

Imperial Tobacco Canada Limited

Responses

1. Economic Recovery and Growth

Given the current climate of federal and global fiscal restraint, what specific federal measures do you feel are needed for a sustained economic recovery and enhanced economic growth in Canada?

A long-term economic recovery will need to be led by the private sector. For the private sector to invest, companies must feel they are operating in a stable business environment governed by reasonable legislation and regulation, and one that is governed by the rule of law. The latter is not currently the case for the legal tobacco industry and law-abiding retailers, who are being forced to compete with illegal manufacturers and First Nations retailers who operate outside any legal, regulatory or tax framework. Contraband tobacco has made up 16.5% to 32.7% of the market nationally since 2006. Illegal tobacco sales appeared to peak in 2008, hitting 48.6% of the market in Ontario and 40.1% in Quebec. Illegal tobacco is produced in unlicensed and unregulated factories on First Nations reserves in Canada and the United States. The RCMP has reported there are 50 illegal cigarette factories operating on reserves in Ontario and Quebec and another 8-10 on reserves in New York State that are supplying the illegal market in Canada. Illegal cigarettes sell for as little as \$10 per carton in some provinces compared to \$70-\$125 for a carton of legal product. Through being allowed to operate outside the law, the illegal trade has gained a huge market share and made it extraordinarily difficult for legal manufacturers and retailers to compete. That is part of the reason why 2300 convenience stores have closed in the past two years in Canada. In addition, the legal tobacco industry loses hundreds of millions of dollars annually to the illegal trade. Newly imposed regulations on the legal tobacco industry have given the illegal operators a further competitive edge. Consider that in the past three years the legal tobacco industry has had to comply with new tobacco stamping regulations and labelling requirements that cost tens of millions of dollars to implement, and neither is likely to accomplish its stated goals. The illegal operators do not abide by these new requirements and therefore do not incur the associated costs. The Government should take immediate steps to fight the illegal tobacco trade, including: 1. Do not raise the federal excise tax and encourage provinces to refrain from further tax increases on tobacco products. A principal driver of contraband is the large price difference between illegal cigarettes and legal ones, which is primarily driven by high taxes that make up on average 68% of the price of a package of cigarettes. Excessively high tobacco taxes are not an effective deficit fighting measure since they stimulate the illegal trade which ultimately robs Governments of expected tax revenues. 2. Allocate promised funding to law enforcement and reconsider the planned move of the Cornwall port of entry. The Conservatives promised new measures on contraband in their 2011 platform. We encourage the Government to move quickly to act on those. Also, the pending move of the Cornwall port of entry to the U.S. side of the Akwesasne reserve threatens to undermine all efforts to fight contraband and needs to be reconsidered. 3. Roll out previously promised public education campaign. Despite promises of such a campaign, Government efforts in this area are minimal. Canadians need to be reminded that contraband tobacco funds organized crime and that there are penalties for buying it. A public education campaign should help reduce demand for contraband. 4. Establish a formal Federal-Ontario-Quebec task force to find long-term solutions to Canada's contraband crisis. Only a fully dedicated and coordinated task force can provide the necessary focus and resource to address the heart of Canada's contraband crisis: the illegal factories manufacturing billions of cigarettes annually and the First Nations smoke shacks selling tobacco outside any legal, regulatory or tax

framework.

2. Job Creation

As Canadian companies face pressures resulting from such factors as uncertainty about the U.S. economic recovery, a sovereign debt crisis in Europe, and competition from a number of developed and developing countries, what specific federal actions do you believe should be taken to promote job creation in Canada, including that which occurs as a result of enhanced internal and international trade?

The response to this question is essentially the same as with the previous. Under the present scenario wherein an illegal tobacco trade is allowed to compete with the legal industry with little threat of sanction, the only beneficiaries are the criminals operating the manufacturing, trafficking and sales networks for contraband tobacco. It is estimated that Federal and Provincial Governments lose approximately \$1.5 billion in tax revenue annually to the illegal trade, with \$600 million lost to the Federal Government alone each year. These figures have been validated by provincial governments. This money is being diverted to groups with links to organized crime. According to the RCMP, there are more than 175 such groups involved in this illegal trade. These groups also traffic drugs and arms and there have been reports that profits from the sales of illegal cigarettes may fund international terrorist organizations. Illegal tobacco is creating employment for criminals and harming law-abiding businesses and retailers. Moreover, at a time of deficit fighting and budget cuts, the lost tax revenue should be of paramount concern to the Finance Committee.

3. Demographic Change

What specific federal measures do you think should be implemented to help the country address the consequences of, and challenges associated with, the aging of the Canadian population and of skills shortages?

Not applicable.

4. Productivity

With labour market challenges arising in part as a result of the aging of Canada's population and an ongoing focus on the actions needed for competitiveness, what specific federal initiatives are needed in order to increase productivity in Canada?

Our company is not opposed to balanced, evidence-based regulation and legislation. However, this is often not the case when it comes to new rules for tobacco. For example, the legal tobacco industry incurred large costs and significant productivity decreases to implement a new stamping regime for tobacco products. This regime was presented as a means to distinguish legal tobacco products from their illegal counterparts. In reality, it is very simple to tell these apart. Legal products come with warning labels and various other packaging requirements dictated by regulation and legislation. Much of the illegal product is sold in clear plastic baggies. In other words, a stamp is not required to tell the two apart. Complicating matters further, however, is the fact that federal tobacco stamps are turning up on contraband tobacco products, most notably those sold at the Dakota Chundee Smoke Shop in Manitoba that was raided four times by the RCMP before the provincial government got a court injunction to close it permanently. The tobacco sold there was deemed illegal by the RCMP because provincial duty had not been paid, even though a federal stamp appeared on the packages. Situations like this make it extremely difficult for consumers to tell what is and is not a legal product. This has to be rectified; otherwise, this showpiece initiative of the Government's anti-contraband strategy will be severely undermined. Another example is the new and expanded warning labels on tobacco products.

These were imposed upon the legal tobacco industry at huge cost despite there being no evidence to support the claim that larger warning labels lead to reduced smoking incidence.

5. Other Challenges

With some Canadian individuals, businesses and communities facing particular challenges at this time, in your view, who is facing the most challenges, what are the challenges that are being faced and what specific federal actions are needed to address these challenges?

The major challenge facing the tobacco industry and the other stakeholders with an economic interest in this industry, including retailers, tobacco growers, and so on, is the inequitable application of justice in Canada at the present time. Regardless of one's views about tobacco or tobacco companies, cigarettes are a legal and heavily regulated product. They are also a critical product line for thousands of Canadian retailers. In recent years, the legal tobacco industry and law-abiding retailers have been forced to compete with a massive illegal tobacco trade that operates outside the law and pays no taxes. The 50 illegal cigarette factories on First Nations reserves and the 300+ smoke shacks selling tobacco outside any legal, regulatory or tax framework are undermining our economic and legal systems. No industry should have to compete with an illegal counterpart that operates in plain view of the authorities. It is time to begin a formal dialogue about solutions. Our company recommends the establishment of a formal Federal-Ontario-Quebec task force to find long-term solutions to Canada's contraband crisis that get to the heart of the contraband problem: the manufacture and sale of illegal tobacco on First Nations reserves. This has to be addressed if the contraband issue is going to be tackled for the long term. Doing so requires the Federal, Ontario and Quebec governments to establish a formal body with an agreed upon mandate to develop a lasting solution to Canada's contraband crisis. Such a body needs clearly defined goals, timelines and measurable outcomes and should begin immediate consultations with all affected stakeholders and the public.