

CONTROLLING ILLCIT TOBACCO TRADE:



A GLOBAL REVIEW OF COUNTRY EXPERIENCES

CANADA: CONTROLLING ILLICIT TOBACCO TRADE

TECHNICAL REPORT OF THE WORLD BANK GROUP
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CANADA

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Controlling Illicit Tobacco Trade

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Chapter Summary

The tobacco industry instigated illicit tobacco trade in Canada in the 1990s in response to tobacco tax increases at both the federal and provincial levels. To illegally avoid these taxes, tobacco companies exported tobacco products over the border to the United States and engaged some Indigenous communities adjacent to the border in smuggling these products back into Canada and selling them untaxed. The tobacco companies admitted to this activity in an out-of-court settlement with the Canadian government and paid fines totaling \$1.7 billion.

To curb illicit tobacco activity in the 1990s, Canadian governments lowered taxes considerably, resulting in confirmed substantial increases in youth initiation and tobacco consumption.

The involvement of some Indigenous communities makes Canada's illicit tobacco market distinctive. Nation-to-Nation sensitivities between Indigenous communities and Canadian governments and the exemption of First Nations people from paying sales taxes on tobacco products constitute an important backdrop against which the illicit tobacco market operates. The Royal Canadian Mounted Police estimates that some 80 percent of illicit tobacco

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originates in border reserves in the provinces of Ontario and Quebec, while most of the remainder is counterfeit product shipped from ports in Asia to the province of British Columbia on Canada's west coast.

Government estimates of the size of the illicit tobacco market are sporadic and outdated. After control efforts all but eliminated illicit tobacco trade following the initial spike in the 1990s, independent estimates suggest that a substantial increase in illicit tobacco use occurred between the early 2000s and around 2008, followed by a gradual decline. Official estimates from Statistics Canada indicate that illicit tobacco reached 39 percent of total tobacco sales in 2008/9 and decreased to 32 percent in 2010/11. More recent estimates from independent non-governmental sources suggest that illicit tobacco has decreased to somewhere around 15 percent of the market in recent years.

Federal and provincial governments have implemented a panoply of policies to curb illicit tobacco, including: licensing; marking/labeling; export taxation; allocation/quota and refund/rebate systems for reserves where First Nations people are exempt from sales taxes on tobacco; tax harmonization agreements with reserves; and, enforcement efforts.

While anti-illicit tobacco measures have done much to reduce and contain the problem, illicit tobacco continues to constitute a substantial share of the tobacco market. The tobacco industry uses fears of stimulating illicit activity to dissuade Canadian governments from substantial tobacco tax increases and from advancing other tobacco control policies.

Canadian governments have been hesitant to adequately address illicit cultivation, manufacture, and sale of tobacco products by some Indigenous communities. This is apparently due to understandable sensitivities around Nation-to-Nation relations and fears of sparking violent confrontations.

More can be done by Canadian governments to curb the illicit tobacco market, including: instituting tax refund/rebate systems for on-reserve retailers in Ontario and Quebec to replace the allocation/quota systems; working with affected Indigenous communities to develop alternative sources of revenue; enforcing existing stipulations in cooperation with the leadership and enforcement arms of relevant Indigenous communities; implementing an effective track-and-trace system not influenced by the tobacco industry; and publishing annual reports on the size of the illicit market and on measures to combat illicit tobacco.

1. Introduction

Canada has a non-illustrious history of trade in illicit tobacco and of policy measures to curb illicit activity. Partially it is a story of tobacco-industry instigation and manipulation. Partially it is about uninformed, insufficient, and ineffective government policy response. Some of Canada's Indigenous communities play a major role in the unfolding drama. Nation-to-Nation sensitivities between Indigenous communities and Canadian governments constitute an important backdrop against which the story plays out. Incremental and symbolic policy

solutions have recently yielded some positive results. However, illicit tobacco continues to affect the Canadian market. Policy players have yet to take the thoughtful and courageous steps needed to solve the problem, and ultimately to save the lives of tens of thousands of Canada's people. Canada has yet to sign the Framework Convention on Tobacco Control (FCTC) Protocol to Eliminate Illicit Trade in Tobacco Products.

2. Unique Characteristics of Illicit Tobacco in Canada

Illicit tobacco presents considerable challenges to Canadian tobacco control efforts. Even conservative analyses estimate that illicit tobacco constitutes some 15 percent of the market. According to the Royal Canadian Mounted Police (RCMP), the lion's share of untaxed tobacco trade occurs in central Canada. Some indigenous communities engage in manufacture, distribution, and sale of illicit tobacco, "often exploiting the politically sensitive relationship between those communities and various governments and enforcement agencies" (Royal Canadian Mounted Police 2008). Certain indigenous communities in the vicinity of the borders of southwest Ontario, southeast Quebec, and New York State are at the epicenter of this activity. Supply from these areas reaches as far as the Atlantic and Northwest regions of the country. Counterfeit cigarettes present a much smaller, though not insubstantial, challenge in British Columbia, where ports facilitate commerce with Asia (Sweeting, Johnson & Schwartz 2009).

In Canada, a majority of illicit cigarettes are reportedly manufactured on four aboriginal reserves located in areas that border Ontario, Quebec, and New York State (Physicians for a Smoke-Free Canada 2010; Non-Smokers' Rights Association 2009). Government sources suggest that these manufacturers are the source for over 90 percent of contraband seizures in Canada (RCMP 2008; Framework Convention Alliance 2008). Cigarettes made and/or sold on reserves can cost substantially less than those bought from traditional retail outlets: as little as \$6 versus an average of \$80 in Ontario and \$73 in Quebec for a carton of 200 cigarettes (Non-Smokers Rights' Association 2012).

Under Canadian law, First Nations people purchasing cigarettes on reserves are exempt from direct taxes on personal property which include provincial tobacco taxes (paid by consumers) and both federal and provincial sales tax. Non-First Nations people purchasing cigarettes, even on reserves, are subject to all taxes. There is no First Nations exemption from the Federal Government's excise tax, paid by manufacturers. In order to regulate the supply of tax-exempt tobacco products on reserves, Ontario uses an allocation system that predetermines the quantity of tax-exempt products to be distributed to reserve retailers, based on population and consumption estimates. However, this policy is often circumvented by shipment of products manufactured on reserves to reserve retailers (Sweeting, Johnson & Schwartz 2009). The federal and provincial governments have undertaken measures to

decrease the supply of illicit tobacco, but the impact and consequences on contraband use are unknown (Schwartz & Johnson 2010).

3. Estimating and Guestimating the Extent of the Problem

There are wide variations in estimates of the prevalence of illicit tobacco use in Canada, with reports using different definitions and a variety of methodologies. No research has examined potential self-reporting bias associated with contraband tobacco; given its illegality, smokers may under-report illicit tobacco use. As in other countries, the tobacco industry and its allies publish estimates which independent review suggests are unreliable. Euromonitor estimates are also suspect, as studies suggest that they have been adjusted to accord with industry claims that increases in tobacco taxation have led to increases in illicit tobacco (Guindon, Burkhalter and Brown 2017).

An independent Canadian source, Physicians for a Smoke-Free Canada, estimates illicit consumption by comparing government data on tax-paid cigarettes sales with self-reported survey data on number of cigarettes smoked. According to these estimates, the proportion of illicit cigarettes consumed across Canada grew from 10 percent in the early 2000s, peaked at some 30 percent in 2007/8, and decreased to as little as 11 percent in 2011 (Guindon, Burkhalter and Brown 2017; Physician for a Smoke-Free Canada 2010). Estimates from Statistics Canada, the official government agency, suggest a somewhat different trend, with illicit sales as a share of total tobacco sales increasing to about 39 percent in 2008 and 2009, then decreasing to about 32 percent in 2010 and 2011 (in Guindon, Burkhalter and Brown 2017). The upward trend to 2007 and 2008 is supported by analysis of survey data reporting the source of respondents' last cigarette purchase as being a First Nations reserve. The proportion of respondents indicating that their last purchase occurred on a reserve increased from 2 percent in 2002 to 10 percent in 2007/8 (Guindon et al 2014). Guindon, Burkhalter and Brown (2017) note that:

Recent estimates suggest conflicting trends. One set of self-reported data suggested a steep increasing trend in cigarette contraband in Canada, and Ontario in particular, peaking at about 40 percent in late 2014, while other estimates suggested that cigarette contraband in Ontario actually declined by more than 1/3 from 2008 to 2012.

A recently published critical re-analysis of data from several sources concludes that Canada experienced a substantial increase in illicit tobacco use between the early and late 2000s and that, since then, there has been a decline, particularly in the province of Quebec (Guindon, Burkhalter and Brown 2017).

In both Ontario and Quebec, the two provinces where the bulk of the problem lies, estimates of the size of the illicit tobacco market vary widely. The population of Ontario and

Quebec combined is 22.6 million, some 62 percent of the entire Canadian population of 36.7 million (Statistics Canada 2018). The number of smokers in these two provinces was recently estimated to be 3.16 million, compared with 5.04 million across Canada (Ontario Tobacco Research Unit 2018). In Ontario, estimates of the prevalence of the illicit market range from 14 to 42 percent of all cigarettes bought by adult smokers (Luk et al. 2009; Physicians for a Smoke-Free Canada, 2010). One Ontario study found that 11.5 percent of current smokers usually bought cigarettes on reserves, and 25.8 percent had bought cigarettes from reserves in the past 6 months (Luk et al. 2009). In Quebec, illicit trade prevalence estimates range from 31 percent in 2007 and 20 percent in 2010-11 to 37 percent (Commission des finances publiques 2012). A representative survey conducted in 2010 by Institut de la Statistique du Québec (ISQ) estimated illicit tobacco consumption at 13 percent among those aged 15 and older (Laprise & Bordeleau 2010). This survey showed 52 percent of contraband users purchased baggies (Ziploc bags of 200 cigarettes) (Laprise & Bordeleau 2010). According to 2010 CTUMS data, 14 percent of Canadian current smokers reported purchasing cheaper cigarettes on First Nations reserves in the past 6 months and 2 percent reported purchasing smuggled cigarettes in the past six months (Tobacco Informatics Monitoring System (TIMS) 2012).

Evidence about the role of socio-economic status (SES) and other demographic factors in illicit tobacco behaviors is mixed and inconclusive. In an Ontario study, smokers of illicit cigarettes were more likely to be over the age of 45, female, have lower educational attainment, live in a rural area, be highly nicotine dependent, have no intention to quit, and to perceive themselves as highly addicted (Luk et al. 2009). A Quebec study, however, found that males were more likely than females to smoke illicit cigarettes (17 percent vs 8 percent). Survey data suggest that youth may be particularly prone to using illicit tobacco. According to one survey-based estimate, daily smokers in Ontario of high school age obtained 43 percent of their cigarettes from illicit sources (Guindon, Burkhalter and Brown 2017).

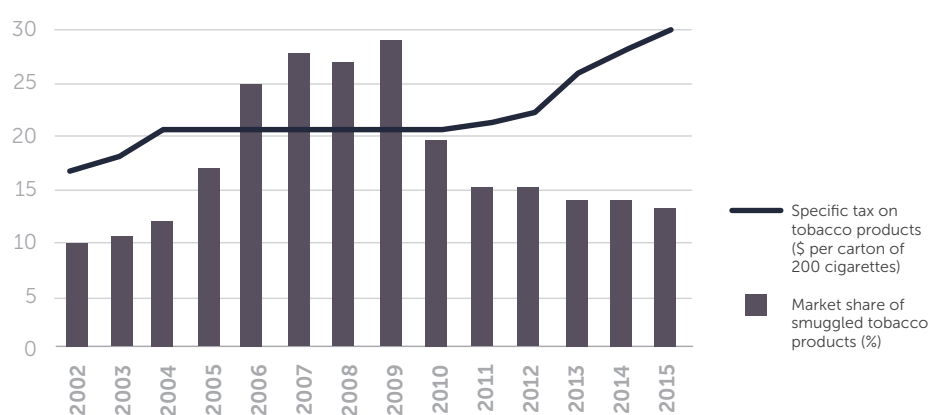
In 2008, Ontario's Auditor General found that the illegal tobacco trade cost the province \$500 million in foregone revenue - enough to cover the provincial budget deficit for the year (Schwartz and Johnson 2010).

Quebec's relative success in decreasing illicit tobacco consumption has been attributed to a concerted and coordinated enforcement effort with substantial funding (see below, Enforcement). The ACCES Tabac (Actions Concertées Pour Contrer les Économies Souterraines / Concerted Action Program to Counter the Underground Economies) Tobacco Program initiative aims to dismantle smuggling networks and to reduce tax revenue losses associated with illicit tobacco trade. The Quebec government credits ACCES Tabac with making substantial inroads in decreasing smuggling and in increasing tobacco tax revenue. According to the Quebec Ministry of Finance, tobacco tax revenue increased from \$654 million in 2008-2009 to \$1,026 million in 2013-2014 – a period during which the prevalence of tobacco use did not increase (Zhang & Schwartz 2015). The illicit market share decreased, according to the Quebec Ministry of Finance, from some 30 percent in 2009

to less than 15 percent in 2012 (Figure 1). It has held steady or declined slightly more since 2012 despite three tax increases (Zhang & Schwartz 2015), providing strong evidence that efforts to improve tax administration and enforcement are much more important than taxes in determining the illicit market share.

Figure 1. Change in the Rate of the Specific Tax on Tobacco Products and in the Market Share of Smuggled Tobacco Products, Quebec, 2002-2015

(dollars per carton of 200 cigarettes and per cent)



Sources: Statistics Canada, Sureté du Québec and Ministère des Finances du Québec.

4. Tobacco Control in Canada – A Brief Summary

Since the 1990s, Canada has gradually adopted a fairly robust spectrum of tobacco control measures. On most of the WHO MPOWER indicators, Canada scores fairly well. MPOWER consists of six indicators that include monitoring prevalence data (M), smoke-free policies (P), cessation programs (O), health warnings on cigarette packages and anti-tobacco mass media campaigns (W), advertising bans (E), and taxation (R). The distribution of power between national and provincial/territorial governments leaves considerable authority for tobacco control in the hands of provincial and territorial governments (Canada has 10 provinces and 3 territories.) The federal government regulates tobacco products, restricts marketing, and charges excise taxes. It also invests in research, surveillance, and public education and in promoting cessation and prevention programming. Provinces and territories have taken the lead in smoke-free policies, cessation programming, prevention measures, and tobacco sales taxes while also investing in public education. Moreover, municipal governments play a major role, particularly in relation to protection from second-hand smoke and to a degree regarding retail sales.

Federal agencies are charged with preventing smuggling across international borders and work with provincial agencies in combatting illicit tobacco activity.

A 2014 analysis gave Canada a score of 24 out of 29 on an MPOWER scale, demonstrating that Canada has largely met minimum standards in the areas of monitoring, smoke-free policies, health warnings on cigarette packages, and advertising bans, but fared somewhat less well on anti-tobacco mass media campaigns and taxation (Dubray et al. 2014).

Canada has been a pioneer and an early adopter of some of the most important tobacco control measures that are both included in and go beyond MPOWER. It was one of the first countries to introduce graphic warning labels and among the first to extend smoking restrictions to all indoor public places and workplaces, to ban point of sale promotion, and to implement retail display bans. Recently, Canada implemented bans on flavored and menthol tobacco. Plain packaging legislation has passed and will also soon be implemented.

Of note, Canada's most populous jurisdictions do not meet the minimum MPOWER standard for taxation. For example, in Ontario, federal and provincial tobacco and sales taxes combined account for 65.1 percent of the retail price of a carton of cigarettes, well below the 75 percent required to meet the highest scoring category in the MPOWER scale (Ontario Tobacco Research Unit 2017).

5. Origins: Tobacco Industry-Induced Illicit Trade

Until the early 1990s, illicit tobacco was not a major challenge in Canada. Trade in illicit tobacco emerged following substantial tax increases in the year 1991, at both the federal and provincial levels. Responsibility for the rapid development of Canada's illicit tobacco market at this time rests with the legal tobacco industry (Cunningham 1996; Non-Smokers' Rights Association 2007-6). It is estimated that illicit tobacco captured more than one-quarter of the overall tobacco market (Schwartz & Johnson 2010).

Following the tax increases, tobacco companies exploited the lack of an export tax on cigarettes and Canada's permeable border with the United States to develop a large-scale smuggling operation. They legally exported cigarettes to the United States where they were stored in duty-free warehouses in New York State. Working with networks of criminal groups, the cigarettes were then smuggled back into Canada and sold illicitly, thus avoiding the high federal and provincial taxes. This allowed tobacco companies to sell cigarettes more cheaply to consumers while still reaping considerable profits (Cunningham 1996; Schwartz & Johnson 2010). Tobacco companies worked primarily with smuggling networks based on three First Nations reserves: The Akwesasne Mohawk First Nation reserve, which strategically straddles the borders between the Canadian provinces of Ontario and Quebec and the US state of New York; the Kahnawake reserve near Montreal, Quebec, and the Six Nations reserve near Brantford, Ontario (Cunningham 1996).

Importantly, observers even at this stage of Canada's illicit tobacco history noted that, even though the government knew where the sources and distribution channels were, officials "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" (Sweeting, Johnson and Schwartz 2009).

Recognizing the dramatic increase in illicit tobacco, the federal government implemented, in 1992, a substantial export tax of \$8 on a carton of 200 cigarettes. Exports immediately decreased by 60 percent. In 1992, the tobacco industry exercised considerable political clout to ensure its ability to continue its illegal practice, and the export tax on cigarettes was rolled back, enabling the industry to continue its smuggling operations (Cunningham 1996). Rather than addressing the illegal activity of the tobacco industry and its associates, federal and provincial governments eventually instituted dramatic tobacco tax cuts. This followed considerable political pressure, including Quebec vendors' openly selling illicit tobacco to dramatize the challenges they faced in not being able to compete with cheap, smuggled tobacco (Cunningham 1996). Federal tobacco taxes were reduced by \$10 per carton and provinces followed suit with tobacco tax cuts of their own. The tobacco export tax was also reinstated (Cunningham 1996; Zhang et al 2006).

While these measures effectively ended the illicit tobacco trade of the early 1990s, they had an overall long-term effect of increasing the prevalence of smoking and cigarette consumption. Epidemiologic studies attribute large increases in tobacco initiation to the domestic tobacco tax cuts of the mid-1990s (Canadian Cancer Society et al. 1999; Waller et al. 2003; Zhang et al. 2006). These studies highlight that the tax cut led to increased smoking, particularly among youth.

Moreover, tobacco industry and government actions and inactions throughout the 1990s allowed for the development of an illicit tobacco supply chain that continues to pose challenges to this day. Eventually, tobacco companies pled guilty in a lawsuit in which they were charged with exporting tobacco products in order to smuggle them back into Canada for sale on the illicit market (Canadian Cancer Society 2017). Claims made by the federal and provincial governments in the legal proceedings totaled \$5,279,631,667 (Canadian Cancer Society 2017). Eventually, the Canadian government settled for a much smaller amount, and the tobacco companies paid fines of \$1.7 billion to the Government of Canada (Canadian Cancer Society 2017).

6. Illicit Tobacco in the 21st Century

By the early 2000s, illicit tobacco once again started to emerge as a serious challenge to Canada's tobacco control efforts. The epicenter of illicit trade was the same as in the 1990s, with the border First Nations reserves in Ontario and Quebec being the source of more than 90 percent of illicit tobacco seizures (Schwartz and Johnson 2010). In the new manifestation of large-scale illicit trade, there is no apparent direct role of the tobacco industry. It does not involve the tobacco industry's exporting its own manufactured cigarettes to the United States and then having them smuggled back into Canada. Rather:

Over the past 20 years the cultivation of tobacco, and the manufacture, distribution and sale of tobacco products on reserves in Ontario has emerged. The on-reserve tobacco industry has not only emerged but, in some communities, solidified itself as an important economy. (Lickers and Griffin 2016)

According to the Royal Canadian Mounted Police (RCMP), illegal manufacture of cigarettes occurs primarily on a handful of First Nations reserves and in particular on the United States side of the Akwasasne reserve that straddles the borders of the Canadian provinces of Ontario and Quebec and the American state of New York (RCMP 2011). The RCMP notes that much of the illicit tobacco activity in the 2000s occurs in the same places it developed in the late 20th century:

In particular, the vicinity of Valleyfield, Quebec, and Cornwall, Ontario, which was the centre of tobacco smuggling operations in Canada in the late 1980s and early 1990s, remains as a critical passageway for the illicit tobacco trade in Canada; smugglers exploit the geography of the area, which borders the St. Lawrence Seaway, moving contraband goods from the U.S. to Canada (RCMP 2011).

While the lion's share of illicit tobacco sales appear to be in the provinces of Ontario and Quebec, the RCMP notes that illicit tobacco from these provinces is also sold in the Atlantic and Northwest regions of Canada and as far west as the Pacific Ocean province of British Columbia. It is estimated that illicitly manufactured and smuggled cigarettes from this region constitute over 80 percent of the contraband tobacco market in Canada. Most of the remainder appears to be counterfeit product shipped from Asia to ports in British Columbia. In 2010, the RCMP reported seizing 51,000 cartons of counterfeit cigarettes (RCMP 2011).

7. Panoply of Federal and Provincial Policies to Curb Illicit Tobacco

Federal and provincial governments have adopted and implemented numerous measures to combat illicit tobacco and, periodically, continue to announce incremental changes. A comprehensive report of anti-contraband measures, published in 2009, discusses several such measures; others are identified in a 2017 Canadian Cancer Society summary of tobacco control legislation in Canada. They include: 1) licensing, 2) marking/labeling, 3) export taxation, 4) allocation/quota systems for Indigenous reserves, 5) refund/rebate systems for reserves, 6) tax harmonization and Indigenous tax agreements/compacts, and 7) enforcement (Sweeting, Johnson and Schwartz 2009, Canadian Cancer Society 2017).

Licensing: Tobacco manufacturers require a manufacturer's license from the federal government. Manufacturers in the provinces of Ontario and Quebec also require a license from these provincial governments (Canadian Cancer Society 2017). In addition, the province of Quebec has licensing requirements for tobacco "importers, wholesalers, retailers,

transporters (including transporters of leaf tobacco), growers, storers/warehouseurs, and persons in possession of manufacturing equipment" (Canadian Cancer Society 2017). A related measure, taken by the federal government and by the provinces of Ontario and Quebec, is restricting the supply of leaf tobacco to licensed manufacturers. As of January 2018, Ontario has also restricted the supply of cigarette filter materials to licensed manufacturers (Canadian Cancer Society 2017).

Marking / labeling: Cigarette packages in Canada must bear a tax stamp indicating that taxes have been paid. Separate tax stamps in different colors indicate that federal and then respective provincial taxes have been paid. There is a separate marking for cigarette packages intended for sale on First Nations (Indigenous) reserves for which federal excise tax has been paid by manufacturers and which are exempt from direct provincial tobacco tax and sales taxes (see below).

Export taxation: General trade practice is that exported goods are not subject to taxes or duties. However, Canada, along with some other countries, has imposed an export tax (federal) on cigarettes to combat the phenomena of untaxed exports of cigarettes being sold in bordering countries and smuggled back into the country to be sold illicitly (with domestic tax unpaid) (Sweeting, Johnson and Schwartz 2009). Canada maintains its export tax on cigarettes at the rate of 8 dollars per carton of 200.

Allocation / quota systems for reserves: Canada's First Nations (Indigenous) people are exempt from sales taxes on tobacco as part of treaty rights that exempt them from taxation of personal property, in accordance with Section 87 of the *Indian Act* (Sweeting, Johnson and Schwartz 2009). The availability of tax-exempt tobacco product for use by First Nations people has created an opening for illicit purchases by non-Indigenous people. Each province and territory has devised its own system for addressing the purchase by non-Indigenous people of tax-exempt tobacco intended for consumption by Indigenous people. Five provinces and one territory (British Columbia, Manitoba, New Brunswick, Nova Scotia, and Northwest Territories) use quotas, based on formulas that take into account the number of adult residents and the number of cigarettes per resident, to allocate shipments of tax-exempt cigarettes to each reserve (Canadian Cancer Society 2017). Sweeting et al (2009) note that quota allocation systems are imperfect mechanisms for controlling the illicit purchase of non-taxed cigarettes by non-Indigenous consumers:

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.

In 2015, the Government of Ontario commissioned an independent external review of its allocation system. The resulting report reviews critical perspectives of a variety of stakeholders. It clarifies that the allocation system does not take into account the emergence of substantial amounts of tobacco that are now cultivated and manufactured on reserves:

First Nations are able to acquire First Nation manufactured brands through trading channels that do not depend upon the allocation regime. This conduct Ontario views as illegal under the TTA (Tobacco Tax Act). There is currently only one on-reserve manufacturer that is also a licensed wholesaler/distributor within the current allocation system. First Nation retailers do not rely upon the allocation amounts to draw against this company's products. Why deplete their quota when they can secure these First Nation products in any event (Lickers and Griffin 2016)?

The review outlines several options for improving Ontario's system. Two years after the report was written, the Ontario Ministry of Finance website, accessed in August 2018, notes that, "The Ministry of Finance is currently reviewing the facilitators' final report and carefully considering each of the recommendations." (<https://www.fin.gov.on.ca/en/tax/tt/fncigaretteallocation.html> - accessed on 12.08.18)

Refund / rebate systems for reserves: Six provinces and one territory apply a refund/rebate system to handle tax-exempt sales on reserves (Alberta, Saskatchewan, Manitoba, Quebec, New Brunswick, Prince Edward Island, and Northwest Territories) (Canadian Cancer Society 2017). Manitoba, New Brunswick, and Northwest Territories combine quota allocation and refund/rebate systems (Canadian Cancer Society 2017). Refund/rebate systems place the onus on on-reserve retailers. The price of tobacco products that are shipped to them includes the amount equivalent to the taxes that would be required of non-Indigenous consumers. The product is then sold to Indigenous consumers, with appropriate identity cards, at a price that does not include the taxes. Retailers then send a form to the provincial government with the amount sold and name of the consumer in order to get reimbursed for the tax amount (Canadian Cancer Society 2017). Some provinces also restrict the amount of tax-exempt product that an Indigenous consumer can purchase in an attempt to decrease their ability to resell to non-Indigenous people (Sweeting, Johnson and Schwartz 2009).

Ontario's independent review report includes a refund/rebate system as one option for policy change, noting that it could utilize the "Certificate of Exemption" recently developed for on-reserve gasoline purchases. The report cautions that an electronic system for real-time transaction tracking would be expensive and might encounter challenges of internet connectivity as well as opposition from Indigenous stakeholders (Lickers and Griffin 2016).

8. Tax Harmonization - First Nations Tax Agreements

Tax harmonization is an often-mentioned measure to counter illicit tobacco sales. Harmonization schemes aim to decrease tax avoidance by ensuring similar tax rates in neighboring jurisdictions so as to reduce or eliminate cross-border trade in cheaper tobacco (Sweeting, Johnson and Schwartz 2009). The availability of non-taxed tobacco products for purchase by non-Indigenous people on First-Nations reserves is akin to two provinces, states, or countries having substantially different tobacco tax rates. Tax harmonization in this case comes in the form of Tax Agreements between First Nations communities and Canadian governments.

Three Canadian provinces have negotiated Tax Agreements with First Nations communities. New Brunswick refunds 95 percent of taxes that First Nations collect on the sale of tobacco and of gasoline to non-Indigenous people making purchases on reserves (Lickers and Griffith 2015). In Manitoba, 59 First Nations are party to Tax Agreements under which they collect tobacco taxes at the province's rate on tobacco products sold to both Indigenous and non-Indigenous people. They then receive back from the provincial government the revenues emanating from purchases by Indigenous people (Lickers and Griffith 2015). Some British Columbia First Nations collect their own levies on tobacco sales and use revenues to cover the cost of community services. For example, the Cowichan Tribes have imposed a levy equivalent to 80 percent of the provincial tobacco tax (Sweeting, Johnson and Schwartz 2009).

Negotiation of Tax Agreements can be a lengthy process. The Government of Ontario signed agreements-in-principle with two First Nations communities only after five years of discussions. Notably, in 2017, an agreement-in-principle was signed with the community of Akwesasne, which is one of the border reserves identifies as being a major source of illicit tobacco. The language of the government press release highlights that the agreement-in-principle is far from being an actual Tax Agreement:

... [T]he Mohawk Council of Akwesasne has begun the internal consultation and legal work to examine how community-based regulation could advance public health priorities while growing its economy. The purpose of the agreement-in-principle is to guide negotiations as Ontario and the Mohawk Council of Akwesasne work toward an agreement.²

² From (<https://news.ontario.ca/mof/en/2017/12/ontario-signs-tobacco-agreement-in-principle-with-mohawk-council-of-akwesasne.html>) Archived News Release. Ontario Signs Tobacco Agreement-in-Principle With Mohawk Council of Akwesasne Province Partnering with First Nations to Support Community Growth and Prosperity. December 20, 2017 2:30 P.M. Ministry of Finance.

9. Enforcement

Since 2007, the federal government has renewed its efforts to tackle illicit tobacco as part of the Federal Tobacco Control Strategy (Guindon, Burkhalter and Brown 2017). Measures taken include the establishment of the “First Nations Organized Crime Initiative,” the RCMP’s Contraband Tobacco Enforcement Strategy, and the Task Force on Illicit Tobacco Products (Guindon, Burkhalter and Brown 2017).

Quebec has taken the lead in pioneering considerable efforts at the provincial level. These include legislation to track and control raw leaf tobacco, increased fines, and empowering municipal governments (Guindon, Burkhalter and Brown 2017). Noteworthy is Quebec’s substantial investment in enforcement efforts through the special collaborative initiative ACCES Tabac cited earlier. Partners in ACCES Tabac include: The Ministry of Finance (MFQ); The Ministry of Health and Social Services (MSSS); The Sûreté du Québec (SQ); The Police Service of the City of Montreal (SPVM); Association of Quebec Police Directors (ADPQ); and the Royal Canadian Mounted Police (RCMP). With an annual budget of \$18 million, ACCES Tabac is able to devote considerable resources to its two strategic activities: 1) Point-of-sale inspections to ensure that illicit tobacco is not being sold; and 2) investigations to “detect and dismantle illegal supply and distribution networks for tobacco product” (Ministere de la Securite Publique Quebec 2018).

Ontario has also been active in announcing measures to curb illicit tobacco. In 2014, Ontario required new tobacco stamps on cigarette packages and fine cut tobacco to improve identification of illicit product. In 2015, the Province improved oversight of raw leaf tobacco, and in 2016 it established a new Contraband Tobacco Enforcement Team in the Ontario Provincial Police Organized Crime Enforcement Bureau. The aim was to improve enforcement by increasing capacity to investigate smuggling and trafficking of illicit tobacco (Smoke-Free Ontario Scientific Advisory Committee 2016). A further enforcement enhancement step is an information-sharing agreement between the Ontario Ministry of Finance and the Alcohol and Gaming Commission of Ontario, providing for suspension of lottery licenses to vendors who sell illicit tobacco. Raw leaf tobacco oversight now includes “baling or packaging, labelling, transportation, record-keeping and reporting requirements and exemptions for raw leaf tobacco registrants” (Smoke-Free Ontario Scientific Advisory Committee 2016)

10. Additional Measures

The Canadian Cancer Society’s (2017) summary of Canada’s legislative stipulations related to illicit tobacco lists several additional measures that are in place in Canadian jurisdictions:

1. Requiring the provision of a bond/security that could be forfeited in the event of non-compliance, as some governments have done.

2. Requiring that importers into a province pay to the government an amount equal to tobacco tax at the time of importation rather than at a subsequent point, such as at the point of sale within the province.
3. Allowing local police to keep fines arising from enforcement action, thus providing greater resources and incentives to local police for enforcement. Quebec has done this.
4. Prohibiting the sale or offering for sale at a price lower than the total amount of federal and provincial tobacco taxes. Quebec has done this.
5. Authorizing tickets to be issued for infractions. Several provinces have done this.
6. Prohibiting individuals from possessing more than a specified quantity of cigarettes/ tobacco products. Several provinces prohibit possession of more than 5 cartons (1000 cigarettes). As an example, Manitoba's possession limit is 5 units, with a unit being 200 cigarettes, or 50 cigars, or 200 grams of any other type of tobacco product.
7. Prohibiting the sale or purchase of more than a specified quantity at any one time, or per day. One or more provinces have done this. At example might be to prohibit more than 2 cartons (400 cigarettes) from being sold / purchased at any one time.
8. Establishing a maximum daily or weekly tax-exempt purchase limit on reserves, such as one carton. Saskatchewan has a limit on purchasing of 200 units of tax-exempt tobacco products per week, and a limit on possessing 800 units of tax exempt tobacco products. A unit includes one cigarette, one cigar, one tobacco stick, or one gram of other tobacco products.
9. Requiring importing consumers to pay tobacco taxes to the government, but setting allowable quantity exemptions. For example, Saskatchewan allows importing consumers to bring in tax-free 200 cigarettes, 200 tobacco sticks, 200 grams of tobacco and 50 cigars provided that the products are marked for sale in another province, or the products are an allowable tax-exempt importation when entering Canada.
10. Cross appointing health inspectors to be inspectors under tobacco tax legislation. This is useful, for example, so that health inspectors can seize illegal product immediately without having to call and wait for a tobacco tax inspector (who might even be in a different city).
11. Requiring a provincial government identification card to be presented to be able to purchase tax-exempt products on reserve.
12. Requiring record keeping for on-reserve retailers selling tax-exempt tobacco products. Saskatchewan and some other provinces have done this.
13. Providing for the ability to suspend a driver's license when a motor vehicle was used as part of a contraband offence. Several provinces have done this.
14. Providing that seized contraband is forfeited to the government. Several provinces have done this. (Canadian Cancer Society 2017)

11. Gaps: What is Missing from Canada's Effort to Curb Illicit Tobacco?

What is clear to observers of Canada's illicit tobacco market is that Canadian governments have largely been unwilling to deploy the tools at their disposal to address the sources and channels for the bulk of the illicit tobacco supply in Ontario and in Quebec. Licensing, tax stamps, allocations systems, rebate systems, and enforcement efforts neglect the cultivation and manufacture of tobacco on some First Nations reserves and its distribution and untaxed sale through channels on multiple reserves and off-reserve (Lickers and Griffin 2016). First Nations representatives participating in an Expert Focus Panel in 2009 indicated that First Nations would oppose government action to control this activity, on the grounds that it is their right to produce and sell tobacco and that the economic benefits are such that taking away the revenues from this activity would create severe hardship (Sweeting, Johnson and Schwartz 2009). This, they agreed, applied equally to efforts at tax harmonization (tax agreements) which they thought "would keep communities trapped in the cycle of poverty." The Government of Ontario's inaction on implementing recommendations of the independent review of the allocation system which it commissioned, and the fact that after five years of negotiating with two First Nations communities, it has still not reached Tax Agreements, demonstrate the challenges to moving forward in this way.

Internationally, tracking and tracing has been a central element in efforts to curb the illicit tobacco trade. Notably, Canada does not have a tracking and tracing system in place (Canadian Cancer Society 2017). 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 (Sweeting, Johnson and Schwartz 2009).

The absence of a tracking and tracing system in Canada is a major deficiency, that should be addressed. However, a recent evidence-informed article indicates that many jurisdictions have relied on the tobacco industry (specifically the Codentify system developed and made available by PMI) to develop and implement tracking and tracing systems that are highly suspect in their ability to identify illicit tobacco (Gilmore, Gallagher and Rowell 2018):

Governments should assume the TI seeks to control T&T systems in order to avoid scrutiny and minimise excise tax payments and that any T&T system based on Codentify, on intellectual property currently or previously owned

by the TI, or being promoted or implemented by companies with TI links, is incompatible with the ITP and would not serve to reduce illicit trade.

12. Industry Harnessing of Illicit Trade Concerns to Fight Tobacco Control

Canada has seen some success in curbing illicit tobacco trade. Government measures have undoubtedly contained illicit activity, and global evidence suggests that government spending on anti-smuggling is effective (Yurelki & Sayginsoy 2010). However, even in the province of Quebec, where enforcement efforts have been strongest, illicit tobacco still accounts for some 15 percent of the overall tobacco market (Figure 1). The tobacco industry exploits the continued illicit tobacco problem in Canada through direct and indirect efforts aimed at preventing governments from adopting effective tobacco control measures. This particularly applies to substantial tobacco tax increases. Industry spokespersons have been largely successful in propagating a belief that tax hikes on tobacco products cause (large) increases in illicit tobacco activity. This perception has likely contributed to Canada's two most populous provinces' maintaining tobacco tax rates below minimum standards set out in the World Health Organization's MPOWER platform. Both international published literature and a recent analysis of the relationship between tobacco tax rates and illicit tobacco trade have clearly demonstrated that tax increases do not necessarily lead to substantial and sustained increases in illicit tobacco consumption (Schwartz and Zhang 2016).

Moreover, Canadian research reveals the tactics employed by the tobacco industry in spreading myths about the current size of the illicit tobacco market and its expected growth, should governments raise taxes on tobacco products or adopt other rigorous tobacco control policies. This happens in three ways: 1) unsubstantiated over-estimates of the size of the illicit market; 2) influence on media sources; and 3) the industry's funding think tanks to publish reports warning that tax increases will lead to high levels of illicit tobacco.

Invalid estimates. The tobacco industry routinely commissions research and publishes results that inflate, sometimes grossly, the size of the illicit market in Canada. Only partial descriptions of methods are typically published. What is published has been sharply criticized by academic researchers (Zhang and Schwartz 2015; Smith et al. 2017).

Influence on media sources. Smith et al (2017) conducted a media analysis of articles related to illicit tobacco in Canadian newspapers over a five-year period (2010-2015). They found that illicit tobacco is most commonly presented in ways that favor the tobacco industry. Articles quote organizations with both known and unrevealed links to the tobacco industry. Examples are the Canadian Convenience Store Association, the Taxpayer's Federation, and the Reason Foundation, all of which receive support from the tobacco industry (Smith et al 2017).

Purchasing the services of think tanks. In the past few years, reports by two generally respected think tanks, the Fraser Institute and the C.D. Howe Institute, came out strongly against raising taxes on tobacco products, citing the risk of large increases in illicit tobacco sales. Neither organization revealed that it had received funding from tobacco companies. The evidence in the Fraser Institute Report has been independently assessed and found to be incorrect or misleading as presented (Zhang and Schwartz 2015).

13. Recommendations

To further decrease the illicit tobacco market in Canada, several measures might be considered:

1. Ontario and Quebec should adopt a refund/rebate system that puts the onus on on-reserve retailers for collecting sales taxes on tobacco purchased by people other than Indigenous people who are entitled by law to not pay these taxes. Technological and administrative solutions should be sought to minimize challenges that this would pose to on-reserve retailers.
2. The federal and provincial governments should work with Indigenous communities where illicit tobacco constitutes an important revenue source to develop alternative sources of revenue to replace lost income.
3. The federal and provincial governments should enforce existing stipulations regarding licensing, manufacture, and distribution of tobacco products for which not all taxes have been paid. Where this involves Indigenous communities, this should be done in cooperation with their leadership and enforcement agencies. The relative success of Quebec's ACCES Tabac efforts, including its larger investments, might serve to inform action by other jurisdictions, such as Ontario.
4. The federal government should require tobacco manufacturers and distributors to implement an effective track-and-trace system not related to the tobacco industry.
5. The federal government should publish annual reports on the size of the illicit market and on measures taken to combat illicit tobacco.

14. Conclusion

Illicit tobacco trade in Canada and efforts to control it have a convoluted history. The problem has been exacerbated by the encouragement given to illicit trade by the tobacco industry itself in the 1990s. Ironically, it is now the tobacco industry that fans the flames of anti-illicit tobacco anxieties in order to dissuade Canadian governments from substantial increases in taxes on tobacco products and from adopting other effective tobacco control policies. As the evidence cited above demonstrates, Canadian governments first raised taxes substantially and then reversed them in light of the contraband problem created by the tobacco industry in the 1990s. This policy reversal resulted in large numbers of young

people initiating tobacco use, many smokers refraining from cessation, and ultimately in a great deal of avoidable morbidity and mortality.

A consequence of large-scale tobacco industry-instigated smuggling of exported tobacco in the 1990s was the engagement of some First Nations communities in illicit tobacco activity. Some of these communities have subsequently become centers of the illicit tobacco market. Canadian governments have been hesitant to adequately address illicit cultivation, manufacture, and sale of tobacco products by some Indigenous communities. While this is apparently due to understandable sensitivities around Nation-to-Nation relations and fears of sparking violent confrontations, there is more that could be done, as discussed above, to reduce illicit production and sales.

The unfortunate outcome is that illicit tobacco has a negative influence on Canada's tobacco control policy: both directly and indirectly, through tobacco industry efforts. It is important to remember that tobacco use remains a severe health epidemic in Canada. More vigorous tax and other tobacco control policies could reduce the current annual initiation of tobacco use by some 50,000 young Canadians – who are price-sensitive and heavy users of cheap, illicit cigarettes. Stronger tax and other control measures would lead more of Canada's 4 million smokers to quit, reducing the billions of dollars in social and healthcare costs that stem from tobacco use. While a series of incremental measures to curb the illicit tobacco trade have met with some success, illicit trade continues to constitute some 15 percent of the market, and misinformation disseminated by the tobacco industry has prevented substantial tax increases that could rapidly and dramatically decrease tobacco consumption (Jha and Peto 2014).

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ⁱⁱ World Health Organization Press Release, July 19, 2017.
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“To tackle illicit trade is to tackle accessibility and affordability of tobacco products, to be more effective on the control of the packaging and to reduce funding of transnational criminal activities whilst protecting the governmental revenues from tobacco taxation.”ⁱ

– **Dr. Vera Luiza da Costa e Silva**
Head of the Secretariat of the WHO Framework Convention on Tobacco Control

“Governments around the world must waste no time in incorporating all the provisions of the WHO Framework Convention on Tobacco Control into their national tobacco control programmes and policies. They must also clamp down on the illicit tobacco trade, which is exacerbating the global tobacco epidemic and its related health and socio-economic consequences.”ⁱⁱ

– **Dr. Tedros Adhanom Ghebreyesus, Director-General**
World Health Organization

“Tobacco still remains the biggest avoidable cause of premature death in the EU, and the illicit trade in tobacco facilitates access to cigarettes and other tobacco products, including for children and young adults. In addition, millions of euros in tax revenues are lost every year as a result of the illicit trade.”ⁱⁱⁱ

– **Commissioner Vytenis Andriukaitis**
Health and Food Safety / European Commission

“Given their light weight, small size, and high value, tobacco products are susceptible to fraud through illegal trade, production, and cultivation. . . . Illegal trade is a context-specific activity that has various modus operandi and therefore requires multi-dimensional context-specific solutions.”^{vi}

– **Patrick Petit (Senior Economist) & Janos Nagy (Senior Economist)**
Fiscal Affairs Department / International Monetary Fund

“Effective tobacco tax regimens that make tobacco products unaffordable represent a 21st century intervention to tackle the growing burden of noncommunicable diseases. We are convinced that, working together with WHO and other partners in support of countries, we will be able to prevent the human tragedy of tobacco-related illness and death, and save countless lives each year.”^v

–**Dr. Tim Evans (Senior Director) & Patricio V Márquez (Lead Public Health Specialist)**
Health, Nutrition and Population Global Practice / World Bank Group

