

IMPACT OF THE EUROPEAN UNION MEMBERSHIP ON ILLICIT TRADE IN SELECTED GOODS (CASE OF SLOVAKIA)

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Abstract

Membership in the European Union also brings regulations and directives that are adopted at the supranational level. Excise duties on tobacco products are highly harmonized in the EU countries. The same types of products are applied, the same regimes in intra-communitarian trading are used, and the same bans are applied in relation to the sale to minors, advertising ban in media or ban of sponsorship donations. Their consumption is connected with adverse health effects on consumers, which often result in premature deaths, which subsequently cause additional economic costs and reduce the productivity of a country. The illicit cigarette trade increases the demand as well as the availability of tobacco products. The aim is to show the impact of the changes in the rates of excise duties on tobacco products on the state budget revenue and subsequently on the development of illicit trade.

Key words: *legal consumption, excise duty on tobacco products, illicit cigarette, cheap whites*

INTRODUCTION

Directives and regulations adopted at supranational level within the European Community by the competent bodies of the European Union bring the consequent need for their incorporation into the legal systems of the Member States. Free movement of citizens and goods brings a need for joint action by the Member States of the European Union. The first harmonized products included tobacco products aimed at preventing shopping tourism at the borders of the states, limiting illegal trade, and eliminating the negative externalities that arise in the sale and

consumption of such goods. What is the impact of the EU membership on illicit trade in selected goods is shown in this article on tobacco products and the excise duty.

One of the most important adjustments in area of our analysis is the European Tobacco Products Directive (EUTPD) (2014/40/EU), which sets out rules for the manufacture, presentation, and sale of tobacco related products. Tobacco and related products are mainly cigarettes, roll your own tobacco but also popular electronic cigarettes, and herbal products for smoking. The regulation covers a number of areas covering this area, which also covers consumer protection in addition to the manufacture of domestic cigarettes as it obliges manufacturers to report to the EU countries on the content of substances that are part of their products or to put health warnings on the packaging of such products. In order to emphasize the political - security context of the issue under our consideration, it is important to note that such precise rules are also part of measures to combat illegal trade and smuggling of such products. It is therefore necessary to perceive this issue in wider socio - political context, not only as an exclusively economic instrument.

However, there are differences in the price of tobacco products among the Member states. This difference represents one of the determinants of illicit trade. The others can include e.g. the level of corruption, the existence of informal distribution networks or involvement of criminal networks in the illicit trade. Illegal trade is a worldwide phenomenon. Its existence has several unwanted consequences, which are specified in more detail in the chart no 1. As a result of them the illicit trading ruins public administration and the aims of public health.

Table 1. Illicit Trade with Tobacco Products and Unwanted Consequences

Illicit Sale of Tobacco Products	Unwanted Consequence
they are not subject to indirect taxation	the loss of stable state revenue in the form of taxes
it makes the offer and the availability of tobacco products wider, so they are cheaper than their legally sold equivalents	smuggling can make the range of tobacco products wider by the types which are not legally represented on the domestic market.
those products usually do not meet various health criteria and limits	impaired health of population, premature deaths and the loss of productivity, all of which negatively influences the economic activity of countries

Source: own processing

A characteristic sign of the consumption of tobacco products is its transfer to developing countries, which do not apply strict rules of tobacco control. In developing countries the consumption decreases. The consumption of tobacco products, which were subject to illicit trade, decreases, too. Within illicit tobacco products, the new types of products come to fore, so called "illicit whites" or

"cheap whites". It is characteristic for these products that they are unknown brands. Their producers are not subject to any regulatory rules. They also rob legitimate companies off the share on the market and profit. It results in the fact that illicit trade influences public sector as well as private sector represented by tobacco industry. Since the illicit trade has a worldwide impact, the worldwide cooperation is necessary for the fight against it. Countries in all parts of the world get united and adopt mutual rules for the fight and elimination of illicit trade with the aim of the protection of their revenue as well as the health of their citizens.

1. LITERATURE REVIEW

In addition to a wider range of international treaties and EU directives governing this issue, it is necessary to base our research on specialized economic literature as traditional possibilities of increasing revenues, such as the growth in tax rates and the introduction of new types of taxes, increase the tax burden but there is no significant impact on the budget revenues. The opportunity to examine the behaviour of taxpayers, in order to prevent the generation of negative externalities along with the preventive measures mainly focused on various tax areas [Heady and Mitra 1980; Callison and Kaestner 2012; David 2010; Dragone, Manaresi and Savorelli 2013]. David [2010] deals with the selected aspects of the taxation of cigarettes in the EU member states, while the limitation of the consumption puts negative externalities on the first place. According to the author the fiscal effect of excise duty is secondary. When monitoring, respectively modifying, tax system it is necessary to take in consideration economically reasonable taxation rate and also psychological limit of taxation [Cnossen 2005; López-Nicolás, Cobacho, and Fernández 2013]. The relation between taxes and economic stimuli and tobacco products and health of inhabitants was investigated by Sassi, Belloni, Capobianco and Alemanno [2014]. They analysed economic, legal and public motives for the application of taxes and other fiscal measures on unhealthy commodities. Moore and Hughes [2000] made a research about the impact of tobacco taxation on the reduction of costs spent on health care. Pros of taxation, as the best means for the limitation of smoking, mostly include the fact that it is a good source of tax revenue, it is possible to impose it at low administrative costs and it simply financially affects smokers to pay for externalities, which are caused by companies. Cons of taxation of tobacco and tobacco products include the fact that it is regressive [Colombo, Galmarini 2017]. Consumers of lower earnings groups have to spend bigger proportional part of their income for their acquisition than consumers of higher earnings groups, which are able to save. The rate of smoking is also higher among low earnings groups. As a result of increased excise duty some consumers stop smoking. However, the other ones will continue. Since the price of cigarettes rises, the costs for other, often important goods will reduce [Lucas 2012]. However, in Gruber and Köszegi's words, excise duties are not regressive, if consumers of lower earnings groups more react on the changes in price when making decisions about tobacco products consumption [2008].

The enforcement of "taxes on sin" aimed at the protection of public health, is not perceived as sincere by all authors, because even after the implementation of the rates of these taxes, the costs still result from them. Instead of being used for the purposes related to the reduction of the number of smokers, they are used for financing of common government projects or repayment of government debt. They

also state that government loses a citizen with the death of a taxpayer, who took from public budgets, but also paid to them. The state will lose money only in case that this person took more than paid. However, it is unambiguous that smokers meet this condition. Although smokers require more health care during their work life, but there are higher expenses in form of pensions, nursing care and social contributions in case of non-smokers. Expenses for the society caused by smokers are largely non-financial and the financial ones are beard by smokers themselves. They state that on the one hand the excise duty on cigarettes helped to reduce the number of smokers in the past, especially among young people, since it is an effective stimuli in discouraging smoking, but nowadays we can observe its unwanted effect in the form of expanding black market. Higher prices lead to the consumption of alternative products, whether they are legal or not. The international market with tobacco products have a double nature consisting of legal and illicit part. The global impact of illicit market means that illicit market is also of global nature and it is a problem for many countries. Illicit market comprises many participants including customs administration, tax administration, law enforcement agencies, consumers, private sector or consumer protection. It results in the typical interaction of offer and demand [INTERPOL, 2014]. There exists an interesting statement about the decrease of cigarettes consumption resulting from their higher price, what leads to increased use of marijuana [Snowdon 2012].

2. METHODOLOGY

The methods, which we used, were influenced by the set aim, which is pointing out the impact of the changes of the rates of the excise duty on tobacco products on the development of illicit market. Mathematical methods were applied within the investigation of the revenue share of excise duty on tobacco products on the total tax revenue and within the calculation of the share of "illicit whites" on the consumption of smuggled and forged cigarettes in the European Union. The consumption of cigarettes represents the biggest part of the consumption of tobacco products. It enables the use of these data. We acquired the data about tax revenue to state budget from the database of Eurostat. It is purely tax revenue without social contributions. The selected period from 2010 to 2016, this represents the last year with the major part of data available. The supporting part was the development of the illicit cigarette trade. The data about the consumption of illicit cigarettes were acquired from the studies of the consulting company KPMG, which were annually published until 2012 under the name of STAR Report and since 2013 under the name of SUN Report. The information of the European Commission on the number of retained cigarette packs in the EU member states were stated in order to provide objectivity. They are annually published in Reports on EU Customs Enforcement of IPR. The analysis of the application of the excise duty on tobacco products was focused on Slovenia, Estonia and Poland, while all of these countries entered the European Union at the same time and their entry was conditioned by the implementation of the common principles of taxation even in the area of the indirect taxes.

3. RESULTS

The excise duties on tobacco products are characteristic by high rates, which are then mirrored, in the higher price of these products aimed at discouraging consumers from the purchase and consumption. This state is a result of a several-year-pointing out the adverse effects of tobacco products consumption, especially cigarettes, on the health of consumers. However, despite the harmonization there are certain differences among the countries. The harmonization did not determine one rate of excise duty, which would be applicable in all countries, but a certain range and minimal rate were determined and they must be met by the member states. Therefore, there are differences in the determination of proportional and specific part of excise duty among the countries. These differences are shown in the different excise duty revenue in the European Union member states. In relation to the total tax burden, despite the differences it is almost the same in all EU member states. However, the price of cigarettes remains different. The price is generally lower at the Eastern border of the European Union compared to the Western and Northern Europe.

However, high prices are a reason for the existence of illicit trade, because these cigarettes are often sold for lower price. It weakens the effort of public officials to discourage the consumption by the means of increasing prices through the higher rates of excise duty. The illicit trade has several triggers. They include the differences in the price of cigarettes, which are a consequence of various tax rates, but also other factors, such as the level of corruption or the presence of criminal groups in the country. The illicit trade has many faces, but it is mostly striking in the form of cigarettes and forged cigarettes smuggling in the European Union. The structure of the market has changed in recent years. Smuggled cigarettes and forged cigarettes of the most known producers have been substituted by so called "illicit whites" or "cheap whites". Although being legally produced in a home country, they are illegally sold on the European Union market.

According to estimates, the black market with tobacco creates 10.4 % of total global market, meanwhile it diverts tax revenue and it is the source of financing organized crime and terrorism. So called Tobacco Directive of the EU and the protocol to the Framework Convention on Tobacco Control (FCTC) of WHO are focused on the issue by some of their parts. Also under the influence of countermeasures the black market with cigarettes is subject to trends, while the biggest problems in the EU and in the Slovak Republic are "illicit whites" which largely replaced forged products of known and verified brands. Illicit whites are produced legally, but they are then smuggled to markets where they are illegally distributed and sold. Cigarettes leave the factory with necessary documents, but they do not have the same control of distribution networks as big producers do. There is not a measure talking about the monitoring of the sale of products and the origin of money. Nowadays they are the most dynamically growing group of illicit tobacco. This fact is driven especially by demand. The regulation of the illicit market in the EU is not sufficient. Therefore, the support of legal industry is necessary. It assumes that they have good knowledge about the market and are better informed about the illicit part of the market. According to the study of KPMG the primary source of illicit cigarettes which come to the EU is Belarus. It is estimated that 5 billion pieces were consumed in the EU in 2015. Belarus also supplies the countries of the Eastern Europe outside the EU - Ukraine, Moldavia

and Russia. There are two producers in the country. One of them, Grodno Tobacco Factory Neman (GTFN), is a state-owned producer and the other one is Tabak Invest company, which produces under the own brands as well as the brands of international companies it has a licence for. 1 of 10 illicit cigarettes which are smoked in the EU comes from GTFN. It is estimated that the tax evasion in the EU represents 3 billion EUR. Illicit whites also come to the EU from the United Arab Emirates. Illegal factories are also situated in the EU member states, especially in Poland and Baltic States and they mainly produce forged cigarettes. It is expected that the illegal production will increase, because it is difficult to detect the import of raw tobacco no customs are applied to. Therefore, many states implement excise duty on raw tobacco which will be applied to the separated part of tobacco principal which is not processed yet.

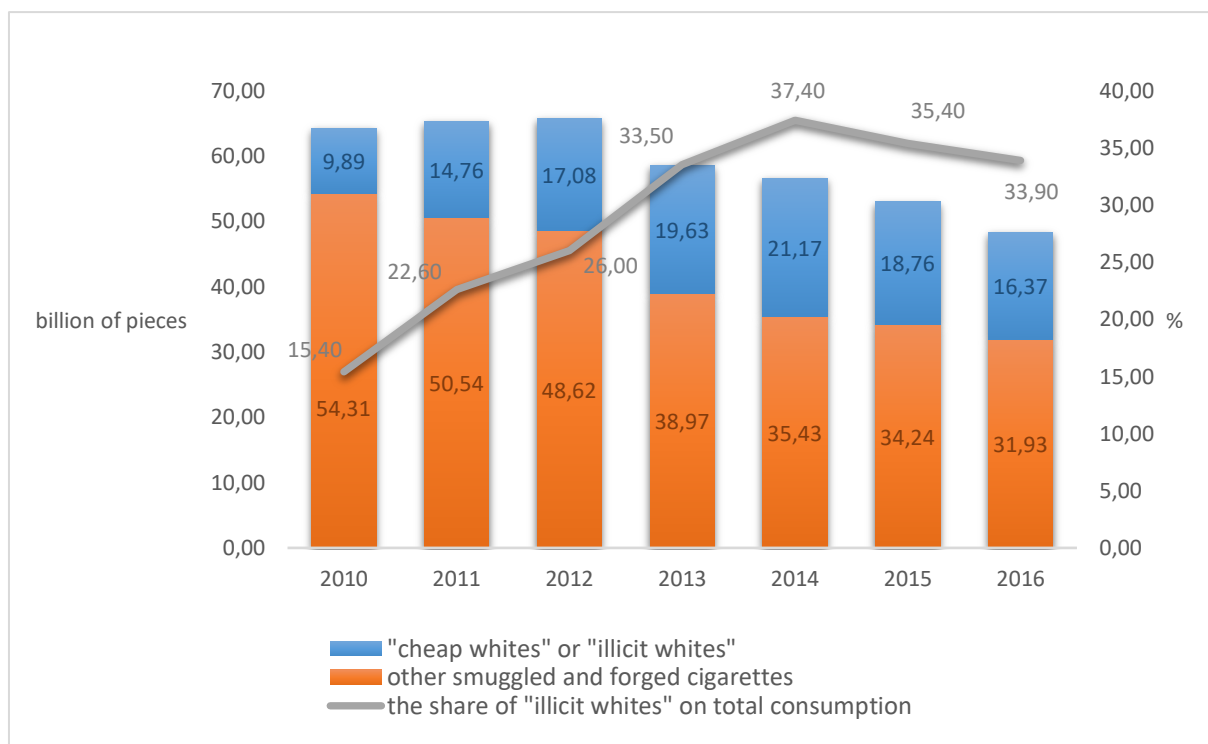
The problem within the EU is also "cheap whites". They are cigarettes of the brands with no legal distribution in the EU. Therefore, they are sold illegally without paying taxes. The EU adopted the directive on tobacco products and the protocol aimed at the elimination of illicit tobacco products market (Protocol FCTC). It strengthened the legislative frame in relation to the fight against this type of illicit market. One of the solutions for the elimination of this tax evasion is also the fact that the European Union signed the Memorandum of Understanding with Belarus in 2016, which relates to "cheap white" cigarettes and it is of technical and operational nature. It was designed to practically assist the cooperation in investigation; meanwhile it should help to make the common effort in the fight against the illicit tobacco market more effective. From May 2019, the Tobacco Directive anticipates the introduction of new extensive system of track and trace of cigarettes situated on the European market or indented for it. On the other hand, FTCT Protocol includes the key requirements for the production of tobacco products and technologies for their production, tools, improving the control of duty free zones and also the measures against money laundering. From the long-term point of view this protocol aims at the creation of the global monitoring system.

All types of tobacco products can be actually smuggled. However, they are mostly the cigarettes. It is mostly thanks to the high consumer demand, their low weight that enables easy movement, high profitability, since their production is quite cheap and high price resulting from the high taxation level. The level of detection and possible fines are quite low. Except from the given types, the illicit trade also include illegal production, which represents the production of tobacco products in conflict with the law including the forgery of tobacco products and undeclared production. These products can be sold on domestic markets or smuggled to another jurisdiction.

The volume of illicit trade can be generally expressed in billion pieces, as a percentage of the market, which is illicit and by the means of tax gap or the loss of tax revenue. The total volume of the smuggled and forged cigarettes consumption of has dropped, because the consumption of cigarettes in the whole European Union dropped too. Twenty years ago, smuggled and forged cigarettes of the biggest tobacco producers were the biggest problem of illicit trading. There has been a significant progress in this area. It has reduced this threat. The success is a result of the cooperation among tobacco industry, its supply chain and the representative of the governments, such as customs office, tax administration and law enforcement agencies. However, new threats in the form of sophisticated

fakes, so called "illicit whites" appear. The following graph confirms this development. "Cheap whites" or "illicit whites" are produced legally in one jurisdiction with the aim to be smuggled to another country, where there does not exist legal market for them. The tax might be paid in the country of production, but it is not paid in the country of destination.

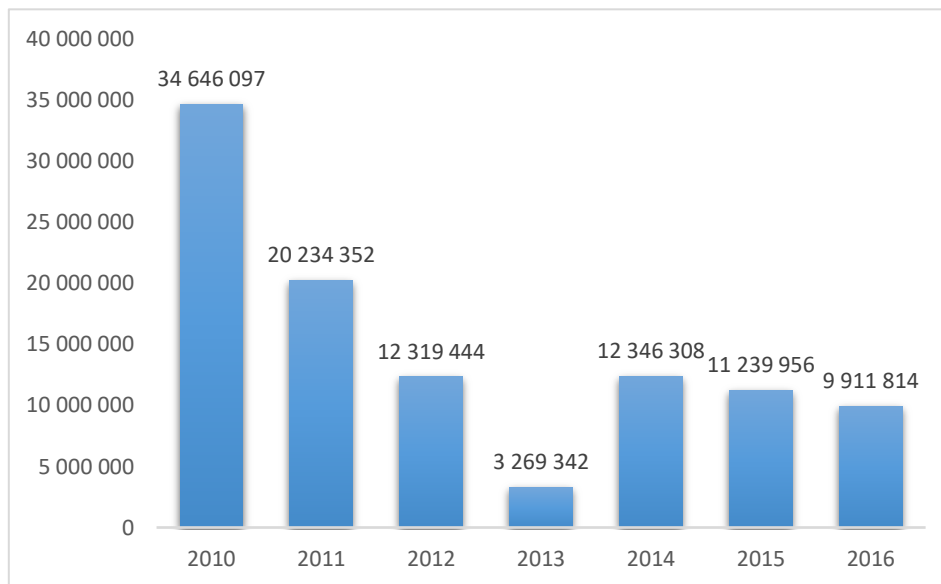
Graph 1. Volume of Illicit Cigarettes Trade according to Their Types in the European Union



Source: own processing according to the data of KPMG Project Star for the period from 2010 to 2013 and Project Sun for the period from 2013 to 2016

The data of the European Commission about the amount of retained cigarette packs for the period from 2010 to 2016 are presented in the following graph in order to provide greater objectivity.

Every year the European Commission publishes the report about the amount of retained products where there is a suspicion that they might violate intellectual property rights. We can see that the number of retained cigarettes annually reduced until 2014. The reduction was probably caused by the fact that it was difficult to control big deliveries. The subsequent growth in 2014 mirrors the improvement in the efficiency within the control of small deliveries. China was the largest source country except 2015, when Montenegro overtook it.

Graph 2. Number of retained cigarette pack in the European Union Customs Office

Source: own processing according to the data of the European Commission for the period from 2010 to 2016

Excise duties represent a relatively small, but significant source of state budget revenue. The effort to provide the revenue generation from the excise duties on tobacco products seems to be antagonistic aiming at the health of citizens. It is partially true, but it is possible to reach both aims as we can see in the example of the EU countries. The revenue from excise duties is more or less stable despite the decreasing consumption. It can be explained by the fact that increasing excise duty, which should cause lower consumption and the reduction of income, is compensated by the growing excise duty rates. The development of the revenue from the excise duties on tobacco products in the monitored countries of Poland, Estonia and Slovenia can be seen in the following chart. The share of the excise duty on tobacco products on the total tax revenue dropped in the monitored period. The share of indirect taxes on total tax revenue in Estonia is high. It is even above the average of the European Union. The long-term aim of tax policy is the transfer of tax burden from income and employment to consumption and environment. This trend is registered in the increase of excise duties. During the monitored period the government regularly increased the rates of the excise duty on tobacco products. It was also registered in the annually higher revenue from this type of indirect taxes. In 2013 in Poland the revenue from the excise duty on tobacco products dropped. The lower yield of the excise duty is a consequence of lower cigarette sale, which might be a result of a higher excise duty rate, but also a consequence of the growth of illegal cigarette consumption or the increase in the number of consumers who stopped smoking. The following stagnation in revenue, but not a further drop, can be explained by the growth of the legal sale of cigarettes for higher price, which led to the growth of tax revenue despite the decreasing cigarette consumption. In 2010 and 2011 in Slovenia the excise duty revenue grew in line with the growth of the rate of the excise duty on tobacco products. This development was convenient from a fiscal point of view. In 2012, the reform of excise duty on tobacco products was realized. It increased the specific part of excise duty and reduced the proportional part. It led to the situation when cheaper cigarette brands went up in price. It

negatively influenced the substitution within this group of tobacco products. Despite the growth of the excise duty in the following years, we can observe the decrease in tax revenue. It was caused by the above reform, but also other phenomena, such as the decrease of the consumption related to the higher price, VAT increase that also proved in the higher price of tobacco products and lower price of fine-cut tobacco.

Table 2. State Budget Revenue from 2013 to 2016 in million EUR

Estonia	Tobacco products				Σ Excise Duty on Tobacco Products	Total Tax Revenue	Excise Duty on Tobacco Products as Percentage of Total Tax Revenue
	cigarettes	cigars	cigarillos	other tobacco			
2010	110.91	0.04	0.59	3.12	114.66	2990.30	3.83%
2011	139.48	0.05	0.74	4.26	144.53	3288.50	4.40%
2012	153.40	0.06	0.91	3.87	158.24	3649.90	4.34%
2013	161.29	0.07	1.02	4.23	166.61	3882.00	4.29%
2014	172.76	0.06	1.00	4.33	178.15	4228.80	4.21%
2015	177.99	0.06	1.07	4.35	183.47	4539.60	4.04%
2016	184.44	0.04	1.11	4.76	190.35	4803.10	3.96%
Poland	cigarettes; cigars; cigarillos; other tobacco						
2010	4249.65				4249.65	74178.00	5.73%
2011	4082.94				4082.94	78358.50	5.21%
2012	4561.76				4561.76	77854.10	5.86%
2013	4370.25				4370.25	77302.90	5.65%
2014	4162.94				4162.94	80716.20	5.16%
2015	4141.47				4141.47	85080.40	4.87%
2016	4189.31				4189.31	87311.60	4.80%
Slovenia	cigarettes	cigars; cigarillos	other tobacco				
2010	389.14	0.15	1.70		390.99	8024.10	4.87%
2011	426.38	0.18	2.74		429.30	8072.20	5.32%
2012	435.35	0.23	6.68		442.26	7948.90	5.56%
2013	410.99	0.26	15.58		426.83	7970.30	5.36%
2014	405.93	0.51	16.13		422.57	8286.80	5.10%
2015	403.00	1.49	17.35		421.84	8540.00	4.94%
2016	395.01	1.26	15.60		411.87	8901.30	4.63%

Source: author based on the data of the European Commission

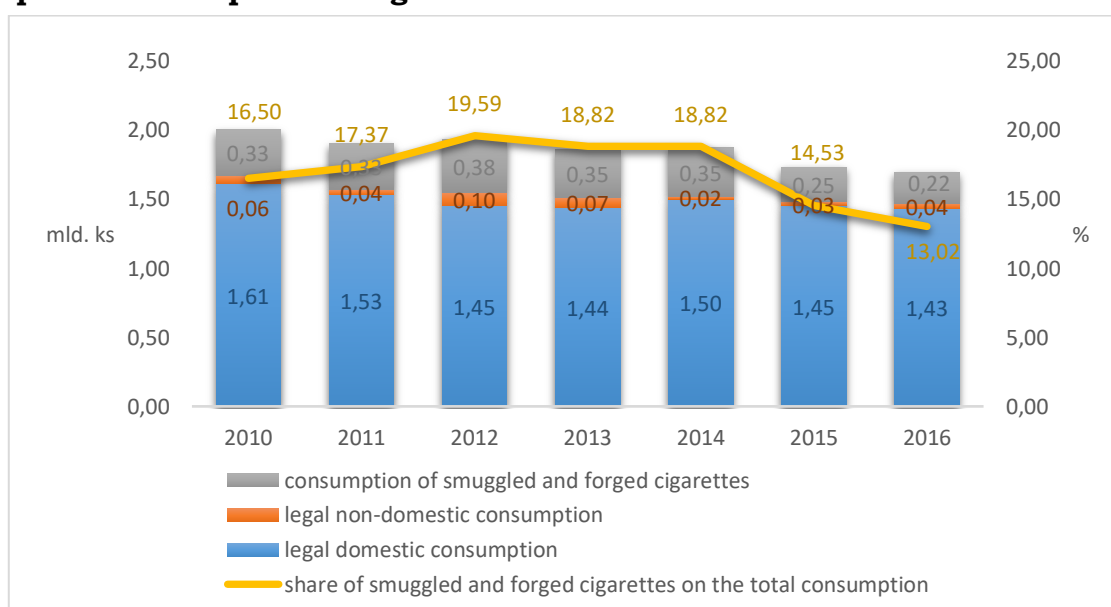
In the following chart we can observe the loss of state budgets of the surveyed countries resulting from the illicit cigarette trade. This loss expresses the additional revenue from the excise duty, which the countries would have gained if smuggled and forged cigarettes were legally consumed.

Table 3. Loss of State Revenue from 2013 to 2016 in million EUR

Country	2013	2014	2015	2016
Estonia	38	41	31	31
Poland	685	730	887	785
Slovenia	27	31	34	39

Source: author according to the data of KPMG Project Sun for the period from 2013 to 2016

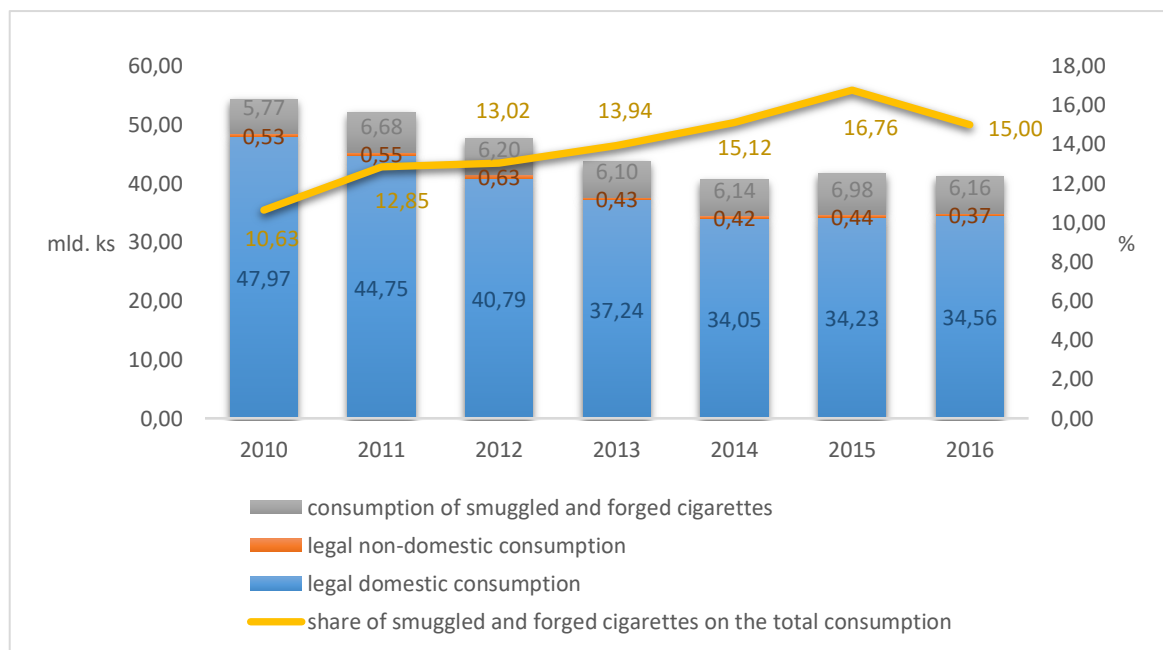
In 2010, Estonia experienced the decrease of non-domestic consumption. It was also expressed in the reduction of the consumption of smuggled cigarettes and their fakes, but their consumption was still above the average of the European Union. The year 2012 was characterized by decrease in the consumption of legal domestic cigarettes. The consumption of the cigarettes from non-domestic sources that year grew due to the increased inflow from Russia, which was caused by the growing number of the tourists travelling between Estonia and Russia. The number of smuggled cigarettes and fakes from Belarus increased, too. They year 2013 was characteristic by the decrease in the consumption of non-domestic cigarettes due to their inflow from Russia. The application of stricter rules limiting the amount of the cigarettes tourists can bring from the countries outside the EU is behind the development. That year the inflow from Belarus doubled and it partially equalized the drop of the inflow from Russia. The legal domestic consumption in 2014 grew despite the growth of prices. Economic conditions participated in the growth. It expressed in the GDP growth and the decrease in unemployment. The total consumption in 2015 decreased thanks to the decrease in the consumption of smuggled and forged cigarettes. Credit for this should be contributed to the increased regulation and law enforcement. The inflow of cigarettes from Russia also decreased due to the implementation of sanctions. It led to the decrease in the number of illicit cigarettes, but also the purchases of legal cigarettes due to the decrease in the number of cigarettes travelling to Russia.

Graph 3. Consumption of Cigarettes in Estonia

Source: author according to the data of KPMG Project Star for the period from 2010 to 2013 and Project Sun for the period from 2013 to 2016

Poland mostly represented a transit country. The cigarettes were consequently transported to Germany and Great Britain. Legal domestic sales in 2011 fell in response to the further growth of prices and the full implementation of the smoking ban in public areas. The consumption of non-domestic products in 2011 grew in relation in accordance with the growth of the inflow from Russia. It also led to the growth of the consumption of fakes and smuggled cigarettes. In 2012, the legal domestic sales of cigarettes dropped in accordance with the growth of the consumption of tobacco leaves, which had not been subject to tax until 2013. Since there were the agreements between the European Union and Belarus, and significant differences in prices predominate, the inflow of cigarettes from Belarus grew. Therefore, it became one of the most important source markets of "illicit whites". The response was the determination of a new limit for the import of cigarettes from Belarus in the amount of two packs per a person. Legal domestic sales of cigarettes in 2013 decreased as a response to the availability of cheaper cigarette alternatives, e.g. e-cigarettes, which were not subject to tax, and tobacco leaves, in case of which only dry tobacco leaves were subject to tax. Therefore, consumers started to sell tobacco leaves as wet, and so they used the gap in the law. Legal domestic sales of cigarettes in 2014 were adversely affected by the growth of tobacco consumption determined for cigarettes rolling. The year 2016 was characteristic by quite stable legal domestic consumption, which resulted from a slight increase in prices and stable excise duty rate. The consumption of forged and smuggles cigarettes fell. It was caused by making the conditions for tightening the conditions for the intervention of tobacco brokers. It was reflected in the decrease in the number of tobacco traders. Borders control at the border with Belarus tightened and the borders with the area of Kaliningrad in Russia was closed. However, Poland remained the biggest output market. It was reflected in the low price of cigarettes and also in the number of Polish citizens working abroad.

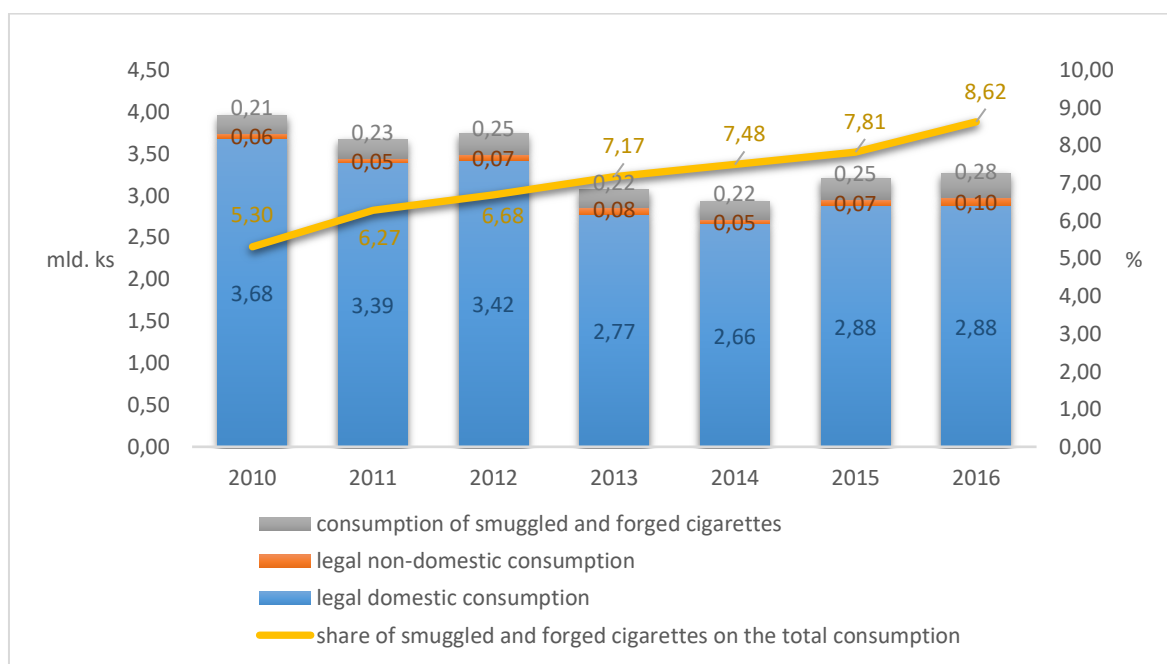
Graph 4. Consumption of Cigarettes in Poland



Source: author according to the data of KPMG Project Star for the period from 2010 to 2013 and Project Sun for the period from 2013 to 2016

Legal domestic cigarette consumption in Slovenia in 2010 fell in comparison to the previous year due to the growth of price. The consumption of smuggled and forged cigarettes fell, too. This development reflected the decrease in the import from Bosnia and Herzegovina. The excise duty rate increased in 2011. It was reflected in the higher price of cigarettes, which lead to the decrease in legal domestic consumption and the increase in the consumption of smuggled cigarettes and their fakes. The decrease was also registered in 2013. It was caused by the growth of prices and also by worsening economic conditions. It resulted in the growth of unemployment. The following year the growth of cigarettes was faster than the growth of the prices of other tobacco products. It implies that consumers started to substitute cigarettes. The share of smuggled cigarettes and their fakes on the total consumption remained stable. The main source of the cigarettes of non-domestic legal consumption and also smuggled cigarettes and their fakes was Bosnia and Herzegovina. The increase in non-domestic legal consumption in 2016 reflects significant increase in the number of tourists travelling from and to Croatia, where the cigarettes were cheaper.

Graph 5. Consumption of Cigarettes in Slovenia



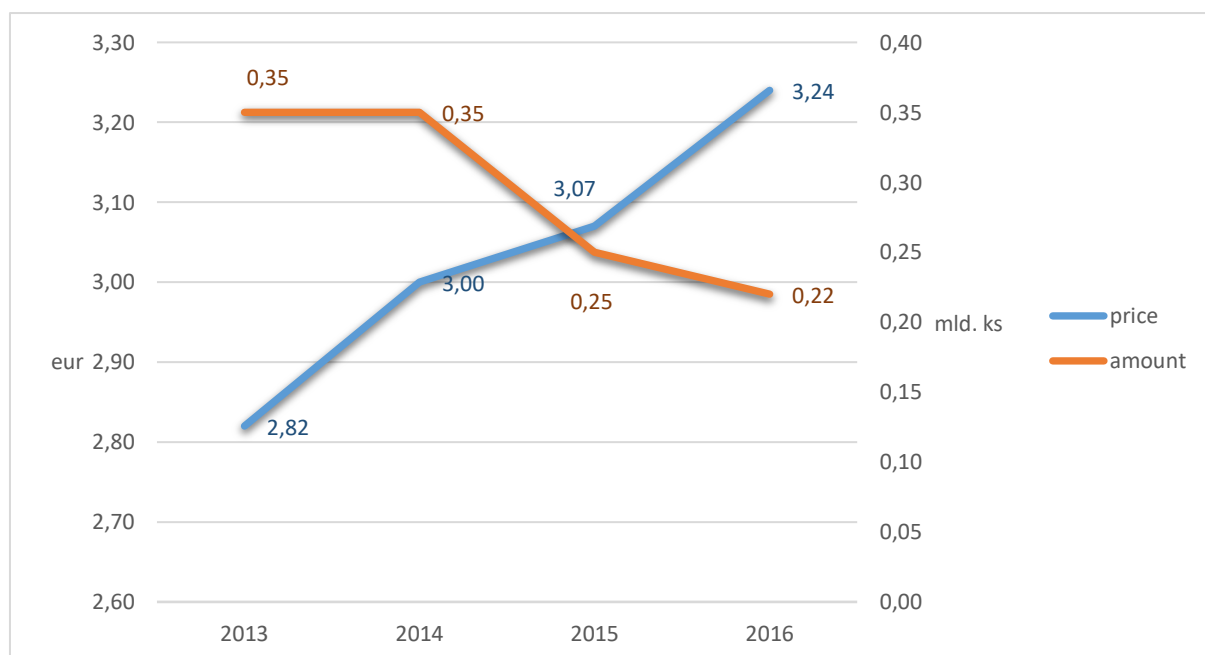
Source: author according to the data of KPMG Project Star for the period from 2010 to 2013 and Project Sun for the period from 2013 to 2016

The cigarette consumption was decreasing in the surveyed countries for the monitored period. However, its composition changed. The decrease in the legal cigarette sales was partially compensated by the growth of legal non-domestic consumption, but also by the consumption of smuggled cigarettes and their fakes. Estonia is the only country, which registered the decrease in all three areas. Several factors contributed to this development. They include effective application of law, effective tax and customs administration and improvement of border controls at the Eastern border of the European Union. The decrease of the total consumption of cigarettes in Poland and Slovenia registered in the decrease in legal consumption,

domestic as well as non-domestic. The consumption of smuggled and forged cigarettes increased. When comparing the consumption of illicit cigarettes with the price of cigarettes we can observe the trend of growing price and decreasing consumption in Estonia. In Poland, the decrease in consumption related to the increased price can be observed in Poland only in 2016. Nor in one year it is not possible to observe such a trend in Slovenia.

The representatives of tobacco industry think that illicit trade is a global threat. In words of one of the producers, illicit trade is the fourth biggest "tobacco company". Tobacco industry believes that the reason for the existence of illicit trading is the differences in the excise duty rates among the countries. It is true that differences in prices and rates can motivate individuals to smuggle, especially in border and transit areas. However, a threat for the governments is smuggling in large volumes. In that case, the connection between the differences in prices and rates proved to be insignificant. The factors, which influence the presence and extent of illicit trade, are poor management, the lack of determination, ineffective customs offices and tax administration, the corruption and complicity of producers, the presence of informal sectors and distribution networks, perception of population and social-economic status. The indirect proportionality between the increase in prices through the increase in the excise duty rate and the increase in the volume of smuggled and forged cigarettes consumption is significant when monitoring the change in cigarette price and the consumption of illicit cigarettes in Estonia.

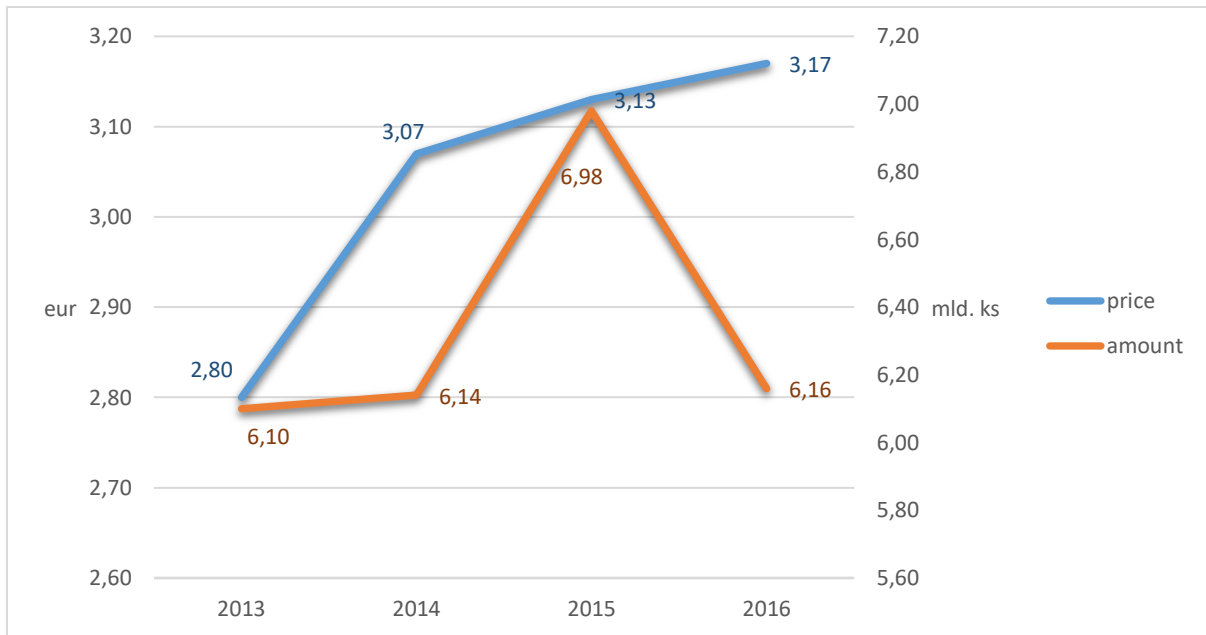
Graph 6. Consumption of Illicit Cigarettes Versus Weighted Average Cost of Cigarettes in Estonia



Source: author according to the data of KPMG Project Sun for the period from 2013 to 2016

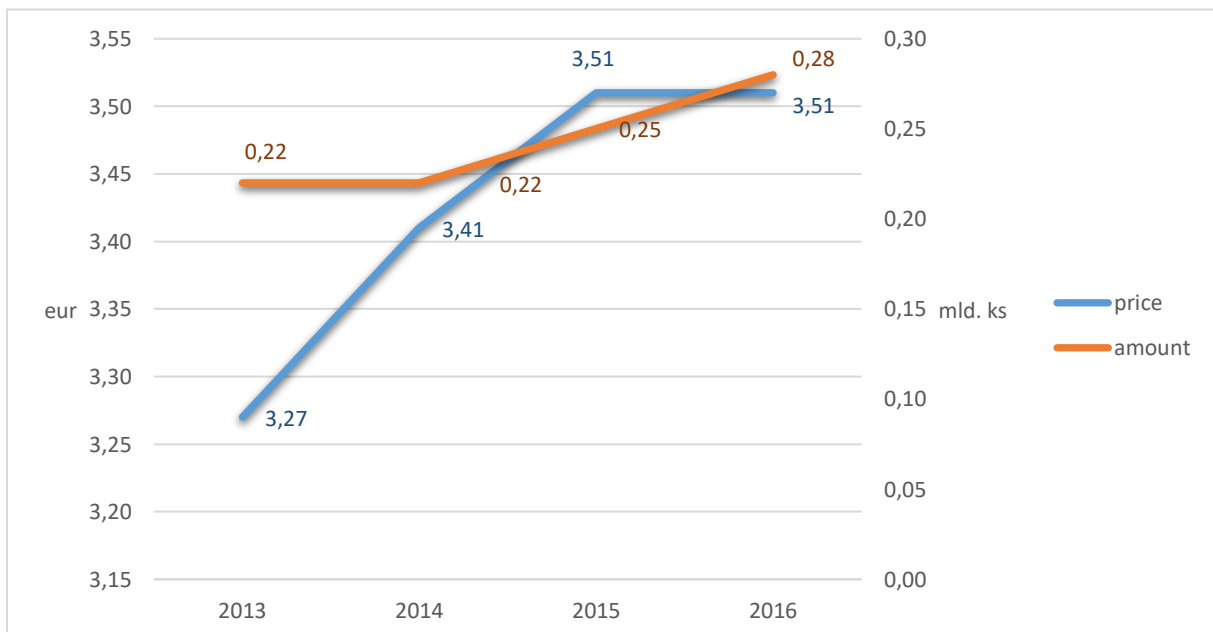
For the sake of completeness, we also present the development in Poland and Slovenia. However, the indirect proportionality between the weighted average cost of cigarettes and the amount of consumed illicit cigarettes is not so obvious.

Graph 7. Consumption of Illicit Cigarettes Versus Weighted Average Cost of Cigarettes in Poland



Source: author according to the data of KPMG Project Sun for the period from 2013 to 2016

Graph 8. Consumption of Illicit Cigarettes Versus Weighted Average Cost of Cigarettes in Slovenia



Source: author according to the data of KPMG Project Sun for the period from 2013 to 2016

CONCLUSION

Since there is free movement of persons and goods in the countries of the European Union, a common approach of the MS is needed. The directives and regulations that are approved at the supranational level within the European Community in the relevant European Union bodies bring the consequent need for their incorporation into the legal system of the Member States, as was pointed out by Slovakia during its presidency of the SR in the Council of the EU. This European legislation needs to be seen in the context of the international obligations of the Slovak Republic, also in the context of the 2003 Protocol to Eliminate Illicit Trade in Tobacco Products, adopted by the 56th World Health Assembly based on a consensus on the WHO Framework Convention on Tobacco Control.

The effects of the EU membership and the country's joint action on illegal trade in these goods were shown, due its high harmonization, on the example of tobacco products and the existence of excise duty.

The illicit trading with tobacco products is low- risk, highly convenient activity, which enable to earn significant financial means with a very low possibility of revelation or strict punishment. From the international point of view it encourages organized crime, corruption and terrorism. It also robs states of tax revenue. It results in the inability of governments to spend expenses on health care, education, government services and law enforcement. Smuggled products do not meet various health regulations and violate many laws. The participants in illicit trading trade with various types of tobacco products which can be smuggled, forged or they are part of the grey market, i.e. they were produced by a legal producer and determined for legal consumption, but they were diverted to another jurisdiction within a supply chain. These cases are most often in free trade zones and a producer usually does not know about the diversion of products. Free trade zone were paradoxically created with the aim of facilitating legal businesses and economic growth. However, it turned out that they are susceptible to illegal activities, since they provide preferential environment for production, wholesale, warehousing, import and export facilities. The products, which are placed in free trade zone, can undergo a scale of economic operations, such as processing, re-packing and re-loading. For example the deliveries, which arrive to these zones, are subsequently reloaded to other containers, so that illicit cigarettes can escape. Then they leave the zone as the goods of low value (e.g. textiles), and so they are incorrectly declared or hidden in other consignments. So-called phantom markets are also interesting. They are the countries, such as Moldavia, Luxembourg or Andorra, which are listed as final destinations in export documents. However, there is small demand in those countries to absorb the amount stated in export documents. It implies that there exists an intention to launch excessive offer of cigarettes on black market in the neighbouring countries.

The excise duty on tobacco products represents a source of tax revenue, the amount of which is not subject to fluctuation too much. Within this commodity it is actually possible to monitor the increase in the yield despite the statement that growing excise duty rate will cause lower yield, because more consumers stop smoking. In that case it is possible to explain stable to growing revenue by the fact that smokers who continue to smoke bear higher excise duty and so they compensate the loss of other smokers. Another possible explanation is that consumers start to use other tobacco products. This might explain the growth of

excise duty yield. In addition, several tobacco products, which are classified in the category of other tobacco products, are not subject to tax. The attempts for the decrease in the tobacco products consumption are the result of a long-standing effort of the governments and non-governmental organisations to the control of tobacco products consumption. The issue in tobacco products consumption and specifically cigarettes are new types, which get to the European Union from the third countries. They are "illicit whites" or "cheap whites". They moved up from quite insignificant market to almost one-third market share. Their share on the overall cigarette consumption nearly doubled in the last couple of years. The characteristic of these cigarettes is that their production is legal in one jurisdiction and therefore better quality can be achieved at their production than in case of fakes. They do not violate intellectual property rights and so it is not possible to prosecute producers. Therefore, it is necessary to spend finances on the fight in this area. The best means will be building consumer awareness about the adverse effects of the consumption of these products and strict application of law, which showed to be effective even in the fight against smuggling and forgery of cigarettes, as well as the cooperation with the countries of these cigarettes origin. It is also important to point out the link to other illegal activities, such as human trafficking and support for terrorist groups.

Tobacco industry believes that behind the existence of illicit trading with tobacco products there are high prices that reflect high excise duty rates. However, the extent of the illicit trade depends on other factors. They include effective functioning of state administration bodies, especially tax and customs administration and law application. This development was proved in Estonia. According to tobacco industry, another reason for the existence of illicit trading is strict regulation of this industry, which is shown in the prohibition on promotion of products or generic cigarette packs. However, the regulation is proper, because tobacco products have a negative effect on human health. Therefore, it is necessary to limit their sales. In order to avoid negative consequences in the form of illicit trading, it is necessary to improve the operation of tax and customs administration and international cooperation. Despite the decrease in the consumption of illicit cigarettes, the share of "illicit whites" increases in illicit consumption. This type of cigarettes brings new risks. Therefore, it is necessary to focus the attention of the European Union on the effort to eliminate the consumption of these cigarettes.

ACKNOWLEDGEMENT

This contribution presents some results from research project VEGA n. 1/0246/16. Effectiveness of fiscal and monetary policy during the economic cycle. Duration of the project is from 2016 to 2019.

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