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## 32. ASSESSING THE LINKS BETWEEN CIGARETTE SMUGGLING AND CORRUPTION IN NON-EUROPEAN COUNTRIES

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**Abstract:** The main idea of the article is to understand how non-European citizens assess the links between corruption and cigarette smuggling. The results of the article are important in formulating strategies to reduce corruption and smuggling, taking into account public attitudes towards corruption and cigarette smuggling. To complete the empirical study, a quantitative survey of 2011 respondents was conducted in Armenia and Georgia. After the study, the main conclusion was drawn that corruption in both the countries has become a huge social problem, where bribes are a usual thing in state institutions (hospitals, clinics and government institutions), which influences the thrive of cigarette smuggling. The means recommended to decreasing cigarette smuggling: „cigarette with excise” should be cheaper and the society should be educated about the harm done by consuming smuggled cigarettes. In both countries, on average 80 % of the respondents surveyed in the research claimed that they knew nothing about consumption of smuggled cigarettes and weren't open-minded about corruption. All this leads to the conclusion that, despite the fact the survey was anonymous, the public mentality and the current political-economic situation in the countries presuppose fear and unwillingness to express their opinion about the negative phenomenon, which they often participate in and support.

**Keywords:** corruption, cigarette smuggling, Armenia, Georgia.

**JEL Classification:** D73, K42

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### 1. Introduction

It is universally recognized that low salaries of officials make bribery the most common form of corruption in public institutions, and thus can be treated as one of the key reasons for rooting of corruption in general. Deep-rooted corruption not only deprives national budgets from significant inflows of tax revenues, undermines governmental ability to collect taxes and has a negative impact on the overall economic development of a state, but also promotes different types of illicit and criminal activities, such as illicit tobacco trade and tobacco smuggling.

Scientific literature (Haysom, 2019; World Bank Group, 2019) suggests that cigarette smuggling is due to corruption. According to FATF (2012), if historically cigarette smuggling mainly involved world-famous international brands that consumers were familiar with and that were easy to sell in black markets, the recent tobacco smuggling activities have additionally started covering cheap white, counterfeit tobacco products as well as smokeless and roll-your-own tobacco (TRACIT, 2019), which is due to the fact that corrupt authorities poorly control tobacco supply chains.

Although it is agreed that addressing the problem of tobacco smuggling calls for a number of political, legal, technological and tax framework-related measures (FATF, 2012; Antonopoulos, von Lampe, 2016; World Bank Group, 2019, etc.), the importance of consumers' attitude should not also be overlooked because namely consumers' involvement, attitudes and tolerance to the cases of corruption and cigarette smuggling can be the major obstacles to combating these phenomena.

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The main purpose of this article is to understand how non-European citizens assess the links between corruption and cigarette smuggling. The defined purpose has been detailed into the following objectives: 1) to reveal the main causes of illicit tobacco trade; 2) to review the results of previous studies on the links between corruption and tobacco smuggling; 3) to select and substantiate the methodology of the research; 4) to introduce the results of the empirical research on consumers' attitudes towards the relationship between corruption and tobacco smuggling in Georgia and Armenia. The methods of the research include systematic and comparative literature analysis and a representative quantitative method of questionnaire, when interviewing Georgian and Armenian population.

## 2. Theoretical Background about the Links between Smuggling and Corruption

### 2.1. Main Causes of Illicit Tobacco Trade

With reference to the definition, provided by the World Bank Group (2019), “illicit tobacco trade refers to any practice related to distributing, selling, or buying tobacco products that is prohibited by law, including tax evasion (sale of tobacco products without payment of applicable taxes), counterfeiting, disguising the origin of products, and smuggling” (p. XII). FATF (2012) defines illicit tobacco trade as the supply of smuggled tobacco products whether they are genuine, counterfeit or cheap white. Illicit tobacco trade, or tobacco smuggling, is practiced not only by economic agents not intending to properly register their activities with authorized governmental agencies, but also by legitimate (i.e. properly registered) agents that are involved in a shadow business.

Illicit tobacco trade is caused by a complex of factors which, on the basis of literature analysis, are briefly summarized in Table 1.

**Table 1. Main factors causing illicit tobacco trade**

Factors groups	Factors	Author(s), year
Financial-economic factors	Low costs of manufacturing, expected and gained profit from illicit tobacco trade, gains of selling without taxes, consumer profit, financing of illicit trade through criminal networks, cash-bases business	FATF, 2012; Alderman, 2012; MacGuill, 2014; Antonopoulos, Hall, 2016; Antonopoulos, von Lampe, 2016; Prieger, Kulick, 2018
Regulatory framework	Governance status (weakness in governance), weak government enforcement capacity, weak regulatory framework, corruption, poor tax administration, weak customs authorities, lack of control on tobacco manufacturing, ease of illicit operating	Blecher, 2010; FATF, 2012; Ross, 2015; World Bank Group, 2019
Juridical factors	Insufficient capacity of judiciary systems and law enforcement, poor prevention of organized crime, inadequate punishments for illicit operation	Alderman, 2012
Social factors	Social acceptance of illicit trade, availability of informal distribution networks	World Bank Group, 2019
Distribution factors	Exploitation of different forms of transportation and methods of concealment; criminal network formation and expansion	FATF, 2012

Source: compiled by the authors

The data in Table 1 indicate that the main determinants of illicit tobacco trade are attributable to such groups as financial-economic incentives, regulatory framework of a country or region, juridical environment, geopolitical environment, social environment and extent of distribution networks.

Financial-economic incentives along with underdevelopment of a national or regional regulatory framework are considered to be most influential determinants of illicit tobacco trade because, firstly, a significant difference between the prices of legally sold and illicit tobacco products fuels its demand, especially during the periods economic crises and post-economic crises when consumer purchasing power is decreasing (MacGuill, 2014; Antonopoulos, von Lampe, 2016), and secondly, weakness in government enforcement capacity doubled by corruption results in inefficient work of customs

authorities and poor control of tobacco sellers and manufacturers, which, in its turn, facilitates illicit operating in black tobacco markets (FATF, 2012; World Bank Group, 2019). Loopholes in a national or regional juridical framework, in particular poor prevention of organized crime and inadequate punishments for illicit operation, also promote illicit tobacco trade by comforting agents with the feeling that their activities are hard to detect and prosecute (Alderman, 2012). The impact of geopolitical environment should not be underestimated in case a country borders on neighbour countries with similarly weak governance and insufficient capacity of their judiciary systems and law enforcement which facilitate the movement of tobacco across borders.

Recognizing the importance of the above-mentioned most influential determinants of illicit tobacco trade, this article nevertheless focuses on the links between tobacco smuggling and corruption because, with reference to the evidence provided by the World Bank Group (2019), high levels of illicit tobacco products are linked more closely to corruption and tolerance of contraband sales rather than, for instance, to economic determinants: it was found that illicit tobacco markets are relatively larger in the countries that have relatively low tobacco taxes and prices, but the countries with relatively high tobacco taxes and prices tend to have relatively smaller illicit tobacco markets, which proposes that tobacco taxes and prices have only a limited impact on illicit tobacco markets at a national level.

## 2.2. The Links between Corruption and Tobacco Smuggling

Although the literature on the relationship between corruption and tobacco smuggling is comparatively scarce (most sources focus on the links between corruption and illicit trade in general or address the whole industry of illicit tobacco trade including not only smuggling, but also manufacturing, structure of the shadow markets and functioning of distribution networks), some studies on the topic under consideration have been found and analysed. The previous findings on the links between corruption and tobacco smuggling are reviewed in Table 2.

**Table 2. Review of some previous findings on the links between corruption and tobacco smuggling**

Author(s), year	Research method(s)	Results
Haysom, 2019	Case study (South Africa), critical assessment	Corruption provides power to beneficiaries in illicit tobacco industry to buy political protection
Shah et al., 2019	Visual inspection, time-series regression and multi-level regression analysis of the data on cigarette tax levels and the ratio of ad valorem to specific taxes at a national and mean EU level for the period 1995-2017/08	The <i>ad valorem</i> to specific cigarette tax ratio is not statistically significantly related to corruption rate in most EU member states; no evidence of any EU member states with higher corruption perception index to favour ad valorem taxes was found
World Bank Group, 2019	Statistical data analysis, critical review	High levels of illicit tobacco trade are linked more closely to corruption rather than to high taxes
Colledge, 2012	Literature review, critical assessment	Public corruption provides favourable conditions for tobacco smuggling between the USA and Mexico
Blecher, 2010	Estimates of illicit tobacco market using simulations of smoking intensity over the period 1997 to 2007	Illicit trade in tobacco is compounded by corruption and weak border control
Alderman, 2012	Law synopsis	Highly organized bootleggers' activities are heavily influenced by the ease of operating, among other factors, caused by the level of political corruption in the area
Lallerstedt, 2018	Critical assessment, case studies	In 2010, 136 EU border guards were prosecuted for corrupt activities, which speaks about undermining of border security through corruption

Source: compiled by the authors

As it can be seen in table 2, most studies that previously addressed the relationship between corruption (commonly caused by weak government enforcement and lack of political will) and illicit tobacco trade (tobacco smuggling) confirm that high corruption rate in a country provides favourable conditions for tobacco smuggling (Alderman, 2012) because it promotes formation of criminal networks (von Lampe, 2006) and empowers beneficiaries acting in the illicit tobacco industry to buy political protection (Colledge, 2012; Haysom, 2019). Haysom (2019) provides the critical assessment of the situation in South Africa and states that the links between the illicit trade in tobacco and corruption mainly emerge due to the inability of governments to effectively regulate tobacco industry which is extremely vulnerable to grey and black markets, i.e. the main problem is related to the incapability of governments to regulate legal markets instead of attempting to eradicate grey and black ones. Blecher (2010) and Lallerstedt (2018) also stress the negative impact of weak border control (according to the statistics provided by Lallerstedt (2018), the fact that 136 EU border guards were prosecuted for corrupt activities in 2010 shows that corruption of officials undermines the security of borders, and this problem can be observed not only in developing third countries, but also in developed regions, such as the EU).

Nevertheless, some other studies provide slightly different results. For instance, Shah et al. (2019), who researched the relation between corruption and tobacco tax structure in 28 EU member states for the period 1995-2017/08, found that *ad valorem* to specific cigarette tax ratio tended to decrease over the period under consideration and was not statistically significantly related to the size of corruption. Although this tendency was observed in almost all EU member states, it should not be overlooked that at an aggregate EU-level, the links between reduced corruption and a significant increase in the *ad valorem* to specific cigarette tax ratio, amounting to 0.04 per unit increase in CPI score, was estimated.

On balance, although previous findings indicate that corruption promotes tobacco smuggling by ensuring favourable conditions for the expansion of smuggled/untaxed tobacco distribution channels through criminal networks and by empowering the beneficiaries in the illicit tobacco industry to buy political protection, some cross-national differences in the nature and strength of the links between corruption and tobacco smuggling may emerge due to the degree of the prevalence and character of the black tobacco market in a particular country or region, which, in its turn, calls for a deeper insight in this issue.

### 3. Methodology of Research

Survey methodology was selected to find out the views of the country on the cigarette smuggling and corruption situation.

Survey was carried out on June, 2019. 1004 respondents aged 18+ were interviewed. Study was carried out as CATI Omnibus survey. CATI in market research stands for Computer Assisted Telephone Interviewing. CATI means that the interviewer conducting the survey over the phone follows a script on the computer while clicking responses and typing open-ended comments from the respondent into the program.

The questionnaire asked six questions to find out whether respondents were aware of who smokes smuggled cigarettes in their environment, the hot spots for smuggling cigarettes, their perception of corruption and its most common forms, and the main areas of their activity. Georgia and Armenia have been selected from non-EU countries on the basis of the following criteria: poor economic situation, high levels of corruption and high levels of cigarette smuggling from/ to countries.

Armenia is classified as a lower-middle income country where about 30 percent of the population lives below the national poverty line, meaning their income is about 100USD per month. According to the International Monetary Fund (2016), the Armenian economy has been declining in recent years due to regional and global economic conditions. According to the Fund, public debt is 55 percent of GDP and fiscal revenue is 22 percent of GDP, resulting in severe fiscal shocks for the country. Starting from 2018, Armenia became upper-middle income country. Analyzing Armenia from the aspect of cigarette smuggling, it can be stated that within five years cigarette smuggling has almost disappeared. According to data from the Transparency Organization in Armenia, high-quality, high-volume tobacco products, their low prices, the establishment of the most popular Western cigarette brands (Winston, Marlboro, Hill, Phillip-Morris) in Armenia and official distributors of these brands have resulted almost no cigarette smuggling into Armenia. However, smuggling from Armenia to other countries (Turkey, Georgia, Germany, Iran, Iraq) is thriving. In May, 2016 the Armenian

Parliament decriminalized smuggling of most of the goods (including cigarettes) to Armenia. Getting deeper in the corruption situation in Armenia, no significant changes have been observed so far, although the country implemented 2003-2007; 2009-2012; 2015-2018 anti-corruption strategies. In 2017 corruption indicator in Armenia was -0.56 (where -2.5 – highly corrupted; +2.5 - very clean, where the higher the index the less the corruption indicated).

Situated between Russia, Azerbaijan, Armenia and Turkey, Georgia emerged as an independent republic following the collapse of the Soviet Union in 1991. Georgia has a population of about 3.7 million people. By the level of its economic development, Georgia is considered to be under middle level of development. Smuggling has become a direct threat to the national security of Georgia. If we take a look to the history the statistics show that in 2003, contraband trade became a very serious problem in Georgia. Its catastrophic growth began in 1998, and in five years it has begun to threaten the very security of the country. It has stimulated corruption, has created powerful criminal clans, and has promoted the collaboration between the criminal world and political groups, central, regional and local authorities, and law enforcement structures of the country. It has also led some parts of the poorer population to become involved this criminal activity. According to the statistics service, in 2016 the import of cigarettes to Georgia decreased by 1.6% and totalled USD 107.3 million instead of USD 109.1 million in comparison with 2015. As for 2017, in January-August, imports amounted to USD 53.9 million. If cigarette consumption decreased by 25%, this should have been reflected first of all on importers. According to the state authority over the past year, cigarette consumption in the country has decreased by 25%. With a score of 58 (56 in 2017), Georgia is the leader in the South Caucasus in terms of improving corruption. However, the country is experiencing a crisis of democratic institutions. This is primarily reflected in the lack of accountability of law enforcement agencies, political interference in the activities of the courts and pressure on the institutions of civil society.

#### 4. Empirical Research Results

The following hypotheses were raised during empirical study:

H1: The ‘hot spots’ for smuggling cigarettes are in markets and border areas.

H2: Corruption promotes the resolution of societal problems.

H3: Most often bribes are given by state inspectorates and hospitals.

H4: Higher salaries would reduce the consumption of smuggled cigarettes.

**Table 3. A comparative analysis of quantitative survey results between Georgia and Armenia**

Question	The result of Georgian public opinion	The result of Armenian public opinion
Are there people in your area who smoke smuggled cigarettes?	4.0 percent of respondents in their environment know people who smoke contraband cigarettes.	3.4 percent of respondents in their environment know people who smoke contraband cigarettes.
What do you think are the ‘hot spots’ (points of sale) for smuggled cigarettes in your country?	17.4 percent of respondents think that <b>border zones of the country</b> is the main point of sale for contraband cigarettes.	3.2 percent of respondents think that <b>kiosks</b> is the main point of sale for contraband cigarettes. 86.7 percent of respondents say that „None / Don’t know“.
Which of the following approaches best suits your view on corruption?	Respondents who were asked to name statement, which most closely matches their opinion about corruption, most often named that „ <b>Corruption is a big social problem</b> “ (57.4 percent).	Respondents who were asked to name statement, which most closely matches their opinion about corruption, most often named that „ <b>Corruption is a big social problem</b> “ (52.0 percent).
In what areas are people in your environment most likely to be bribed?	4.2 percent of respondents think that people usually are giving "bribes" in <b>state institutions</b> . 79.0 percent of respondents said that it is hard to answer/they don't know.	15.3 percent of respondents think that people usually are giving "bribes" in <b>hospital, clinic</b> .

What do you think should happen to people around you not to smoke smuggled cigarettes?	Respondents who were asked to name, what should happen so that people would stop smoking contraband cigarettes, most often mentioned that „ <i>cigarette with excise should be cheaper/price should be lower</i> “ (22.4 percent).	Respondents who were asked to name, what should happen so that people would stop smoking contraband cigarettes, most often mentioned that there should be „ <i>more information on how smuggled cigarettes pose a much greater risk to health than officially purchased cigarettes</i> “ (7.2 percent).
In your opinion, which of the following are the most common forms of corruption in your country?	Respondents who were asked to name which forms of corruption is the most prevalent in their country, most often mentioned that it is „nepotism - placing one's own family member/friend/relative to a job or position“ (49.6 percent).	Respondents who were asked to name which forms of corruption is the most prevalent in their country, most often mentioned that it is „giving bribes (for medical treatments, public services“ (40.8 percent).

Source: compiled by the authors

When discussing the results, why respondents in both countries reported an extremely low percentage of people buying contraband cigarettes, interviewers provided the following type of explanation:

*The results discovers Georgia situation. Generally, this survey's topics are very sensitive and our citizens aren't open during the interviews, so we have many "do not answer/ hard to answer", but the concrete opinions which are revealed in the survey are relevant for our country.' The Armenian interviewers did not provide an explanation.*

In order to confirm or reject the hypotheses, the questionnaire data of the interviews were analysed:

- In the case of Armenia, H1 has not been confirmed, because out of 1007 respondents, only 136 (13.51%) reported a ‘hot spot’ for one type of smuggling and only 0.4% reported two types of ‘hot spots’ of smuggled cigarettes. Respondents generally reported that ‘hot spots’ were: in newsstands 3.18%, 95% CI = [2.18%; 4.46%] (95% confidence intervals (95% CI) for proportion calculated using SAS and Clopper-Pearson (Exact) criterion); official stores (2.09%, 95% CI = [1.03%; 3.17%]), people’s apartments (1.89%, 95% CI = [1.14%; 2.93%]).
- A very small minority of respondents reported ‘hot spots’ in the border area (0.7%, 95% CI [0.28%; 1.43%]) and in the bazaars (0.5%, 95% CI [0.16%; 1.15%]). Other places were named by 4.07% respondents. In the case of Georgia, **H1 has only partially proved its worth**. Of the 1004 respondents, 73.18% said they know no type of ‘hot spot’; 67.83% said ‘I don’t know/ Hard to answer’; 3.09% said ‘I have not heard of such places at all’; 2.19% - rejected to answer. The highest number of respondents reported ‘hot spots’ as border areas of the country – 19.62% (95% CI = [17.21%; 22.22%]). Other ‘hot spots’ were mentioned by a very small proportion of respondents: open market - from external vendors (2.39%); street (0.9%); individuals – in apartments (0.6%).
- **Hypothesis H2** was not confirmed in the Armenian and Georgian cases. Only 6.44% of respondents in Armenia believe that corruption contributes to many social problems; 8.81% of respondents believe that corruption contributes to some social problems. In **Georgia**, only 2.29% of respondents think that corruption encourages many social problems, and 1.89% think that corruption causes some social problems.
- **Hypothesis H3** is **only partially** validated in the case of Armenia. Respondents indicated that bribes are most often given in hospitals and clinic (15.29%, 95% CI = [13.12%; 17.67%]). A similar percentage (9-10%) of respondents indicated that bribes were given to: schools, universities, kindergardenstruction inspection, ministries (10.03%, 95% CI = [8.24%; 12.05%]); tax office, construction Inspection, ministries (9.63%, 95% CI = [7.88%; 11.26%]); Court (9.14%, 95% CI = [7.43%; 11.09%]). Few respondents reported bribes to the police (6.36%, 95% CI = [4.93%; 8.04%]). No respondent mentioned that bribes are given at Customs. 11.92% of respondents named other places to give bribes.
- **In the case of Georgia, the H3 hypothesis failed**. Only 5.18% (95% CI = [3.89%; 6.74%]) of respondents reported that bribes are mostly given by state institutions (tax office, construction inspection, ministries). As many as **92.33%** of respondents did not mention any bribe (77.99% - I don’t know / Hard to answer; 8.86% - I have not heard of such facts; 5.48% - rejected to answer).

- ***H4 has not proved true in the case of Armenia.*** Only 5.46% (95% CI = [4.19%; 7.05%]) of respondents believe that higher salaries would reduce the use of smuggled cigarettes. Respondents do not believe that the measures listed in the questionnaire can effectively reduce the use of smuggled cigarettes. For example, only 6.45% (95% CI = [4.19%; 7.05%]) of respondents believe that smuggling cigarettes can be reduced by bigger fines/ penalties. None of the respondents believe that smuggling cigarettes can be reduced by more information on TV, news, radio, newspapers, etc. Another reason was given by 7.25% of respondents. ***H4 has not proved true in the case of Georgia.*** Only 9.06% (95% CI = [5.21%; 8.41%]) of respondents believe that higher salaries would reduce the use of smuggled cigarettes. 22.91% (95% CI = [20.34%; 25.63%]) of respondents believe that smuggling cigarettes can be more effectively reduced. Cigarette with excise should be cheaper/price should be lowered. 19.62% (95% CI = [17.21%; 22.22%]) of respondents believe that the use of smuggled cigarettes can be reduced, making law on this issue stricter/prohibition/strict punishment (more engagement from the state); 13.84% (95% CI = [11.77%; 16.14%]) of respondents believe that the use of smuggled cigarettes can be reduced by *stricter control at border cross points/ stricter control, monitoring in general*; 10.86% (95% CI = [9.0%; 12.95%]) – by *bigger fines/penalties*. Other reasons that could reduce the use of smuggled cigarettes were rarely mentioned: 2.79% of respondents reported better quality of officially purchased cigarettes; 2.89% - getting more information on TV, news, radio, newspapers, etc., stressing that contraband is a bad thing; 1.1% - more information on how smuggled cigarettes pose a much greater risk to health than officially purchased cigarettes.

### 3. Conclusion

In theory, the links between corruption and cigarette smuggling reveal that corruption contributes to cigarette smuggling, which in turn funds criminal activities. Meanwhile, the results of the empirical study reveal very interesting results in selected countries. Although cigarette smuggling is widespread in Georgia and Armenia (the donor country), only a small percentage (4% in Georgia and 3.4% in Armenia) report being aware of smokers in their environment. In Armenia, the ‘hot spots’ of smuggled cigarettes are kiosks, official stores and people’s apartments, while in Georgia it is the border. Citizens on both sides point out that corruption is a major problem, with bribes being most prevalent in state institutions (Georgia) and hospitals and clinics (Armenia). In order to solve the problem, respondents say it is advisable to reduce the price of ‘cigarette with excise’ (Georgia case) and educate the public about the more harmful health effects of smuggled cigarettes (Armenian case). It is concluded that with decreasing levels of corruption in countries (especially in public institutions), the volume of smuggled cigarettes would decrease as well. *The limitations of the study* are related to the fear of individuals to express their views openly.

*The practical applicability of the study* manifests itself through identifying hot spots for cigarette smuggling, exploring public attitudes to corruption, the most corrupt government agencies, and the tools that will most effectively reduce cigarette smuggling in Armenia and Georgia.

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