

TOBACCO PRODUCTS TAXATION POLICY

National Center for Disease
Control and Public Health



Ministry of Labour, Health
And Social Affairs of Georgia

The Union

International Union Against
Tuberculosis and Lung Disease
Health solutions for the poor

Preamble

Tobacco Products Taxation Policy Document has been prepared in the framework of the project *“Building Supportive Environment for the Enforcement of Effective Tobacco Control Tax and Price Measures in Georgia”*, supported by the International Union Against Tuberculosis and Lung Disease, Inc (The Union – North America) and World Lung Foundation with financial assistance from the Bloomberg Philanthropies.

The project has been implemented in close collaboration with the Ministry of Labor, Health and Social Affairs, the Ministry of Finance and the Committee of Health and Social Affairs of the Parliament of Georgia.

The project has been in line with the WHO FCTC Article # 6 ‘Price and Tax Measures to Reduce the Demand for Tobacco’. The goal of the project was to develop effective tax and price policy document on tobacco products, submission of the document to the Ministry of Finance and build supportive environment for its adoption. The project considered working with partner organizations, stakeholders, media and civil sector to raise the need for an effective taxation policy and building supportive environment for changes in the legislation to be in consistent with the WHO FCTC requirements. Tobacco Products Taxation policy document has undergone the International expertise.

The preparation of the document has been made possible through the support of the multi-sectorial working group members including representatives of the Ministries of Labor, Health and Social Affairs; Finance; Agriculture, Revenue Service of Customs Department, Office of State Minister of Georgia on European and Euro-Atlantic Integration, World Bank, WHO, Non-Governmental Organizations, local and International Independent Experts.

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1. Introduction (Situation Analysis)

1.1 Prevalence of Tobacco Consumption

1.3 million people over the age of 15 around the world are tobacco dependent. The highest smoking rates persist in low and middle-income countries. Globally, tobacco use has taken the lives of 100 million people in the 20th century, and tobacco-related deaths will number around 1 billion in the 21st century if current smoking patterns continue. If governments do not implement effective policies to prevent tobacco use, the number of deaths caused by tobacco-related diseases will increase to up to 8 million people annually by 2030 (World Health Organization, 2015)

Georgia is one of the “top” smoking countries in the European region. The STEPS survey conducted in Georgia in 2010 by the World Health Organization demonstrated that, at present, 30.3% of the adult population (55.5% men and 4.8% women) are users of some kind of tobacco products (smoking tobacco and smokeless tobacco), which surpasses by 8% the average world rate, and by 2% the average European rate. The survey also revealed that 40% of adult smokers have had unsuccessful attempts at quitting smoking (NCDC¹, 2010).

The prevalence of smoking among adolescents is alarmingly high. In 2008, the smoking rate among 16 year-old smokers was 16%. Among them, 12% were regular smokers and 1.1% of adolescents consume 20 or more cigarettes per day. Buying cigarettes is not a problem for 60% of those studied. 30% began using tobacco products at the age of 13 and earlier, and 10% of the subjects began at the age of 9 and earlier. 87% of adolescents say that they have a friend that is a smoker (ESPAD² 2009; GYTS³ 2008). According to the last survey held in 2014, 12.3% of 13-15 year-old teenagers were consumers of tobacco products, among them 16.5% were boys and 7.8% were girls (GYTS, 2014).

The non-smoking population, including more than 40% of children, are exposed to secondhand smoke daily (ESPAD 2009; GYTS 2008, 2014; Berg⁴ 2014), and 77% of Georgians easily buy tobacco products at points of sale (GYTS, 2014).

1.2 Impact on Health and Burden

Tobacco use is one of the most acute public health problems in the world. Tobacco consumption is the number one risk factor for lung cancer and other cancers, strokes, heart attacks and other cardiovascular diseases like chronic obstructive pulmonary disease (COPD). It is also associated with infertility, congenital abnormalities, chronic diseases, and other severe health problems (US Health and Human Service Department⁵ 2014). The cost of treatment for such diseases represents the direct economic burden that tobacco poses, which is very high.

The global tobacco epidemic kills nearly 6 million people each year, and over 600,000 non-smokers die from exposure to secondhand smoke. Around 80% of those people are residents of low and middle-income

¹ Non-communicable Diseases Risk-factors Survey STEPS 2010

² European School Project on Alcohol and Other Drugs 2009

³ Global Youth Tobacco Survey 2008

⁴ Berg C. et al. (2014) Reactions on partial tobacco free policies in Tbilisi: PHD Study. Atlanta, USA: USA Emory University, NCDC, Tbilisi State University

⁵ US Health and Human Service Department (2014). Impact of smoking on Health: 50 years of progress.

countries. Half of smokers die from diseases caused by tobacco use. Smokers lose on average, 15 years of life. (World Health Organization⁶, 2015)

Tobacco consumption in Georgia causes 9,000 to 11,000 deaths annually (G. Bakhturidze⁷, 2008). Thus, tobacco use represents an important demographic problem in the country as well. Besides mortality, the indirect impact of tobacco-use is also significant, and entails lost years of life, a decrease in working ability and performance caused by diseases. These losses are both economic and social in character. Aside from the above-mentioned significant health and life risks, tobacco also impacts the environment, and contributes to the incidence of fires and soil depletion. (Shaphei⁸, 2009; John⁹, 2013).

Economically, tobacco consumption creates catastrophic expenses for the economies of all states. These expenses are especially pronounced for developing countries. A direct annual damage to the world economy caused by tobacco-use is around 500 billion USD: 96 billion USD per year in the United States, 7 billion USD per year in Germany, and 1 billion USD per year in Australia (Shaphei, 2009). A similar rate cannot be calculated in Georgia due to the lack of basic statistics. However, taking into account the smoking prevalence in Georgia, the exposure to second-hand smoke, the fact that 80% of all diseases are those caused by tobacco-use, and the rate of state and family expenses related to health care, it is likely that the annual economic damage tobacco-use causes is very high.

1.3 Public Attitudes

The majority of Georgia's population supports the reinforcement of tobacco control-related measures, including an increase in tobacco taxation. A 2008 survey on public attitudes towards penalty enhancement and the maximum ban of smoking promotion and advertising of tobacco products in public areas, at the workplace, in restaurants and in public transportation, revealed that public support for a tobacco advertising ban was on average 83%. The highest support was found within the age group of 56-70 year-olds where it reached 98.2%. About 88.6%-98.9% of the surveyed non-smokers and ex-smokers support the banning of all kinds of tobacco advertising, as well as 73%-82% of regular smokers (Bakhturidze¹⁰ et al. 2013).

The Public Attitudes Towards Restrictions on Trade of Tobacco Products in Georgia survey published in 2012 similarly demonstrated that the level of public support towards restrictions on tobacco trade (e.g. prohibiting tobacco sales to minors and sales of retail cigarettes, prohibiting the trade of tobacco products in geographically distant areas and in designated sales points, an increase in penalties for any non-compliance with tobacco control laws), is rather high, and on average, constitutes 85.2% (G. Bakhturidze¹¹, et al. 2012).

According to a survey conducted in 2014 (the response on partial tobacco-free policy in Tbilisi), 36% of the population supported price and tax increases on tobacco products, 35% hesitated to answer, and only 29% of survey respondents opposed the price increase policy (Berg, 2014).

⁶ WHO (2015) Report: Global Tobacco Epidemics

⁷ Bakhturidze et al (2008) Tobacco Economics Study in Georgia (pp. 4-22). Tbilisi: State Department of Statistics; Tobacco Control Framework Convention Implementation and Monitoring Center in Georgia

⁸ Shafei O. et al (2009). Tobacco Atlas, third edition. Atlanta: American Cancer Association

⁹ John R., Hall J., (2013). Fire Problem caused by smoking products: USA National Fire Protection Association

¹⁰ Bakhturidze G., Mitelmark M., Aaro L.E., Feikrishvili N. (2013) Attitude of Georgian Citizens towards Smoking Restrictions and Ban of Tobacco Advertisement BMJ doi: 10.1136/bmjopen-2013-003461

¹¹ Bakhturidze et al. (2012). Population Attitude towards Tobacco Sale Bans: In Post-Soviet countries, facts of National Representative Survey in Georgia. *Tobacco Control and Public Health in Eastern Europe* 2(2), 99-108. doi: 10.6084/m9.figshare.97675

1.4 Indirect taxes levied on tobacco products in Georgia

In Georgia, indirect taxes are imposed on tobacco products, (i.e. excise duty and VAT). The standard VAT rate is 18%, and that is payable at the time of the tobacco import, or in the case of local tobacco manufacturing, when the supply to the consumer takes place. Excise duties are payable at the time of import, or in the case of domestic production, at the time it is supplied to the final consumer or upon the goods pickup from the warehouse facility for sales purposes (Tax Code of Georgia).

The so-called combined system of excise duties has been in force in Georgia since 2015, and implies the taxation of tobacco products with both specific excise duties, and *ad valorem* (proportional) excise duties. The rate of specific excise duty does not depend on tobacco price, and is a fixed amount per pack of cigarettes. The rate of *ad valorem* excise duty, applicable from January 2015, represents a proportional rate to be determined with the due account of retail cigarette prices.

Since 2001, the amount of special excise duties in Georgia on both domestic and imported, filtered and unfiltered cigarettes, has changed several times (see Table 1).

Table 1. Excise duties by reference to the time of amendments made to the Tax Code of Georgia (In tetris¹² per pack, i.e. per 20 cigarettes)

	2001	07.2004	01.2005	05.2006	01.2010	09.2013	01.2015	01.2016
Domestic filtered	20		70	40	60	75	90	110
Domestic unfiltered	7	10	15	10	15	20	25	30
Imported filtered	40		90	60		75	90	110
Imported unfiltered	20		25	15		20	25	30

The first considerable increase in excise rates was recorded in 2005, when the rate for domestic filtered cigarettes rose by 250% (from 20 tetri up to 70 tetri), the rate for the domestic unfiltered cigarettes grew by 50% (from 10 tetri up to 15 tetri), the rate for the imported filtered cigarettes grew by 125% (from 40 tetri to 90 tetri) and the rate for imported unfiltered cigarettes grew by 25% (from 20 tetri to 25 tetri). However, the increased rates were only applicable until May 2006. From this period, the excise rates were reduced (from 40 to 10 tetri on domestic cigarettes and from 60 to 15 tetri on imported cigarettes). Supposedly, the growing illicit trafficking of cigarettes to Georgia in 2005 was cited as one of the reasons for the reduction in excise duties. However, this opinion is not evidence-based by any direct study (study about the consumption of smuggled cigarettes by population), only indirect data is available, showing that in 2005 tobacco import and the total supply (hereafter, conventionally referred to as “consumption”¹³) amount was low – 88.6 million packs. In 2006, cigarette consumption immediately increased by 137%, amounting to 209.7 million packs. The increase continued after the reduction of taxes, and in 2007, consumption increased by 58%. If we rely on this data, then such a large increase in tobacco consumption was supposedly due to the fact that the majority of Georgians in 2005 were purchasing smuggled cigarettes. However, it is noteworthy that in 2004 and in previous years, the total amount of registered import and supply was much less than in 2005. So another explanation for the increase that occurred in 2005-2007 is that the administration was advancing and becoming more sophisticated during these years, and consequently, smuggling was decreasing gradually, and product legalization and registration was increasing at the same time. Thus, it would not be correct to say that the scale of smuggling increased in 2005, and moreover to directly connect it to increased

¹² 1 Tetri=1 Georgian Lari (GEL)/100

¹³ Under the term “Tobacco consumption” is considered sum of imported and domestically supplied tobacco. The methodology of calculating the consumption of cigarettes is described in chapter 4.1

taxes. This opinion is backed-up by the fact that excise tax in Georgia compared to Georgia's neighboring countries was still high, and became even higher in subsequent years, but smuggling remained zero. For example, in 2010, despite the increased excise tax, the volume of smuggled cigarettes did not increase, because the level of administration was greatly improved. It is also noteworthy, that tobacco control organizations also relate the reduction of excise taxes in 2006 compared to 2005 with the influence and possible manipulation of the tobacco industry. Until January 2010, imported and locally-produced cigarettes were taxed at different rates in Georgia, with a considerably higher tax burden on imported cigarettes. Starting from 2010, excise rates for locally-produced and imported cigarettes equalized (60 tetri for filtered cigarettes and 15 tetri for unfiltered cigarettes).

The consistent growth in specific excise duty started beginning in January of 2010, when the excise rate was increased by 50% for domestic filtered and unfiltered cigarettes, and equaled the excise duty on imported cigarettes (60 tetri for filtered cigarettes and 15 tetri for unfiltered cigarettes). The following increase in the excise rates took place in 2013, when the rate on filtered cigarettes grew by 25%, on unfiltered cigarettes excise rates increased by 33%. In January of 2015, there was another 20% and 25% increase in the excise rates. This constituted 90 tetri for filtered cigarettes and 25 tetri for unfiltered cigarettes. According to the amendments made to the Tax Code of Georgia, starting from January of 2016, specific excise tax has become 1.1 Lari for filtered cigarettes and 30 tetri for unfiltered cigarettes.

It should be noted that until July 2015 all tobacco products were imposed with specific excise duty only. From July of 2015, alongside the specific excise, *ad valorem* excise duty came into force as well, which constituted 5% of the retail sales price (RSP) of the pack of cigarettes (standard pack of 20 cigarettes) with and without filter (Tax Code of Georgia, Article 188, paragraph 1¹). According to the amendment made to the Tax Code of Georgia, the *ad valorem* excise tax increased up to 10% starting from January 2016. The retail sales price for a pack of cigarettes is determined on the basis of the information about retail sales prices provided by the manufacturer/importer to the tax authorities and any other information collected by the tax authorities. Every year until December 1, all manufacturers and importers submit a list of the RSP of their tobacco products per brand to the tax authorities, and these prices are used by them to calculate the *ad valorem* excise duty for the coming year starting from January 1.

During the last ten years, the total share of excise (both specific and *ad valorem*) on average constituted 35% of the average price of a pack of cigarettes (Table 2). The share of excise in the price of the pack of cigarettes was particularly high in 2005 when excise rates were the highest. In the following periods, the tax burden continued its gradual fall. Only in 2014, when the excise duties were increased did the tax burden increase as well, constituting 32%. However, the indicator of the tax burden remains far below the standard prescribed by the EU directive on the Structure and Rates of Excise Duty Applied to Manufactured Tobacco (requirements of this directive are described in more details below in chapter 2.2.2). As per this EU Directive, the excise duties shall constitute at least 60% of the average weighted retail sales price.

Table 2. Average weighted excise rates and other indicators

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Excise duty¹⁴	0.80	0.54	0.50	0.50	0.50	0.60	0.60	0.60	0.63	0.75
Price per pack¹⁵	1.41	1.41	1.63	1.55	1.50	1.66	1.79	2.01	2.23	2.32
Share of the excise in the price	57%	38%	31%	32%	33%	36%	33%	30%	28%	32%

Source: Calculated as per the data provided by the Ministry of Finance and National Statistics Office of Georgia

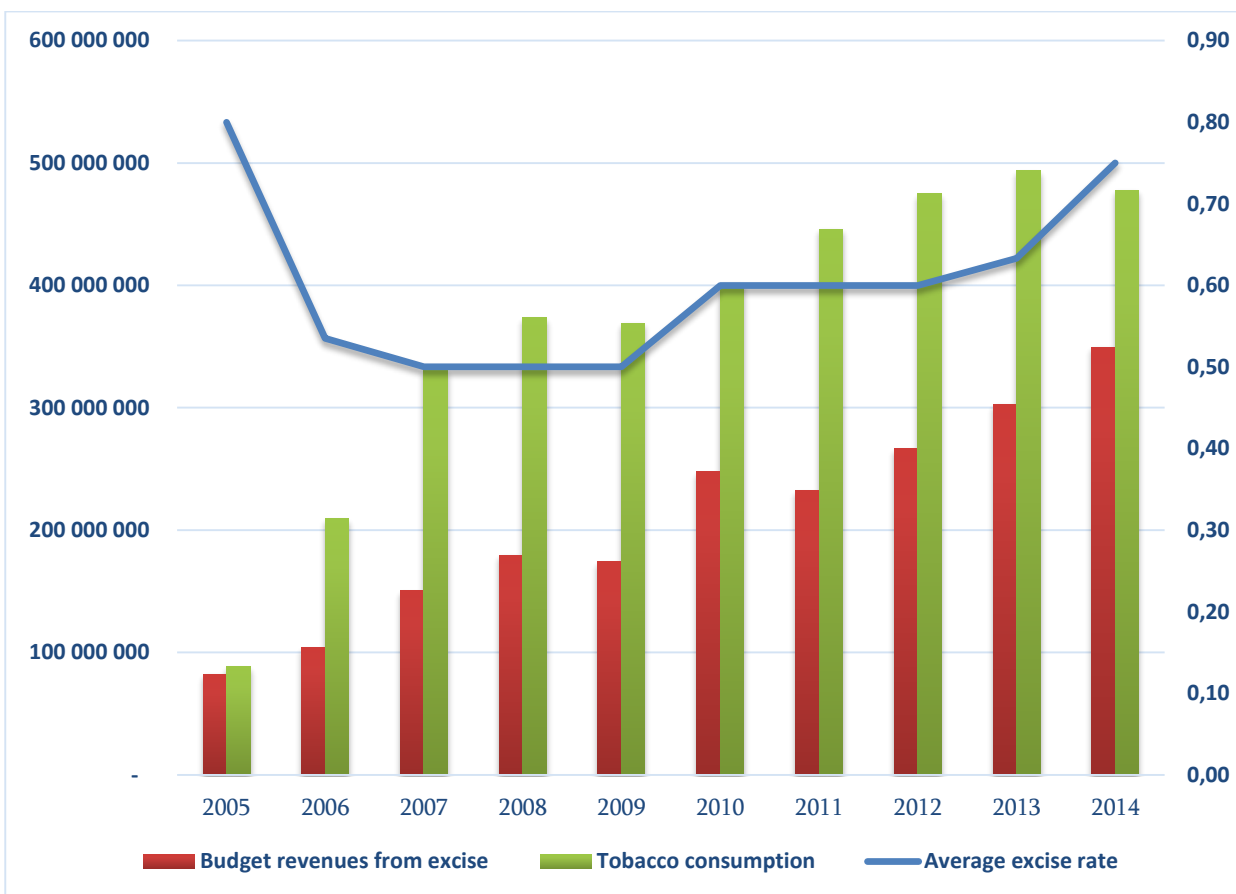
An increase in the excise rates is expected to have a positive impact on the budget revenues derived from tobacco excise. From 2005-2013, there was a 20% increase of tobacco consumption in Georgia), only in 2014 there was a slight decrease. The biggest share of this amount is tobacco consumption inside the country. However, it also includes smuggling in other countries, managing of industry supplies etc. It is also worth considering that in line with the strengthening of administration, tobacco smuggling was decreasing and legalization and registration was increasing. In 2010, an increase in the excise rate increased revenues from tobacco taxes by 42.1%, and in parallel consumption was increased by 8.9% (chart 1)¹⁶. Likewise, in 2013, an increase of excise tax increased budgetary revenues by 13.5%, and consumption continued to increase (4%). In 2014, the excise tax rate was increased by 18.4%, and budgetary revenues increased by 15.4%, while sales were less by 3.2%. Thus, we may come to the conclusion that under otherwise equal conditions, the increase in the excise rates lead to growth of budget revenues.

¹⁴ This figure is a weighted average excise duty- excise rates on imported and domestic filtered cigarettes are weighted by consumption and then averaged.

¹⁵ This figure is a weighted average price - prices of a pack of imported and domestic filtered cigarettes are weighted by consumption and then averaged.

¹⁶ The chart was built based on the data on budget revenues from excise provided by the Ministry of Finance.

Chart 1. Average excise rate (on the right axis, in GEL), budget revenues from tobacco excise (in GEL) and tobacco consumption (in packs)



1.5 Experience of other countries

A number of surveys conducted in different countries of the world confirm that an increase of tax and prices on tobacco products reduces tobacco consumption. In developed countries, an increase of 10% on tobacco prices leads to a reduction of tobacco consumption by 4% on average, while in developing countries – by 5% on average. About one-half of the reduction in tobacco consumption volume falls within ex-smokers who quit smoking due to rising cigarette prices. Another half falls within smokers who chose to reduce the number of cigarettes smoked (IARC, 2011; Orzhekovsky and Walker, 2014; WHO, 2015).

For example, the tobacco tax increased by 350% in the United States from 1990, halved cigarette consumption and reduced the number of smokers by one-third. The increase in tobacco taxation does not only reduce the consumption of tobacco, but also increases budget revenues. According to a survey conducted in the EU, a 10% increase in the real prices, which is a result of the tax increase, causes a 5-7% reduction in tobacco consumption, meanwhile increasing the budget revenue. Similar tendencies are observed in other countries that have implemented similar practices. This is precisely why the World Health Organization (WHO) and the World Bank (WB) consider an increase in tobacco taxes as the most effective and cost-effective method to reduce tobacco consumption, and advise countries to increase taxes on any

tobacco products at least up to 75% of the price (IARC¹⁷, 2011; Orzhekovsky and Walker¹⁸, 2014; WHO, 2015).

According to the European Commission, some EU countries recorded the following data by 1st of July, 2015:

- The lowest average weighted retail sales price of cigarettes was recorded in Bulgaria (2.4 Euros per pack); the highest was in the United Kingdom (9 Euros); and the medium was 4.4 Euros. In new EU member countries, this figure was on average about 2.9 Euros.
- The minimum share of the excise in the average weighted retail sales price of cigarettes was 69.61% (in Luxembourg), and the maximum share was 85.69% (in the UK). Average share in the EU countries was 79.6%. In new EU Member States this figure was on average 79.8%.
- Bulgaria recorded the lowest excise duty per pack of cigarettes at 1.5 Euros. The highest excise was found in Ireland at 5.8 Euros. The EU country average is 2.5 Euros, and in new EU Member States it hovers around 1.8 Euros on average.

In new EU member states, the increase of tobacco tax started from 2004, and the minimum requirements were met within 3-4 years. As to the requirement of a minimum 64 Euros per 1000 cigarettes, these countries met this target after a short while, i.e. in 2010.

The increase of excise duty in these countries has impacted tobacco consumption. In new EU member states (with the exception of Malta and Cyprus), the average tobacco consumption rate per person decreased by 7.6% between 2004 and 2009. Such a moderate reduction in tobacco consumption against the background of a considerable price rise was the result of a personal income growth that took place in simultaneously, which in its turn enhanced the affordability and the accessibility of cigarettes.

As of 2015, Georgia's neighbor countries demonstrate the following data (Krasovsky¹⁹, 2015, WHO, 2015):

- In Turkey the tax per pack of filtered cigarettes amounts on average to 3 GEL and an *ad valorem* excise tax constitute 65%. With prices approximately 2.6 times higher than Georgia, smoking prevalence decreased from 33% in 2008, to 27.1% in 2012.
- In Russia, the excise duty per pack of filtered cigarettes amounts to 1 GEL and shall increase by up to 80% by 2018. Currently, cigarette prices are 17% higher compared to Georgia. In 2010, smoking prevalence in Russia was 39%.
- In Azerbaijan the official excise duty on cigarettes equals 0.2 GEL, but the prices are 40% higher compared to Georgia. In 2013, smoking prevalence in Azerbaijan was 23.5%.
- In Armenia the excise duty equals 0.5 GEL with the prices 20% lower compared to Georgia. Armenia is planning a considerable increase in excise duty. In 2010, the estimated smoking prevalence in Armenia was 29%.

An eight-fold increase in the tobacco excise rates during the period of 2008-2012 was demonstrated in Ukraine, the country Georgia imports 80% of its tobacco. At the same time, there was a seven-fold increase in the budget revenues from tobacco taxes in Ukraine. The portion of excise duty in the average retail sales price per pack of cigarettes increased from 19% (in 2008) up to 45% (in 2012). The portion of all the taxes on tobacco constitutes 59% of the retail sales price. The number of smokers aged over 12 year- old has decreased by 1.75 million i.e. by 17% between 2008 and 2012.

¹⁷ IARC. (2011). effectiveness of tax and price measures for tobacco control. *IARC handbooks of cancer prevention*, 14.

¹⁸ Orzhechvsky & Walker (2014). Burden of Tobacco Taxes. Historic Compilation, 49

¹⁹ Krasovsky K. (2015). Tobacco Excise Taxes in Georgia: 2015. Kiev

1.6 Accession to the Protocol to Eliminate Illicit Trade in Tobacco Products and the introduction of a licensing system to maximize the impact of the taxation policy

1.6.1 Overview of Protocol to Eliminate Illicit Trade in Tobacco Products

In order to maximize the effect of the proposed tobacco taxation policy on the national level, it is important to consider and rule out other aspects such as illicit trade in tobacco. The illicit tobacco trade offers products at lower prices, primarily by avoiding government taxes through smuggling, illegal manufacturing and counterfeiting. Cheaper tobacco encourages younger tobacco users (who generally have lower incomes) and cuts government revenues, reducing the resources available for socioeconomic development, especially in low-income countries that depend heavily on consumption taxes. This money might otherwise be spent on the provision of public services, including healthcare. According to WHO, the elimination of illicit trade in tobacco products “would generate an annual tax windfall of USD \$31 billion for governments, improve public health, help cut crime, and curb an important revenue source for the tobacco industry.”

WHO FCTC has a unique legal instrument to counter, and eventually eliminate illicit trade in tobacco products in the form of the Protocol to Eliminate Illicit trade in Tobacco Products. If fully implemented, it will replenish government revenues and allow more spending on health.

The protocol is an international treaty in its own right negotiated by parties of the WHO Framework Convention on Tobacco Control (WHO FCTC), which has been ratified by 180 Parties. Article 15 commits signatories to eliminate all forms of illicit trade in tobacco products. Up to now, the protocol has 15 parties and 54 signatories. It needs to be ratified by at least 40 countries to become international law. Once that happens, the protocol’s provisions on securing the supply chain, enhanced international cooperation and other safeguards will come into force.²⁰

The WHO illicit trade protocol contains three main elements for addressing illicit trade: 1) controlling the supply chain of tobacco products through track-and-trace systems (Articles 6–13); 2) addressing unlawful conduct and criminal offenses through enforcement means such as seizure and disposal of confiscated products (Articles 14–19); and 3) promoting international cooperation through information sharing, mutual administrative and legal assistance, and extradition (Articles 20–31)²¹.

The protocol requires a wide range of measures relating to the tobacco supply chain, including the licensing of imports, exports and the manufacture of tobacco products; the establishment of a tracking and tracing system, and imposing penalty sanctions on those responsible for illicit trade. It would also criminalize illicit production and cross border smuggling.

Although establishing track-and-trace systems has been identified as a central approach for limiting illicit trade, its implementation is not yet widespread. Some countries may not have the resources to support a fully functioning track-and-trace system, or they may have alternative structures already in place. For example, the EU has implemented a substitute computerized system (Excise Movement and Control System), which differs from the standard track-and-trace model, by collecting only limited information in excisable goods, not monitoring duty-paid products, and relaxing the requirement for product markers. Some countries and the EU employ agreements with tobacco companies to limit tax evasion, but evidence suggests that the industry-operated monitoring system is subject to limited transparency, and insufficient tracing capabilities. Turkey is among the countries that have recently implemented track-and-trace systems with noted success (the size of the illicit market has been controlled despite ongoing increases in tobacco taxes in the country).

²⁰ <http://www.who.int/fctc/protocol/about/en/>

²¹ <http://www.cdc.gov/mmwr/preview/mmwrhtml/mm6420a3.htm>

“The protocol faces overt and covert resistance from the tobacco industry,” says Dr Vera da Costa e Silva, Head of the WHO FCTC Secretariat. “Manufacturers know that once implemented, it will become much harder to hook young people and the poor into tobacco addiction.”

While publicly stating its support for action against the illicit trade, the tobacco industry’s behind-the-scenes behavior has been very different. Internal industry documents released as a result of court cases demonstrate that the tobacco industry has actively fostered the illicit trade globally. It also works to block implementation of tobacco control measures, like tax increases and pictorial health warnings, by arguing they will fuel the illicit trade. Policymakers should recognize that the illicit tobacco trade exacerbates the global health epidemic, and has serious security implications. Ratification of the Protocol to Eliminate the Illicit Trade in Tobacco Products is a necessary step to combat these twin evils.

According to the WHO FCTC Joint Needs Assessment Report 2013, there is a track and trace system in place in Georgia. Tax stamps are affixed in the factory for both domestic production and imports. This stamp shows the country of manufacture, and the bar code on each pack includes the code for the destination country, although it is not written on the package. Both the Customs and the Revenue Office are able to track cigarettes from production or import to final sale. Georgia is a member of the World Customs Organization (WCO). Harmonization of national legislation with the European Union is in process. Therefore, Georgia is well positioned to have the capacity to fulfill all requirements under the protocol, and prevent illicit trade in tobacco products for maximizing the effect of the tobacco taxation policy document.

An overview of the measures against the illicit trade in tobacco products with the identified needs, is given in Table 3 below.

Table 3. Overview of the measures taken against illicit trade in tobacco products in Georgia

Paragraph in Art. 15	Content	Level of compliance	Comments and identified gaps
2	Each Party shall adopt and implement effective legislative, executive, administrative or other measures to ensure that all unit packets and packages of tobacco products and any outside packaging of such products are marked to assist parties in determining the origin of tobacco products.	OBLIGATION MET	According to the Tax Code, all domestically-produced and imported cigarettes must have excise stamps that indicate the country of origin by the code.
2(a) and 3	Require that unit packets and packages of tobacco products for retail and wholesale use that are sold on its domestic market carry the statement: “ <i>Sales only allowed in (insert name of the country, subnational, regional or federal unit)</i> ” or carry any other effective marking indicating the final destination or which would assist authorities in determining whether the product is legally for sale on the domestic market.	OBLIGATION MET	The bar code on every pack of cigarettes indicates the country of sale, so this can be determined. However, it is not written in plain text.
2(b) and 3	Consider as appropriate, developing a practical tracking and tracing regime that would further secure the distribution system and assist in the investigation of illicit trade.	OBLIGATION MET	The machine readable stamp system is an effective way to track and trace production and imports.

4(a)	Monitor and collect data on cross-border trade in tobacco products, including illicit trade, and exchange information among customs, tax and other authorities, as appropriate, and in accordance with national law and relevant applicable bilateral or multilateral agreements.	OBLIGATION MET	Data on cross-border trade in tobacco products is collected and can be shared with the relevant ministries.
4(b)	Enact or strengthen legislation, with appropriate penalties and remedies, against illicit trade in tobacco products, including counterfeit and contraband cigarettes.	OBLIGATION MET	It is under the Tax Code and Criminal Offence Code.
4(c)	Take the appropriate steps to ensure that all confiscated manufacturing equipment, counterfeit and contraband cigarettes and other tobacco products are destroyed, using environmentally-friendly methods where feasible, or disposed of in accordance with national law.	OBLIGATION PARCIALLY MET	Illicit manufacturing equipment, counterfeit and contraband cigarettes and other tobacco products are confiscated and destroyed. But the Ministry of Environment and National Resources Protection has not established environmentally-friendly methods to destroy them.
4(d)	Adopt and implement measures to monitor, document and control the storage and distribution of tobacco products held or moving under suspension of taxes or duties within its jurisdiction.	OBLIGATION MET	
4(e)	Adopt measures as appropriate to enable the confiscation of proceeds derived from the illicit trade in tobacco products.	OBLIGATION NOT MET	There is no such provision in the current legislation.
5	Information collected pursuant to subparagraphs 4(a) and 4(d) of this Article shall, as appropriate, be provided in aggregate form by the Parties in their periodic reports to the COP, in accordance with Article 21.	NOT IMPLEMENTED	Information on illicit trade in tobacco products was not reported in both the two-year and five-year implementation reports submitted by Georgia.
6	Promote cooperation between national agencies, as well as the relevant regional and international intergovernmental organizations as it relates to investigations, prosecutions and proceedings, with a view to eliminating illicit trade in tobacco products. Special emphasis shall be placed on cooperation at regional and sub-regional levels to combat the illicit trade of tobacco products.	OBLIGATION MET	Georgia is a Member of the WCO.
7	Each Party shall endeavour to adopt and implement further measures including licensing, where appropriate, to control or regulate the production and distribution of tobacco products in order to prevent illicit trade.	OBLIGATION NOT MET	Currently there is no licensing to regulate or control the production, importation, distribution and sale of tobacco products in Georgia.

1.6.2 Overview of licensing on tobacco products

A license is a permission issued by a competent authority following the submission of an application and/or other documentation. Governments can require participants throughout the supply chain (e.g., tobacco growers, manufacturers, distributors, wholesalers, retailers) to be licensed, imposing obligations or restriction on them under the threat of administrative, civil, or criminal penalties.

The overriding rationale for the support of licensing arrangements is that it facilitates the enforcement of a number of tobacco control measures (e.g. prohibitions on sales to minors, mandated point of sale regulations etc.). In this light, licensing is seen as a way of: 1) reinforcing the understanding that selling tobacco is a privilege, not a right; 2) providing health authorities with the addresses of sellers, thus facilitating monitoring of their compliance with tobacco control laws, and enabling authorities to communicate directly with the tobacco seller (i.e. to inform them of changes to the law etc.); 3) providing a regulatory mechanism that allows conditions to be placed upon the manner in which sales are made and a mechanism by which authority to sell can be revoked).

Linking licensing systems with record-keeping, tax stamps/markings, and tracking and tracing systems makes it more effective for reducing the quantity of contraband cigarettes sold in formal retail outlets. Background checks, enhanced enforcement, and zero tolerance also make licensing more effective.

In Georgia regulation of tobacco products started towards the end of the 1990s. The first regulatory document was issued in 1998 by the decree of the President of Georgia of June 28 #391 “Measures to regulate tobacco products production, import, wholesale and retail in Georgia”²²

This decree introduced mandatory licensing on the production, import and wholesale of tobacco products. The license for the production was issued by the agencies of the Ministry of Agriculture and Food of Georgia, and the license for import and wholesale was issued by the then Trade and Foreign Economic Relations Ministry of Georgia. At the same time, the regulations of tobacco products design were defined – namely, the information about the product had to be displayed in Georgian and had to include the following: the list and amount of ingredients harmful to human health; the date of issue and expiration date; text about the harmfulness of tobacco smoking – “Ministry of Health of Georgia is warning you that smoking is harmful for your health”. It was also necessary to indicate health warnings such as “smoking causes cancer”, “smoking causes premature death”, “smoking during pregnancy endangers the health of the embryo” and so on. Since this decree was enacted and up until 2010, only one type of health warning was displayed on tobacco packs: “smoking during pregnancy endangers the health of the embryo”.

The decree also prohibited tobacco sales on school grounds, or any area where there were childcare, or medical facilities. It was also prohibited to sell tobacco products in the dining rooms of education and medical facilities without indicating exact stamps and producers. In addition, the sale of tobacco products that have reached their expiration dates was prohibited, as well as the sale of tobacco to minors under the age of 18. However, these norms were not followed by change surveillance was not implemented. The decree was annulated on September 29, 2006. The Law on Food and Tobacco²³ was adopted on June 25, 1999. The goal and objectives of the law was to promote the provision of quality tobacco for consumers; to protect consumers’ health and the consumer market from harmful and falsified products; to define general requirements and restrictions, qualitative indicators and the characteristics of tobacco, and identify the role of state bodies in this area. The term “quality tobacco” is a misnomer in itself because this is a product that kills at least half of its consumers when it is used according to its intended purpose. In international practice, the established term is not quality, but compliance to standards. According to the aforementioned law, it is

²² <https://matsne.gov.ge/ka/document/view/1239546>

²³ <https://matsne.gov.ge/ka/document/view/11938>

prohibited to produce, store, transport and sell falsified food and tobacco products. Tobacco is considered to be falsified if its composition, characteristics, assortment and source do not meet established requirements or information on the attached documents and labels.

The Georgian Ministry of Health was entrusted to define the maximum permissible levels of toxic compounds (nicotine and tar in tobacco smoke), which was defined, but its check was almost never performed. In 2005, the law was suspended, and on December 29, 2010 it was cancelled.

In 2003 the Law on Licensing of Production of Food and Tobacco Products was adopted. According to this law, licensing was required for tobacco processing and/or packaging. Unfortunately, this law was canceled on December 28, 2005.²⁴

On June 24, 2005, a new law was adopted – “about licensing and permissions”. In it, the activities that require licensing or permissions did not include activities related to tobacco production, import or wholesale.²⁵ In 2005, the Standardization Department was eligible for the control of the composition of tobacco products and was liquidated. In the same year, tobacco was not included in the Ministry of Agriculture’s regulation area, and consequently, the control of raw tobacco composition was canceled. Certification became voluntary, and as a result, there was a full deregulation of products that were harmful to people’s health.

On May 15, 2006, the WHO FCTC went into force in Georgia²⁶. Its articles 15 and 7 oblige parties to the convention to implement the appropriate measures, including licensing to control or regulate the production and distribution of tobacco products in order to prevent illicit trade in tobacco products.

Unfortunately, 10 years after the convention was ratified, this issue has not been moved forward in Georgia, despite the fact that in 2008 and 2013, the relevant legislative initiatives were prepared. This issue is also mentioned in the Government Decrees #196 of July 30, 2013 and #304 of November 29, 2013. Up till now, Georgia has not made any progress in terms of regulating tobacco production – import or wholesale – and does not meet the obligations under the Convention, which is considered as one of the most effective measures in preventing illicit trade in tobacco products.

1.6.3 Conclusion

It is recommended that Georgia reintroduce licensing to control or regulate the production and distribution of tobacco products in order to eliminate illicit trade. It is further recommended that Georgia become a signatory to the Protocol to Eliminate Illicit Trade in Tobacco Products, followed by accession, and promote international, bilateral and multilateral cooperation to curb illicit trade in tobacco products.

²⁴ <http://matsne.gov.ge/ka/document/view/14812>

²⁵ <http://matsne.gov.ge/ka/document/view/26824>

²⁶ WHO Framework Convention on Tobacco Control www.fctc.org.ge

2. Legal framework for tobacco taxation policy in Georgia

2.1 National Legislation

In 2013, the Government of Georgia adopted two decrees laying out the main directions for tobacco control in the country. The government adopted decree № 196 on the Approval of Tobacco Control National Strategy on 30 July, 2013. This decree stipulates concrete, measurable objectives for the national strategy, and action plan, as well as the tobacco tariff and tax measures on tobacco products that have been set forth. More specifically, according to Article 3.1 of the Decree:

“The policy on accessibility to tobacco products shall comply with achieving the healthcare objectives aimed at the reduction of tobacco consumption, and for the same purposes, additional research and analysis will be carried out with regard to the possibilities for the gradual increase of taxes on tobacco products, and optimal approaches will be elaborated and implemented in consideration of the convention and the interests of the country.”

On November 29, 2013, the National Action Plan on Tobacco Control was adopted for the purposes of implementing the National Strategy according to the Decree №196 of the government of Georgia. Article 2 of this Action Plan sets forth concrete measures of the taxation of tobacco products. The consistent and gradual increase of taxes on all types of tobacco products are determined in an effort to increase the percentage of ex-smokers, and those intending to quit smoking (from the current 40% to 50%), to reduce the percentage of young people purchasing cigarettes for personal use (from the current 60% to 20%), which is not less than the annual inflation rate. The action plan also considers the ban on the tax-free import of any amounts exceeding 10 packs of cigarettes, 10 cigars or cigarillos by individuals for their personal use.

2.2. International Obligations

2.2.1. Framework Convention on Tobacco Control

In December 2005, the Parliament of Georgia ratified the WHO Framework Convention on Tobacco Control (FCTC) that came into force in the country starting May 15, 2006. The convention determines the tariff rates and taxes on tobacco products. More precisely, according to Article 6 of the FCTC, countries shall implement the taxation – and where applicable – the pricing policy, in order to reduce tobacco consumption (UNO²⁷, 21 May, 2003). The corresponding guideline of this article put forth recommendations and the implementation principles for the country’s tobacco taxation policy (WHO²⁸, 16 October 2014).

As per the guidelines, the key principles of the country taxation policy on tobacco products consist of the sovereign rights of the parties, aim and efficiency of the policy (reduction of tobacco consumption), public health needs and the protection of the tobacco industry from commercial or other interests.

The guidelines provide the parties with clear recommendations for effective taxation policy, in particular:

²⁷ https://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IX-4&chapter=9&lang=en

²⁸ http://www.who.int/fctc/treaty_instruments/Guidelines_article_6.pdf

1. When determining tax rates, the following should be taken into account among other things – both price elasticity and income elasticity of demand, inflation, household income, regular updates and regular tariff revaluation procedures.
2. Parties should implement the simplest and the most efficient system, including specific or combined excise taxes, and determine a tax floor.
3. Parties should develop a consistent long-term policy on their tobacco taxation structure, and carry out complex monitoring on a regular basis.
4. All tobacco products should be taxed as appropriate, in order to minimize the risks of substitution and shifting to cheaper tobacco products.
5. Parties should ensure that transparent licence or equivalent systems are in place.
6. Parties are urged to ensure the systems of storage to facilitate excise controls on tobacco products. Tax payments should be required by law to be remitted at fixed intervals, or on a fixed date each month, and should ideally include the reporting of production and/or sales volumes, and price by brands, taxes due and paid, and other characteristics. If possible, this information should be public, taking into account confidentiality rules in accordance with national law.
7. In anticipation of the tax increases, parties should consider imposing effective anti-forestalling measures.
8. Parties should consider requiring the application of fiscal markings.
9. Parties should clearly define tax enforcement authorities. Parties should also provide an appropriate system of penalties for tax avoidance.
10. Parties should direct income towards tobacco control programmes in accordance with the legislation.
11. Parties should consider prohibiting or restricting the sale to and/or importation by international travellers, of tax-free tobacco products.

2.2.2 EU-Georgia Association Agreement

On June 27, 2013, the European Union and the European Atomic Energy Community and their member states, on the one side, and Georgia, on the other side, concluded the Association Agreement, which includes Deep and Comprehensive Free Trade Area (DCFTA) components (Government of Georgia²⁹, EU, 27 June, 2013)

The Georgian Parliament ratified the Agreement on July 17, 2014. The ratification process is currently continuing in EU member states. The agreement shall come into force upon completion of all ratification procedures.

Therewith, from 1 September 2014, a major part of the Association Agreement came into force, including some part of the Deep and Comprehensive Free Trade Area (DCFTA).

The Association Agreement sets forth the framework for cooperation between the parties on tobacco control enhancement measures, and the harmonization of their laws in this field.

In particular Article 283 reads:

“The Parties shall develop their cooperation and harmonise policies in counteracting and fighting fraud and smuggling of excisable products. This cooperation will include, inter alia, the gradual approximation of

²⁹ Gov. of Georgia, European Union (June 27, 2013). Agreement between Georgia and EU on the Association Agreement; Brussels

excise rates on tobacco products, as far as possible, taking into account the constraints of the regional context, and in line with the World Health Organisation Framework Convention on Tobacco Control. To that end, the Parties will look to strengthen their cooperation within the regional context.

Article 356 of the agreement reads as follows:

“(c) prevention and control of non-communicable diseases, mainly through the exchange of information and best practices, promoting healthy lifestyles, physical activity, and addressing major health determinants, such as nutrition, addiction to alcohol, drugs and tobacco;

(f) effective implementation of international health agreements to which the Parties are party, in particular the International Health Regulations and the Framework Convention on Tobacco Control.”

Upon signing the above agreement, the government of Georgia is committed to implementing Directive 2011/64/EU³⁰ of June 21, 2011 on the Structure and Rates of Excise Duty Applied to Manufactured Tobacco (Council of Europe, 21 June 2011) within five years from the agreement’s effective date, but with the exception of articles 7(2), 8, 9, 10, 11, 12, 14(1), 14(2), 14(4), 18 and 19.

As to the latter articles, the country commits to submit within one year from the Association Agreement’s effective date, their respective implementation plan and schedule, including considerations of Georgia’s needs regarding the fight against smuggling and protection of income.

The Directive articles to be implemented within 5 years from the agreement effective date, largely comprise of the terminology and classification of tobacco products; these articles for which Implementation Plan and schedule has to be presented and agreed, determine the following:

- both types of the excise duties shall be the same for all types of cigarettes, and represent at least 60% of the weighted average retail sales price of cigarettes released for consumption. That excise duty shall not be less than EUR 90 per 1, 000 cigarettes. The excise tax may or may not include any customs fees and VAT;
- For cigars or cigarillos, excise duty shall be 5% of the retail sales price or EUR 12 per 1,000 pieces or per kilogram;
- From January 1, 2015, the excise duty on tobacco intended for the rolling of cigarettes shall represent at least 46% of the weighted average retail sales price, or at least EUR 54 per kilogram. From January 1, 2018, it shall be at least 48% of the retail sales price, or at least EUR 60 per kilogram, and from January 1, 2020, - at least 50% of the retail sale price or at least EUR 60 per kilogram;
- For other types of smoking tobaccos, the excise duty shall be 20% of the retail sales price, or EUR 22 per kilogram.

Moreover, within three years from the agreement’s effective date, Georgia shall implement the Council Directive 2007/74/EC of December 20, 2007 On the Exemption from Value Added Tax and Excise Duty of Goods Imported by Travelers from Third Countries (Council of Europe³¹, December 20, 2007).

The government of Georgia is implementing the association agenda and the Association Agreement based on the National Action Plan. In June of 2014, Georgia and the EU agreed on the terms of the association agenda, thereby setting priorities for the implementation of their obligations prescribed by the Deep and

³⁰ European Commission (21 June, 2011). Directive #2011/64/EU

³¹ European Commission (December 20, 2007) Directive #2007/74/EU

Comprehensive Free Trade Area (DCFTA) components and the EU-Georgia Association Agreement for the years 2014-2016.

The aforementioned agreement of 2014-2016, *inter alia*, insofar as it refers to taxation issues, provides for the measures that mitigate against excise goods smuggling and fraud, and counter measures in response for the same. In compliance with this document, the country developed the National Action Plan for 2015 that duly provides for the gradual increase of tobacco products excise rates, and their approximation to the rates prescribed by EU standards (obligations in Article 285), and the implementation of the measures set forth in the National Action Plan for 2013-2018 on tobacco control in Georgia (obligations listed in clause “f” of Article 356) (Government of Georgia³², 26 January 2015).

3. Tobacco Products Taxation Policy

The proposed tobacco taxation policy in the focus of this document aims to reduce tobacco consumption by increasing tobacco tax, which in turn will result in the reduction of tobacco-associated morbidity and mortality rates in Georgia. At the same time, it aims to increase the country’s budget revenues. The increased budget revenue will enable the financing of anti-tobacco activities, and the ability to carry out general healthcare projects.

By signing the Association Agreement, Georgia has committed to implementing the EU Directive on the Structure and Rates of Excise Duty Applied on Manufactured Tobacco. In accordance with Article 10 of the same directive, the excise duty on cigarettes shall constitute at least 60% of the average weighted retail price, but not less than 90 Euros per 1,000 cigarettes. Accordingly, this indicator represents the target the country shall reach within a specified period of time (the duration of which is based on the implementation plan of this article, which is still to be determined).

Moreover, Decree №196 of the Government of Georgia on Approval of Tobacco Control National Strategy (Government of Georgia, July 30, 2013) provides that the tobacco consumption among the adult population shall be reduced by 2% annually.

This model was adopted with due account of the above two targets and is based on certain assumptions.

³² Gov. of Georgia (26 January 2015) Order #59

4. The Model Policy for the Taxation of the Tobacco Products

4.1 Assumptions

The model is designed considering the assumptions made regarding tobacco consumption, tobacco prices, smuggling, economic variables, and the price and non-price-related factors influencing tobacco consumption.

TOBACCO CONSUMPTION, PRICES AND EXCISE

Coming from the fact that statistical information about the consumption of cigarettes varies considerably depending on the studies, we used volumes of imported tobacco and volumes of domestically-produced tobacco which was supplied to the consumer to derive the amount of consumed cigarettes. We conventionally assumed that total consumption of tobacco is the sum of imported and domestic cigarettes that have been subject to excise tax. This indicator may not reflect the real number of consumed cigarettes, because it contains the entire volume of imported cigarettes. It also does not consider the stocks of the companies. In addition, this indicator includes the number of consumed cigarettes by foreigners (tourists), and does not account for cigarette smuggling (from Georgia). If all above-mentioned factors were considered, tobacco consumption figures could have been less. However, we believe that under the current conditions, it is the best indicator to estimate consumption³³.

Based on the statistical information on the purchased stamps, we may say that the share of the stamps purchased for unfiltered cigarettes constituted an average of 0.3% of the total volume of purchased stamps in 2013. In 2014, this share was 0.4%, and for January 2015 to August 2015 it was 0.5%. Subsequently, it can be assumed that the ratio of unfiltered cigarettes in the total quantity of imported cigarettes is so insignificant, that it could be neglected. In other words, we may conclude that only filtered cigarettes are imported to Georgia.

As for the locally produced-filtered cigarettes, its volume was estimated based on the information provided in the excise tax declarations. As we know, locally-produced cigarettes are imposed with excise duty at the time of supply to the final consumer or upon the goods pickup from the warehouse facility for sales purposes. From the total excise tax due (the third line of the third unit in the excise tax declaration), we allocated the share to the filtered cigarettes (based on the share of stamps purchased for filtered cigarettes). By dividing this number (excise tax due on filtered cigarettes) by the excise rate of the relevant period, we came up with the amount of domestically-produced filtered cigarettes.

The tobacco consumption data calculated with this methodology exceeds by 3, 4, 5 and in certain years, six-times the data provided by the National Statistics Office. Thereby, the yearly data of tobacco consumption looks like the following:

³³ Everywhere the calculation/prognoses about tobacco consumption statistics are provided, under the consumption sum of volumes of imported and local cigarettes is assumed and not the real volume of consumed cigarettes

Table 4. Tobacco consumption (packs) in Georgia; 2005-2014

Year	Tobacco consumption (number of packs)
2005	88,607,207
2006	209,661,228
2007	331,054,423
2008	373,646,783
2009	369,190,643
2010	401,883,056
2011	445,932,710
2012	475,016,220
2013	493,942,458
2014	478,062,256

The data on the retail sales prices of the filtered tobacco were provided by the National Statistics Office. The prices were individually determined for local, as well as imported filtered cigarettes. For the purposes of calculating the average retail sales price, we weighted the given prices by the share of consumption of the local and imported tobacco in the total consumption. The average retail sales price for the year 2015 was calculated based on the data of the retail sales prices established by the Ministry of Finance, and in accordance with paragraph 1¹ of Article 188 of the Tax Code of Georgia. In particular, the average retail sales price for 2015 is the average of the prices of the filter cigarettes given in the list.

Average excise rates were derived by weighting excise rates on imported and locally-produced tobaccos by consumption. It is also assumed that rate of the *ad valorem* excise tax will be 10% from 2016 as per the amendment made to the Tax Code of Georgia.

THE EFFECT OF PRICES ON TOBACCO CONSUMPTION

Studies have shown that increases in tobacco excise rates and the corresponding increase in tobacco prices have a negative effect on the level of tobacco consumption. The influence of the tobacco price on tobacco consumption is depicted in the coefficient of elasticity. The tobacco price elasticity coefficient shows the percentage change in tobacco consumption as a result of a 1% increase in the tobacco price. It is obvious that the increase in tobacco prices reduces tobacco consumption. However, generally, tobacco represents a more inelastic product, which means that the consumption of this product decreases by a smaller amount than the price increase (the elasticity coefficient remains a 0:1 interval).

Since, there is no empirically-estimated price elasticity coefficient of tobacco consumption in Georgia, the elasticity coefficient determined for the medium brand cigarette that is recommended in the WHO Tobacco Tax Simulation Model (WHO Tobacco Tax Simulation Model, June 2013) is applied in our model as well. This coefficient is -0.5 and indicates that an average of 1% increase in tobacco price will result in a decrease in tobacco consumption by 0.5% provided that all other factors influencing tobacco consumption remain unchanged.

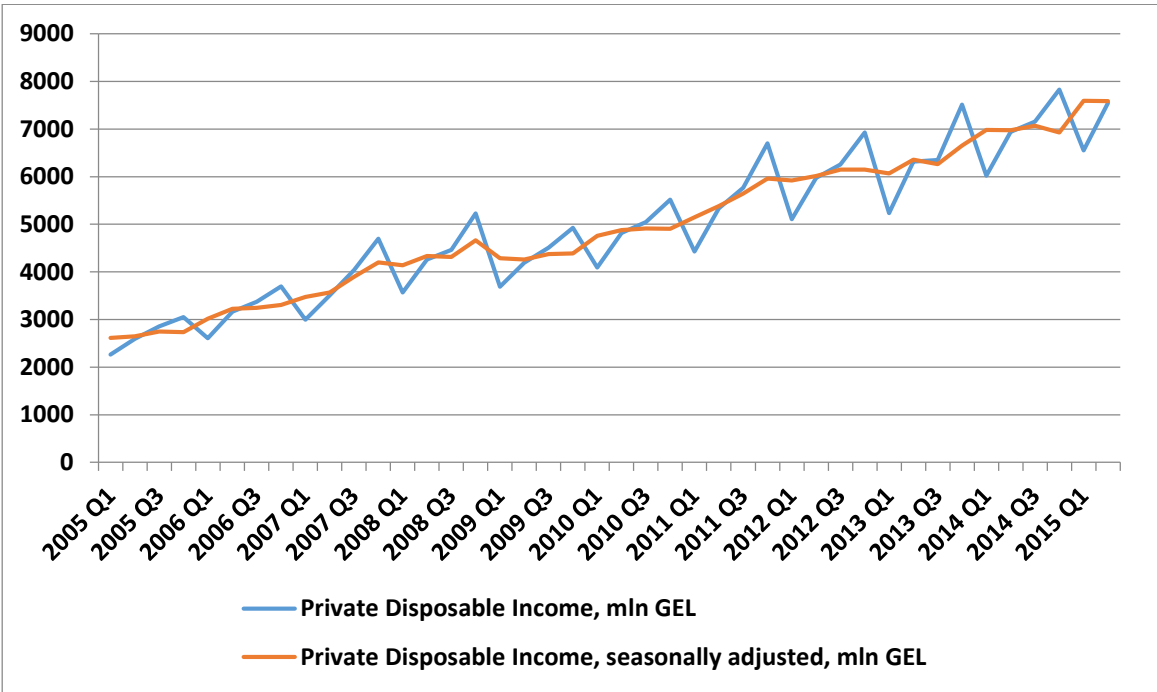
THE EFFECTS OF INCOME ON TOBACCO CONSUMPTION

Tobacco consumption rises alongside increases in consumer income, since higher income allows people to afford more of all products. Private Disposable Income (PDI) is a good indicator of consumer income. The National Statistics Office of Georgia does not publish statistics for PDI. As such, we applied the analytical data of the national accounts, balance of payments and budget retrieved from the MOF, to

calculate the PDI. After, the effect of the increase in PDI on tobacco consumption was estimated by applying the time series regression method. The historical data on tobacco consumption and PDI for the period of 2005-2014, and for the first two quarters of 2015 were available to us. However, regression analysis was conducted on only the quarterly data starting from 2008. The 2005-2007 period was neglected since tobacco consumption in these years was characterized by an unusually high increase (consumption increased by 137% in 2006 compared to 2015, and by 58% in 2007 compared to 2006). The reason for this is likely to be the smuggling of cigarettes that took place in 2005-2006. This period of contraband is obviously not depicted in the statistics, and for this reason consumption is unusually low in 2005. Then it increases in 2006 and 2007 and stabilizes beginning in 2008. Thus, if we consider the data of 2005-2007 in the regression, it would have resulted in a biased coefficient that would have overestimated the effect of PDI on tobacco consumption.

It should be noted that PDI is a seasonal variable like GDP (Gross Domestic Product). The consideration of a seasonal variable in the regression would produce a biased coefficient. Therefore, we corrected PDI by applying the standard method (the so-called central moving average). This is the statistical method that removes the seasonal component from the time series data. Seasonally adjusted PDI is characterized by a relatively smooth growth pattern (Chart 2).

Chart 2. Private Disposable Income before and after seasonal adjustment (2005 Q1-2015 Q2)



Time series regression analysis demonstrated that the quantity of consumed tobacco increases by 0.59% together with the 1% increase in PDI. This coefficient may be slightly overestimated since the quantity of the consumed tobacco packages, which is our dependent variable, was calculated by us, and is the best possible estimate of the true tobacco consumption variable. The results of the model demonstrate that PDI is a statistically important variable (probability that this variable does not affect tobacco consumption is zero). Therefore, it has a real effect on tobacco consumption.

EFFECT OF TAXES ON SALES PRICES AND PRODUCERS' PRICES

This model assumes that a tax increase is directly reflected on the consumer prices. Producers might adapt prices. However, the producer's price depends on the profit maximization plan, and on many other factors that make it technically impossible to consider this in the model. The model also makes the presumption that the producer's price increases with the rate of inflation and real GDP growth.

CIGARETTE SMUGGLING

An excise tax increase could lead to an increase in the import of smuggled cigarettes in the country, which will have a negative effect on budget revenue. A reduction in tobacco consumption as a result of the excise tax increase could be in fact caused by consumers switching to smuggled cigarettes. However, it is impossible to estimate the expected level of smuggling within the scope of the present project since it also depends on other non-price related factors (e.g. tax administration level, existence of organized crime, and the power of tobacco industry). Moreover, the level of smuggling depends on the prices of tobacco in neighboring countries. Since the future policy on tobacco prices in neighboring countries is not available to us, it is impossible to consider the latter in the model. It is equally impossible to consider in the model the level of tobacco export smuggling from Georgia. It is supposed that cigarettes are also smuggled from Georgia to Turkey, but the volume of the smuggling has not been evaluated so far.

Therefore, the model conventionally presumes that there is no smuggling of cigarettes to and/or from Georgia. So, we assume that the level of tobacco consumption in the model depicts reality, and the decrease in consumption is caused by a decreasing quantity of consumed cigarettes.

ECONOMIC VARIABLES

The model is built based upon the forecasts of GDP growth rate, PDI growth rate and inflation (consumer price index, period average) for the time period of 2015-2025. Projections that include 2019 are taken from the Basic Economic and Financial Indicators available on the web-site of the Ministry of Finance as the date of December 2015. The same growth rates are presumed for the following years of 2020-2025 (table 3).

Table 3. Forecasts of economic variables used in the model

Year	PDI growth rate	Real GDP Growth rate	Average annual inflation
2015	7.5%	2.8%	4.0%
2016	8.4%	3.0%	5.5%
2017	10.7%	5.5%	5.0%
2018	9.5%	5.5%	4.5%
2019	9.7%	5.5%	4.0%
2020	9.7%	5.5%	4.0%
2021	9.7%	5.5%	4.0%
2022	9.7%	5.5%	4.0%
2023	9.7%	5.5%	4.0%
2024	9.7%	5.5%	4.0%
2025	9.7%	5.5%	4.0%

It is also presumed that throughout the whole projection period, the official GEL to EUR exchange rate will remain fixed to the average rate of 2015 (1 Euro=2.52 GEL). The average GEL to EUR exchange rate for the year 2015 was calculated based on the data of monthly exchange rates published by the National Bank of Georgia.

4.2 Description of the Model

The model is built based upon the requirements set by the European Union that prescribe total excise duty (specific and ad valorem) on the cigarettes released for consumption to be at least 60% of their average weighted retail price, but at least 90 Euros per 1,000 sticks, i.e. 1.8 Euros per package of cigarette. Considering the above-mentioned assumption about the GEL to EUR exchange rate, total excise duty per pack of cigarettes shall be 4.54 GEL at minimum.

In addition, the Tobacco Control National Strategy envisages that the prevalence of smoking in adults shall decrease by 2% annually. The reduction in smoking prevalence is likely to mean a reduction in the number of smokers (adults). The prediction of smoking prevalence is thus related to demographic projections, which could not have been part of this project. Consequently, instead of the 2% reduction of smoking prevalence, as one of the scenarios in our model, we assumed a decrease of tobacco consumption by 2% annually.

Considering these targets, we have developed four scenarios related to the excise tax increase policy:

1. Increase of total excise tax by equal amounts so that EU requirements are met within five years (in 2020)
2. Increase of total excise tax by equal amounts so that EU requirements are met after within years (in 2025)
3. Assume a fixed growth rate of total excise tax, so that EU requirements are met within ten years (in 2025)
4. Increase of total excise tax to achieve 2% annual reduction in tobacco consumption (10-year plan)

The ultimate goal for the first and second scenarios of the model is to achieve the target of excise share in the average sales price (60%), and the requirement about the minimum excise amount (1.8 Euros per pack). In order to meet EU requirements within 5 years, the total amount of excise by 2020 should comprise a minimum of 4.54 GEL. In order to meet EU requirements after 10 years, the total amount of excise by 2025 should be at least 6.10 GEL.

In both of the above-mentioned scenarios, total excise duty would increase by equal amounts annually. After estimating total excise tax, we calculate tobacco sales prices. The average retail sales price of tobacco is determined annually in the following way: the average producer's price is increased by an average total excise tax and VAT. After calculating the sales price, it is possible to determine the average tobacco consumption by applying price and income elasticities. Furthermore, since the average retail sales price is already determined, the average amounts of VAT, *ad valorem* and specific excise taxes are then calculated. Finally, the average volume of tax revenue is derived.

In the third scenario of the model, the total average excise tax increases by the same rates so that by 2025, we attain the level required by the European Union. Whereas in the fourth scenario, the average sales price of tobacco, as well as the average specific and average *ad valorem* excise taxes are derived by considering an annual 2% decrease in tobacco consumption.

4.3 Model results and challenges

4.3.1 Models results (influence on tobacco consumption and fiscal effects)

The results of the first scenario of the model are provided in Table 4. , Starting from 2016, it is necessary to increase the volume of the total excise (which represents average rate) by 70 Tetris annually, in order to meet the EU requirement by 2020 regarding the share of the total excise in the average retail sales price and a minimum amount of excise tax.

Presuming that this tax increase will be reflected in the consumer prices, the average sales price of one pack of filtered cigarettes will be 7.22 GEL by 2020. Such a price increase is also caused by the continuous, and stable growth of the production price, which was assumed in the model. This excise growth policy scenario will gradually reduce tobacco consumption. However, this reduction will have a decreasing pattern since according to our assumption, PDI grows with a stable high rate, which in turn increases consumption. According to the five-year plan, by 2019 we will reach the EU requirement as it pertains to the minimum share of the total excise in the average retail sales price (61.6%). By 2020, the required level of the minimum total excise will be attained (minimum of 1.8 Euro per pack). The share of VAT and excise in the retail price will also increase, and by 2020, it will reach 78.1%. The raised excise duty increases budget revenue through excise and VAT (since VAT is charged on the sales price, which already includes specific excise). Budgetary revenues will be increased by 37.6% from the tobacco excise and VAT in 2016, and by 26.8% in 2017. The growth rate of budgetary revenue gradually decreases, and in 2020, will constitute 15.2%. The average growth of the budgetary revenue between 2016-2020 will be 23.4%, while in nominal terms, the additional revenue collected will constitute 1,24 million GEL.

Table 4. Scenario I – 5-year plan and increase of the total excise tax by equal amounts

Year	Average price	Change in tobacco consumption	Total excise	Increase in total excise	Share of total excise in the price	Share of excise and VAT in the price	Additional tax revenues from excise and VAT
2014	2.32	-3.2%	0.75	0.12	32.4%	47.6%	46,330,340
2015	2.37	3.3%	1.02	0.27	43.0%	58.2%	153,797,255
2016	3.30	-14.7%	1.72	0.70	52.2%	67.4%	255,870,920
2017	4.27	-8.3%	2.43	0.70	56.8%	72.1%	250,769,575
2018	5.24	-5.8%	3.13	0.70	59.7%	74.9%	240,601,173
2019	6.22	-3.7%	3.83	0.70	61.6%	76.8%	246,571,030
2020	7.22	-2.3%	4.54	0.70	62.8%	78.1%	254,152,337

According to the second scenario of the model, the amount of the total excise increases by less - by 51 tetri annually throughout 10 years (Table 5). The EU target of 60% of share of the excise tax in the average retail sales price of cigarettes will be attained by 2025. In addition, the amount of the total excise by 2025 will be 6.1 GEL, which actually exceeds the required minimum amount (equivalent to 1.8 Euro). The share of excise and VAT in the retail sales price increases up to 75.3%.

In this scenario, the reduction in tobacco consumption is characterized by a stable decreasing pattern, and from 2023, tobacco consumption will start to increase again. The level of consumption will increase because the price growth rate decreases while the PDI growth rate increases in a stable pace (from 2019 PDI is assumed to be increasing by 9.7% annually). Consequently, the price effect does not cover the effect of PDI and ultimately, tobacco consumption increases. Budget revenues from tobacco excise and VAT will

increase by 30.3% in 2016, and the growth rate will decrease in subsequent years. In 2025, revenue will grow by 10.3% compared to the previous year. The average growth rate of budgetary revenue in 2016-2015 will be 16.1%, while in nominal terms additional revenue collected will constitute 2,310 million GEL in total.

Table 5. Scenario II – 10-year plan and increase of total excise with equal amounts

Year	Average price	Change in tobacco consumption	Total excise	Increase in total excise	Share of total excise in the price	Share of excise and VAT in the price	Additional tax revenues from excise and VAT
2014	2.32	-3.2%	0.75	0.12	32.4%	47.6%	46,330,340
2015	2.37	3.3%	1.02	0.27	43.0%	58.2%	153,797,255
2016	3.07	-9.8%	1.53	0.51	49.7%	65.0%	206,703,498
2017	3.81	-5.6%	2.03	0.51	53.4%	68.7%	210,402,931
2018	4.55	-4.2%	2.54	0.51	55.9%	71.1%	204,170,635
2019	5.30	-2.5%	3.05	0.51	57.6%	72.8%	210,939,683
2020	6.07	-1.5%	3.56	0.51	58.7%	73.9%	218,281,606
2021	6.85	-0.7%	4.07	0.51	59.4%	74.7%	227,571,577
2022	7.65	-0.1%	4.58	0.51	59.8%	75.1%	238,444,151
2023	8.46	0.3%	5.08	0.51	60.1%	75.3%	250,690,195
2024	9.30	0.7%	5.59	0.51	60.1%	75.4%	264,187,528
2025	10.17	1.1%	6.10	0.51	60.0%	75.3%	278,865,759

In the third scenario (table 6) the stable growth rate of total excise is presumed for 10 years, so that by 2025, the total amount of excise will constitute a minimum 60% of the average sales price, and the minimum amount of excise per 1 pack of cigarette will be 1.8 Euros. In such a case, the total excise should increase annually by 20% from 2016. In nominal terms, the increase of total excise will be 20 tetri in 2016, 24 tetri in 2017 and so on.

In the case of such a policy, an average of 2.3% annual reduction in tobacco consumption will be attained. The average growth rate of tax revenue between 2016-2025 will constitute 16.3%. In nominal terms, the volume of the additional budget revenue collected will constitute 2,406 million GEL.

Table 6. Version III of the model – 10-year plan and a stable growth rate of total excise

Year	Average price	Change in tobacco consumption	Total excise	Increase in total excise	Share of total excise in the price	Share of excise and VAT in the price	Additional tax revenues from excise and VAT
2014	2.32	-3.2%	0.75	0.12	32.4%	47.6%	46,330,340
2015	2.37	3.3%	1.02	0.27	43.0%	58.2%	153,797,255
2016	2.71	-2.3%	1.22	0.20	45.1%	60.3%	108,008,959
2017	3.14	-1.5%	1.47	0.24	46.8%	62.0%	135,162,547
2018	3.63	-2.2%	1.76	0.29	48.5%	63.8%	150,432,535
2019	4.19	-2.1%	2.11	0.35	50.4%	65.6%	176,726,653
2020	4.86	-2.2%	2.53	0.42	52.2%	67.4%	205,114,645
2021	5.64	-2.3%	3.04	0.51	54.0%	69.2%	237,899,665
2022	6.55	-2.4%	3.65	0.61	55.7%	70.9%	275,740,157
2023	7.63	-2.5%	4.38	0.73	57.4%	72.6%	319,391,762
2024	8.91	-2.6%	5.26	0.88	59.0%	74.3%	369,721,786
2025	10.41	-2.7%	6.31	1.05	60.6%	75.8%	427,725,826

The fourth scenario of the model is based on the target determined by the government decree on Approving the National Strategy for Tobacco Control, which claims that smoking prevalence should decrease by 2% annually. In order to reduce consumption by 2% annually, the average retail price should increase each year by 15.3% on average (considering price and income elasticities). However, in this scenario the share of excise in the retail price is not expected to reach 60% by 2025, whereas the requirement regarding the minimum excise will be met.

Budget revenue from tobacco excise and VAT will increase on average by 15.9% during the 10-year period. In nominal terms, all collected revenue will constitute 2,289 million GEL.

Table 7. Scenario IV – 10-year plan and 2% tobacco consumption reduction

Year	Average price	Change in tobacco consumption	Total excise	Increase in total excise	Share of total excise in the price	Share of excise and VAT in the price	Additional tax revenues from excise and VAT
2014	2.32	-3.2%	0.75	0.12	32.4%	47.6%	46,330,340
2015	2.37	3.3%	1.02	0.27	43.0%	58.2%	153,797,255
2016	2.70	-2.0%	1.21	0.19	44.9%	60.1%	104,089,814
2017	3.15	-2.0%	1.48	0.27	46.9%	62.2%	142,802,434
2018	3.63	-2.0%	1.76	0.28	48.5%	63.8%	146,645,420
2019	4.19	-2.0%	2.11	0.35	50.3%	65.6%	174,517,360
2020	4.83	-2.0%	2.51	0.41	52.0%	67.2%	199,898,409
2021	5.57	-2.0%	2.99	0.48	53.6%	68.9%	228,791,651
2022	6.43	-2.0%	3.54	0.56	55.1%	70.4%	261,670,972
2023	7.42	-2.0%	4.20	0.65	56.6%	71.8%	299,073,338
2024	8.56	-2.0%	4.96	0.76	58.0%	73.2%	341,607,125
2025	9.88	-2.0%	5.86	0.89	59.3%	74.5%	389,961,547

In the first scenario of the model, the excise increases more than in other versions. If we consider that the ultimate goal of the tobacco taxation policy is the reduction of tobacco consumption, this scenario could be even better since we believe consumers frequently show adaptability to price rises. Adaptability towards prices is revealed through the fact that consumers easily adapt to slight price increases, and the demand on a specific product is slightly or never reduced. On the other hand, an instant increase in price causes more sensitivity in consumers, and as a result, the demand decreases. There is a greater chance that this theory will prove right in the case of such products as tobacco, since tobacco is characterized by low elasticity. However, it should also be considered that a rapid tax increase contains high risks in terms of smuggling, and due to the increased contraband, amount of collected taxes, may even reduce instead of increasing.

4.3.2 Possible Challenges and Response

The existing model is fully based on the assumption that there is no cigarette smuggling in and/or from Georgia. Therefore, the findings obtained would be achievable only in the case where the level of smuggling is zero.

However, there is a high probability that an instant increase in excise rates will cause increased attempts of importing smuggled cigarettes from neighboring countries if the cigarette price in Georgia sharply exceeds the price directly outside of Georgia. This is the main risk and challenge related with the given taxation policy. Since we will not be aware of the tobacco taxation policy of Georgia's regional neighbors for the next few years, it is impossible to assume from which country, and to what volume the smuggled cigarettes will enter Georgia.

It is crucial that smuggling should be strictly controlled no matter which scenario is chosen by policymakers. Any taxation policy should also be accompanied by a strengthened tax and customs administration that is able to trace the contraband. If at any stage of the policy smuggling is traced (even within the range of 5-10%), the causes should be thoroughly studied. If the reason lies with weak administration, more work should be done to improve it. If there is no chance of improving the administration, the tobacco product taxation policy should be reviewed.

5. Tobacco Tax as a Source of Sustainable Funding to Reduce the Burden of Non-communicable Diseases

5.1. History in Georgia

Georgia has a 20 year history of taxing products that are harmful to health. In the 1990s there was an active discussion about introducing such taxes in order to prevent harm, and to ensure the sustainable financing of prevention activities.

In 1995 the "Tax on Production and Distribution of Harmful Products for Health" was passed. According to this law a special tax was imposed for the production and distribution of the products harmful to health,

which was a central indirect targeted tax and would go to the State Public Health Foundation. It was targeted to finance activities considered under the republican public health programs.^{34 35}

The list of harmful products for health, and the amount of the tax was defined by the Ministry of Health of the Republic of Georgia, and adopted by the Cabinet of Ministers of the Republic of Georgia. The Cabinet of Ministers of Georgia adopted the list of harmful products for health in 1995, which consisted of tobacco, alcohol and asbestos products. e. g. 1 Coupon (currency name) was imposed on tobacco products. Unfortunately, because of the rapid devaluation of Georgia's national currency surrogate (coupon), the practice of mobilizing such taxes was not implemented.

According to the December, 23, 2001 Decree No 69 of the President of Georgia, it was defined that part of the taxes on harmful products for health (fuel, cigarette, and alcohol) would be allocated in the State Medical Insurance company budget. But it was not precisely defined what part of the tax had to be allocated in the State Medical Insurance budget. This decision was supposed to be followed by amendments to the relevant laws, but instead in July of 2012, the aforementioned decree was abolished.³⁶ From 2004, the succeeding government created a strict monetary-credit system, and eliminated all targeted foundations. Consequently, the discussion about imposing so-called earmarked taxes and sustainable funding of health promotion activities became impossible. Regardless of multiple attempts of the non-governmental sector to restore the aforementioned law, and to mobilize taxes in existing health structures, on February 25 of 2009 the law on "Production and Distribution of Harmful Products for Health" was abolished.³⁷

In 2012, after another change in government, the Health Promotion and Education Foundation (NGO, advocated aforementioned issue from 2005) requested that the new government revise the Health Promotion Strategy which was elaborated in 2009, and asked them to create a sustainable financing system for ensuring funds to finance the strategy. In 2013, the process of revising the strategy was renewed, but has still not been approved by the government. As for the necessity of the sustainable funding of tobacco control and health promotion, it is mentioned in two governmental decrees, which concern tobacco control issues.^{38 39}

Only by the end of 2015 was it possible to allocate a very limited budget (200, 000 GEL) for health promotion. But this limited resource was not enough to resolve the public health problems in Georgia. It is of the utmost need to allocate more resources to the field of prevention and health promotion. From our point of view however, there are a number of ways this can be done:

1. Direct 10% of the healthcare budget to health promotion programs in order to ensure sustainable financing of prevention programs. Resources will be mobilized and managed by the Ministry of Health (Latvian model)
2. The Government should establish the Health Promotion Foundation for mobilizing state and private resources (compensations e.g. tobacco industry or donations) and implementing health promotion objectives (Poland model).
3. Impose liability costs on the tobacco industry as compensation for health damage. This amount will be calculated annually, and industry representatives will contribute as many rates as they have on the

³⁴ Law on "production and distribution of harmful products for health" <https://matsne.gov.ge/ka/document/view/29746>

³⁵ Parliament Decree on the law on "production and distribution of harmful products for health" <https://matsne.gov.ge/ka/document/view/37546>

³⁶ The order #69 of the President of Georgia of February 23, 2001 <https://matsne.gov.ge/ka/document/view/114604>

³⁷ About abolishing the law on "production and distribution of harmful products for health" <https://matsne.gov.ge/ka/document/view/17854>

³⁸ Governmental Decree #196 of 2013, July 30 http://gov.ge/files/276_37824_942493_196300713.pdf

³⁹ Governmental Decree #304 of 2013, November 29 <https://matsne.gov.ge/ka/document/view/2096830>

market. This amount will also be directed to a specially created foundation, and will be distributed to the prevention programs according to the strategy. (Switzerland and partly the US model).

4. Restore the law that existed prior to 2009, and define and outline a new list of harmful products for health. Impose the relevant taxes, which will be directed to the foundation especially created for this purpose. The supervising body of the foundation can be a Prime Minister Council. The foundation would finance the relevant organizations on the basis of tenders, and competitions according to the health promotion strategy priorities (Thailand and Korea model).
5. It is possible to synergize the models or to create a new model, which will be more appropriate to the country's situation.

5.2. Models and Sources of sustainable funding for prevention and control of NCD

The health and social burden of tobacco places an enormous financial strain on governments, the health system, and the health of the public. Many nations have health budgets that are already stretched to cope with the rising healthcare costs of treatment and curative care, as well as the burden of the NCD epidemic. Tobacco is one of the most significant, but avoidable causes of mortality and morbidity in the world. It imposes a huge social and economic burden on healthcare systems, government and society.

The decrease in the consumption of tobacco plays an important role in reducing the burden of non-communicable diseases and achieving Sustainable Development Goals (SDGs). Tobacco and other risk-factors for non-communicable diseases can also greatly contribute to reducing poverty and increasing economic growth.

To reduce the burden of NCDs and decrease tobacco consumption, long-term comprehensive control measures are needed, and this requires guaranteed and sustainable funding for fostering the necessary behavioral, environmental and policy changes.

All countries, even the poorest, have the means to reduce tobacco-use if tobacco taxes are increased, and funds are applied to fund comprehensive NCD risk-factor control programs.

Raising tobacco taxes and applying all or some (at least one percent) of the additional funds raised from tobacco and NCD control is one approach to meeting this challenge in a way that is fair, logical and cost-effective. Global experience shows that the effectiveness of tobacco control measures remain vulnerable if its financing depends on short-term financing sources – be it state, philanthropic organizations or other sources. To control tobacco and non-communicable disease risk factors requires the unity of financing, opportunities and long-term strategies. Thus, efforts towards tobacco and the control of other non-communicable diseases should be comprehensive and long-term, in order to achieve the desired effect. Respectively, it is necessary to ensure sustainable funding for supporting complex behavioral environment and political changes.

More than twenty countries around the world have acted on this, recognizing the need for strengthening traditional funding sources for tobacco control, health promotion and NCD prevention, or the need for creating innovative, more sustainable fiscal mechanisms. Determining the relevant sources for sustainable funding for the control of tobacco and NCD risk-factors is a significant challenge, and requires consideration of country-specific normative, political, and economic factors. Different sources and approaches are used in various countries for the sustainable funding of health promotion measures.

Taxation of the tobacco product is the most widespread and most logical source of funds for tobacco control. Moreover, raising tobacco taxes can serve a dual purpose by enabling countries to curb tobacco consumption whilst also mobilizing financial resources to fund tobacco control/health promotion.

Tax increases substantially raise the retail price of cigarettes, and will reduce tobacco demand and consumption. Higher prices decrease the prevalence of tobacco use by increasing interest in quitting, quit attempts and successful cessation. Higher prices can also reduce consumption among remaining smokers by reducing consumption by daily smokers. It is estimated for example, that a price increase of 33% would result in between 22-65 million smoking-attributable deaths being averted worldwide, with up to 90% of these averted deaths in LMICs.

It is far more effective however, when all or at least some of the tax revenue generated is invested back into tobacco control programs. In some countries, this new source of revenue is also being used to address other preventable priority health issues, such as NCDs (Estonia, Finland, Thailand, and Mongolia).

Another important source for financing health promotion and tobacco control activities is placing a tax on other goods harmful to health (Ireland, and the Philippines) (Chart 10).

The following sources are also used for financing tobacco control and health promotion activities: A treasury appropriation; value added tax (VAT) (Austria, England), Philanthropic donations (Blumberg Initiative, Bill and Melinda Gates Foundation), Health, sickness or universal healthcare insurance donations (Switzerland and Croatia), private, corporate and donor sources (Korea), funds collected through penalties for violations of legislation (India) (Chart 10).

Examples from different countries show the importance of the aforementioned. In 2013, Bangladesh was able to direct 12 million USD into a tobacco control foundation through tobacco taxes. The Philippines is using approximately 790 million USD from so called “sin taxes” to finance tobacco control measures.

What concerns Georgia, as was already mentioned, tobacco products are subject to imposing excise tax. From July 2016 tobacco products will be a subject to imposing an import duty and from January 2018 raw tobacco will become a subject to imposing an import duty as well. Additionally, some penalties and sanctions are in place for noncompliance to tobacco control measures. All these sources, general budget allocation, and philanthropic donations can be used to finance prevention and control activities related to tobacco and other non-communicable diseases and other risk-factors.

However, in Georgia, the state budget is characterized by so called universality – all revenue directed to the budget are directed to finance common payments. Therefore, the source for financing non-communicable diseases and tobacco control activities can be general revenue of the budget. However, current legislation does not allow for the opportunity to use tobacco taxes or tax on other goods harmful for health.

5.3. Mechanisms for Funding Allocation

Raising tobacco taxes is just the first step in securing sustainable funding for tobacco control, as the funds then need to be allocated in a way that ensures they are spent in an effective evidence-based way. Mechanisms for allocating funds vary in different countries (Chart 10).

In most cases the funding allocation is undertaken by the government, and the key ways this can be done warrants further explanation. Nowadays, substantive earmarked taxes is the most commonly observed allocation type for tobacco control. For example, substantive earmarked taxes are enforce in Thailand,

Mongolia and Qatar, where 2% of all revenue from tobacco taxes are directed towards tobacco and alcohol control, or to health promotion activities. However, the Laos PDR Tobacco Control Fund, and the Iceland Tobacco Control Board use a symbolic earmarked fund (chart 10).

Another method of allocation is via special funds, which entails a provision to set aside funds from consolidated revenue for a specific purpose such as tobacco control, but differs from earmarked funding in that the amount or method of appropriation is not necessarily specified in legislation. Application based funding by contrast comes from general revenue. The amount is not stipulated in legislation, therefore it is not assured. This differs from special funding in that there is no base level of funding. Instead, it is allocated on the basis of an application from the administering organization to the government.

Choosing the method of allocation depends on the political will of the country, the normative, social and economic environment, and the arrangement of the budgetary and taxation system. Ideally, those wishing to create a fund for tobacco control on sustainable and solid financial footing, would be well advised to aim for one of the earmarked methods, which requires strong legislative support, and state explicit amounts that should be modified to reflect the Consumer Price Index (CPI).

A good example of the aforementioned is Vietnam, where it was decided that an earmarked tobacco tax would be the most appropriate source of funding for the VNTCF. The amount and method of collection of the tax was stipulated in the Law on the Prevention and Control of Tobacco Harms, which states that the amount is to be calculated on a percentage of the excise tax liable prices. This is specified as 1% from May 2013, 1.5% from May 2016 and 2% from May 2019.

Despite the fact that earmarking is a long-standing and popular practice in many countries around the world for the control of tobacco and other NCD risk-factors programmes, Georgian legislation (Budget Code) does not allow to use it for financing the prevention of non-communicable diseases and control activities, because no revenue, excluding revenue financed by donors, should be earmarked for financing a concrete duty (measures).

Chart 10. Sources for funding healthcare support/tobacco control and allocation mechanisms

Source of Funding	Allocation Process	Countries
Tobacco taxes – substantive earmarked taxes	Treasury allocates a proportion of tax revenue collected for health promotion/tobacco control	Estonia, Finland, Thailand, Mongolia, Vietnam, Korea, Nepal, Qatar
Tax for healthcare on other harmful goods – substantive earmarked taxes	Treasury allocates proportion of tax revenue collected for health	Thailand, Philippines
Committed funds – (Symbolic earmarked funds) – committed in legislation to support specific purposes, such as tobacco control or health promotion	Treasury allocate funds from consolidated revenue/ funds which may include, but are not exclusively from tobacco or other specific tax.	Healthway (1996-2006) Ireland Tobacco Control Board Laos PDR Tobacco Control Fund
Special Funds (allocated from consolidated revenue)	Assignment/allocated from government/ Treasury (amount/method of appropriation not specified in legislation)	Healthway (after 2006)
VAT/fiscal adjustments (a form of consumption tax, which generates tax revenues for government)	May be earmarked or committed	Austrian Health Promotion Foundation, African Tobacco Control Alliance Public Health England

Government department funding	Not committed but based on periodic applications for funds	Singapore Health Promotion Board New Zealand Health Promotion Agency Malaysian Health Promotion Board Tonga Health Promotion Foundation
Social Insurance payments (also described as personal income tax). Raises revenue through mandated pay roll taxes		
Private Health Insurance	May be earmarked or committed	Switzerland, Croatia
External funding	Potential to allocate as grants or loans, based on applications	
Donor aid – internal and external NGOs	Non-government organization funding	The Korea Health Promotion Foundation relies partly on private donors
Philanthropic Funds	Philanthropic donations (either as general donation or via grant applications to philanthropic fund)	Blumberg initiative on reduction of tobacco consumption; Bill and Melinda Gates Foundation funding on tobacco control
Corporations		Canadian Council for Tobacco Control
Funds collected through penalties for violations of legislation	Fines and court proceeding costs transferred to fund to fight tobacco. Fines and penalties given to offenders are put back into preventative programs	India

Source: International Union against Tuberculosis and Lung Diseases. Sustainable Funding Models for Tobacco Control: a Discussion Paper, 2014

5.4. Funds for Healthcare support/tobacco control

Forming funds for tobacco control/healthcare support/control of risk factors for non-communicable diseases represents the basis for solving the dilemma of sustainable funding. They are perceived as funds, the purpose of which is to “solve healthcare problems which also create political problems”. While creating the fund, its mission, goal and objectives should be determined. The scope of activity, and the role of the fund should be well thought through. It should also be determined whether it is dedicated to tobacco control, healthcare support or for implementing measures for managing risk factors of the non-communicable diseases. Moreover, the source of funding, volume, timeframe and human resources necessary for implementing the measures should be well defined.

Determining the model of administration is particularly important for the establishment of the fund. Accumulated experience shows that funds commonly use three types of administration models: autonomous organization, semi-autonomous, and a separate unit within a ministry or governmental department (Chart 11). Autonomous is the most preferred model based on international experience. It is critical that legislation or regulations give it clear administrative separation from the other funds and activities run by government departments.

As seen in those countries (Austria, Canada, Estonia etc.) where self-governing or partly independent funds are in place, they are typically governed by the board of directors (Chart 11). Management structure determines the rights and responsibilities of different stakeholders, including members of the board of directors, managers, auditors, lawyers and other stakeholders. For example, the Tobacco Control Foundation of Vietnam, which was founded in 2013, is a semi-autonomous agency, and a unit within the MOH. It is governed by the Inter-sectoral Management Board, which is chaired by the minister of health. A compulsory contribution equals to 1-2% of the factory price of all cigarette packs. Accordingly, it was possible to mobilize 4.3 million USD for tobacco control measures in 2013-2016.

It is of the utmost importance to define the goals and focus of the foundation. In some countries (Vietnam, African Tobacco Control Alliance and the Canadian Council for Tobacco Control), emphasis is placed on tobacco control activities only. Vietnam focuses on tobacco and alcohol control, ThaiHealth, VicHealth, Healthway is focusing on financing health promotion activities and TongaHealth is focusing on control of non-communicable diseases.

In Georgia, which has a high level of tobacco and alcohol consumption, as well as high mortality rates and burdens caused by non-communicable diseases, the country is facing a great need for the creation of a non-communicable diseases prevention and control foundation. Despite the fact that the Health Promotion State Programme has been operating in Georgia since 2015, this is still not sufficient. The source for financing the programme comes from budgetary assignments, revenues are allocated in the State Treasury, and the programme is being administered by the National Center for Disease Control and Public Health. The goal of the programme is public awareness raising, education, and the creation of a health promotion environment.

5.5. What funding is needed?

Research shows that the more that is spent by the government on comprehensive tobacco control programs, the greater the reductions in smoking. The more time and money that is invested in such programs, the greater the impact and the quicker the impact.

The source and scale of financing varies among countries. For example, the budget of California's tobacco control program is 1.4 billion GEL, whereas the budget of the Health Promotion Program in Georgia was 200, 000 GEL in 2015 and 400, 000 GEL in 2016.

Likewise, in many other countries, it is also important for Georgia to first define Tobacco Control and risk factors for non-communicable disease policies. As seen in table 12, in different countries, the share of funds collected from tobacco taxes and/or tobacco sales that is directed to tobacco control foundations varies from 0.9% to 3.2%. It is very important for Georgia to define such benchmarks from tobacco excise taxes, and import duties, or to identify and legalize other sources of financing.

The Tobacco Atlas suggests \$0.11 per capita is needed in LMI countries to deliver four best buys for tobacco control: tobacco tax increases, smoke-free policies, package warnings, and advertising bans. But that is only a minimum. More is needed to fund other elements of tobacco control. According to WHO, for less than 0.30 GEL per person per year (total 1.1 mill GEL), Georgia will be able to pay for the four 'best buys' in tobacco control policy, through raising tobacco excise taxes, enforcing a comprehensive national smoke-free law and a ban on tobacco advertising and promotion, as well as mandating large graphic warning labels that appear on tobacco product packaging. This small investment will reap enormous dividends in health and prosperity.

Coming from the fact that, there is the political will to support tobacco control and health promotion initiatives, it is pivotal to gain societal and intersectorial support. In many countries, non-governmental organizations and community groups play a critical role in informational and advocacy campaigns. Georgia has been given significant technical and financial support from the World Health Organization and other UN agencies, the Bloomberg Foundation, World Bank, and USAID.

Chart 12. Health promotion and tobacco control foundations around the world

Name	Administration	Governance	Source and Volume of Funding (where applicable)
Austrian Health Promotion Fund, 1998	Self-governing/ autonomous agency	Board of Trustees chaired by Minister of Health	Value Added Tax distributed by the Ministry of Finance Annual budget: USD \$9.95 million (2013) ≈ (USD \$1.18/head)
Canadian Council for Tobacco Control, 1974	Semi-Autonomous	Non-governmental, Chair and Board of Directors	Tobacco Tax and Corporate Sponsorship Tax Revenue: USD \$6.34 billion (2012-2013)≈ (USD \$188.91/head)
Estonia Health Promotion Commission, 1994	Self-governing/ autonomous agency	Ministry of Social Affairs, Health Insurance Fund and Health Care Board	Tobacco tax (3.5%) (Total Health Expenditure*: USD \$1.32 billion, 2012 ≈ USD \$1015/head)
Foundation Lucie et Andre Chagnon, Canada, 2000	Autonomous	Non-governmental, Board of directors	Charity organization which has a partnership with the Canadian government.; budget \$ 17 million (2012) (per capita \$ 2.10)
Iceland Tobacco Control Board, 1996	Government department	Tobacco control board (Ministry of Welfare)	Tobacco tax (0.9%)
Korea Health Promotion Foundation, 2011	Autonomous Agency under MOH	Board of Directors chaired by a president	Treasury Budget and donations (but mainly from the Ministry of Health and Welfare) USD \$10 million (2013) ≈ (USD \$0.20/head)
Malaysian Health Promotion Board (MySihat). 2006	Semi-autonomous agency under MOH	Board of Directors and Chairman appointed by the Prime Minister upon the advice of the Minister of Health	Treasury Budget USD \$5 million (2011-2012) ≈ (USD \$0.17/head)
Singapore Health Promotion Board (HPB), 2001	Semi-autonomous agency and in MOH	Chairman and Board of Directors	Government, Ministry of Health budget (tobacco excise duties) (USD \$0.31 excise per cigarette) USD \$55.22 million ≈ (USD \$10.42/head)
Qatar tobacco control, 2002	Government department	Ministry of Health, Department of Public Health	2% of overall Tobacco sales taxes
Switzerland Health	Semi- Autonomous Agency	Foundation council and independent chair	Health insurance (recurrent budget through health insurance levy of

Promotion, 1994			around USD\$2.60per every insured person annually Annual budget: USD \$19.4 million (2012) ≈ (USD \$2.60/head)
Vietnam Tobacco Control Fund, 2013	Semi- Autonomous Agency and a unit in MOH	Inter-sectoral Management Board chaired by Minister of Health	A compulsory contribution equal to 1-2% of factory price of all cigarette packs (2013-2016), USD \$4.3 million ≈ \$0.05/head (2016-2019) \$6.5 million ≈ \$0.07/head (2019 onward) \$8.5 million ≈\$0.09/head
Tonga Health Promotion Foundation (Tonga Health) 2007	Autonomous Agency	Board of Governance and Chair appointed by the Minister of Health	Governmental Treasury Budget, Secretariat Pacific Community and private donations USD \$500 000 (2012) ≈ (USD \$4.76/head)

Source: International Union against Tuberculosis and Lung Diseases. Sustainable Funding Models for Tobacco Control: a Discussion Paper, 2014

5.6. Conclusion

Sustainable funding of healthcare support and tobacco control measures has significant importance in reducing premature morbidity due to non-communicable diseases.

Every country has the possibility to support NCD prevention and reduction of tobacco consumption by increasing taxes on tobacco products, and by funding tobacco control and healthcare support programs through the received revenues.

Any approach to sustainable funding for managing risk factors for non-communicable diseases should be based on state initiatives and strategies, and should be implemented through the mutual participation of the state, non-governmental organizations, as well as civil society, and with the cooperation of interested parties.

It is important to create a non-communicable diseases prevention and control autonomous or semi-autonomous agency under the Ministry of Health, governed by the Board of Directors, and chaired by the Prime Minister of Georgia. Based on the current legislation, the financing source for the Non-communicable Diseases Prevention and Control Program will be budgetary assignments. They will be allocated in the state treasury. Other possible sources may also include philanthropic donations. Proceeding from program budgeting, the scale of the program financing will be defined annually, and its amount should not be less than 10% of the funding for state health programs, which amounts to \$8.25 per capita.

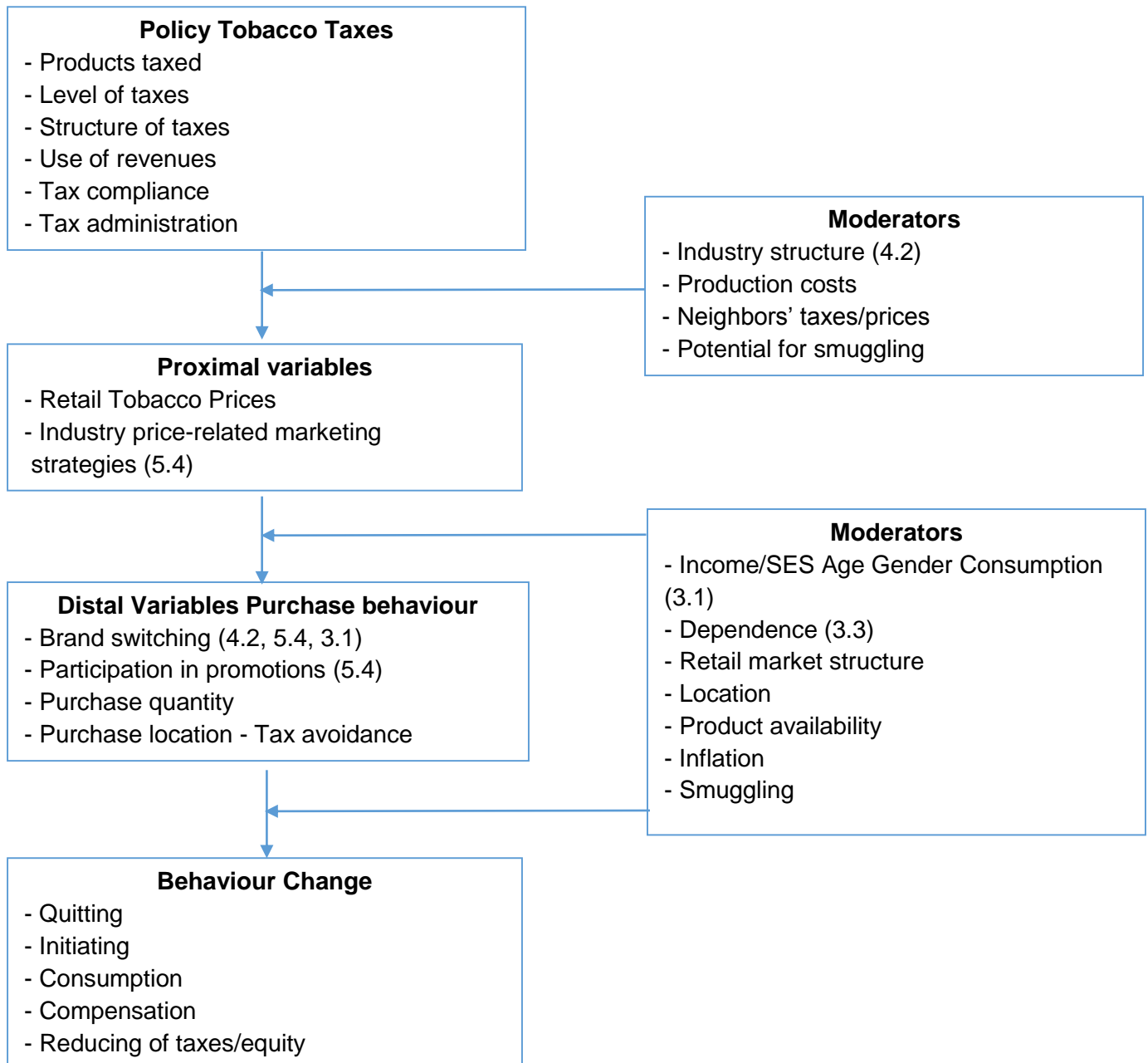
6. Monitoring and Evaluation

6.1 Indicators

For evaluate the alternative goals and potential outcomes of tobacco taxation policy change it is necessary to assess some outcome indicators. For this we will use Conceptual framework for the evaluation of tobacco tax policies provided in the handbooks for Cancer Prevention of the International Agency for Research on Cancer (IARC). Besides the variables provided in this conceptual framework there are other variables related to the tobacco taxation policy change but their assessment is out of the scope of assessment approaches of this document⁴⁰.

⁴⁰ This part will be possible to fill in more details after the decision is made which policy option is chosen to be implemented

Conceptual framework for the evaluation of tobacco tax policies



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TOBACCO PRODUCTS TAXATION POLICY

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