

Case Studies in Illicit Tobacco Trade: Montenegro

Background

A variety of factors determine the size and characteristics of a country's illicit tobacco market. Policies concerning customs and tax administration are instrumental in either blocking or facilitating the flow of illicit products. At the same time, legal tobacco manufacturers may also fuel illicit trade by supplying raw materials or completed products through illicit channels. Substantial differences in the price of tobacco products, often resulting from variations in tax and price policies across regions, can create economic incentives for a variety of actors to engage in the illicit market. Despite these challenges, evidence from around the world suggests governments can decrease the size of the illicit market by strengthening border controls and tax administration.

This case study focuses on trends in the illicit tobacco market in Montenegro. Over the last decade, the country's illicit trade has slowed tobacco control efforts and threatened tax revenue collection. Recent steps taken by the government, however, have significantly reduced the illicit market, even while policy makers continue to raise tobacco taxes.

Montenegro's Efforts to Reduce Illicit Trade

The illicit cigarette market in Montenegro has decreased significantly over the last several years. Estimates suggest the market share for illicit tobacco was 51 percent in 2019 and decreased to between 22.1 and 26 percent in 2021, depending on the methodology used (Tobacconomics, 2022). This success is likely largely due to the implementation of policies that align with best practices to control the tobacco supply chain.

Recently, the government demonstrated a renewed commitment to addressing the illicit trade problem. Dritan Abazovic, who was Deputy Prime Minister at the time and is now the Prime Minister (in March 2023), announced a ban in July of 2021 on the storage of tobacco products in

the Port of Bar free-trade zone, effective as of January 2022 (Radio Slobodna Evropa, 2021). Abazovic also announced an increase in the surveillance of the Novi Duvanski Kombinat Podgorica (NDKP) free-trade zone, which is located within the NDKP cigarette factory (Radio Slobodna Evropa, 2021). These free-trade zones allow businesses to store goods for an unlimited amount of time and circumvent inspections, while reaping a variety of tax benefits. Although free-trade zones are meant to simplify legal trade, as in some other regions, in Montenegro they became hubs for smuggling and illicit cigarettes (Prebreza et al., 2019).

Following the decision to increase oversight of the NDKP free-trade zone, the owner of the factory shut down operations in November of 2021 (D. C. & Kapor, 2021). Meanwhile, in the Port of Bar,

there were several illicit cigarette seizures in 2022 totaling more than 160,000 packs worth tens of millions of euros (Tomović, 2022; Jovanovic & Kapor, 2022; Radio Slobodna Evropa, 2022). The implementation of these policies has significantly reduced the size of the illicit market and likely will continue to do so in the future.

Tobacco Taxes and Illicit Trade in Montenegro

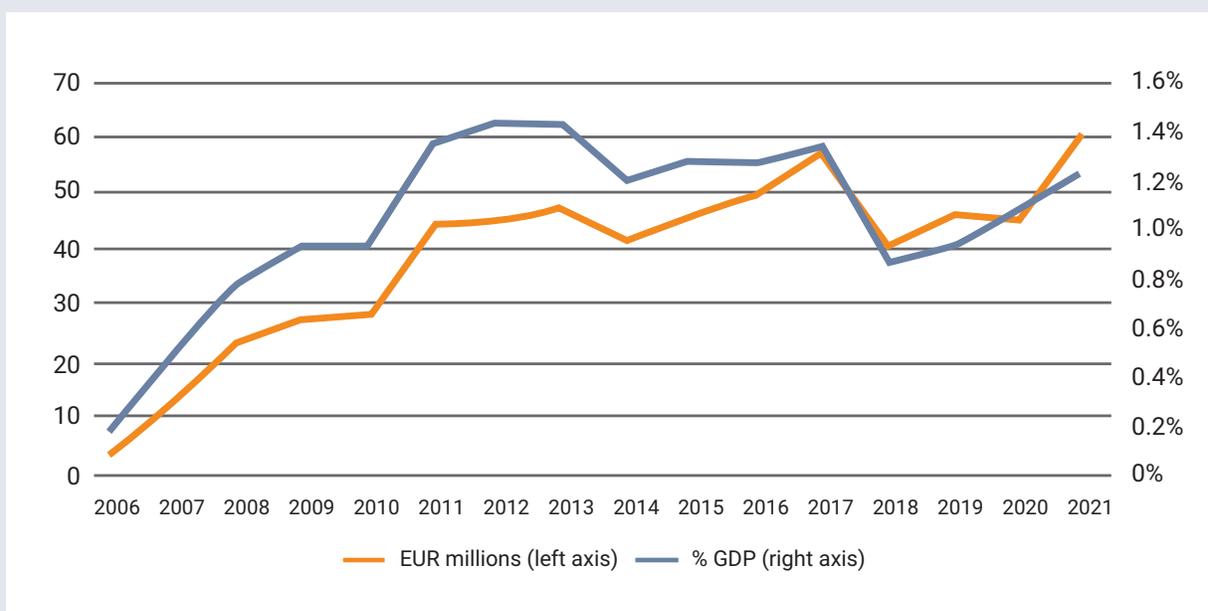
Montenegro began administering a mixed excise tobacco tax system in 2005 and continued implementing steady tax increases thereafter. Between January of 2009 and December of 2017, policy makers raised the specific excise tax from EUR 5 per 1,000 sticks to EUR 30 and reduced the ad valorem component from 40 to 32 percent. After the specific excise tax was further raised to EUR 40 in January of 2018, however, revenues dipped from 1.3 percent to 0.9 percent of gross domestic product (GDP), or EUR 40.6 million,

prompting a reversal back to the EUR 30 specific excise tax (Figure 1). Finally, at the end of 2019, the government restarted annual increases in the specific excise component by EUR 3.5 and a decrease in the ad valorem rate by 1.5 percentage points.

By 2021, tobacco excise tax revenue made up 1.2 percent of GDP, or EUR 60.4 million (Figure 1). This prompted two tobacco tax adjustments in 2022, one in January and one in June, each increasing the specific excise component by EUR 3.5 while reducing the ad valorem rate by 1.5 percentage points. In January of 2023, the specific excise increased again by EUR 3.5 to a total of EUR 47.5 per 1,000 sticks. At the same time, revenues from the tobacco excise increased by 52.5% in 2022 as compared to 2021.

While cigarette excise taxes increased, the illicit market was shrinking, and tax revenues were increasing. These trends show clearly that policymakers can raise tobacco taxes while

Figure 1
Tobacco excise tax revenues, 2006–2021



Source: Ministry of Finance, Government of Montenegro

controlling illicit trade. It is also worth considering that, although the reduction in revenue in 2018 coincided with tax increases, the opening of the free-trade zone of NDKP in May of that year and the associated tax evasion could have been the trigger. The continual uptick in tax revenue, on the other hand, coincides with the increased surveillance of the NDKP and the owner's decision to shut down the tobacco factory.

Conclusion and Recommendations

This evaluation of the illicit cigarette market in Montenegro points to the effectiveness of tax administration in the fight against illicit trade. At the same time, continually increasing cigarette excise taxes raises additional tax revenue without causing an uptick in the size of the illicit market. Concerns about the negative impacts of tobacco tax increases on illicit trade are often raised by the tobacco industry to protect their profits. The evidence from this study, however, strongly suggests that governments should continue to implement evidence-based best practices in tobacco taxation while strengthening and improving tax administration to reduce illicit trade rather than falling for the misrepresentations perpetuated by the industry. These best practices are enshrined in the Protocol to Eliminate Illicit Trade in Tobacco Products, of

which Montenegro has been a Party since 2017 (WHO, 2013).

In Montenegro, policy makers can maintain the momentum of their progress and continue to reduce illicit trade by:

- Investing significantly in tax administration to ensure there is adequate capacity to enforce policies.
- Introducing strong penalties for any involvement in the illicit tobacco market.
- Empowering judicial authorities to pursue cases against those involved in illicit trade.
- Transitioning to tax stamps that are more difficult to replicate and implementing an effective tracking and tracing system that shares information with neighbors and trading partners.
- Destroying seized illicit cigarettes to align with best practices in the Framework Convention on Tobacco Control and the Protocol to Eliminate Illicit Trade in Tobacco Products as well as to improve public health.
- Implementing mass media campaigns and funding cessation services that target subgroups who are more likely to consume illicit cigarettes, such as low-income smokers.

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Tobacconomics is a collaboration of leading researchers who have been studying the economics of tobacco control policy for nearly 30 years. The team is dedicated to helping researchers, advocates, and policy makers access the latest and best research about what is working—or not working—to curb tobacco consumption and its economic impacts. As a program of the University of Illinois Chicago, Tobacconomics is not affiliated with any tobacco manufacturer. Visit www.tobacconomics.org or follow us on Twitter www.twitter.com/tobacconomics.