 18.6 billion in 1993,<sup>119</sup> where much of the contraband was exported duty-free to warehouses in New York State.<sup>120</sup> From there, most cigarettes were diverted, still duty free, through the Akwesasne/St. Regis Aboriginal reserve which straddles the Ontario, Quebec, and New York borders.<sup>121</sup> An estimated 80% of all of the contraband market was supplied through this route.<sup>122</sup> Other points of distribution were Brantford, Ontario and Kahnawake, Quebec.<sup>123</sup> Tellingly, more than 90% of the contraband in Canada was of Canadian origin, pointing to the misuse of the export system by manufacturers.<sup>124</sup> Though aware of the sale and distribution of contraband through this route, authorities were reluctant to conduct seizures, due to the multi-jurisdictional context of the problem, as well as the impact of the “Oka Standoff,” which was a conflict between the Mohawks of Oka and the Quebec police.<sup>125</sup>

<sup>118</sup> Non-Smokers’ Rights Association, Canada. (2006) *It’s Time for Action on Tobacco Smuggling and Contraband*. NSRA, Toronto, Ontario, p. 1.

<sup>119</sup> Cunningham R. *Smoke and Mirrors: the Canadian tobacco war*. Ottawa: International Development Research Centre; 1996, p. 125.

<sup>120</sup> Non-Smokers’ Rights Association, Canada. (2006) *It’s Time for Action on Tobacco Smuggling and Contraband*. NSRA, Toronto, Ontario, p. 1.

<sup>121</sup> William Marsden (1999) “Tobacco Insider Talks: Part 1: Major firms were deeply involved in cross-border smuggling, former executive says.” *The Gazette*. Montreal, Que. Dec 18, 1999. p. A1.

<sup>122</sup> Cunningham R. *Smoke and Mirrors: the Canadian tobacco war*. Ottawa: International Development Research Centre; 1996, p. 126.

<sup>123</sup> *Ibid.*

<sup>124</sup> Canadian Cancer Society et al. (1999) *Surveying the Damage: cut-rate tobacco products and public health in the 1990s*. Canadian Cancer Society, The Non-Smokers’ Rights Association, and Physicians for a Smoke-Free Canada. Ottawa, Ontario, p. 24.

<sup>125</sup> Here, a land dispute between the Mohawks and the town of Oka, Québec, resulted in three deaths. The Mohawk nation argued that an ongoing land-claims dispute was being violated, as the Town of Oka made plans to develop part of this land as an expansion of a golf course. A two-month standoff ensued, where one Québec police officer was shot, and two others died, although not due to gunshots. Eventually the Royal Canadian Mounted Police, and the Canadian Army were sent in to monitor the situation.

Efforts to resolve the contraband problem began in 1992, when the federal government implemented an export tax of \$8.00 per carton of cigarettes.<sup>126</sup> Immediately, exports dropped substantially. However, industry pressure, including pressure from tobacco growers in Canada, led to the repeal of this tax.<sup>127</sup> In return, industry promised to work to minimize exports, and discourage smuggling.<sup>128</sup> However, Cunningham (1996) contends that “time would prove the commitments to be worthless,” as the companies failed to install a coding system they promised to put in place, and were reluctant to print packages indicating “not for sale in Canada” for exported cigarette packages.<sup>129</sup>

Contraband activities continued in 1994, but governments took another course of action. After substantial industry pressure, the federal government decreased excise taxes by \$5.00 a carton, which was then followed by similar moves among provincial governments in Central/Eastern Canada.<sup>130</sup> In conjunction with this, the Quebec government lowered its tax by \$11 a carton,<sup>131</sup> and as part of the domino effect, Ontario, New Brunswick, Nova Scotia, and Prince Edward Island all reduced their taxes as well.<sup>132</sup> Collectively, the provinces that lowered their taxes amounted to over 60% of the Canadian tobacco market, providing further incentive for manufacturers to stop smuggling and focus their efforts on expanding the domestic market.

Accompanying the tax roll-back was an export tax of \$8.00, the same as was introduced in 1992.<sup>133</sup> Together, these policies had the effect of addressing most issues of smuggling. However, further literature has argued that significant increases in smoking (especially among youth) were seen after the tax-rollbacks, seemingly trading one issue for another.<sup>134</sup>

<sup>126</sup> Cunningham R. *Smoke and Mirrors: the Canadian tobacco war*. Ottawa: International Development Research Centre; 1996, p. 127.

<sup>127</sup> Ross Howard. (1992) “Threats derailed tobacco tax companies’ warning led Ottawa to ease ‘war on smugglers.’” *The Globe and Mail*. Toronto, Ontario, May 22, 1992., p. A1.

<sup>128</sup> Cunningham R. *Smoke and Mirrors: the Canadian tobacco war*. Ottawa: International Development Research Centre; 1996, p. 129.

<sup>129</sup> Ibid.

<sup>130</sup> Ibid, p. 132.

<sup>131</sup> Ibid, p. 133.

<sup>132</sup> Ibid, p. 134.

<sup>133</sup> Ibid, p. 132.

<sup>134</sup> See: Canadian Cancer Society et al. (1999) *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. October 1999, as well as Waller B J, Cohen J E, Ferrence R, Bull S, and Adlaf E M. (2003). “The early 1990s cigarette price decrease and trends in youth smoking in Ontario.” *Canadian Journal of Public Health* Jan/Feb 2003. 94, pg. 1.

## Canada: Modern Context

The RCMP Contraband Tobacco Enforcement Strategy, released in the spring of 2008, outlines four main methods of tax-avoidance and smuggling. The Strategy notes the illicit production of cigarettes in both Canada and the United States, as well as some lawful production in the US that is smuggled into Canada; products that are tax-exempt sold on First Nations reservations that are either purchased by non-Aboriginals, or smuggled off-reserve for sale without the applicable taxation; counterfeit products entering the country illegally; and finally, other “related criminality” such as robberies or hijackings of cargo.<sup>135</sup> Distinct approaches might need to be orchestrated to address problems at the provincial level (such as tax-exempt sales), versus smuggling of contraband or counterfeit products (a more federal responsibility).

RCMP statistics reveal that in 2007, the RCMP seized 618,077 cartons of cigarettes, compared to 472,268 cartons in 2006,<sup>136</sup> whereas in 2001 only 28,966 cartons of cigarettes were seized.<sup>137</sup> In 2006, roughly half of all seizures made by the RCMP were by the Central St. Lawrence Valley RCMP detachment near Cornwall, Ontario, which encompasses the Akwesasne/St. Regis reserves.<sup>138</sup> Many key informants felt that seizures made by the RCMP are the “tip of the iceberg,” compared to the estimated scope of the problem.

The RCMP Contraband Tobacco Enforcement Strategy outlines several of the major sources of contraband production, which can refer to either Native brand cigarettes being produced illegally on-reserve, or baggies of loose cigarettes being sold, often in quantities of 200.<sup>139</sup> Of primary importance is the Akwesasne/St. Regis reserve which is considered to be the source of roughly 90% of contraband seizures in Canada.<sup>140</sup> However, it should be noted that this estimate reflects seizure statistics only and therefore cannot be generalized to the entire illicit market. Furthermore, the RCMP identifies three other reserves in Canada as sources of contraband tobacco: Kahnawake in Québec, and Six Nations and Tyendinaga in Ontario.<sup>141</sup> During a presentation to the Canadian Government’s Standing Committee on Public Safety and National Security, a representative of the

<sup>135</sup> See Royal Canadian Mounted Police (RCMP). (2008) *Contraband Tobacco Enforcement Strategy*. RCMP Customs and Excise Branch and the Government of Canada.

<sup>136</sup> Royal Canadian Mounted Police. (2008b) *Tobacco Operational Priorities – Statistics*. RCMP. 12 March 2008. Accessed on April 28, 2008 from: [http://www.rcmp.ca/customs/tobacco\\_stats\\_e.htm](http://www.rcmp.ca/customs/tobacco_stats_e.htm).

<sup>137</sup> Ibid.

<sup>138</sup> Data from the Royal Canadian Mounted Police.

<sup>139</sup> See Royal Canadian Mounted Police (RCMP). (2008) *Contraband Tobacco Enforcement Strategy*. RCMP Customs and Excise Branch and the Government of Canada, p. 13.

<sup>140</sup> Non-Smokers’ Rights Association, Canada. (2006), p. 2.

<sup>141</sup> Ibid, p. 13.

RCMP stated that the RCMP identified approximately 13 illicit manufacturers on the US-side of the Akwesasne, 11 illicit manufacturers on Kahnawake in Quebec, and 7 on Six Nations in Ontario.

The prevalence of counterfeit cigarettes has not received much attention on Canadian government agendas, although this may soon change as the scope of the problem gets better understood. During the May 7, 2008 meeting of the Standing Committee on Public Safety and National Security, a Canada Border Services Agency (CBSA) representative stated that the CBSA made a total of 3,800 seizures of illicit tobacco, which totaled 268,754 cartons of cigarettes, and 17,000 kilograms of fine-cut tobacco in 2007,<sup>142</sup> a 47% increase compared to the previous year. Of the 268,754 cartons seized, 257,531 of these (96%) originated in China, and therefore were likely to be either counterfeit or Chinese brands.<sup>143</sup> Key informants from Western Canada suggested that counterfeit tobacco has been a long-standing concern, with recent confiscations uncovering counterfeit cigarettes marked for sale in Ontario or Quebec, underscoring the national scope of the problem. The CBSA reported a string of counterfeit seizures several years ago, prompting policymakers to look at this issue more closely. An MOU was drafted with Imperial Tobacco in order to produce enhanced tear-tapes for the BC market, which allowed policymakers to identify the counterfeit products. As a result of this initiative, it became possible to identify counterfeit packages on retailer shelves across the province. Remarkably, once this occurred the counterfeit market quickly dried up, and no significant seizures of counterfeit cigarettes have been made at the retail level in BC ever since. It appears that the issue of counterfeit cigarettes requires more attention in Canada. As of now, a disproportionate amount of attention is focused on baggies, which politically, is a more difficult problem to address, when increased retail inspections can effectively curtail counterfeit operations.

At the same public safety committee meeting, a representative from the Canada Revenue Agency stated that in 2007 the CRA authorized 46 manufacturing licenses, 14 of which were issued to operators on First Nations land. There remain questions about the enforcement and compliance of license regulations among certain manufacturers on some reserves. For instance, the Canada Revenue Agency admits that as a courtesy, band council is advised in advance of all on-reserve facility inspections. Although this policy both shows respect to First Nations' territory and ensures that smaller operations are operating on the day of the inspection,<sup>144</sup> it undermines the surprise element that inspections should have.<sup>145</sup>

<sup>142</sup> See: <http://cmte.parl.gc.ca/Content/HOC/Committee/392/SECU/Evidence/EV3476622/SECUEV28-E.PDF> page 4.

<sup>143</sup> Ibid, p. 7.

<sup>144</sup> Victoria Expert Focus Panel, 2008 Jul 29.

<sup>145</sup> Information from Canada Revenue Agency.

Neither information on the overall size of the illicit market in Canada nor the combined federal and provincial revenue losses are reported by Canadian authorities, though some studies have postulated figures. A 2007 national study commissioned by Imperial Tobacco stated that in Canada, 22% of tobacco consumption is contraband, up from 16.5% the previous year.<sup>146</sup> Regionally, over 30% of the market in both Ontario and Québec was contraband, while the atlantic provinces had an overall illicit market of approximately 7%.<sup>147</sup> Western Canada appeared to have the lowest prevalence of contraband tobacco, with all provinces estimated to have an illicit market under 5%.<sup>148</sup> The study also stated that loose cigarettes accounted for the majority of illicit sales (62%), and that nearly half of all such sales were delivered either via a friend, colleague, or relative.<sup>149</sup> Only 32% of contraband purchases were found to be from reserves.<sup>150</sup> The study concludes by hypothesizing that the total losses to government (both federal and provincial) amount to \$1.6 billion annually. Contraband cigarettes are sold at affordable prices, \$6 to \$10 per carton (as compared to \$50-\$70 per carton legally), making them very attractive.<sup>151</sup> Given that this study was commissioned by the tobacco industry, and that the data collection methods have not been disclosed publicly, these statistics should be considered instructive rather than objective.

In 2007, the Ontario Tobacco Research Unit study entitled, *Contraband Cigarettes in Ontario*, found that 11.7% of smokers reported “usually purchasing” cigarettes on-reserve between July 2005 and June 2006, while an additional 25.8% of smokers “bought at least 1 pack in the last six months” from a reserve.<sup>152</sup> The study found that among purchasers who “usually purchase” cigarettes from on-reserve retailers, 33.4% purchased cigarettes produced by the major commercial brands (likely through the tax-exempt mechanisms), while 31% purchased Native-made cigarettes, and 16.3% purchased “reserve/no name” brands.<sup>153</sup> Finally, the study reports that approximately 14% of all cigarettes consumed in Ontario were purchased on-reserve, representing \$72.3 million in lost revenues to Ontario, and \$49.9 million in lost revenues to the federal government.<sup>154</sup>

A study commissioned by Health Canada found public attitudes toward and understanding of

<sup>146</sup> The GFK Group. (2007). *New Information on Illegal Tobacco Sales: National Study for the Canadian Tobacco Manufacturers' Council*. Accessed on November 13, 2007 from: [http://www.imperialtobaccocanada.com/onewebca/sites/IMP\\_5TUJVZ.nsf/vwPagesWebLive/DO65HJNQ?opendocument&SID=&DTC=&TMP=1](http://www.imperialtobaccocanada.com/onewebca/sites/IMP_5TUJVZ.nsf/vwPagesWebLive/DO65HJNQ?opendocument&SID=&DTC=&TMP=1), Slide 7.

<sup>147</sup> Ibid.

<sup>148</sup> Ibid.

<sup>149</sup> Ibid, slides 11 and 12.

<sup>150</sup> Ibid, slide 12.

<sup>151</sup> Ibid, slide 14.

<sup>152</sup> Luk R, Cohen J E, Ferrence R. (2007). *Contraband Cigarettes in Ontario*. The Ontario Tobacco Research Unit: Toronto, ON, p. 13.

<sup>153</sup> Ibid, p. 17.

<sup>154</sup> Ibid, p. 1.

contraband tobacco to be nebulous. For instance, over 50% of respondents who use contraband tobacco products felt that purchasing First Nations cigarettes “was or might be” legal (38% said yes, 16% said not sure), and when asked for a rationale for these beliefs, 28% said “because they haven’t heard otherwise,” and 27% argued that “it was legal or legitimate on Aboriginal reserves.”<sup>155</sup> Furthermore, despite reports that contraband tobacco can have worse health effects than regulated tobacco (see, Stephens et al. 2005), most respondents (59%) felt First Nations cigarettes were equally harmful as brand name cigarettes.<sup>156</sup> Based on this data, it appears that the general public does not recognize the illegal and harmful consequences of using contraband tobacco products.

Recent announcements have been made at the federal level, including a new tax-paid marking on cigarettes, renewed inspection efforts of cigarette manufacturers, and greater controls over cigarette production machinery, indicate the willingness of government to act on the contraband issue. However, major political and public health issues will need to be addressed, including First Nations sovereignty in Canada and the impact of tobacco taxes on smuggling.

A significant awareness campaign has existed since 2005, when the Government of Québec, in coordination with the Royal Canadian Mounted Police (RCMP), the Canada Revenue Agency (CRA), and Revenu Québec conducted a joint-effort campaign among merchants focused on the consequences of selling illegal tobacco products.<sup>157</sup> The brochure<sup>158</sup> outlines many of the legal consequences of selling illegal tobacco products (including a fine of up to \$500,000), while also emphasizing the negative effects of illegal tobacco products on society at large.<sup>159</sup> The document outlines methods in which retailers might identify illegal tobacco products, displaying an example of the tear-tape required on tobacco packages, as well as the text-labels applied to such tear-tapes, indicating duty paid.<sup>160</sup> A list of the tobacco tax rates in Québec is also included, in order to allow the retailer to identify potential duty-not-paid tobacco products.<sup>161</sup> In conjunction with this, the campaign also created a toll-free telephone number that retailers could use to anonymously report suspected illegal activities.

<sup>155</sup> Health Canada. (2007) *Discount Smokers in Ontario and Quebec: Exploratory Analysis*. Report prepared by Phoenix Strategic Perspectives Inc: Ottawa, Ontario, p. 38.

<sup>156</sup> Ibid, p. 37.

<sup>157</sup> Revenu Quebec. *Information Campaign on the Consequences of Selling Illegal Tobacco Products*. Government of Québec. Accessed on December 3, 2007 from:

[http://www.revenu.gouv.qc.ca/eng/ministere/evasion\\_fiscale/tabac/t\\_campagne.asp](http://www.revenu.gouv.qc.ca/eng/ministere/evasion_fiscale/tabac/t_campagne.asp)

<sup>158</sup> The brochure is accessible at: [http://www.revenu.gouv.qc.ca/documents/eng/publications/in/in-264-v\(2005-08\).pdf](http://www.revenu.gouv.qc.ca/documents/eng/publications/in/in-264-v(2005-08).pdf), accessed on December 3, 2007.

<sup>159</sup> Revenu Québec.

<sup>160</sup> Ibid.

<sup>161</sup> Ibid.

## Provincial Tax-Exempt Distribution Policies

A detailed description of Canadian tax-exempt policies was provided on pages 37-38. Table 6 shows the differences between provincial tax-exempt policies

**Table 6: Provincial Tax-exempt Distribution Mechanisms<sup>162</sup>**

Province	Allocation	Refund	Purchase Quota	Marking
British Columbia	X	None	2 cartons/day up to 8 cartons/month	Black-stock
Alberta	None	X	2 cartons/week	Black-stock
Saskatchewan	None	X	3 cartons/week	Saskatchewan
Manitoba	X	X	"guideline" 2 cartons per week	Manitoba
Ontario	X	None	None	Black-stock
Québec	None	X	"guideline"	Québec
New Brunswick	X	X	"guideline"	New Brunswick
Nova Scotia	X	None	Unknown	Black-stock

Of the eight provinces for which we have data, five impose an allocation of tax-exempt products, and five have a refund mechanism. Both New Brunswick and Manitoba have a combination of each of these elements. British Columbia, Ontario, and Nova Scotia only use allocation, while Saskatchewan, Alberta, and Québec only use a refund system to control tax-exempt sales. British Columbia, Alberta, Ontario and Nova Scotia all require duty-paid products to have black-stock markings, differentiating between duty-paid and tax-exempt products. Only British Columbia, Alberta, and Saskatchewan have explicit purchase quotas. These range from 2 cartons per week per customer, in British Columbia and Alberta, to 3 cartons per week per customer in Saskatchewan. The absence of a purchase quota is one mechanism for abuse of tax-exempt systems by those who purchase large amounts of cigarettes intending to re-sell them to non-Aboriginals. It should be noted that several provinces do provide retailers with guidelines that outline recommended maximum quantities of cigarettes that should be sold to each customer.

When analyzing the efficacy of the various approaches, one of the first comments from key informants has been the ability to differentiate between tax-exempt and tax-paid product. In Ontario all tax-exempt products must be sold with the black-stock markings, while sales to non-Aboriginals require the provincial markings. The markings enable officials to quickly identify instances where retailers are selling tax-exempt products off-reserve. In contrast, Saskatchewan

<sup>162</sup> Data for PEI and Newfoundland and Labrador is unavailable.

tobacco products sold under the tax-exempt system bear the same markings as the provincially-taxed packages. Therefore if products are purchased on-reserve, and resold off-reserve, officials are not able to differentiate between the provincial tax-paid and tax-exempt products. Key informants acknowledged that this is not an overwhelming issue, as those who abuse the system are unlikely to re-sell to retailers, but rather sell directly to their own customers. Nevertheless, differentiating between tax-exempt and tax-paid products can work as a safeguard in ensuring that re-sale of tax-exempt products in off-reserve retailers does not occur, eliminating one avenue for tax-avoidance. This sentiment was also expressed by enforcement officials across Canada.

Between the two approaches, the refund system seems less susceptible to abuse, as each customer must provide proof of eligibility to make tax-exempt purchases. In these cases, the eligible consumer must show their Status Indian card, and allow the retailer to record the Status Indian number, the customer's name, the date of purchase, and the quantity purchased. The Alberta Indian Tax Exemption (AITE) program requires Status Indians to present a special AITE card in order to make purchases of tax-exempt products. Yet, several informants hold that refund systems are still prone to abuse. Non-smoking Status Indians may allow non-Aboriginal consumers to use their numbers to purchase tax-exempt, or may simply purchase and re-sell cigarettes themselves. Though not foolproof, the refund approach is effective at preventing tax-exempt purchases by non-Aboriginals because the retailer is motivated to recover the taxes paid up-front to the distributor. Audit officials verify retailer claims by inspecting all refund requests, vigilant for large quantities purchased by one individual, and/or purchases with a Status Indian number belonging to someone deceased.

Since quota systems allocate tax-exempt products based on estimates of the consumption and population of the community, an ineligible consumer might purchase tax-exempt products at the retailer's discretion. In contrast to the refund system, here the retailer does not have a financial incentive to require proof of eligibility to purchase tax-exempt because the tobacco products were purchased tax-free up-front. Nevertheless, Ontario officials consider the program to be working adequately. One Revenue official stated that "First Nations do not purchase their total allocation, which is an indication there is a sufficient supply of unmarked cigarettes to meet their needs."<sup>163</sup> However, some informants claim this is because the allocations are too generous. In Ontario the allocation is based on 2.5 cartons per month per on-reserve member over 15 years of age, and 2.7 cartons per month per off-reserve member. The Ontario allocation can be increased by 10% for special events, and by an additional 20% for reserves with a retail agreement with the province. While this might seem like a significant increase, Revenue officials clarify that by entering into a retail agreement with the Province, the reserve agrees to "update the ministry on the operating status

<sup>163</sup> Response by Ontario Ministry of Revenue informant.

of retailers (i.e. active, deceased, closed, etc.).” This results in more accurate and perhaps more fair, allotments to active reserve retailers.<sup>164</sup>

Similarly, officials in BC suggest that their allocation system is also adequate, believing their allocations are liberal enough to accommodate the needs of the community, while possessing sufficient measures to ensure that leakage off-reserve does not occur.<sup>165</sup> BC requires a fairly stringent application process for Exempt Sale Retail Dealer Permits (ESRD permits), therefore ensuring that tax-exempt retailers do not multiply disproportionately to demand. To apply for an ESRD permit, the potential tax-exempt retailer must present a business plan, an indication of other ESRDs in the market area, a band council resolution approving the proposed retail location, and the name of the tobacco wholesaler for the proposed business.<sup>166</sup> The rigor of the process discourages all but the most determined retailers. ESRDs must comply with the “2/8” rule, which means a maximum purchase of 2 cartons per week per customer, to a total of 8 cartons per month per customer. ESRDs must also record information on all tax-exempt customers, including the date of sale, Status Indian number, and quantity sold.<sup>167</sup>

Some informants have suggested that the Saskatchewan personal purchase quota is too high, allowing some customers to purchase the legal 3 cartons per week (600 cigarettes), and then sell these products to ineligible consumers. Additionally, the Saskatchewan point-of-sale program is updated bi-weekly, so it is more difficult to track an individual making purchases at various stores. This means an individual could potentially purchase 3 cartons at several different stores, with finance officials only able to catch this by auditing the store’s returns. The overall size of refunds has increased since the inception of the program, from \$7.1 million in 2001-02 (roughly 36 million cigarettes) to \$46.2 million in 2006-07 (roughly 252 million cigarettes).<sup>168</sup> During this period the number of tax-exempt retailers increased from 56 to 109 (a twofold increase), whereas refunds have increased by more six times the amount in 2001-02, leading some to suggest that someone is abusing the system.<sup>169</sup>

The most successful approach has perhaps been Alberta’s AITE system, although officials there note that their point-of-sale retailers are not updated in real-time, rather overnight. All tax-exempt

<sup>164</sup> Response by Ontario Ministry of Revenue informant.

<sup>165</sup> Key informant interview, 2008 May 08.

<sup>166</sup> Ministry of Small Business and Revenue. (2007) *Exempt Sales Made by Retail Dealers (ESRDs)*. Government of British Columbia. December 2007, p. 3.

<sup>167</sup> *Ibid*, p. 6.

<sup>168</sup> Data from Saskatchewan Finance.

<sup>169</sup> Canadian Cancer Society and the Heart and Stroke Foundation of Saskatchewan. (2006) *Connecting the Dots: The Case for a Comprehensive Tobacco Control Strategy in Saskatchewan*. October 2006, p. 11.

customers must present an AITE card to purchase tax-exempt tobacco, although customers can still abuse the system by purchasing their 2 carton allocation at multiple stores. The ability to address this concern is improved by the 24-hour retailer updates to the government, rather than weekly or bi-weekly updates required in some provinces. Moreover, Alberta officials have also encountered forged or stolen AITE cards. These officials would like to see an all-in-one Status Indian card.

The most significant concern that most informants have discussed is the fact that tax-exempt systems do not affect sales of contraband cigarettes sold in baggies of 200. Since these products are illegally sold in Canada, legal tax-exempt programs have no effect. As one informant suggested, while the quota system might appear to work well in Ontario and BC, this might be because ineligible consumers are not purchasing tax-exempt products; rather, they are buying baggies.

### First Nations Tax Agreements

The Government of Canada has negotiated a series of tax agreements with First Nations communities, through either the enactment of a First Nations Tax (FNT) on “listed goods,” (tobacco, fuel, and alcohol), or through the First Nations Goods and Service Tax (FNGST) which applies to all goods and services that are privy to the federal GST.<sup>170</sup> Both the FNT and FNGST apply at a rate 5% as of January 1, 2008.<sup>171</sup> As of March, 2008, the Canada Revenue Agency lists ten communities as having implemented the First Nations Tax (see Appendix 3),<sup>172</sup> and nineteen First Nations as having implemented the FNGST (see Appendix 4).<sup>173</sup> The bulk of these agreements seem to be with First Nations in the Canadian territories, or in BC.

In terms of impact, Finance Canada states that annual FNT remittances are in the range of \$15,000 to \$1.5 million per year for each community, and the FNGST remittances are in the range of \$26,000 to \$1.5 million.<sup>174</sup> While these are significant revenues, it must be remembered that as of 2008 the FNT or FNGST would only apply to 5% of the cost of a cigarette on-reserves. Thus, it is unlikely that the FNT or FNGST would considerably harmonize the taxation rates between on-reserve and off-reserve sales.

<sup>170</sup> Canada Revenue Agency. (2006) *First Nations Goods and Services Tax (FNGST)*. Government of Canada, June 22. Accessed on November 19, 2007 from: <http://www.cra-arc.gc.ca/E/pub/tg/rc4365/rc4365-e.html>.

<sup>171</sup> Ibid.

<sup>172</sup> Canada Revenue Agency. (2007) *First Nations that have Implemented the FNT*. Government of Canada. Accessed on March 14, 2008 from: <http://www.cra-arc.gc.ca/tax/business/topics/gst/indian/fntapp-e.html>.

<sup>173</sup> Canada Revenue Agency. (2007b) *First Nations that have Implemented the FNGST*. Government of Canada. Accessed on March 14, 2008 from: <http://www.cra-arc.gc.ca/tax/business/topics/gst/indian/fngstapp-e.html>.

<sup>174</sup> Key informant interview, 2008 Jan 10.

One interesting case exists in regards to the Cowichan tribe in BC. This community has an FNT agreement, as well as an agreement with the BC Government, whereby they collect an equivalent tax to the provincial tobacco tax, and the tribe is reimbursed for purchases made. As described above however, key informants noted that this may be an exceptional case, as the geographic proximity of the tribe to the city of Duncan, BC, ensures that a significant non-First Nations population resides within the community. Therefore, a substantial non-First Nations consumer base will likely continue to make on-reserve purchases, regardless of the taxation rate. However, this case study does confirm that taxation agreements are possible, and can have dual benefits in terms of public revenues and public health. Very little research exists in terms of an analysis of this agreement, and therefore it should be a priority to better understand the context in which this agreement was made, and the impact that it has had.

Although not a formal taxation agreement, the Province of Manitoba's "Band Assessment Collection Agreement Program" merits attention. Within this agreement, the band imposes a "band assessment" amount on purchases of tobacco sold to First Nations purchasers which is equal to the provincial tobacco tax.<sup>175</sup> This agreement equalizes the price of tobacco on and off reserve for First Nations purchasers. The province, which receives the proceeds of the tobacco tax at the wholesale level, then forwards the band assessment proceeds to each band on a monthly basis.<sup>176</sup> Each band assessment is calculated via estimates of the percentage of retailers' wholesale tobacco purchases sold to First Nations purchasers, thereby acting as a mechanism for maintaining tax-exempt status for First Nations. Though similar to a tax agreement, officials noted that these assessments are levied by the band, and therefore do not violate Section 87 of the *Indian Act*.<sup>177</sup> As of March 31, 2007, there were 55 bands (out of approximately 74) in Manitoba with agreements, indicating substantial support for the policy.<sup>178</sup> As noted by Manitoba Finance officials:

From the Band's perspective the program delivers an additional source of revenue for its programs and the higher on reserve tobacco price discourages smoking and contributes to improved health among the Band's members. From Manitoba's perspective, the program results in tobacco prices becoming equalized between on reserve and off reserve retailers, thereby protecting provincial revenues.<sup>179</sup>

<sup>175</sup> Information from Manitoba Finance accessed August 28, 2008.

<sup>176</sup> Ibid.

<sup>177</sup> Ibid.

<sup>178</sup> Ibid.

<sup>179</sup> Ibid.

In the United States, there are several interesting examples of tobacco tax agreements with Native American tribes, among which Washington State's experience has been most compelling. In this case, the state has negotiated "tax compacts" with Native tribes and nearly 20 compacts exist among the 29 tribes.<sup>180</sup> Within these agreements, special tribal stamps have been created which advertise the packs as for sale strictly to tribe members. Moreover, when compacts are reached, the tribe agrees to tax sales of cigarettes at a rate equivalent to the state tobacco tax rates.<sup>181</sup> Allocations of tax-exempt cigarette packages can be negotiated with the tribe, for specific sale to eligible Natives (however, these cigarettes will still be stamped with the unique tribal stamp).<sup>182</sup> Finally, for sales of cigarettes from tribal stores with tax included, the individual tribe retains the taxes collected, rendering the tax a revenue generating tool for the community.<sup>183</sup>

Through these agreements, Washington State, in partnership with the relevant tribes, has been able to address concerns over tobacco tax evasion. First, the unique stamping of cigarettes destined for sale to individual tribes helps differentiate between cigarette packages that are strictly for sale on reserve, and those meant for the remainder of the state.<sup>184</sup> By ensuring that taxes are collected through the application of the tribal tax stamp, retailers 'level the playing field' between tribal and non-tribal stores. The allocation of cigarette packages with tax-exempt status also ensures that the Native right to tax-exempt product is maintained. Tribes can decide to forgo any tax-exempt allocations, and simply tax all cigarette sales to Natives and non-Natives alike, and retain the revenue generated; however, it is unclear how many tribes utilize this ability.

Washington State negotiated a separate compact with the Puyallup Tribe, where 23 independent tribal retailers opposed the idea of taxation, worried they would lose revenue from current non-Native customers.<sup>185</sup> The State settled by negotiating new terms with the Puyallup Tribe, allowing the Tribe to tax cigarettes at 80% of the State rate, retaining 70% of these revenues and remitting 30%

<sup>180</sup> Thronson S. *Intergovernmental Tax Agreements: Washington State's Experience with Cigarette Tax Compacts*. PowerPoint Presentation. Slide 11.

<sup>181</sup> When compacts are signed, the tribe agrees to first tax the cigarettes at 80% of the state rate, increasing to 100% of the state rate over three years.

<sup>182</sup> Washington State Department of Revenue. *Cigarette Tax: RCW 82.24*.

[http://dor.wa.gov/docs/reports/2007/Tax\\_Reference\\_2007/07cigarette.pdf](http://dor.wa.gov/docs/reports/2007/Tax_Reference_2007/07cigarette.pdf), p. 53.

<sup>183</sup> Ibid.

<sup>184</sup> Stamps can be seen here: <http://dor.wa.gov/Docs/Pubs/IndustSpecific/Cigarette%20Tax.pdf>.

<sup>185</sup> Office of Governor Gary Locke. 2005. "Gov. Gary Locke, Puyallup Tribe Reach Cigarette Taxation Agreement; Governor Declares 'Cigarette Wars' between Tribes and State over." *State of Washington*, January 5.

<http://www.digitalarchives.wa.gov/GovernorLocke/press/press-view.asp?pressRelease=1760&newsType=1>

to the State.<sup>186</sup> In fiscal year 2006, this produced \$6.3 million in revenues for the State of Washington, indicating that nearly \$21 million in tobacco taxes was collected on Puyallup land.<sup>187</sup> Further research is warranted to better understand the mechanics of these agreements, as the Puyallup agreement demonstrates a novel approach in generating buy-in from communities concerned about taxation.

A failing of this paper is that a Canadian First Nations case study was not done. The authors struggled to make contacts in the First Nations community and were unsuccessful until after the report had been completed. At that time, several First Nations' key informants agreed to participate in one expert focus panel, the results of which are discussed in Section Five of this report. As such, there is dire need for increased research and collaboration on issues of smoking on-reserve, in both contraband and non-contraband contexts. The issue of contraband tobacco was very contentious during the research for this project, and indicates the need for a more high-level discussion around contraband on-reserve to generate a better understanding of the issue, while also engaging Aboriginal communities.

## California

During an April 2008 meeting with members of the California Board of Equalization, the state's approach to tackling contraband tobacco was discussed. Reports in 1999 and 2003 estimated annual revenue losses due to cigarette-tax evasion at \$130-270 million in 1999 (approximately 12-26% of the market), and \$292 million (approximately 26% of the market) in 2002.<sup>188</sup>

The main issue cited by officials was the purchase of unmarked or improperly marked (for instance, out-of-state stamped product) cigarettes and counterfeit product. Several policies were enacted in response to the problem. First, the *Cigarette and Tobacco Products Licensing Act* (2003) required licensing of the entire supply-chain of tobacco products, starting from the manufacturers/importers, to the distributors/wholesalers, down to the retailers themselves. Complementing this, an enhanced tax-stamp was introduced in 2005 which was machine-readable, and contained a unique identification number for each stamp, the name and address of the distributor affixing the stamp, the

<sup>186</sup> Thronson S. *Intergovernmental Tax Agreements: Washington State's Experience with Cigarette Tax Compacts*. PowerPoint Presentation, slide 13.

<sup>187</sup> Washington State Department of Revenue. *Cigarette Tax: RCW 82.24*. [http://dor.wa.gov/docs/reports/2007/Tax\\_Reference\\_2007/07cigarette.pdf](http://dor.wa.gov/docs/reports/2007/Tax_Reference_2007/07cigarette.pdf), p. 53.

<sup>188</sup> Alamar B, Mahmoud L, Glantz SA. (2003). *Cigarette Smuggling in California: Fact and Fiction*. Center for Tobacco Control Research and Education (University of California, San Francisco), p. 9.

date of stamping, and the denomination of the stamp. In addressing the Investigations Division's capacity itself, inspectors were given "limited peace offer" status enabling them to write criminal and civil citations to any licensee containing unmarked goods.<sup>189</sup> Finally, an investment of up to \$11 million was provided to help implement and enforce these provisions.

After the licensing of the supply-chain, the Investigations Division was expected to increase their overall number of inspections. This occurred, with inspections increasing from 8,490 in 2004 to 11,438 in 2007.<sup>190</sup> The ratio of seizures per inspection fell from approximately 27% prior to the legislation, to 13% in 2004-05, and finally less than 3% in 2006-07.<sup>191</sup> Given that retail locations make up over 95% of the site inspections, one can assume these seizure statistics are fairly representative of retail locations as a whole. Accordingly, the total numbers of seizures has decreased significantly, from 1,206 seizures in 2004 to 331 seizures in 2007.<sup>192</sup> As described above in the tax-markings/stampings lessons, the overall percentage of seizures involving counterfeit cigarettes has declined from 70% of seizures in 2004-05 to 43.2% of seizures in 2006-07.<sup>193</sup> Not only has non-compliance dropped significantly, but so has the act of counterfeiting, signifying that the enacted policies have been successful.

Officials estimate that a total of \$139.1 million in excise and sales taxes has been collected due to the new strategy.<sup>194</sup> Estimates from the Board of Equalization suggest that overall cigarette-tax evasion has dropped by \$56 million since the 2003 study, bringing the overall cigarette tax-evasion estimate to \$182 million per year.<sup>195</sup>

An important point that several officials noted was that the most significant aspect of the strategy was the investment in resources (the investigations capacity roughly quadrupled), and the limited peace officer status of inspectors. Though the enhanced stamps helped inspectors identify counterfeit products, it was the increased human resources in the field that affected compliance.<sup>196</sup>

<sup>189</sup> Key informant interviews, 2008 Apr 15.

<sup>190</sup> California State Board of Equalization (2008) *Investigations Division – Cigarette and Tobacco Products Inspection Program*: <http://www.boe.ca.gov/invest/inspectionprog08.htm>.

<sup>191</sup> California State Board of Equalization (2006) and (2008).

<sup>192</sup> California State Board of Equalization (2008) *Investigations Division – Cigarette and Tobacco Products Inspection Program*: <http://www.boe.ca.gov/invest/inspectionprog08.htm>.

<sup>193</sup> *Ibid.*

<sup>194</sup> Key informant interview, 2008 Apr 15.

<sup>195</sup> Fitz J. (2007) *Revenue Estimate: Cigarette and Tobacco Products Tax Evasion*. California Board of Equalization, June.

<sup>196</sup> California Board of Equalization. (2008) *Investigations Division – Cigarette and Tobacco Products Inspection Program*. 27 February 2008. <http://www.boe.ca.gov/invest/inspectionprog07.htm>; Accessed 28 April 2008.

Since inspectors now have limited peace officer status, they are able to write citations on the spot, whereas previously the inspectors had to pass violations to another unit in a process that took weeks.<sup>197</sup> One informant mentioned that retailers would laugh as inspectors seized products. This has changed now that inspectors can issue quick and substantial penalties.<sup>198</sup>

In California, the source of contraband is not as dynamic and adaptable as it is in other jurisdictions. Very recent survey data is not available for Californian cigarette purchasing patterns, but 2002 data show that only 6 % of smokers in California actively tried to evade cigarette taxes, through either purchasing out of state, on-line, on Indian reservations, or on military bases.<sup>199</sup> Though California officials have observed tobacco purchases via informal sources, such as friends, these are considered to be minimal.

## Australia

The illicit market in Australia, small in comparison to various other countries, is nevertheless a good source of anti-contraband tobacco policies. The phenomenon of “chop-chop” tobacco is instructive by illustrating the efficacy of licensing, and the desire among policymakers to maintain a cordial and respectful relationship with licensees while performing thorough inspections.

The chop-chop phenomenon emerged as tobacco growing in Australia began to decline significantly throughout the 1990s. Growers in Australia were largely centered on two areas, Victoria and Queensland, which included 130 and 115 growers respectively.<sup>200</sup> Research by the VicHealth Centre for Tobacco Control suggests that while 12 million kilograms of tobacco were produced in 1994/95, this output had declined to less than 6 million kilograms by 2002/03—a 50% decline in less than ten years.<sup>201</sup> Tobacco growing in North Queensland ceased in 2003, when Australian tobacco manufacturers decided to “consolidate the purchase of domestic leaf within the Myrtleford (Victoria) region.”<sup>202</sup> Thus, tobacco growing became concentrated around the Victoria region, with “130 growers producing an average of four million kilograms each season equating to a farm gate value of \$27 million.”<sup>203</sup>

<sup>197</sup> Key informant interview, 2008 Apr 15.

<sup>198</sup> Ibid.

<sup>199</sup> Gilpin EA et al. (2003). *Tobacco Control Successes in California: A Focus on Young People, results from the California Tobacco Surveys, 1990-2002*. La Jolla, CA: University of California, San Diego., p. 9-19.

<sup>200</sup> Geis G. (2005) *Chop-chop: the illegal cigarette market in Australia*. Centre for Tax System Integrity: Working Paper, p. 2.

<sup>201</sup> VicHealth Centre for Tobacco Control. (2003) *The Tobacco Industry in Australia*. Prepared by Sandra Younie. p. 2.

<sup>202</sup> PriceWaterhouseCoopers. (2005) *Research Report on the Illegal Tobacco Market*. March 2005.

<sup>203</sup> VicHealth Centre for Tobacco Control (2003), p. 3.

Tobacco leaf could only be legally sold through cooperatives, while diversion of tobacco leaf directly to the consumer meant evasion of applicable excise taxes. Estimates from the ATO suggested that \$98 million was lost in excise taxes in 2004-05, while the Australian National Audit Office reports that in 2002, this value was between \$99-220 million lost per year.<sup>204</sup> Industry estimates pegged this value as high as \$600 million per year in lost tax revenues, though the sources of these estimates are not publicly available.<sup>205</sup>

In regulating the tobacco market, the Australian Taxation Office (ATO) licenses each tobacco grower, in order to monitor production, as well as to collect excise taxes. Gil Geis (2005) notes that given the declining market for tobacco in Australia, and the large profits possible, some growers sold their tobacco to the illicit market. Geis states that a grower received approximately \$7 per kilogram of tobacco, while the equivalent tax on that same kilogram of tobacco would be about \$287.<sup>206</sup> When sold through the cooperative to the tobacco manufacturer, a tobacco grower would receive roughly \$600 per bale of tobacco grown, while on the illicit market a grower could receive \$3000 to \$4000 for that same bale, drastically more.<sup>207</sup>

In order to minimize evasion by tobacco growers, the ATO would conduct inspections of growers' crops, and generate risk profiles of growers, based on factors such as prior histories, years involved in the trade, etc. Geis (2005) notes that growers would be notified prior to any inspections, and rightfully criticizes the effectiveness of this practice. Interviews with Taxation officials clarified that announced visits only applied to low-risk growers.<sup>208</sup> In 2005, approximately 30 growers were rated as high-risk, and inspection tactics such as unannounced visits, crop forecasting and yield measurements, and surveillance from the farm to the retailer would occur.<sup>209</sup> Visits would be conducted frequently, from two to six visits per growing season and severe risk growers were visited on a weekly basis; unscheduled and unannounced.<sup>210</sup> The different mechanisms for risk profiling help outline how ATO officials maintained positive relationships with tobacco growers, and avoided being perceived as overly authoritarian, while still being able to conduct inspections. However, if the profiling mechanisms were flawed in any way, then perceived low-risk growers would have had time to hide their illicit stock, minimizing the effectiveness of the licensing.

<sup>204</sup> Australian National Audit Office (2006) *Administration of Petroleum and Tobacco Excise Collections: Follow-up Audit*. S. 1.14., p. 28. and Australian National Audit Office. (2002) *Administration of Tobacco Excise*. s 2.46, p. 52.

<sup>205</sup> PriceWaterhouseCoopers (2005), p. 26.

<sup>206</sup> Geis G. (2005) *Chop-chop: the illegal cigarette market in Australia*. Centre for Tax System Integrity: Working Paper 48, p. 2.

<sup>207</sup> Ibid.

<sup>208</sup> Ibid, p. 17.

<sup>209</sup> Information from ATO officials.

<sup>210</sup> Ibid.

Despite the regular inspections, ATO officials continued to state that it was difficult to catch growers involved in the illicit trade.<sup>211</sup> Instead, they suggested that other individuals would arrive at the farm (usually at night), and drive off with bales of tobacco. Additionally, numerous individuals often participated in the smuggling so that it was difficult to catch the organizer. It was also difficult to prove that the grower was complicit in the operation, and not just the victim of theft.<sup>212</sup> Thus, ATO officials stated that while “licensing in itself gave us an indication of who was in the system...it certainly didn’t stop the illicit trade.”<sup>213</sup> The inability to prove complicity in smuggling, and the multiple actors engaged in the trade, made it difficult to fully monitor the growers. In terms of tobacco leaf seizures, data collected suggests significant seizures were made in the country, although each year is highly diverse, see Table 7.

**Table 7: Tobacco Seizures in Australia**

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Total Seized Tobacco (cut and leaf) kg	129,554	33,637	59,525	68,205	22,444	17,413	7,613

Source: Australian National Audit Office (2006) *Administration of Petroleum and Tobacco Excise Collections: Follow-up Audit* and Australian Taxation Office informants.

From a significant volume of seizures in 2000-01, there was a sharp drop in 2001-2002, before a slight rebound and then steady decline to 2006-07. Noted by ATO officials, “the decline in seizures reflected the change in the tobacco industry that resulted from the buyout of the tobacco growers’ contracts.”<sup>214</sup>

There are few estimates of the prevalence of chop-chop smoking. The 2004 National Drug Strategy Household Survey indicated that only 8.8% of Australians aged 14 years or older had ever smoked “unbranded, loose tobacco,” and of these, only 21% “smoked it half the time or more,” suggesting that a very small sample of the Australian population routinely used chop- chop.<sup>215</sup> In contrast, a 2007 industry study reported that chop-chop users made up 16% of all smokers in Australia, though

<sup>211</sup> Key informant interview, 2008 Jan 16.

<sup>212</sup> Ibid.

<sup>213</sup> Ibid.

<sup>214</sup> Information from ATO officials.

<sup>215</sup> Australian Institute of Health and Welfare. (2005) *2004 National Drug Strategy Household Survey: Detailed Findings*. AIHW cat. no. PHE 66. Canberra: AIHW (Drug Statistics Series No.16). p. 32.

the methodology for this study could not be confirmed.<sup>216</sup> The lack of transparent and comprehensive estimates of chop-chop prevalence presents a dilemma for policymakers. Despite large tobacco seizures in the country, the overall scope of the problem is still vague.

Geis' work demonstrates that many of the growers who might have participated in the chop-chop trade were doing so out of a sense of desperation, as the overall income of tobacco growers had been declining due to less consumer demand and growing taxation rates. Several growers attempted to find an export market for their products, but given the cost of both production and shipment, this was not reasonably established.<sup>217</sup>

As the market for tobacco in Australia continued to decline, the final growers in Victoria were bought out by both the industry and the Government of Australia in 2006.<sup>218</sup> This resulted in the cancellation of all tobacco growing licenses in Australia, though monitoring of previous growers continues to ensure that illicit growing operations do not materialize. In order for tobacco growers to be granted a new tobacco growing license, growers must demonstrate a market for their crops. Due to the difficulty in satisfying this requirement, no growers have presented successful applications to the ATO.<sup>219</sup> By including a demand requirement in the license application, the ATO prevents growers from growing tobacco for sale in the illegal market. As far as the ATO was concerned at the time of interview, no previous license-holder was still growing tobacco.

At the time of the buy-out, the ATO and the Australian Customs Service (ACS) was mindful of the possibility of smuggling attempts from overseas to supply the illegal market. While some might consider the geographical situation of Australia to be fairly incompatible with a major cross-border smuggling market, the level of tobacco and cigarette seizures dramatically increased in 2007. According to the ACS, there was a fourteen-fold increase in tobacco seized at the border in 2007,<sup>220</sup> yielding up to 236 tons (236,000 kilograms) of tobacco, and up to 95 million cigarettes.<sup>221</sup> This case study once again underscores the adaptability of the source of illicit tobacco in the presence of sufficient demand and distribution. In Australia, contraband operations have shifted from domestic production to smuggling from beyond the border.

<sup>216</sup> PriceWaterhouseCoopers. (2007). *Illegal Tobacco Trade: Costing Australia Millions*. Sydney, Aus. August 2007, p. 18.

<sup>217</sup> Geis G. (2005) *Chop-chop: the illegal cigarette market in Australia*. Centre for Tax System Integrity: Working Paper 48, p. 6.

<sup>218</sup> PriceWaterhouseCoopers (2007), p. 9.

<sup>219</sup> Key informant interview, 2008 Jan 16.

<sup>220</sup> Australian Customs Service. (2007) *Customs Stems Unprecedented Flood of Smuggled Cigarettes and Tobacco*. Customs Media, December 19.

<sup>221</sup> Ibid.

The existence of chop-chop tobacco indicates the significance of monitoring both tobacco manufacturers and growers, who can play equal roles in facilitating the tobacco black market. The direct licensing of tobacco growers in Australia was unable to prevent the illicit trade from growing, due to the difficulties in demonstrating direct participation by growers in the illicit market, as well as the difficulties in maintaining firm crop yield data. That being said, the ability to monitor and regulate the growing of tobacco in Australia does provide a level of control over who participates in the trade, allowing ATO officials to treat growing tobacco in Australia as they would the growing of illicit drug crops, hopefully preventing the illicit market from being fuelled domestically.

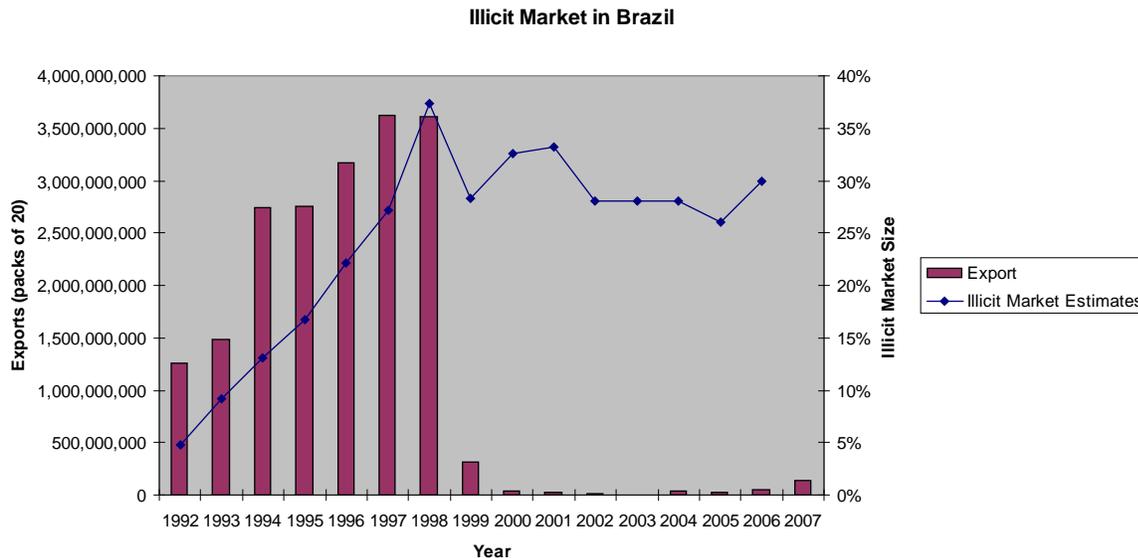
## **Brazil**

Brazil's experiences with tobacco smuggling illustrate the persistence of the illicit market, despite numerous policy interventions to address the problem. During the mid 1990s, a growing number of cigarettes were exported from Brazil to neighboring Paraguay, only to be smuggled back into Brazil, tax-free. Shafey et al. (2002) hold that in 1988, only 1% of cigarettes produced in Brazil were exported to Paraguay, rising to 51% by 1998.<sup>222</sup> In Paraguay, per capita cigarette consumption would have had to increase from 678 in 1986 to 10,929 in 1998 to account for all of the Brazilian imports.<sup>223</sup> It is more likely that these products were smuggled back into Brazil. One informant suggested that many of these exported cigarettes were not properly marked "for export only," allowing manufacturers to falsely claim the products were counterfeits when they were seized re-entering Brazil. Shafey et al. (2002) estimate that the illicit market in Brazil grew to 31-37% of the overall cigarette market in Brazil, as a result of these smuggled cigarettes (see Figure 2).<sup>224</sup>

<sup>222</sup> Shafey O, Cokkinides V, Cavalcante et al. (2002). Case-studies in International Tobacco Surveillance: cigarette smuggling in Brazil. *Tobacco Control*, 11: 215-219, p. 217.

<sup>223</sup> Ibid. 216.

<sup>224</sup> Ibid, p. 217.

**Figure 2: Cigarette Exports and the Illicit Market**

Source: Data from: Receita Federal (2007) Demonstrativo Anual de Destruição de Cigarros (em maços).

<http://www.receita.fazenda.gov.br/DestacaoMercadorias/DestruCigarros/default.htm> and Iglesias R, Nicolau J. Brasil: a Economia Do Controle Do Tabaco nos países do Mercosul e associados. Washington (DC): Organização Pan-Americana da Saúde; 2006.

In response, the Brazilian government imposed a 150% export tax on cigarette exports in 1998.<sup>225</sup> Consequently, the level of exports to Paraguay plummeted, from approximately 3.6 billion packs in 1998 to 40 million packs in 2000.<sup>226</sup> However, the illicit market declined only slightly, due to an increase in cigarette manufacturing operations in Paraguay, growing from 2 operations in 1995 to over 20 in 2000.<sup>227</sup> According to Revenue officials, these manufacturers imported machinery and production resources from Brazil, prompting the government to expand the export tax to also apply to machinery and cigarette filters in 2000.<sup>228</sup> This decision was ultimately rescinded due to challenges through the MERCOSUR free-trade agreement. Due to the manufacturing of cigarettes in Paraguay, the illicit market remained at approximately 25-30% of the overall cigarette market in Brazil.<sup>229</sup>

<sup>225</sup> Fisch, M., *The illegal cigarette market in Brazil. A case study*. A non-paper commissioned by the WHO TFI for the technical briefing during the first session of COP of the WHO-FCTC, 6-17 February 2006, Geneva, Switzerland.

<sup>226</sup> Data from Shafey et al. (2002) as well as Brazilian Revenue.

<sup>227</sup> Shafey O, Cokkinides V, Cavalcante et al. (2002). Case-studies in International Tobacco Surveillance: cigarette smuggling in Brazil. *Tobacco Control*, 11: 215-219, p. 217.

<sup>228</sup> Fisch, M., *The illegal cigarette market in Brazil. A case study*. A non-paper commissioned by the WHO TFI for the technical briefing during the first session of COP of the WHO-FCTC, 6-17 February 2006, Geneva, Switzerland.

<sup>229</sup> Shafey O, Cokkinides V, Cavalcante et al. (2002). Case-studies in International Tobacco Surveillance: cigarette smuggling in Brazil. *Tobacco Control*, 11: 215-219, p. 217.

By containing smuggled “export” cigarettes into Brazil, three major forms of contraband emerged, as documented by Iglesias et al. (2007): smuggling from Paraguay, tax-evasion by domestic manufacturers, and counterfeit cigarettes.<sup>230</sup> No concrete number of manufacturers in Paraguay has been concretely documented, though estimates range from twenty to forty manufacturers. For example, Iglesias et al. (2007) estimate that Paraguay’s production is more than three times the size of the country’s domestic consumption, with a significant proportion of production being smuggled into Brazil.<sup>231</sup> A number of manufacturers in Brazil started producing for the illicit market, estimated to be in the range of 6 to 10 manufacturers in the late 1990s.<sup>232</sup> The Brazilian government responded with a series of measures in 1999 to better control the manufacturing sector in Brazil. This included a special registry (a licensing and record-keeping regime), and a new control stamp to be applied to packages of cigarettes.<sup>233</sup> Despite these measures, Brazilian Revenue officials still suggest that the illicit market is 30% of all consumption, with 15.9 billion illegal cigarettes being produced by domestic manufacturers, and 20.9 billion cigarettes being smuggled in to the country.<sup>234</sup>

Since 1999 when 24 million packs were seized, seizures comprised of smuggled product from Paraguay, or domestically produced illegal cigarettes have increased to over 100 million in 2007.<sup>235</sup> Due to the large size of the illicit market, estimated to be 34 billion illegal cigarettes, officials are only confiscating 5% of total illicit goods despite large seizures. One argument put forward by some informants was that the penalties for smuggling are inadequate. Another informant suggested that the courts are lenient on smugglers, because most smugglers are poor. It was also noted that Brazilian authorities do not prosecute Paraguayan smugglers, therefore making deterrence minimal.<sup>236</sup> While large amounts of cigarettes are being captured (see Figure 3), some suggest smugglers view this as simply “the cost of doing business.”

<sup>230</sup> Iglesias R et al. (2007). *Tobacco Control in Brazil*. HNP Discussion Paper, The World Bank: Washington, DC, p. 30.

<sup>231</sup> *Ibid.*, p. 35.

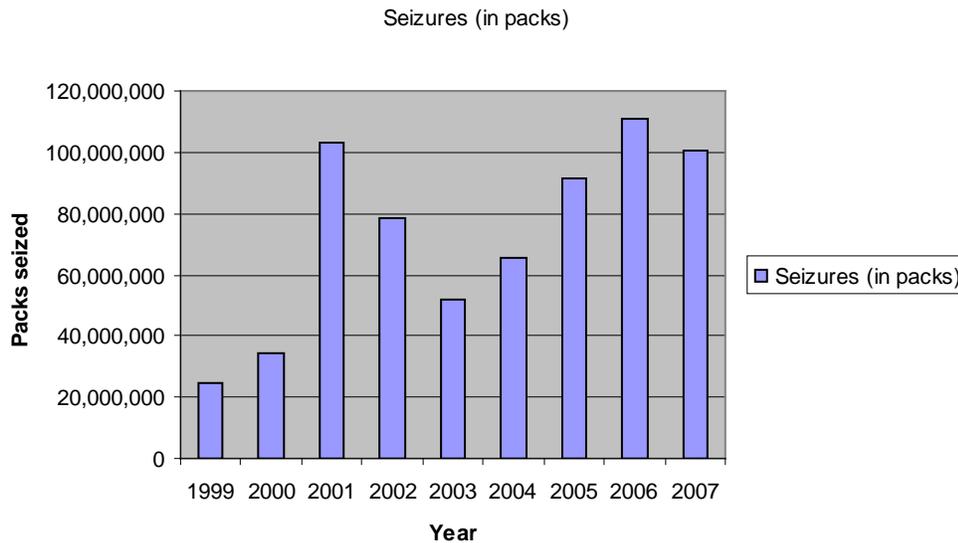
<sup>232</sup> *Ibid.*

<sup>233</sup> *Ibid.*

<sup>234</sup> Fisch, M., *The illegal cigarette market in Brazil. A case study*. A non-paper commissioned by the WHO TFI for the technical briefing during the first session of COP of the WHO-FCTC, 6-17 February 2006, Geneva, Switzerland.

<sup>235</sup> Receita Federal (2007) *Demonstrativo Anual de Destruição de Cigarros (em maços)*. Accessed April 28, 2008 from: <http://www.receita.fazenda.gov.br/DestinacaoMercadorias/DestruCigarros/default.htm>.

<sup>236</sup> Key informant interview, 2008 Apr 25.

**Figure 3: Seized Packs of Cigarettes in Brazil**

Source: Receita Federal (2007) Demonstrativo Anual de Destruição de Cigarros (em maços).  
<http://www.receita.fazenda.gov.br/DestinacaoMercadorias/DestruCigarros/default.htm>

In 2007, Brazilian officials added a machine-readable, enhanced taxation stamp to packages of cigarettes directly on the production line.<sup>237</sup> Each stamp has a unique ID number, and provides information on: the manufacturing site and production line, the date the stamp was validated, the tax category of the stamp, and the first destination of the cigarettes.<sup>238</sup>

Each stamp machine (“Scorpions”) attaches directly to the manufacturing machinery, and communicates in real time with the Brazilian authorities.<sup>239</sup> It is therefore difficult for a manufacturer to produce cigarettes without Brazilian authorities receiving information about it, reducing the ability to use the machine after hours without authorities’ knowledge. The scanning capability allows officials to trace a product back to the manufacturer who produced it, further deterring Brazilian companies from supplying the illicit market.

A number of Brazilian cigarette manufacturers protested the 1999 taxation and regulatory changes in court. While deliberating whether these measures violate the free enterprise of the manufacturers, the claimants have been allowed to operate under judicial authorization until any decision is made

<sup>237</sup> Fisch, M., *The illegal cigarette market in Brazil. A case study*. A non-paper commissioned by the WHO TFI for the technical briefing during the first session of COP of the WHO-FCTC, 6-17 February 2006, Geneva, Switzerland.

<sup>238</sup> Key informant interview, 2008 Feb 13

<sup>239</sup> Ibid.

(five at the time of writing).<sup>240</sup> Revenue officials argue that manufacturers are abusing the courts' lenience by continuing to supply the illegal market. However, so long as the courts eventually rule in favor of the Brazilian Government, manufacturers will be forced to either comply with regulations, or be shut down.

The Brazil case study illuminates the dynamism of contraband networks. The source of illicit tobacco can change quickly, so long as there are distribution networks and consumer demand. This is why contraband persists, despite the copious government policies and regulations aimed at eliminating it. The regulatory and tracking and tracing regime in particular, was considered especially effective, however has had no impact on smuggling from neighboring Paraguay, indicating a need for regional cooperation and coordination.

### **European Union Agreements with Philip Morris International (PMI) and Japan Tobacco International (JTI)**

In 2000, the European Commission and 10 Member States sued several tobacco manufacturers under the US Racketeer Influenced and Corrupt Organizations (RICO) legislation, arguing that these manufacturers were complicit in smuggling operations.<sup>241</sup> In 2004, in return for a comprehensive, legally-binding agreement with the European Community, the charges against Philip Morris International (PMI) were dropped.<sup>242</sup>

Under the terms of the agreement, PMI admitted no liability to the allegations, but agreed to a number of future stipulations.<sup>243</sup> PMI agreed to pay over US\$1 billion over 12 years, and committed itself to repaying 100% of the duty required on any seizures of their products made after the agreement.<sup>244</sup> Moreover, if annual seizures include greater than 90 million PMI cigarettes, PMI will repay an additional 400% of the duty required.<sup>245</sup> As of May, 2008, OLAF officials state that PMI has paid US\$575 million to the European Commission and its member states.<sup>246</sup>

<sup>240</sup> See Receita Federal: *Estabelecimentos Fabricantes de Cigarros Autorizados a Operarem no Brasil*. Accessed on April 28, 2008 from:

<http://www.receita.fazenda.gov.br/DestinacaoMercadorias/ProgramaNacCombCigarrollegal/EstabFabrOpBrasil.htm>.

<sup>241</sup> Framework Convention Alliance. (2008) *Fact Sheet About the EU Agreements With Tobacco Manufacturers to Control the illicit trade in Cigarettes*, January.

<sup>242</sup> Ibid.

<sup>243</sup> Ibid.

<sup>244</sup> The European Community (EC). (2004) *Anti-Contraband and Anti-Counterfeit Agreement and General Release*, July 9. Accessed on April 30, 2008 from: [http://ec.europa.eu/anti\\_fraud/budget/agreement.pdf](http://ec.europa.eu/anti_fraud/budget/agreement.pdf).

<sup>245</sup> Framework Convention Alliance. (2008). *Fact Sheet About the EU Agreements With Tobacco Manufacturers to Control the illicit trade in Cigarettes*, January.

<sup>246</sup> Response by OLAF.

PMI also committed to distribution controls on its products, including tracking and tracing mechanisms, know-your-customer protocols, and labeling requirements.<sup>247</sup> Finally, PMI tests all seizures for counterfeit products, in conjunction with the European Anti-Fraud Office.<sup>248</sup>

PMI is required print the following information every pack and/or carton of cigarettes: the date of manufacture of the product, the manufacturing facility, the machine of manufacture, and the production shift in which the product was manufactured.<sup>249</sup> This information is stored in a barcode which is placed on all master cases (50 cartons or 10,000 cigarettes).<sup>250</sup> The barcode is to be scanned when sold to “first purchasers,” and the information contained is to be uploaded to a first purchaser database.<sup>251</sup> The database contains the: first purchaser name and order number, shipment date, destination of shipment, point of departure from PMI factory or warehouse, the consignee to whom the product is shipped, and the intended market of retail sale.<sup>252</sup> The agreement further outlines the possibility of “second layer tracking,” where information is collected in a similar manner to the first purchaser database, based on shipments ordered by the First Purchaser. While this component would improve tracking of master cases, it depends on adequate technology, which PMI argues is not yet available.<sup>253</sup> Regardless, significant information can still be ascertained using just the two available capabilities.

In 2007, Japan Tobacco International (JTI) signed an agreement similar to the PMI one, committing itself to US\$400 million over 15 years, and implemented the same product control and seizure protocols.<sup>254</sup> A noteworthy element of the agreements is the know-your-customer protocols, where an approval process for potential PMI and JTI customers facilitates a stringent know-your-customer process. OLAF and the member states may request customer information in order to gain intelligence on the companies involved, and for each seizure of JTI or PMI products, the companies are required to provide information on the first, and where applicable, second customer to whom the cigarettes were sold.<sup>255</sup> Combining the know-your-customer protocols with tracking and tracing protocols builds intelligence for investigators and reduces the ability to smuggle cigarettes from these two companies.

<sup>247</sup> The European Community (EC). (2004) *Anti-Contraband and Anti-Counterfeit Agreement and General Release*. 9 July 2004. [http://ec.europa.eu/anti\\_fraud/budget/agreement.pdf](http://ec.europa.eu/anti_fraud/budget/agreement.pdf); accessed 30 April 2008.

<sup>248</sup> Ibid.

<sup>249</sup> European Anti-Fraud Office (2007) *Appendix D – Tracking and Tracing protocols*. Accessed on May 28, 2008 from: [http://ec.europa.eu/anti\\_fraud/budget/D.pdf](http://ec.europa.eu/anti_fraud/budget/D.pdf), p. 3.

<sup>250</sup> Ibid.

<sup>251</sup> Ibid, p. 5.

<sup>252</sup> Ibid.

<sup>253</sup> Response by OLAF.

<sup>254</sup> Framework Convention Alliance. (2008) *Fact Sheet About the EU Agreements With Tobacco Manufacturers to Control the illicit trade in Cigarettes*, January.

<sup>255</sup> Response by OLAF.

Preliminary data suggest that the vast majority of EU seizures have been counterfeit products, indicating that the legitimate supply of smuggled goods within the EU may be shrinking. OLAF officials state that under the PMI agreement, over 1000 seizures have been made of PMI product, but over 80% of these seizures represent counterfeit goods.<sup>256</sup> Informants have suggested that it was not the agreements per se that helped reduce the amount of legitimate brands being smuggled in Europe, but rather the threat of litigation or legislation that forced many manufacturers to account for their export procedures. Regardless of the motivations for the agreements, most informants concurred that the agreements are a powerful control on smuggling operations in Europe.

## UK

During the mid-1990s, advocates did not consider smuggling in the UK a noteworthy issue. However, by the late 1990s, it became clear that the UK had one of the largest smuggling problems in the European Union. According to a report by Her Majesty's Customs and Excise (HMCE) in 2000, nearly 20% of the cigarette market in the UK was illicit, culminating in £2.5 billion in lost revenues in 1999.<sup>257</sup> At first, the smuggling market primarily consisted of cross-border shopping and bootlegging, but by the 2000 HMCE report, approximately 70-80% of the smuggled market was through large-scale organized smuggling of cigarettes in freight containers and "roll-on-roll-off lorries."<sup>258</sup>

In response, the UK government instituted a series of measures, mostly focusing on securing the border against smuggling. Investments in resources such as a "national network of x-ray scanners to detect high volume cigarette smuggling in freight" were undertaken, along with tougher penalties for both smugglers and sellers of illicit goods.<sup>259</sup> All cigarette packages sold in UK were required to bear a duty-paid marking, helping identify at the retail level goods with taxes unpaid.<sup>260</sup> These measures were expected to stop the increase in smuggling (which had been dramatic since the mid-1990s), and ensure that the illicit market in cigarettes did not grow beyond 20% of the overall market.<sup>261</sup>

<sup>256</sup> Response by OLAF.

<sup>257</sup> HM Customs and Excise. (2000). *Tackling Tobacco Smuggling*. HM Customs and Excise & HM Treasury. London, UK, p. 2 and 6.

<sup>258</sup> *Ibid*, p. 5.

<sup>259</sup> *Ibid*, p. 10.

<sup>260</sup> *Ibid*.

<sup>261</sup> *Ibid*, p. 12.

In HMCE's 2001 pre-budget report, Customs and Excise reported that:

- The market for smuggled cigarettes remained stable at 21%
- In 2000-01 customs seized 2.8 billion cigarettes – almost a billion more than in 1999-2000
- Customs reduced cross-channel smuggling by 76%
- The network of x-ray scanners detected around 80 million cigarettes and 4.5 tons of hand-rolling tobacco
- Customs seized 10,200 cars, vans and lorries used by smugglers<sup>262</sup>

The approach taken by customs was deemed effective in controlling cross-border smuggling and bootlegging. Hornsby and Hobbs (2007) argue that while small-scale bootlegging operations became a fairly lucrative business for some, when Customs began their zero-tolerance approach to smuggling, and began regularly seizing vehicles, many smugglers got out of the cross-border market.<sup>263</sup> Supplementing the zero-tolerance approach was a public awareness campaign targeted towards those who would participate in cross-border smuggling. Over £5 million was spent on media campaigns from 2000 to 2007.<sup>264</sup>

During the years 2002 and 2003, the UK government entered into a number of MOUs with the three major cigarette manufacturers in the UK. An MOU was signed with Gallaher in April 2002, with British American Tobacco in October 2002, and with Imperial in June 2003.<sup>265</sup> The MOUs “were designed to reinforce co-operation in tackling tobacco smuggling into the UK,” while looking “to the manufacturers to ensure that they supply product only where there is a legitimate demand for it in the intended final market, sharing their understanding of that demand with Customs as necessary.”<sup>266</sup> A card system was put in place within these MOUs, whereby the manufacturer would receive a yellow or red card when Customs believed that the manufacturer was not adequately controlling the shipments or exports of their products.<sup>267</sup> Between February 2001 and March 2002 it was reported that nineteen cards were issued to Imperial, two to Gallaher, and none to British

<sup>262</sup> All statistics found at: Her Majesty's Customs and Excise. (2001) *Pre-Budget Report 2001 – Tackling Fraud and Smuggling*. Her Majesty's Customs and Excise & Her Majesty's Treasury. 27 November 2001. Accessed on April 29, 2008 from: [http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile?contentID=HMCE\\_PROD\\_009639](http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile?contentID=HMCE_PROD_009639).

<sup>263</sup> Hornsby, R. and Hobbs, D. (2007) “A Zone of Ambiguity: The Political Economy of Cigarette Bootlegging.” *British Journal of Criminology* 47: 551-571., p. 560-61.

<sup>264</sup> House of Commons. (2007) *Smuggling: Tobacco*. House of Commons Hansard Written Answers for 08 Oct 2007: column 235W. <http://www.publications.parliament.uk/pa/cm200607/cmhansrd/cm071008/text/71008w0049.htm>; accessed 29 April 2008.

<sup>265</sup> House of Commons Treasury Committee. (2005) *Excise Duty Fraud*. Fourth Report of Session 2004-05. 15 March 2005, p. 11.

<sup>266</sup> Ibid.

<sup>267</sup> Ibid, p. 12.

American Tobacco.<sup>268</sup> The 2005 House of Commons Treasury Committee report on the strategy highlighted that no red or yellow cards had been issued in the preceding two years, signifying that the manufacturers were taking these issues seriously.<sup>269</sup> Nonetheless because MOUs are not legally binding, unenforceable, and hinge on the willingness of industry to comply with their terms, scholars have argued they are not particularly useful in practice.<sup>270</sup>

By 2004, HMCE estimated that the illicit market share of cigarettes had fallen from 21% in 2000-01 to 15% in 2003-04, suggesting a degree of success.<sup>271</sup> However, in 2001-02, only 15% of cigarette seizures were counterfeits, but by 2003-04 that rose to 54%, indicating a shift in the source of smuggled goods.<sup>272</sup> Finally, the illicit market share of hand-rolled tobacco (HRT) remained high, declining only 6%, from 63% in 2000-01 to 57% in 2003-04.<sup>273</sup>

A partial explanation for this shift from legitimate to counterfeit cigarettes may be the criminal lawsuits filed under the RICO legislation (see the EU case above), combined with investigations by the UK Health Select and Public Accounts Committees, which prompted companies to take control of their supply-chains, and cease any tobacco smuggling activities, especially within Europe. As such, seizures of genuine UK product, especially from Imperial, had fallen prior to any direct action with the manufacturers through the MOUs, and therefore scholars have argued that it was the threat of criminal prosecution that drove many manufacturers out of the smuggling industry, rather than the voluntary agreements reached under the MOUs.<sup>274</sup>

In October 2006, Her Majesty's Revenue and Customs (HMRC, after a reorganization of the Ministries) implemented supply-chain legislation, which differed from the MOUs. First, this legislation required manufacturers to create their own supply chain policy.<sup>275</sup> When seizures are made, the product is tested to see if it is genuine or counterfeit, and penalties can be imposed on the

<sup>268</sup> House of Commons Treasury Committee. (2005) *Excise Duty Fraud*. Fourth Report of Session 2004-05. 15 March 2005, p. 12.

<sup>269</sup> Ibid

<sup>270</sup> Joossens L, Raw M. (2008). Progress in combating cigarette smuggling: controlling the supply chain. *Tobacco Control* (online Sept 10, preceding publication) <http://tobaccocontrol.bmj.com/onlinefirst.dtl>

<sup>271</sup> HM Customs and Excise. (2004) *Measuring and Tackling Indirect Tax Losses – 2004: An update on the Government's strategic approach*. December 2004. HM Customs and Excise. London, UK, p. 16.

<sup>272</sup> Ibid, p. 16. and p. 18.

<sup>273</sup> Ibid, p. 17.

<sup>274</sup> Joossens L, Raw M. (2008). Progress in combating cigarette smuggling: controlling the supply chain. *Tobacco Control* (online Sept 10, preceding publication) <http://tobaccocontrol.bmj.com/onlinefirst.dtl>

<sup>275</sup> Her Majesty's Revenue and Customs. (2006). *Tobacco Products Duty: control of supply chains (Notice 477)*, October, p. 3.

manufacturer if the product is genuine.<sup>276</sup> A notice would be issued if compliance became a concern, while penalty notices would be issued if the manufacturer had failed to strengthen their supply-chain controls.<sup>277</sup> On receiving a penalty notice, a financial penalty of up to £5 million could be levied.<sup>278</sup> This shift from voluntary MOUs to mandatory legislation strengthened the obligations of manufacturers to have a strict supply-chain policy, and hence discourage smuggling. Given the dubious efficacy of MOUs, expressed by key informants, the shift was seen as an improvement in practice.

Given the growing size of the counterfeit market, HMRC announced, in cooperation with the Tobacco Manufacturers' Association (TMA), a voluntary agreement by the tobacco manufacturers to add covert anti-counterfeit security marks to each pack, starting October 2007.<sup>279</sup> Introduced as a means to "enable enforcement officials to readily identify counterfeit product and prevent them from infiltrating the formal retail sector,"<sup>280</sup> key informants had mixed feedback about this policy. While there were many counterfeit cigarettes being smuggled into the UK, all displaying false duty-paid markings, several key informants were skeptical about how the policy could be enforced, given that most counterfeit sales are made by informal distribution networks. However, other key informants reiterated that the intended purpose of anti-counterfeit markings is not necessarily to identify counterfeit product, but to ensure that counterfeit products can be identified should they ever infiltrate the retail level. Though there may not be an immediate impact in terms of controlling counterfeit sales on the streets, key informants noted that these mechanisms discourage retailers from starting to sell counterfeit, effectively confining the counterfeit market to informal distribution networks.

Prior to these markings, in 2004 a booklet entitled, "Counterfeit Cigarettes," was released which focused on three features of counterfeit: identification, associated health risks, and the involvement of organized crime.<sup>281</sup> More recently, on April 18, 2008, HMRC launched a "Counterfeit Kills" public awareness campaign aimed at exposing the health risks associated with smoking counterfeit cigarettes.<sup>282</sup> Key informants were divided on the impact of the campaigns. Several informants felt that many purchasers of counterfeit cigarettes do not know they are purchasing fake products, meaning increased media attention would act as a deterrent. However, other key informants insisted

<sup>276</sup> Her Majesty's Revenue and Customs. (2006). *Tobacco Products Duty: control of supply chains (Notice 477)*, October, p. 5.

<sup>277</sup> *Ibid.*, p. 11 and 13.

<sup>278</sup> *Ibid.*, p. 13.

<sup>279</sup> HM Revenue and Customs. (2007). *Autumn Performance Report*, December, p. 16.

<sup>280</sup> *Ibid.*

<sup>281</sup> HM Customs and Excise, (2004).

<sup>282</sup> HM Revenue and Customs. (2008). *Hard Hitting 'Counterfeit Kills' Campaign Highlights Dangers of Illicit Cigarette Trade*, April 18.

that most smokers are aware that smoking is harmful, and are also aware that they are buying illegal products, reducing the likelihood that an awareness campaign about the dangers of counterfeit cigarettes will be effective, and may potentially re-legitimize the consumption of commercial cigarettes as a “healthier” option. Some key informants felt that despite the negative advertising, price would trump all related concerns.

Overall, current estimates provided by HMRC reveal that though the illicit cigarette market has fallen to between 8-18% of the market, hand-rolled tobacco still maintains an illicit market share of between 50-62%.<sup>283</sup> Among cigarettes, counterfeit brands made up 70% of all seizures in 2006-07, while “genuine UK brands” made up only 17% of seizures.<sup>284</sup> Finally, the total fraud and smuggling revenue losses in 2005-06 were estimated to be between £1.6-3.2 billion.<sup>285</sup> The illicit market has therefore dramatically shifted since 2000, when genuine UK brands made up 31% of all cigarette seizures in 2002. This case study is a testament to the resilience of the contraband market, and the need for a comprehensive anti-smuggling strategy. Despite the numerous policy interventions in the UK, the smuggling market still exists.

<sup>283</sup> HM Revenue and Customs. (2007). *Measuring Indirect Tax Losses – 2007*. London, UK, October, p. 11-12.

<sup>284</sup> HM Revenue and Customs. (2007). *Autumn Performance Report*, p. 40.

<sup>285</sup> *Ibid.*

## **Section Four: Assessment of the Effects of Policy Measures under a Variety of Contexts**

There are many forms of contraband tobacco. Experience shows that contraband activities change over time, often in response to anti-contraband measures. For example, the UK has seen a decline in seizures of genuine-UK brands, with a parallel increase in seizures of counterfeit product, corroborating the conclusion that illicit tobacco operations adapt to the regulatory climate. Furthermore, in Australia, when domestic illegal tobacco was eliminated by buying-out the growers, seizures of imported tobacco leaf increased dramatically, suggesting that as long as sufficient demand and distribution networks exist, a new source of contraband tobacco will emerge.

Cross-border smuggling of tobacco products may be the most pervasive contraband problem, yet illicit domestic production and distribution also remains common. There are numerous cases of domestic tax-evasion, where borders are not crossed. For example, manufacturers can produce cigarettes strictly for the illicit market, as seen in case studies from Brazil and Canada, where manufacturers either attempt to evade licensing obligations, or simply benefit from such obligations not being enforced. Furthermore, the lawful availability of tax-exempt products for some people or in particular jurisdictions, such as for aboriginal people on First Nations reserves in Canada and the United States, can present a lucrative environment for smugglers, who can re-sell the cigarettes for a quick and easy profit.

The contraband market is a complex enterprise that includes many players: growers, manufacturers, distributors, retailers, and consumers. Given the range of actors, policymakers can respond to contraband in different ways, such as further regulations and controls on the manufacturers, inspection and monitoring of sales made by licensed retailers, targeting consumers via public awareness campaigns, and notices of taxes owed from Internet purchases, among others.

One of the major contributions this paper aims to make is to help distinguish the difference between varieties of contraband tobacco, in order to help shed light upon what policies might become most effective under different circumstances. Table 8 presents the various types of contraband tobacco, based on two fundamental distinctions: whether the entity producing the product is legal or illegal, and whether the smuggling occurs via the crossing of jurisdictional borders or is contained within one domestic jurisdiction. These two distinctions will be discussed further, but it should be emphasized that in all cases some form of smuggling/tax-evasion occurs, and therefore the activity is illegal. The typology table helps determine which entities are involved in illicit trade, and how the smuggling occurs. Defining distinctions between illegal/legal entities and domestic/cross-border tax-evasion assists in determining which policy measures might be most appropriate, as each player involved in contraband will respond differently based on their material interest and legal obligations.

The production source axis (y-axis) is sub-divided into legal and illegal production, determined by compliance with the regulatory framework that exists in the given jurisdiction. For instance, tobacco industry manufacturers that are licensed/regulated by their host jurisdiction are deemed legal producers because they are licensed/registered as legally allowed to produce tobacco products. Though their actions may sometimes be illegal by intentionally manufacturing product for contraband markets for example, they are still considered part of the legal regulatory structure. Conversely, unlicensed tobacco manufacturers and growers (depending on jurisdiction) are categorized as illegal. Policy responses would need to focus on bringing these manufacturers into the legal realm, and compelling them to operate under the regulatory/legal framework, or else shutting these operations down. One grey area that emerges is production in a jurisdiction with a corrupted regulatory system, such as Paraguay, which will be discussed below.

Distribution type, located on the x-axis of the table, refers to whether the method of evasion requires the crossing of borders between states, provinces, or countries. While the bulk of contraband problems are cross-border in nature, examples exist of domestic tax evasion occurring. For example, the sale of unmarked or tax-exempt cigarettes to ineligible consumers would fall under domestic distribution; the method of evasion/smuggling does not require the entity to cross borders in order to take advantage of the duty-free status of exports. Conversely, when a manufacturer exports their cigarettes to another jurisdiction, where those cigarettes are then purchased in the illicit market without relevant taxes being applied, this would fall under the category of cross-border distribution (for example, exports from Paraguay to Brazil). Finally, a number of jurisdictions have witnessed the phenomenon of “returning exports,” whereby a manufacturer exports their products to a neighboring jurisdiction in order to take advantage of the duty-free status of exports, only to have the cigarettes smuggled back into the country of origin, for tax-free sales on the illicit market (for example, Canada in the early 1990s). This would also be classified as cross-border distribution, as it is taking advantage of export laws in regards to taxation that allows for the evasion of domestic taxes.

Table 8: Contraband Context Table

		Distribution type	
		Domestic	Cross-Border
Production Source	Legal	<p><b>Growers</b></p> <ul style="list-style-type: none"> <li>• Diversion of legal tobacco crops                             <ul style="list-style-type: none"> <li>▪ Australia</li> </ul> </li> </ul> <p><b>Manufacturers/ Distributors</b></p> <ul style="list-style-type: none"> <li>• Tax-evasion by licensed manufacturers                             <ul style="list-style-type: none"> <li>▪ Brazil</li> </ul> </li> <li>• Production over-runs by legal manufacturers</li> </ul> <p><b>Retailers</b></p> <ul style="list-style-type: none"> <li>• Sale of tax-exempt tobacco to ineligible consumers                             <ul style="list-style-type: none"> <li>▪ abuse of tax-exempt systems by non-Aboriginal consumers when purchasing on-reserve (Canada)</li> <li>▪ abuse of duty-free or likewise tax-exempt retail outlets</li> </ul> </li> <li>• Sales of counterfeit-stamped or unmarked cigarettes                             <ul style="list-style-type: none"> <li>▪ California</li> </ul> </li> </ul> <p><b>Consumers</b></p> <ul style="list-style-type: none"> <li>• Purchases of tax-exempt or unmarked/counterfeit marked cigarettes</li> </ul>	<p><b>Growers</b></p> <ul style="list-style-type: none"> <li>• Illegal exports of crops                             <ul style="list-style-type: none"> <li>▪ to unlicensed manufacturers</li> </ul> </li> </ul> <p><b>Manufacturers/ Distributors</b></p> <ul style="list-style-type: none"> <li>• Organized smuggling</li> <li>• Uncontrolled exports in excess of consumption                             <ul style="list-style-type: none"> <li>▪ UK exports to Andorra</li> </ul> </li> <li>• Smuggling of tobacco products into a jurisdiction                             <ul style="list-style-type: none"> <li>▪ HRT into UK</li> </ul> </li> <li>• “Returning exports”                             <ul style="list-style-type: none"> <li>▪ Canada in early 1990s, Brazil in mid-1990s, UK in 2000</li> </ul> </li> <li>• Smuggling of products from a weakly regulated jurisdiction, termed “quasi-legal smuggling”                             <ul style="list-style-type: none"> <li>▪ smuggling of products from Paraguay into Brazil, non-UK brands into UK</li> </ul> </li> </ul> <p><b>Retailers</b></p> <ul style="list-style-type: none"> <li>• Sales of unmarked or “out-of-state” marked cigarettes                             <ul style="list-style-type: none"> <li>▪ US, European markets</li> </ul> </li> </ul> <p><b>Consumers</b></p> <ul style="list-style-type: none"> <li>• Purchases of legal cigarettes from internet vendors or out-of-state sources                             <ul style="list-style-type: none"> <li>▪ US</li> </ul> </li> </ul>
	Illegal	<p><b>Growers</b></p> <ul style="list-style-type: none"> <li>• Illegal growing of tobacco                             <ul style="list-style-type: none"> <li>▪ growing in Australia without a license</li> </ul> </li> </ul> <p><b>Manufacturers/ Distributors</b></p> <ul style="list-style-type: none"> <li>• Illicit/unlicensed manufacturing                             <ul style="list-style-type: none"> <li>▪ Brazil, Canada</li> </ul> </li> </ul> <p><b>Retailers</b></p> <ul style="list-style-type: none"> <li>• Sales of illegal cigarettes                             <ul style="list-style-type: none"> <li>▪ baggies in Canada</li> </ul> </li> </ul> <p><b>Consumers</b></p> <ul style="list-style-type: none"> <li>• Purchases of illegal tobacco products from internet vendors</li> <li>• Purchases of illegal tobacco products from informal or illegal sources                             <ul style="list-style-type: none"> <li>▪ baggies in Canada, from pubs or “boot sales” in UK</li> </ul> </li> </ul>	<p><b>Growers</b></p> <ul style="list-style-type: none"> <li>• Illegal growing of tobacco for export</li> <li>• Smuggling of tobacco leaf into jurisdiction</li> </ul> <p><b>Manufacturers/ Distributors</b></p> <ul style="list-style-type: none"> <li>• Smuggling of counterfeit cigarettes</li> <li>• Smuggling of illicit brands                             <ul style="list-style-type: none"> <li>▪ baggies in Canada</li> </ul> </li> </ul> <p><b>Retailers</b></p> <ul style="list-style-type: none"> <li>• Sales of smuggled illicit cigarettes</li> </ul> <p><b>Consumers</b></p> <ul style="list-style-type: none"> <li>• Purchases of illegal cigarettes from Internet vendors or informal sources</li> </ul>

*Note:* To increase clarity, items on the table have been simplified, such as by including distributors under the ‘manufacturer’ definition and leaving importers out entirely, mainly due to the importance of law enforcement in scanning and inspecting incoming cargo in this sector.

The above table only categorizes the types. It does not address contexts relevant to implementing anti-contraband measures, such as political sensitivities, extensiveness of contraband, and/or pervasiveness of organized crime. For example, a noteworthy political sensitivity in Canada is the role of manufacturing/sales of tobacco products on First Nations reserves, where issues around sovereignty and self-determination present obstacles to enforcement and regulatory efforts.<sup>286</sup> These elements also influence which policy options are feasible, thereby having an important impact on the efficacy of anti-contraband strategies as a whole.<sup>287</sup>

**Table 9: Raw Context Table**

		Distribution type	
		Domestic	Cross-Border
Production Source	Legal	1	2
	Illegal	4	3

Each quadrant will be analyzed separately, describing policy alternatives that address each aspect of the contraband problem. Policy alternatives are labeled as “high potential” and “some potential,” depending on the impact that particular alternative has been seen to elicit in practice, based upon the policy lessons and case studies above. After each analysis of the policy problems and alternatives, there is a brief discussion of the consequences of action and the expected displacement of risk.

**Quadrant 1: Legal Products Distributed Domestically**

Quadrant 1 of the raw context table (Table 9) pertains to legal tobacco products that are illegally distributed within one jurisdiction, tax-exempt. Examples of this quadrant’s policy problems include diversion of tobacco leaf by growers, the sale of tax-exempt tobacco to ineligible customers, and similar themes of tax-evasion. Most jurisdictions have licensing or registration processes which allow government officials to differentiate between legal and illegal products, and therefore Quadrant 1 policy alternatives focus on enforcement activities, regulation, and tax collection. Table 10 below

<sup>286</sup> See: Ivison J. (2008) “Sovereignty Stands in Way of Tobacco Deal.” *The National Post*. Wednesday May 14.

<sup>287</sup> See for example an analysis of the tax-rollback in Canada in 1994 from a political science perspective: Breton E, Richard L, Gagnon F, Jacques M, Bergeron P. (2006) Fighting a Tobacco-Tax Rollback: A political analysis of the 1994 cigarette contraband crisis in Canada. *Journal of Public Health Policy* 27: 77-99.

outlines the various scenarios captured under this quadrant, as well as the policy responses deemed to have high potential or moderate potential in addressing these issues.

**Table 10: Policy Alternatives: Legal Products Distributed Domestically**

Policy Problem	Policy Measure	
	High potential	Moderate potential
<b>Growers</b> <ul style="list-style-type: none"> <li>• Diversion of legal tobacco crops</li> </ul>	<b>Enhanced enforcement</b>	Licensing Record-keeping/controls
<b>Manufacturers/ Distributors</b> <ul style="list-style-type: none"> <li>• Tax-evasion by licensed manufacturers</li> <li>• Production over-runs by legal manufacturers</li> </ul>	<b>Tax-markings/stamps</b> <b>Tracking and tracing</b>	Enhanced enforcement Legally binding agreements Licensing Record-keeping/controls
<b>Retailers</b> <ul style="list-style-type: none"> <li>• Sale of tax-exempt tobacco to ineligible consumers <ul style="list-style-type: none"> <li>▪ abuse of tax-exempt systems by non-Aboriginal consumers when purchasing on-reserve</li> <li>▪ abuse of duty-free of likewise tax-exempt retail outlets</li> </ul> </li> </ul>	<b>Tracking and tracing</b>	Licensing Tax Agreements/Compacts Tax-markings/stamps Record-keeping/control measures
	<b>Retailers</b> <ul style="list-style-type: none"> <li>• Sales of counterfeit-stamped or unmarked cigarettes</li> </ul>	<b>Enhanced enforcement</b> <b>Licensing</b> <b>Tax-markings/stamps</b>
<b>Consumers</b> <ul style="list-style-type: none"> <li>• Purchasing tax-exempt tobacco products or unmarked/counterfeit stamped tobacco products</li> </ul>		Enhanced enforcement Public Awareness Campaigns Record-keeping/controls

### **Growers**

Although in most cases, tobacco growers in a jurisdiction are regulated or licensed by the government, and accordingly follow mandated protocols for the sale and distribution of tobacco leaf, the case study of Australia demonstrated that despite a rigorous licensing regime, some growers will still divert their product to the illicit market, by selling product directly to illegal distributors. Therefore, though the growers are legal entities in the supply chain, their participation in the illicit market merits effective policy responses.

Enhanced enforcement is designated as the policy response with the highest potential for addressing contraband concerns among growers. Because growers must be licensed and are subject to random government inspection, enhanced enforcement strategies, such as monitoring grower crop sizes, and engaging in “controlled sales,” can be an effective deterrent. Growers divert their product in an effort to increase profits, therefore the fines and other penalties extracted by inspection officers undermine the motive. Other policy solutions, such as improved licensing, have some potential, but may be ineffective for two reasons: first, licensing is hampered when numerous entities exist, and second, the efficacy of licensing regimes is dictated by the number and quality of enforcement officers, without which the licensing is moot. The case study of Australia demonstrated that enforcement alone is not sufficient and can be difficult.

### **Potential Unintended Consequences of Policy Change**

Though considered to have high potential to eliminate diversion of legal tobacco crops to the contraband market, one consequence of enhanced inspection of and enforcement on tobacco growers may be a breakdown in the relationships between the growers and enforcement officials. This was a significant concern among policymakers in Australia.

### ***Manufacturers/ Distributors***

In this context, it is uncommon for tobacco manufacturers to sell directly to the illicit market, except manufacturers located on First Nations reserves in Canada. The most likely scenario off-reserve is deliberate manufacturer production overruns, although this can be minimized with adequate marking/stamping and licensing requirements. Given this, enhanced tax stamps, particularly tracking and tracing stamps, are important to maintain an accurate and objective measure of cigarettes produced by each manufacturer. This was demonstrated most clearly by the Brazilian case study. If an effective tracking mechanism is built into all production machines, taxation authorities would receive automatic updates of how much product is being produced, and the requisite tax amount. Tracking and tracing and marking/stamping both are considered high potential solutions to control manufacturer tax evasion.

In contrast to the potential efficacy of the previous measure, enhanced enforcement is considered to only have moderate potential, as was seen in California. If the regulatory framework is sufficiently described and enforced, contraband should not gain share in the market. Implicit in this is the assumption that licensing and marking/stamping systems are implemented with adequate enforcement.

Legal agreements are considered by many informants to have only moderate potential for the same reasons as enhanced enforcement. It is assumed that an adequately enforced licensing regime pre-empts the need for legal agreements. However, legal agreements can help to clarify manufacturers' roles in the distribution of tax-exempt tobacco products, which can ensure that their products are sold within the requisite quota or refund systems on First Nation reserves.

Licensing and record-keeping/controls are also deemed to have moderate potential. This is because these policies are less pro-active, merely ensuring a paper-trail. However, requiring that licensed manufacturers only purchase raw tobacco from licensed growers and sell to licensed retailers is a policy that has met with some success, as seen by the "know your customer" protocols in the EU agreements.

### **Potential Unintended Consequences of Policy Change**

It is unlikely that increased inspection and enforcement will generate unintended effects on manufacturers or distributors because they are already government regulated.

**Retailers**

In the formal and informal retail sector, both legal and illegal product might be sold at discounted prices. A good example of this is the way tax-exempt cigarettes are sold on Canadian First Nation reserves. Often the cigarettes are legally manufactured but illegally sold tax-exempt to ineligible consumers. Hence, tracking and tracing is considered the policy measure with the highest potential because it allows enforcement officers to see where shipments end up, in this case, whether they end up off reserve. Furthermore, tracking and tracing markings allow tax-exempt and tax-paid product to be differentiated when on the shelf, and help ensure that markets regulated by quotas are not being oversupplied.

Though tracking and tracing mechanisms can help reduce diversion of tax-exempt cigarettes to off-reserve retailers, they do little to address the informal sales that occur outside of the formal retail sector, highlighting the need for tax-agreements/compacts with First Nations reserves. Such agreements undermine the profit incentive for tax avoidance/smuggling from reserves. Examples include the tax compacts implemented in Washington State and the policy in New Brunswick where tribes are reimbursed the taxes collected from non-First Nation customers. This policy measure was classified as having moderate potential due to the practical difficulties with implementing this in all First Nation communities, discussed fully in section five.

Most of the policies, including licensing, tax-paid markings/stamps, and record-keeping are considered to have moderate potential given the presumed legitimate nature of the tobacco manufacturers in this quadrant. Such measures increase the effectiveness of any anti-contraband regime but do not solve the underlying motivations for retailers in the illicit market. Policies such as requiring retailers to have a license, restricting retailers from purchasing goods from anybody other than a licensed distributor/manufacturer, and requiring retailers to maintain two distinct stocks of product, one tax-exempt, one tax-included, are recommended.

Canadian provinces regulate tax-exempt sales with one of three mechanisms, through a quota system, a refund system, or a mixture of the two; however, each mechanism is prone to abuse. While refund programs put some onus on the consumer to prove their eligibility, most provinces with refund programs note that many retailers will sell tax-exempt product to individuals without adequate proof of eligibility. As well, sometimes eligible consumers buy product for non-eligible users, also undermining the program. Quota systems attempt to cap the number of tax-exempt cigarettes sold to reserves, however, most allocations are very high and still allow surplus product to exist in the community. Moreover, as with refund systems, quota-bound retailers also sell to ineligible customers, and eligible customers who do not smoke will buy product for ineligible smokers. Finally, though many provinces attempt to impose a daily or weekly purchase limit, without a real-time electronic system to monitor these purchases, consumers can purchase more than their quota by visiting multiple retailers with no way to stop them. Thus, the quota and refund

systems are designated as having only moderate potential, as the systems' loopholes undermine their effectiveness. Practices such as Alberta's use of electronic eligibility cards are certainly better practice, but is nevertheless an incomplete solution to addressing on-reserve sales.

British Columbia's practice of regulating the tax-exempt retail market through discretionary licensing, and refusing to license retailers who attempt to operate in a market that already densely populated with tax-exempt retailers does seem to be effective and warrants further study. A more sophisticated system that includes a refund and quota system, discretionary licensing, and electronic eligibility cards would likely have high potential in the Canadian context.

The California case study illustrates another scenario where legally manufactured cigarettes are diverted and either marked with counterfeit stamps or sold unstamped by retailers. Although the product being sold is legal, the lack of authentic fiscal markings creates an illicit market. California responded by implementing a rigorous licensing and enforcement regime that resulted in near complete elimination of contraband sold from licensed retailers, underscoring the effectiveness of this approach. Enhanced tax stamps, with both overt and covert security features, augmented enforcement officials' ability to inspect products and lay charges where necessary. Thus, this trio of policy measures appears to have high potential in addressing concerns of counterfeit sales within the retail sector.

In both the tax-exempt and counterfeit scenarios, jurisdictions disseminated public awareness information, usually to the retailers themselves, outlining retailers' obligations under the law and how to identify illicit product. While this was seen as a useful public relations effort, and demonstrated the government's commitment to address the problem, most key informants noted that the campaign had minimal impact because the retailers were knowingly selling illegal products.

### **Potential Unintended Consequences of Policy Change**

Enhanced inspection and enforcement runs the risk of leading to increased informal cigarette sales. When sales move to the informal level, policy solutions become constrained, as enforcement officials can only rely on identifying illegal distributors and seizing and penalizing individuals caught selling illegal tobacco products.

### **Consumers**

There are few policy solutions to address consumers' tax-avoidance in this quadrant. Enhanced enforcement is considered to only have moderate potential because attempting to crack down on tobacco tax avoidance would require significant resources, and might not get the necessary political and judicial support. An enhanced enforcement campaign similar to that implemented in the UK would deter a portion of tax-avoiders, but the sheer volume of retail outlets (both formal and informal) and the required resources and political support make this a lukewarm policy solution.

Public campaigns are not likely to be effective, given that the products being purchased are from legitimate manufacturers, and therefore cannot focus upon the unknown nature of counterfeit or illicit cigarettes, as is done in the UK. Public awareness campaigns can merely help to clarify the legality of purchasing tax-exempt cigarettes, though the impacts of this would likely be minimal, given that consumer demand is driven by the cost-savings.

### **Potential Unintended Consequences of Policy Change**

Enhanced inspection and enforcement efforts would need to be publicized through public awareness campaigns to effectively notify consumers that purchasing tax-exempt or unmarked tobacco products is an illegal activity. Coupling public awareness leaflets with enforcement activities related to seizing illegal product, and penalizing consumers for purchasing tax-exempt or unmarked tobacco products might have a significant impact on consumer demand. However, this also would likely encourage informal sales, generally impervious to policy measures. Another unintended consequence of public awareness campaigns would be the legitimizing effect the campaign may have on legal tobacco. The campaigns may be received in the same way tobacco advertisements would be, undermining anti-tobacco policies in general.

### **Quadrant 2: Legal Products Distributed Cross-border**

Quadrant 2 of the raw table (Table 9) addresses legal tobacco products that are illegally distributed across more than one jurisdiction. Cross-border smuggling of legal brands is common, and is perhaps the easiest way to smuggle. Because the brands themselves are legal, the key is to intercept those who are illegally diverting and distributing the product, evading the requisite taxes. A qualification to the analysis of this quadrant (and to Quadrant 3 below) is in cases where the source of the illegal product is in another jurisdiction. One example is the current situation in Canada where illicit cigarettes are manufactured on the US side of the Akwesasne reserve and smuggled north into Canada. Since Canadian officials have no jurisdiction over US manufacturers, policy solutions focus upon either intercepting the products before they cross the border, or identifying the products when they are sold at retail, either through formal or informal retailers. Beyond that, political pressure to force the neighbouring jurisdiction to take action is the only available option. Therefore, Table 11 suggests policy measures relevant to manufacturers and growers within one jurisdiction, rather than assuming that regulatory controls could be applied to these actors in another country.

In cases where products are smuggled in from a neighbouring jurisdiction, the most common policy measure implemented is enhanced border enforcement through x-ray scanners, spot-checks, and strict penalties. This policy solution has high potential to disrupt illicit trade, though attempts to control all entries to the country can require huge investments in resources, given the high volume of

imports to most countries, therefore limiting the potential of this approach. Key informants illustrated this point using the UK experience, where border authorities successfully identified and seized large quantities of tobacco products, but likely only intercepted a small proportion of the illegal products crossing the border. Informants posited that if there is enough demand, smugglers will consider border seizures as simply “the cost of doing business,” given that most shipments successfully enter the intended jurisdictions.

As exemplified by the Spanish case study, one vital approach in this quadrant is inter-jurisdictional cooperation and intelligence sharing, as pressure from multiple countries can promote policy-mobilization to shut down the source of the smuggled product, even if it is cross-border. However, in cases where countries are significantly dependent upon the tobacco production sector, as is the case in Brazil, this tactic may not be effective, as some jurisdictions might be unwilling to suffer the potentially adverse economic consequences.

**Table 11: Policy Alternatives: Legal Products Distributed Cross-border**

Policy Problem	Policy Measure	
	High potential	Moderate potential
<b>Growers</b> <ul style="list-style-type: none"> <li>• Illegal exports of crops                             <ul style="list-style-type: none"> <li>▪ to unlicensed manufacturers in other jurisdictions (i.e. Brazil)</li> </ul> </li> </ul>	<b>Export tax</b>	Enhanced enforcement Licensing Record-keeping/controls
<b>Manufacturers/ Distributors</b> <ul style="list-style-type: none"> <li>• Organized smuggling</li> <li>• “returning exports”</li> </ul>	<b>Tracking and tracing</b> <b>Legally binding agreements</b> <b>Export Tax</b>	Tax-markings/stamps Enhanced enforcement Licensing
<b>Retailers</b> <ul style="list-style-type: none"> <li>• Sales of unmarked or “out-of-state” marked cigarettes                             <ul style="list-style-type: none"> <li>▪ US, European markets</li> </ul> </li> </ul>	<b>Tax-markings/stamps</b> <b>Licensing</b> <b>Enhanced enforcement</b>	
<b>Consumers</b> <ul style="list-style-type: none"> <li>• Purchases of legal cigarettes from internet vendors or out-of-state sources</li> <li>• Cross-border smuggling of cigarettes</li> </ul>	<b>Enhanced enforcement</b>	Record-keeping/controls

A common theme across these studies has been a phenomenon termed “returning exports,” where tobacco products are grown or manufactured within one jurisdiction, exported to a neighbouring jurisdiction (in order to avoid domestic tobacco taxes), and subsequently smuggled back into the original jurisdiction and sold at a lower price. The case studies of Canada in the early 1990s, Brazil, and the UK are all demonstrative of this. Thus, policy measures can target both the production source and the point of re-entry.

**Growers**

The Brazil case study illustrates how tobacco growers can be complicit in the illicit market by

exporting tobacco leaf to a neighbouring jurisdiction, where it is manufactured into cigarettes, to be subsequently smuggled back into the grower's jurisdiction. In Brazil, levying an export tax on tobacco leaf was effective at disrupting this type of illicit trade. While export taxes are a blunt measure that can cause displacement of the site of production to neighbouring jurisdictions, or encourage smuggling across the border, it is still considered a policy measure with high potential.

Measures such as enhanced enforcement, stricter licensing, and record-keeping have only moderate potential because it can be difficult to implicate growers as complicit actors in the contraband market, given the number of entities (in the case of Brazil, thousands) and the numerous points of distribution. Thus, while officials might attempt to monitor and disrupt exports to illicit production sites, revoking licenses where appropriate, the difficulty inherent in directly placing a certain grower's tobacco leaf at the base of a smuggling ring makes this measure less effective. Record-keeping processes requiring growers to disclose all their shipping partners, and whether they are legal manufacturers are not particularly effective, given the cross-border nature of this approach. It will not always be possible to ascertain which manufacturers on the list are in the contraband market, or whether the intention of the grower was to supply the contraband market.

### **Potential Unintended Consequences of Policy Change**

Enhanced border controls and increased export taxes will likely deter growers from diverting their product to outside jurisdictions. Therefore, this policy, along with enhanced inspection and enforcement should be effective at discouraging domestic growers from engaging in contraband operations. However, this policy may not be sufficient to stop non-domestic growers.

### ***Manufacturers/ Distributors***

The phenomenon of "returning exports" is well known to have occurred in Canada in the early 1990s, in Brazil in the mid-1990s, and continues presently in other countries. In their own defense, manufacturers argued that they have no control over what happens to their products after they are shipped; however, several case studies in this report belie this argument, illuminating how manufacturers intentionally exported cigarettes to be smuggled back in, tax-free, and sold at a reduced price.

There are two policy measures, tracking and tracing and legally binding agreements, which have proven effective in such cases. Tracking and tracing mechanisms can reliably reveal the export practices of a manufacturer such as to whom the product is being shipped. Both the Brazil and EU case studies show this. The ability to trace a product to a particular site or retailer allows enforcement officials to gather information on common distribution routes and practices and the role that manufacturers play in the smuggling network. Legally binding agreements augment this

policy by requiring that manufacturers provide a list of all recipients of their products, thereby enabling authorities to pinpoint when and where the products are diverted in the distribution chain. Legal agreement allows authorities to force manufacturers to cease distribution to illegal recipients, or risk stiff penalties and investigation.

Memoranda of understanding (MOUs) are not considered useful because they do not have the weight of legally binding agreements. As seen in the Canadian case study, even though manufacturers signed a “gentleman’s agreement” with the Canadian government to stop exporting their products to be smuggled back into Canada, the inability of the government to enforce these voluntary agreements meant that nothing changed. Therefore, strong legal agreements that require manufacturers to provide a list of distribution points and demonstrate how they monitor and control their supply chain are recommended as high potential solutions.

Similarly, as seen in the case study of Brazil (and to a lesser extent, Canada), levying an export tax undermines the financial incentive to participate in the illicit market, forcing manufacturers to seek new distribution routes or shift production. While this is an unintended consequence of export taxation, the immediate impacts on the smuggling network are such that export taxes are nonetheless considered a high potential policy solution.

Tax-markings/stamps are identified to have moderate potential, given that they do not always disclose the place of manufacture or distribution points and practices, unless they are enhanced tax stamps. Without this information, it is more difficult to implicate the manufacturers in a smuggling scheme. Therefore, while markings/stamps are useful tools to identify tax-status or intended export market, they provide little other information, and can easily be ignored by manufacturers and consumers. For example, the Canadian cigarettes that were exported and then smuggled back into Canada in the 1990s bore an “export only” marking, but that was still insufficient to successfully implicate the manufacturers exporting the cigarettes to be smuggled.

For similar reasons, stricter licensing practices, including some know-your-customer protocols, might fail to change manufacturers’ practices if they cannot be explicitly connected to the illicit market. Linking licensing systems with tracking and tracing stamps makes licensing a more effective policy that enables monitoring of smugglers’ distribution practices. Thus, this policy has potential only if it is deployed with a tracking and tracing regime.

Enhanced enforcement is deemed to only have moderate potential because seizures of smuggled product and tobacco manufacturer investigations only seem to scratch the surface of contraband activities. Legal agreements and comprehensive tracking and tracing components can be far more

effective than individual enforcement activities because they definitively prove manufacturer participation in the illicit market.

### **Potential Unintended Consequences of Policy Change**

Given the cross-border nature of this context, manufacture and distribution sources are often larger and more organized. Therefore, an unintended consequence of further regulating legal manufacturers/distributors may be a shift of the source of contraband to Quadrant 3, characterized by illegally produced tobacco products, such as counterfeit brands, or “quasi-legal” brands produced in weakly-regulated states. For example, when the smuggling of exported UK produced cigarettes had declined, the UK contraband market was re-populated with non-UK produced and counterfeit cigarettes.

### ***Retailers***

Tax stamps/markings are especially effective at the retail level and can ensure that products smuggled in from lower-taxed jurisdictions are not sold in the formal retail market in higher-taxed jurisdictions. This also applies to tax-exempt product that is smuggled off-reserve. However, tax-markings are limited to protecting only the formal retail sector, and do not address informal sales of cigarettes.

Furthermore, as seen in the California case study, licensing and adequate inspection of the retail sector can reduce the quantity of contraband cigarettes sold in formal retail outlets. The threat of losing a retail license for possessing contraband cigarettes was perceived as very serious by California retailers, making licensing a policy measure with high potential. Jurisdictions that require both retailer licensing and cigarette tax-markings are better insulated against contraband being sold at the formal retail level.

Enhanced enforcement, requisite for the success of markings and licensing, is also a measure with high potential, considering that it is enforcement officers who check for markings and revoke licenses. Key informants from California attested that prior to the state licensing requirements, retailers did not take inspectors seriously. However, now that inspectors are empowered to revoke licenses, retailers have incentive to keep their stock clear of contraband.

### **Potential Unintended Consequences of Policy Change**

Increased enforcement of measures affecting the formal retail sector risks pushing sales to the informal market. The likelihood and extent to which this may occur varies by jurisdiction.

## **Consumers**

At the consumer level, the case study of the UK is instructive, where small groups of civilian consumers took advantage of lower-taxed jurisdictions around the UK by smuggling tobacco products in over the border. Improved enforcement/inspections efforts, coupled with strong penalties for smugglers helped reduce the smuggling networks. Therefore, a concerted enforcement campaign, with substantial penalties for engaging in cross-border smuggling can be an effective measure.

Beyond enforcement campaigns, few other policies affect the consumer level. As seen with the US problem of Internet tobacco sales, attempts to recover tobacco taxes from Internet purchasers have not been successful, with many consumers either going unidentified by the Internet vendors or ignoring government tax notices, and too few resources available to proactively recoup lost taxes.

## **Potential Unintended Consequences of Policy Change**

At the level of consumers, cross-border smuggling, or casual bootlegging is a serious issue for a number of jurisdictions. A combination of border enforcement and tax markings are promising solutions. “Duty-paid” or “export only” markings ensure that smuggled product is easily identifiable at the border to facilitate seizures. Imposing severe penalties is also a good deterrent. The UK practice of impounding vehicles used in bootlegging operations has reduced casual smuggling activities, shifting the sources of smuggling to larger containers and postal methods.

## **Quadrant 3: Illegal Products Distributed Cross-border**

Quadrant 3 of the raw context table (Table 9) pertains to illegal tobacco products (counterfeit or unlicensed manufacturer) that are distributed throughout more than one jurisdiction. Smuggling through large-scale shipments of counterfeit products is a burgeoning global threat, demonstrated through various case studies, such as the UK. The distribution of counterfeit cigarettes from producers in China and Eastern Europe has already become a major source of contraband in many countries, and requires different policy solutions than those aimed at legitimate producers.

Given that policymakers have no regulatory jurisdiction over cross-border manufacturers, the most common policy measure implemented is enhanced border security and imports inspection, in order to intercept illicit products. However, because domestic policymakers do have jurisdiction over the retail sector and cigarette consumer, these actors will be the focus of the analysis (see Table 12).

**Table 12: Policy Alternatives: Illegal Products Distributed Cross-border**

Policy Problem	Policy Measure	
	High potential	Moderate potential
<b>Retailers</b> <ul style="list-style-type: none"> <li>Sales of illicit or counterfeit cigarettes</li> </ul>	<b>Licensing</b> <b>Tax markings/stamps</b> <b>Enhanced enforcement</b>	Public Awareness Campaigns
<b>Consumers</b> <ul style="list-style-type: none"> <li>Purchases of illegal cigarettes from internet vendors or informal sources such as pubs, friends, etc</li> </ul>		Enhanced enforcement Public Awareness Campaigns

**Retailers**

Protecting the retail level from illegal brands requires a comprehensive licensing regime with adequate inspection and enhanced tax markings/stamps to ensure that illicit products do not enter the legitimate supply-chain. This was demonstrated by the California case study. The emphasis on enhanced tax-stamps is important because numerous case studies have confirmed the relative ease with which smuggling operations are able to counterfeit generic tax markings. As such, enhanced tax markings have high potential for ensuring that illicit products do not permeate the retail sector. Licensing and enhanced inspections also demonstrate high-potential in this area, due to the threat of retail license revocation.

Public awareness campaigns can also affect the retail sale of illicit cigarettes, by explicitly explaining retailer requirements in the sale of cigarettes, how to distinguish authentic from counterfeit tax markings, and how to identify counterfeit goods. Although key informants held that most retailers knowingly sell contraband product, the distribution of awareness information can preclude “but I didn’t know” arguments.

**Potential Unintended Consequences of Policy Change**

Important in this quadrant is the ability to prevent counterfeit and unmarked tobacco products from being sold at the formal retail level. Scanning tax-stamps and inspecting tobacco outlets to screen for counterfeit products can effectively keep legitimate retail suppliers out of the contraband business. Unfortunately, many case studies showed that smuggled products are often sold through informal networks, such as friends, which are outside the purview of formal retail inspection officers. Regardless, key informants suggested that maintaining a contraband-free formal retail supply-chain is still important because it minimizes the overall size of the contraband market and deters those consumers who are wary of purchasing cigarettes informally.

**Consumers**

At the consumer level, enhanced enforcement is not very effective because cigarettes are often sold through informal channels. Enforcement officers can only attempt to identify major informal distribution points and penalize individuals caught purchasing illicit cigarettes. However, as one key

informant stated, this is merely “cleaning up the mess” after the cigarettes have already reached the general population.

The effect of the UK “Counterfeit Kills” campaign, urging smokers to avoid smoking counterfeit cigarettes is an area for future research. Based on the case study, this report finds public awareness campaigns to have moderate potential to address contraband cigarettes by underscoring their uncertain ingredients and other risks associated with using such cigarettes. For some consumers clearly outlining that these cigarettes are illegal, and a form of tax-evasion, is enough of a deterrent. However, numerous key informants suggested that few consumers of cheap illicit brands are that naïve and simply want a cheap cigarette, legal or not. Thus, this policy will likely only have a small impact on consumers, and runs the risk of re-legitimizing commercial cigarette brands.

### **Potential Unintended Consequences of Policy Change**

Policies that undermine consumer demand by offsetting its low price with penalties, such as car impoundment, could be effective at reducing Quadrant 3 types of smuggling. Furthermore, if policies are aimed at individuals selling illicit cigarettes informally, the incentive to participate in the trade might be weakened. Public awareness campaigns highlighting the illegal and hazardous nature of illicit cigarettes from other countries may also reduce the contraband market, though key informants were mixed on the impact that these campaigns would have.

Several key informants fear that this quadrant symbolizes the future of contraband tobacco. The combination of global trade as well as continual declines in brand recognition might move consumer demand towards cheap tobacco, regardless of the form or country of origin. Given the cross-border nature of contraband trade, key informants suggested that some weakly regulated states might become hubs of illicit tobacco production. Policymakers in affected jurisdictions will have few options other than to better control points of entry, and pressure those states to crack down on illegal production.

### **Quadrant 4: Illegal Products Distributed Domestically**

Quadrant 4 of the raw context table (Table 9) addresses illegal tobacco products (without a license or registration) that are distributed within one jurisdiction. Likely some form of licensing or registration already exists, delineating a distinction between legal and illegal manufacturing operations. Analysis of this quadrant assumes that the manufacturer is purposely avoiding a legal responsibility to acquire a license, and is capable of doing so due to either lax enforcement, or legal complications. An example of this would be illicit manufacturers operating in Canada without a license on First Nations reserves.

Tobacco can also be grown illegally by unregistered or unlicensed growers, who may sell tobacco leaf to manufacturers or directly to consumers. In this case, growing tobacco is similar to the growing of marijuana, where authorities inspect suspected growers, and enforce penalties for engaging in such

activities. Officials in Australia speculate that this likely occurs among some of the previously licensed growers. This quadrant highlights the importance of enforcing compliance with existing laws (see Table 13). This, along with identifying illegal growing or production operations, is crucial to addressing the problem.

**Table 13: Policy Alternatives: Illegal Products Distributed Domestically**

Policy Problem	Policy Measure	
	High potential	Moderate potential
<b>Growers</b> <ul style="list-style-type: none"> <li>• Illegal growing of tobacco <ul style="list-style-type: none"> <li>▪ i.e. growing in Australia without a license</li> </ul> </li> <li>• Could also be grown for supplying unlicensed manufacturers</li> </ul>	Enhanced enforcement	
<b>Manufacturers/ Distributors</b> <ul style="list-style-type: none"> <li>• Illicit/unlicensed manufacturing <ul style="list-style-type: none"> <li>▪ i.e. Brazil, Canada, etc.</li> </ul> </li> </ul>	Enhanced enforcement	Licensing
<b>Retailers</b> <ul style="list-style-type: none"> <li>• Sales of illegal cigarettes <ul style="list-style-type: none"> <li>▪ i.e. baggies in Canada</li> </ul> </li> </ul>	<b>Licensing</b> <b>Tax Markings / Stamps</b> <b>Enhanced enforcement</b>	Public Awareness Campaigns
<b>Consumers</b> <ul style="list-style-type: none"> <li>• Purchases of illegal tobacco products from internet vendors</li> <li>• Purchases of illegal tobacco products from informal or illegal sources <ul style="list-style-type: none"> <li>▪ baggies in Canada, from pubs or “boot sales” in UK</li> </ul> </li> </ul>		Enhanced enforcement Public Awareness Campaigns

### **Growers**

Within the case studies, there were few examples of illicit tobacco growing, largely due to few jurisdictions having formal licensing regimes for growers. However, key informants from Australia did indicate that they continue to monitor for illicit tobacco growing, even after a country-wide buy-out of all growers which has made the growing of tobacco similar to the growing of other illegal crops such as marijuana. In this instance, enhanced enforcement/inspections appears to be the most prudent of policy measures, in order to adequately monitor previous tobacco growers and ensure that no crops are still being grown. This policy would also require coordination with other partners, to help identify illicit operations.

### **Potential Unintended Consequences of Policy Change**

It is unlikely that increased inspection and enforcement will generate unintended effects on growers because they are already government regulated.

### **Manufacturers/ Distributors**

Enhanced enforcement is the measure with the highest potential because it promotes the closure of a manufacturer in violation of regulatory laws. Key informants in Brazil have reported success in this

area. However, some political/legal barriers may exist, preventing a straightforward resolution. For example, Canadian First Nation manufacturers on reserves routinely invoke treaty rights in an attempt to exempt themselves from licensing regulations. Fostering cooperation between manufacturers and enforcement officials in order to adequately address the situation requires culturally sensitive negotiation.

An enhanced licensing regime can bring some illegal manufacturers into the regulatory system. As seen in the case study of Brazil, despite attempts by some manufacturers to produce illegal cigarettes, the Government has successfully defended their case for licensing in the courts, which has forced most tobacco product manufacturers to either comply with the license, or cease operations. Thus, there is some potential in acquiring legislative changes to the licensing regime when necessary, and subsequently penalizing those who fail to adhere to the requirements.

### **Potential Unintended Consequences of Policy Change**

Illegal manufacturers thrive when the licensing/regulatory framework of their jurisdiction is inadequately enforced, and politics play a role in enforcement. A good example of this is contraband manufacturing on First Nation reserves in Canada. Some on-reserve manufacturers argue that they are not subject to Canadian laws, and therefore what they are doing is not illegal.<sup>288</sup> Solving this issue might prove to be more political than policy-oriented, requiring either political will to enforce compliance, or negotiations to bring contraband manufacturers into the legal realm.

### **Retailers**

Policy alternatives in Quadrant 4 are very similar to Quadrant 3, with licensing, enhanced tax-paid markings/stamping, and enhanced enforcement all having high potential for addressing contraband activities. The ability to successfully identify contraband product through enhanced tax-stamps, coupled with the financial risks of losing a retail license can have a profound effect upon retailers' willingness to engage in the illicit trade.

Furthermore, for the same reasons as described in Quadrant 3, a public awareness campaign among retailers can have some impact by clearly outlining what products are legal, and how to spot illegal ones. Furthermore, given legal uncertainty in some cases such as Canada, outreach campaigns can outline the illegal nature of tax-exempt tobacco products sold off-reserve, and undermine retailer arguments of innocent ignorance.

<sup>288</sup> Canadian Broadcasting Corporation. (2006) "Shawn Brant Interview." *CBC News*. <http://www.cbc.ca/sunday/brant.html>; accessed 07 August 2008.

**Potential Unintended Consequences of Policy Change**

Similar to other quadrants, policies aimed at identifying contraband at retail, along with inspection and enforcement can help ensure the retail market is not flooded with illicit products. However, similar to Quadrant 3, many parallel informal networks of distribution usually exist also. Thus, greater penalties and intelligence on distribution networks is recommended.

**Consumers**

As indicated in Quadrant 3, both enhanced enforcement and public awareness campaigns will likely have only minimal impact on consumer willingness to purchase illicit cigarettes. However, in cases such as Canada where legal uncertainty exists around products manufactured by First Nations producers, public awareness campaigns can have some impact by clearly outlining what products are illegal. Many key informants held that consumer motivation to buy cheap cigarettes might supersede other concerns.

**Potential Unintended Consequences of Policy Change**

With consumers, enhancing penalties for possession of illicit tobacco products can have an effect, though many key informants noted a perception within the legal system that it is “just” tobacco, and therefore not as serious as the possession of other illicit products, such as drugs or weapons. Many consumers simply want a cigarette, and are not concerned about where it comes from, or how it tastes. Thus, policies might be better tailored towards addressing the manufacturers of the products, rather than the consumers.

Solving Quadrant 4 problems would likely shift the source of contraband from a domestic to an international producer. For example, if Brazil is able to eliminate all domestic illicit manufacturers, smuggled products from Paraguay will replace the lost domestic ones. Because of the continued demand, and the dynamism of the source, focusing only on domestic producers will likely not solve the problem in any given jurisdiction.

**Role Specific Policy Alternatives**

Each quadrant requires a different set of policies, while some interventions, such as enforcement, run throughout each context. The following tables highlight policy measures that are common to several (or all) quadrants, presenting an overall ‘better practice’ in anti-contraband measures for each entity, regardless of the context. As in the tables above, the policy measures are divided into the four quadrants, with an upper-case “X” symbolizing “high potential” policies and a lower-case “x” symbolizing policies with “moderate potential.” “High potential” policies received two points, while “moderate potential” policies received one point. It should be understood that this is not a scientific comparison, but useful for illustrative purposes.

**Tobacco Growers**

**Table 14: Ranked Policy Alternatives for Tobacco Growers**

Policy Alternative	Q 1	Q 2	Q 3	Q 4	TOTAL
Licensing	x	x			2
Tax marking/stamp					0
“Enhanced” tax stamp					0
Tracking and tracing					0
Record-keeping / control measures	x	x			2
Enhanced enforcement – investigations/seizures	X	x		X	5
Enhanced enforcement – border controls		X	X		4
Enhanced enforcement – inspection penalties					0
Export Taxation		X			2
Tax Harmonization					0
Tax agreements / compacts					0
Legal agreements					0
Memoranda of Understanding (MOUs)					0
Public awareness campaigns					0

Enforcement/inspection capacity is critical to ensuring that tobacco crops are not diverted to the illicit market. Improved inspection and monitoring are the most effective mechanisms to do this. Noted by Australian key informants, and mirrored by Canadian experience, it can often be difficult to prove that a tobacco grower is complicit in the diversion of tobacco and therefore monitoring may be the best way to do this. Control measures restricting the sale of tobacco to licensed/registered manufacturers are also useful tools in ensuring that growers themselves are held accountable for the use of their crop.

**Manufacturers/Distributors**

**Table 15: Ranked Policy Alternatives for Manufacturers/Distributors**

Policy Alternative	Q 1	Q 2	Q 3	Q 4	TOTAL
Licensing	x	x		x	3
Tax marking/stamp	X	x			3
“Enhanced” tax stamp					0
Tracking and tracing	X	X			4
Record-keeping / control measures	x				1
Enhanced enforcement – investigations/seizures	x	x		X	4
Enhanced enforcement – border controls		X	X		4
Enhanced enforcement – inspection penalties					0
Export Taxation		X			2
Tax Harmonization					0
Tax agreements / compacts					0
Legal agreements	x	X			3
Memoranda of Understanding (MOUs)					0
Public awareness campaigns					0

Several different policy measures can be implemented at the manufacturer/distributor level, depending on the context. For example, Quadrant 1 and 2 have more possible policy alternatives compared to 3 and 4, reflecting the legal versus illegal distinction in production sources. In Quadrant 1 and 2, each policy alternative, though different in nature, serves a similar end, which is greater accountability and transparency of tobacco distribution. In a cross-border setting tracking and tracing helps provide information and investigation capacity to control supply-chains, whereas the same policy in a domestic setting serves a production monitoring and tax-collection purpose.

Similarly, legal agreements can have a strong effect in Quadrant 2 (and a minor impact in Quadrant 1), where the obligations and penalties of licensed manufacturer can be explicitly outlined and agreed upon, as in the EU agreements. Here, the incentive to participate in the illicit market (or engage in weak supply-chain controls more generally) is undermined, minimizing the role that tobacco manufacturers might play in smuggling.

Enforcement activities are important in all quadrants, but the nature of investigations will be different depending on the context. Enforcement in Quadrant 1 would focus on production over-runs and lax supply-chain controls within one jurisdiction; enforcement in Quadrant 2 would focus on tobacco manufacturer distribution practices and their role in supplying tobacco smugglers worldwide; enforcement in Quadrant 3 would focus on increasing border controls to prevent product from entering the country; and enforcement in Quadrant 4 would focus on locating domestic illicit manufacturing sites, and shutting them down, with less focus on the activities of the manufacturers themselves. Thus, the term ‘enforcement’ takes on different practical meaning depending on the context, and the specific needs of policymakers.

## **Retailers**

**Table 16: Ranked Policy Alternatives for Retailers**

<b>Policy Alternative</b>	<b>Q 1</b>	<b>Q 2</b>	<b>Q 3</b>	<b>Q 4</b>	<b>TOTAL</b>
Licensing	X	X	X	X	8
Tax marking/stamp	x	X	X	X	7
“Enhanced” tax stamp	X		X	X	6
Tracking and tracing	X				2
Record-keeping / control measures	x				1
Enhanced enforcement – investigations/seizures					0
Enhanced enforcement – border controls					0
Enhanced enforcement – inspection penalties	X	X	X	X	8
Export Taxation					0
Tax Harmonization					0
Tax agreements / compacts	X				2
Memoranda of Understanding (MOUs)					0
Legal agreements					0
Public awareness campaigns	x		x	x	3

Licensing and enhanced inspection are considered the most effective anti-contraband measures directed at retailers. However, the feasibility of licensing retailers is low in some jurisdictions. In cases where retailers are too plentiful or mobile for licensing, officers should still have sufficient inspection/seizure capacity to penalize the retailer in a meaningful way, potentially restricting the ability to sell any products.

The use of tax-paid markings and enhanced anti-counterfeit markings may have the greatest effect at the retail level, where such markings can ensure that contraband products are not sold openly at retail outlets, but are forced to informal areas. While enforcement and seizures are more difficult to execute in the informal retail sector, these policies at least ensure that formal retail outlets are not saturated with illicit products, making these products easy for the average consumer to access.

**Consumers**

**Table 17: Ranked Policy Alternatives for Consumers**

Policy Alternative	Q 1	Q 2	Q 3	Q 4	TOTAL
Licensing					0
Tax marking/stamp					0
“Enhanced” tax stamp					0
Tracking and tracing					0
Record-keeping / control measures	x	x			2
Enhanced enforcement – investigations/seizures	x	X	x	x	5
Enhanced enforcement – border controls		X	x		3
Enhanced enforcement – inspection penalties					0
Export Taxation					0
Tax Harmonization					0
Tax agreements / compacts					0
Memoranda of Understanding (MOUs)					0
Legal agreements					0
Public awareness campaigns	x		x	x	3

The findings of this study suggest that demand-side policy interventions can influence consumer purchasing patterns. For example, the UK case study showed that hefty penalties for cross-border shopping/bootlegging were an effective deterrent for casual bootleggers. Furthermore, due to a lack of penalties and dishonesty on the part of some retailers, many Canadian consumers assume that it is legal to purchase tax-exempt products, or even baggies of cigarettes. Therefore, publicizing strict penalties (such as vehicle seizures, large fines, etc.) can deter some individuals from participating.

Public awareness campaigns aimed at undermining contraband tobacco may also influence purchasing patterns, though they remain a matter of debate given the potential unintended consequences of this approach, described above.

## **Section Five: Concerns Unique to the Canadian Context**

Parts of Canada and the United States face unique issues related to the production and sale of contraband tobacco by First Nations or Native Americans. This section describes anti-contraband policy measures in the context of Canadian First Nations.

### **Expert Focus Panel with First Nations**

As mentioned earlier, the authors were not successful at making contacts with First Nations key informants, and therefore were not able to include a case study of Canadian First Nations in this report. Fortunately, near the end of the project, several First Nations key informants agreed to participate in an expert focus panel, specifically tailored to First Nations perspectives on anti-contraband tobacco policy measures. The expert focus panel revealed new and unique concerns about the feasibility and likely effects of various anti-contraband policy measures in this context.

#### ***Economics***

Perhaps the most salient theme during the Expert Focus Panel was the economic impact that the tobacco trade has on-reserve, and the significant negative economic impact that a crackdown on contraband would have. Because First Nations communities are often small and remote, tobacco retailers have to rely on providing lower prices as a way to entice customers. The tobacco trade, both legal and illegal, was identified as a funding source for community initiatives such as day cares and libraries by panel members, and was described as an essential source of income for some reserves. Apparently, even if controlling contraband was a priority for First Nations communities, panel members indicated that it would not be financially feasible currently, as many reserves are poor and have no other significant sources of income.

Panel members argued that due to government practice of cutting First Nations' funding whenever extra cash flows in, there is little incentive for equalizing tax rates in order to inject the tax revenue back into the community. Collectively, participants felt that implementing tax harmonization on reserves would prevent First Nation prosperity and keep communities trapped in the cycle of poverty.

#### ***First Nations' Autonomy***

First Nations' right to self-govern was strongly emphasized during the focus panel. Participants expressed a perception that the Canadian government does not genuinely respect First Nations' sovereignty, paying lip-service to the notion while behaving otherwise in practice. They noted that the First Nations community is suspicious of government attempts to partner with them on anti-contraband tobacco measures, as past experience shows that the partnership only works as long as First Nations comply with what they are told by government.

Panelists suggested that First Nations communities have a stake in reducing on-reserve criminal activities. According to panelists, some communities have already implemented their own tobacco law with community-based licensing and oversight, though the extent of these community-based regulations was not widely known. All panel members vehemently stated that First Nation community autonomy must be maintained, therefore any new compacts would have to be endorsed, executed, and enforced by the community.

Sensitivities about taxation and use of the term ‘taxation’ emerged as an important concern. Participants noted that First Nations are often ideologically opposed to collecting taxes from citizens, and do not want to take on roles as tax collectors. In order to achieve First Nations buy-in, the language used in discussions has to reflect this. For example, a policy term like tax-harmonization can be re-phrased as a band rule requiring that a set percentage of every tobacco sale is to be given back to the community. Panel members noted that some communities impose levies or fees, which although serving the same purpose of a tax, does not carry the same linguistic baggage. Non-First Nation key informants in Manitoba echoed these concerns, noting that “band assessments,” which are applied to tobacco products, are not described as a tobacco tax. The language of policy solutions is important, and can be a step towards reconciling different perspectives.

### ***Perceptions of False Accusations***

Participants also expressed frustration with government allegations of First Nations involvement in organized crime. Some tobacco trade routes have existed for centuries and the tobacco trade was described as an integral part of reserve culture. It is considered a First Nations right. According to a panelist, one family may own a smoke shop and employ extended family members, involving up to 40% of the community in tobacco sale; therefore, selling tax-exempt cigarettes (to all customers, First Nations and non) is not perceived as criminal activity, but rather as a form of economic development.

Panel members felt that the emphasis on contraband tobacco as a revenue-generator for organized crime is considered a police-instigated, fear-mongering ploy to criminalize First Nations, and support police presence on-reserve. Therefore, categorizing First Nations tobacco traders as organized criminals closes the lines of communication.

Panelists noted that First Nations people are blamed for sale of tax-exempt tobacco products to non-First Nations people. Specifically, it is often non-First Nations people who deliberately make trips to reserves to purchase large quantities of tax-exempt tobacco products, and non-First Nations people often abuse on-reserve tax-exempt tobacco by selling it off-reserve. First Nations participants expressed opinions that their community is being unfairly criminalized by law enforcement and government. Given this perception, policies of collaboration and cooperation are therefore unlikely to get off the ground.

### ***Confusing Government Roles***

Collaboration between First Nations and government to find a solution to contraband is perceived as being encumbered by confusion about the roles of different levels of government and of various government agencies, according to panelists. Lack of communication between federal and provincial governments was cited, along with seemingly haphazard allocation of jurisdiction over First Nations' affairs. Panel members noted that Revenue Canada oversees tobacco taxation; Indian and Northern Affairs Canada oversees housing and economy, and provincial agencies also attempt to play a role. The numerous non-First Nation entities attempting to have a presence on-reserve was identified as a source of frustration for many panel members, especially given the perception of government infringement on First Nation sovereignty.

Another problem cited was law enforcement. Reserves fall under First Nations, provincial, and federal laws, which are sometimes at odds. Unless the other governments acknowledge First Nations supremacy of law and allow First Nation law enforcement, panel members suggested that law enforcement will remain ineffective. Allowing First Nations law enforcement also means investing in it, as one panelist posited that there are only approximately 2.5 First Nations police officers per community. Panel members argued that greater investments in First Nations police forces could lead to considerable improvement in addressing smuggling, as the enforcement presence would not be from the "outside," but by members of the community itself.

### ***Unequal Treatment of First Nations***

Participants identified unequal treatment by government as another barrier to collaboration. A specific example discussed is the quota system implemented in some communities, where on-reserve retailers may only purchase a specified quantity of tobacco for a given time period. Because non-First Nation retailers are not bound by any purchasing restrictions, participants viewed this as discriminatory. Participants also posited that quotas have the unintended consequence of creating a market for contraband because many retailers assume that a large supply of cigarettes must be purchased up-front. When retailers do not have the money to buy a month's supply of cigarettes (as they are often delivered on just one day per month) they purchase illicit cigarettes to maintain stock.

Another problem panelists associated with buying legal tobacco is that retailers sometimes experience difficulty collecting their tax rebate. Panel members argued that Revenue officials may question the authenticity of signatures, or demand additional paperwork.

Finally, participants shared their distaste for the treaty cards they are required to show before buying cigarettes (among other items). They considered it another way that the government can monitor their purchasing patterns.

### ***Education Needed***

Participants called for more education on both sides of the table. Government needs to be educated on First Nations' cultural tradition of 'community first,' while First Nations need to be educated on the health consequences of smoking and other resources they can use to bolster their economy. There needs to be an on-going, open-minded dialogue that seeks solutions tailored to the unique needs of different communities. Models that worked in New Brunswick, British Columbia, or the US may not be effective in Ontario, for example, and therefore creative, collaborative thinking is required. Policymakers have to approach this with sensitivity, being careful not to judge First Nations.

To summarize, the panelists indicated that the process undertaken has to be respectful of First Nations' nationhood and ability to set priorities. It was made clear that First Nations will resist any laws that are forcefully implemented, and therefore the Canadian government needs to be flexible, and negotiate with First Nations nation-to-nation.

### **First Nations' Tobacco Distributed Off-Reserve**

If First Nations reserves are considered sovereign nations, smuggling from reserves can be considered cross-border. Therefore, solutions proposed in Quadrant 2 are theoretically applicable. By law, First Nations are exempt from tobacco taxes. Through the quota or refund systems described in detail in Section Three, First Nation retailers can legally purchase tax-exempt tobacco to sell on reserve. The problem arises when this legal tobacco is smuggled off-reserve, "cross-border," to be consumed by non-First Nations tobacco users.

However, the policy options discussed thus far in this report would not likely prove effective, given the current tense political situation between First Nations communities and the Canadian government. Due to this political climate and in an effort to keep the tension from escalating, the Canadian government does not consistently enforce manufacturer or retailer regulations on-reserve. Were this not the case, recommendations such as enhanced enforcement, licensing, public awareness campaigns, and record-keeping would be recommended and likely prove effective, however given the situation, other measures would need to be implemented first to address the primary arguments revealed in the panel. Based on the issues raised by the panel, potential policy measures to address these issues are described below.

### ***Economic Development Plan***

As was stressed by First Nations key informants, the poor economic conditions on-reserve must be addressed. First Nations cannot be expected to surrender a prominent source of their revenue without being helped to transfer their economy onto something else. Specifically what this 'something' should be is outside the scope of the paper, although one possibility is to develop, in

concert with First Nations stakeholders, an economic development plan to help identify new sources of income and employment in exchange for co-operation about contraband. Panelists alluded that without a new revenue-generator, First Nations will continue to oppose government efforts to regulate tobacco on-reserve.

### ***Statement of First Nations Autonomy***

To address the concern raised by the panel that First Nations autonomy is not respected by government, a formal statement from government to the contrary may be required. At the start of the negotiation session, government representatives could attest to their commitment to uphold First Nations sovereignty in deciding their own affairs, define what they mean when they use the term “First Nations sovereignty,” and briefly outline how they will ensure that it remains top of mind throughout the negotiations. The language and wording used in this process should also be carefully chosen.

Another way to address this concern would be to encourage and assist more First Nations communities to implement their own tobacco laws, licensing, and oversight of on-reserve criminal activities. Part of this could involve educational campaigns on-reserve about the negative effects of the contraband trade.

Finally, it has been suggested that ratification of the FCTC treaty and implementation of tax harmonization by First Nations are both ways to augment First Nations autonomy. Voluntarily signing on to an international treaty in an effort to increase the health and wellness of on-reserve citizens and generate tax revenue that can be spent to further improve conditions on-reserve would make a bold statement of exercising autonomy as a nation.<sup>289</sup>

### ***Evidence-based Allegations***

A possible way to mitigate the perception of false accusations of First Nations involvement in organized crime would be for enforcement officers to become more transparent with their information and data collection methodology. Increased transparency and closer communication and collaboration between enforcement and band leaders would show that every effort has been made to confirm that all First Nations individuals accused of being part of organized crime actually are, and help prevent false accusations. In addition, the role that non-First Nation individuals play in smuggling tobacco off-reserve should also be flagged in published materials. In partnership with First Nations police, enforcement officers should publish all document evidence that contraband

<sup>289</sup> Physicians for a Smoke-free Canada. 2007. Towards effective tobacco control in First Nations and Inuit communities.

trade is present and thriving on reserves, highlighting the ways in which such trade fosters criminality on reserves.

### ***Clarify Government Roles***

One possible way to simplify First Nations dealings with both federal and provincial government Ministries is to have a single point of contact where all items for clarification are given to the same government official (or group of officials). Those officials would then locate the right Ministry and individual to contact about the issue, receive a response, and transmit the response back to First Nations in a timely manner. In addition, an index could be created and provided to all band councils that illustrates and describes the structural organization of all the government Ministries involved in Aboriginal affairs, displaying both their relationships to one another and First Nations.

### ***Quota System Unfair***

The concern about unequal treatment raised by panelists is of a dual nature. Panelists expressed displeasure that First Nations are subject to quota laws when purchasing cigarettes at both the wholesale and retail levels, and non-First Nations citizens are not. However, the fact that First Nations are allowed to purchase tobacco products tax free can also be seen as unequal treatment by other Canadians. One solution is to repeal section 87 of the *Indian Act*, and with it First Nations ability to purchase tax-exempt tobacco. All quotas could then be lifted and all Canadians would be treated equally. Although fair, this solution is not likely to garner political support.

### ***Health Promotion Education***

According to the panelists, First Nations need to be given the same access to information and opportunity to make informed health decisions as the rest of Canadians. The tobacco control triumphs logged by non-First Nation communities did not happen overnight. Rather, they have been the result of long and slow processes of incremental changes in social attitudes towards tobacco, facilitated by public health campaigns and anti-smoking policies. Now, many Canadians have chosen to quit smoking or simply not start. First Nations citizens should be educated about the dire health effects of smoking using similar methods. Education about the traditional, sacred use of tobacco is also recommended. However, given that First Nations' tobacco is often sold off-reserve to non-First Nations consumers, the health promotion impetus to prevent tobacco from being distributed off-reserve may not prevail over the profit motive inherent in such operations. The solutions presented require political impetus, patience, and firm commitment from both sides to negotiate and listen to one another. It will not be a short or easy process, but with perseverance will yield excellent long-term health and financial outcomes. Increased awareness of Canada's contraband problem among policymakers and the public can help to create momentum towards implementing these policies and getting the issue of contraband on the federal agenda.

## Section Six: Conclusions and Future Considerations

The likely effectiveness of anti-contraband policy measures is context dependent. Moreover, generally no single anti-contraband measure will solve the problem, rather a comprehensive, proactive, and reactive strategy is needed to address current problems and prepare for those of the future. International experience demonstrates that purveyors of contraband tend to seek new avenues through which to conduct their illicit business when policy measures succeed in limiting their success in existing approaches. For long-term success, anti-contraband policy must therefore be comprehensive, nimble and forward-looking.

Evidence from the literature, key informant interviews and expert focus panels indicates that each of the ten identified anti-contraband policy measures can make a contribution to contraband control in particular contexts. Contexts under which each anti-contraband measure has high potential for alleviating the problem are summarized below:

Enhanced enforcement was considered a high potential solution for growers in all four quadrants, manufacturers in quadrants 2, 3, and 4, retailers in all four quadrants, and consumers in quadrant 2. Enhanced enforcement can uncover growers who divert their product to the black market and prevent them from supplying manufacturers and smugglers further up the supply-chain. Enhanced enforcement also catches manufacturers involved in smuggling illegal product cross-border through better border control measures and intelligence sharing between jurisdictions. Among retailers, enhanced enforcement can strengthen penalties issued by retail inspectors and increase the number of inspections. Finally, for consumers enhanced enforcement can mean seizure of personal property such as vehicles, thereby acting as a strong deterrent to illegally buy tax-exempt tobacco.

Export taxation was considered a high potential solution for growers and manufacturers in quadrant 2. Export taxation deters growers from exporting product to be manufactured and distributed on the black market and for manufacturers, undermines profits made from smuggling duty-free, exported products back into the original country for sale.

Implementation of legal agreements was considered a high potential solution for manufacturers in quadrant 2 because legal agreements, coupled with mandatory penalties can motivate tobacco manufacturers to drastically improve their supply-chain controls.

Licensing was considered a high potential solution for retailers in all four quadrants because inspection and revocation of retail licenses are likely to be effective for monitoring retail outlets.

Public awareness campaigns did not emerge as a high potential solution in any context.

Record-keeping measures, such as distribution of tax-exempt eligibility cards, did not emerge as a high potential solution in any context.

Tax agreements were considered a high potential solution for retailers in quadrant 1 because equalizing the price of tobacco products in tax-exempt jurisdictions undermines tax evasion.

Tax harmonization did not emerge as a high potential solution in any context.

Tax marking/ stamping was considered a high potential solution for manufacturers in quadrant 1 and retailers in all four quadrants. Tax markings allow officials to easily differentiate duty-paid and tax-exempt product in manufacturer warehouses and identify what jurisdiction the product was from and where the product is destined to go.

Tracking and tracing was considered a high potential solution for manufacturers quadrants 1 and 2 and retailers in quadrant 1. Tracking and tracing allows real-time monitoring of tobacco product manufacture, thereby ensuring better supply-chain control.

### ***Prepare for Counterfeits***

One theme linking many key informant interviews was the apparent ease with which individuals are able to replicate overt tax-stamp markings. For this reason, key informants often noted that simple markings are rarely useful in addressing contraband; counterfeit versions can be created within a matter of weeks, if not days, depending on demand.

Adding covert markings to tax-stamps can play an important role in ensuring that goods can be identified as counterfeit by officials, even though counterfeit brands might look authentic. Measures to ensure that counterfeits are identifiable at the retail level can have important long-term effects against illicit tobacco.

### ***Prevent Contraband Sales at Retail***

Key informants also noted the importance of ensuring that all products sold in formal retail outlets are legal, and that the formal retail level is not compromised by contraband. While many case studies demonstrated that contraband often shifts easily to the informal distribution sector, key informants nevertheless held that mass-distribution along the informal networks is difficult, whereas selling contraband at registered/licensed retail outlets provides a much larger customer base and level of demand. Thus, policies such as tax-paid markings/stamps are important to ensure that only duty-paid products are sold at the retail level, and that the duty-paid status is immediately obvious. Enhancing tax-paid markings/stamps with covert anti-counterfeit markings ensures that retail outlets (knowingly or unknowingly) do not sell counterfeit goods, which are not easily identifiable by

the naked eye. An ability to license these retail outlets directly assists in inspecting retail stores, and therefore should be considered whenever feasible. Finally, even if retail outlets are not licensed, authorizing tobacco inspection officials to fully inspect retail outlets (including the back area) can further ensure that illicit products are not being sold.

### ***Promote Cooperation***

Anti-contraband tobacco measures are concerned with fiscal integrity, public health policy, and criminal enforcement, and involve numerous local, regional, national and international jurisdictions. Inter-agency cooperation, both internationally and domestically, is essential to comprehensively address contraband. The practice seen in Manitoba of partnering an RCMP and provincial officer to jointly conduct investigations could be considered by other jurisdictions. In these cases where intelligence is jointly collected, enforcement action can be simultaneous and better coordinated. While many other organizations noted that such arrangements do exist in their own jurisdictions, these were often on an ad hoc basis. Furthermore, several key informants noted the benefits of simply having representatives of different agencies occupy the same building, allowing for face-to-face interactions, and facilitating information networks.

### ***First Nations Collaboration***

A central concern within Canada has been the use of First Nation reserves as distribution networks, and more recently, as manufacture and retail points for contraband. There is too little communication between First Nations, policymakers, and advocate networks in Canada, which greatly reduces forums for discussing mutual concerns, and adequately understanding each other's perspectives. Mechanisms for greater consultation and buy-in to tobacco control and anti-contraband measures are a vital component to a long-term anti-contraband strategy in Canada, and should be a priority. Numerous advocates have cited the importance of First Nation tax harmonization in addressing contraband, but this measure continues to be met with sensitivity (and in some cases, opposition) among many First Nations. Mobilizing First Nation police forces is a promising approach as it fosters for community-based enforcement, rather than an outside-in approach.

There have been many small steps towards collaboration with First Nations on tobacco taxation. For example, the practice within New Brunswick of reimbursing on-reserve retailers for 95% of the provincial tobacco tax collected on sales to non-First Nations consumers provides incentive to ensure on-reserve retail compliance, while also building collaborative bridges. The experiences from Cowichan, Manitoba, and Washington State suggest that while the obstacles separating First Nations and policymakers might appear insurmountable, they are not, and each seemingly minor policy change broadens the policy development horizon towards more comprehensive and long-term engagements.

### ***Reduce Consumer Demand***

Anti-contraband measures must consider both the supply of contraband tobacco and the underlying consumer demand. Traditional supply-side policy measures may be less effective in combating the emerging illegal cigarette manufacturing phenomena. Thus, policymakers should also consider the demand side of the equation, including why consumers are purchasing contraband, how they have engaged in this activity, and what might help them stop. To this end, public awareness campaigns and individual penalties for possessing contraband are important steps, but especially in the latter case, are resource-intensive. Policymakers should also draw on the lessons and resources of broader tobacco control measures, and ensure that if smokers want to quit, they have adequate avenues to do so. Anti-contraband policies should complement existing tobacco control measures, in order to address the broader problem, which goes beyond smoking illegal cigarettes, to the fact that citizens are smoking at all.

### **Future Considerations**

#### ***Dynamic Nature of Contraband***

There is no single silver bullet to eliminate contraband tobacco, nor should one expect that successful policy implementation in one jurisdiction represents a best practice that will be equally successful in another jurisdiction. Policymakers should be particularly attentive to the methods of smuggling and production, to what entities are involved in the trade, and how successfully regulatory policies can curb these activities. This issue is laden with political overtones, and therefore attention must be paid to the political feasibility of different policies, in order to foster a long-term sustainable resolution.

A central theme within this document has been the multi-faceted nature of successful anti-contraband tobacco policies which requires combinations of regulation, fiscal/taxation policy, enforcement, and public awareness campaigns. Policies designed to address contraband tobacco must take into account the potential for unintended consequences on broader tobacco control measures, as the two are not always complementary in nature. For example, in Canada in the early 1990s sales tax cuts, higher export taxes, and regulatory measures significantly reduced the level of contraband tobacco but promoted higher smoking rates, especially among youth, representing a step backwards for tobacco control. Price cuts due to lowered taxes allowed tobacco companies to focus their efforts on expanding the legitimate tobacco market in Canada. Contraband tobacco policies should support general tobacco control measures, because, as some informants suggested, addressing one at the expense of the other is an unsustainable approach.

### **Brand Recognition**

Several key informants noted the growth of a market for baggies of loose cigarettes in Canada. Tobacco control measures such as advertising bans, public awareness campaigns, and point-of-sale display bans have had the cumulative effects of denormalizing traditional cigarette brands, stripping them of the social significance they once had. As big tobacco company brands have been denormalized, there has been growth in demand for “no-name” cigarettes and discount brands. This burgeoning demand has been filled by the contraband market through baggies and Native brands of cigarettes. The significance of this shift is twofold. First, it explains why baggies have not emerged significantly in other countries, especially the United States. Some suggest that brand recognition is stronger in the US than in Canada, and therefore smokers in the US would prefer to smoke brand name cigarettes (namely Marlboros), rather than no-name singles. Thus, there has been a rise in counterfeit Marlboros in the US, as well as cross-border smuggling (either by truck, or through internet sales), rather than baggie sales, despite suggestions that the US side of the Akwesasne is a major source of baggies in Canada. Second is the fact that policymakers may see baggies emerge in other countries also, as tobacco control policies have a continual impact, and smoking rates decline.

### **Ease of Transport**

Contraband tobacco is successful in carving out a market share is because it is both easy to manufacture and easy to smuggle. Some policy solutions propose controls on cigarette machinery or production-related products (such as tipping paper), but given the simplicity of transport and the huge demand for cigarettes, policymakers should be aware of the ability smuggling operations to remain dynamic. An interesting example of this is in the UK, where smugglers use the Royal Mail to ship individual components of counterfeit cigarette products, such as packaging, tobacco, or paper, to be collected and assembled at a single site.<sup>290</sup> These operations are a testament to the “cottage industry” possibility of contraband tobacco, which should be considered by policymakers.

### **Data Sources**

Transparent, public data on contraband tobacco is extremely limited, and in some jurisdictions, non-existent. One major recommendation of this paper is to make statistics and information regarding the tobacco trade and contraband tobacco much more available to the public, in order to assist with research and debate of this subject. For example, many jurisdictions (including Canada) do not provide official estimates of the size of the illicit market or comprehensive data on contraband tobacco seizures made by federal and provincial agencies, making it extremely difficult to evaluate and assess approaches in this area.

<sup>290</sup> Interviews with HMRC officials.

In contrast, the UK government should be applauded for its relatively open and accessible statistics on seizure activity and illicit market estimates. These data provide a clearer picture of the effects of different policies and the evolving nature of the trade. However, some key informants suggested that the data presented might be incomplete and therefore misleading. For example, strict reliance on seizure data might be inadequate, as seizure data is often directly tied to resources and intelligence, which is variable. Also, the apparent increases in counterfeit seizures might, as some key informants suggest, be a result of cooperation with the tobacco industry, which can provide biased data given the industry interest in protecting their market shares. Data that suggest a dramatic increase in counterfeit seizures does not always mean an increase in counterfeit activities as a whole, but instead a greater competency in identifying and seizing these goods. Seizure data should be complemented with overall illicit market estimates, in order to better understand the shape of the illicit market, rather than attempting to infer such data from seizures.

Another potential outcome of providing public data on contraband is increased public awareness, and by extension, political will. Since such data is often unavailable, it is difficult to make a compelling case or report based on anecdotal evidence, and “guess-timates.” Government estimates and data on contraband improve policymakers’ and researchers’ capacities to study the trade, and therefore can build better cases for political action, when the public has a sense of the scope of the problem and the size of financial losses.

## **Conclusion**

The recommendations we have made based on our findings match closely with the pending World Health Organization Framework Convention on Tobacco Control Intergovernmental Negotiating Body protocol on illicit trade (outlined fully in the background section). The issue of contraband requires the attention and insight of governmental and non-governmental actors. Increased funding is also needed for studies of the size, scope, and distribution of illicit tobacco in order to effectively address this problem. In providing a concrete analysis of common anti-contraband policies and documenting the contexts in which contraband is found, policymakers and researchers will have a better sense of how to approach contraband tobacco. Tobacco control policies have had a dramatic impact on smoking rates in the last decade. Yet contraband tobacco can and will undermine these public health gains if policymakers, academics, and advocates do not take action soon.

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## Appendix 2: Literature Search Terms and Databases

Database	Search Terms and Dates
<b>CBCA Reference</b>	<p>(tobacco or cigarettes) AND (smuggling or trafficking or counterfeit or contraband)</p> <p>Look for terms in: Citation and abstract Publication type: All publication types</p> <p><b>Dates:</b> August 2007 April 24 2008</p>
<b>ProQuest Database</b>	<p><i>(tobacco OR cigarette) AND (smuggling OR contraband OR evasion OR trafficking OR counterfeit)</i></p> <p><b>Dates:</b> April 24 2008</p>
<b>CDC Smoking and Health Database</b>	<p>"SMUGGLING" OR "CONTRABAND"/KW or trafficking or counterfeit/TI</p> <p><b>Dates:</b> April 2005 April 24 2008</p>
<b>Criminal Justice Abstracts</b>	<p>KW=(cigarettes or tobacco) and KW=(smuggling or trafficking or contraband) or KW=(counterfeit or anti*smuggling or anti*contraband)</p> <p>PY=1990-2007</p> <p><b>Dates:</b> February 22, 2007 April 24 2008</p>
<b>Ovid MEDLINE</b>	<ol style="list-style-type: none"> <li>1 cigarettes.mp. or exp Tobacco/ (25713)</li> <li>2 limit 1 to yr="1990 - 2007" (18161)</li> <li>3 exp Tobacco Industry/ or smuggling.mp. (2247)</li> <li>4 trafficking.mp. (15051)</li> <li>5 counterfeit.mp. (151)</li> <li>6 contraband.mp. (40)</li> <li>7 cigarette purchasing pattern.mp. (0)</li> <li>8 3 or 4 or 5 or 6 (17456)</li> <li>9 1 and 8 (549)</li> <li>10 limit 9 to yr="1990 - 2007" (547)</li> <li>11 (cigarette\$ or tobacco).m_titl. (27032)</li> <li>12 8 and 12 (1589)</li> <li>13 limit 13 to (english language and yr="1990 - 2007") (1517)</li> <li>14 ("cigarette smuggling" or "tobacco smuggling").mp. [mp=title, original title, abstract, name of substance word, subject heading word] (19)</li> <li>15 ("cigarette trafficking" or "tobacco trafficking").mp. [mp=title, original title, abstract, name of substance word, subject heading word] (0)</li> <li>16 "contraband cigarettes".mp. [mp=title, original title, abstract, name of substance word, subject heading word] (2)</li> <li>17 (cigarettes and internet).mp. [mp=title, original title, abstract, name of substance word, subject heading word] (40)</li> <li>18 "cigarette purchasing pattern".mp. [mp=title, original title,</li> </ol>

	<p>abstract, name of substance word, subject heading word] (0)</p> <p>19 15 or 17 or 18 (60)</p> <p>20 find similar to Cigarette purchasing behaviors when prices are high. (520)</p> <p>21 find similar to Turning off the tap: the real solution to cigarette smuggling (0)</p> <p>22 find similar to How can cigarette smuggling be reduced?. (510)</p> <p>23 from 20 keep 1-2,4-5,7-8,10-12,14,19-22,25-26,29-30,33,35,40-43,47-53,56,59-60 (34)</p> <p><b>Dates:</b> February 22 2007 April 24 2007</p>
<b>PAIS International</b>	<p>Last Search Query: DE=(tobacco or cigarettes) and KW=(smuggling or contraband or counterfeit)</p> <p><b>Dates:</b> February 22 2007 April 24 2007</p>
<b>SCOPUS</b>	<p>(TITLE-ABS-KEY(cigarettes OR tobacco) AND TITLE-ABS-KEY(smuggling OR contraband OR counterfeit OR "illicit trade" OR "cigarette purchasing pattern")) AND PUBYEAR AFT 1989</p> <p><b>Dates:</b> February 22 2007 April 24 2008</p>
<b>Web of Science</b>	<p>Topic=(cigarette* OR tobacco) AND Topic=(smuggling* OR contraband* OR counterfeit* OR evasion)</p> <p>Timespan=All Years. Databases=SCI-EXPANDED, SSCI, A&amp;HCI.</p> <p><b>Dates:</b> February 22 2007 April 24 2008</p>

### Appendix 3: Quality Assessment Framework

Author:

Title:

Reference:

Reviewer #1:

Reviewer #2:

**Overall Rating:** \_\_\_\_\_ (strong, moderate, or weak)

Rate each question according to whether this aspect of the study/article is **strong**, **moderate** or **weak**.

Components	Strong (2)	Moderate (1)	Weak (0)	N/A
<b>Study Design</b>				
1. Does the study have a clear and concise research question or aim that is important to advancing the field?				
2. Was the study design appropriate for the research question or aim?				
<b>Context</b>				
3. Was the context clearly described?				
4. Was the policy or intervention clearly described?				
<b>Data Collection Method</b>				
What data collection methods were used?				
5. Were the data collection methods appropriate for the research question or aim?				
6. Were the data collection methods described in enough detail for someone to be able to replicate the approach?				
7. Does the information collected have sufficient detail and depth to answer the research question or aim?				
<b>Data Analysis</b>				
9. Were appropriate methods used for analyzing the data?				
10. Does the analysis provide a 'deeper understanding' of the issue being addressed – i.e., involve interpretation, not merely counting the frequency of events or categories?				

List reasons why:				
<b>Components (cont'd)</b>	<b>Strong (2)</b>	<b>Moderate (1)</b>	<b>Weak (0)</b>	<b>N/A</b>
11. Were alternative explanations to the analysis discussed or accounted for?				
<b>Findings</b>				
12. Was there a clear statement of the findings?				
13. Was there adequate discussion of the evidence both for and against the conclusions?				
14. Do the researchers discuss contribution the study makes to existing knowledge?				
15. Have assumptions and limitations been clearly stated?				
16. Do the researchers identify new areas (questions) where research is necessary?				
<b>Practicality</b>				
17. Does the study advance our understanding of the question being asked or issue being addressed?				
18. Can the findings be generalized/transferred to other contexts and settings?				
<b>Total Score</b>				
<b># of Items Scored (omit items marked N/A)</b>	<b>(max. score )</b>			
<b>Percentage</b>				

**Scoring Legend:**

Study designated :

*Strong:* 72% or more (13 – 18) of individual item ratings are in this category

*Moderate:* 50-72% (9-12)

*Weak:* 50% or less (under 9)

**Reviewers**

Is there a discrepancy between the two reviewers with respect to ratings? Yes  No

If yes, indicate the reasons for the discrepancy.

Oversight

Differences in interpretation of criteria

Differences in interpretation of study

## Appendix 4: First Nations that have Implemented the FNT

First Nation	Listed Products		
	Alcoholic Beverages	Fuel	Tobacco Products
Westbank (BC)	x September 1, 1999	x September 1, 1999	x February 1, 1998
Kamloops (BC)	x September 1, 1998	x September 1, 1998	x September 1, 1998
Sliammon (BC)		x September 1, 1999	x September 1, 1999
Chemainus (BC)	x September 1, 2000	x September 1, 2000	x September 1, 2000
Buffalo Point (Manitoba)	x October 1, 2000	x October 1, 2000	x October 1, 2000
Adams Lake (BC)	x May 1, 2001	x May 1, 2001	x May 1, 2001
Tzeachten (BC)	x July 1, 2001	x July 1, 2001	x July 1, 2001
Shuswap (BC)	x February 1, 2002	x February 1, 2002	x February 1, 2002
Cowichan (BC)	x June 1, 2002	x June 1, 2002	x June 1, 2002
Whitecap Dakota (Sask)	x June 1, 2004	x June 1, 2004	x June 1, 2004

Source: Canada Revenue Agency. (2008) *First Nations Tax*. Government of Canada. 03 January 2008. [http://www.cra-arc.gc.ca/E/pub/gp/rc4072/rc4072-e.html#P217\\_23662](http://www.cra-arc.gc.ca/E/pub/gp/rc4072/rc4072-e.html#P217_23662). Accessed 14 March 2008.

## Appendix 5: First Nations that have Implemented the FNGST

First Nation	Lands	Effective date
Champagne and Aishihik First Nations (Yukon)	Settlement lands of the Champagne and Aishihik First Nations under the Champagne and Aishihik First Nations Final Agreement and the <i>Yukon First Nations Land Claims Settlement Act</i> , S.C. 1994, c. 34	July 1, 2004
First Nation of Nacho Nyak Dun (Yukon)	Settlement lands of the First Nation of Nacho Nyak Dun under the First Nation of Nacho Nyak Dun Final Agreement and the <i>Yukon First Nations Land Claims Settlement Act</i> , S.C. 1994, c. 34	July 1, 2004
Little Salmon/ Carmacks First Nation (Yukon)	Settlement lands of the Little Salmon/Carmacks First Nation under the Little Salmon/Carmacks First Nation Final Agreement and the <i>Yukon First Nations Land Claims Settlement Act</i> , S.C. 1994, c. 34	July 1, 2004
Selkirk First Nation (Yukon)	Settlement lands of the Selkirk First Nation under the Selkirk First Nation Final Agreement and the <i>Yukon First Nations Land Claims Settlement Act</i> , S.C. 1994, c. 34	July 1, 2004
Ta'an Kwach'an Council (Yukon)	Settlement lands of the Ta'an Kwach'an Council under the Ta'an Kwach'an Final Agreement and the <i>Yukon First Nations Land Claims Settlement Act</i> , S.C. 1994, c. 34	July 1, 2004
Teslin Tlingit Council (Yukon)	Settlement lands of the Teslin Tlingit Council under the Teslin Tlingit Final Agreement and the <i>Yukon First Nations Land Claims Settlement Act</i> , S.C. 1994, c. 34	July 1, 2004
Tr'ondëk Hwech'in First Nation (Yukon)	Settlement lands of the Tr'ondëk Hwech'in First Nation under the Tr'ondëk Hwech'in First Nation Final Agreement and the <i>Yukon First Nations Land Claims Settlement Act</i> , S.C. 1994, c. 34	July 1, 2004
Vuntut Gwitchin First Nation (Yukon)	Settlement lands of the Vuntut Gwitchin First Nation under the Vuntut Gwitchin First Nation Final Agreement and the <i>Yukon First Nations Land Claims Settlement Act</i> , S.C. 1994, c. 34	July 1, 2004
Kluane First Nation (Yukon)	Settlement lands of the Kluane First Nation under the Kluane First Nation Final Agreement and the <i>Yukon First Nations Land Claims Settlement Act</i> , S.C. 1994, c. 34	January 1, 2005
Tlicho First Nation (Northwest Territories)	Tlicho lands and Tlicho community within the meaning assigned by the Land Claims and Self-Government Agreement among the Tlicho, the Government of the Northwest Territories and the Government of Canada, signed on August 25, 2003 and approved, given effect and declared valid by the <i>Tlicho Land Claims and Self-Government Act</i> , as that Agreement is amended from time to time. Behchokö (Rae-Edzo), Whati (Lac la Martre), Gamèti (Rae Lakes), Wekweèti (Snare Lake)	December 5, 2005
Tsawout First Nation (BC)	Reserve of the Tsawout First Nation	October 1, 2006
Kwanlin Dun First Nation (Yukon)	Settlement Land of the Kwanlin Dun First Nation under the Kwanlin Dun First Nation Final Agreement and the <i>Yukon First Nations Land Claims Settlement Act</i> , S.C. 1994, c. 34	August 20, 2007
Inuit, within the meaning assigned by the Agreement, as defined in the Labrador Inuit Land Claims Agreement Act, S.C. 2005, c. 27 (Newfoundland and Labrador)	Labrador Inuit Lands and Inuit Communities, within the meaning assigned by the Agreement, as defined in the <i>Labrador Inuit Land Claims Agreement Act</i> , S.C. 2005, c. 27	August 20, 2007
Carcross/Tagish First Nation (Yukon)	Settlement lands of the Carcross/Tagish First Nation under the Carcross/Tagish First Nation Final Agreement and the <i>Yukon First Nations Land Claims Settlement Act</i> , S.C. 1994, c. 34	December 17, 2007
Akisqnuq First Nation (BC)	Reserves of Columbia Lake, other than the reserve designated as St. Mary's No. 1A	January 1, 2008
Lower Kootenay Indian Band (BC)	Reserves of Lower Kootenay, other than the reserve designated as St. Mary's No. 1A	January 1, 2008
Shuswap First Nation (BC)	Reserve of Shuswap First Nation	January 1, 2008
St. Mary's Indian Band (BC)	Reserves of St. Mary's, other than the reserve designated as St. Mary's No. 1A	January 1, 2008
Tobacco Plains Indian Band (BC)	Reserves of Tobacco Plains, other than the reserve designated as St. Mary's No. 1A	January 1, 2008

Source: Canada Revenue Agency. (2008) *First Nations that have Implemented the FNGST*. Government of Canada. 03 January 2008. <http://www.cra-arc.gc.ca/tax/business/topics/gst/indian/fngstapp-e.html>. Accessed 14 March 2008.