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# BORDER INTEGRITY, ILLICIT TOBACCO, AND CANADA'S SECURITY

Jean Daudelin  
with Stephanie Soiffer and Jeff Willows

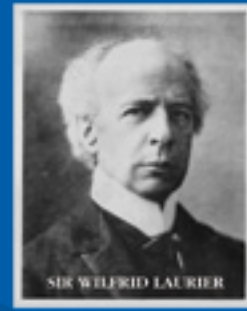
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# Executive Summary

The Seaway International Bridge over the St. Lawrence River connecting the city of Cornwall, Ontario in Canada to the town of Massena, New York in the US.

**T**he small town of Cornwall in eastern Ontario can be considered the contraband capital of Canada, thanks to the high volume of cross-border smuggling and illicit trade in the area. The problem has two sources: the unique local geography combined with practical, legal, and political problems that make it easy to bypass border controls; and the tolerance of Canadian and US law enforcement toward the illicit manufacture and sale of tobacco products on the Mohawk territory that straddles the Canada-US border between Ontario, Quebec, and New York State.

Much of the local problem revolves around tobacco; however, significant amounts of illegal drugs, weapons, and humans have been trafficked through the area, all of these accounting for a chain of collateral crime in the surrounding region. The gross value of these illegal practices reaches into the hundreds of millions of dollars.

Contraband has national security implications for Canada. Tobacco and its trade generate important economic benefits for the Mohawk community that lives on the Akwesasne (Canada) and St. Regis (US) Mohawk reserves that straddle the border. A substantial part of the production and sale is legal, but the Mohawk generally refuse to apply taxes to their legal tobacco products, and they tolerate the illegal production and sale of tobacco. As a result, a direct attack on those activities may provoke confrontations, and possibly even a loss of federal control over

the border area. In addition, US authorities are preoccupied with the movement of illegal drugs and humans through Cornwall: any measures they take to stem the flow would hurt Canada economically by inhibiting the free circulation of goods and people across the border.

Illicit tobacco accounts for about 15 percent of cigarette sales in Canada, a large proportion of which comes through Cornwall. Attempts to constrict that flow have failed. However, the pressure exerted on the trade has helped keep profits much lower than they could have been. Given the sensitive political situation and the overlapping jurisdictions and legal frameworks, enforcement authorities have been remarkably effective in containing broader security fallout. We found little evidence of extensive smuggling of drugs, weapons, and humans in recent years, and the large-scale involvement of organized crime appears to have been curtailed. Tensions with the Mohawk community have been rare, confrontations largely avoided, and a fluid and effective relationship with the Mohawk police on everything but tobacco on reserve has been built.

In summary, federal authorities on both sides of the border appear to tolerate the illicit tobacco trade in favour of containing the broader criminal and security dangers that smuggling and its repression represent. On that count, current efforts have been quite successful.





## Sommaire

La petite ville de Cornwall, dans l'Est de l'Ontario, peut être considérée comme la capitale de la contrebande au Canada, en raison de l'importance du volume du commerce et des échanges transfrontaliers réalisés illégalement dans la région. Le problème a deux sources. D'abord, une géographie locale unique se conjugue à des problèmes pratiques, légaux et politiques de mise en œuvre des contrôles frontaliers pour faciliter le contournement de ceux-ci. Ensuite, les produits du tabac fabriqués et vendus de manière illicite sur le territoire mohawk qui jouxte la ville, et chevauche la frontière canado-américaine séparant les provinces de l'Ontario et du Québec de l'État de New York, bénéficient d'une tolérance des autorités dans l'application des lois prohibitives canadiennes et américaines.

Le problème dans la localité est surtout attribuable au tabac, mais des quantités notables de drogues illicites, d'armes et de personnes font aussi l'objet d'un trafic, ce qui a entretenu dans les environs un réseau d'activités criminelles connexes. La valeur brute de telles pratiques illégales peut atteindre des centaines de millions de dollars.

La contrebande a des incidences sur le plan de la sécurité nationale du Canada. Le commerce de tabac entraîne d'importantes retombées économiques pour la communauté Mohawk des réserves mohawks d'Akwesasne (Canada) et de Saint-Régis (États-Unis), dont les territoires s'étendent des deux côtés de la frontière. Une part importante de la production et de la vente est légale, mais les Mohawks refusent généralement d'appliquer les taxes sur le commerce légal, alors qu'ils tolèrent la production et la vente des produits du tabac faites dans l'illégalité. Par conséquent, les interventions directes visant à circonscrire ces activités risquent de provoquer des affrontements qui pourraient aller jusqu'à entraîner

la perte de contrôle fédéral sur la zone frontalière. En outre, les drogues illicites et les migrants clandestins qui pourraient transiter par la région de Cornwall préoccupent les autorités américaines, et des mesures mise en place par les États-Unis en vue d'endiguer ces flux risqueraient de nuire au Canada sur le plan économique en entravant la libre circulation des biens et des personnes aux frontières.

Le tabac vendu illégalement, qui représente environ 15 % du commerce de cigarettes au Canada, transite en grande partie par Cornwall, et les tentatives d'endiguer ce flux ont échoué. Cependant, les bénéfices liés à ce commerce sont bien inférieurs à ce qu'ils auraient pu être sans la vigilance qui a été exercée. De plus, les retombées de cette activité sur la sécurité en général ont été contenues grâce à la remarquable efficacité dont ont fait preuve les autorités policières, compte tenu d'un contexte politique très délicat et des chevauchements des compétences et des cadres juridiques. Ainsi, il y a eu peu d'indices de présence massive de contrebande de drogues et d'armes ou d'une circulation importante de migrants clandestins au cours des dernières années. En outre, l'implication d'organisations criminelles majeures semble avoir été contenue. Les tensions avec la communauté Mohawk ont été rares, et les affrontements en grande partie évités. Une coopération efficace s'est développée avec les services policiers mohawks et une coopération efficace semble prévaloir, sauf en ce qui a trait au tabac à l'intérieur des réserves.

En résumé, les autorités fédérales des deux côtés de la frontière semblent tolérer le commerce illicite de tabac afin de concentrer plutôt leurs efforts sur la lutte contre les activités criminelles et les menaces à la sécurité plus graves que la contrebande de tabac. De ce point de vue, les efforts actuels apparaissent fructueux.

# Introduction

**A**s the saying goes, Canada and the United States (US) are separated by the longest undefended border in the world. The two countries have developed a level of interdependence unique among major economies. Keeping that border secure and open stands as a crucial security preoccupation for the two countries, especially Canada, which is smaller and more dependent on access to its neighbour's market. The problem is particularly acute for Ontario, whose industrial fabric is woven into the manufacturing heartland of the US.

**A secure, open border is a security priority for Canada and the US.**

For the last 20 years, contraband tobacco has represented one of the most significant challenges to border integrity. The problem centres in the Cornwall area around the Akwesasne-St. Regis Mohawk Reserve, which straddles the frontier at the juncture of New York State, Ontario, and Quebec. Despite its small size, the area has become the most important channel for smuggling tobacco products into Canada.

Geography and a jurisdictional vacuum at the frontier are the main contributor to the creation of a contraband haven in the Cornwall area. The St. Lawrence Seaway is the dividing line between Canada and the US and between the Aboriginal lands of the Mohawk Council of the Akwesasne (Canada) and the St. Regis Mohawk Tribe (US). The Mohawk Nation of Akwesasne also controls a number of small islands within the river and lands south of the river in Quebec, which lie adjacent to the US border and the St. Regis Mohawk territory.

The Seaway International Bridge runs from Cornwall, Ontario, to Massena, New York, crossing over Cornwall Island and the St. Lawrence Seaway, thus spanning the territory of the Mohawk Nation of

Akwesasne. Although the Canada-US border geographically divides this region, residents of the Mohawk nation travel freely across this territory without interference by customs authorities. The official border crossing at Cornwall-Massena is only one of many possible access points in this sparsely populated, largely rural region. The river often freezes over during the winter, resulting in numerous unofficial "ice roads" between the US and Canada. Covert travellers can traverse undetected through remote areas with a combination of all-terrain vehicles, snowmobiles, and speedboats, or they can simply cross at one of the unmanned crossings east of Cornwall (ONDCP 2012, 30).

The smuggling infrastructure established to sustain the tobacco trade has been used for other "goods" and the amount of money involved have developed into a major law enforcement and security conundrum. Weapons, drugs, and people, sometimes in large quantities, have been illegally trafficked through the reserve, and the profits generated by the various smuggling activities constitute a large amount of money whose use escapes all control. With illicit tobacco at its core, the whole problem can be understood as a series of concentric circles with increasingly broad security implications.

**The smuggling routes established for tobacco are also used for drugs, weapons, and humans.**

The illicit trade in tobacco is a criminal activity in itself. It also breeds criminality: directly, in protecting illegal production, commerce, and money laundering; and indirectly, by encouraging criminal organizations to be active in other illegal ventures. In addition, the criminal architecture built around illicit tobacco, particularly the trafficking routes and networks, has been used to transport other "products", from drugs and weapons to humans. The profits can be used to seed other criminal activities or finance terrorist organizations. Since much of the illicit trade takes place around and across the border between Canada and the US, it also potentially threat-

ens Canada's relations with the US by raising US insecurities about its northern border. US measures taken to stem contraband could impair the free flow of merchandise and people between the two countries, creating a direct cost to Canada's economy.

A significant part of the illicit trade involves tobacco itself and tobacco products grown, manufactured, stored, and sold on Aboriginal reserves, or smuggled across the Canada-US border through the Akwesasne/St. Regis Mohawk reserve, which straddles the border. Tobacco products are legally manufactured in these communities, but the legitimacy of any prohibition or taxation of both licit or illicit tobacco is also strongly challenged within the community. This situation, combined with the threats to and sanctions against the production and trade considered illicit by non-Aboriginal governments, creates a significant potential for confrontation between law enforcement agencies and the communities. Over the last 25 years, such confrontations have led to the blockade of roads, rail lines, bridges, border entry points, and, in extreme cases, to the *de facto* suspension of the federal presence on the communities' territories. Such occurrences represent significant security threats in themselves.

These challenges are magnified by overlapping jurisdictions, a thicket of treaties, legislations, and regulations, competing and sometimes conflicting policy priorities, and a throng of agencies (such as law enforcement, Indian affairs departments, health, and revenue) brought in as a consequence of the multi-dimensional nature of the problem.

This paper examines the nature and scale of the challenges posed by contraband in the Cornwall area and the efforts being made to tackle it. The first section provides a general background to the study by situating illicit tobacco in the broader context of Canada's tobacco economy. Section two proposes a general framework to assess the security implications of contraband, which section three then applies to Canada. Section four examines current efforts at fighting the trade, as well as a series of policy options.

# 1 Background: Illicit Trade and the Tobacco Economy in Canada

In 2011, Canada's approximately five million smokers consumed between 25 and 31 billion cigarettes (the equivalent of 125 to 150 million cartons of cigarettes).<sup>1</sup> In the same year, the market value of legal cigarettes distributed wholesale (150 million cartons) was around \$10 billion (NSRA, 2012).<sup>2</sup> Taxes represent roughly three quarters of the retail value of a pack of legal cigarettes for a potential tax revenue of \$7.5 billion, of which provincial governments capture 60 percent. Breaking this down further, \$3.3 billion goes to the federal government, \$1.6 billion to Ontario, \$860 million to Alberta, \$790 million to Quebec, and \$700 million to British Columbia.<sup>3</sup>

**Legal tobacco sales generated \$7.5 billion in tax revenue in 2011.**

Assessing the volume of the illegal tobacco economy is more challenging. Estimates of the share of illicit tobacco hover between 15 and 33 percent of Canada's market, reaching 40 percent in Quebec and 50 percent of Ontario. Recent surveys, however, converge toward the lower end of those estimates. In a study done for Philip Morris International, the GfK Group found a market share of 27.2 percent in Ontario and 14.9 percent in Quebec (Philip Morris International 2012, slide 48). The Non-Smokers' Rights Association (NSRA), using estimates from Physicians for a Smoke-Free Canada (PSFC) and data from Health Canada, suggests that about 12 percent of the whole Canadian market was made up of illicit tobacco in 2010 – down from 20 percent in 2009



and 25 percent in both 2008 and 2009 (NSRA 2012, 7). For the purpose of this study, we will assume a national share of 15 percent, which is compatible with the GfK Group results (given that the problem of illicit tobacco is generally considered to be worst in Quebec and Ontario) and with the recent PSFC numbers.

Using the aforementioned tobacco use data, between 19 and 23 million cartons of illicit cigarettes are consumed every year in Canada, with a market value – at the national average price of \$83 – of \$1.5 to \$2 billion. In turn, potential tax losses are between \$900 million and \$1.2 billion, concentrated in Quebec and Ontario. However, these numbers grossly inflate both the value of illicit tobacco and the losses to governments. The main reason is that illicit tobacco is sold at a massive discount: bags of 200 cigarettes are sold for as low as \$6 on reserves (Luck et al. 2009, 489) to between \$14 and \$20 outside (RCMP 2011a; Stinson 2010). Given that much of the trade takes place on reserves, we will use \$15 as the average price per illicit carton, yielding a market for illicit tobacco worth between \$285 and \$345 million dollars in 2010. At such low prices, consumption of illegal products is probably much higher than it would be for legal products and consequently tax losses are probably also significantly lower than the numbers quoted above suggest.

**Illicit tobacco is sold for as little as 3 cents per cigarette on reserve and 7 cents off reserve.**

More important to our purpose, however, is the net value of illicit tobacco. To go from gross to net value, one must deduct production and distribution costs. In 2002, it cost about \$1.02, net of taxes, to produce a pack of cigarettes (Health Canada 2003), including everything from labour and capital to the purchase of raw tobacco. These costs have changed since 2000, with the price of significant components, such as raw tobacco, rising rapidly in Canada.<sup>4</sup> Still, even using 2002 cost numbers, production alone would consume a substantial portion of gross revenue,

leaving between \$97 and \$135 million before distribution. Retail costs – likely to be high because of the inefficiency of a large number of small sellers either on- or off-reserve – are still to be subtracted from this. The leftover, which reflects wholesale and distribution, is impossible to determine precisely, but a reasonable estimate is \$75 million dollars annually. This represents “pure” illicit revenue, or the gross profit to criminal organizations.<sup>5</sup>

**The net revenue of the illicit tobacco trade is \$75 million annually.**

As figure 1 (on page 10) makes clear, smuggling illicit cigarettes into or out of Canada is much less lucrative and much more risky than smuggling legal cigarettes across jurisdictions in the US. Because they sell at a much higher price, the profit generated by the sale in New York City of legal cigarettes bought in low-tax jurisdictions like Virginia is larger than the price of native-manufactured cigarettes in Montreal or Toronto. While some of the numbers used by the US Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) strain belief (such as its estimate of \$85 profit per carton for a sale in New York of Virginia cigarettes), there is much leeway before reaching the \$6-\$20 sales price of native cigarettes.

Before moving to a systematic discussion of the functioning and consequences of the illicit economy, one should note the very skewed relation between the illegal gains of trafficking and the losses imposed on the legal industry and on governments. Assuming that illicit products account for a 15 percent share of the market and that half of consumption stopped as prices rose after the elimination of contraband, then the gross revenue of the legal sector would increase at most by \$423 million and government tax revenues by \$572 million. So overall, about one billion dollars is lost to the legal economy, with about a third (gross) going to the whole illicit sector. The rest, about 70 percent, is pocketed by smokers themselves. Indeed, and strictly from an economic perspective, smokers benefit the most from cur-

rent arrangements, and would consequently suffer the most, through higher prices and reduced consumption, from the elimination of contraband.

**About \$1 billion is lost to the legal economy due to illegal tobacco.**

## **2 The Workings of the Illicit Tobacco Trade**

This section proposes a simple framework that breaks down the various components of the illicit tobacco economy and applies it to the Canadian case. It specifies the conditions that make illicit tobacco profitable, and thereby pinpoints where policy can intervene most effectively.

### **2.1 The political economy of illicit tobacco**

The black market in tobacco is made possible by differences in applied government taxes (Gabler and Katz 2010). Figure 1 gives a vivid picture of the incentive these price differentials create between jurisdictions in the US and in Canada. The map located in appendix 1 makes clear that taxes drive the potential for illicit trade.

The kind of price gap that exists between North Dakota and Manitoba (about \$5 a pack) is enough to stimulate significant cross-border smuggling. The same holds for the gaps between prices in New York State and those that prevail in Pennsylvania or Virginia – with an interstate highway linking them and no border controls.

The price differential introduced by tax rates, how-

ever, is only part of the equation. Production and transportation costs matter too. But above all are the costs from the illicit nature of the activity, which can be broken down into three broad categories: the “clandestine premium”; the cost of sanctions, both formal and informal; and the opportunity costs from involvement in criminal activities.

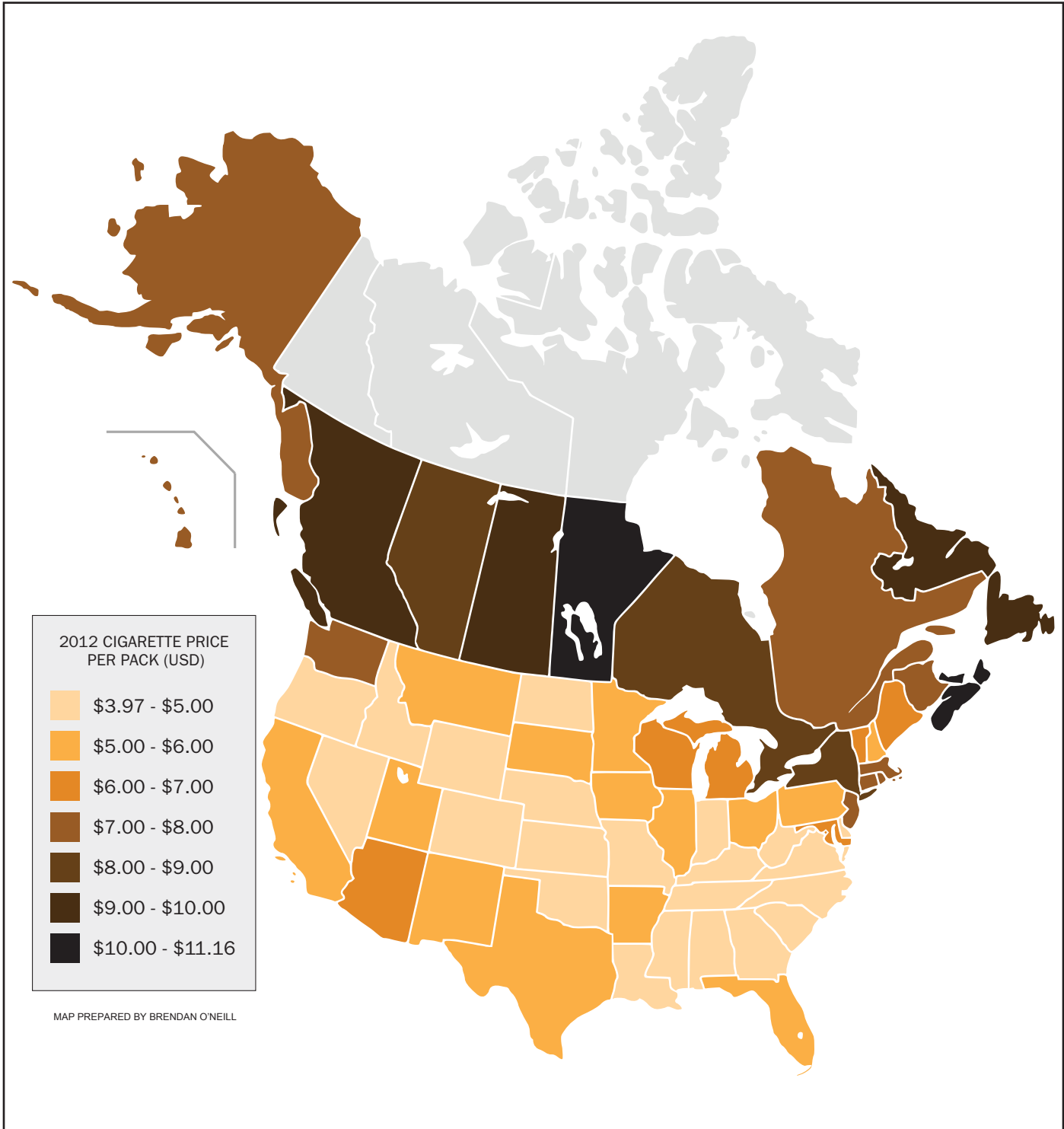
Clandestine activities have major drawbacks, despite avoiding taxes. Obviously, they cannot rely on customary state protection, leaving vigilante self-help, with all the risks and costs entailed, as the only recourse. Operators must acquire more passive protection than normal citizens, but also have their own “police” and finance their training and equipment (which involves further illicit activity). Nor can operators rely on judicial institutions to resolve the large amount of conflict. The rules, generally unwritten, are not always clear, and it is difficult to get reliable information on price, quality, quantities, or the identity of potential partners. Access to financial and banking services are constrained, creating a need to launder money, which also has a cost and involves more illicit actions. Finally, operators cannot fully rely on the institutional infrastructure of society, such as the transportation network or the use of professional services.

**The black market in tobacco is made possible by differences in applied taxes.**

Not content with leaving clandestine activities defenceless, state authorities actively sanction them. The cost that state and societal sanctions represent depends on their severity and on the probability that they will be imposed. These problems are compounded by the opportunity costs that individuals choose to forego by being involved in illicit activities instead of earning a legal living.

In other words, the profit created by differential taxes is only part of the story. This simplified model can be summarized in the following table:

**FIGURE 1 Prices of individual cigarette packages in North America, 2012**



MAP SOURCES  
[http://www.nsra-adnf.ca/cms/le/les/121120\\_map\\_and\\_table\\_reviewed.pdf](http://www.nsra-adnf.ca/cms/le/les/121120_map_and_table_reviewed.pdf)  
<http://www.tobaccofreekids.org/research/factsheets/pdf/0097.pdf>  
<http://www.smokefree.gov/SmokersData.aspx>  
<http://www.smokefree.gov/map.aspx>  
[http://en.wikipedia.org/wiki/File:BlankMap-USA-states-Canada-provinces,\\_HI\\_closer.svg](http://en.wikipedia.org/wiki/File:BlankMap-USA-states-Canada-provinces,_HI_closer.svg)



Smuggling is a function of

$$P - (AP\&T + I + O)$$

where

*P* is the black market profit created by interdiction or taxation,

*AP&T* is the cost of acquiring, producing, and/or trading the smuggled product,

*I* is the cost of illegality itself, which is made up of

the clandestinity premium (CP): legal products can be handled more cheaply than illegal ones (for example, transporting large quantities in the most efficient way possible), and they are not subjected to the extra activities that must be done when engaging in illegal trade;

government sanctions (GS): the impact of which must be weighted by their severity and the probability that they will be imposed; and

social sanctions (SS): the reputational costs linked to engaging in illegal activities, weighted by their severity and the probability that they will be imposed, and

*O* is the opportunity cost of engaging in smuggling: the benefits from other activities that are set aside as a result of devoting time, resources, and effort to smuggling.

## 2.2 Illicit tobacco in Canada

Today, illicit tobacco in Canada has four main components: (1) counterfeit cigarettes imported from overseas; (2) illegal cigarettes manufactured in Canada and the US on Aboriginal reserves and sold in Canada; (3) cigarettes produced legally in Canada, the US, or abroad, and sold tax-free to non-Aboriginals; and (4) “fine cut” tobacco imported illegally, mostly by Canadian-based manufacturers (CBSA 2010, 4; RCMP 2011, 8).

In the 1990s, most tobacco contraband involved cigarettes legally produced in Canada by major manufacturers. Brands that had no significant market in

the US were exported to that country and imported back by smugglers, mostly through Aboriginal reserves, to be sold illegally and tax-free in Canada. In 2008 and 2010, following police investigations and legal proceedings, Imperial Tobacco Group, Rothmans, Benson & Hedges Inc., JTI-MacDonald Corp., and the Canadian subsidiary of RJR Reynolds Tobacco Company agreed to pay a total of \$1.7 billion dollars in criminal fines and civil restitutions (RCMP 2011, 8) for their role in the smuggling scheme.

**It is a grave mistake to conflate the growing Aboriginal tobacco industry with contraband.**

The original “model” for illicit tobacco was replaced in part by the trade of cigarettes manufactured on Aboriginal reserves. An important part of that production takes place in Canada and is perfectly legal. For example, Grand River Enterprise (GRE), which is based on the Six Nations of the Grand River reserve in the heart of Ontario’s tobacco country, “is now the third or fourth largest tobacco company in Canada, producing about as many cigarettes as JTI-Macdonald, which has 13 percent of the Canadian tobacco market”, although much of its production is exported to the US (NSRA 2012, 03). In addition, a number of smaller First Nations manufacturers operate under licence on other reserves.<sup>6</sup> It is a grave mistake to conflate the growing Aboriginal tobacco industry with contraband. However, illegal production does take place on Canadian and US reserves, and US products and US-sourced fine cut tobacco is smuggled illegally into Canada. Most of this tobacco crosses the border between formal ports of entry by land through unmanned crossing points or by boat (snowmobiles in winter) across the St. Lawrence River. Fine cut tobacco from the Carolinas (Brennan 2009) is smuggled through the same routes by illicit manufacturers in Canada, who rely increasingly on diverted and stolen tobacco from Ontario farmers (Blackwell 2010). In addition, legal cigarettes from Aboriginal or major manufacturers meant to be sold tax-free to Aboriginals are instead sold illegally to non-Aboriginals (RCMP 2011).

Finally, the sale to non-Aboriginals of cigarettes legally allowed to be sold on reserve, but only to Indians, has grown into an important component of the illicit trade. A recent study done for the Canadian Taxpayers Federation (Fildebrandt 2012, 18) suggests that 2.3 million cartons – representing 10-12 percent of total illicit sales – are distributed in this way.

**Illegal manufacturing on reserves is the main source of illicit tobacco products.**

According to the Royal Canadian Mounted Police (RCMP), illegal manufacturing on Mohawk reserves on both sides of the border continues to be the main source of illicit tobacco products (RCMP 2011).<sup>7</sup> However, data on seizures from the Canadian Border Service Agency (CBSA) suggests that imports of counterfeit and legal cigarettes from China, mostly through Port Metro Vancouver, are quickly gaining ground (CBSA 2010). The 197,445 cartons that the CBSA seized in marine containers during 2010 (CBSA 2010, 4) equal 55 percent of the number of cartons confiscated that year by the Cornwall Regional Task Force, which includes seizures made by the CBSA, the RCMP, and other police forces outside the CBSA controlled ports of entry (CBSA 2010, 5). Illicit tobacco also enters Canada through mail and courier services (CBSA 2010, 5), either within smuggling networks or by direct Internet sales.<sup>8</sup> As well, part of the market is occupied by tobacco and cigarettes stolen from farms or legitimate businesses.

The central role of Aboriginal reserves in the illicit market stems from the differential tax treatment of Aboriginals and non-Aboriginals. Gabler and Katz write

(S)tatus Indians remain exempt from federal and provincial sales taxes when purchasing goods and services on reserves, including sales taxes on tobacco. However, merchants on a reserve are obligated to collect sales taxes when

selling goods and services to Aboriginals without Indian Status and non-Aboriginals. Status Indians are also exempt from provincial excise taxes, but are required to pay federal excise taxes, including taxes on tobacco products, both on and off a reserve. In reality, however, Canadian law enforcement is effectively powerless to enforce tax obligations on Aboriginal territory because of Aboriginal territorial autonomy and charter rights. (2010, 36).

Arguably, the law could be enforced as smuggled cigarettes leave the reserves (Dickson-Gilmore 2002). It is to some extent, but enforcement is severely constrained by legal and political factors. Section 8 of the *Canadian Charter of Rights and Freedoms* regulates the ability of law enforcement authorities to search and seize, imposing very high standards for reasonable and probable grounds. Even at borders where standards are somewhat relaxed, important restrictions remain.<sup>9</sup> Searches done immediately surrounding the limits of Aboriginal reserves are submitted to higher standards of privacy, which require strong grounds. Applying standards used at border control zones for these areas has huge implications, as they would entail some legal recognition of the international character of reserve boundaries. This is not a discussion that governments appear willing to enter and as a result, most seizures result from old-fashioned investigations and inspections restricted by the law. As our survey of illicit tobacco consumption makes clear, the results are meagre. At its height in 2009, only one out of every 27 packs of illicit cigarettes bought in Canada was seized by law enforcement authorities.

**In 2009, only 1 in 27 packs of illicit cigarettes bought in Canada was seized by law enforcement.**

Much of the discussion concerning the basic equation above is notional, as estimating the precise

costs and revenue from illegal activities is extremely difficult. It is nonetheless possible to identify a number of key variables in each component that affects illicit tobacco and its trade.

### **R: GROSS PROFIT FROM ILLICIT TOBACCO**

As discussed in section 1, the gross overall black market profit generated by illicit tobacco is substantial (\$285 to \$345 million). In principle, it could be much larger. Some researchers have stated that illicit tobacco is “a near perfect substitute” for legal products<sup>10</sup> (Gabler and Katz 2010, 38), since surveys show “smokers fail to perceive a difference in quality between lawful and contraband cigarettes, and...do not acknowledge any harm associated with the black market.” Luk et al. confirm that consumers treat illegal tobacco as legal (2009, 489). This attitude is very surprising given the price at which illicit tobacco is offered. A discount of \$1 to \$2 a pack should be sufficient to buy a perfect substitute for what one normally consumes and treats as legal. In this scenario, the illicit gross profit would be multiplied by four or five, to \$1.2 billion to \$2 billion.

The answer to this puzzle lies in two factors. Contrary to the studies quoted above, consumers appear to consider illicit tobacco less desirable than legal tobacco products. First, whether because of inferior quality, poorer taste, brand loyalty (TIFP 2009, 5) or the illegality itself, they are unwilling to pay as much for contraband tobacco as they are for the legal product. Law enforcement is a second, more influential factor. By complicating distribution outside reserves, police enforcement creates an exceedingly competitive sales environment on the reserves, the only locations where tobacco products can be bought openly. This gives consumers tremendous leverage over the numerous “smoke shack” owners and further depresses prices.<sup>11</sup> In other words, the largest impact of law enforcement on tobacco smuggling lies less in seizing illicit products than in depressing the market price and, consequently, the gross profit (*R* in the equation above). While much smaller than it could be, the profit from illicit tobacco remains substantial.<sup>12</sup>

### **AP&T: THE COST OF ACQUIRING, PRODUCING, AND/OR TRADING THE SMUGGLED PRODUCT**

These costs vary according to the product and its origin. For the substantial volume of legal or counterfeit

cigarettes imported through Port Metro Vancouver, transportation costs to the market in southern Ontario and Quebec are substantial. For cigarettes produced on reserves, a central issue would be importing fine cut tobacco, mostly from North and South Carolina. On-reserve manufacturers and smugglers also have to contend with inefficient bulk transportation – the speedboats, snowmobiles, private cars, and trucks with which much of the smuggling takes place (Brennan 2009) are not designed to transport large volumes. Smuggling a few large containers through Toronto’s Pearson Airport, Windsor’s Ambassador Bridge, or Port Metro Vancouver would be much more efficient.

Manufacturers of illegal tobacco products also have to find and buy filters, papers, machinery, and parts.

### **I: THE COST OF ILLEGALITY**

The costs of illegality can be broken into three parts: the costs linked to the clandestine character of the trade, government sanctions, and social sanctions.

**A number of costs derive from the simple fact that illicit tobacco is exactly that.**

A number of costs derive from the simple fact that illicit tobacco is exactly that. Manufacturers and smugglers have to invest significant amounts of money to protect their trade. Production facilities need to be acquired, staffed, and run without legal guarantees, insurance, or the possibility of resorting to courts and public safety institutions. These facilities must be protected with weapons and qualified personnel. Losses from damage to production or storage facilities, or from the destruction of, theft of, or damage to products from the smuggling process have to be covered. Government policy affects these costs. The licensing of tobacco farmers and government programs to wean farmers away from the crop force manufacturers to rely on illegal acquisition from distant US tobacco farmers. Law enforcement pressures and credible threats against convenience stores and other retailers push the illegal trade onto the streets



and force on-reserve sellers to compete against one another.

Law enforcement also involves sanctions that impose some direct costs on illicit activity. These include the seizure of tobacco and tobacco products and the confiscation of vehicles as well as fines and arrests. The impact of sanctions depends on their severity, their swiftness, and their certainty. As we will see in section four, the government has just proposed changes to the *Criminal Code* that would severely stiffen the sanctions imposed on tobacco smugglers. Until now, however, those have typically been light, with large fines rare and often ignored. Only a very small proportion of illicit tobacco is seized, and most smuggling is never sanctioned. In other words, direct sanctions have not imposed a very high cost to the trade.

Things could be different from a social standpoint. Indeed, people who engage in illicit activities typically have little respect for social norms. In the case of illicit tobacco on reserves, reputational costs appear to be minimal, especially in the Mohawk territories where much of the trade is concentrated. Official statements, media sources, and the scholarly literature suggest that few people oppose smuggling and that the occasional disagreement stems less from illicit tobacco itself than from the other criminal activities that surround it. Indeed, a very broad agreement seems to exist among Mohawks about the legitimacy of tobacco trade across the Canada-US border *within Mohawk territory*. There is similarly little support for collecting federal and provincial taxes on the reserves (RCMP 2008; Sweeting, Johnson, and Schwartz 2009; Dickson-Gilmore and Whitehead 2003; Gabler and Katz 2010, 37). In the greater Cornwall region, the economic benefits of illicit tobacco are widely recognized (Brennan 2009), again despite the side effects of crime and insecurity.

#### O: OPPORTUNITY COST

While the Cornwall region's unemployment rate is slightly lower than Ontario's average, it has suffered from the collapse of key industries since the 1980s. This makes smuggling an attractive source of income (Blackwell 2012). While detailed statistics are hard to find, the situation in Akwesasne is unlikely to be better. In such a context, cigarette production and smuggling is appealing, even if only to top up

weekly or monthly earnings. For young people and the unemployed, smuggling three or four cases of cigarettes out of the reserve in a small passenger car represents more net profit in a matter of hours than could be earned in a week working at minimum wage.<sup>13</sup>

**Smuggling three or four cases of cigarettes out of a reserve nets more profit than a week working for minimum wage.**

To summarize, the overall gross profit generated by illicit tobacco smuggling is \$300 to \$400 million. Our estimate of the net profit, at around \$75-80 million, is much smaller. Effective police enforcement and an extremely competitive retail market prevent revenues and profits from being much higher. Illegality increases production costs (especially in obtaining the actual tobacco), and it generates significant inefficiencies as well as protection costs. Sanctions through direct law enforcement and social pressure have little or no impact. Opportunity costs are relatively low in southern Ontario and Quebec reserves, given economic conditions in production and smuggling areas.

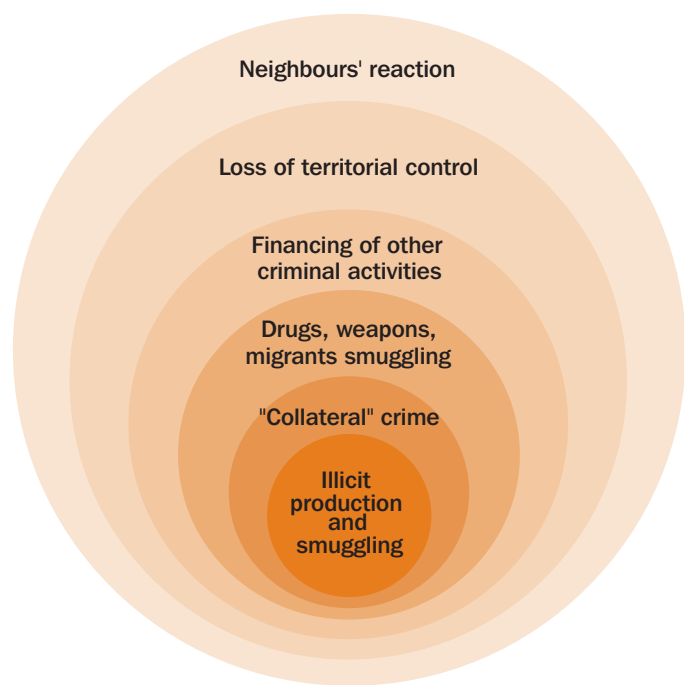
### 3 The Security Implications of Illicit Tobacco

In this section, we explore the consequences of illicit tobacco for the broader security of Canadians. We look primarily at its linkages with crime and the potential for significant threats to national security. These include terrorism, loss of territorial control, and the adverse impact of changes

in US foreign policy towards Canada. The analysis focuses on the Akwesasne-Cornwall area, although a significant and growing portion of tobacco smuggling passes through Port Metro Vancouver, where CBSA tobacco seizures were about half as large in 2010 as in the Cornwall area (CBSA 2010).

The impact of cigarette smuggling on security can be seen as a series of concentric circles whose core is illicit tobacco (see figure 2).

**FIGURE 2 Illicit tobacco’s ripple effect on security**



Surrounding the core are illegal activities linked to supplying the factories, protecting the facilities and the trade, and laundering profits from it (“collateral crime”). A third circle involves the use of smuggling routes and networks for the illegal trade of other commodities, in this case drugs, weapons, and humans. The fourth circle includes activities that can be financed with the proceeds from illicit trade, of which two broad types are relevant: other criminal activities and terrorism. A fifth circle concerns the potential loss of control over territory caused by the consolidation of illicit networks or conflicts between the territory’s population and law enforcement agencies over the repression of illegal activities. The reaction of neighbouring states to the inse-

curity generated by smuggling and its repression is also part of the equation.

In the rest of this section, we discuss the peculiarities of each circle with regard to illicit tobacco in Canada, and assess the threat that each represents based on the following sources: a comprehensive analysis of CBSA seizures at Akwesasne/Cornwall since 2008 (obtained through an Access to Information request), the review of all Canadian judicial cases referring to Cornwall or Akwesasne since 1990,<sup>14</sup> the reports about illicit tobacco, transborder crime, drugs, weapons, or human smuggling produced by the RCMP, CBSA, Canada’s Department of Public Safety, and by US government agencies and US think tanks. We also draw on the scholarly literature about illicit tobacco in North America, on media reports from Canadian and US sources, and on informal discussions with consumers and buyers of illicit tobacco and drugs in Quebec, Ontario, and Manitoba. Additionally, our assessment is based on the testimonies of current and former Canadian law enforcement officers who are or were directly involved with the enforcement of illicit tobacco and illegal drugs.<sup>15</sup>

### 3.1 Illicit tobacco

Illicit tobacco has developed into a major business in southern Ontario and western Quebec, particularly in the Cornwall area, because of the unusual confluence of geographical, legal, jurisdictional, institutional, and social factors. Article II of the 1794 *Jay Treaty*, signed by the British Crown and the US, states that “[n]o Duty of Entry shall ever be levied by either Party on Peltries brought by Land, or Inland Navigation into the said Territories respectively, nor shall the Indians passing or re-passing *with their own proper Goods and Effects of whatever nature*, pay for the same any Import or Duty whatever” (our emphasis). Mohawk representatives have argued publicly and in court that this clause implies a right to trade goods across the border without paying any duty or tax. Canada never adopted legislation to implement the treaty, however, and Canadian courts refuse to accept it as a basis for Indian claims, a stand that Mohawks have never accepted.<sup>16</sup> Moreover, given that tobacco has been grown and smoked from time immemorial in eastern North America, Mohawks believe its trade to be legal under even the most restrictive reading of the

*Jay Treaty*. The outcome is an uncomfortable *modus vivendi* where the application of Canadian and US law to tobacco is broadly seen as illegitimate. As a result, the scope of effective law enforcement has to be constantly negotiated. For all practical purposes, police ignore cigarette production and trade on Mohawk territories, and focus their enforcement efforts on capturing tobacco products as they exit by land or water.

**For all practical purposes, police ignore cigarette production and trade on Mohawk territories.**

Closely related to this issue, the tax status of Aboriginals is a key component of the problem (see above). In theory, the price for non-Aboriginals would be the same on- or off-reserve. The vast majority of Aboriginal retailers, however, refuse to collect taxes from any customer, Aboriginal or not, because it gives them a competitive advantage, at the expense of off-reserve merchants. Nevertheless, there are a variety of other reasons for this refusal, some political or concerning sovereignty claims, but others very pragmatic and bound to the fiduciary duty of the federal government towards Aboriginals (Graham and Bruhn 2008), an issue to which we return when examining policy options.

The geographical boundaries of the Mohawk territories of Quebec and Ontario are not unique. Several reserves in the US and Canada lie on or close to the border between prairie provinces and northern midwestern states, or along the shore of the Great Lakes that separate the two countries. What makes them unique is that they both lie close to or – in the cases of Akwesasne – right over the border *and* they are very close to huge markets in Canada. Some eight million Canadians (from the Greater Toronto Area to Montreal in the east) live within two hours of a Mohawk reserve, half of them within 60 minutes.

Several other converging factors have made Akwesasne in particular a node of illicit tobacco smuggling in North America. First, the territory falls

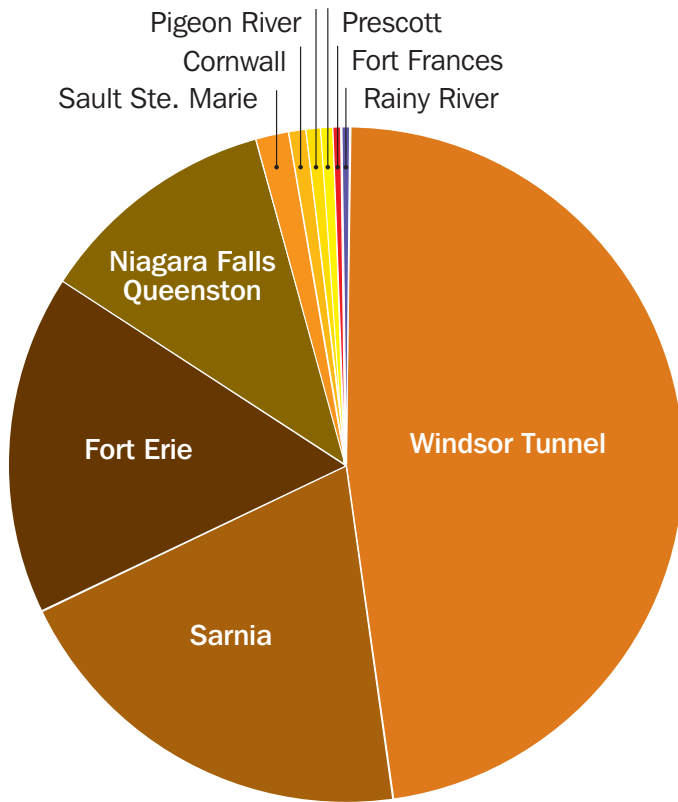
within the jurisdiction of two national governments (Canada and the US), two provincial governments (Ontario and Quebec), one state government (New York), and two Aboriginal governments (for the US and Canadian sides of Akwesasne). Leaving aside the thicket of administrative agencies (discussed in the next section), this creates huge opportunities for forum shopping and the exploitation of legal, regulatory, administrative, or political discrepancies, contradictions, tensions, and conflict. As well, through tense and sometimes violent political mobilization, the Mohawk have claimed a degree of sovereignty over the territory that non-Aboriginal governments have *de facto* acknowledged in a multitude of negotiations, consultation and cooperation for, joint initiatives, or simple everyday interactions. In practical terms, a space has been created in which practices that are clearly illegal beyond the reserve are tolerated on it. This is precisely the space occupied by the illicit manufacture and sale of tobacco products.

An oft-mentioned advantage of the Akwesasne/Cornwall area from a smuggler standpoint is its location on both sides of the St. Lawrence River and on several small islands, including St. Regis and Cornwall Island. Given the location of the toll in the middle of Cornwall Island, it was long possible for vehicles to circumvent it and cross the border with little or no control. In 2009, the simple and strikingly belated relocation of the toll to Cornwall on the north bank of the river complicated smuggling by forcing smugglers to rely increasingly on speedboats or, in the winter, snowmobiles or small trucks over the frozen river.

This last point introduces an important element. Using our previous estimates of illicit sales (4.2 billion cigarettes/year) and of the content of a typical case of cigarettes (50-60 cartons), a large proportion of the roughly 350,000 cases this total represents needs to be transported over the border. With an average truck carrying 800 cases (Bureau of Alcohol, Tobacco, Firearms and Explosives 2011), hundreds of trucks and thousands of ordinary vehicles are engaged in smuggling. This is where Cornwall's comparative advantage as an entry point for high volumes of low-value contraband diminishes (see figure 3).



**FIGURE 3 Top ten truck entry points into Ontario since 2000**



Source: Statistics Canada. 2010. Table 427-0002 - Number of vehicles travelling between Canada and the United States, annual.

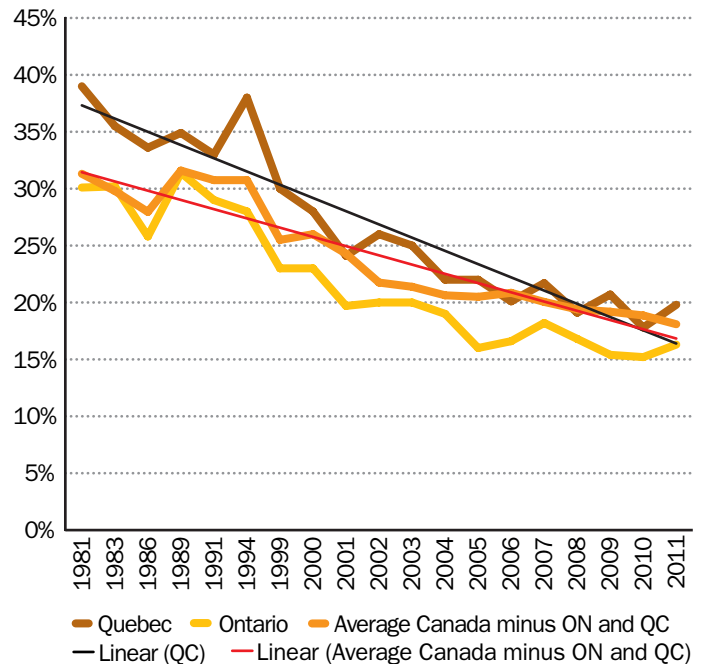
What the Akwesasne/Cornwall area does have, however, is a complex riverine border area that extends some 40 kilometres almost all the way to Valleyfield, Quebec. An individual can cross the border and the river while staying within the reserve – or can cross the river by boat, car, or truck while staying both within the reserve *and* within Canada, thereby avoiding border control. In addition, long practice (for legitimate and illicit business) has made a number of local people experts at manoeuvring the channels and islands that dot the river to the east. The Ontario river bank is densely built with houses and quays that offer hundreds of possible docking places. With the road option essentially blocked when the toll was moved, the waterway has become the main option for smugglers. It is far from ideal, however. County Road 2, which follows the river bank, is heavily patrolled day and night, which may explain why smuggling has been pushed further east. Reduced seizures in Cornwall and increases in western Quebec attest to this.<sup>17</sup>

Cornwall/Akwesasne does not have a strong advantage for high-volume trade, but (as discussed in the next section) it is an appealing channel for low volumes of high-value trade because of the lack of effective law enforcement or supervision over significant areas of rural territory that can be easily crossed with speed boats and all-terrain vehicles.

Smoking has been declining steadily in Canada.

Nevertheless, other factors are at play. Smoking has been declining steadily in Canada in the general population and among young people. Rates in Ontario and Quebec, where illicit tobacco is concentrated, have closely followed national trends (see figure 4 below). Even though the presence of illicit tobacco affects average prices and availability, effective health policy has offset much of its influence on smoking rates.

**FIGURE 4 Smoking prevalence in Canadians over age 15, 1981-2011**



Source: Health Canada, 2012.

While not central to our discussion and extensively covered elsewhere, the health implications of illicit tobacco warrant a note here. Smoking has important health consequences and significant financial implications for smokers and the healthcare system. Research consistently shows that price is a critical determinant of smoking levels. The lower price of

illicit tobacco clearly increases consumption, especially among low-income smokers. Smoking makes them sick, shortens their lives, and facilitates initiation for minors. A broad approach to security would consider the very existence of illicit tobacco a security threat (Joosens et al. 2009; Luk et al. 2008).<sup>18</sup>

**The lower price of illicit tobacco increases consumption.**

### 3.2 Collateral crime

The illicit manufacture and trade of tobacco products is a business. It involves suppliers, running production, and storage facilities (including their protection, the recruitment of workers, the establishment of distribution networks, the need to access credit and to “bank” and protect revenues and profits and to invest the latter). These activities make up a large constellation of illicit activities and involve a significant number of people.

From a narrow security perspective, the most significant threats from collateral crime derive from protecting facilities and activities, and from enforcing the large number of informal contracts that underlie the business. Most of these activities take place in Akwesasne.

A number of studies and media reports indicate that intimidation is common around production and storage facilities, and that violence has been used extensively to secure control of shares of the traffic and to protect them (Blackwell 2010; Marsden 2009; Gabler and Katz 2010, 10). However, a comprehensive review of court cases in Quebec and Ontario since 2000 reveals very few instances of violence and no reports of theft or violence around distribution networks. An effective protection racket thus appears to be in place. The *de facto* tolerance of illicit tobacco on *reserve* by the police seems to ensure that the racket is not disrupted, and probably contributes to reducing violence off reserve. In addition (see below), the legitimacy of the trade within the com-

munity and the fact that violence is not condoned (Dickson-Gilmore and Whitehead 2003) encourage smugglers to tread as softly as possible and avoid police interventions, which would likely be seen by the community as legitimate.

### 3.3 Mixed smuggling: drugs, weapons, and humans

A smuggling infrastructure is made up of a network of people who are knowledgeable about the border, trafficking routes, and law enforcement infrastructure and practices and who have reasonably good relations with the local population and, when possible, with law enforcement authorities. Setting up and maintaining such an infrastructure is costly and takes time. In the case of Akwesasne/Cornwall, existing smuggling networks have significant “sunk” investments in their infrastructure, which provides a huge advantage over newcomers. Indeed, given the relatively small size and cohesion of the community, setting up new networks would prove difficult, risky, and costly. Those who control existing networks are likely then to use them to smuggle other goods, and outsiders likely to link up with them to exploit the infrastructure further. The relative disadvantage of Cornwall from the standpoint of large-volume smuggling disappears in favour of high value but small volume trade.

**Cornwall’s smuggling infrastructure attracts high value but small volume trade.**

Overwhelming evidence exists that the mix of drugs, weapons, and people illegally crossing the border in the Akwesasne/Cornwall area differs for flows into and out of Canada. Weapons, cocaine, and, to a much lesser degree, heroin enter Canada, while illegal migrants, ecstasy, and high potency marijuana are smuggled into the US. However, reports from Canadian law enforcement (CBSA and RCMP) suggest that, tobacco aside, the region is not a major entry point for illegal goods coming into Canada. The reverse appears not to be true. Media reports and

statements by US public officials suggest that this region of the international border is a major conduit for illegal drugs and human trafficking into the US.

## DRUGS

The CBSA's Quarterly *Drug Assessments Reports* for the period between November 2009 and February 2011 do not include a large number of drug seizures. The largest one, in August 2010, involved \$3500 worth of ecstasy pills (about 175) – a minute amount given consumption levels in Canada. There are several reports of mostly very small seizures of marijuana. We only found one instance of heroin trafficking in our review of court cases, dating back to the 1990s and involving one kilogram of pure heroin.

The story in the other direction is very different. According to US government sources, illegal drugs worth \$1 billion are exported illegally through Akwesasne/Cornwall. US border authorities have seized significant quantities of marijuana, and they allege that much more gets through (Schumer 2009). According to one media report, “tons of high-potency marijuana” are smuggled through Akwesasne, “representing 20 percent of the overall Canadian production” (Kemp 2011).<sup>19</sup>

**Amphetamines dominate the illegal drug trade.**

One Canadian court case in the last 14 years explicitly links the area to marijuana smuggling into the US. The case involved individuals associated with the Italian mafia exporting 225 pounds of marijuana per month in 2005. Given the very high proof requirements, full prosecutions necessarily underestimate the scale of the problem, but the rarity of cases still suggest that large-scale trafficking is unusual in the area (*R. v. Di Rienzo*, [2006] J.Q. no 14089). Moreover, recent legislative initiatives in the US, where laws restricting marijuana use are being relaxed, are likely to reduce the appeal of Canadian imports. In addition, these numbers need to be put in context: according to the White House Office of the Nation-

al Drug Control Policy, “relative to Mexico and the US, the Canadian supply is small” (UNDCP 2012, 94 n.85).<sup>20</sup>

With marijuana losing ground, amphetamines – both MDMA (ecstasy) and methamphetamines – appear to increasingly dominate the trade in drugs, with Canada becoming a major producer and exporter to the US (NDIC 2011, 31; UNDCP 2012, Chap. 4). Some reports suggest that Akwesasne/Cornwall plays a significant role in the trade; however the RCMP believes that most production takes place on the West Coast (Kemp 2011) and is unlikely to be exported through Ontario. The US Department of Justice (NDIC 2011, 9) agrees and considers West Coast Canadian Asian gangs the main culprit in the trade. Moreover, larger points of entries are likely to be preferred because the chemical precursors necessary to produce the drugs are shipped in bulk. Indeed, aside from the confiscation of 50,000 tablets from a Cornwall couple<sup>21</sup> at the Massena point of entry (across from Cornwall), seizures of ecstasy mentioned in the CBSA Drug Assessment Reports outside BC took place at the Champlain, Peace Bridge, or Blue Water Bridge US points of entry.

In both cases, transborder trade appears to be losing its charm. Again according to a US Department of Justice report, both high-potency marijuana (NDIC 2011, 29) and MDMA production are moving to the US. In the case of MDMA, the main motives are “to lower transportation costs, and to avoid the risk of seizure at the US-Canada border” (NDIC 2011, 9).

## WEAPONS

Illicit weapons are regularly seized at the Cornwall border. Media reports describe sizable seizures of high-powered automatic weapons. A spokesperson for the RCMP told the *Toronto Star* that “it is not unusual [for Mounties and Akwesasne Aboriginal police] to find hundreds and hundreds of guns. There are AK-47s, grenade launchers and so forth” (Brennan 2009). Our review of court cases and of CBSA seizure reports finds such occurrences unusual and we were in fact unable to trace any massive weapons seizure to the area. Moreover, the RCMP considers the main channel through which illegal weapons are introduced into Ontario the Interstate 75 corridor from Florida, Georgia, Ohio, and Michigan, which crosses the border either at Detroit-Sarnia or at Sault Ste. Marie. For Quebec, the main sources of illegal



weapons were Vermont, New Hampshire, and Maryland, which suggests a route east of Cornwall (RCMP 2007).

Overall, weapons do not appear to be a major item of smuggling in Akwesasne. However, the very nature of the illicit tobacco trade calls for those who engage in it to use violence or its threat to protect their business and enforce contracts. The limited number of illegal weapons seized may thus only reflect the care with which they are brought over the border.

**Cigarette shipments are not typically mixed with other illegal commodities or human trafficking.**

#### PEOPLE

At the end of the 1990s, an organization responsible for smuggling 3600 Chinese nationals in 1998 and 1999 was dismantled by a joint operation of the US Immigration and Naturalization Service, various US federal agencies, the St. Regis Mohawk Police, the RCMP, and other Canadian law enforcement agencies. The illegal immigrants were smuggled from Canada to the US through the Akwesasne/St. Regis Mohawk reserve. The smuggling ring is estimated to have grossed \$170 million over these two years (GAO 2000; Barnes 1999). Since then, the trafficking of illegal migrants has been a staple of media reports on illicit activities in the Akwesasne/Cornwall area. Except for one report about a Pakistan-based network trying to bring immigrants into Canada, cases regarding illegal entry are of individuals or small groups of migrants from a wide range of countries (China, Korea, Poland, and recently Nigeria) passing through the territory and into the US (Moore 2001; Spencer 2011; Barrera and Jackson 2012). According to the most recent US Department of State’s annual report on human trafficking, the Cornwall/Akwesasne area does not represent a major point of entry for illegal immigrants into the US (US Department of State 2012).

Overall, the case of illegal immigrants appears typical of the broader picture of “mixed smuggling”.

Much more than cigarettes has been crossing the border illegally over the years but the volumes have been relatively small (except for the major human smuggling operation dismantled at the end of the 1990s), and appear to have declined since 2008. While tobacco, cigarettes, and some weapons flow into Canada, drugs and migrants flow south. Moreover, CBSA seizures between 2006 and 2010 suggest that cigarette shipments are typically not mixed with other illegal commodities. Unlike the trade in illicit tobacco, trafficking in drugs and people involves criminal organizations and networks from outside the reserve, often from immigrant communities, although the extent to which these outsiders collaborate with local smugglers is unclear.

### 3.4 Support for other criminal activities

Law enforcement and media reports have established a broad range of links between organized crime and the large amount of money generated by illicit tobacco. A number of channels have been mentioned. Non-Aboriginal criminal organizations have directly joined the trade and revenues finance unrelated criminal ventures, such as weapons and drug-trafficking (RCMP 2011, 11).

The RCMP has pointed out that a large proportion of the country’s known criminal organizations are directly involved in illicit tobacco. These estimates vary from 25 out of a total of 105 groups (Brennan 2009), to “as many as 100 organized crime groups” out of an unmentioned total, operating in Akwesasne (Brennan 2010). Such numbers (for a community numbering about 10,800 on the Canadian side)<sup>22</sup> would imply a stunning density of criminal organizations. Much of this appears to be an artefact of the way in which “organized crime” is defined. In keeping with international practice, Canadian law enforcement considers that an organized criminal organization can have as few as three members.<sup>23</sup>

Canadian law enforcement agencies have long argued that important criminal organizations, such as the Hells Angels and Asian mafias, have linked up with Aboriginal tobacco smugglers (CISC 2004) and become involved in the distribution of illicit tobacco or used the territory to smuggle tobacco across the border. This is consistent with the RCMP’s view

that “most of the organized crime groups across the country involved in the illicit tobacco market are also active in other forms of criminality” (RCMP 2011, 9).

**Proceeds from illicit tobacco finance other criminal activities.**

Canadian analysts have also quoted European public officials to the effect that the proceeds from illicit tobacco finance other criminal activities (Myers 2012, 9-10). At face value, this is surprising, as it suggests that some illegal practices, highly valued but not very profitable, have to be subsidized by others. In practice, profits from smuggling would logically be used to protect the trade and keep it running. Above all, other criminal activities open up avenues to spend illegal profits, only parts of which may be laundered at a good price in the legal economy.<sup>24</sup> The availability of business opportunities where few questions are asked about the origin of the money invested is clearly appealing.

Very little evidence is available to support these claims. Of the many cases we found in the Quicklaw database that mention the Hells Angels (497) or any mafia (500), only five refer to the Akwesasne-Cornwall area. While one (*R. v. Di Rienzo*, [2006] J.Q. no 14089) deals with a significant cannabis trade controlled by the Italian mafia, none of those five makes a connection with illicit tobacco.

### 3.5 Financing terrorism?

While profits from legal activities, such as the construction business in Saudi Arabia, can be used to finance terrorism, illicit profits are more appealing since they are much more difficult to trace. Illicit tobacco and the criminal activities that surround it could support terrorism. Gabler and Katz (2010, 8-9) report that the RCMP and the ATF are concerned that “tobacco smuggling is being used to fund terrorism.” More concretely, since 2001, court cases in Europe and the US have identified illicit tobacco as a source of funding for the Kurdish PKK (Kurdistan Worker’s Party) and one of Saddam Hussein’s sons,

and for Hezbollah in Michigan and North Carolina (Shelley and Melzer 2008). The cases involved tobacco giants RJ Reynolds and Philip Morris International, which used illicit channels controlled in part by terrorist organizations to circumvent the embargo against Iraq and market their products in that country. There also was a Hezbollah cell in Charlotte, North Carolina, which exploited price differentials between that state and Michigan to generate revenue for the organization.

The scope for this type of “diversion” of illicit tobacco revenue is extremely broad; however, the illicit economy is immense – the cocaine market in North America and Europe is worth \$70 billion – yet the financial needs of terrorist organizations relatively limited. The overall cost to al-Qaeda for the 9-11 attacks was estimated at \$1 million (Kleiman 2004). While tobacco smuggling certainly contributes to the pool of money that terrorist organizations could use, it is difficult to argue it represents a security threat because it facilitates terrorism.

**It is difficult to argue that tobacco smuggling facilitates terrorism.**

### 3.6 Sovereignty and territorial control

From a government’s standpoint, effective territorial control is one of the most basic conditions of national security and public safety. The issue becomes even more critical for border areas. Full access to Mohawk territories and freedom of movement for government officials and law enforcement officers needs to be secured. Control over who enters and exits these territories is an important security issue, particularly in Akwesasne.

For historical reasons, the kind of control over space and people that the government claims in the Mohawk territories is weaker than in the rest of Canada and, in practice, it is the object of constant implicit and explicit negotiations. Freedom of circulation between the US and Canadian sides of Akwesasne im-

plies an inherent limit on Canada's ability to control the movement of people. Similarly, the very fact that illicit production of cigarettes and especially illicit sales to non-Aboriginals are tolerated implies that law enforcement authorities recognize that they are not to enforce all the laws of the country in that particular space. The systematic use of joint operations involving the Akwesasne Mohawk Police is another admission that the freedom of action of Canadian law enforcement is reduced in that space.

In general, however, government access to the territory is largely free, and Canadian laws are enforced. This has not always been the case. Following the Oka crisis, which involved an armed confrontation and stand-off between Mohawk warriors and Canadian law enforcement (Pertusati 1997), access to the Kanesatake Mohawk reserve was denied for years, creating a pocket of territory near Montreal in which Canadian government authority simply did not apply. Kanesatake is not on the border, however, and nothing of the sort has happened in Akwesasne. The lessons from that crisis are relevant as it brewed from a simmering conflict that was poorly managed and led to an escalation and a major challenge to the government's effective sovereignty. The implications for the management of illicit tobacco are clear: better to compromise on full control than potentially lose all of it.

The other side of this issue is even more directly related to the management of illicit tobacco. As discussed in the next section, joint Canada-US law enforcement is a logical way to deal with a problem largely stemming from overlapping transborder challenges. However, many Canadians perceive joint enforcement with the US as a breach of the country's sovereignty and, as such, as a security threat. This rationale is behind resistance within Canada against extending the current cross-border policing activities on waterways to land patrols (Meyer 2013).

### 3.7 An indirect threat through its impact on the US and the reaction this may provoke

Canada's security has long been intimately related to that of its southern neighbour. Intertwined interests have led to the closest bilateral security relationship currently in existence. Intertwined, however, does

not mean identical. A threat to the US can present a security challenge for Canada in two very different ways. One derives from the two countries' common interests; for example, the terrorist attacks on the US as the embodiment of "the West." The other derives from Washington's reaction to threats that may not target Canada or to problems within Canada that may have security implications for the US. This is the case with the existence of terrorist cells in Canada, with drug production and violence in Latin America (Daudelin 2013), or with illicit production and smuggling of tobacco, drugs, and immigrants through a northern border deemed insufficiently secure.

**The free flow of goods across the border remains crucial for Canada's economy.**

The free flow of goods across the border remains crucial for Canada's economy. That dependence is reciprocal but extremely asymmetric, with Canada having much more at stake than the US. The result is that a major security aspect of Canada's fight against tobacco smuggling involves demonstrating that it is making enough effort to limit the threat to the US. Public statements and government reports showing Canada to be a major source of drugs for the US are a threat to the bilateral relationship.

Overall, and in spite of the substantial value of the trade, the security threats that illicit tobacco represents appear to be moderate due to a number of factors. The most important is the huge discrepancy between the risks and costs involved in smuggling cigarettes and tobacco compared with drugs, weapons, or illegal migrants. With profits substantial enough, smugglers have few incentives to graduate to more lucrative but riskier ventures. As we discuss farther down, changes to the *Criminal Code* could affect these calculations.

The illegal nature of the trade and the need to launder and spend its proceeds put pressure on those involved to get become more involved or to engage in other illegal activities. In addition, groups for



whom sanctions are likely to be higher than those of the Mohawk have a very different incentive structure, and can use illicit tobacco to support more ambitious and dangerous criminal and political endeavours. Although this has not yet happened on a significant scale, connections with criminal organizations and well established operational procedures would make it relatively easy to diversify away from tobacco if circumstances warranted.

## 4 Current Policies and Options

Policies regarding illicit tobacco pursue three broad objectives: recapture lost tax revenue, reduce smoking rates, and reduce crime. Wiping out smuggling would serve all three. A part of current consumption would turn to taxed tobacco products; some consumption would vanish as a result of the price increase, and illicit trade and collateral crime would be curtailed. These objectives are embedded in broader security preoccupations that centre on maintaining a good relationship with the Mohawk communities, maintaining access and a degree of control over the border area, and avoiding confrontation that could lead to an Oka-like disaster. It is not clear that the outright elimination of illicit tobacco would serve these broader objectives. Conversely, the pursuit of these latter goals significantly constrains the fight against illicit tobacco.

**Eliminating smuggling would recapture lost tax revenue, reduce smoking, and reduce crime.**

This section briefly reviews the peculiarities of the environment in which policies regarding illicit tobacco are developed and implemented. It then examines the main components of current policies, and assesses plausible ways to amend them.

### 4.1 A complex policy environment

The problem of illicit tobacco in central Canada, particularly in the Akwesasne/Cornwall area, lies at the confluence of four of this country's most thorny and important policy challenges: tobacco consumption and control, which is a major public health concern and engages massive amounts of resources; the social and economic situation of First Nations, which carves islands of extreme poverty out of one of the world's richest countries, and their unsettled relationship with federal/provincial governments; Canada's relations with the US, by far this country's most important foreign policy file for economic, political, and strategic reasons; and the management and containment of crime and violence, which pre-occupy a quickly aging population.

Each problem involves different constellations of players, whose preoccupations, priorities, and interests are typically distinct but also conflict or overlap in surprising ways. For example, the tobacco industry, the anti-tobacco lobby, and government treasuries – especially provincial ones – converge to eliminate tobacco smuggling. Law enforcement organizations and the First Nations authorities of the territories involved in tobacco manufacturing or smuggling agree on the need to avoid violence and broader criminality from developing around the tobacco trade and its repression. The national security establishments in Canada and the US appear less worried about illicit tobacco than about transborder smuggling or the possible loss of control over territories that straddle the border or lie very close to it.

Policy intervention in such a context acts like a cue ball on a pool table and yet, the scatter of current policies constitutes a surprisingly effective compromise. This is particularly remarkable when one considers the complexity of the jurisdictional, regulatory, and administrative environment, vividly illustrated by the diagrams in appendices 2 and 3, about the administrative and policy frameworks relevant to illicit tobacco, particularly around Akwesasne-Cornwall.

The rest of this section examines the main principles of the current policy framework, organized around their objectives and functions, and the options that are on the table.

## 4.2 Reduced tobacco consumption

A black market is still a market and, as such, it depends on the existence of demand. Without smokers, there is no market for tobacco, legal or not. Given a slate of measures that maintain the proportion of illicit tobacco to about 15-20 percent of total demand, reduced consumption would directly affect profits from illicit activities and collateral crime. The fact, noted above, that tobacco consumption has declined in Ontario and Quebec in step with the rest of the country, shows that public education outweighs the lower average price for illicit tobacco in those two provinces. Any gain on the smoking front has a positive impact on the security equation.

## 4.3 Taxation

Without high taxation, there would be little profit in illicit tobacco. Lowering taxes, a measure that the legal industry supports, would drastically reduce profits from smuggling and make much of the endeavour uneconomical (Blackwell 2012). The ripple effect on collateral crime would be weakened or, if taxes were low enough, eliminated. Obviously, those who have sunk resources into establishing smuggling networks would diversify and other products would likely be brought in to uphold the basic smuggling pipeline. The huge difference, however, is that the smuggling of people, drugs, and guns has no local legitimacy, making enforcement much easier.

**Smuggling people, drugs, and guns has no local legitimacy, making enforcement much easier.**

Lower taxes would very significantly reduce government revenues, to the point of losses being larger than those caused by smuggling. In addition, smoking rates would undoubtedly rise. Although difficult to calculate precisely, most studies converge on a relative increase of about 4 percent for each decrease of 10 percent in the purchase price. In other

words, a large reduction in taxes could wipe out a substantial part of the progress made in recent years on smoking cessation.

A compromise would be to maintain high taxes, but share them with reserves where illicit tobacco is produced or smuggled, or mandate reserve authorities to collect taxes from non-Aboriginals (Luk et al. 2009, 494; Graham and Bruhn 2009), which they would now have an incentive to do. In this scenario, governments still lose some tax revenue, but smoking rates would not be affected.

The proposal is seductive but replete with difficulties. For one thing, First Nations have until now adamantly refused to collect taxes. Collecting taxes for the federal or provincial government implies the negation of sovereignty claims over the territory in favour of a subsidiary position relative to external political authorities. There is also a fear that if taxes were collected and kept in the community, the federal government's fiduciary duty towards those First Nations (which would now have some self-sustaining income) would be weakened, and the security that derives from this duty would be threatened (Graham and Bruhn 2008). Finally, this option is unlikely to affect illicit trade, as those who would benefit from the new tax revenues are unlikely to be those who benefit most from smuggling. Changes in taxation policy appear to hold few promises.

## 4.3 Stronger enforcement of prohibition

Compared to drugs or minerals, cigarettes and tobacco products have a relatively low value per unit of volume. Their production and storage on a significant scale requires space, posing enormous challenges. This is why most activity takes place in countries such as China and the Balkans, where it is tolerated by some local, regional, or national governments. In Canada and the US, where governments do not turn a blind eye, prohibition should be a simple affair.

As stated above, however, there are spaces in southern Ontario and western Quebec where it is extremely difficult to police the illicit tobacco trade. Law enforcement authorities have focused instead on controlling the flow of traffic into and out of these territories, with some limited success.

## **Contraband is intercepted at the border post in Cornwall.**

Contraband is intercepted at the border post in Cornwall, through which most cars and trucks leaving Akwesasne on the Canadian side have to pass. Until 2009, the location of the border post in the middle of Cornwall Island allowed vehicles leaving the reserve with tobacco products to bypass inspection. As a result of moving the toll to the Canadian river bank, smugglers must now cross the St. Lawrence River to avoid it. However, this border post may be relocated to the US side. From the smugglers' perspective, this would be ideal as they could cross by boat from the US side, always staying within the Akwesasne/St. Regis reserve territory, and then move the goods via the road without any inspection.

Other than at the CBSA border posts, the RCMP leads Canadian enforcement efforts. The RCMP detachment in Cornwall is the second largest in Ontario, with 46 officers and 6 civilians.<sup>25</sup> A number of new initiatives involve the coordination and joint action of all the law enforcement agencies in the region. The Cornwall Regional Task Force, established in 2010, includes the RCMP, the CBSA, the Ontario Provincial Police (OPP), and the Akwesasne Mohawk Police. A specialized unit devoted to tobacco smuggling has also been set up: the Cornwall Combined Forces Special Enforcement Unit-Contraband Tobacco Initiative (CFSEU-CTI) includes RCMP officers, OPP, Cornwall Police, CBSA, and Akwesasne Mohawk Police.<sup>26</sup> In addition, the RCMP and OPP have embedded officers in the Akwesasne Mohawk Police.

Coordination with US law enforcement agencies has also increased, although this is meant to strengthen border integrity as a whole, not just contraband interdiction. A binational Border Enforcement Security Task Force (BEST) has been established in the Cornwall/Massena area. The RCMP leads Canadian participation, with various task forces or regional police services (for example, Peel Regional Police Service, RCMP Toronto Immigration Task Force, Cornwall and Greater Toronto Area (GTA) CBSA

Enforcement and Intelligence Operations Divisions) brought in as needed.<sup>27</sup>

The most recent initiatives are based on the *Integrated Cross Border Law Enforcement Operations Act* that allows US officers to cross the border into Canada where they have "the same power to enforce an act (sic) of Parliament."<sup>28</sup> The best known initiative launched under the Act is the Shiprider program, which involves joint patrols by US and Canadian border enforcement units. Joint land patrols are being planned, although the idea is generating significant discomfort and opposition in Canada. Shiprider is not operational in the Akwesasne-Cornwall area either, at least in part because non-Aboriginal governments' full jurisdiction over the waterways is contested by Mohawk authorities.

## **Joint US/Canadian land patrols are controversial.**

US collaboration is obviously crucial, though prohibition appears to be just as constrained there by limited *de facto* access to the US side of reserves, where a large cigarette manufacturing capacity exists (partly because it is much easier there to obtain legal tobacco, which does not have to cross a border to reach production facilities). If up to 90 percent of illicit tobacco indeed originates from those factories, US efforts would have the largest impact on the trade.<sup>29</sup> Such numbers are highly disputable, however, as production in Canada (particularly in Kahnawake and on the Six Nations of the Grand River reserve) has increased substantially in recent years.

In practice, most efforts involve arresting smugglers and seizing shipments as they leave the reserve through border posts or the Canadian side of the St. Lawrence River. Fines are imposed for possessing illicit tobacco, but media reports suggest few are ever fully paid or that payments are staggered over such long periods that the fines become irrelevant. Most people caught at the border post, in Cornwall or on Highway 401 between Montreal and Toronto are



teenagers or young men – almost invariably “small time smoke runners” (Stinson 2010). The manufacturers and criminal networks that control large-scale distribution beyond the reserve are rarely caught or sanctioned unless they engage in other kinds of smuggling.

The impact of these efforts should not be dismissed. Relocating the toll to Cornwall and intensifying patrols along the river bank had numerous effects (Brennan 2010). Seizures were displaced from Cornwall eastward towards Valleyfield, Quebec. Shipments have been confiscated regularly or destroyed when smuggling boats throw cases overboard before speeding away. Together with what fines are paid, the resulting pressure appears to be significant enough to change the pattern of smuggling. The adaptation required imposes additional costs and reduces the net profit, with a domino effect on collateral crime.

Overall, the results remain disappointing for a very simple reason: the manufacturing and storage facilities (where larger loads are bought in bulk) and the stores and “shacks” (where tobacco products are sold to non-Aboriginals) are on-reserve and are essentially immune to police action. Outlets operate in plain sight behind the legitimacy conferred on them by the fact that the community on both sides of the border cares little about this illegal trade.

**Bulk manufacturing and storage facilities on reserves are immune to police action.**

If Shiprider is not extended to the area, pressures on the smugglers are unlikely to increase, unless important investments are made to patrol the whole Canadian river bank by land – a policy that will be constrained by legal restrictions to search-and-seize beyond border areas; that is, along most of the two banks of the St. Lawrence River east of Cornwall. Whether or not such resources are invested, it is difficult to see how the highly controversial joint land patrols would change the enforcement landscape given that the problem lies over the water or strictly on the Canadian side.

In March 2013, the Canadian government announced measures which will significantly tighten the current regime for illicit tobacco. The most important one consists of proposed amendments to the *Criminal Code* that introduce more severe sentences for those who “shall sell, offer for sale, transport, deliver, distribute or have in their possession for the purpose of sale a tobacco product, or raw leaf tobacco that is not packed, unless it is stamped” (Senate of Canada 2013). Prison terms of up to five years are specified for 10,000 cigarettes (50 cartons or a single case) or 10 kg of tobacco or other tobacco products. Compulsory minimum sentences are introduced for repeat infractions, with prison terms of 90 days, 180 days, and two years less a day respectively, for second, third, and subsequent infractions. In addition, a new 50 member RCMP unit devoted exclusively to illicit tobacco is being set up (The Canadian Press 2013).

The impact of these measures will depend on the extent to which they will be enforced, particularly on-reserve. Until now, the *de facto* immunity mentioned above has severely constrained the effect of formal prohibition on the trade. From a security standpoint, however, enforcing the new measures on-reserve may have negative implications (see 4.6 below).

#### 4.4 Limiting illicit profit margins

Various government initiatives have reduced the production of raw tobacco leaves in Canada and better controlled its commercialization; examples include the \$300 million federal Tobacco Transition Program, Ontario’s Smoke-Free Ontario Strategy, the Raw Leaf Tobacco Growers’ Licensing Program, and changes to the *Tobacco Tax Act* meant to better regulate raw leaf tobacco. These measures have compelled manufacturers to rely on imported tobacco and they impose increased costs and use of contraband imports to illicit producers. Efforts to balance out these costs by using cheaper raw material (which may explain the poor quality of tobacco in illicit products) in turn affects the product’s market price. (RCMP 2011; Frank 2012). Any initiative that complicates or directly increases the costs of illicit production, such as better control over paper, filters, or cigarette machines, or higher taxes on all those (Luk et al. 2009, 493-494) would have a similar effect (Blackwell 2012).

As well as upstream initiatives, downstream programs such as effective public health programs have led to a continued decline in smoking rates despite the lower price of illicit products. Lower demand for a lower quality product explains in part the poor market price that illicit products command, which also constrains profit margins.

All such measures eat away at the gross profit on which the black market has developed. The costs associated with illicit activities and the low market price of illegal tobacco have a direct impact on the economic scale of the trade, with a ripple effect on collateral crime and the security threats that it feeds.

## 4.5 Confronting broader criminal side effects

Recent research in criminology suggests that selective enforcement can be extremely effective at reducing particular crimes (Kleiman 2010; Felbab-Brown 2013). “Focused deterrence”, as exemplified in programs such as Boston’s famous Operation Ceasefire experiment, have had a large impact on homicides while leaving untouched the drug markets of US inner cities. The key to such an effect is the concentration of efforts on particular areas or crimes and on ensuring that sanctions will be swift, certain, and severe enough to radically change the criminals’ incentive structure.

**Sanctions must be swift, certain, and severe to radically change the criminals’ incentive structure.**

Perhaps unwittingly, the way in which policing has been applied to the illicit tobacco trade looks a lot like focused deterrence. Indeed, severe sanctions have been reserved for those who trafficked drugs, weapons, and humans while leaving essentially untouched the “pure” tobacco smugglers. The significant amount of money available within the tolerated crime space may well have further deterred criminals from engaging in other types of smuggling that

would risk a relatively safe but substantial source of revenue. This is the most plausible explanation for the remarkable absence of “mixed smuggling” in CBSA and RCMP seizures and for the very small number of trials and convictions involving smugglers.

For Canada, the adoption in 2012 of the *Safe Streets and Communities Act* (Bill C-10) for terrorism (Section 2), drug trafficking (Section 4), and human trafficking (Section 10),<sup>30</sup> and the *Protecting Canada’s Immigration System Act* (Bill C-31), which includes severe penalties for human smuggling, clearly serve such a purpose.<sup>31</sup> It is striking that Bill C-10 – by far the most important of the two – cites tobacco when discussing the health impact of drugs but makes no mention at all of smuggling, which clearly contributes to those health impacts.

The same rationale appears to guide US initiatives such as NY Senator Charles Schumer’s *Cross Border Reservation Drug Trafficking Sentencing Enhancement Act*, which, if adopted “would add ten years to the sentence of any cross-border drug traffickers that utilize Native American land”, while leaving tobacco smugglers off the hook (Spencer 2011; Schumer 2009).

Two directions can be taken from here. One option is to reinforce the selective incentives by making it explicit that mixed smuggling will be severely punished while the pressure and sanctions on tobacco smuggling would stay at current levels. A particularly effective way to do that would be to threaten those who engage in mixed smuggling with severe sanctions for both smuggling tobacco and other goods.

The other option is to focus on illicit tobacco itself and try to deter its trade by concentrating resources where it is particularly severe and/or on known manufacturers and smugglers. These first cases could then be used to deter other people or in other areas. The key to such “dynamic concentration” (Kleiman 2010) is the sustained investment of enough resources to ensure swift, certain, and severe enough sanctions to truly eradicate illicit smuggling in a core area, and to make sure that any attempt to re-establish it there is punished. Without this assurance, smuggling simply shifts around to avoid the worst pressure points of law enforcement. In a best case scenario, this would be the effect of the harsher regime that the Canadian government is now introducing. Leaving aside the amount of

resources needed to ensure swiftness and certainty of sanction, this option however may also generate important side effects given the political conditions under which law enforcement must function in and immediately around reserves.

#### 4.6 Containing the potential for major security challenges

The manufacture and smuggling of illicit tobacco on and through Mohawk reserves combined with the general legitimacy they enjoy in the population create a dilemma for law enforcement authorities. On one hand, smuggling clearly generates revenues that feed into collateral crime and could end up financing terrorist activities. On the other hand, directly confronting it is likely to galvanize the affected communities into resistance action.

**Directly confronting smuggling is likely to produce resistance.**

Given the location of the affected reserves, blockades could effectively block important transportation hubs. The Mercier Bridge, one of the main accesses to the island of Montreal, was closed for months during the Oka crisis. The bridge to Cornwall, albeit much less strategic, was blocked for days in protest against the permission given to CBSA officers to carry weapons.<sup>32</sup> The prospect of law enforcement agencies losing access to substantial areas close to the border, as happened in Oka both during and for years after the crisis, is also profoundly disquieting.

Authorities on both sides of the border appear to have concluded that the multifaceted threat of illicit tobacco was lower than the risk of upsetting the on-reserve population through over-zealous enforcement. But managing the relationship with the Mohawk communities had involved more than just turning a blind eye to tobacco smuggling. In fact, this represents only a fraction of the ways in which non-

Aboriginal governments have been building bridges with the communities. The establishment and financing of and close collaboration with Akwesasne Mohawk Police is the most prominent of such efforts. The implicit and partial recognition these efforts embody for the sovereignty claims of the Mohawks contributes to a better relationship with the community. Embedding non-Aboriginals into the local police forces and the participation of the Akwesasne Mohawk Police in the various regional task forces and initiatives contribute to a fluid relationship and make the quick deterioration of a local crisis much less likely. Dialogues about taxes, even when they touch on tobacco, between revenue agencies and local partners similarly help build a relationship that contributes to effective oversight, if not full control, of the area. Preserving those linkages while intensifying enforcement will be challenging.

#### 4.7 Avoiding US discontent with border security

The US government's policy towards illicit tobacco on Mohawk territories is the mirror image of Canada's. The priority appears to be to contain its implications for border security, illegal immigration, and drug smuggling. Part of the two countries' tobacco problem today stems from US tolerance of cigarette manufacturing on reserves within its own borders. Canadian anti-smoking activists have even argued that Canada should push to US to act.<sup>33</sup> In the face of strong measures on crime and human trafficking, growing investment in law enforcement capabilities in the border area, and a clear willingness to engage in joint initiatives and to welcome (as much as politically feasible) US law enforcement into Canadian

**US tolerance of cigarette manufacturing on reserves within its own borders is part of the problem.**

territory, it is difficult to claim that Canadian authorities have been lackadaisical.



Two challenges still dominate the bilateral agenda. The first is the illegal production and exportation of ecstasy through Akwesasne, an issue that Franklin County District Attorney Derek Champagne has raised forcefully. Once again, however, Canada has taken measures to resolve the problem – in particular by licensing critical manufacturing equipment, such as pill presses, the sale of which has long been tightly controlled in the US. The fact, noted above, that production appears to be moving within the US suggests that these measures are producing results. One must also bear in mind that ecstasy can hardly be considered a major security preoccupation in the US.

The second challenge concerns illegal immigrants, an issue that has been very prominent on the US security agenda since the arrest of Ahmed Ressam, the Millenium Bomber, who entered from Canada, and especially after September 11, even though none of the terrorists had in fact come from Canada. Canada has invested massively in border security, and the latest legislative changes are the culmination of a long series of legal and administrative measures taken in part to soothe US sensitivities.

Governments must thus balance the risks involved in confronting the communities with those that result from tobacco smuggling. The confrontations between governments and Aboriginal organizations that mark Canada's recent history have led Canadian and US authorities to avoid disrupting their relations with the communities. As a result, and essentially for security reasons, law enforcement has hovered over the problem, intercepting a small part of the product and trying to ensure that the smuggling infrastructure is not used to transport other goods, in particular weapons, drugs, and humans. Government attempts to maintain a level relationship with the Mohawks and to limit the use of cross-border routes appear to have been quite successful. On the basis of the data we could access, the legislative, administrative, and operational measures adopted have prevented non-tobacco trafficking from reaching significant levels. Moreover, levels of violence, both among trafficking organizations and between the police and the smugglers, have been low. Proposed legislative changes are very likely to disrupt this *modus vivendi*.

**Governments must balance the risks involved in confronting the communities with those that result from tobacco smuggling.**

## Conclusion

Illicit tobacco has security implications for Canada, primarily because it generates millions of dollars of illegal profit, part of which finds its way into the hands of organized crime and feeds collateral crime. Most of the activity lies in the manufacturing and smuggling of illicit cigarettes in a few Aboriginal reserves located in southern Ontario and western Quebec. As such, it is an extremely vulnerable activity, and could be quickly wiped out by concentrated law enforcement efforts.

However, tobacco production and sale, illicit or not from the standpoint of non-Aboriginal governments, also enjoys a broad legitimacy among the population of the Mohawk territories where they take place because of the economic potential they represent.

We have identified a few avenues that would make current arrangements more efficient. The prospects for tax reforms that imply either significant reduction of taxes or the transfer of taxing responsibility and revenues to Aboriginal communities do not appear very bright.

We feel, however, that two broad avenues are promising. The first involves narrowing the profit margins of illicit manufacturers and smugglers by improving control of inputs and continuing downward pressure on demand for all tobacco products. This would reduce the value of the trade and lessen its appeal for large criminal organizations. The second involves further strengthening the focused deterrence that has limited the use of smuggling routes for other purposes.

In the end, however, these represent a small tweak in a policy constellation that is already effective at limiting the security impact of illicit tobacco. This is a remarkable outcome considering the complexity of the jurisdictional, administrative, and political environments.

**Controlling inputs and reducing demand would narrow the profit margins of illicit tobacco.**

### Key uncertainties and limitations

There is a wide consensus that most of the illicit tobacco in Canada is consumed in southern Ontario and Quebec. In its study for the Canadian Tobacco Manufacturers, the GfK Group argues that 95 percent of illegal tobacco smokers are in those two provinces (2008, slide 9).<sup>34</sup> This view is not consistent with the CBSA data on West Coast “marine” smuggling. The idea that cigarettes are transported between Vancouver and southern Ontario to be sold at \$2 a pack is hardly believable. The most likely explanation is that a substantial market for illicit tobacco exists in BC and Alberta, one that surveys have not penetrated, and that is much more open to international and Chinese brands. If this is correct, estimates of consumption of illicit tobacco need to be revised upward and analyses of the security implications should examine western Canada more closely.

Finally, a full assessment of the security implications of illicit tobacco would call for a much more careful consideration of the way in which the production and sale of legal and illicit tobacco are embedded in the economic, social, and political dynamics of the Aboriginal communities where it takes place. The kind of long-term engagement with those communities that such research would involve was not possible within the time and resource frame of this study.

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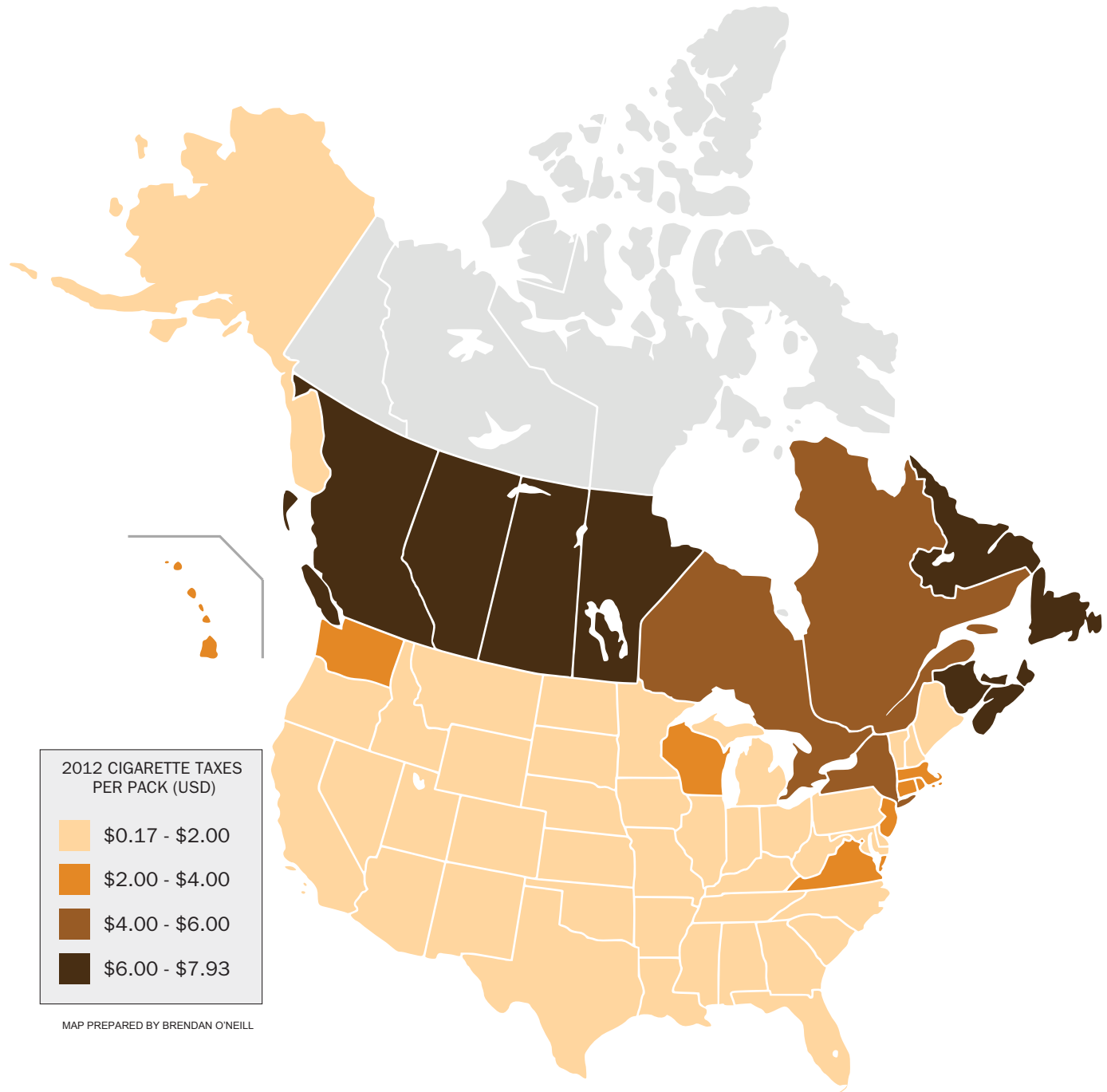


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# Appendix 1

## 2012 Taxes on Cigarettes in North America



### MAP SOURCES

[http://www.nsr-aadnf.ca/cms/le/les/121120\\_map\\_and\\_table\\_reviewed.pdf](http://www.nsr-aadnf.ca/cms/le/les/121120_map_and_table_reviewed.pdf)

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<http://www.smokefree.gov/SmokersData.aspx>

<http://www.smokefree.gov/map.aspx>

[http://en.wikipedia.org/wiki/File:BlankMap-USA-states-Canada-provinces,\\_HI\\_closer.svg](http://en.wikipedia.org/wiki/File:BlankMap-USA-states-Canada-provinces,_HI_closer.svg)

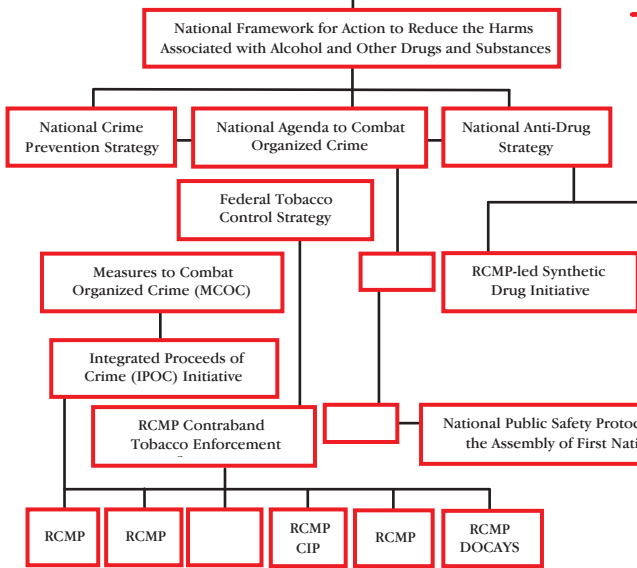


# Appendix 2

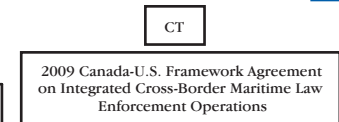
## Policy Framework Governing Tobacco and Narcotics Enforcement in Canada and the US

### Canadian Federal Policies

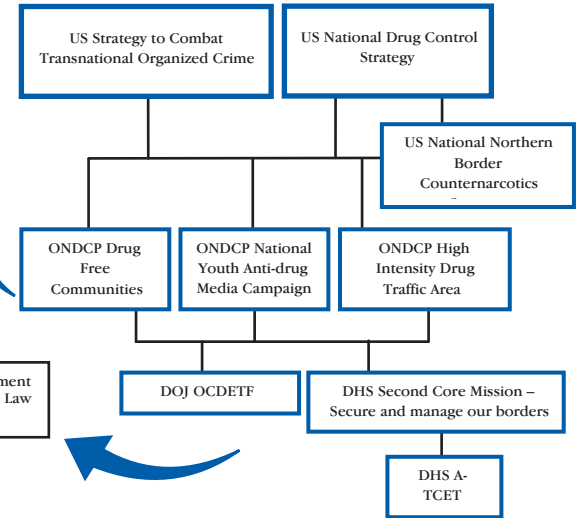
Speeches from the Throne  
 The importance of building safer communities by combating various forms of smuggling and trafficking was addressed consistently from the 2nd Session of the 36th Parliament of Canada (October 12, 1999 – October 22, 2000) until the 1st session of the 40th parliament (November 18, 2008 – December 4, 2008). The speech that opened the 3rd session of the 40th parliament of Canada (March 5, 2010 - March 26, 2011) stated that judicial tools would be modernized to fight organized crime.



### Joint Policies

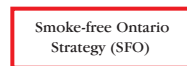


### US Federal Policies



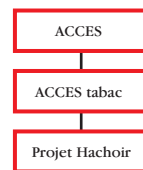
### Ontario

### Provincial Policies



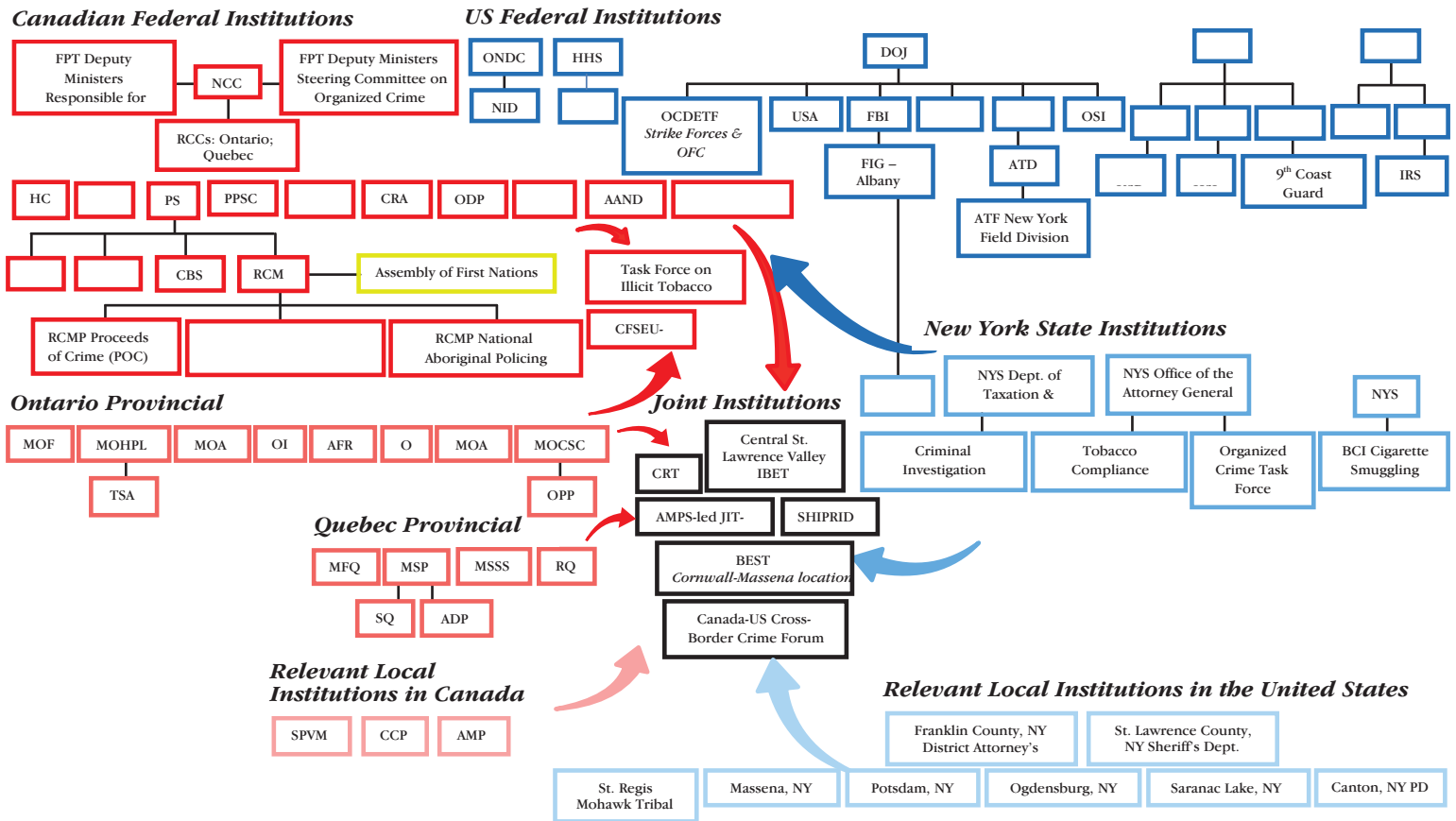
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### Provincial Policies



# Appendix 3

## Administrative Framework Governing Tobacco and Narcotics Enforcement in Canada and the US



# Appendix 4

## Sources Used for Establishing the Policy and Administrative Frameworks

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## Endnotes

- 1 These substantial variations come from the fact that consumption data and wholesale data diverge significantly, with the former much lower than the latter. The lower bound here is calculated by multiplying the number of declared smokers by the average consumption of daily smokers (14.4/day) (Health Canada 2011). The higher bound is the wholesale data declared by manufacturers (Health Canada 2013).
- 2 Calculations based on wholesales (31 billion cigarettes) and an average price in Canada (weighted by provincials) of \$83 for a carton of 250 cigarettes. Data from Non-Smokers' Rights Association 2012, 7.

- 3 The most recent and detailed overview of the evolution of the federal and provincial government revenues from tobacco between 1990 and 2012 is “*Tax Revenues from Tobacco Sales*,” by Physicians for a Smoke-Free Canada. <http://www.smoke-free.ca/factsheets/pdf/totaltax.pdf>. Although it includes revenue from the sale of raw leaves, loose tobacco, tobacco products, and cigars, the total for 2011 is only slightly higher than here (\$7.5 billion for 2010-2011 and \$7.4 billion for 2011-2012), because the organization explicitly does not account for provincial sales taxes or for the federal GST. In contrast, this study uses the average final sale price of cigarette cartons, which includes those taxes.
- 4 According to the FAO, the price of raw tobacco in Canada increased from \$3356 (US) in 1996 to \$3528 in 2004, and \$4627 in 2010.
- 5 “The big money comes from the distribution side. According to police, one ‘kingpin’ admitted to making \$250,000 a week, while a courier transporting the cigarettes to smoke shacks on reserves pockets up to \$6000 a week.” (Brennan 2009)
- 6 Jim Dorn’s documentary, *Smoke Traders* (2012), similarly examines the legal business of another native manufacturer, Rainbow Tobacco, which operates on the Kahnawake reserve in metropolitan Montreal.
- 7 “The majority of the contraband cigarettes the RCMP seizes across Canada originate from manufacturing plants on the U.S. portion of the reserve.... These plants are supplied with refined tobacco from North and South Carolinas.... There are 10 factories located there on the New York portion (and only one of them is legal),... the RCMP estimates these plants can produce up to 50 million cartons of cigarettes a year” (Brennan 2009).
- 8 Websites such as <http://www.canadacigarettes.org/camel-cigarettes.html> facilitate these transactions.
- 9 Pilon (1992) provides a full discussion of section 8 of the Charter for search and seizures. See in particular section 3 on Border Crossings.
- 10 “If smokers fail to perceive a difference in quality between lawful and contraband cigarettes, and if they do not acknowledge any harm associated with the black market, then there is little reason for them to cease their participation in the black market” (Gabler and Katz 2010, 38).
- 11 Some kind of informal arrangements, cartel or “cooperative”, would clearly make sense here. However, transaction costs linked to the socio-political make up of Mohawk communities, as well as enforcement itself, which constantly disrupts the equilibria on which stable informal arrangements could be sustained, hamper the creation of such arrangements. For a close but successful parallel, consult B. J. McCay (1980).
- 12 These estimates are much smaller than the numbers that circulate in the media and in law enforcement reports. The main reason has to do with the imputed market price used for the latter calculations. For example, the *Winnipeg Sun* reported that, according to court documents, illegal cigarettes “manufactured on reserves in Southern Ontario and in areas along the U.S. border” and then smuggled into Manitoba can provide a profit of \$1300 to \$2350 per case of 50 bags (Turner 2012). Leaving aside the fact that cigarettes can be bought legally in North Dakota for less than half of their price in Manitoba, without having to travel all the way from Southeastern Ontario, generating the kind of profit mentioned, implies that the packs sell for \$26 to \$47 *above the costs* of acquisition, transportation, and smuggling – which is not realistic.
- 13 In Ontario, a 40-hour work week at the minimum wage pays \$380.00. This would represent the profit to the smuggler of 152 cartons of cigarettes; that is, slightly more than three 50-cartons cases, if one discounts production costs (\$1), some profit for the manufacturer and what the retailer may keep on a \$2 pack (perhaps 0.75 altogether), leaving about \$0.25 per pack, or \$2.50 per carton, to the smuggler. This should be seen as a minimum: the RCMP estimates that the trunk of a Chrysler Intrepid, a favourite vehicle of smugglers, can hold up to 18 cases, or 900 cartons.
- 14 Using the Quicklaw database.
- 15 CBSA reports underestimate the relative importance of trade in “products” such as drugs, weapons, and humans because the agency only records seizures made at border posts, which means it systematically underestimates the quantity of these goods traded between them. While the other sources do not suffer from the same bias, the empirical basis of the following discussion is not as strong as we would have liked.
- 16 See “Aboriginal Border Crossing Rights and the *Jay Treaty* of 1794” for the Mohawk interpretation of the treaty’s implications for cross-border trade. <http://www.akwesasne.ca/jaytreaty.html>.
- 17 “Seizures in Valleyfield, Quebec, where the smugglers have concentrated because of the crackdown in and around Cornwall, have topped 100,000 cartons and 12,968 kilograms of fine cut tobacco in the period from Jan 1 to Monday.” (Brennan 2010).



- 18 It is not clear that such an understanding is very useful, however. To the extent that the direct negative effects of illicit tobacco can be traced to its consumption, which is legal and not deemed an unacceptable hazard, we are not sure that it clearly hurt peoples' "freedom from fear", which is a more satisfying understanding of human security introduced by Franklin D. Roosevelt in the 1941 *State of the Union Address*, and later enshrined in the *UN Declaration of Human Rights*.
- 19 This report from the CBC mentions a "Department of Justice Report," most likely the National Drug Threat Assessment, which is the only DOJ publication dealing in some details with drug trafficking. We could not find this number anywhere in that report (National Drug Intelligence Center 2011).
- 20 The UN Organization for Drugs and Crime agrees: "the smuggling of cannabis herb from Canada into the United States appears to be decreasing and cannabis production seems to be shifting to the United States side of that country's border with Canada" (2012).
- 21 According to the August 2009 CBSA's *Quarterly Drug Assessment Report*, the US border services at Massena, NY, seized 50,000 ecstasy tablets from a Cornwall couple. The same report notes that two other large seizures of ecstasy headed towards the US had been made over the same period but both were on the West Coast (CBSA, Rapport trimestriel de la contrebande des drogues, September 2009, 14-5).
- 22 *Mohawks of Akwesasne v. Canada* (Minister of Public Safety and Emergency Preparedness) [2009] F.C.J. No. 1661; 2009 FC 1296; 357 F.T.R. 227; 100 Admin. L.R. (4th) 218; [2010] 2 C.N.L.R. 214; 2009 CarswellNat 4545.
- 23 As per the definition of the *UN Convention on Transnational Organized Crime*, which was enshrined in Canadian law in 2002 following the implementation of Bill C-24. For a clear discussion of the rationale for this change, see *R. v. Meloche*, [2010] J.Q. no 4774.
- 24 While premiums vary, laundering money is costly.
- 25 "O" [Ontario] Division Detachments <http://www.rcmp-grc.gc.ca/on/detach/index-eng.htm>.
- 26 Canada NewsWire, October 21, 2010 "Combined Forces Special Enforcement Unit Seizes Important Quantity of Contraband Cigarettes and Cash and Arrests 2 Cornwall Residents." <http://www.lexisnexis.com.proxy.library.carleton.ca/hottopics/lnacademic/?shr=t&sfi=AC00NBGenSrch>.
- 27 Canadian Government News. September 14, 2012. "Ministers Toews and Kenney commend law enforcement for arrests in alleged human smuggling/trafficking ring." <http://www.lexisnexis.com.proxy.library.carleton.ca/hottopics/lnacademic/?shr=t&sfi=AC00NBGenSrch>.
- 28 <http://www.cbc.ca/news/canada/story/2012/07/10/cross-border-policing-integration-sovereignty.html>.
- 29 "Rob Cunningham, a senior policy analyst with the Canadian Cancer Society,...offered some solutions, including urging Public Safety Minister Vic Toews to persuade U.S. Attorney General Eric Holder to shut down illegal factories on the U.S. side of Akwesasne First Nations reserve, where 90 per cent of the contraband smokes originate." (Brennan 2010)
- 30 Canada, Library of Parliament, Bill C-10, Legislative Summary. <http://www.parl.gc.ca/Content/LOP/LegislativeSummaries/41/1/c10-e.pdf>.
- 31 Canadian Government News. September 14, 2012. "Ministers Toews and Kenney commend law enforcement for arrests in alleged human smuggling/trafficking ring." <http://www.lexisnexis.com.proxy.library.carleton.ca/hottopics/lnacademic/?shr=t&sfi=AC00NBGenSrch>.
- 32 This protest directly caused the relocation of the toll to Cornwall, an outcome that smugglers – who prefer CBSA officers to be unarmed – certainly did not intend.
- 33 "They...advocate putting more pressure on U.S. authorities to crack down on rogue plants in New York state.... As for lobbying the U.S., Mr. Toews's office pointed to a July agreement between the Minister and Janet Napolitano, the U.S. Homeland Security Secretary, to develop a "shared vision" of border security. A news release issued at the time, however, made no mention of contraband tobacco" (Blackwell 2012).
- 34 Rob Cunningham, a senior policy analyst with the Canadian Cancer Society, said "90 per cent of the contraband smokes originate [from] illegal factories on the U.S. side of Akwesasne First Nations reserve" (Brennan 2010).

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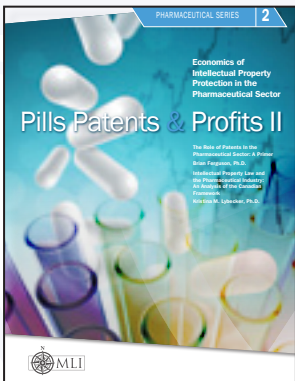
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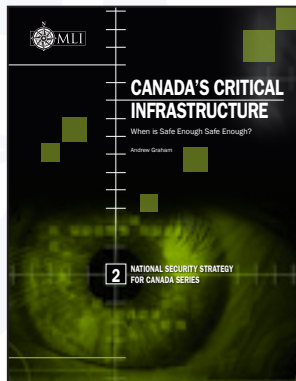
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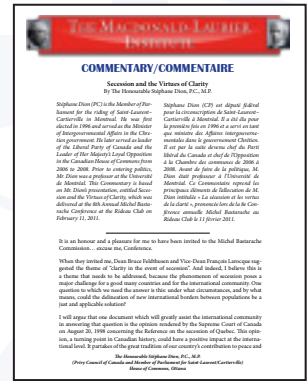
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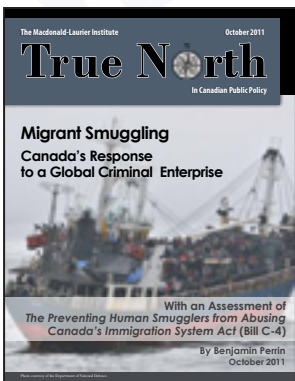
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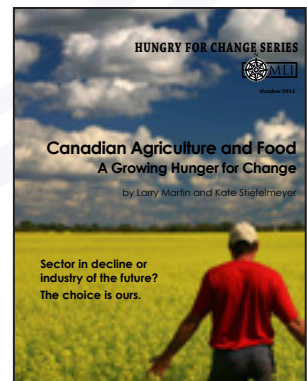
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