

On Violations Characteristic for the Import, Production and Marketing of Tobacco Products

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Presented study aims to investigate legal basis and fiscal administrative procedures for the import, production and marketing of tobacco products; to identify existing shortcomings and develop a proposal for the total mobilization of money from product turnover to the budget.

Great number of governmental decisions disregarding legal entrepreneurial interests during the last 10-15 years resulted in illegal entrepreneurship - the import, production and supply of smuggled and/or unregistered goods – that turned out to be one of the vital life-saving means. Important part of the economy of the country has been operating in a shadow/unregistered sector for years. Rather efficient mechanisms are established for concealing of the state budgetary money and, for certain fee, of such types of violations. Most part of the population is unemployed and is ready to take on any job for the survival.

The import, production and marketing of tobacco products are not isolated and dissimilar from other sectors of economy. It reflects current situation in the country. Due to the impact of above-mentioned factors (indicators) and considering variety of specific characteristics of the sector (high demand on tobacco production, small size of goods and relatively low costs, conditions beneficial for the marketing of the production, and what's very important, higher average profitability compared to other sectors of economy) turns tobacco industry into the most attractive in terms of violation of law, i.e. turnover of shadow (unregistered) and/or smuggled goods among other sectors of economy. Therefore, in 2004 with the best indicators (293 million

excise stamps purchased, more than 90 million GEL transferred to the state budget) the share of unregistered, mainly smuggled production constituted 25% of the sold production.

Analytical research is uncommon in the sector of tobacco import, production and marketing. Besides, the necessity to solve problems in registration and taxation of tobacco products has for a long time been under the permanent consideration in legislative and executive branches of the government. Due to inadequate perception/management of the existing situation by the authorities and the inefficient administration the production, import and marketing of tobacco products has for years been an attractive area of “black money” turnover and illegal revenues.

Therefore, the research of tobacco production and related processes is crucial for the detection and prevention of economic crime, as permanent lawlessness resulted in the vicious practice that today could be overcome only by means of the complex of activities.

In accordance with the research undertaken in 2000 by the State Department of Statistics of Georgia the number of smokers in Georgia is 1.2 million; 315.1 million packages of tobacco products are consumed annually in the country; in case of complete taxation of the turnover the annual transfer to the state budget should amount to GEL 65.959 million

In accordance with the informational bulletin *Risk Factor of the National Anti-tobacco Center* dated March 2000, in total about 1200 thousand male and 500 thousand female smokers consume tobacco in Georgia; the consumption of tobacco products is 400 million packages annually. Averaging of these data (the entrepreneurs have calculated consumption of 360-370 million packages in Georgia) allows to calculate that the amount from the excise tax in accordance with 2004 excise rate was GEL 90-95 million; according to the rate established since 1 January 2005 this amounts to GEL 153 million. Considering that in the second half of 2004 excise tax was supplemented by the VAT and payment of the profit tax is also obligatory,

estimated contribution to the state budget from the tobacco products in 2005 should exceed GEL 200 million. First quarter of 2005 demonstrated that 2-2.2-fold increase of the excise rate and considerable growth of tobacco costs paralyzed local industry and reduced the import dramatically. This has very much increased the demand for the smuggled production and the numbers of people engaged in such kind of trade, even despite the ban on peddle of tobacco products.

Sources of unregistered tobacco products in Georgia:

1. Selling of tobacco products on the territory of Georgia during the transit traffic of baggage; this would be impossible without the agreement and participation of foreign suppliers and owners of transit baggage.
2. Unprotected borders (Russia, Azerbaijan) and conflict territories (Ergneti, Zugdidi) – existing gates for the introduction of tens of million packages of tobacco products. Based on the profitability of the business Abkhazian soldiers and Georgian partisans jointly provide unlabeled cigarettes from Abkhazia to the rest of the Georgian territory. Small-scale smuggling of tobacco products has also become main source of income for the IDPs and considerable part of the population residing on territories adjacent to the borders (Kvemo and Shida Kartli). Therefore, confrontation to the mentioned process puts into operation social factors parallel to the economic demands; the existence of these factors complicates the steps to be undertaken in this direction and requires very delicate, complex approach of the government.
3. The influx of unregistered products labeled with false re-used excise stamps with same numbers.
4. Manifold re-use of an excise stamp tore off (stripped) mainly during the marketing of low quality goods produced locally;

5. Export of tobacco to Russia for the production of low quality cigarettes, and their labeling, import and marketing with excise stamps intended for the local industry.

In 1999-2000 4.4300 million excise stamps with the nominal price of GEL 1.7 million were discarded as unused or damaged. Large number of damaged stamps in concert with the fact that only the stamps of 2-3 large importing enterprises were damaged raises the suspicion that the stamps could have been used for the labeling.

Following factors hinder comprehensive taxation of the tobacco supply to Georgia:

1. Georgia is a new independent country making its first steps in international relations; therefore, due to the lack of practical experience and a number of subjective and objective reasons the deficiencies, violations and difficulties characteristic for the development of market economy in its initial stage are present.

2. Permanent and often controversial changes have been characteristic for the taxation of tobacco products for years; as a result neither the state budget, nor an entrepreneur is able to get desired outcomes. Often these unreasoned changes provide the basis for the unstable and unpredicted business environment and the growth of the law violation rate. New tariff of excise stamps are a good example. Eventually the government will be forced to lower tariffs.

3. The executive branch of the government failed to undertake consistent, purposeful and reasonable activities for the full mobilization of money from tobacco industry to the state budget; it rather preferred to declare the willingness of such activities. Lack of coordinated activities of various state institutions results in inefficient administration.

4. Excise stamps of tobacco products could not acquire the controlling function in Georgian reality.

5. Following factors have direct impact on the dissemination of smuggled and unlabeled tobacco products: high unemployment rate, low living standards of large groups of population;

low wages of public servants including representatives of law enforcement bodies; and what's the most important –territorial disintegration of the country.

In order to gain maximum state fiscal control over the import, production and supply of tobacco products following measures seem to be reasonable:

1. To normalize the situation on tobacco market long-term stable legal basis should be developed for the regulation of the business environment through participation of businessmen and considering their arguments; these regulations should be equally acceptable for the state and the business community.
2. Activities of institutions related to the mentioned sector should be coordinated and cooperative; activities have to become transparent.
3. All distributors of tobacco products should be registered in tax administration, while the whole chain of imported and locally produced tobacco products supply should be controlled, including the control by means of excise stamps. Permanent control of all importers and manufacturers by financial institutions could also be considered as economically justified and purposeful.
4. An effective mechanism should be developed for the registration of cost inconsistencies established in the process of supply.
5. Strict control should be established on the production and import of packaging materials (cigarette packages, blocks and boxes).
6. Georgian government should implement social program for the employment of people engaged in manual trade of tobacco products.

Considerable increase of excise rates on tobacco products approved by the new (2005) Tax Code resulted in regressive changes in volumes and structure of consumed tobacco products. Based on the results of the first quarter 2005, the conclusions and recommendations of mentioned research related to 1995-2004 practice require certain corrections. Therefore,

considering new reality, it is possible to develop legislative and practical measures that would enable the state to eradicate sector-specific violations and maximize transfers to the state budget from tobacco industry.