

ACCELERATING PROGRESS ON EFFECTIVE TOBACCO TAX POLICIES IN MONTENEGRO

INTRODUCTION

The prevalence of smoking in Montenegro is high, having risen especially during 2012-2017, causing numerous negative economic and health consequences that require an immediate policy response.

The number of smokers in Montenegro decreased during 2000-2012, but has since risen by 5 percentage points from 2012-2017. During this period, smoking prevalence among women has increased at rates faster than men. Total smoking prevalence among youth is also high, estimated to be at 18.7%, with a higher share of females than males. World Health Organization (WHO) research shows that without any changes in regulations, Montenegro's adult smoking rates would rise to 52% by 2035, with the majority being adult women. This would result in a higher prevalence of smoking-related diseases and consequently increase direct health-care costs.

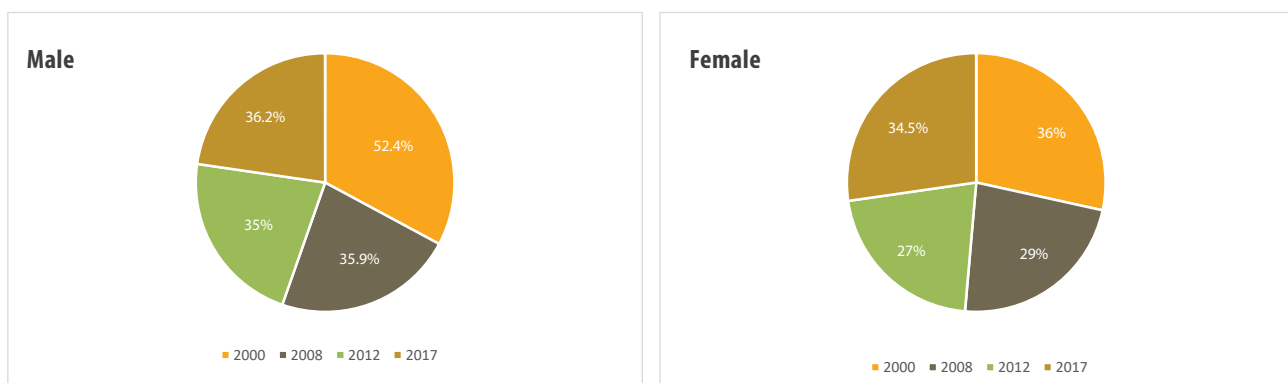
The Government of Montenegro, as a signatory to the WHO Framework Convention on Tobacco Control (FCTC), is committed to the reduction of tobacco products use through a set of smoking control measures¹. Evidence from countries of all income levels prove that higher prices induce cessation and prevent the initiation of tobacco use. According to WHO, a 10% increase in the

price per pack of cigarettes on average decreases consumption by 5% in low- and middle-income countries. These results are confirmed in previous relevant scientific research, pointing out that the price elasticity of the demand in low- and middle-income countries varies from -0.2 to -0.8 (U.S.NCI and WHO2, 2016; Chaloupka et al3., 2010; John4, 2008; Bader et al5., 2011). Thus a 10% increase in prices would reduce consumption between 2-8%.

Research conducted by the Institute for Socio-Economic Analysis (ISEA) confirms that an increase in tobacco excise taxes in Montenegro would cause a significant decrease in consumption of tobacco products and increase government revenues. ISEA research shows that even a moderate price increase (from 30 to 40 euros of specific excise, and ad valorem increase by 2 percent – price increase of 12.4%) through higher taxes would reduce consumption by 7% and bring an additional 8% of tax revenue to the government.

Increasing tobacco taxes is recommended as a part of comprehensive tobacco control policies that include clean indoor air laws, prevention of illicit trade in tobacco, bans on tobacco advertising and marketing, policies that empower graphic health warnings, public education campaigns, and support for cessation.

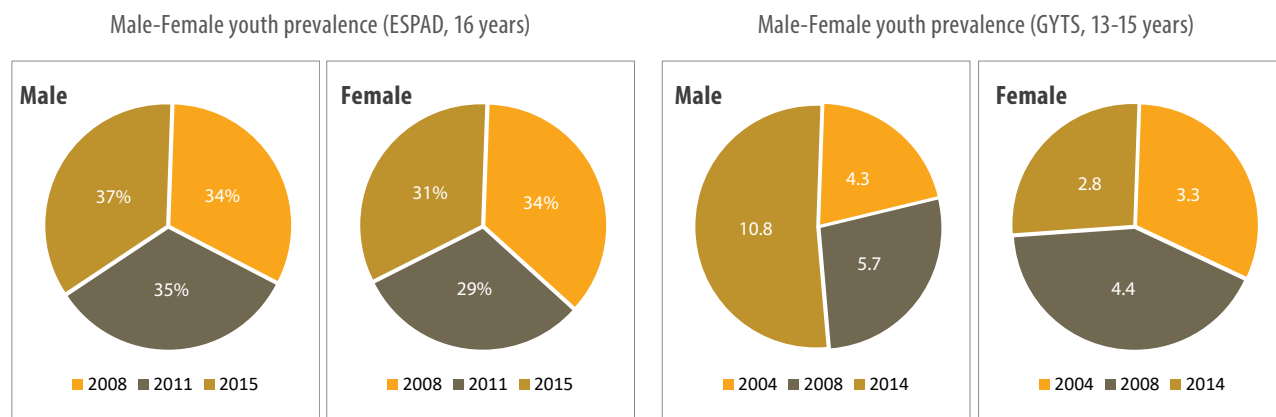
Graph 1. Smoking prevalence by gender (adults)



Source: Institute of Public Health⁶

² EU Commission official data, available at: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/excise_duties/tobacco_products/rates/excise_duties-part_iii_tobacco_en.pdf

Graph 2. Smoking prevalence by gender (youth)



Every third student smokes (34%) and prevalence is higher among male; prevalence at early age, 13 and under, increased from 1% in 2008 to 3% in 2015

Prevalence increasing in 2015; In the research done by the Institute for Public Health in 2017, the share of female was higher (15-24; 15-34)

The availability of tobacco products is still very high 48.6% in 2004, 96.5% in 2008, 84.8 in 2014

Among girls a notable reduction of prevalence

Source: Institute of Public Health⁷; ESPAD (2008, 2011, 2015)^{8,9,10}

TOBACCO TAXATION AND TOBACCO PRICES

Although cigarette prices have shown a significant increase since 2010, cigarette prices in Montenegro are still low when compared to the European Union (EU).

The weighted average price per pack of cigarettes (WAPC) in Montenegro is EUR 2.1 which is significantly lower when compared to the EU-28 average of EUR 4.8². Although the average weighted price has risen 3.5 times since 2010, further adjustments are required to catch-up with the EU.

The specific excise tax rate is currently at EUR 30.0 (36.67% of WAPC), while the ad-valorem tax is 32% of the WAPC.

The overall excise rate currently amounts to EUR 63.5 per 1000 cigarettes, which is significantly lower compared to the EU recommendation of EUR 90 per 1000 cigarettes.

Tobacco excise taxes were increasing until 2018, when the excise tax timetable was changed due to public revenues decrease. The

Government decided to reduce the excise tax rate temporarily as they argued that the revenues had indeed declined due to the tax increase, which caused problems with grey economy. Apart of excise taxes being an efficient tool in process of decreasing cigarettes consumption, there is a need of systematic approach in tackling other policy changes in order to optimally regulate the market.

Montenegro's excise tax policy is defined by Excise Tax Law, which predicts an increase in specific taxes by EUR 3.5 during 2018-2023 and a decrease in ad valorem rate by 1.5%.

Starting from September 2018, the overall excise tax rate is expected to be at 60.57% of WAPC (60% of WAPC is a minimum according to EU). In terms of overall excise tax per pack, this amounts to EUR 1.27, while the EU recommends that the overall excise tax rate must be at least EUR 1.8 per pack.

¹ Article 6 of the WHO Framework Convention on Tobacco Control "Price and Tax Measures to Reduce the Demand for Tobacco", recognizes the importance of this policy and suggests that policy changes should move toward prices and taxes increase. The long term goal of these policy changes is the contribution to the population health.

MAIN RESEARCH RESULTS – PRICE AND INCOME ELASTICITY

Research conducted by ISEA was based on data from 2001-2017 and 2006-2017. The results of this research confirm that an increase in tobacco excise taxes will lead to a decrease in tobacco products consumption. Depending on the applied policy scenario and dynamics of the excise tax increase, the increase of prices will positively impact not only population health, but also the fiscal situation.

In one scenario, estimates of the ISEA research team suggest that increasing specific excise taxes from EUR 0.6 to 0.8 and increasing the ad-valorem excise taxes by 2 percent would increase prices by 12.3% and reduce consumption by 7%. Meanwhile total tax revenues would go up by 8%. In another scenario, increasing specific excise taxes from EUR 0.8 to 1, and ad-valorem excises by 2%, would increase the price by 23.8%, reduce consumption by 14% and increase total tax revenues by 12.35%.

The research conducted by the ISEA team on the data related to consumption, income and prices are in line with international

estimates of the price inelasticity of demand. Results of the estimation indicate a price elasticity of cigarettes ranging from -0.619 to -0.68, depending on the methodology and sample used. In other words, increasing the retail prices by 10% would lead to a long-run decrease in tobacco products consumption by 6.2% and have a positive impact on the fiscal revenues at the same time.

The ISEA research also points out that an increase in income could, to a certain extent, neutralize the effects of price increases. If income increases by 10%, tobacco would be more affordable and that would increase the consumption of tobacco products by 2.32%. The strategic planning of tobacco tax policy could benefit from the results of this scientific research, using it as an important factor in the decision-making process, as an increase in the standard of living could potentially neutralize the effects on tobacco tax increases.

CONCLUSIONS & RECOMMENDATIONS

In accordance with the previous empirical research and this analysis, it can be concluded that excise policy has a positive impact on public revenues. Additionally, impact could be even greater in case of faster and more dynamic increases in tobacco excise taxes which would also reduce tobacco consumption. Population's health has been endangered by the increase of the number of smokers, especially during the last few years. At the same time, it is evident that there is a lack of more intensive dialogue among relevant stakeholders, as well as a lack of sufficient publicly available data on tobacco control.

- Accordingly, the main problems related to Montenegro's tobacco taxation policy are:
- A taxation policy implemented without comprehensive framework which includes other economic policies focused on market regulation, is neglecting potentially favourable impact that increased excises might have on healthcare system resulting from reduced tobacco consumption.
- Current levels of tobacco excise taxes are significantly below EU recommendations of excise levels of EUR 90 per 1000 cigarettes.
- Based on the results of this research, ISEA recommends the following as key tobacco control policy initiatives:
- Increase excise taxes (especially specific excise taxes) which will cause a price increase, a decrease in tobacco consumption and an increase public revenues;
- Structure tobacco tax systems to minimize costs of compliance and administration in the collection of tax revenues, while reducing tax evasion and the risk of illicit trade;
- Use revenues from excise tax increases to invest in health programs;
- Developing regional tax harmonization - harmonize taxation policy process and limit incentives for cross-border transactions;
- Apply a comprehensive approach - tackling other policy changes and tobacco control systems (more efficient law enforcement, anti-tobacco campaigns, stricter controls of points of sales etc.);
- Aim towards full compliance with EU excise tax requirements.
- Adopt and implement tobacco control policies and strategies that are in line with WHO FCTC.
- Create more intensive interaction between key stakeholders in order to more effectively implement tobacco taxation and control policy;
- Decrease direct health care costs and number of diseases through excise taxes increase.
- Decrease prevalence of youth smoking by increasing excise taxes and implementing other strategies and effective programs that will target youth.

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About the project

The Institute of Socio-Economic Analysis is working in cooperation with the Institute of Economic Sciences from Belgrade, which is coordinating a regional network of researchers in Western Balkan Countries on tobacco taxation. The statements and conclusions in this Policy Brief reflect only the views of the authors, not the University of Illinois at Chicago or the Bloomberg Philanthropies.