



## Government policy drives tobacco black market

*High excise taxes are forcing people to break the law to save money*

By: Steve Lafleur and Andrew Chai – May 30, 2013

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Public Safety Minister Vic Toews defended his government's decision to set mandatory minimum sentences for anyone convicted of trafficking in contraband tobacco by claiming that "contraband tobacco fuels the growth of organized criminal networks, contributing to the increased availability of illegal drugs and guns in our communities."

While this may be true, it is government policy that is driving black market activity. The high taxes imposed on tobacco products actually increase the smuggler's profit margins, since they don't pay taxes. And the higher the taxes, the more buyers enter the black market and the higher the premium they'll be willing to pay.

If the federal government is serious about cracking down on black market activity and wants to minimize the costs associated with tobacco, it should reduce excise taxes to a level at which people don't feel the need to break the law to save money.

The politics behind tobacco policy is dominated by appeals to emotion. For example, federal Minister of Health Leona Aglukkaq stated that "Baggies of cheap, illegal tobacco can make it easier for children and teens to get cigarettes into their hands and start smoking, which obviously has a negative impact on their health." While appeals to "think of the children" may resonate on an emotional level, they ignore the fact that federal policy actively encourages contraband tobacco.

Don't believe that inflating the cost of legal tobacco increases the demand for illegal tobacco? Then take a look at New York State, the state with the highest tobacco taxes. Sixty per cent of available tobacco there is smuggled, while virtually all tobacco in low excise tax states such as North Dakota, South Carolina, and Tennessee is sold legally. An estimated 27 per cent of Canadian tobacco is contraband.

And given that contraband tobacco is sold without age-verification, the high taxes on cigarettes that encourage black market activity – the very thing that Toews railed against – may make it easier for children to get their hands on tobacco – the very thing Toews seeks to avoid. Setting a more effective trap to catch rats makes little sense when they wouldn't come around if there was no cheese.

And while "locking the thugs up" may keep the streets safer, the same is not true with non-violent offenders. According to Tim Lynch of the CATO Institute, the low-level traffickers who are often incarcerated under minimum sentencing legislation are easily replaced, with no real effect on the level of crime. Mandatory minimum sentences simply send more people to prison without improving public safety.

And think of the effect on First Nations, which worry that the legislation will only increase incarceration rates in their communities. The number of Aboriginal inmates has increased by 43 per cent over the last five years and now represent 23 per cent of all federal inmates, despite only being 3.8 per cent of the population. This has had a devastating effect on Aboriginal communities. While tobacco has real social costs, incarcerating people for selling an otherwise legal product is much more costly.

Another motive for the shift in policy is that black market tobacco, according to the Conservative Party's 2011 election platform "results in huge losses in revenue" for the federal government.

While tobacco use does impose social costs, and tobacco taxes do amount to substantial revenue for the government, the volume of smuggled tobacco should be a hint that it has gone too far and that taxes are worsening the problem. Indeed, when the federal government cut tobacco taxes in 1994 from \$19.14 per carton to \$7.29 to combat smuggling, smuggling dropped. It has since increased taxes to roughly \$15 (all prices in 2002 dollars), with a commensurate increase in smuggling.

Tobacco taxes do have some potential to reduce smoking and can help pay for some of the social costs of smoking, but setting rates too high fuels black market tobacco sales. Inflating black market activity leads to greater policing and court costs, negating the benefits of increased tobacco tax revenue.

While talking tough on crime may win votes, harm reduction is a preferable approach to dealing with contraband. The federal government should determine the optimal excise tax level to minimize the overall social cost of tobacco, including law enforcement costs. Ratcheting up taxes and criminal sanctions is not the best solution.

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