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Tobacco Smuggling [1]

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Smugglers might get help from cigarette companies

By Raymond Bonner and Christopher Drew
New York Times News Service

The largest tobacco companies are selling billions of dollars of cigarettes each year to traders and dealers who funnel them into black markets in many countries, say law enforcement officials and participants in the trade.

In the last decade, the volume of cigarettes smuggled around the world has nearly tripled, according to a leading tobacco research organization. This reflects a general surge in cigarette sales abroad, especially for American brands.

And industry officials acknowledge that a sizable share -- the researchers say one-fourth -- of the cigarettes sold overseas passes through smuggling rings set up to evade foreign taxes and sell major brands at a discount.

The companies say they do nothing to encourage the smuggling and do not condone it. But recent criminal investigations in several countries show that people in the tobacco industry have played a significant role at times in stimulating and fueling it.

In one case, two sales managers for Brown & Williamson Tobacco Corp. have pleaded guilty to aiding smugglers. But what law enforcement agents say is far more common is for the companies to sell huge quantities of top brands to traders and dealers who are little more than pipelines to the smugglers.

For instance, newly released court documents show that R.J. Reynolds Tobacco Co., the second-largest American cigarette-maker, sponsored trips to a posh Canadian fishing resort for several dealers who have since been charged with conspiring to smuggle cigarettes into Canada. On one fishing trip in 1995, a Reynolds salesman even joked with the dealers about the smuggling.

And some of the dealers admit that they pour huge volumes of cigarettes right into the smuggling networks.

One of Europe's biggest cigarette traders said he had been buying Winstons from Reynolds for 15 years and had resold many of them to smugglers in Spain.

Other inquiries show that two organized-crime groups in Italy take in $500 million a year by smuggling Marlboros they buy from Swiss dealers selling products made by Philip Morris Cos., America's largest cigarette-maker.

The smuggling costs foreign governments an estimated $16 billion a year in lost revenue. But more important, health experts say, is that it threatens to undermine initiatives in many nations to discourage smoking, particularly among teen-agers.

That is because young people tend to smoke more when they can buy cigarettes cheaply. Smuggled brands often sell for about a third less than ones on which taxes and customs duties have been paid.

Editorial

The New York Times ON THE WEB

May 18, 1998

Voting for Higher Cigarette Prices

The Senate Finance Committee made a comprehensive anti-smoking bill stronger last week when it voted to increase cigarette taxes by $1.50 per pack over three years. That hefty increase should go far to deter youth smoking, and it is not apt to encourage widespread smuggling of cigarettes as industry propaganda suggests. Indeed, such smuggling can occur on a large scale only if the industry itself allows it.

Senator Alfonse D'Amato, Republican of New York, provided a key swing vote that allowed the committee to approve the tax increase by 10 to 9. Senator Daniel Patrick Moynihan of New York, the committee's ranking Democrat, also voted for it.

The committee's proposal will be voted on by the Senate this week as an amendment to the tobacco bill approved earlier by the Senate Commerce Committee. The Commerce bill, drafted by Senator John McCain, would impose annual assessments on the industry that would raise per-pack cigarette prices by $1.10 over five years. Estimates are admittedly rough, but many public health experts say an increase of at least $1.50 is needed to cut youth smoking rates significantly, and experts convened by the National Academy of Sciences have recommended increases of $2 per pack.

The tobacco industry is raising the specter of a new black market in cigarettes if Congress forces a steep increase in cigarette prices. But such fear-mongering is insulting given the industry's apparent complicity in the growth of international cigarette smuggling.

Investigators of the European Union are now asking the United States Government to help combat illegal trade involving billions of American cigarettes that are smuggled into Europe to evade cigarette taxes. European authorities believe American companies knowingly sell to dealers who ship the cigarettes into the contraband pipeline, but they have been unable to get the companies to cooperate with their investigation. The companies' refusal shows they have no interest in shutting down an illicit trade that directly benefits them.

Contraband cigarettes currently in the American market are largely the result of interstate smuggling driven by vastly different levels of state tobacco taxes. A higher national tax would not add to that problem since the tax would apply to all states.

Few experts believe that a black market will arise from foreign-made cigarettes because Americans are accustomed to higher-quality cigarettes than those produced in places like China.

Instead, the worry is that American-made cigarettes will be exported to avoid the new Federal tax, then smuggled back to be sold at lower prices. Just this kind of export-import operation developed in Canada after it raised tobacco taxes. Because Canada's exported cigarettes were not marked with "export only" labels, it was impossible to distinguish between contraband packs that were smuggled back and legally sold packs. Canadian officials concluded that their top domestic manufacturers, affiliated with American and British tobacco companies, were aware of and benefited from the illegal activity.

That need not happen here. Strict licensing and marking requirements can help authorities track the movement of cigarettes from manufacturers to wholesalers, distributors, exporters and retailers. Tight Federal regulations have long applied to alcohol distribution, effectively ending illegal sales of wine and spirits in this country. The Senate should ignore the scare talk and approve a strong bill that would reduce smoking by raising prices.

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August 25, 1997

Cigarette Makers Are Seen as Aiding Rise in Smuggling

In This Article

By RAYMOND BONNER and CHRISTOPHER DREW

The largest tobacco companies are selling billions of dollars of cigarettes each year to traders and dealers who funnel them into black markets in many countries, say law enforcement officials and participants in the trade.

In the last decade, the volume of cigarette smuggling around the world has nearly tripled, according to a leading tobacco research organization. This reflects a general surge in cigarette sales abroad, especially for American brands.

And industry officials acknowledge that a sizable share -- the researchers say one-fourth -- of the cigarettes sold overseas pass through smuggling rings set up to evade foreign taxes and sell major brands at a discount.

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For instance, newly released court documents show that R.J. Reynolds Tobacco Co., the second-largest American cigarette maker, sponsored trips to a posh Canadian fishing resort for several dealers who have since been charged with conspiring to smuggle cigarettes into Canada. On one fishing trip in 1995, a Reynolds salesman even joked with the dealers about the smuggling.

And some of the dealers admit that they pour huge volumes of cigarettes right into the smuggling networks.

One of Europe's biggest cigarette traders, Michael Haenggi, said in an interview that he had been buying Winstons from Reynolds for 15 years and had resold many of them to smugglers in Spain. Haenggi said his three-person trading company in Switzerland had handled $100 million in sales last year. "Of course I know where the cigarettes are going," he said. "But is that my problem?"

Other inquiries show that two organized-crime groups in Italy take in $500 million a year by smuggling in Marlboros they buy from Swiss dealers selling products made by Philip Morris Cos., America's largest cigarette maker.

And later this year, Hong Kong prosecutors plan to place a former marketing manager for British-American Tobacco Corp., a subsidiary of B.A.T. Industries and a British affiliate of Brown & Williamson, on trial on charges that he took more than $3 million in bribes from dealers involved in smuggling cigarettes into China.

Spokesmen for the three cigarette companies said they did not knowingly sell to dealers who supply smugglers. They declined to discuss any of the criminal cases. But they said that while a few salesmen might have been too aggressive, their executives had done nothing wrong and that the companies should not be held accountable for what happens once they sell their products.

The smuggling costs foreign governments an estimated $16 billion a year in lost revenue. But more important, health experts say it threatens to undermine initiatives in many nations to discourage smoking, particularly among teen-agers.

That is because young people tend to smoke more when they can buy cigarettes cheaply, and smuggled brands often sell for about a third less than ones on which taxes and customs duties have been paid.

The sheer scope of the smuggling also could force changes in the $368.5 billion settlement being negotiated with the American tobacco industry. The proposed agreement says that before the government could order the companies to lower the nicotine in cigarettes, it would have to guarantee that smugglers would not bring in more potent substitutes. But given how easily smuggling can take place, President Clinton said last month that this provision was unreasonable and should be changed.

The recent surge in black-market sales has many causes, from the relaxation of customs inspections in Europe to the opening of vast new markets in Russia and Eastern Europe.

Market Tracking International Ltd., a research firm in London that provides data to tobacco industry publications, estimates that 280 billion of the 1 trillion cigarettes exported each year by all producing nations pass through the hands of smugglers, up from 100 billion in 1989.

The rise in smuggling also has coincided with a massive push by the American firms to expand overseas, which they see as a way to offset a decline in sales at home. American cigarettes are regarded as top quality and are seen as chic in many countries.

But as popular as American and other Western brands are, the companies also run into various sales barriers, including high taxes, limits on imports and countries where cigarette distribution is corrupt.

The smugglers, though, have increasingly maneuvered around such limits.

To be sure, in cities from Naples to Bogota, Colombia, the image of street peddlers hawking contraband cigarettes has been an enduring one.

The manufacturers benefit in that they normally receive the same price for cigarettes whether they end up in contraband markets or not. And despite markups by dealers, smugglers and salespeople, contraband cigarettes can still be sold cheaply and profitably because the savings from evading taxes can be so great.

Law enforcement officials say that the dealers usually provide such a distance between the companies and the smugglers that it would be hard to consider charging the companies with doing anything illegal. Yet even some dealers say that they and the companies sell the cigarettes so indiscriminately that they both know certain sales are headed for the black market.

If the companies say they do not, "it's a lie," said Corrado Bianchi, who said he had sold Philip Morris cigarettes as a dealer in Switzerland before retiring two years ago. "Of course they know."

Bianchi said he had sold large quantities of Philip Morris brands "to 200 people maybe, and they come from all over, Dutch people, Germans, Spanish, Greeks, Italians." But, he said, he never asked the buyers what they were going to do with the cigarettes. "In our work, you can't ask what they do with the cigarettes."

One result is that Bianchi ended up selling Philip Morris products to an organized-crime figure now on trial in Italy, prosecutors there say. Bianchi himself is not a defendant, and he denied that he did anything wrong.

Andre Reiman, a senior vice president for a Philip Morris subsidiary in Europe, questioned whether the company had sold cigarettes directly to Bianchi. "As far as we can determine, he has never been a customer."

Reiman added: "I am not going to sit here and tell you there is not contraband in cigarettes. It's there. The causes are just a little more complicated than people believe."

Philip Morris officials in New York said smugglers also competed with the company's distribution system and had jeopardized its investments in overseas factories.

Adam Bryan-Brown, a spokesman for Reynolds' international tobacco subsidiary in Geneva, said governments were responsible. "The root causes of contraband are well known -- the high duties and taxes imposed on cigarettes," he said.

But Per Brix Knudsen, the director of an antifraud unit for the European Union, said: "It's astonishing that these big producers are not more concerned that such a large quantity of their product is arriving on the illegal market. How is it that such a trade can take place?"

Smuggling by Sea: Cargo Goes to Spain Instead of Africa

When the Wendy I, a huge cargo ship, edged out to sea from a port near Antwerp, Belgium, late last year, it was loaded with 16,000 cases of Winstons, or 160 million cigarettes. R.J. Reynolds, a subsidiary of RJR Nabisco Corp., had made them in the United States and shipped them to a warehouse in Antwerp. And its Swiss subsidiary sold them to a company owned by Haenggi, the Swiss trader.

Haenggi said he then sold the shipment to a Panamanian company and told a warehouse worker to indicate on shipping documents that the Wendy I was going to Senegal in West Africa. But it would go no farther than Spain, where the cigarettes would bring up to $15.5 million on the black market. And this was just the start of a rich tale of intrigue that shows how sophisticated the smuggling networks have become and how hard they are to stamp out.

The stage was set in Antwerp because it is one of the main distribution hubs for American cigarettes. Vast quantities pass through the port on their way to Russia and other places. Some of the cigarettes stay in legitimate hands; others shift course.

Knudsen and other authorities described Haenggi, 48, as one of Europe's largest and most brazen suppliers of cigarettes to smugglers. And before Spanish police seized the Wendy I in January, they said, it was part of a long-running operation that last year smuggled 2.3 billion Winstons -- $200 million worth -- into Spain.

Investigators said the Wendy and other ships typically stopped in international waters well beyond Spain's 12-mile limit to minimize risks. There they transferred their loads to a high-speed torpedo boat once used by the German Navy, which took the cargoes close to the 12-mile mark. Then another set of boats would rush the cigarettes to shore.

When investigators began to piece together what had happened, they found some tantalizing evidence at the Belgian warehouse -- a series of faxes showing that for years Reynolds officials in Geneva kept track of the volume of cigarettes that Haenggi supposedly was shipping to Senegal.

Given that all the shipments were diverted to Spain, the figures could not possibly have matched Reynolds' sales reports from Dakar, the capital of Senegal, investigators said.

In fact, U.S. Agriculture Department figures show that Senegal imports no more than 500 million cigarettes a year -- less than one-fourth of what was unloaded from the ships that Haenggi sent off Spain in 1996.

Referring to Reynolds officials, Carlos Castresana Fernandez, a prosecutor in the Wendy I case, said, "The amount is so high, they can't say they don't know."

Neither Haenggi nor Reynolds has been charged with any wrongdoing. Reynolds would not discuss the Wendy I case or confirm that Haenggi was a customer.

But in an interview at a yacht club on Switzerland's Lake Geneva, the irrepressible Haenggi acknowledged that he had been buying from Reynolds and reselling to smugglers for 15 years -- and insisted he had done nothing illegal.

Yes, he said, he had bought the cigarettes that were on the Wendy from Reynolds. Haenggi, who is struggling to break a 3- to 4-pack-a-day habit with antismoking patches, said he then shuffled ownership through three of his companies. Investigators suspect this was to mask the trail, though Haenggi says it was to reduce Swiss taxes.

He also said that he sold them to the Panamanian company before they left the warehouse, and he maintained that he was no longer legally responsible after that.

Still, Haenggi, who got into the tobacco industry as an apprentice when he was 15, remained involved, shepherding the shipment on the Panamanian company's behalf.

He had workers at the Belgium warehouse remove labels specifying where the Winstons were made. He also said he had dispatched the one-time torpedo boat to meet up with the Wendy off Spain.

Why were the labels removed from the cases? That is what the Panamanian client wanted, Haenggi said.

Who was that client? He said he could not remember the company's name.

Haenggi also was coy about what Reynolds knew about where the shipments were going. He shrugged, grinned and said, "I cannot speak for the companies."

Haenggi also said the cigarette companies' motives for selling to middlemen like him were clear: to bolster sales in countries like Spain and Italy where American cigarettes normally cost much more than local brands produced by state-run monopolies.

In Spain, for instance, Winston is the most popular foreign brand, and last year 60 percent of its sales were contraband, industry officials there said. The smugglers can sell a pack of contraband Winstons for $1.30 to $1.60, about the same price as a local brand and one-third less than the price of legal Winstons.

For the investigators, it is one thing to know that Haenggi and others are dealing so openly with smugglers, and it is another thing to stop it.

Haenggi, a Swiss citizen who once worked in Spain, runs his cluster of trading companies from Switzerland, in a small office above a grocery and a dress shop in the tree-lined village of Muttenz, near Basel.

Much of Europe's tobacco trade takes place in Switzerland, where Philip Morris and Reynolds have their European headquarters. Swiss law basically does not view selling cigarettes to people who smuggle them into another country as a crime. Investigators throughout the rest of Europe say that Swiss authorities -- and the tobacco companies themselves -- are rarely willing to cooperate.

Knudsen of the European Union said that when his investigators posed questions to Reynolds officials, they responded: " 'We'd like to help you, but Swiss legislation on commercial secrecy prevents us.' So they have provided nothing."

In the Wendy case, the investigators still have not figured out who owned the company in Panama that bought the shipment from Haenggi. And Castresana, the prosecutor, said it seemed unlikely that he would get to the bottom of what happened.

The seizing of the Wendy did force the smugglers to suspend the sea operations. But they quickly turned to the air.

Early this year, a jet flew from Ukraine to Belgium, where it picked up 20 million Winstons supposedly meant for North Africa. The plane then flew to two other countries before landing in Spain's Basque region, where the crew produced documents saying it was carrying auto parts.

Over six weeks, the plane made 11 such trips, hauling a total of 220 million cigarettes, until Spanish police seized it. Investigators do not know who sold the cigarettes to the smugglers.

"I did, of course," Haenggi said.

He said a company registered in Aruba bought the cigarettes. Did he know the crew was going to smuggle the cigarettes into Spain? He laughed. "No, I thought they were going to smoke them."

Assault on Canada: Higher Taxes Set Off a Lucrative Trade

It was a rainy day at a salmon-fishing resort in British Columbia in September 1995. Les Thompson, an R.J. Reynolds salesman, was sitting around a fireplace with some of his customers.

Unbeknownst to Thompson, one man was an American informant. And according to court records unsealed in Syracuse on Aug. 13, he later described to a grand jury how the conversation took an intriguing turn -- right into a discussion about smuggling cigarettes into Canada.

One document -- an affidavit from a federal law enforcement officer -- quoted the informant as saying it was clear Thompson knew the dealers were selling the cigarettes to American Indians who smuggled them across the St. Lawrence River.

The informant said Thompson chided the dealers that if they did not keep better sales records, he would start selling directly to the Indians. And on another day when one guest fell ill on a fishing boat, Thompson joked that the man "should be used to the water from hauling the cigarettes," the affidavit said.

As raw as it might seem, industry critics and law enforcement officials say this episode was just the latest in a chain of evidence that the tobacco industry fueled a smuggling assault on Canada in the early 1990s.

The smuggling took off after Canada raised taxes several times largely to discourage cigarette consumption, one of the first countries to try this approach. Beginning in 1982, its taxes became increasingly stiffer. By 1992 a pack cost about $4.50 (United States) in Canada, compared with just less than $2 in the United States, making the situation ripe for smuggling.

Canadian health researchers think consumption did fall because of the taxes. And Canada's top three tobacco companies -- each affiliated with either Philip Morris, Reynolds or B.A.T. -- lobbied to repeal them.

The taxes did not apply to exports, and the companies started shipping large amounts of Canadian brands, like Players and Export A, to the United States even though few Americans smoke them.

Where once only a tiny portion of the cigarettes made in Canada had been exported, that total jumped to a third by 1993, with the bulk going to upstate New York and other border locales. Reynolds also began making Canadian brands in the United States and shipping them to dealers in states that border Canada. Most quickly found their way back into Canada through smugglers.

None of this was any secret in Canada. The industry "absolutely" knew that most of the exports were being smuggled back, Michel Descoteaux, a spokesman for Imperial Tobacco Ltd., which is partly owned by B.A.T., said in an interview.

But Descoteaux said this was not the industry's fault. "We had warned the government for years that when the taxes were increased, there would be smuggling." He also said Imperial was simply "shipping cigarettes in response to orders" by American dealers. "What would you have us do?"

Still, by February 1994, the smuggling had gotten so intense that Prime Minister Jean Chretien was forced to start rolling back the taxes. "The fact is," he said then, "that the Canadian tobacco manufacturers have benefited directly from this illegal trade." He said they had "known perfectly well" what was happening and added: "I believe they have not acted responsibly."

Since then, two criminal cases have reinforced what he said.

Federal undercover agents in New Orleans recorded talks with two Brown & Williamson sales managers in 1994 as they arranged shipments of Imperial products that were supposed to go to fishing vessels but were really smuggled back into Canada. Both men have since pleaded guilty to federal charges of aiding smugglers.

Court documents show that one of them, Michael Bernstein, told an undercover agent that a sales official at Imperial had agreed to supply cigarettes for the smuggling as long as each order was kept small.

The documents quote Bernstein as saying the Imperial official would "go along with that." But, Bernstein cautioned, "he assured me that if and when we get snagged with the packet of stuff anywhere in Canada, they're going to cut me off."

Bernstein also told investigators that selling to smugglers was part of Brown & Williamson's marketing strategy. Brown & Williamson and Imperial officials have denied this, and federal prosecutors recently closed the case without bringing additional charges.

The second investigation, centered in Syracuse and in Canada, is now raising similar questions about Reynolds.

The grand jury in Syracuse indicted 21 people in June on charges that they were involved in smuggling $700 million worth of cigarettes and alcohol through the St. Regis Indian Reservation in upstate New York from 1992 through 1996. Court documents state that some dealers regularly bought cigarettes from Reynolds and resold them -- usually for cash -- to members of an Indian tribe, who slipped them into Canada.

Affidavits by investigators in both countries show that Reynolds routinely entertained the dealers at the Sonora Island Resort in British Columbia, where the company sponsored an annual fishing tournament. One dealer told an informant last summer that he was about to take 12 to 14 associates to the tournament and that Reynolds was going to pay a $10,000 entry fee for each of them.

Reynolds says it does not condone smuggling and would not comment on the investigation. Thompson did not return calls for comment.

But David Sweanor, an antismoking advocate in Canada, said the industry "basically played Canada for a banana republic and got rewarded for it."

China Connection: Tobacco Floods Into Next Frontier

Tommy Chui's body was found floating in Singapore Bay on April 1, 1995.

Chui had been a cigarette dealer in Hong Kong, and had made sensational allegations about corrupt dealings there. These were the highlights: From 1986 through 1993, Chui's firm bribed a succession of B.A.T. marketing managers in Hong Kong to insure a steady supply of cigarettes. It resold most of them to smugglers running them into China, and the profits were so large that organized crime had muscled in.

Prosecutors in Hong Kong have charged Jerry Lui, who was B.A.T.'s commercial director there from 1991 to 1993, with taking more than $3 million in bribes from Chui's company. Lui has denied the charges, and B.A.T. executives have dismissed the whole affair as the work of rogue employees.

But there is no question that the smuggling has given B.A.T. a foothold in China, the most prized cigarette market. One-third of all the cigarettes in the world are consumed there. And the tobacco industry views China as its ultimate salvation.

So far, however, China has not played along. It wants to protect its state-run tobacco company, a major source of government revenue. Chinese officials also have voiced concern about the health problems that could follow an aggressive, Western marketing assault. And China has allowed foreign companies to form only limited ventures with its company.

So inevitably, smuggling is flourishing there. Industry analysts say it accounts for 4 percent to 5 percent of the cigarettes sold in China. But the market is so vast that this amounts to 70 billion to 85 billion cigarettes a year. And B.A.T. accounts for half of that.

China also seems bewildered by how to stop the smuggling. China's customs agency seizes only a tiny fraction of the contraband, and it has almost never prosecuted any of the big operators behind it.

So if the smuggling remains unchecked, China and the developing world will "really be bearing the brunt of it," said Judith Mackay, an antismoking advocate in Hong Kong.

And while the tobacco companies have pledged to reduce smoking by teen-agers in the United States, she said, the flood of smuggled cigarettes will only increase smoking by young people in other countries.

United States General Accounting Office

GAO

Testimony

Before the Senate Democratic Task Force on Tobacco

For Release on Delivery Expected at 1:30 p.m. EDT Monday May 4, 1998

CIGARETTE SMUGGLING

Information on Interstate and U.S.-Canadian Activity

Statement of Robert A. Robinson, Director,
Food and Agriculture Issues,
Resources, Community, and Economic
Development Division

GAO/T-RCED-98-182

Mr. Chairman and Members of the Task Force:

Thank you for the opportunity to discuss the results of our work on cigarette smuggling. As you know, this is part of a larger body of work we are conducting on issues surrounding the proposed tobacco settlement.[1] In conducting this work, we are addressing a wide variety of issues, including the national and regional economic impacts of the tobacco industry, smoking trends among youths in the United States and Canada, and the effect of a settlement on state excise taxes. As you requested, our statement today focuses on information concerning cigarette smuggling—in particular, interstate cigarette smuggling in the United States and Canada's recent experience with international smuggling. In summary, we found the following:

- Smuggling cigarettes from low- to high-tax states, or interstate smuggling, prominent in the 1970s, may now be a reemerging problem. Such activity is likely to occur when the differences in cigarette taxes across the states are significant enough to make it profitable. Recently, many states have opted to sharply increase their cigarette taxes. Yet most low-tax states have not. As a result, recent studies suggest that the level of interstate smuggling activity may now be increasing. In fact, recent estimates suggest that smuggling is responsible for states collectively losing hundreds of millions of dollars in annual tax revenues.
- In addition, recent experiences demonstrate that international smuggling can occur when cigarette tax differentials are substantial. International smuggling has occurred recently between Canada and the United States. According to the Canadian government, sharp increases in Canadian federal and provincial cigarette taxes in the late 1980s and early 1990s led to large-scale smuggling between the United States and Canada conducted almost entirely by organized crime. Violence increased, merchants suffered, and in one year alone, Canada and its provinces lost over $2 billion (in Canadian dollars) in tax revenues. Canada responded in 1994 by sharply reducing federal and provincial cigarette taxes and increasing its enforcement efforts, among other steps. Since then, smuggling has declined considerably.

To address these issues, we discussed U.S. interstate cigarette smuggling and U.S.-Canadian international smuggling with the Bureau of Alcohol, Tobacco, and Firearms (ATF) officials; reviewed estimates of interstate cigarette smuggling prepared by the Washington State Department of

[1]This body of work will be presented in Tobacco: Issues Surrounding a National Tobacco Settlement (GAO/RCED-98-110), scheduled to be released in mid-May 1998.

Health; and tested the Washington State estimates using an alternative methodology. To understand Canada's experience with international smuggling, we reviewed the Canadian Government Action Plan on Smuggling, a study conducted for the National Coalition Against Crime and Tobacco Contraband,[2] and a report by the Canadian Office of the Auditor General. Again, we would like to stress that the information that follows will be included in a more expansive report scheduled to be released in mid-May 1998.

Interstate Smuggling: a Reemerging Problem as Differences in States' Taxes Increase

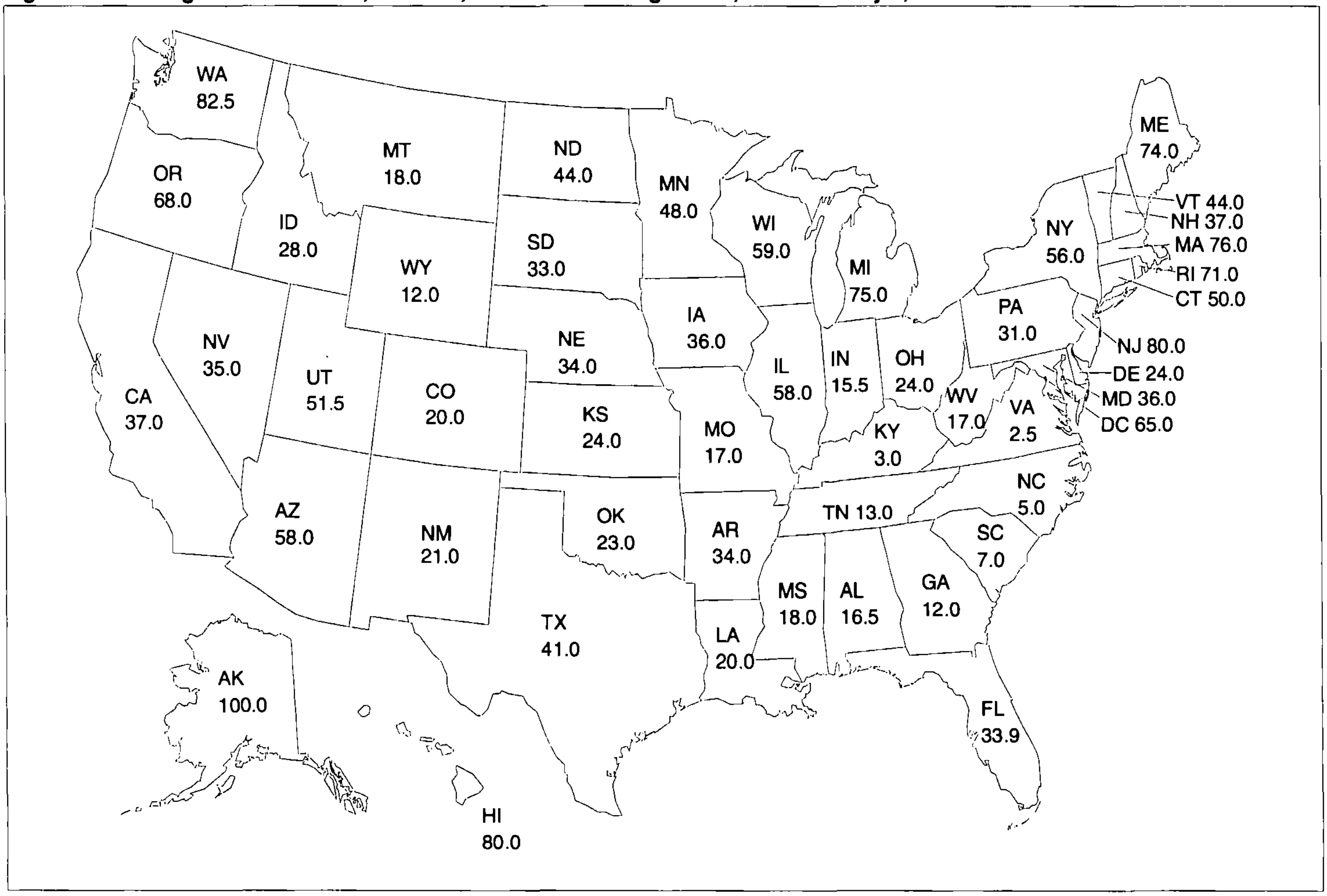
According to ATF, cigarettes are currently being smuggled across state borders to avoid the payment of state excise taxes, and such smuggling can violate federal and/or state laws.[3] The opportunity for individuals to profit from interstate smuggling exists because of the wide disparity in excise taxes across the states. As of January 1, 1998, state excise taxes on cigarettes ranged from 2.5 cents per pack to $1.00 per pack (see fig. 1). According to estimates from the Washington State Department of Health on the extent of current smuggling activity, some states are losing nearly $100 million annually in potential tax revenues.[4]

[2]The National Coalition Against Crime and Tobacco Contraband is a U.S. coalition composed primarily of retailers, wholesalers, and tobacco manufacturers. The coalition's report on smuggling entitled Cigarette Smuggling in the United States (Aug. 15, 1994) was prepared by Lindquist Avey Macdonald Baskerville, Inc.

[3]It is unlawful for any person to ship, transport, receive, sell, distribute, or purchase 60,000 cigarettes or more that bear no evidence of state tax payment in the state in which the cigarettes are found, if such state requires a stamp to demonstrate payment of taxes (18 U.S.C. 2342). States may also have stricter laws related to cigarette smuggling. For example, in Maryland, it is generally illegal for a consumer to bring into the state more than two packs of cigarettes on which Maryland taxes have not been paid.

[4]These estimates treat all forms of tax avoidance—both large and small—as "smuggling," even though some actions, such as local cross-border purchases in small quantities, may not be illegal.

Figure 1: State Cigarette Tax Rates, in Cents, Per Pack of 20 Cigarettes, as of January 1, 1998



Source: The Tobacco Institute.

The incentives to smuggle cigarettes into any particular state obviously depend on the amount that the state's tax rate exceeds that of neighboring or other states. Substantial differences in states' tax rates in the late 1960s and early 1970s encouraged significant smuggling activity. By the early 1980s, the nominal value of tax rate differentials had stabilized, but because of inflation, the constant dollar value of the differentials—and thus the profitability from smuggling—had eroded. For example, a 25-cent difference in tax rates in 1997 dollars is worth less than a 25-cent difference in tax rates in 1980 dollars. In addition, law enforcement efforts may have added to the risk of smuggling. As a result, smuggling declined. Since the mid-1980s, however, tax rates have increased substantially in some states. By 1996, differences in states' tax rates had returned to mid-1970s levels in constant dollars—thereby restoring incentives for smuggling. Consequently, according to recent studies, the profitability, and therefore the extent, of interstate smuggling activity is likely to have increased in recent years.

In 1997, the state of Washington estimated the extent of interstate smuggling activity in terms of tax per day by state—which we converted to the associated loss (or gain) in state tax revenue. Washington State's estimates were derived using an approach that statistically determines how demographic factors, such as income and religious preferences, and differences in tax rates relative to other states affect cigarette sales on which state taxes are paid. The estimated relationships can then be used to simulate actual consumption.[5] The amount by which estimates of actual consumption exceed estimates of taxed sales in a state would then represent the net cigarettes smuggled into that state. Using survey data provided by the Centers for Disease Control and Prevention, we tested the Washington State estimates and found them to be reasonable.

On a national level, the Washington State study indicated substantial smuggling from states with low tax rates to states with high tax rates. For example, the estimates of tax revenue losses in the states with the highest tax rates at the time the Washington State study was done—Washington and Massachusetts—were $52 million and $61 million annually, respectively.[6] Similarly, the estimates of tax revenues lost for New York, a state with a slightly lower tax rate but which has a large population, exceeded $90 million annually. Exporting states, such as Kentucky, North Carolina, and Virginia, showed only modest revenue gains because their tax rates are so low that extra sales to buyers in the high-tax states do not generate significant tax revenue.[7]

[5]This approach was pioneered by the Advisory Commission on Intergovernmental Relations in Cigarette Tax Evasion: A Second Look, ACIR, Washington, D.C., March 1985, and recently updated in A Tax Study: Cigarette Consumption in Washington State, Washington State Department of Health, January 1997.

[6]At the time of the Washington State study, Washington, with a cigarette tax rate of 82.5 cents per pack, and Massachusetts, with a rate of 76 cents per pack, had the two highest tax rates in the United States. Since then, however, Alaska has raised its tax rate to $1.00 per pack, and Hawaii has raised its rate to 80 cents per pack.

[7]The state cigarette tax rates for New York, Kentucky, North Carolina, and Virginia have all remained unchanged since the Washington State study was done.

The results of the Washington State study and other similar studies should be viewed as providing ball-park estimates. The estimates may be imprecise for a number of reasons. Estimates of revenues lost may be (1) overstated because they do not account for the fact that smokers would buy fewer cigarettes if they were unable to avoid the state cigarette tax (and therefore pay more for their cigarettes on average) or (2) understated because they do not account for federal and state tax revenues avoided because of international smuggling.[8]

Large Increases in Canadian Cigarette Taxes Led to Widespread Smuggling Into Canada

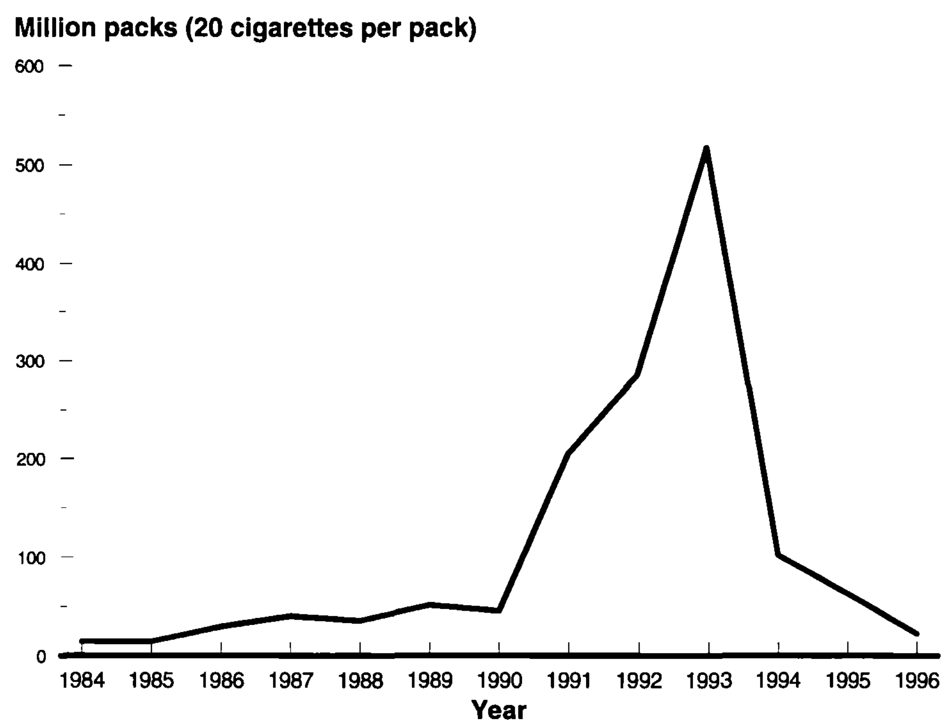
According to the Canadian government, for several years Canada increased the price of cigarettes through federal and provincial excise taxes, which resulted in a steady decline in the number of Canadians who smoke. However, these efforts had an unintended consequence—a sharp increase in smuggling activity resulting in revenue losses exceeding $2 billion (in Canadian dollars) for the federal and provincial governments in 1993 alone, according to the Canadian government. From 1984 through 1993, federal taxes on a pack of 20 cigarettes increased from 42 cents to $1.93 in Canadian dollars. Provincial taxes, levied in addition to the federal taxes, increased significantly as well. For example, from 1984 through 1993, Québec's cigarette taxes rose from 46 cents to $1.78 per pack, and Ontario's rose from 63 cents to $1.66 per pack (in Canadian dollars). As a result, the average real price of a pack of cigarettes in Canada—in 1994 Canadian dollars—increased from $2.64 in 1984 to $5.65 in 1993.

According to a 1994 study for the National Coalition Against Crime and Tobacco Contraband, because of these price increases, Canadians found lower-priced alternatives on the black market. During most of this period, cigarettes made in Canada were exported tax-free to the United States. Organized criminal groups purchased Canadian cigarettes that had been exported to the United States and smuggled them back into Canada. This resulted in more than an 11-fold increase in U.S. cigarette imports from Canada from 1990 to 1993 (see fig. 2). The 1994 study found that an Indian reserve that straddles the U.S.-Canadian border between Cornwall, Ontario, and Massena, New York, had become the primary conduit for smuggling cigarettes into Canada. Once in Canada, the cigarettes were passed through elaborate networks for distribution to vendors throughout the country. By evading the Canadian federal and provincial taxes, smugglers were able to earn huge profits from contraband cigarettes. According to the Canadian government, profits for smuggled cigarettes

[8]For some states, revenue from state sales taxes, in addition to cigarette taxes, may also decline because of cross-border purchases and contraband sales.

were an estimated $500 per case,[9] or $500,000 per truckload, in Canadian dollars.[10]

Figure 2: U.S. Cigarette Imports From Canada, 1984 Through 1996



Source: GAO's analysis of U.S. Department of Agriculture's data.

In 1993, approximately 2.1 million Canadians consumed an estimated 90 million to 100 million cartons of contraband cigarettes with a legal retail value of about $4.5 billion in Canadian dollars. That year, the problem was greatest in the province of Québec, where, the Canadian government estimated, contraband cigarettes made up over 60 percent of the market. In other parts of the country, according to the government, between 15 and 40 percent of the cigarettes sold were contraband.

[9]A case of Canadian cigarettes contains 50 cartons.

[10]Prime Minister Jean Chrétien, Government Action Plan on Smuggling, House of Commons, February 8, 1994.

While citing the effectiveness of past efforts to reduce smoking by increasing cigarette taxes, Prime Minister Chrétien stated in February 1994 that the widespread availability of relatively inexpensive contraband cigarettes was negating government controls on the distribution, sale, and consumption of cigarettes. According to the Canadian Prime Minister, as the portion of the Canadian market supplied by smuggled tobacco increased, the average price paid for cigarettes dropped. Access to cheap contraband tobacco undermined the government's health policy objectives of reducing tobacco consumption, particularly among youths. He added that he believed that Canadian tobacco manufacturers were aware that tobacco exports to the United States had been reentering Canada illegally and that these manufacturers benefited directly from this illegal activity.

In February 1994, Prime Minister Chrétien addressed the smuggling problem by proposing, among other actions,

- strengthening enforcement at targeted smuggling areas, particularly along the U.S.-Canadian border;
- reducing the federal cigarette tax by $5 per carton in all provinces, effective February 9, 1994, and matching any provincial tax reduction over $5 to a maximum federal reduction of $10 (in Canadian dollars);
- imposing an export tax of $8 per carton (in Canadian dollars) to be paid by tobacco manufacturers;
- imposing a 3-year federal surtax on tobacco manufacturers' profits to fund a major public education program and other health measures;
- requiring manufacturers to clearly mark individual cigarettes to differentiate cigarettes manufactured for domestic and export use; and
- further restricting access to cigarettes by minors.

From February 9 through April 15, 1994, federal and provincial taxes were significantly lowered in the five provinces where international smuggling was particularly troublesome, including Québec and Ontario. For example, combined taxes in Québec fell by $2.10 per pack, and taxes in Ontario fell by $1.92 per pack in Canadian dollars.[11] Although taxes in these provinces have increased slightly since, once the initial tax cuts took effect, the U.S.-Canadian contraband cigarette market dried up, according to the 1994 study for the National Coalition Against Crime and Tobacco Contraband. Consistent with the study's findings, U.S. cigarette imports from Canada dropped about 96 percent from 1993 through 1996 (see fig. 2).

[11]Based on 20 cigarettes per pack.

Thank you again for the opportunity to appear before you today. We would be pleased to respond to any questions you may have.

Jerry - just a few comments - Rachel

I am writing to ask you to work with me to enact into law this year restrictions that will prevent the cloning of a human being, without disrupting biomedical research. On June 9, 1997, I sent legislation to the Congress that would achieve these goals. My bill was carefully and narrowly crafted to prevent the cloning of a human being, but not interfere with important biomedical research that could lead to meaningful advances in treating illnesses such as cancer and diabetes. Reports this week of the cloning of more than 50 ~~adult~~ mice adds to the urgency of our task.

As you know, scientists, the public, and policymakers alike were stunned last year by reports that a scientist had cloned an adult sheep. Most experts had previously believed that ~~it was not~~ possible to reactivate all of the genes of an adult specialized cell* to produce all of the other cells. But as has happened so often, human ingenuity pierced old assumptions and provided a new understanding of what is possible. This technology holds great promise.* Many scientists and doctors now believe cloning technology can be used to produce cell lines that could result in breakthrough treatments ~~of~~ for many dreaded illnesses such as replacing a failing organ without the need for a donor or the risk of tissue rejection.

But the new technology also poses difficult moral questions. ~~Scientific advancement should not occur in a moral vacuum.~~ Technological developments divorced from values will not bring us one step closer to meeting the challenges of the next millennium. Virtually everyone agrees that the use of new cloning techniques to create a human being is untested, unsafe, and morally unacceptable.

This week's reports on the advances in cloning technology make it important that we set aside politics and send a clear message that cloning a human being is not an acceptable endeavor. I am concerned that efforts to address other moral questions, such as when does human life begin, in cloning legislation are endangering our chances of passing a bill this year. We have the opportunity to pass cloning legislation in the next two months. But we will only succeed if we stay focused on prohibiting the cloning of human beings, and not try to resolve other moral conundrums.

* almost like or tantamount to turning back the clock [on development].

~~Jerry~~

Let's talk

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Jeff Nussbaum

David Orszak

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Indians say they had help at front end

Akwesasne case could topple industry arguments against proposed cigarette tax.

Published June 07, 1998, in the Herald American.

By John O'Brien, Staff Writer

Evidence that tobacco companies may have assisted a huge cigarette smuggling operation on the Akwesasne Indian Reservation is fueling a Clinton administration attack on industry executives who oppose the president's plan for a dramatic increase in the U.S. cigarette tax.

The administration has proposed hiking the tax on a pack of cigarettes by $1.10 as a way to curb smoking among teen-agers.

Tobacco company officials argue such a tax in 7crease would create a huge black market similar to one that existed in Canada for several years before that country lowered its tobacco tax in 1994.

"The illegal market becomes so efficient and robust that every thief sees a pack of cigarettes as ready cash," Steven Goldstone,chairman and chief executive officer of RJR Nabisco, said in a speech in April. "If Washington creates a raging black market for cheap cigarettes on street corners and in schoolyards, the people will be furious, and they will ask, just as they did in Canada: "How did we get ourselves into this terrible mess?'"

But evidence that emerged in the Northern New York smuggling case could topple Goldstone's argument, White House officials say. The evidence suggests the black market may not have existed without tobacco industry help.

"We believe it is hard to imagine that large-scale tobacco smuggling could occur without the manufacturers' knowledge, and are interested in new evidence coming to light regarding the role of companies in Canada," said Cynthia Rice, special assistant for domestic policy at the White House.

The evidence comes from several sources, among them Tony Laughing, a Mohawk Indian who is accused with 20 others of ringing up $687 million over four years by smuggling Canadian cigarettes through Akwesasne, which straddles the U.S.-Canadian border in Northern New York.

Laughing, held in the Justice Center jail in Syracuse, said in recent interviews that tobacco company officials were intimately involved in getting the contraband onto the black market in Canada.

Laughing said he and his underlings transported about seven cases a day across the St. Lawrence River to the Canadian side of the Mohawk Nation starting in the mid-1980s. Police called it smuggling, but Laughing called it free trade to which his nativesovereignty entitled him.

By 1993, Laughing was moving 240 cases a day and was having a hard time keeping up with the increasing supply. The supply in 1993 amounted to 12,000 cartons, or 2.4 million cigarettes a day - up from 70,000 cigarettes a day in the mid-1980s.

The difference between the mid-1980s and early-1990s was that the Indians had some help at the front end, Laughing said.

Tobacco company executives had begun to team up with smugglers more than ever before in an attempt to force the Canadian government to lower its steep tax on tobacco, according to Laughing.

Laughing's claim is backed up by another accused smuggler, Larry Miller of Massena, who said tobacco executives helped him move cigarettes back into Canada to avoid taxes.

The number of Canadian-brand cigarettes exported to New York state rose from 500,000 in 1989, when a hefty tax was imposed, to 20 billion in 1993. Those brands, such as Export A's and DuMauriers, don't have near that many American customers. They were clearly headed for the black market in Canada, according to tobacco industry experts.

An R.J. Reynolds spokesman, John Singleton, denied the company encouraged or aided smugglers in any way.

"Clearly, we certainly don't condone smuggling," Singleton said. RJR-Macdonald, an R.J. Reynolds affiliate based in Toronto, like other tobacco companies, was aware that the drastic increase in the export of Canadian brands to the United States was headed for the black market in Canada, Singleton said. He said he didn't know whether the tobacco companies could have curtailed smuggling by not increasing those exports.

"We did as much as we could to make sure the Canadian government understood what was going on so they could apply any law enforcement remedies they thought were appropriate," Singleton said.

How smuggling worked

According to Laughing, the smuggling operation worked like this:

Canadian cigarette makers in Montreal would legally ship their products to the United States through entry points such as Buffalo and Champlain. Since the cigarettes were exported, they were exempt from a Canadian tax that had driven up theaverage cost of a pack of cigarettes from $2.64 in 1984 to $5.65 in 1993.

Smugglers would then move the cigarettes through Akwesasne and back into large Canadian cities. Laughing said Mohawks would pay $8 for a carton and sell it for $18 on the Canadian side of the reservation. A carton would then sell for $22 on Canadian store shelves. At the time, Canadians were paying $40 to $60 a carton for taxed cigarettes.

Laughing said he was introduced to R.J. Reynolds marketing executive Les Thompson at Akwesasne about two years ago, when Thompson was a guest at the restaurant of another accused smuggler, Loran Thompson. The two Thompsons are not related.

"They knew exactly what business we were in," Laughing said. "They knew their product was going to my warehouse and to other Indians who were taking it across the river (into Canada)."

In 1994, Laughing went with Miller aboard Miller's Learjet to Winston-Salem, N.C., the headquarters of R.J. Reynolds Tobacco. Miller told Laughing that the $5,000 travel cost was paid for by the company.

"They treated us as good customers of theirs," Laughing said. "Gave us the royal treatment. A private tour, promotional products. T-shirts, hats - boxfuls of them to pass out on the reservation."

"They accommodated us by getting more of their product into this country," Laughing said.

Other evidence

Laughing's claim is just one piece of evidence indicating R.J. Reynolds executives were working hand-in-hand with accused smugglers:

Miller has said that R.J. Reynolds executives Les Thompson and Stan Smith were intimately involved in getting cigarettes onto the black market in Canada. Smith is now chief executive officer of RJR-Macdonald.

Miller said in an interview four months ago that Smith and Thompson not only brokered sales of Export A's to him, but told him which brands were hottest in which areas of Canada.

"They'd give us the details on what's hot in Quebec, and what's hot in Ontario and what's hot in BC (British Columbia)," Miller said. The cigarettes that they were selling were not supposed to end up back in Canada, Miller said.

Neither Smith nor Thompson could be reached for comment.

A truck driver for the smuggling ring, Michael Mangan, testified before a federal grand jury in 1996 that Les Thompson was brokering deals with Miller and with two other accused smugglers, Robert and Louis Tavano, during a fishing trip to SonoraIsland Lodge in British Columbia in 1995.

A Royal Canadian Mounted Police report raised questions about large sums of money that R.J. Reynolds was wiring to the fishing lodge while the accused smugglers were there.

A federal grand jury last summer subpoenaed records from RJR Nabisco in an investigation of smuggling activities, according to the company's filings with the Securities and Exchange Commission.

In addition, the White House is looking into the unusual design of RJR-Macdonald's packaging of cigarettes that it was makingin Puerto Rico in 1992. RJR-Macdonald makes Export A's.

When Canada imposed an export tax in 1992 in an attempt to curtail smuggling, the company started making cigarettes in Puerto Rico that were purportedly going to the United States, according to David Sweanor, a lawyer with the Non-Smokers' Rights Association of Canada.

The packs carried the wording of a U.S. health warning, but the company designed the package with a large label similar to the shape and color of the Canadian health warning, Sweanor said. From a distance, the packs looked as if they were Canadian cigarettes when they ended up on the black market in Canada, he said.

Sweanor testified before two congressional committees looking into the proposed tobacco legislation in the United States, and was called to the White House three weeks ago to talk about the unusual package designs in Puerto Rico and other issuesrelated to Canada's smuggling problem.

Claims of innocence

Miller and Laughing, who face criminal charges in federal court in Syracuse, contend they did not break any laws. Miller said he was merely hauling cigarettes and had no control over whether they ended up on the black market. Laughing said he never moved cigarettes off Indian territory.

Laughing and Miller say if they're facing criminal charges, so should the tobacco companies. Miller's lawyer has asked a judge to dismiss the charges against him on those grounds.

Sweanor told two congressional committees and the White House that Canadian tobacco companies engaged in smuggling to prod the government into lowering the cigarette tax and to profit from the black market sales.

"These same companies then seek to use the existence of a smuggling threat as a tool in avoiding tax increases," Sweanor testified May 4 before the Democratic Task Force on Tobacco.

"Smuggling only exists to the extent that there's complicity by the tobacco companies," Sweanor said in an interview.

THE POST-STANDARD
MORNING

Herald American
SUNDAY

SYRACUSE HERALD-JOURNAL
EVENING

CLINTON SQUARE, P.O. BOX 4915, SYRACUSE, NEW YORK 13221-4915

Michael J. Connor
EXECUTIVE EDITOR

May 13, 1998

Dear Elena,

These are generally the questions I want to ask you at your earliest convenience:

1. Why is the White House interested in tobacco smuggling in Canada and upstate New York, particularly the developing evidence that tobacco companies may have helped create a massive black market?
2. What prompted your inquiry?
3. What in particular are you looking at regarding this situation, and why?
4. Was this in response to claims by Steven Goldstone and other tobacco executives that a rise in cigarette prices would create a massive black market in the U.S.?
5. How do you hope to use the information that has come out about RJR-Macdonald and Imperial Tobacco?
6. What significance do you give the drastic increase in the export of Canadian cigarettes to the U.S. in 1993? Is that an indication that the tobacco companies knowingly created the massive black market in Canada?
7. Are you working with the Department of Justice on this case? Do you have any information from DOJ about the ongoing federal grand jury investigation of RJR in connection with the Larry Miller smuggling ring?
8. What questions are raised by RJR's manufacturing of cigarettes in Puerto Rico and the unusual packaging design they used?
9. Are tobacco companies being disingenous when they raise the specter of massive tobacco smuggling, given what you know about the cause of Canada's smuggling problem?
10. Sen. Hatch held up a pack of smuggled Chinese cigarettes at the hearing, and questioned whether they would flood the market if cigarette prices in the U.S. went up. Is this realistic?
11. What's the next step for you in your inquiry into the smuggling case here and in Canada?
12. Is there anything else I should know, or documents you can steer me to?

If you're unable to reach me by phone tomorrow (Thursday), please fax me answers to these questions. Thank you.

Sincerely,

John O'Brien

John O'Brien
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John O'Brien <jobrien @ syracuse.com>
04/30/98 08:20:54 AM

Record Type: Record

To: Jerold R. Mande/OSTP/EOP

cc:
Subject: Re: test

CIGARETTE PLOT SUSPECT: EXECS KNEW OF DEALS
COMPANY OFFICIALS TALKED ABOUT WHICH ILLEGAL CIGARETTES WERE SELLING WELL IN CANADA, SAYS A MASSENA DISTRIBUTOR.

The Post-Standard
Tuesday, January 20, 1998
EDITION: Metro SECTION: News PAGE: A1 LENGTH:

BYLINE: By JOHN O'BRIEN The Post-Standard

At least two high-ranking executives at a Canadian tobacco company were aware that the cigarettes they were exporting to the United States would end up on the black market in Canada, according to a Massena man charged with leading a massive smuggling conspiracy.

Lawrence V. Miller said in an interview Monday that he met often with Stan Smith and Les Thompson of RJR-Macdonald Inc. at a fishing lodge in British Columbia to broker cigarette deals.

Miller, 52, and 20 others are accused of defrauding the U.S. and Canadian governments by assisting the smuggling of $687 million worth of tobacco and liquor through the Akwesasne Indian Reservation in Northern New York from 1992 to 1996. Miller is a cigarette dealer.

Smith, executive vice president of RJR-Macdonald in Toronto, met Miller at Sonora Island Lodge near Vancouver several times in recent years, Miller said.

Neither Smith nor Thompson could be reached for comment. Thompson is now a marketing executive with the company's U.S. affiliate, R.J. Reynolds Tobacco Co. in Winston-Salem, N.C.

Miller said Smith and Thompson even told him and his associates which of their brands were selling best in Canada after being smuggled from the United States.

"They'd give us the details on what's hot in Quebec, and what's hot in Ontario and what's hot in British Columbia," Miller said.

Miller said he never smuggled cigarettes into Canada or did anything illegal in his cigarette distribution business. But he said if he has to face criminal charges, so should the tobacco company executives who went through him.

If someone else smuggles the cigarettes after buying them from Miller, that's not his business, Miller said. The tobacco companies can make the same argument, he said.

Miller's disclosure wasn't the first evidence of a connection between RJR-Macdonald and the alleged smuggling operation. In August, documents from U.S. Customs agents revealed that Thompson sat in on meetings with the accused smugglers at the fishing lodge.

Canadian police documents show that in 1996, RJR-Macdonald agreed to pick up the $10,000 per person entry fee for Miller and his friends to be in a fishing derby at Sonora Island Lodge.

Janet Hatfield, a spokeswoman for RJR-Macdonald, said the company would not comment because Miller's case is part of an ongoing police investigation.

Smith told the Canadian Broadcasting Co. in an interview to be broadcast in Canada tonight that he did not help Miller or any other smugglers.

Miller's allegations seem to support what tobacco industry critics have surmised: Canadian cigarette makers had to know their products were headed for the black market. Before Canada imposed a huge tax on cigarettes in 1989, it was exporting about 700 million cigarettes a year to the United States. By 1993, 20 billion Canadian cigarettes were being exported, said David Sweanor of Nonsmokers' Rights Association of Ottawa.

"What we shipped in went into upstate New York, where nobody smokes those cigarettes," Sweanor said.

Sweanor agreed with Miller on one point: If police charged Miller, they should charge the tobacco executives who helped him.

Federal prosecutors have refused to say whether they are investigating possible crimes involving the tobacco companies.

Reference Number: 9801200265

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RJR LINKED TO TOBACCO SMUGGLERS

THE TOBACCO COMPANY KNEW ITS

PRODUCTS WERE ENDING UP AS
CONTRABAND ON AKWESASNE AND
ENCOURAGED IT, SAY RECORDS
SUBPOENAED BY A GRAND JURY.

The Post-Standard
Saturday, August 16, 1997
EDITION: Metro SECTION: News PAGE: A1 LENGTH:

BYLINE: By JOHN O'BRIEN The Post-Standard

As the leaders of a massive cigarette smuggling ring discussed their booming business at a Canadian fishing lodge two years ago, tobacco giant R.J. Reynolds had an ear to the conversation, according to federal court records unsealed this week in Syracuse.

A marketing official with the cigarette manufacturer sat in on the meeting and indicated he knew that his company's products would end up on the black market in Canada, according to an affidavit from U.S. Customs agent Gil Schmelzinger.

The documents reveal for the first time possible complicity by a tobacco company in the smuggling ring that moved $687 million worth of contraband cigarettes and hard liquor into Canada from 1992 to 1996.

R.J. Reynolds, the second-largest cigarette manufacturer in the United States, has become a focus of a federal grand jury in Syracuse investigating the smuggling operation that sneaked products through the Akwesasne Indian Reservation in northern New York.

The grand jury subpoenaed R.J. Reynolds' financial records three weeks ago, according to the company's filings with the Securities and Exchange Commission. RJR-MacDonald of Toronto, an affiliate of R.J. Reynolds, makes Export A cigarettes in Canada.

Here's how prosecutors say the ring worked:

The smugglers exported cigarettes such as Export A from Canada to the United States to avoid paying high Canadian tobacco taxes, then smuggled them back into Canada and sold them far below the market price at a big profit.

The newly released documents revealed a possible link between the smuggling ring's leaders and Les Thompson, a marketing agent who has an office at R.J. Reynolds' headquarters in Winston-Salem, N.C.

Thompson did not return phone messages left at his office. Jan Smith, a spokeswoman for R.J. Reynolds, said the company could not comment because of the grand jury investigation.

Schmelzinger's affidavit said that Michael Mangan, a former truck driver for the smuggling ring, was invited to a fishing vacation in British Columbia in September 1995. The accused leaders of the operation were all there, Mangan said: Larry V. Miller, Robert and Lewis Tavano, and Loran Thompson, the affidavit said.

Those four men are among 21 people indicted in June in connection with the smuggling operation.

"We sat around this big fireplace, and there was a big discussion and smuggling of the cigarettes, and Les Thompson was present at this meeting," Mangan testified in April 1996. "And I mean he definitely put it together that the cigarettes were being smuggled into Canada," said Mangan, who was granted immunity from prosecution in exchange for his testimony.

One day during the trip to British Columbia, Mangan was on a boat with Les Thompson and Loran Thompson, who are not related. Loran Thompson, a Mohawk accused of running contraband cigarettes across the St. Lawrence River, was getting seasick on the rolling waves of the Pacific Ocean, Mangan testified.

Les Thompson "couldn't understand it because (Loran Thompson) was, well, used to boats and crossing the water hauling cigarettes," Mangan testified.

It wasn't the first time police have found possible links between cigarette manufacturers and the alleged smuggling ring headed by Miller and the Tavanos. Royal Canadian Mounted Police are investigating the connections of two tobacco companies, including R.J. Reynolds, to a fishing lodge in Sonora Island, B.C., which Miller and the Tavanos frequented.

Louis Tavano, a Las Vegas lawyer and the son of Lewis Tavano, said that if anyone was aware that the cigarettes were being smuggled, it was the tobacco companies that supplied them. He said his father's company was doing legitimate business when it sold cigarettes to licensed Akwesasne merchants.

Reference Number: 9708160255

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SMUGGLING BOOSTS SALES OF CIGARETTES, ANALYSTS SAY
SKYROCKETING EXPORTS OF CANADIAN BRANDS SHOULD HAVE BEEN A TIP-OFF, THEY SAY.

The Post-Standard
Saturday, August 16, 1997
EDITION: Metro SECTION: Local News PAGE: B5 LENGTH:

BYLINE: By JOHN O'BRIEN The Post-Standard

Tobacco manufacturers have compelling reasons to help smugglers move their products illegally onto the black market in Canada, according to tobacco industry experts.

And Canadian cigarette companies had to know that was just what was happening, with a huge increase in Canadian-made cigarettes exported to the United States since 1990, the experts said.

Those observations fueled the interest in this week's revelations of a possible link between an official with R.J. Reynolds Tobacco Co. and the leaders of a $687 million smuggling ring. The link was revealed in federal court papers in Syracuse.

Greg Connolly, an expert in tobacco control who advises the World Health Organization, said regardless of whether tobacco companies are involved in smuggling, the practice helps them.

The companies make money by selling to smugglers, which sell the products at a cheaper price on the black market and thereby increase consumption, said Connolly, with the Massachusetts Department of Public Health.

And tobacco companies point to smuggling when they lobby governments to lower cigarette taxes, Connolly said.

"Smuggling is promoted as a deterrent for a country to raise its tax, and in Canada's case, smuggling was the principal reason it lowered its historic tax, the highest tax among developed countries at the time," Connolly said.

A Canadian cigarette tax in 1989 created a huge jump in Canadian cigarettes exported to the United States - from 3 billion in 1990 to 9 billion in 1991. They were Canadian brands such as Export A's, duMauriers and Players.

Most of those were likely smuggled back to Canada through the Akwesasne Indian Reservation in New York, authorities say.

"It wasn't because a bunch of people in Buffalo all of a sudden decided they like Players cigarettes," said Heather Selin, a policy consultant with Nonsmokers Rights Association in Ottawa. "Tobacco companies were flooding the export market knowing full well that those cigarettes would end up in Canada illegally."

R.J. Reynolds officials refused to comment on a federal grand jury investigation into its ties to the ring, which prosecutors claim was headed by Larry V. Miller of Massena and Robert and Lewis Tavano of Niagara Falls.

The grand jury subpoenaed records from R.J. Reynolds Tobacco International in Geneva, Switzerland; R.J. Reynolds Tobacco Co. in Winston-Salem, N.C.; and Northern Brands International in Winston-Salem. They're all subsidiaries of RJR Nabisco Holdings Corp.

"Tobacco companies may benefit from smuggling, but they obviously don't want to get their hands dirty," Selin said. "If there is something going on, they could be expected to keep it very well-hidden."

Louis Tavano, a Las Vegas lawyer and the son of Lewis Tavano, said if anyone was aware the cigarettes were being smuggled, it was the tobacco companies that supplied them. His father's company was doing legitimate business when it sold cigarettes to licensed Akwesasne merchants, he said.

Reference Number: 9708160246

New Search

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POLICE SAY SUSPECT WAS GLOBAL SMUGGLER
PROSECUTORS ALLEGE LARRY MILLER OF MASSENA HAD TIES TO TOBACCO COMPANIES HE SMUGGLED AGAINST.

The Post-Standard
Wednesday, July 9, 1997
EDITION: Metro SECTION: News PAGE: A1 LENGTH:

BYLINE: By JOHN O'BRIEN The Post-Standard

Visitors to a $284,000 fishing lodge in a remote corner of British Columbia must arrive by plane or boat to bypass Campbell River.

That proved no problem for Massena bar owner Larry V. Miller last summer, according to Canadian police. Miller flew in with friends aboard his $2.5 million Learjet for a high-priced fishing derby at the Sonora Island Lodge, police said.

U.S. prosecutors say Miller was one of three kingpins in a smuggling ring that moved $687 million worth of contraband cigarettes and liquor through the Akwesasne Indian Reservation in northern New York from 1992 through 1996.

Who picked up the $10,000 per person tab for Miller and his friends to enter the fishing tournament that day last summer? RJR-Macdonald Inc., the maker of Export A's, one brand of cigarettes that the smuggling ring is accused of moving through Akwesasne.

Miller surrendered in U.S. District Court in Syracuse Tuesday, three weeks after he was indicted on charges of defrauding the U.S. and Canadian governments through smuggling, and laundering profits from the operation. He pleaded innocent.

Twenty other people were also charged in the smuggling operation; all but two have surrendered or been arrested.

The details of Miller's trip, the smuggling operation and his lavish lifestyle are spelled out in a 140-page affidavit filed last year by the Royal Canadian Mounted Police in a court in Hamilton, Ontario.

The affidavit also gives a glimpse of Miller's association with tobacco companies whose products he's accused of smuggling.

RJR-Macdonald is affiliated with RJ Reynolds, which makes Camel cigarettes in the

United States. The company also has invested money in the lodge, according to the affidavit.

Canadian police are investigating RJR-Macdonald's connection to Miller and his smuggling ring, said Sgt. Gilles Duguay of the RCMP's anti-smuggling task force in Cornwall, Ontario.

Another cigarette maker, Imperial Tobacco Corp., also is being investigated for its ties to Miller's smuggling ring and the fishing lodge, Duguay said. Imperial Tobacco makes duMaurier and Players cigarettes, which also were among the smuggled brands, authorities said.

No one from the cigarette makers has been accused of knowingly helping the smugglers, but the police affidavit raises questions about the association.

"How can you do it without some people intentionally closing their eyes?" Duguay asked. He refused to comment further.

Imperial Tobacco made "suspicious" deposits of cash to the lodge in 1995 that drew the attention of the Hong Kong Bank of Canada, the police affidavit said. The company transferred $200,000 in cash to the lodge in May 1995 with the only explanation from Sonora Island Lodge that it was the payment for a "customer vacation," the affidavit said. The next month, the company transferred another $110,000 in cash to the lodge, the affidavit said.

The bank asked Sonora Island Lodge to stop receiving such large cash transactions without better documentation for their purpose, the affidavit said.

Officials at RJR-Macdonald in Toronto and RJ Reynolds in Winston-Salem, N.C. said they were unaware of the Canadian police investigation or the affidavit, and would not comment on the allegations. Imperial Tobacco officials could not be reached for comment.

The central character in the smuggling investigation is Miller, the 52-year-old owner of Club 37 in Massena. The affidavit portrays Miller as a high roller with connections that span the globe - from Las Vegas to Moscow to Massena.

Miller, dressed in a navy blue, button-up sweatshirt, black jeans and black cowboy boots, refused to comment after entering his plea Tuesday.

He was released on $500,000 bail after posting two Las Vegas properties with equity of $260,000, a $150,000 cashier's check, and a $150,000 bail bond.

Miller's daughter, Victoria Glines, and her husband, Timothy Glines, also pleaded innocent and were released after posting bail. They said they were headed back to California, where she works as a substitute school teacher and he's in training to do the same work.

The affidavit, filed in connection with smuggling charges that Canadian authorities filed against Miller and others, is based on information obtained from a RCMP officer who infiltrated the smuggling ring for several months last year. The officer worked undercover as the owner of a fictitious trucking company based in Bulgaria.

The affidavit said U.S. prosecutors told Canadian police that they planned to use the evidence gained by the undercover Canadian officer as part of their case against the Miller smuggling operation.

The affidavit gave these details and allegations about Miller's life:

He spends time in Moscow tending to a newly opened $22 million casino in Red Square that he started in partnership with Hollywood action-film star Chuck Norris. Miller's associate, Shawn Burke, told the undercover officer that Miller had worked through a Russian organized crime group to set up the casino, and that he used profits from the Akwesasne smuggling operation, the affidavit said.

He was setting up a smuggling operation in Russia. Miller asked the undercover officer if he could help him smuggle potassium pechlorate and aluminum powder out of Russia into Canada then to the United States, where they would be used to make explosives and fireworks that would be sold in the United States.

Miller has a history of convictions for "firecrackers and tax evasion." No other details were given.

Miller made $35 million from 1994 through 1996 by smuggling alcohol and liquor. He bought the Learjet in Tijuana, Mexico, for $2.5 million, but sold it last year because it cost too much to operate. Miller was paying $66,000 a month to maintain and fly the plane, the affidavit said.

Miller frequently travels around the world to do his business, going from Russia to Egypt to Las Vegas and back to Massena and his $200,000 home.

Miller owns at least five properties in Las Vegas, and one of his associates in the smuggling operation, Dick Rancati, is vice president of Arizona Charlies Casino in Las Vegas.

Miller's organization was "well protected" on Akwesasne by his contacts on the reservation, where gunfire broke out seven years ago between pro- and anti-gambling factions among the Mohawk nation. Because of the possibility of violence, federal authorities have vowed not to enter the reservation to make arrests or seize property as part of the smuggling case.

He put his businesses and property in the name of his live-in girlfriend, 31-year-old Toni M. Chase of Massena. In court Tuesday, Miller's lawyer, Donald Bierman, said he strongly suspected that Chase had become a witness for the prosecution against Miller. Assistant U.S. Attorney Gregory West did not confirm or deny that claim, but asked U.S. Magistrate Daniel Scanlon to instruct Miller not to have any contact with Chase.

The affidavit said Miller took a co-defendant, Lewis Tavano, to the Sonora Island Lodge in June 1995 for the fishing derby. Tavano was an associate of Buffalo-area crime boss in the 1970s and was cleared of felony gambling charges. His brother and co-defendant, Robert Tavano, was convicted at about the same time of stealing $400,000 in insurance premiums from Niagara County while he was chairman of the county's Republican party.

Authorities identified the Tavanos as the other leaders of the smuggling ring, along with Miller. Lewis Tavano's lawyer, Edward Z. Menkin, said his client is a legitimate businessman, and that the cigarette makers were simply courting customers to get them to keep buying their product.

ILLUSTRATION: PHOTO
DENNIS NETT/The Post-Standard
Larry Miller of Massena surrendered in U.S. District Court in Syracuse Tuesday, three weeks after he was indicted on charges of defrauding the U.S. and Canadian governments through smuggling, and laundering profits. Color.

GRAPHIC: Massena to Moscow Syracuse Newspapers Color (Note: for text of graphic, see microfilm.)Reference Number: 9707090330

HOW BORDER AGENTS BEGAN TO PLUG THE `BLACK HOLE' OF AKWESASNE
BRAZEN SMUGGLING RING OPERATED IN BROAD DAYLIGHT.

Syracuse Herald American
Sunday, June 29, 1997
EDITION: Final SECTION: News PAGE: A1 LENGTH:
TYPE: LIST

BYLINE: By John O'Brien Staff Writer

For four years, Dan Letourneau sat frustrated in his second-floor U.S. Customs office at the northeastern tip of New York state while a 10-mile stretch of border an hour's drive to the east opened like a sieve.

"The black hole" is what Customs agents had dubbed the U.S.-Canada border that runs through the Akwesasne Indian Reservation in northern New York.

It's the only portion of the Canadian or Mexican borders with the United States straddled by an Indian reservation. That unique geography had always given easier access to anyone who wanted to smuggle goods past Canadian and U.S. customs agents.

But in recent years, the contraband crossing Akwesasne's border swelled at an alarming rate. Letourneau's office started getting calls from police around the country who'd stopped someone with Persian rugs, or Freon, or some other product that can't legally be imported.

"They call up here and say, `You know anything about an Indian reservation called Akwesasne?"' Letourneau said.

His answer? "`Yeah. What you got? Rugs, drugs, carpets, illegal aliens, Freon?"'

But it was cigarettes and liquor that were the hottest commodity and the most frustrating for Letourneau and his small staff of investigators.

With the Canadian government imposing huge taxes on cigarettes, and later alcohol, a black market was created and a $1 billion-a-year smuggling pipeline had opened along Akwesasne. Some smuggling rings were bringing in at least $300,000 a week, or $15 million a year, Letourneau said.

The smuggling trade on Akwesasne this week was dealt what authorities hope was a fatal blow. Twenty-one people were indicted on charges of smuggling liquor and cigarettes through the reservation and onto the black market in Canada, then laundering the profits back on the U.S. side.

Prosecutors say the smugglers made $687 million in four years.

That, they say, shows how huge the profits had become.

Showing off

By 1993, when Letourneau took over as head of Customs investigations out of Rouses Point, the smugglers had become blatant in their operation and in showing off their profits.

The boathouses along the St. Lawrence River had become opulent, reminding one Customs official of those used by the Georgetown University crew along the Potomac River. And the smugglers started zipping across the river in broad daylight in their small motorboats loaded with 50 cases of cigarettes.

But most of the trafficking was at night, when gunfire could be heard from the boats as a warning or a rite of passage.

"You could stand there and see it," Letourneau said. "And they were doing it with impunity." Eventually, the smugglers even bragged on local television news shows and let cameras record them breaking the law.

Customs investigators had many options. They could put a boat in the channel and patrol. They could set up a video camera and watch the river, or they could patrol from the shore of the reservation. But all of those tacks posed a risk of setting off violent confrontations on the reservation, Letourneau said. It was only seven years ago that the Nation erupted in gunfire between factions that favor and oppose casino gambling, resulting in two deaths.

"We couldn't have the instant gratification of being able to say, `There's the violation, there's a violator. Grab him,"' Letourneau said. "We weren't about to go on the reservation like that. We needed another approach."

Letourneau had worked the Mexican border near San Diego for 14 years before going to Rouses Point, where he'd grown up as the son of the village's mayor. Down there, one customs office would make 20 drugs arrests a day. The Mexican border with Texas had 220 Customs agents. The Canadian border with New York, about the same length, had just 10.

The crackdown

The frustration of Customs officials over Akwesasne reached a boiling point last year, when they invited one of their top bosses from Washington, D.C., to the border to see for himself.

Walter Biondi, then assistant commissioner of Customs investigations, stood beneath the International Bridge north of Massena with a pair of binoculars, watching boatloads of cigarettes and alcohol zipping the 200 yards across the St. Lawrence River to the Canadian side of the reservation.

"I looked at him and I said, `There it is. They're smuggling liquor and God knows what,"' said Jerry Sullivan, the agent in charge of the Buffalo office. "He looked at me and he said, `Well, what do you need here, Jerry?"'

Customs investigations now has two new offices, in Massena and Alexandria Bay, and six more investigators to try to close the smuggling sieve that Akwesasne has become.

The charges announced this week represent their first major crackdown.

The defendants were not charged with doing the smuggling, but with running conspiracies to aid smugglers and laundering profits back to the United States.

L. David Jacobs, a former Mohawk chief, was accused of running the affairs of the tribe as a criminal enterprise. It was only the second time that federal prosecutors had invoked the Racketeer Influenced Corrupt Organization Act against tribal leadership.

The Customs Service was one of at least seven agencies in a task force set up three years ago to bring down the brunt of the alcohol and tobacco smuggling at Akwesasne. Headed by Assistant U.S. Attorney Gregory West, the task force used a different strategy for stopping the smuggling.

Instead of making arrests for individual smuggling trips, the agents infiltrated the smuggling ring with undercover agents and hidden microphones, tapped phone lines and seized documents, said Sgt. Gilles Duguay of the Royal Canadian Mounted Police, which assisted in the investigation.

The plan was to hit the smugglers where it hurt most: in their wallets, said U.S. Attorney Thomas Maroney. Federal prosecutors are seeking to take possession of more than 100 homes, vehicles and other pieces of property that they say were bought with laundered money from smuggling.

The investigation pointed to possible connections to organized crime, outlaw motorcycle gangs and even the Russian mafia, Letourneau and Duguay said.

It was the biggest alcohol and tobacco smuggling ring ever busted by the federal government, and one of the largest money-laundering schemes ever uncovered, federal authorities said.

`It's about time'

Many of the 9,000 Mohawk residents of the 28,000-acre reservation quietly cheered the government's actions, said Julius Cook, a former traditional tribal chief. But they feel intimidated by the gun-toting faction of Mohawks involved in the smuggling, he said.

"It's about time they were stopped," said Cook, who lives on the St. Lawrence, in the midst of the heavy smuggling traffic. "They used our collective rights as Indians to make themselves rich, and hide behind our sovereign rights."

The indictment charges crimes that could put the defendants away for 20 years. But it apparently didn't carry much weight with some people on the reservation last week. Two days after the charges were announced, a van pulled up at a loading dock on Akwesasne, and two young people loaded boxes that appeared to contain cigarettes into a boat.

"It should be a big deterrent, but these people don't see it that way," Letourneau said. Many smugglers have been arrested many times on the Canadian side, paid a small fine, and kept going, he said.

"Cost of doing business," said Letourneau. The smuggling involves only a small fraction of Akwesasne's residents - but a very powerful fraction, Letourneau said.

Some of the accused smugglers have argued that they're exercising their sovereign rights by running cigarettes and liquor across their land.

Anthony Laughing, a Mohawk who is one of the accused leaders of one of four conspiring smuggling rings, told the Syracuse Newspapers in 1995 that he never moved cigarettes anywhere but onto other Indian reservations.

"We never considered it smuggling," Laughing said. "We didn't take this product and sell it on the streets of Montreal or Ottawa, or Cornwall or Toronto. ... They just never figured the Indians would be smart enough to get into that area. ... A lot of Indians became a little more educated and they got into exporting and importing, in a lot of different ways."

Laughing was shown in a Canadian television broadcast last summer smiling as he proclaimed his right to move cigarettes.

"You call it smuggling," he said. "I call it free trade."

A greater fear

Laughing is one of seven defendants who have not yet been arrested. He is believed to be on the reservation, said Maroney, who has vowed not to send any officers there for fear of a violent confrontation.

Stanley Cohen, a New York City lawyer representing Fabian and Gail Hart, said the smuggling accusations are racist. If the North American Free Trade Agreement is legal, so is the legitimate business that his clients conduct, Cohen said.

"This is a Canadian problem, and they're using the United States government as their collection agency," Cohen said, referring to the taxes that Canada claims it is owed. "They will be acquitted, and then we'll all stand on the border and thumb our noses at Canada. We'll get the vehicles back that are being seized, and we'll have Canada hold a car wash for us."

Sullivan, the Customs agent in charge of the Buffalo office, said he's notified his bosses in Washington about his greatest fear that the Akwesasne and smuggling has presented. If someone can move goods so easily into or out of the U.S., there's no reason why a terrorist can't get in and out just as easily, he said.

Last year, a suspected terrorist was arrested by Border Patrol agents in Champlain. They had spotted him through video surveillance, Sullivan said. He told them that he was supposed to have met his contact on the Canadian side of the Akwesasne and walk across to the United States, Sullivan said.

"I thought, `Here's a guy who, if he'd made it through the reservation and met his point of contact, he would've been in a van, driven to New York City like most of the illegal aliens that are smuggled through there, in a matter of about seven hours,"' Sullivan said. "How many times has this been done that we don't know about?"

John O'Brien <jobrien @ syracuse.com>
04/30/98 08:27:31 AM

Record Type: Record

To: Jerold R. Mande/OSTP/EOP

cc:
Subject: Re: test

Jerry: these are the earlier stories on the smuggling ring.

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SMUGGLERS SPANNED BORDER OF U.S.,
CANADA, AGENTS SAY
L. DAVID JACOBS IS ACCUSED OF RUNNING
THE MOHAWK NATION AS A CRIMINAL
ENTERPRISE.

Syracuse Herald-Journal
Tuesday, June 24, 1997
EDITION: City SECTION: News PAGE: A1 LENGTH:

BYLINE: By John O'Brien Staff Writer

Federal authorities said Monday they cracked a consortium of smuggling rings that rang up $687 million in four years by running alcohol and cigarettes into Canada through the Akwesasne Indian Reservation in northern New York.

Among those indicted by a federal grand jury was the former chief of the Mohawk tribe, L. David Jacobs, who was accused of running the Mohawk Nation as a criminal enterprise through bribery and extortion.

Another member of the Mohawk tribe, Anthony Laughing, 49, of Hogansburg, faces the same charge.

In all, 21 people were charged in a 54-page indictment with conspiring to defraud the U.S. and Canadian governments by smuggling alcohol and tobacco across the St. Lawrence River and laundering their profits.

The arrests marked an end to what may be the largest tobacco and alcohol smuggling ring that the federal government has ever broken up, according to local agents with the federal Bureau of Alcohol, Tobacco and Firearms.

"This is bigger than Al Capone," said Bud Bleyman, agent in charge of the ATF office in Albany.

Seven of the defendants were arrested Monday and were to be arraigned in U.S. District Court in Watertown. One defendant was to voluntarily surrender, and arrest warrants were issued for the remaining 13.

The ring made its money by selling the smuggled merchandise to retailers in major Canadian cities, where sales taxes are higher than in the United States. By selling products on the black market, the smugglers avoided paying Canadian sales tax and duties, the indictment said.

Federal prosecutors plan to seize homes, parcels of land, snowmobiles, cars and trucks, including armored vehicles owned by a former state trooper.

Agents with the U.S. attorney's office, U.S. Border Patrol and U.S. Customs started seizing the property Monday, storing it at a warehouse in Champlain.

Among items seized Monday was Jacobs' 37-foot Sea Ray Express motorboat cruiser, valued at about $115,000. The seized property was either used in the smuggling operation or bought with its profits, U.S. Attorney Thomas Maroney said.

Jacobs, who served as Mohawk chief from 1988 to 1994, violated his people's trust with the smuggling operation, Maroney said.

The smuggling ring was composed of three smaller smuggling conspiracies that at times worked together and other times in competition with each other, Maroney said.

The case is one of the largest money-laundering schemes the federal government has ever investigated, said Jeremiah Sullivan, special agent in charge of the U.S. Customs office in Buffalo. Undercover agents were used to help break the rings.

BECAUSE THE Indian reservation straddles the U.S.-Canadian border, there are no points of entry that the governments can patrol there, making smuggling easier, Sullivan said.

"It's the Achilles heel of the northern border," Sullivan said.

The smuggling ring consisted of two or three networks of "finders" who made connections with distilleries or cigarette makers, then worked as middlemen to ship the products by tractor-trailer to any of at least six prefabricated warehouses on the reservation, Maroney said.

At least one tractor-trailer full of about $70,000 to $80,000 worth of alcohol and cigarettes arrived at the Indian reservation each day, Bleyman said.

The warehouse owners would then sell the items to smaller distributors, who would run them across the St. Lawrence River to Canada by boat or, in the winter, snowmobile, Maroney said.

TO GET the loot onto the Canadian mainland, the runners often would go across the St. Lawrence to Cornwall Island, Maroney said. From there, the loot went onto the black market, where retailers in Toronto or other major Canadian cities bought it at a lower price than they would if they bought it from legitimate wholesalers, Maroney said.

The smugglers had become brazen in recent years, Maroney said.

"You could sit at Loran Thompson's dock in broad daylight and watch them load the cases on little bass boats and run them across," Maroney said. "Not exactly secretive."

Thompson, 49, of Rooseveltown, is one of the Mohawks accused of storing alcohol and cigarettes in warehouses before they were smuggled across the border.

Laughing bragged to a Canadian television newsmagazine about the smuggling operation and took a TV crew with him on one of the operations, Maroney said. Laughing, the former owner of Tony's Vegas International casino, has previous convictions of running an illegal gambling business, resisting arrest, and assaulting U.S. Customs inspectors.

AMONG THE property seized Monday were two armored vehicles belonging to John "Chick" Fountain, 56, of Malone. Fountain retired as a state trooper in 1983 after 21 years on the force, and started his own armored truck business. He's accused of using his vehicles in the money-laundering scheme. One of the leaders of the smuggling ring, Larry Miller, owned a Lear jet at one time, Maroney said. The government seized three boats of Miller's along with two homes in Massena, five homes or parcels of land in Las Vegas, and a pickup truck.

The smugglers cheated the United States and Canada out of income and sales taxes, along with the licensing fees that should have been paid for selling alcohol and cigarettes, Maroney said.

Maroney said he hopes the arrests will make other smugglers think about getting into a new line of work. But he said he realizes it won't stop everyone.

"This won't make them go away blissfully overnight," Maroney said. "But it will have some impact. There's a lot of money in the illegal sale of these products. We're going to take the incentive out of it."

Seized assets

Here are some of the $687 million in items that federal authorities plan to seize as assets bought with smuggling proceeds or used in smuggling itself:

10 boats.

25 homes, including six in Las Vegas, Nev.

Seven snowmobiles.

18 pickup trucks.

Two armored vehicles.

17 trailers for boats or cars.

19 cars, including at least four Corvettes.

23 vans or sport/utility vehicles.

A Rolex watch.

A motorcycle.

A $72,000 coin collection.

ILLUSTRATION: GRAPHIC: Smugglers' path Syracuse Newspapers (Note: for text of graphic, see microfilm.)
Reference Number: 9706240521

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FEDS CRACK $687 MILLION BORDER SMUGGLING RING
TWENTY-ONE PEOPLE ARE CHARGED WITH CONSPIRING TO DEFRAUD THE U.S. AND CANADIAN GOVERNMENTS. "THIS IS BIGGER THAN AL CAPONE," SAID AGENT.

The Post-Standard
Tuesday, June 24, 1997
EDITION: Metro SECTION: News PAGE: A1 LENGTH:

BYLINE: By JOHN O'BRIEN The Post-Standard

Federal authorities said Monday they cracked a consortium of smuggling rings that rang up $687 million in four years by running hard liquor and cigarettes from the United States through the Akwesasne Indian Reservation into Canada.

Among those indicted by a federal grand jury was the former chief of the Mohawk tribe, L. David Jacobs, who was accused of running the Nation as a criminal enterprise through bribery and extortion.

Another member of the Mohawk tribe, Anthony Laughing, 49, of Hogansburg, faces the same charge.

In all, 21 people were charged in a 54-page indictment with conspiring to defraud the U.S. and Canadian governments by smuggling alcohol and tobacco across the St. Lawrence River and laundering their profits.

The arrests marked an end to what may be the largest tobacco and alcohol smuggling ring that the federal government has ever broken up, according to local agents with the federal Bureau of Alcohol, Tobacco and Firearms.

"This is bigger than Al Capone," said Bud Bleyman, agent in charge of the ATF office in Albany.

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District Court in Watertown. One defendant was to voluntarily surrender, and arrest warrants were issued for the remaining 13.

The ring made its money by selling the smuggled merchandise to retailers in major Canadian cities, where sales taxes are higher than in the United States. By selling products on the black market, the smugglers avoided paying Canadian sales tax and duties, the indictment said.

The indictment lists at least 114 homes, parcels of land, cars, trucks, snowmobiles and other property that federal prosecutors want to seize from the defendants. Agents with the U.S. attorney's office, U.S. Border Patrol and U.S. Customs started seizing the property Monday, storing them at a warehouse in Champlain.

Among the property seized Monday was Jacobs' 37-foot Sea Ray Express motorboat cruiser, valued at about $115,000. The seized property was either believed used in the smuggling operation or bought with its profits, U.S. Attorney Thomas Maroney said.

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ILLUSTRATION: GRAPHIC: Smugglers' Path Syracuse Newspapers Color. (Note: for text of graphic, see microfilm.)
Reference Number: 9706240340

THE CANADIAN TOBACCO TAX EXPERIENCE : A CASE STUDY

By

David T. Sweanor
Senior Legal Counsel

Luc R. Martial
Policy Analyst

John B. Dossetor
Associate Counsel

The Non-Smokers' Rights Association (Canada)

and

The Smoking and Health Action Foundation (Canada)

August 1993

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August 1993

This study was made possible through a
grant from the Thrasher Research Fund

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1.0 INTRODUCTION

During the past 40 years, as scientists established the connection between tobacco use and serious risks to health, those interested in promotion of public health have been seeking ways of reducing tobacco consumption. In the early years efforts concentrated on conventional methods - with the emphasis on health education allied to the publicity generated by the health scares themselves. But despite such efforts tobacco use continued to grow in Canada as elsewhere. In fact per capita consumption of cigarettes in Canada increased between 1950 and 1981 by 39%. The effects of health promotion interventions are hard to discern. The tobacco companies continued to promote their products, young people continued to get addicted, and people now are dying in middle age as a direct consequence.

As evidence mounted showing the lack of significant impact of early tobacco control activities, the need for more thorough and effective action became clear. During the 1980's and 1990's the pro health lobby in Canada has pressed for action on three fronts:

(1) Dealing with issues of **consumer protection**. This has included ensuring that the decision to smoke is based on informed consent (that is, that the smoker chooses to smoke only after full information on the health effects and without being misled into tobacco use by the promotional efforts of the industry). This has led the Canadian 'health lobby' to successfully press governments to introduce much larger and more detailed and prominent health warnings on packs and to ban the advertising and promotion of tobacco products.

(2) **Protecting non-smokers** from involuntary exposure to tobacco smoke. This concern resulted from scientific findings on the danger of passive smoking. It has led to the development and implementation of legislation at the Federal level to ban smoking in federally regulated workplaces, including international airline flights. There has also been a great deal of action aimed at protecting people from the effects of environmental tobacco smoke at the local government level.

(3) **Reducing access** to tobacco products. This has led to moves that have resulted in the raising of the legal age for sales of tobacco products from 16 to 18, restrictions on the placement of cigarette vending machines and efforts to remove tobacco products from pharmacies. But it has also led to measures to reduce access through price increases. This has meant using taxation policy to reduce dramatically the affordability of cigarettes and other tobacco products.

As a result of all these measures, Canada has seen a reduction in tobacco consumption that is greater than any other major country has ever accomplished in any ten year period. There has also been an accelerating pace to this decline.

This report concentrates on taxation policy. That is not to say that the other components have not been an important part of Canada's reduction in tobacco use we have witnessed over the past 10 years. But the evidence suggests that, of all these elements, the single most effective policy has been increasing taxes.

We believe that the Canadian experience can be replicated elsewhere. This report is intended as a case study of using tax policy as a key element in a comprehensive strategy and on how best to overcome obstacles to an effective tobacco tax policy. The industry knows every bit as well as the health lobby that increases in tobacco tax are probably the most potent of all currently used measures to reduce tobacco use. Tobacco taxes, by reducing overall tobacco use, also open the way to additional tobacco control measures such as the greater provision of smoke-free spaces. The tobacco companies will throw their tremendous resources against moves to raise taxes. But one of the key lessons from Canada is that they can be beaten - time and again.

2.0 THE THEORY: THE ROLE OF TOBACCO PRICING AS A HEALTH PROMOTION TOOL

2.1 Price-Sensitivity

It is generally recognized in economic theory, as well as in every day life, that purchasing decisions are influenced by changes in the price of goods. Economists talk about the degree of responsiveness of demand to changes in price as a product's "price elasticity of demand". This is measured as the percent change in the quantity of a good demanded, divided by the percent change in price that caused the demand change. This means that an elasticity of -0.4 signifies that a 10% increase in the real (ie. inflation adjusted) price would reduce sales by 4%. The effect of a tax change of 10% will be less because an increase in the tax will lead to a less than proportional increase in price since taxes are only one component of retail prices.

The academic data on the price-responsiveness of tobacco use is well summarized in the 1992 report of the United States Surgeon General. It is reproduced here as Appendix 1 of this report.

The American research had suggested that tobacco products would show a price elasticity of about -0.4 among adults. Of great interest to those of us interested in child health, and therefore in preventing the addiction of a new generation of smokers, the research had also indicated that young people were particularly price-sensitive. In fact the most comprehensive look at teenagers in the United States had indicated a price-elasticity of -1.4 , indicating a tremendous potential role for price policy.

What these figures mean is that every 10% increase in the 'real' (ie. inflation adjusted) price of tobacco will reduce adult consumption by about 4% and teenage consumption by about 14%.

Canadian experience with raising taxes during the past decade has lead to estimates of price elasticity that are very much in line with the earlier American research. An unpublished analysis of trends during the 1980's, conducted by a team led by Dr. Roberta Ferrence of the Addiction Foundation in Toronto supports the view that adult elasticity is about -0.4 and teenage elasticity is substantially higher, perhaps even higher than earlier American research had forecast. The most recent analysis of Canadian price-sensitivity for tobacco, prepared by the federal Department of Finance and released in July 1993, reports an increasing elasticity as prices have increased.

The research was never as settled as we would have liked when we engaged in our efforts to change public policy on tobacco taxation. We learned that there is seldom (if ever) any absolute agreement among economists. What we did know was that price would play a very important role in reducing overall tobacco use and would appear to be even more effective in reducing use among young people. This is exactly what we found.

There has recently been some research evidence from the U.S. which appears to suggest that price may play a less significant role than the Canadian experience suggests. This may be due to a problem with the underlying data.

One key element in any econometric work on the relationship between price and consumption is having reliable data on the price people are actually paying for cigarettes. U.S. evidence suggesting the relative ineffectiveness of price as an influence on consumption may be distorted by the development of the discount end of the U.S. market. During the 1980's we have seen a significant segmentation in the U.S. tobacco market. The price of "full price" brands has increased significantly in real terms and the discount market has grown, offering price sensitive smokers a range of very cheap products. This is a situation very similar to what is already experienced in many other countries where taxes are based on a percentage of the retail price (known as ad valorem taxes) and manufacturers market a wide range of cigarette prices.

Now that there is a plethora of prices, "average price" is no longer a good indicator. Price-sensitive people will naturally gravitate toward lower-priced products. Using "average price" would under-estimate the impact of price on consumer behavior, by assuming they have absorbed price increases that they had actually avoided. It may well be the case that for many of the smokers who are price-sensitive, the price they are actually paying has been going down rather than increasing in line with average prices. It should be pointed out that the existence of this low price segment in the U.S. market is, to a very large extent, a result of the low level of U.S. tobacco taxes which gives manufacturers a very considerable degree of discretion over what prices to charge. High levels of tax in Canada have greatly reduced the possibility of a multiple price market for cigarettes.

2.2 Income Sensitivity

The price of tobacco is not the only economic factor influencing tobacco consumption. The real concern is with how "affordable" tobacco is and what we can do to reduce its affordability. This means looking at incomes as well as prices. As is obvious, a price increase that is more than matched by an increase in disposable income does not reduce the affordability of a product.

Changes in income are particularly important in the development of markets for tobacco products. This is a major concern in poor countries that start seeing a rapid growth in disposable income. It is equally a concern among the other major growth area for tobacco sales, young people. We need to keep in mind that the incomes of young people are not static. Many receive money from their families. A growing number appear to have part time jobs. This could well result in an increasing affordability for tobacco products even when there are moderate increases in the price of these products.

We are not aware of any studies that have identified an income elasticity of demand for tobacco products for young people. Estimates of adult income elasticity are also rare. What little we know from researchers seems to indicate an income elasticity of somewhere between 0.3 and 0.5. This means that a 10% increase in disposable income would be expected to increase the demand for tobacco by between 3% and 5%. Based on the greater price-sensitivity of young people we would assume that there is also a greater income-sensitivity.

The fact that there is an income-sensitivity for tobacco does not mean that the higher one's income, the more tobacco is consumed. In fact higher income individuals tend to have very low levels of consumption. This is likely due to the fact that these high income earners have other characteristics, such as awareness of the magnitude of the risk, which make them unlikely to use tobacco at any price. Where price or income sensitivity makes the greatest impact is among those who may be predisposed to use tobacco due to other factors. Among this group increased affordability is likely to lead to increased consumption.

2.3 Revenue Impact

The result of the relationship between price and demand is that tobacco tax increases, though reducing consumption, also lead to massive increases in tobacco tax revenue. An elasticity of -0.4 will guarantee that the total spent on tobacco products will be more after a price rise than it was prior to the rise since consumption falls by only 4% for every 10% increase in price. From the standpoint of any government the revenue gains are enhanced by the fact that taxes make up only a portion of the final selling price. Therefore an increase in the tax represents a proportionately smaller increase in overall price. This means that a government with a tobacco tax that currently represents 20% of the retail price of cigarettes could double its tax per pack while total sales would be expected to decline by only about 8%. The net revenue gain would be in the range of 84%.

3.0 THE STRUCTURE OF GOVERNMENT

As with the United States and Australia, Canada has a federal system of government. What they call states we call provinces. Both our federal government and provincial governments can, and do, levy tobacco taxes. With the exception of one province, they also have sales taxes.

Canada, like the United Kingdom, Australia and numerous other countries, has a parliamentary system of government. Political parties tend to exert more control over the politicians than is found in the United States, and the Cabinet is made up of elected members of Parliament from the Party receiving an electoral majority. Working within a parliamentary system at two levels of government clearly had implications for the way in which we acted. At the same time, government systems exhibit more similarities than differences and the facts concerning tobacco taxation and public health travel across borders and between government structures exceedingly well.

The way in which we went about lobbying in Canada was obviously determined by the system of government in which we were working. The key difference between the Canadian parliamentary system and a system such as the U.S., is that the budget making process is undertaken behind closed doors and the public does not know what the government plans to do until the budget is announced. At that point the battle is usually over since a government with the majority of members in a legislature can ensure the budget measures are passed into law. In fact, the legislation authorizing tax increases on tobacco usually stipulates that these increases come into force when the budget is announced, not when the law is finally passed.

This system of budget formation has advantages and disadvantages for the health advocate. More than anything else it forces health advocates to become 'insiders', to influence decisions before they are presented to the outside world. Needless to say, the tobacco industry also seeks an inside track. The industry is skilled at dealing with such situations and has a long history of hiring the right people in order to be able to influence policy formation unseen by the general public.

We were successful at becoming 'insiders' and turned the secrecy of the budget making process to our advantage. The key factor was developing the knowledge base necessary to allow us to be an important and valued source of information to those preparing the budget. We ensured that our economic and health analyses were the best they would receive and we did public opinion polling which we would hand over to the advisors to the politicians in charge of budget development. We also used freedom of information legislation to find out what the tobacco lobby was saying to government, and we made sure we refuted it. This all added up to replacing the tobacco lobby as the most trusted insiders as budget formation was taking place.

Influencing government officials and Ministers was only part of the process. We also aimed to create an outside climate conducive to the government presenting substantial tax increases. That meant targeting two main groups: the media and politicians - particularly government supporters in Parliament who were outside the Cabinet. Although the government produces the budget in secret, it tries to make a judgement of what will play well. One of the key roles of tobacco control groups is to ensure that the conditions are created where the government believes that a big tobacco tax hike will play well with its supporters and the public. Clearly the governments in Canada thought that this was the case.

The same groups are players in the U.S. budget making process, but their roles and degrees of importance differ because the Budget is much more likely to be amended once brought forward. That offers both more opportunities, but also more threats.

Establishing an inside track with the officials advising the President/Governor, is crucial to ensuring that a tobacco tax increase features in the Budget he/she presents to the legislature. Again, the willingness to include a tobacco tax increase will depend on a judgement of likely support for such an increase. Consequently, preparing the ground, briefing the media and establishing public pressure is all important.

But, unlike Canada or the U.K., the process does not stop there. If the draft Budget includes a tobacco tax increase, the tobacco industry will turn the heat on individual legislators to get them to remove it, or moderate it. That pressure will need countering. But if there is no increase included, health groups have another chance to have it included.

The good news is that this process should stimulate much more public debate, and a debate that should be won by the side with the best arguments. The bad news is that it may require a lot more money to wage a successful campaign.

In some states in the U.S., there is a third possible route to put through a tax increase - through a voter initiative. This was not an option in Canada. Although such initiatives have been successful in California and Massachusetts, these are very much last resort strategies, to be deployed only when it is clear that there is no prospect of success through the legislature. The initiative route is high risk, time consuming, very expensive and labor intensive. It also risks one-off burn-out. But it can also succeed in raising the profile of tobacco tax increases and tobacco control generally in a way that has positive spin-offs.

4.0 THE CANADIAN TOBACCO CONTROL SCENE : Historical Context

Canada was not an obvious candidate for successful tobacco control efforts. Indeed, all the features that usually lead health advocates to look for the next flight to a more promising jurisdiction were present.

4.1 The Tobacco Industry and the Government

The tobacco industry has long been a powerful force in our country. Canada has a tobacco growing industry that is larger, on a weight per capita basis, than even that of the United States. In fact, Ontario is not only the most powerful province in Canada, but it is the third largest tobacco growing jurisdiction in North America, surpassed only by North Carolina and Kentucky.

There is also significant leaf processing and cigarette manufacturing activity. The Canadian market is dominated by three affiliates of the large multinational tobacco companies. The largest tobacco company is controlled by B.A.T. Industries of the U.K. The second largest manufacturer is Rothmans International of the U.K. and Philip Morris of the U.S. The smallest Canadian tobacco manufacturer is owned by U.S.-based RJR-Nabisco.

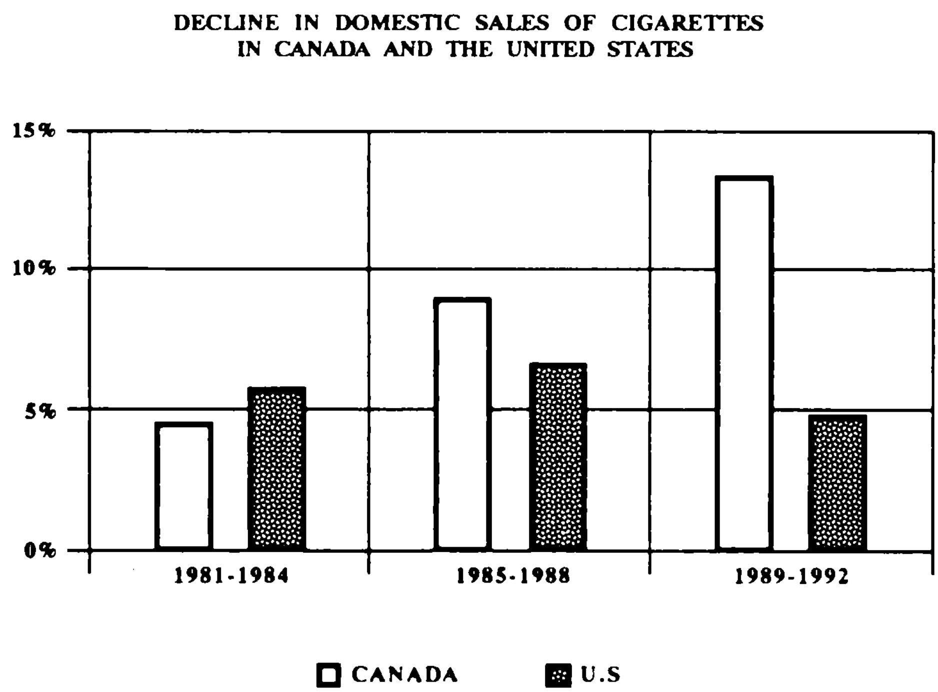
Canadian tobacco companies have historically made sure that they had strong connections to government. For instance, at the time of the landmark 1964 United States Surgeon General's Report, the Chairman of the Board of one of our tobacco companies was none other than a former Prime Minister whose political party was in power at the time. Many senior politicians had very close connections to the tobacco industry through the 1960's, 70's and 80's. The industry ensured that it hired individuals with political connections and adeptly changed its hired guns in accordance with changes in government. After the Progressive Conservative Party came to power in 1984, the industry lobby group hired as its president a man who had set up the Prime Minister's Office, had been principle advisor to a former Conservative Prime Minister, and had strong contacts throughout the corridors of power. In fact, during the successful re-election campaign of the Progressive Conservatives in 1988, this man was a high-profile member of our Prime Minister's Campaign staff while simultaneously continuing to lobby the government on behalf of the tobacco industry.

Given the strong tobacco industry presence, the connections of the tobacco industry to our politicians, and the general reluctance of health organizations to become involved in the politics of tobacco control, it is not surprising that Canada had a level of cigarette consumption higher than any other major country at the beginning of the 1980's. Canada has come a long way since that time, but Canada also had a long way to go.

4.2 Tobacco Control in Canada

The tobacco control efforts in Canada are now generally considered to be among the most effective in the world. During the past decade not only were taxes increased to among the highest in the world, but tobacco advertising was banned, prominent warnings placed on packages and legislated protection from environmental tobacco smoke has been implemented for a great many areas. As a result of all these measures, Canada has seen a reduction in tobacco consumption that is greater than any other major country has ever accomplished in any ten year period. There has also been an accelerating pace to this decline. A comparison of domestic sales figures for the U.S. and Canada makes this point quite well.

Graph 1



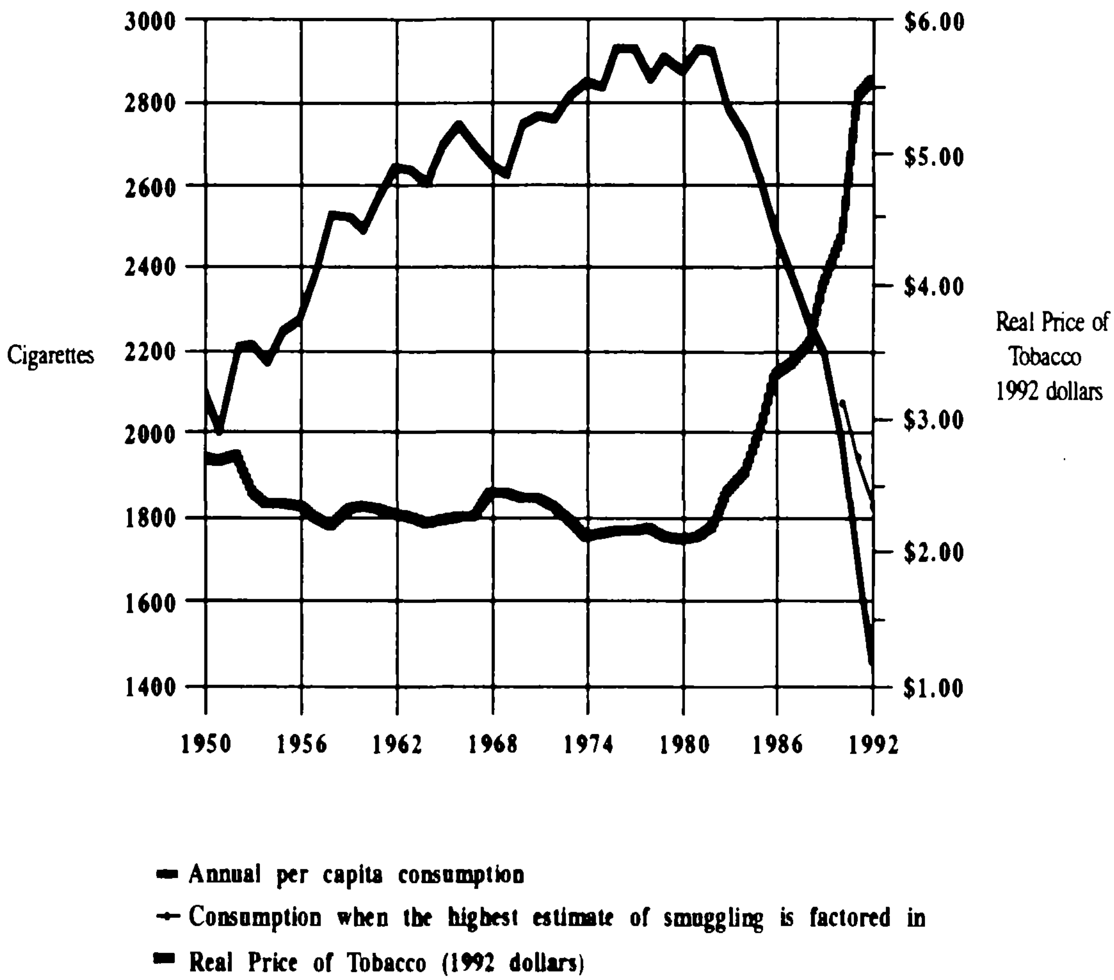
	CANADA	U.S.
1981 - 1984	4.55%	5.78%
1985 - 1988	8.94%	6.65%
1989 - 1992	13.36%	4.80%

The current tobacco control scene in Canada is a radical departure from what had been happening prior to the early 1980's. From the time science started to produce its indictment of tobacco in the 1950's until the advent of major health advocacy initiatives in the 1980's, Canada had one of the worst tobacco control records of any country. The picture of tobacco control in Canada at that time included:

- Smoking was deeply entrenched in Canadian society.
- Per capita consumption in the early 1980's was higher than any other major country.
- There was a weak voluntary code on advertisements which was widely violated.
- Package health warnings were dictated by the tobacco industry and virtually invisible.
- There were few if any restrictions on smoking.
- There was little by way of public education efforts.
- Tobacco consumption was promoted by the fact that prices had declined in real terms.
- Consumption had grown fairly steadily until the 1980's.

Graph 2

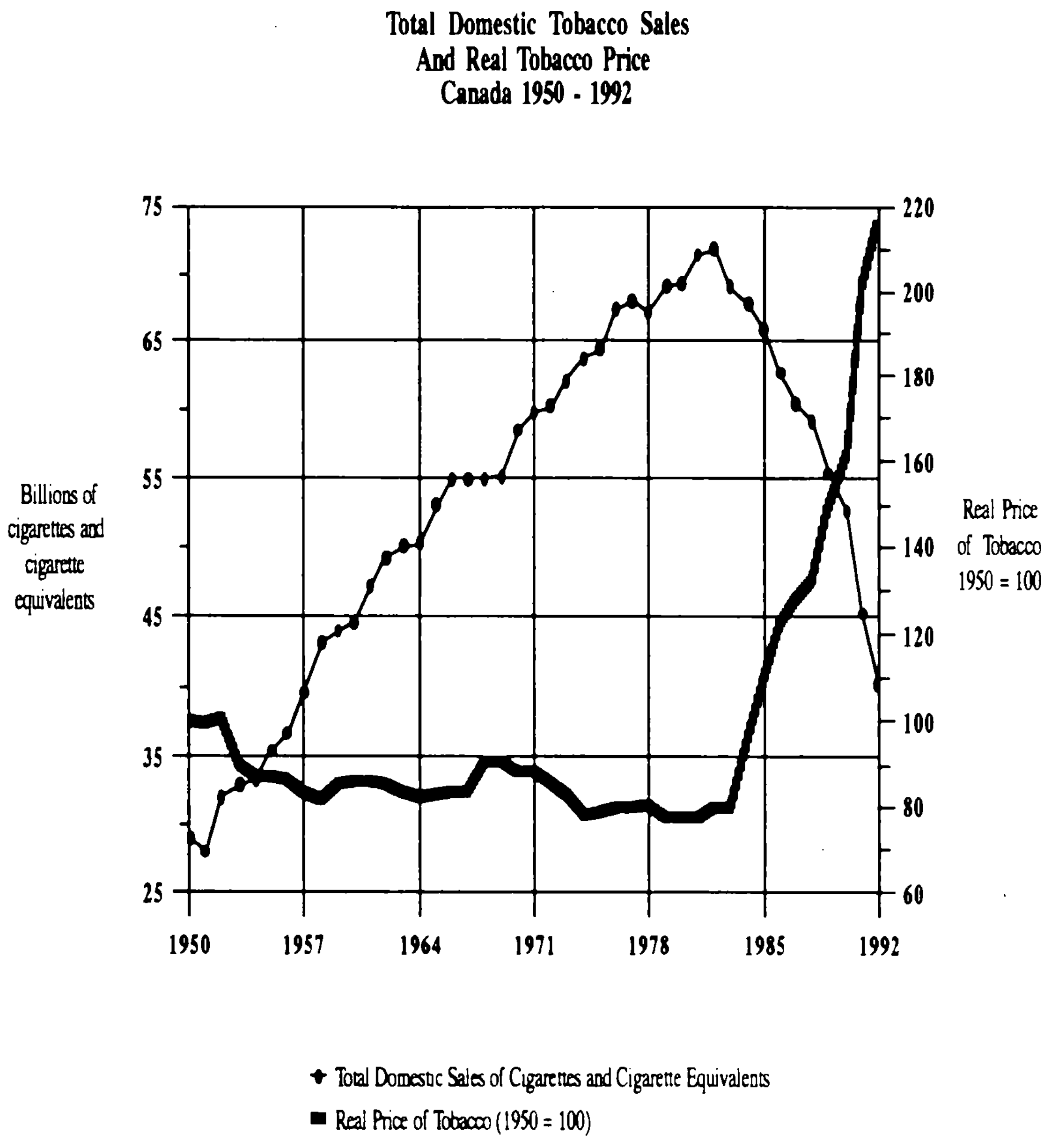
ANNUAL PER CAPITA CONSUMPTION OF CIGARETTES
AND REAL PRICE OF TOBACCO (per 20 cigarettes)
CANADA 1950 - 1992



Note: Cigarettes include fine-cut equivalents (1g.)

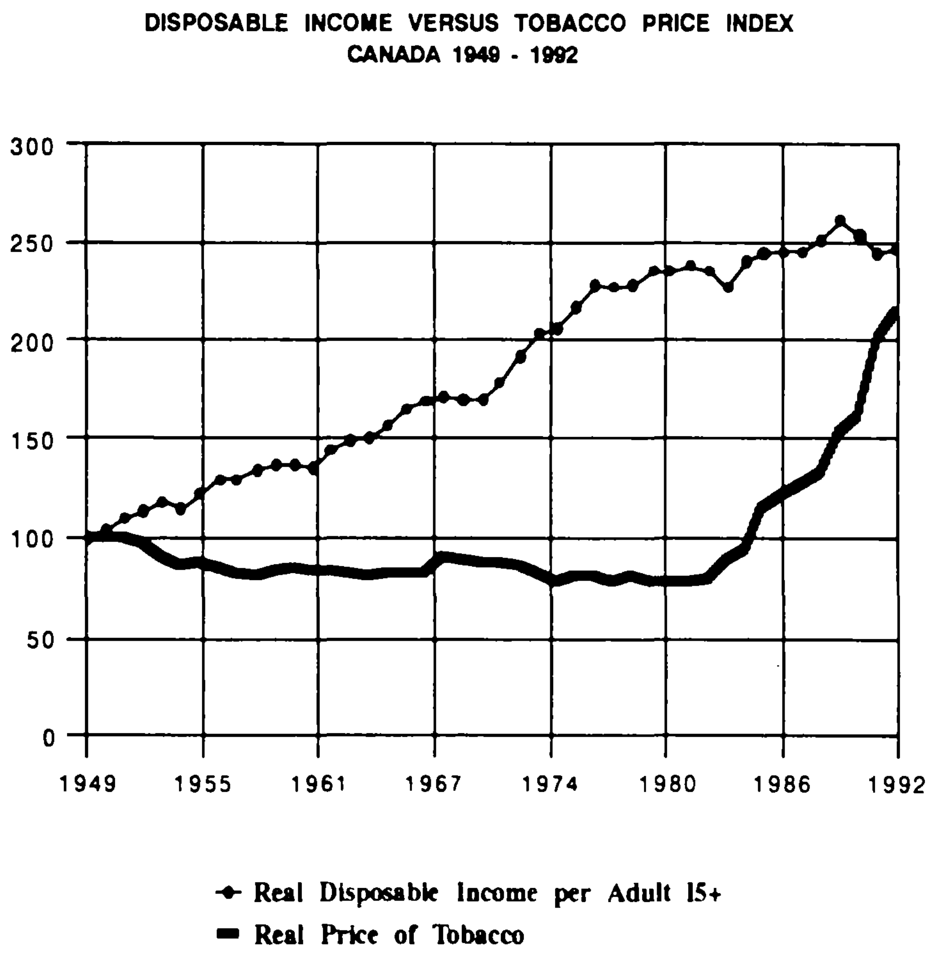
The actual level of domestic tobacco sales in Canada increased dramatically during the two decades following the definitive evidence on the health effects of tobacco use. Canada's population was increasing during this time and the failure to reduce per capita sales resulted in large increases in the actual quantity of tobacco being sold, as shown in the following graph.

Graph 3



There were many reasons for Canada's failure to make major tobacco control inroads prior to the 1980's. Perhaps the most significant was that the 'health lobby' never managed to make a concerted effort at manipulating the public policy levers that can dictate the social environment for tobacco. The tobacco lobby, on the other hand, was able to foster very strong relations with governments and effectively avoided any measures which could have reduced industry sales. Among the obstacles placed in the way of tobacco control by this failure to deal with the 'tobacco environment' was the fact that tobacco became increasingly affordable at precisely the time health goals would have dictated the opposite outcome. Once adjusted for inflation, the actual price of cigarettes was falling. Due to the rapid expansion of the economy, personal incomes were simultaneously rising very rapidly. The combination of lower prices and higher incomes (see Figure below) made tobacco increasingly more affordable. As we detail elsewhere in this report, price and income have powerful effects on tobacco consumption.

Graph 4



5.0 THE TAX CHANGES ATTAINED IN CANADA

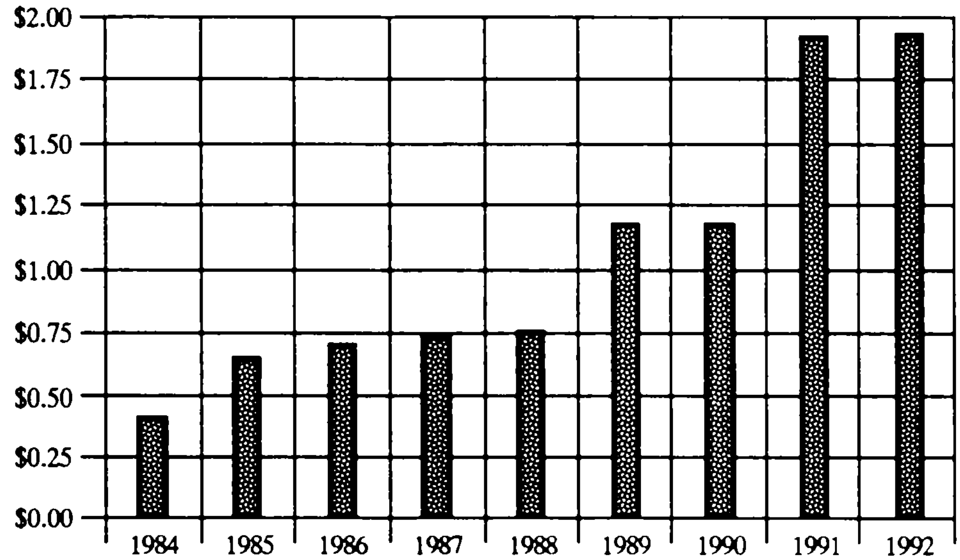
Canada, like the United States, has a federal system of government. Among other things this results in both countries having taxes placed on tobacco products by both the national government and the states/provinces. We will first look at the changes in federal taxes placed on cigarettes in Canada since the early 1980's, then turn to provincial tax changes.

5.1 Federal Taxes

There have been three, progressively more significant, major tobacco tax increases in Canada during the past decade. There have also been some minor changes. The overall escalation in federal tobacco taxes is shown in graph 5.

Graph 5

TOTAL FEDERAL TAXES PER 20 CIGARETTES
CANADA 1984 - 1992



1984	$ 0.42	1987	$ 0.74	1990	$1.19
1985	$ 0.65	1988	$ 0.76	1991	$1.92
1986	$ 0.71	1989	$ 1.19	1992	$1.93

In the early 1980's federal taxes on tobacco products were quite low. In fact, not unlike those existing in the United States in early 1993. In 1985 'healthy fiscal policy' was given its first significant boost with a tax increase of one cent per cigarette. While the health lobby achieved small tax increases in 1986 and 1987, it was not until 1989 that further significant progress was made. The taxes in that year were increased by two cents per cigarette after a well-orchestrated campaign by health groups. The latest of the escalating tax increases occurred two years later, in 1991. This time the increase in the tobacco excise tax was three cents per cigarette, and health groups were rewarded for their most sophisticated campaign to date. Since Canada applies a national sales tax, the actual increase in total federal taxes per pack of cigarettes actually works out to more than the excise increase alone.

5.2 Provincial Taxes

The effort to increase tobacco taxes in Canada was not limited to the federal government. While federal increases can have a truly national impact, we recognized the importance of focusing considerable attention on our 10 provincial governments.

The provinces of Canada traditionally had very low taxes on tobacco products. In 1970 the average provincial tax on a package of 20 cigarettes was less than eight cents. The average U.S. state had a tax that was about 50% higher. British Columbia began the 1970's with a tax of only two cents a pack, the same as was then found in North Carolina but lower than every other jurisdiction in North America.

By 1980 most Canadian provinces had increased taxes in nominal terms in an effort to keep pace with inflation. Taxes were still low, ranging from 6.4 cents per pack in Alberta to 27 cents in Newfoundland.

By 1984, provincial taxes on tobacco ranged from a low of 30 cents a pack in Alberta to a high of $1.19 in Newfoundland. By June 1, 1993 the lowest total provincial tax was $1.40 in Alberta and the highest was in Newfoundland at $2.76 a pack. These taxes all come on top of the federal tobacco tax. The provincial tobacco taxes also increase the amount of the federal 'goods and services' tax (GST), since this tax is a sales tax added to the overall price of a product. Furthermore, the federal GST increases the sales taxes of some provinces. This is because some provinces calculate their sales tax on the basis of price that includes the Federal GST which gives another twist to tobacco taxes.

We had to use different arguments in each province. Alberta, for example, is a province with huge reserves of oil and gas that traditionally prides itself on low taxes. Consequently, we had to make a case for making tobacco an exception to the general anti-tax philosophy. In Ontario, which is Canada's main tobacco farming province, we had to show that low tobacco taxes did not make sense as a way of keeping tobacco farmers in business.

In Québec, we had to counter the fact that the tobacco industry is an important employer. In other provinces, with no tobacco growers or manufacturers, we could argue that low tobacco taxes presented an effective subsidy to out of province industry, at the cost of local lives.

It was a case of tailoring the arguments to fit local circumstances --the revenue arguments that would buttress the health case in financially strapped provinces would not, for instance, play as well in a wealthy province facing a budgetary surplus. But in every case, the fundamentals of the case remained the same -- namely that governments should take positive action to reduce the toll from tobacco and that the most effective method at their disposal was *raising*(higher)tobacco taxes. Some provinces were prepared to embrace the health arguments and pride themselves on having higher tobacco taxes than their neighbours. Others were prepared to follow, but not lead.

The degree of involvement from local health groups has varied from province to province. In some there has been a strong local impetus behind higher tobacco taxes. In others it has more often been the case of seeking some local endorsement for positions written by NSRA and backed by groups such as the Canadian Council on Smoking and Health.

In the provinces with smaller populations the tight links between the politicians and their communities has meant that key individuals, armed with the right arguments, have been able to have a major impact on budget outcomes without the need to devote substantial resources to an elaborate lobbying effort. For the largest provinces, for example Ontario, the effort required was similar to that required at the federal level.

6.0 THE RESULTS OF CANADA'S TOBACCO TAX INCREASES

We sought the tax increases with one goal in mind: reducing tobacco consumption. In this section we look at the impact these increases actually had on tobacco consumption. These can be measured in different ways, and figures are available from different sources. On any measure there has been a very significant fall in tobacco use in Canada during the time we increased our tobacco taxes. We will now examine the Canadian experience in relation to different measures of tobacco consumption.

In doing so we account for two important factors beyond simply domestic cigarette sales. First, we take into account the sale of the loose tobacco used for making 'roll-your-own' cigarettes. This is the only other significant tobacco market in Canada and we feel it is important to look at the entire tobacco market rather than just the cigarette sub-component. Secondly, where appropriate, we have adjusted our numbers to account for the smuggling of tobacco from the United States. This can make a difference in overall consumption levels since the low tobacco taxes in the

United States has led to Canadian manufacturers shipping large quantities of tobacco products to the northern United States, from where smugglers bring it back into Canada. The fact that Canadian cigarettes are a different blend from American, and that there is very little demand in Canada for American style cigarettes means that virtually all cigarettes smuggled into Canada originate from Canada.

6.1 Per Capita Sales

This is a measure that is often preferred by the tobacco industry. In fact the estimates assembled for the United States by the Tobacco Institute (and published yearly in their document entitled **The Tax Burden on Tobacco**) use this measure exclusively.

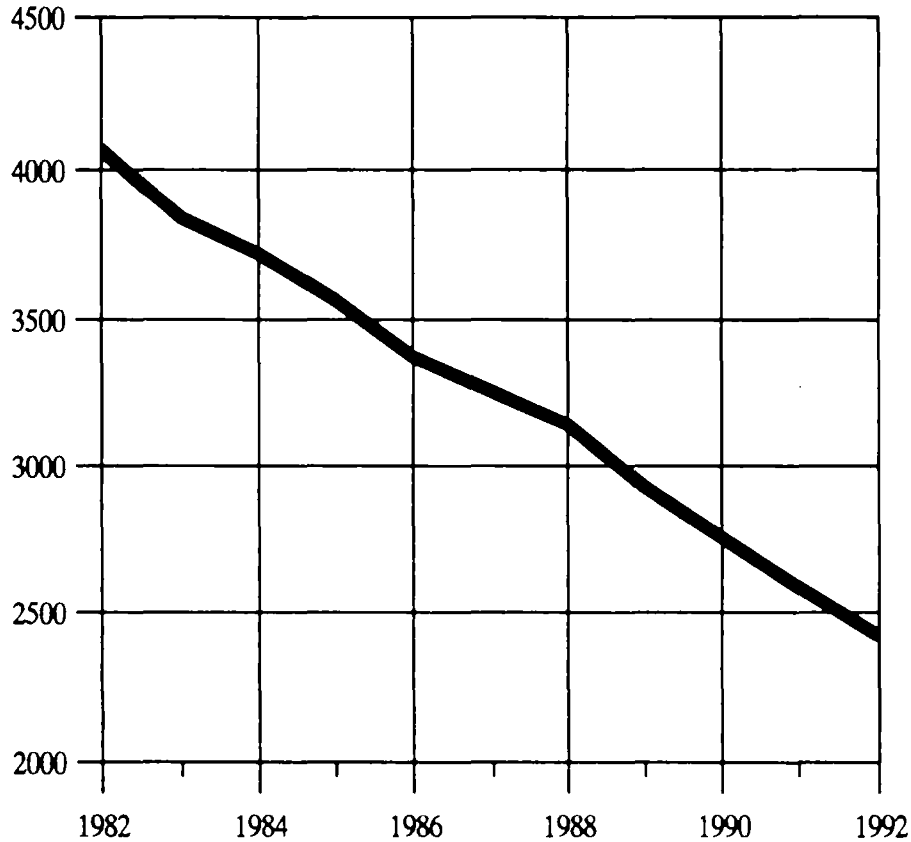
The Canadian data, presented in this way, is seen as Graph 2, earlier in this report. Even after accounting for the highest credible estimates of tobacco smuggling total per capita consumption in Canada fell by 38% between 1982 and 1992.

6.2 Adult Per Capita Sales

Since total per capita figures include a lot of children some people (including most health groups) prefer to look at adult per capita sales. This can present a rather different picture since the proportion of the population under the age of 18 has differed a great deal during the past 40 years in North America due to the effects of the post-war "baby boom". When we look at total Canadian tobacco sales per person 18 years of age and over we see the pattern shown in graph 6.

Graph 6

ANNUAL SALES OF CIGARETTES PER CAPITA (18+)
CANADA 1982 - 1992

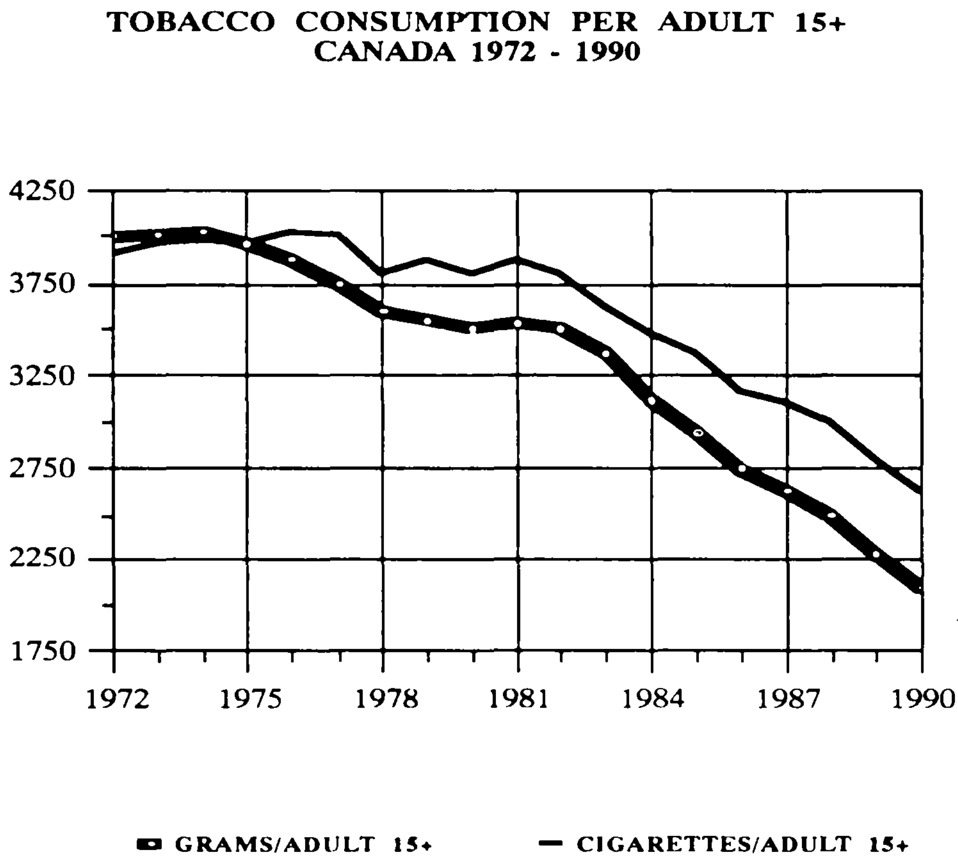


Note: Cigarettes include fine-cut equivalents (1 g.) Data includes all domestic sales and 80% of all exports (which are re-imported illegally into Canada for domestic sale).

6.3 Per Capita Weight of Tobacco Consumed

The actual amount of tobacco consumed per 'adult' has been used by some as a measure of the potential harm being inflicted on a population. Although this measure is disputed due to questions about whether lower weight cigarettes are actually any less harmful, it is still used in some international comparisons. Since this measure is based on an analysis of the impact of generally declining tobacco weight per cigarette, the data is dependent upon someone determining the weight of tobacco in cigarettes. As a result, the information usually lags behind other measurements. Canadian data on the changes in grams of tobacco consumed per Canadian aged 15 or over is presented in graph 7.

Graph 7



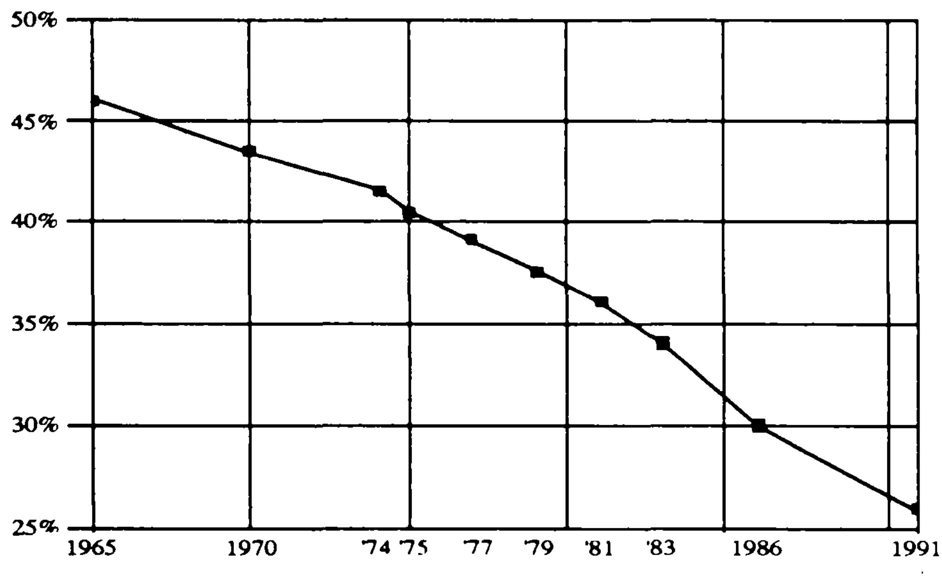
6.4 Smoking Prevalence

Many health organizations and governments place a lot of authority on prevalence data. Like all measurements, there are benefits and downsides. Because it depends on survey evidence, it is vulnerable to large-scale under-reporting of tobacco consumption. As public information campaigns seek to change social attitudes about smoking there is a very real possibility that the increasingly negative view of smoking will lead to greater under-reporting by the population in general or specific segments of the population. In fact, should under-reporting not be increasing, there would appear to be grounds for questioning the efficacy of the campaigns aimed at changing social attitudes concerning tobacco use.

Given such caveats, prevalence declines in Canada have been very significant over time, and particularly steep during the time of rising prices. The fact that the declines in prevalence mirror declines in per capita sales tends to lend credibility to both measurements. An analysis of major prevalence surveys from the Canadian government shows a clear trend. As shown in graph 8, prevalence of regular smoking has fallen much more quickly as prices rose in the past 10 years.

Graph 8

PREVALENCE OF REGULAR SMOKING AMONG ADULTS (15+) CANADA 1965 - 1991

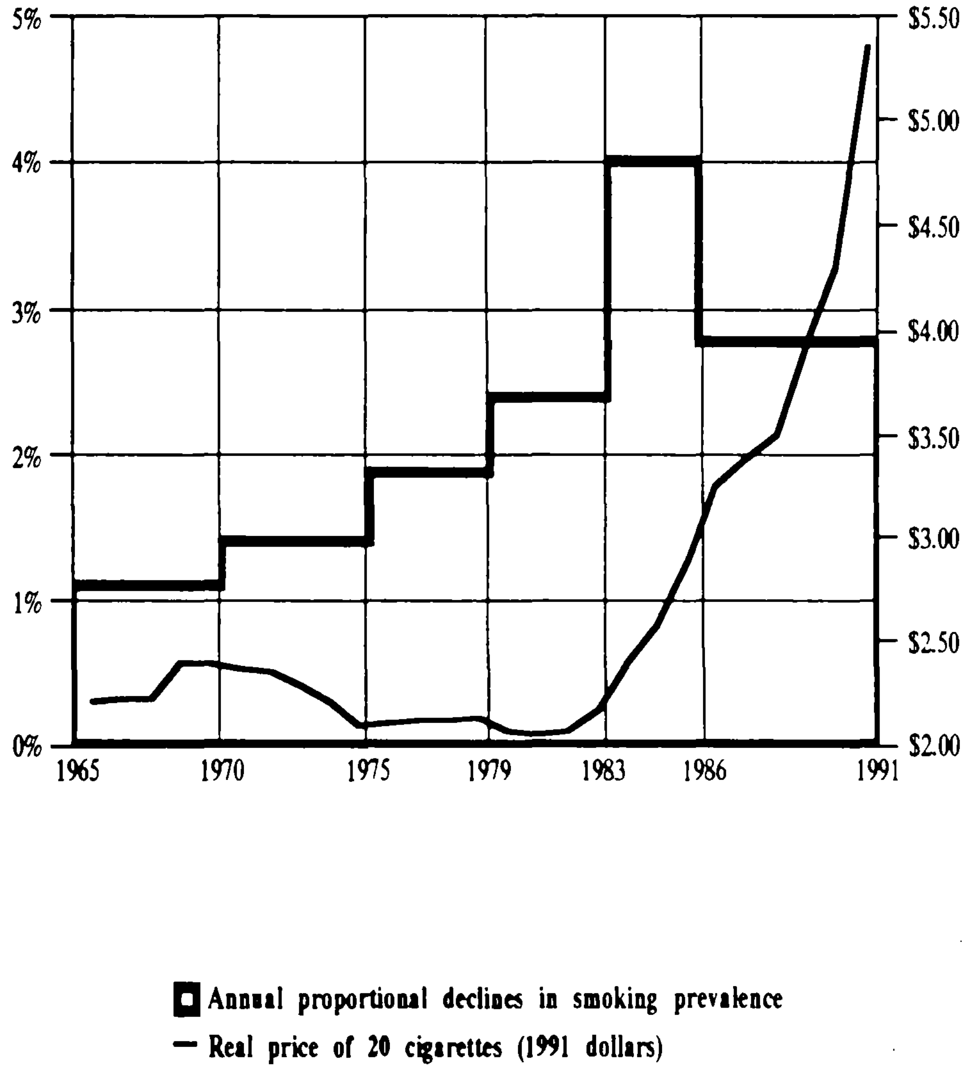


1965 46%	**1974** 42%	**1977** 39%	**1981** 36%	**1986** 30%
1970 44%	**1975** 41%	**1979** 38%	**1983** 34%	**1991** 26%

The relationship between price increase and declines in smoking prevalence have been quite pronounced. We can take the prevalence data, determine the annual decline in the proportion of the population that is smoking, and compare these "quit rates" to changes in price. The result is shown in graph 9.

Graph 9

THE ANNUAL PROPORTIONAL DECLINES IN THE PREVALENCE OF DAILY SMOKING
AND THE REAL PRICE OF 20 CIGARETTES
CANADA 1965-1991



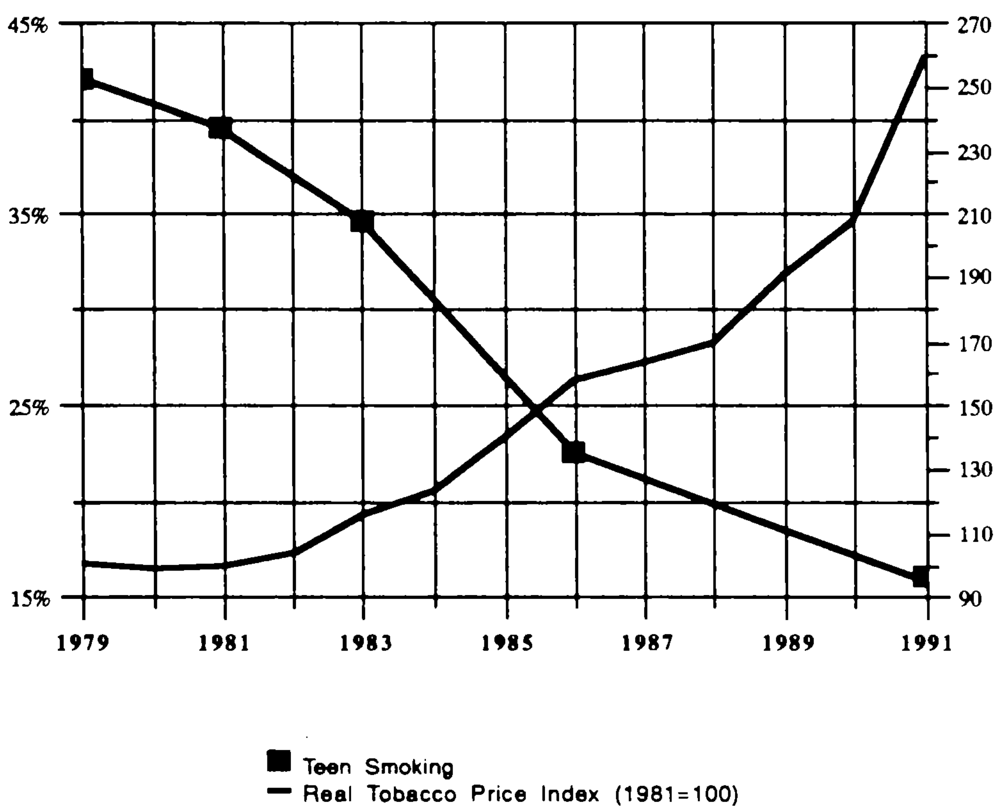
6.5 Declines in Consumption Among Young People

Young people are a particular concern, possibly the greatest concern, of most of those working on tobacco control. The vast majority of smoking onset in Canada, as in other countries, occurs before people reaches adulthood. Since tobacco use is addictive, many of these young people are never in the position of making informed choices about tobacco use. Furthermore, a large proportion of the young people who start smoking are likely to die prematurely as a direct result. Since it is easier to prevent smoking than to try to stop smoking once it is ingrained, it makes sense to direct our primary interventions at preventing children from ever becoming addicted.

The research on the effects of tobacco price increases indicated that young people were more price-sensitive than adults. The Canadian experience confirms this view. The most telling indication of price-sensitivity is shown when we juxtapose teenage smoking trends and the real price of cigarettes. This is shown in graph 10.

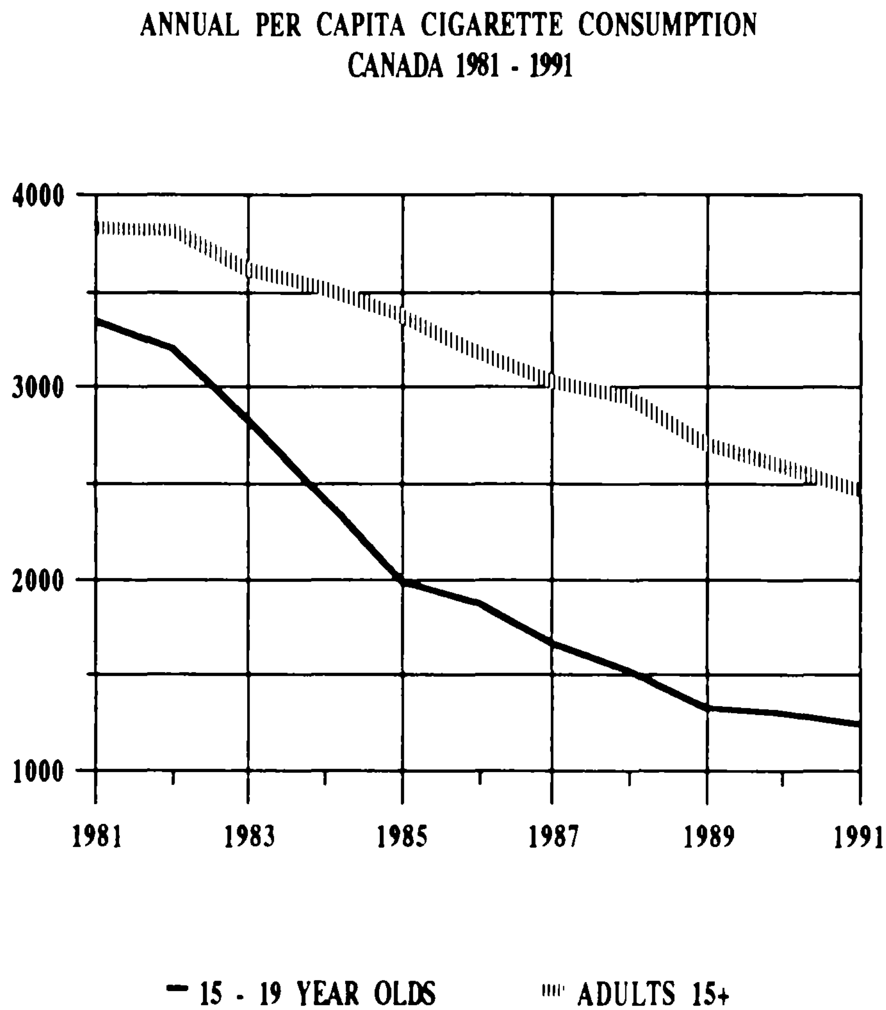
Graph 10

REAL CIGARETTE PRICES AND DAILY CIGARETTE SMOKING
AMONG CANADIANS AGE 15 TO 19



The more rapid decline in teenage consumption is also shown when we look at annual per capita consumption. Dr. Roberta Ferrence of the Addiction Research Foundation in Toronto looked at these trends from 1981 to 1989. We used her data analysis and updated the data to 1991 using the same techniques. The result is shown in graph 11.

Graph 11



Note: Calculations include highest credible estimate of smuggling. Cigarettes include fine-cut equivalents.

6.6 Changes in Daily and Occasional Smoking Patterns

One apparently dramatic change in the Canadian tobacco market in recent years has been a shift among young smokers from daily (or 'regular') smoking to occasional smoking. This is a trend which we have not previously seen reported, but would appear to have a significance for health policy that is as great as the drop in the overall proportion of the population that is smoking.

Among Canadians aged 15-19 the percentage reported to be smoking fell from 46.5% in 1979 to 22% in 1991. This is a dramatic reduction, and represents hundreds of thousands fewer young people using tobacco.

As dramatic as this decline appears, the decline in daily smoking was even more pronounced. From 1979 to 1991 this fell from 42% of 15-19 year olds to only 16%. This is a decline of 62% in the proportion of teenagers smoking daily. As would have been anticipated, this coincides with the period of our successful efforts to significantly increase tobacco taxes.

Of course the decline in daily smoking being more rapid than the decline in total smoking means that occasional smoking has increased. Occasional smoking has increased in absolute terms and, most particularly, as a proportion of the teenage smoking population.

This trend toward occasional smoking is even more pronounced among those aged 20-24. Smoking among this age group declined from 49% in 1979 to 39.5% in 1991. Regular smoking in this age group fell dramatically, from 45.5% to 27.5% during this time. At the same time, occasional smoking grew from 3.5% to 12% of this population.

While price policies seem to have greatly reduced overall smoking, and even more significantly impacted upon daily smoking, there is now a very large group of occasional smokers among Canada's young people. Many of these people have possibly reduced tobacco use due to price rather than due to any understanding of the health implications. While this reduction in overall use is of great benefit to public health, it raises questions about future levels of tobacco use among this group. It might be that a reduction in tobacco prices or increases in personal income will lead to many of these occasional smokers becoming regular smokers. If price has caused a great reduction of tobacco use among this group, but not resulted in a decision to simply forgo tobacco entirely, this trend makes a strong case for ancillary tobacco control strategies.

7.0 A REVIEW OF STRATEGIES

We have now reviewed the results of Canada having moved its tobacco taxes from among the lowest to among the highest found in wealthy countries. We now need to see how we managed to do this. There are many lessons to be learned from the

Canadian Tobacco Tax Project. The following is a review of some of the strategies we used.

7.1 Focus on the Goal; be Flexible Elsewhere

Our core goal was to improve public health through a reduction in tobacco consumption. Our key means was to persuade governments to increase tobacco taxes. In order to maximize our chances of achieving this goal, we had to compromise in other areas. For example, the governments we were seeking to influence were strongly opposed to tied or 'earmarked' tobacco taxes for health promotion.

There were serious dangers in seeking earmarking, including the perception that health groups would only be pursuing tax changes as a way of promoting their own funding. There were also questions about whether certain forms of earmarking could lessen public support for tax changes and the concern that health groups could end up fighting over potential funding rather than pushing the policy initiative. However, our single biggest obstacle to earmarking was a strongly held view among government finance officials that future government control over finances is jeopardized if revenue is not kept separate from spending.

Even though we believed that there was a strong case for using some of the revenues to fund more health promotion activity, we realized that making an explicit link would undermine our chances of getting a big tax hike. We therefore ensured that revenue proposals were made independently of expenditure requests.

In yet another example of this pragmatic approach, we had to decide what to do about our belief that an 'excess profits' tax on tobacco companies made sense. We had recommended such a measure in our 1991 federal tax submission. This recommendation was based on the fact that the lack of price competition among tobacco companies had led to massive corporate profits which, in turn, increased the industry's clout in opposing health measures. But when we discovered there was little political support and we might end up jeopardizing our other proposals we dropped the idea (for the time being).

7.2 Be Able to Make Decisions Rapidly

The capacity to make rapid decisions on strategy as the campaigns would unfold is crucial to success. This rapid decision making is important in any public policy issue and is particularly important when dealing with such time-sensitive issues as the government budget making process. A delay in responding to changes in a typically fluid situation can lead to the public health agenda being marginalized in the budget making process.

In order to achieve this, we maintained fairly strong central control over the tax project. This made planning and implementation easier. The key was to have one person in charge, so that reaction did not have to wait for a meeting to hammer out a 'consensus'. It also meant that we could always be ready with a response to the press when necessary. Government and media deadlines do not move to accommodate health group meetings.

An example of this ability to make rapid decisions was when tobacco companies started introducing a hybrid cigarettes which they claimed were a substitute for roll-your-own tobacco. Due to the structure of our tax laws these cigarettes were subject to rates of taxation that were much lower than cigarettes. In a meeting with government officials we were told that they were considering whether to allow the retention of this lower tax rate in order to encourage those using roll-your-own tobacco to switch to this new lower taxed, but filtered, product. We had to be able to respond immediately. We were able to immediately make the case that no such preferential tax treatment should be given, give our reasons and be confident that our coalition members would support our stand. As a result, an idea floated by tobacco companies was dealt with in a decisive manner before it had a chance to gather government support.

7.3 Hire the Right Staff

You would not want a lawyer or economist to perform your coronary by-pass surgery. To the same extent, you do not want someone untrained to be responsible for pushing a major initiative in fiscal policy. As our tax work became more complicated it was essential that we did not assume that it could be done by amateurs and volunteers. The need to get credibility with governments dictated that we either retain, or have on staff, people who could deal with economists, policy advisors, politicians and the media. We realized that the tobacco lobby does not turn to a farmer or cigarette machine operator to make their case on tax policy and we decided to be no less professional than they try to be. The point made to health organizations is that they would never ask a volunteer to do their biomedical research and should be no more willing to have legislative policy dealt with in such a manner.

Hiring the right people does not necessarily mean huge sums of money. It might mean no more than having someone who is interested in, and good at, issues of finance and health policy. To a very large degree we were able to have our in-house expertise grow with the issues and learn from experience during the course of our campaigns. Having a lawyer as the staff person in charge of the project gave us credibility and underscored the fact that this was a serious effort by the health community. Having a staff that could rapidly deal with complicated issues and tough questioning also helped ensure our success.

We have had constant reinforcement of the decision to have knowledgeable staff. Throughout our efforts the knowledge of our staff, and the recognition of this knowledge, continued to grow. As a result, we are now contacted on a regular basis by governments and media, confident that they are getting the best information available.

7.4 Answer the Tobacco Lobby, But Don't Get Sidetracked

The tobacco industry has a lot of trouble coping with the forces of public health. One of the tactics the industry has used is to confuse public health arguments by framing the issue as part of a greater - and vastly more complicated - policy question. Numerous examples of this have been experienced during our tobacco taxation project. These have included issues of job loss, smuggling, of overall fiscal policy direction and philosophy, different analysis of public opinion, legal constraints to proposed tax changes and procedural roadblocks to the successful implementation of tax changes.

This approach is exemplified in the comments of a senior tobacco industry spokesman in the December 1992 issue of the trade publication **Tobacco Reporter** talking about tobacco control issues in the United Kingdom. He is reported to have said that " the media may be starting to recognize that tobacco opposition groups . . . are reaching their limit to comment intelligently because they are simply out of their league when it comes to the kind of trade matters now arising in Europe".

The obvious solution to the problems caused by tobacco companies trying to inextricably relate health measures to formidable 'larger' issues is to have a grasp of these issues. This often requires specialized knowledge that can often be acquired in no other way than by hiring it. To have full time professional staff makes it easier to deal with potential problems. While the staff may not have expertise on all relevant issues, they are often in a position to know who to contact to get additional information as it is required.

In one recent situation we found that the tobacco industry's constant focus on the jobs dependent on tobacco was sidetracking some senior politicians from the health issues. The health community dealt with this problem by retaining a group of the top economics professors in the country to show that there does not have to be a trade off between lives and jobs. Having crippled the industry's position we then re-focused on health issues.

7.5 Resources

The type of campaign that can be run can be dictated by the resources available. Our position from the outset was that this project had a very real possibility of reducing tobacco use by enough to prevent hundreds of thousands of deaths from the diseases caused by this use. This was a serious project. It would be run as a serious project, and that required serious funding. Initial work was able to be done for a relatively small financial outlay, somewhere in the range of $50,000 per year. As the project developed the cost to NSRA surpassed $100,000 per year. Other health groups were contributing additional funds. The total cost of the project peaked during the 1991 campaign and was in the range of $200,000.

Even with the costs we incurred it is worth noting that much of this cost was for staff time. If staff had not been brought on to do this work this money would have been spent on some other projects. It was therefore not so much a matter of an additional cost as it was of moving resources to a much more cost effective intervention. In many cases, where experienced staff is already in place but working on non-tax issues, the marginal cost of a serious tax project can be quite small.

The costs of any particular campaign could be extraordinarily low. Some of the annual efforts in our smaller population provinces cost virtually nothing. The real lesson was to do something rather than nothing. The tobacco industry has resources that cannot be matched, nor need to be matched. Getting tax changes can be very cost effective, the facts are very much on our side, and it is simply a matter of being in the game. While major research and polling efforts can be expensive, such measures as organizing a letter writing campaign can be very inexpensive. It is a matter of knowing what needs to be done and how best to use the resources available

The money for our campaigns was never sufficient to run as significant a campaign as we would have liked, but it was enough to allow us to be serious players. What was lacked in resources had to be made up through additional hard work and creativity. It was essential to have enough money to allow the work and creativity to be properly utilized. A great idea for a submission would have meant nothing without the ability to print it and a timely news conference can only happen if someone can cover the costs.

We also learned that different coalition patterns have relative advantages in different types of resources. As an example, many health organizations have a fairly easy time finding money for public opinion polling, printing of documents or booking a room for a media conference. At the same time, these same organizations might have a rule against paid advertising or hiring lobbyists. It made much more sense to ask for a contribution that was likely to be given.

7.6 Coalitions: Do You Need More Support?

It helps to be able to show a wide base of support for tax proposals. A project backed by most of the major health and medical organizations can have tremendous credibility and show a social consensus. It could also prove to be embarrassing to some non-participatory health organizations to explain why they do not appear to be involved when an evaluation of the results of the project are so beneficial to health. Similarly, it can be politically expedient to not have to explain why some groups with a clear interest in public health do not appear to support such an effort.

In some of our federal tax submissions we not only listed the endorsing organizations on the cover, but included in the actual brief a half page overview of the nature of each group. This showed the breadth of our coalition as well as the role each group played in our society. For the recipients of our submission it was safe to assume that they knew something about most of these organizations but lacked full knowledge of the extent of their social involvement, number of volunteers, etc. By including this information in our submission we increased the image of the coalition and, by necessary implication, the credibility of our position.

Larger coalitions were also developed for those efforts where the appearance of wider public support (and the support of mainstream health groups) was important, most notably in the campaigns for federal tax increases. But these coalitions were always issue-specific. Groups were brought together to endorse a particular proposal which would have already been developed by a core group of advocates. The coalition would push for implementation of the proposals but would be centrally coordinated by a very small number of key people. The day-to-day operations of the campaign was left in the hands of the NSRA to avoid the risk that coalition procedures or in-fighting would undermine effectiveness. This structure allowed us to move with far greater rapidity than a conventional coalition style of management.

There was a dual responsibility in such a coalition arrangement. We needed to get a draft copy of our position paper to potential coalition members in time for them to do what was necessary to endorse the overall proposal. At the same time, those endorsing the proposal were not to interfere with the campaign itself. The way we structured this was by having the coalition members simply endorse the submission. Further aspects of the project then came down to tactics (meetings with politicians, news conferences, public opinion polling etc.) and only those from the coalition who were interested and could assist in attaining our objectives would be involved in each of the tactics.

There are also times when a 'coalition' was really quite small. As the tobacco tax project developed we sought to get the arguments out to as wide a group of interested parties as possible. While this did not often result in active participation of the groups themselves, individual members of some of these groups proved extremely valuable. We had several instances where people who were very well connected to important politicians would help us make our case. They provided the entre and we provided the information. A small but effective 'coalition'.

It also became clear that a coalition was not always a necessity. In some provinces, the situation would be so favourable to tobacco tax increases that it was simply a matter of getting the right information to the right people at the right time. As an example, a jurisdiction with a looming deficit, no strong tobacco industry presence, a high level of public health awareness and lower taxes than its neighbours. In some of these situations we sent a detailed analysis of the role that tobacco tax changes could make in terms of health and revenue and showed the public support for such measures. In short, provided we got the information into the government as budget deliberations were beginning and were able to answer questions as they arose, we had a high probability of success.

Another example which demonstrated that a coalition is not always necessary involved the province of New Brunswick. We submitted that a technical interpretation of the tobacco tax laws of that province indicated that taxes on tobacco should have been automatically adjusted to a higher level. We put together the legal reasoning and sent this information to the politicians and officials in charge of tax policy. The result was that we attained a significant tax increase with a little legal research and no coalition of any sort.

7.7 Become the Source of Information

When we began our efforts to increase tobacco taxes it was clear that the tobacco industry was regarded as the primary, if not the sole, source of tobacco tax information in Canada. But that meant that the information, often accepted without question, was always slanted to serve the interests of the tobacco industry. For instance, taxes were described as a "tax burden" or tax rates were shown without adjustment for inflation.

The Tobacco Institute in the United States is probably the best example of the tobacco industry being able to set itself up as such a source of information.

We identified a huge potential gain in becoming the preferred source of tobacco tax information. We started by getting updated tax information from each province and establishing a list of contacts within each government. We put this together on a one page summary and would update it as soon as any change was made anywhere in the country. The new tables would then be sent around the country. We were thus able to have information disseminated more rapidly than the tobacco industry and we did so in a convenient, user friendly, way.

We started producing detailed analysis of tobacco taxes that took into account not only inflation but changes in disposable income. This allowed us to produce a large number of graphs that show tobacco control trends.

In many cases the graphs make an immediate impression and reinforce the health considerations in tobacco tax policy.

At the same time we undertook high value added research. This has included an analysis of public support for various tax changes, the impact of potential changes on youth smoking and the revenue forecasts for our proposals. Much of this work was of immediate benefit to governments.

7.8 Develop Credibility With the Media

When we first started our project the media appeared rather taken aback that a health group would be trying to discuss such issues as economics and fiscal policy. We needed to change this and so set a goal to be quoted more in the newspapers than the tobacco industry as a source of tobacco tax information. We succeeded by the easy-to-understand presentation of our information, particularly in graphs, and the development of short backgrounders on tobacco tax issues.

We also followed general rules about working with the media. We made sure we were always available for media calls and gave them the information they needed within their allotted time frame. We also generated stories that were newsworthy, such as using freedom of information laws to reveal tobacco industry lobbying techniques and the monthly release of sales information to detail trends in consumption.

We also worked to get newspaper editorial boards on side. We would brief them on our proposals and explain the rationale. We would also answer whatever concerns they might raise (and newspaper people are good at raising a lot of them). In most cases we could get editorial support for our proposals.

7.9 Lobbying in Small Population Jurisdictions

We made a lot of contacts with key individuals through our solicitation of support from health and medical associations. Often there would be volunteers with these groups who were wanting to assist us, had little knowledge on tobacco tax issues, but had some very important contacts. Through some of these people we learned an important lesson about effective lobbying in smaller population jurisdictions.

Unlike major population centers, we found that a province with fewer than two million inhabitants had a much more informal style of government. The politicians seemed much 'closer' to the voters, probably because they are living among them on a day-to-day basis. Access to these politicians, and a courteous hearing of our proposals, could usually be arranged through a local member of a health or medical organization.

In most of these provinces there would be a 'political elite' that was well known to some of the volunteers within the organizations we would approach. They often grew up together, went to the same schools, lived in the same neighbourhoods or were connected socially in some other way. The tobacco industry has referred to such a critical grassroots group of people as the "grasstops". We found that such people are powerful influencers of the political system and are particularly effective when they are pushing issues of public health with no personal vested interest.

In one province a prominent local doctor was told during an evening meeting at his home of a particular politician who needed to be brought on side. He indicated that this should not be a problem, grabbed his coat and headed for the door. It turned out that the politician in question lived just down the street and that they were quite good friends. After this doctor had acted as our conduit for information the tobacco lobby did not stand a chance and we got the increase we wanted. In another province a senior volunteer with the Canadian Cancer Society did a superb job of taking a short brief we would prepare and pushing the concepts with every significant politician, all of whom appeared to be close personal friends.

8.0 CASE STUDIES: AN OVERVIEW OF SPECIFIC APPROACHES

8.1 Raising Tobacco Taxes In A Tobacco Growing Jurisdiction

The problem

With Canada growing more tobacco per capita than the United States, the tobacco farmers can be a very powerful lobby. This is particularly so in Ontario where the vast majority of Canada's tobacco is grown. In fact, Ontario's tobacco tax was traditionally as low as those found in such tobacco belt states as North Carolina, Kentucky and Virginia.

This was a particularly significant problem because Ontario has by far the largest population of any Canadian province. This low tax policy kept Ontario's consumption higher, which in turn inflated national tobacco consumption. Ontario's low tax policy also made it more difficult for other provinces to raise tobacco taxes.

Tobacco taxes did rise in Ontario from the early 1970's to the point that they reached 50 cents (Canadian) by 1984. Much of this rise was due to an indexing system that automatically increased the tax.

In 1985 there was a change in government. The politician who emerged as the person with control over the provincial budget was from Ontario's tobacco belt. He had a long history of supporting tobacco growers and opposing tobacco taxes. There was a very real possibility that Ontario's tobacco tax would not be going up and there was even a risk of a roll-back.

The politician in question remained in charge of the budget process until 1990. During this time we had to deal with all of the roadblocks that stood in the way of higher tobacco taxes. And we did. During his five year tenure we obtained the two largest tobacco tax increases the province had ever seen. The tobacco taxes in Ontario not only did not fall, they doubled. And, with the subsequent change in government in 1990, the tobacco tax increases continued. By 1992 the tobacco tax in this major tobacco growing jurisdiction had reached $1.30 per pack of 20 cigarettes.

How this was done provides an lesson in the creative use of rather simple economic concepts.

The arguments

Sometimes politicians can be motivated solely by the magnitude of the health problems caused by tobacco use.

Sometimes a simple comparison of the number of lives lost to tobacco and the number of people the tobacco industry employs will sufficiently show the absurdity of placing the financial well-being of tobacco growers above the health of the entire population. Our experience is that these arguments, as well as the estimates of increased government revenue, should virtually always be used. But sometimes these arguments are not sufficient in the absence of a direct analysis of the impact of higher taxes upon tobacco farmers.

In looking at the impact of a tobacco tax increase on tobacco farmers, two facts are very important. The first is that tobacco leaf constitutes only a very small part of the cost of cigarettes (remember that the average cigarette contains well under one gram of tobacco). The second point is that a tax increase in a tobacco growing jurisdiction will only impact upon the proportion of the locally grown tobacco that is consumed in the state.

For Ontario we obtained figures showing that about 170 million pounds of tobacco were then being produced and about half of this was being sent out of the country. We then estimated, based on sales figures, that about a third of national tobacco consumption took place in Ontario. This left us with about 29 million pounds, or only 17% of production, that was actually consumed in Ontario. Since a tax increase in Ontario would only directly impact on consumption within Ontario, we only had to look at the impact on this 29 million pounds.

We then looked at what would happen to these tobacco sales were the tax increase we were lobbying for actually implemented. This meant determining the percentage decline in consumption and applying this percent to the Ontario market for Ontario's tobacco. In those days cigarettes were still cheap, about $2 (Cdn) per pack and we were seeking an increase of 15 cents in the tax per pack. This would give us a price increase of about 7.5%. Using the estimates of price-sensitivity we could estimate that this would reduce tobacco consumption by about 3%.

This 3% decline in Ontario's tobacco consumption would theoretically reduce the demand for locally grown tobacco leaf by about 860,000 pounds, which represented only half of one percent of local tobacco production. The potential loss of revenue to Ontario's tobacco growers was calculated by multiplying this decline in sales by the price at which this tobacco was selling. This showed that the tobacco farmers would have sales reduced by about $1.5 million. By looking at the average production of tobacco farms we could estimate that this translated into about 13 average sized tobacco farms being put out of business.

But then we looked at the revenue numbers, which showed that a tax increase of this size would raise an additional $130 million. This meant that the government would be forgoing $10 million per year for each farmer kept in the business. We characterized this as the least efficient farm support scheme in national history, particularly when one calculates the additional teenage addiction, disease and mortality associated with promoting this higher level of consumption.

The point was made that keeping tobacco taxes down to "help tobacco farmers" was simply unjustified in economic as well as health terms. Far better that a politician who wants to assist these farmers should support higher tobacco taxes but simultaneously take some small part of the additional revenue raised and use it to assist tobacco growing areas to adjust to alternative sources of revenue.

The case was clear cut and the logic of it was constantly reiterated in our quest for health oriented tobacco taxation. And it worked ;

- Taxes went up,
- Consumption went down,
- Tax revenue increased
- And assistance was given to tobacco farmers to adjust to lower consumption levels.

8.2 Applying a Sales Tax

Of Canada's ten provinces all except Alberta have a sales tax. Early in our campaign, however, only two provinces applied this sales tax to tobacco products. This was seen as a serious matter. A sales tax can have a serious impact on overall prices, it can accentuate further tax or wholesale price increases and its absence might unjustifiably identify tobacco as being among those goods the use of which the government does not wish to reduce. For all of these reasons we chose to try to have sales taxes extended to tobacco products.

We were able to discern several reasons why governments had not applied the sales tax to tobacco products. These included the fact that the tobacco tax made a sales tax unnecessary and the fact that tobacco had not previously been taxed in this way.

Each year, due to limited resources, we targeted one or two provinces in our efforts to have the sales tax applied to tobacco products. We would argue that some jurisdictions already did so (an argument which became ever-more powerful as more provinces applied the tax). We would make the case that an extension of the tax was a better way to raise revenue than an increase in the overall rate.

Primarily we relied on an argument of fairness. It simply was not right to place tobacco products among a select group of goods (such as food, pharmaceuticals, children's clothing etc.) the consumption of which governments did not want to discourage. We argued that this created an entirely inappropriate image for tobacco products and was running counter to public health goals.

We gradually won. By the early 1990's only two provinces with a sales tax had not yet applied this tax to tobacco products. We also succeeded in our efforts to ensure that all of these sales tax extensions were done without an off-setting reduction in tobacco taxes.

9.0 FUTURE DIRECTIONS IN TOBACCO TAXATION

9.1 Tobacco Taxation: Options

At present, cigarettes sold in Canada are subject, in most provinces to four separate taxes:

- A specific federal tobacco tax levied per cigarette (rate = federal excise duty of 0.55¢ and an excise tax of $1.04 for a total of $1.59).
- A specific provincial tobacco tax levied per cigarette (rates range from a high of $2.20 to a low of $ 1.30).
- The federal Goods and Services Tax (GST), levied at seven per cent (7%).
- Provincial sales taxes, where applicable, levied at rates ranging from 0.70¢ to 0.34¢ per package of 20 cigarettes. (The provinces of Alberta, British Columbia, and Prince Edward Island do not apply a Provincial Sales Tax to tobacco).

Using the province of Ontario as a representative example, the total tax on a packet of 20 cigarettes is therefore made up as follows:

Federal Excise Tax	$1.59
Provincial Tobacco Tax	$1.30
Federal GST	$ 0.32
Provincial Sales Tax	$ 0.36
Total Taxes	$ 3.56
Retail Price	$ 5.19
Total Taxes as %	68.6% of the retail selling price.

Other tobacco products are also taxed, but at a much less than proportional rate. Roll-your-own tobacco bears the same types of tax as cigarettes. But at the federal and provincial levels, the effective tax on a hand - rolled cigarette is much lower than on a manufactured cigarette. Similarly for other tobacco products such as cigars and pipe tobacco, the effective tax is lower than on manufactured cigarettes. These discrepancies lead to industry substitution, attempts by the tobacco industry to exploit the loopholes by introducing new products to take advantage of the anomalous tax treatment and the like.

This illustrates a key point - that the structure of taxation is an important factor in shaping the tobacco market. This is particularly relevant when taxes reach the high levels we now see in Canada.

Thus far, policy has focused almost exclusively on the level of taxation. That makes sense, because the level of taxation is the most potent influence on total consumption. But we may also want to look at the scope for changing the structure of taxation to serve health goals.

No tax system is neutral. The present tax structure in Canada has the following effects:

- Promotes price convergence for cigarettes. The high specific duty means that manufacturers would have to take a large hit on their profit margins if they were to indulge in price competition;

- Promotes the sale of king size cigarettes, because the tax is levied on a per cigarette basis, not on the basis of the size of cigarettes;

- Makes no differentiation between high tar/ high nicotine cigarettes and low tar/ low nicotine cigarettes, filtered or unfiltered cigarettes.

- Allows manufacturers to raise their prices with relative impunity, thus allowing them to continue to enjoy very large profits in the Canadian cigarette market;

- Promotes the shift of price sensitive consumers to roll-your-own and encourages the industry to exploit existing loopholes.

Possible options for reforming taxes

The health objective is to reduce the harm from tobacco use. If we are using tax policy to reduce the harm, we could pursue a number of possible options, namely :

- Levy higher taxes on higher tar cigarettes. The United Kingdom did this in the late 1970's and removed the highest tar cigarettes from the market. The European Community is now committed to banning the production of the highest tar cigarettes in two stages - no cigarettes can be sold after a predetermined date with a tar content over 15mg, and from a subsequent date that will be reduced to 12 mg. At present there are cigarettes with much higher tar content on the Canadian market. Tax policy could be used to eliminate them. Various measures are possible- a tax graduated according to the tar content, or simply a surcharge on the highest tar cigarettes. The floor for the surcharge could be lowered each year. This would not only influence consumers to buy lower tar brands, it would also counter the tobacco industry's practice of passing off high tar brands as "light" cigarettes. The Government has proved unwilling to tackle this through enforcement of the consumer protection laws. This could offer an alternative route, namely:

    - Surcharge the most unhealthy cigarettes. For example one could tax the unfiltered cigarettes at a higher rate than the filtered variety. Such a measure might lead to the eventual removal of unfiltered cigarettes from the market.

    - Tax according to weight of tobacco rather than on a per cigarette basis.

    - Use the tax system to eliminate nicotine from cigarettes;

    - Tax additives.

In all cases, what we need first is some basic robust science to show that a certain property of a cigarette is worse than another and then to use the tax system to make the more dangerous cigarette more expensive. Using price signals in this way can also counter misleading representation of products by the tobacco industry. If the industry call a product an " ultralight" cigarette, but it has the same tar as a "regular" cigarette, it would bear the same tax, while a genuine ultralight might bear less.